

WELSH BOOKS COUNCIL DISTRIBUTION CENTRE

A STRATEGY FOR THE FUTURE

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## **1. Introduction**

The distribution centre exists as a central source of supply for books published in and about Wales. It has the objective of holding in stock all relevant titles in the Welsh or English languages for which there is a continuing market. In the year ending March 2001, it had achieved a sales turnover of more than £2.8 million (around £4.2 million at retail prices).

Its existence reflects the unique characteristics of the book industry in Wales, and specifically the nature of the publishing industry – small companies, often printers in origin, producing small print runs of books primarily for local consumption – and comes about from the belief that the advantageous pooling of resources in distribution would generate a sufficient critical mass to achieve operational economies.

This pooling of resources was originally made possible by the ‘transfer’ system devised to regulate and standardise discount structures. Under this arrangement, publishers’ stock is held on consignment by the centre and is paid for on a monthly basis at a discount which in most cases is 43.125% from the recommended retail price. At the same time the discount given to the bookseller is normally 33.3% which, taken together with the 2.5% settlement discount which most booksellers take, provides the distribution centre with a margin of just over 8% which is the basis for its financial position.

Since its creation with the co-operation of publishers, the centre has always been a department of the Welsh Books Council but one which operates as a commercial enterprise, meeting its running costs from its own activity. It does, however, derive both funds and support in kind from the Welsh Books Council through access to public funding for capital projects and from WBC staff and management. This is not,

however, an unmixed blessing: its links with the WBC lead to a perception that it exists as a public service which influences the way in which both customers and clients take advantage of its services.

In addition to the transfer scheme, the centre's stated role of holding in stock all titles published in or about Wales leads to a significant amount of stock (around 30% by value) which is bought in on commercial terms at the risk of the centre.

This practice gives the centre the characteristics both of a distributor (for the titles which are held on consignment) and of a wholesaler. It is important that this distinction between the two roles is preserved when planning strategy for the coming years.

Aside from this conventional activity, however, by far the most important development for the centre has been the creation of gwales.com, an interactive catalogue and e-commerce ordering web site based on Vista's PubEasy model. Development work on refining the database has been the primary task to date, and full integration into the centre remains to be done. There is, however, no doubt that in the years to come it will become a crucial tool for the Welsh book trade, fulfilling a variety of B2B (business to business) and B2C (business to consumers) functions.

## **2. The current situation**

This five-year plan for the Welsh Books Council's distribution centre comes at a crucial time for the distribution centre. After a highly successful decade in which sales doubled, growth and profitability have been substantially harder to achieve over the past two years or so. There are two chief reasons for this:

- Heavy investment aimed at a radical transformation in the way the distribution centre does its business, though capital funded from lottery and other grants, has brought about a very heavy burden in terms of running costs which the centre will

### 3 / Strategy plan for the WBC distribution centre

need to bear on a continuing basis. This, together with related one-off costs such as Y2K compliance, has already had an impact on cost despite continued sales growth.

- The centre urgently requires an increase in, and guarantee of, sales volumes to compensate for the higher operational costs. Under existing policies this is largely impossible since it has no effective control over the titles it is called upon to distribute; growth in current sales, though it may be influenced by better selling and better marketing, ultimately depends on the strength and number of titles supplied for distribution.

The first of these problems was brought into stark focus while this plan was in preparation, when discussions took place with Vista Computer Services, the centre's systems supplier, over the replacement of the VAX computer used to run the fulfilment system. This machine is now reaching the end of its life and the original intention to replace it within the next two years with new hardware now seems increasingly unattractive: Vista are quoting around £100000 for migrating and reconfiguring software for the new machine. In view of the difficulty of securing grant funding for anything other than capital investment, both this essential upgrade and the potentially attractive alternative of Vista hosting the centre's system are likely to result in significant increases to the centre's cost base over the next few years.

As this matter is still under discussion, it has not been thought sensible to prejudge any solution in the financial projections at the end of this report. However, both short-term and medium-term solutions need to be investigated during the coming year.

These financial issues, which are common to all commercial distributors as well as to the Welsh Books Council, should be of sufficient gravity to persuade the centre's users of the wisdom of building up significant reserves. This was possible through the healthy years of the nineties and their value has been proved in the more difficult times which have followed. The need for more of the same financial prudence over the coming years has been fundamental to the recommendations in this report.

However, because of the centre's inability to control the volume of its sales, there is a further short-term concern that the margins currently being granted by publishers are not adequate to secure the centre's continued operation. This is part of a wider concern that the structure of the transfer scheme is becoming increasingly at variance with trading terms elsewhere in the industry. More will be said about these issues in section 4.

Despite these specific anxieties, however, this plan is based on the assumption that, in broad terms, the centre is serving its intended purpose and provides a benefit to the book community in Wales and elsewhere which could not be obtained by any other means. The intention of this report is to ensure that it continues to do so, by addressing particular issues and making a number of recommendations for action which ought to be taken to ensure its successful operation over the plan period.

### **3. Objectives of the strategy plan**

The overriding objective of the plan is to ensure that the distribution centre is able to continue to serve the interests of publishers and booksellers in Wales over the coming years. This report will concentrate on key factors which will deliver this objective:

- volume: increasing the range of products distributed and reducing the centre's exposure to the random output of the Welsh publishing industry...
- ... and ensuring that the centre is used to maximum capacity for the benefit of its users;
- operations: asserting the policy and principles of the service provided through formalising procedures and practices and by establishing a more realistic margin structure;
- gwales.com: integrating electronic communication into the physical supply chain;
- cost: identifying possible areas for cost savings in the centre's operations.

#### 4. Operational background

It was stated above that some 70% of the centre's turnover is derived from the transfer system under which both the discounts received from publishers and given to booksellers are on standard terms. It is important to bear in mind that this discount structure does not reflect current trading terms in the UK book industry, which over recent years have become increasingly retailer-driven. The discount to retailers of 33.3% is nowadays at the lowest point in a spectrum of discounts which may rise to 55% or more; and pressure from retailers for higher discounts is inevitable, especially if current attempts to increase sales to bookshop and other retail chains are successful.

At the same time some publishers consider the 43.125% discount given high for a transaction where cash is only forthcoming when an onward sale is made. This has contributed to the problem addressed below of publishers seeking a discount advantage by preselling new titles at lower discounts direct to individual shops. However, this needs to be seen against the context of the substantial benefits they gain from use of the distribution centre: not only free distribution and storage but also the benefit of a sales force and marketing support through the Welsh Books Council. If they were operating as commercial publishers elsewhere in the UK, distribution would typically cost 10-12.5% of net receipts, either as an overhead cost or as a bought in service; sales representation much the same. Furthermore, the centre takes responsibility for cash collection.

It is worth noting also that, for the remaining 30% of the centre's business – books bought in for resale – discounts given by publishers are generally substantially higher at up to 50 or 55%.

Given these factors, there seems a strong case for attempting to raise the levels of discount required from the publishers using the transfer system. In view of the budgeted deficit in the current year resulting from an anticipated reduction in turnover and static costs, an immediate increase to 45% is recommended to restore the centre's financial equilibrium.

One of the guiding principles of the centre in recent years has been that it should compare favourably in the service it provides with major distributors elsewhere in the UK. This is the policy which led to the investment in a Vista fulfilment system and the move to next-day delivery to its customers. This was achieved by abandoning its own fleet of vans providing a weekly delivery service to shops in favour of a contract with a national carrier - Securicor, who carry the vast majority of books in the UK already - able to deliver anywhere in the UK in 24 hours.

The centre retains one van in order to backhaul new stock from publishers.

The centre is clearly efficiently run and well organised, and normally all orders are processed within a day of receipt. Its problems come from its limited control over the books it stocks and the resulting inability to plan space requirements. It should be noted that there is no available space within the main picking area for expansion of range without structural modifications.

Also notable is the centre's excellent record for cash collection. Many booksellers take advantage of a 2.5% settlement discount which helps to keep the centre within its own ambitious targets for cash collection.

## **5. Operational problems**

Despite this background the operation of the centre is not without its frustrations and difficulties. Most of these appear to derive from the perception of both publishers and booksellers that it exists to provide a public service. For example:

- Some publishers are inefficient in providing information about their new titles and books frequently turn up without pre-advice.
- The centre is not entirely able to influence the amount of stock delivered on consignment; there is a tendency for publishers to try to use the centre for free storage.

## 7 / Strategy plan for the WBC distribution centre

- Some publishers expect the centre to collect their books at its expense.
- The system of standing order sales, aimed at ensuring a coverage of key titles across Welsh bookshops, leads to a high volume of returns.
- Publishers hold the centre responsible for damage to returned stock.
- The centre is expected to pay returns carriage costs, contrary to normal UK practice.
- The centre is expected to compensate booksellers for certain direct transactions, such as children's book clubs.

Some of these problems are partially self-inflicted, or at least brought about by the principles of service to which the centre adheres. There is no doubting that the centre enjoys an excellent relationship with the vast majority of its publishers and its customers but this should be within the framework of reasonable commercial requirements which enables the centre to plan and to benefit from available efficiencies.

## 6. Exclusivity of supply

As mentioned above, because of the informal nature of the relationship publishers have with the distribution centre, some take advantage of the opportunity of making sales of new titles direct to booksellers before sending the balance of the stock to the centre. A recent report by Grant Thornton put the percentage loss of volume to the centre at 20%.

The additional volume exclusivity of supply would provide, especially of books which are going to be sold immediately and not remain in stock, would be a significant factor in the centre's overall ability to pay its way.

In the context of the overall service the distribution centre exists to give to the Welsh book industry - including, it should be remembered, free representation and marketing support – this is not an acceptable practice and should so far as possible be resisted.

Some of the possible ramifications from securing exclusivity of supply are discussed in section 8.

## 7. **Gwales.com**

Gwales.com is outstandingly easy to use, with excellent functionality and navigation. As such it provides an admirable means of access to a virtual catalogue of the titles stocked by the distribution centre or otherwise available. It also provides an ordering mechanism which enables both booksellers and individuals to place orders.

Booksellers are able to order directly from the distribution centre and to set up accounts with it if necessary. Use of this facility will depend on the development of ICT – in simple terms, access to the internet – in Welsh shops and on alternative ordering methods such as Teleordering. As technology use becomes more accepted, the system is likely to be of prime attraction to booksellers chiefly selling titles in Welsh or about Wales rather than to general bookshops requiring a wider range; the hope must be that its value to them as an information source will also encourage a wider range of sales from the site.

Importantly the site is also able to take orders from individuals but, as it now stands, these orders are placed through a selected number of participating booksellers. This has led to unacceptable delays in the supply of books. In the first place, there is no certainty that the required book will be available at the shop from which it has been ordered. If that is the case, it will have to be ordered from the distribution centre. Given the geographical spread of bookshops in Wales, there is a strong likelihood even then that it will be necessary for the bookshop to post the book to the ordering individual. Consequently what has been a very straightforward internet transaction results in an inefficient and cumbersome supply process. Consumers who even two years ago were able to accept delays of this kind have now been encouraged by the impressive service levels set by Amazon.co.uk to expect next-day delivery.

In addition, of course, this arrangement provides the distribution centre with only limited access to information about the orders being placed and the efficiency with which they are being fulfilled. The belief is, however, that the system is not providing the level of service which consumers are entitled to expect from this kind of resource.

This is particularly important if the site is to serve the needs of customers outside Wales. The benefit of such a site is its ready access for Welsh speakers and those of Welsh origins or with Welsh interests anywhere in the world to a catalogue of available titles, and the hope is that the site will become sufficiently well known to widen the geographic market for books about Wales very significantly. Such users are unlikely to want their orders channelled through local bookshops.

In these circumstances, and given the public funding which has enabled gwales.com to be created, it is essential that the centre should move to direct supply. The site clearly indicates availability (in stock at the distribution centre; obtainable through the publisher; available direct from the publisher, or out of print) but this information is valueless to the consumer if a bookshop is the intermediary, especially if – as is very likely in a country such as Wales – the bookshop is not conveniently sited for the customer.

The role of the distribution centre being what it is, it is possible that consideration may be given to compensating booksellers for direct purchases by consumers from the distribution centre. This should be resisted. Any form of compensation would inevitably be arbitrary in terms both of the bookshops entitled to receive it and the sums involved, and would contribute to perpetuating damaging precedents already existing in the centre's activities.

It is true that there are potential logistical issues arising for the centre from the need to supply and dispatch a high volume of single copies. Some of the additional cost would be recouped through the gain in value from not giving discount to booksellers; and some from carriage charges – though it is suggested that these should be set at a level providing incentives for multiple purchases.

## 8. Defining the business

The most important priority in operational terms is to redefine the centre's terms of trade. This should be done through two processes. First, the centre should draw up its own policy of how it wishes to operate, both internally and as far as external dealings are concerned, making a clear distinction between its roles as a distributor and a wholesaler. Secondly, this policy should be formalised through agreeing contracts with the publishers who supply books on consignment.

### *Distribution issues*

It is strongly recommended that the terms under which publishers use the resources of the distribution centre are clearly stated and formalised through contracts. At its simplest, this would define the responsibilities of the parties to the contract and should include:

- whatever obligation might be agreed with publishers regarding exclusivity of supply;
- discount structure, and permissible variations from it;
- the service levels in terms of representation and marketing support publishers can expect;
- service levels publishers can expect from the centre;
- requirements of publishers in terms of advance information;
- the processes by which invoices are raised and payments made;
- detail and form of sales data provided;
- rate of sale per title after which the centre will surrender the distribution rights and return stock to the publisher;
- applicable returns policy;
- scale of charges for exceptional operations or handling;
- allocation of carriage and other costs where applicable.

The desirability of having formal contracts with publishers should be obvious. More contentious, however, is the opportunity this presents to vary the existing terms of supply to gain the prize of exclusivity.

This prize relates primarily to new titles. Once sales have dwindled, although the centre may wish to hold limited stock to fulfil occasional orders, it is probably in the centre's best interests to surrender exclusive distribution rights to free up space. The publisher, in any case, must retain the responsibility for eventual pulping or remaindering, though this could be done in consultation with the centre by agreement.

The contract should, however, be designed to encourage those publishers benefiting from free representation and marketing support to channel all their new title distribution through the centre. The English language publishers comprising Literary Publishers (Wales) have already agreed to do this in return for sales information, which is withheld from other publishers who use the transfer mechanism. This may be a valuable precedent for further contract negotiation.

There is, in any event, a strong case for providing sales data to publishers once they have become contracted users of the distribution centre. It would enable publishers to identify specific sales shortfalls and provide direction to the representatives on potential sales opportunities; and it would also be valuable in helping them to evaluate, and thereby improve the quality of, their publishing.

It is recommended, therefore, that such sales data – a monthly report of sales volume by outlet is probably all that would be needed – should be made available to publishers in return for exclusive supply arrangements, and that for these the proposed new discount of 45% should continue. For publishers reluctant to concede exclusivity, a higher discount in the range of 48-50% should be negotiated.

If this seems an aggressive change to the current situation, comparison should be made with the dramatic improvement in credit control with booksellers which was achieved some years ago. Though this took a long time and much persuasion, the benefits to the centre have been incalculable. Formalising the relationship between publishers and the centre could have a similarly beneficial effect. In any event, the

benefit of the contract is bilateral: publishers need to know where they stand in their relationship with the centre just as much as the centre needs the certainty of its terms of business.

It should also be borne in mind that contracts, which should be renewable on a periodic basis, would leave open the possibility of renegotiating discount and other terms as circumstances change. This is another major benefit of introducing contracts.

### *Wholesaling issues*

As a wholesaler, the centre is able to buy in titles from publishers at significantly greater discount than it receives from the books supplied on consignment. Thus, the cash flow disbenefit is offset by higher margins on sales. Control of stock is the most crucial element and the new book industry initiative on returns is likely to work to the benefit of the centre, offering a window of opportunity to a wholesaler to return overstocks from three months after publication to fifteen months after the last order for that title. Though it may take some time for this process to become established, the principle is already enshrined as an industry standard and will be available from five of the UK's leading distributors by the early part of next year.

It is essential that, when possible, advantage is taken of this mechanism to avoid the danger of overstocks of titles bought by the centre; and that the sales history and ordering patterns are closely monitored to keep the stock 'clean' (that is, saleable) on a continuing basis. This is particularly important if books are being scaled out under the standing order system (see section 13) and where a high proportion of returns may be expected. Equally, the centre should take advantage of the ready availability of books at short notice from most of the more sophisticated publishers and distributors and, wherever possible, continue to order in small but repeatable quantities.

## 9. Volume and range

Any distribution business has a relatively high capital base. The key to making it profitable is to expand the business to amortise the capital base over higher volumes. Most distribution businesses find that they can take on substantial additional volumes without untoward increase in cost, provided this does not involve a requirement for additional space. Despite the relatively small scale of its current transactions – small quantities coming in, small parcels going out, a situation that will be hard to change – the WBC distribution centre would benefit hugely from even modest increases in its business.

Some of the ways to achieve this might be:

- Exclusivity of supply for the transfer pricing publishers. If Grant Thornton are right, the prize is a 20% increase in throughput.
- Direct fulfilment of orders from consumers via gwales.com.
- Increasing international sales thanks to the worldwide reach of gwales.com.
- Increasing conventional sales by pursuing the current policy of establishing a more secure relationship with WH Smith and by selling to supermarkets – if the discount structure permits.
- Widening the range of products offered.

Provided that the Welsh Books council sees no conflict between its public service obligations in support of Welsh books and the development of commercial activity in the distribution centre – and, of course, provided that such development is not allowed to jeopardise the primary objectives of the centre - there appear to be various opportunities for widening range and increasing turnover. These include:

- Supplying additional products to the existing customer base and consolidating delivery. This opportunity seems most likely to be realised from the centre's customers who are not primarily booksellers - tourist outlets, CTNs, post-offices and general stores – though perhaps some of the independent bookshops too. Products such as maps, stationery, post cards and greetings cards, gift items,

computer software and games, and music and spoken word CDs and cassettes are probably the most suitable, both for the shops and for the processes of the centre. This might be addressed by the representatives canvassing the shops regarding possible opportunities. No doubt such needs are already accommodated by other supply chains, but it may prove that the facilities the distribution centre has for fast turn-round of orders and next-day deliveries might be superior to what is on offer elsewhere.

- Publisher distribution. The operation of a Vista fulfilment system and ready access to the Securicor Omega Express network mean that the geographical location of the centre should be no obstacle to its taking on distribution contracts for publishers outside Wales. Small publishers face a dilemma where distribution is concerned: whether to persevere with their own distribution in the face of the changes happening in the wider supply chain – electronic communication for orders, invoices etc - in which they are unlikely to be able to participate because of their limited resources; or to try to find a major distributor who can deliver all the services the growing sophistication of the market demands but at a cost both financial and to levels of personal service. Many of them might find the existence of the WBC distribution centre an attractive proposition.
- Specific services to the Welsh market. Publishers outside Wales with books – or music or other product - of specifically Welsh interest might find a commercial distribution deal, coupled with specialist representation and marketing, an attractive option.

Increases in volume throughput might result in the centre being able to retrieve some of the business it has lost to other wholesalers, even if this meant competing on discount. It is, for instance, a matter of regret that sales of some successful products, previously supplied through the centre, are no longer possible because of more attractive discounts elsewhere.

Any increase in sales volume, unless dramatic and dependable in the long term, would have to be achieved without incurring significant additional capital cost in terms of space requirements. The hope would be that increased volume could be

accommodated by the introduction of a more aggressive policy on stockholding and the ability to plan which a contractual relationship with publishers would permit.

## 10. Cost savings

There is no evidence that there are any obvious direct cost savings to be readily achieved from the operations of the centre. It is well equipped and evidently well managed. The only area which should be reviewed, on a continuing basis, is the carriage contract with Securicor. This has already resulted in a substantial reduction in cost but the situation needs to be kept under review.

Securicor have built up a near monopoly in the book industry in the UK and must take the credit for the huge improvement in typical delivery times which have been brought about. They are not without their detractors, however: and there has only recently been a spate of complaints about a decline in their service levels. However, the logistics business has become increasingly competitive in recent years and it must be only a matter of time before Securicor's market dominance is challenged. HarperCollins have their distribution contract with ANC and other distributors are making local and specific arrangements which reduce their dependence on Securicor.

One chief reason for a contract review is the size and nature of the parcels. By definition the centre's main traffic is in small parcels to multiple destinations and it is important to ensure that this product mix continues to be right for the carrier. Both ParcelForce and Parceline are known to be eyeing the books market and discussions with them, and with ANC, might be fruitful. This might prove particularly valuable if there is a growing volume of single copy deliveries deriving from gwales.com orders.

## 11. Representation

The marketing services provided by the Welsh Books Council include free representation through a force of three (four, if the recent appointment of a representative with specific responsibility for English language literary titles published in Wales is included), one of whom is directly funded by the distribution centre.

There has been much debate in recent times about the future role of representatives. This has come about from the erosion in the volume of business generated in this way, the result of more central buying, chain booksellers in particular seeing it as being a waste of their staff's time, alternative means of selection, and so on.

There seems little doubt that the role of the representative will be further diminished as time goes on, especially as publishers devise – and booksellers accede to, or require – alternative forms of presentation, generally in electronic form. However, both the lack of investment in ICT by Welsh booksellers and the limited markets supplied by publishers are likely to make this a slow process in Wales.

Given time, however, gwales.com has the potential to be an alternative showcase and ordering source for Welsh booksellers, though it may need some additional refinement. In the short term, however, the existing representation arrangements are likely to continue to be the most effective way of presenting titles to booksellers.

Some analysis of the results achieved by the existing team would be required to assess whether the current level of representation, both in terms of numbers and call pattern, is cost effective. There may be a need for closer monitoring of individual calls and specific reporting procedures.

Two potential weaknesses in the present arrangements need consideration in the medium term. First, there is some evidence of a need for enhanced sales management: much of the traditional role of the representative has been eroded over recent times and absorbed by 'head office' staff, partly because of the growth of bookselling chains and their service requirements. Secondly, if exclusivity of supply is achieved,

some publishers will insist on an element of merchandising to be carried out in some outlets. This could be especially problematic given the cost and ownership of specific racking and display stands. It is suggested that, with these two needs in prospect, the area of sales representation should be kept under constant review.

## **12. Staffing**

The level of staffing in the centre seems entirely appropriate, though of course needing to be kept under review. Inevitably, the higher volume of business envisaged in this report would require reconsideration of staffing needs.

Middle management in the centre comprises three roles: accounts; ordering and stock administration; and warehouse management. This division of responsibility has evidently worked well, but the first of these has been deliberately left vacant following the incumbent's retirement and, although a new appointment will be made in due course, it may prove possible to operate effectively without reverting to the previous overall numbers. Such opportunities to refine headcount needs should be reviewed on a continuing basis as they arise.

## **13. Standing orders**

Under current practice, fixed quantities of new titles are scaled out to some fifty key shops without an order being placed. This is a well intentioned device for ensuring that new titles are represented in the shops but it has numerous disadvantages: waste of representatives' time in calling on shops whose order quantity is already pre-decided; shops failing to order appropriate quantities or provide proper display; and, in practice, an excessive level of returns, with consequent increased cost to the centre. Numbers have been scaled down in recent years and it has been suggested that one copy per shop might be a compromise solution. However, this might also turn out to

have a negative impact by depressing opportunities for titles with potential for greater sales. There is clearly no substitute for considered judgment of sales potential, coupled with commitment from a bookshop to display and promote titles where sales can be anticipated; and it is recommended that the standing order system be either abandoned or substantially refined in discussion with the shops in question.

#### **14. Returns**

Returns are a key concern for the centre and a watching brief should be maintained on the progress of the PA/BA returns initiative aimed at taking cost out of this aspect of the supply chain. This initiative is based on a number of principles which have varying relevance to the operations of the distribution centre:

- Booksellers' right to return. As stated above, booksellers are allowed a window within which returns will be accepted without question. This runs from three months after publication until fifteen months have elapsed since their last order of the title in question. In its role as a distributor, the centre would be entitled to refuse to accept the early returns which typically arise from the standing order system. On the other hand, books which have been bought in could be returned on the same terms to participating suppliers.
- Returns will only be credited if preauthorised. The automatic preauthorisation software is currently being developed for Vista users as an upgrade to existing fulfilment systems. The centre should investigate the costs and benefits of this software: given the relatively slow take up of ICT in bookshops, it may not be a cost-effective investment at present. However, even a manual or semi-automatic adoption of the proposed principles may give benefit.
- Returns will be credited at a preagreed standard valuation. This will be an average cost price on supplies to individual customers over a twelve-month period. By including this valuation in the returns authorisation, disputes over account reconciliation and the need for booksellers to raise debit notes can be avoided.

- System-driven preauthorisation precludes individual judgements about the condition of returns. It is proposed that all returns which have been authorised will be credited regardless of their condition. Publishers who have agreed to the adoption of the new process by the distribution centre (as in practice all would be obliged to do, if the benefits are to be gained) would of course have to bear the cost of losses arising where books cease to be resaleable.
- Centralised disposal. This proposal would enable returns which are not wanted back for restocking to be disposed of by a ‘trusted third party’. This part of the project has not yet been fully developed, but it should be noted that the decision on whether a book should be returned for restocking would rest with the individual publisher, not with the distributor. It will also establish a division of cost based on the assumption that the bookseller pays carriage on returns.

It is worth noting that the new returns process is intended to remove the role of representatives in the administration of returns.

Adoption of this process is in its early stages and it is not possible to be specific about all the benefits which might apply to the centre. However, five major UK distributors – HarperCollins, Littlehampton, Macmillan, Penguin and Random House – and the two leading UK wholesalers – Bertrams and Gardners – will be introducing automatic preauthorisation of returns between now and the new year. Others are certain to follow and, with support from all the chief retail chains, the process is likely to become very widespread over the coming years.

Not only the process itself but the principles behind it may be valuable to the centre. For instance, it provides an opportunity to insist that booksellers pay carriage on returns and to resist publishers who expect the centre to pay for damage incurred to books which have been returned. The centre should use this initiative to regularise its terms of trade, in the case of publishers through the proposed contracts.

## **15. Public service factors**

It is clear that the Welsh Books Council, being a publicly funded body, needs to move cautiously to implement change in the distribution centre. The centre depends on a fine balance based on its relationships with publishers and booksellers and on the cross subsidies in kind from other departments of the WBC. Indeed, the present allocation of costs has come about partly because of the necessities of obtaining funding from wherever it may be found.

There is a temptation to question the present structure because of those factors and to suggest alternative structures which lend additional clarity. However, there is no evidence that this would be beneficial. It may be an anomaly that the distribution centre operates as a commercial organisation within another body which is publicly funded, but it is reasonably clear that the centre benefits as a whole both from the subsidy in which it participates and the freedom of action which its commercial credentials dictate. What is important is that a clearly defined policy exists which governs how these potential conflicts are handled.

However, more significant is the degree of benefit the centre has been able to provide to the Welsh book industry. The entire process of support for the industry and the Welsh language through publishing grants and capital funding is part of a complex mechanism which has served the needs of the book industry well. A key ingredient of that mechanism is the ability to provide distribution – without which the fundamental objectives of encouraging reading in the Welsh language or about Wales cannot be realised.

## **16. Conclusions**

The future of the distribution centre is not without problems: the fine balance it maintains between the needs of publishers and booksellers begins to look increasingly precarious. As discount structures change and distribution becomes ever more capital-

intensive as a result of higher service demands, there is a danger that its existence will become untenable. That is why such importance is attached to the development of gwales.com and the role it is likely to play in the Welsh book industry in the future.

The Welsh Books Council's complex task is to encourage the availability of reading material in Wales's two languages and to support the trading infrastructure which makes this possible. The distribution centre is a crucial part of this strategy. It is hard to imagine that many of the smaller publishers would be able to provide fulfilment services on their own account, even at a lower level than the centre provides, if the centre did not exist – let alone the representation and marketing support the WBC provides; or that for booksellers distribution systems elsewhere in the UK would be able to provide a substitute either in terms of cost or service levels.

Without the distribution centre, the consequences would be likely to be: fewer publishers and fewer published titles; fewer specialist booksellers; reduced access to books in the Welsh language and about Wales and its heritage; and an undermining of the Welsh Books Council's mission.

## Summary of recommendations and their financial implications

- The centre should take immediate steps to increase the standard level of discount granted by publishers under the transfer mechanism to 45%. This should take effect from the beginning of the next financial year in April 2002.
- The centre should insist on the adoption of formal contracts with publishers to affirm existing terms of trade and establish the respective responsibilities of each party. This will remove uncertainty about the services the centre is expected to provide and allocate their cost in an unambiguous way. This should in itself deliver a modest financial benefit.
- This process should secure exclusivity of supply, where possible, in return for sales data. This initiative, which is likely to be resisted by some publishers in the short term, may well take time to implement – as the changes to payment terms for booksellers did – but it is an essential safeguard for the future of the centre. Not all of the 20% of lost sales through direct supply which Grant Thornton identified will probably be recovered but there should be a steady improvement in performance over the next two to three years. The plan assumes that a significant portion of the centre's business will be on an exclusive basis by year 2 and also takes into account improvements in discount which ought to be available from publishers not prepared to grant exclusivity.
- The centre should move to direct supply of sales to consumers made through gwales.com. This raises a number of issues which need consideration: how the change can best be presented to the trade and promoted to potential users: whether payment should be made exclusively by credit card; and other practical details. There should be a strengthening revenue stream from this over the plan period. The plan assumes a relatively slow start, with growing momentum over time.
- The decision should be taken not to pay compensation to booksellers on direct sales. This provides extra margin (no discount given) which would, however, be

somewhat offset by higher handling costs. However, a postage and packing charge – comparable perhaps to that charged by amazon.co.uk – ought still to be made.

At the same time, other arbitrary payments of compensation to booksellers for direct supply conducted by the centre should be reviewed.

- The centre should seriously consider the impact of taking on commercial distribution for publishers outside Wales. This need not be too ambitious in the first instance: identifying two or three small publishers with turnover in the region of £50-100k would be extremely valuable. If suitable publishers can be identified, 12.5% of net turnover ought to be achievable. The plan assumes benefits from this initiative coming through during the plan period, though of course there are compensating costs in terms of staffing, parcel delivery and general servicing requirements.
- The centre should explore, in consultation with its customers, widening the range of products it provides. If opportunities are available, this could be a very useful additional source of revenue; however, it would be premature to take any revenue benefits into this plan.
- The centre should keep under review its parcel carrying contract with Securicor Omega Express. This should include discussions with alternative carriers. By this means, carriage costs ought to be stable in real terms over the plan period, though volumes will grow.
- There should be a review of current representation arrangements and of the standing order system of supplying new titles. These two initiatives should be taken in tandem in order to ensure that any change to the standing order system does not impact on real sales performance.
- The new returns process developed by the book industry supply chain steering committee of the Publishers Association and Booksellers Association should be assessed for any impact it may have on the distribution centre's business. In

particular, this should ensure that (a) books are not returned until they have had a reasonable chance to sell through and (b) books which have been bought in can be returned without argument if sales are not forthcoming. At the same time, contracts with publishers supplying stock on a transfer basis should be as specific as possible about the implications of this initiative, including their responsibility for damaged returns. This should help to define responsibilities for costs incurred within the returns process and permit some cost recovery.

- The existing efforts which are being made to widen the centre's sales base – through supermarkets and a sounder relationship with WH Smith branches – should be pursued, though available discount may prove problematical.
- The future of the Vista system needs to be considered as a matter of priority and all options assessed, including the possibility of a hosting service.

These recommendations are designed to have a generally strengthening impact on the profitability of the distribution centre and, in broad terms, can be classified as follows:

- Increased turnover, through regaining lost sales (exclusivity), using the centre's resources and commercial facilities to provide commercial distribution to third parties, efficient servicing of direct orders both within Wales and internationally, and through seeking opportunities to widen the product base.
- Enhanced margin, through improved discounts from publishers within the transfer system, defining the terms on which the centre deals with publishers (and to some degree booksellers), and recovering costs which are no part of a distribution centre's responsibility.
- Cost reduction, through seeking opportunities to reduce the cost base and gaining the advantages of full utilisation of capacity and resources.

## Notes on the financial projections

- All sales figures have been increased by 3% per annum over the period of the plan to allow for inflation. An allowance has also been made for the expected increase in turnover from April 2003 as a result of exclusive contracts being negotiated.
- An increase in gross profit has been allowed for from April 2002 as a result of increasing the standard discount received from publishers from 43.12% to 45%. A further increase has also been allowed for from April 2003 as a result of a further increase in discount to 48% for publishers not opting for exclusivity.
- The effect of direct sales from gwales.com and margin on third party distribution has not been brought in until April 2003 and at the same time a sum has been included for a computer development fund (a sum of £30,000 per annum would appear to be a reasonable amount in order to build up a fund that could be used as matched funding).
- All other costs have been increased in line with inflation except in a few instances such as carriage and packing where there has been a further allowance due to the increased costs expected as a result of increased sales.

<b>DISTRIBUTION CENTRE 1996-2007</b>									
<b>Income and expenditure forecast</b>									
	<b>1999-2000</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>	<b>2006/07</b>	
	<i>actual</i>	<i>actual</i>	<i>budget</i>	<i>plan</i>	<i>plan</i>	<i>plan</i>	<i>plan</i>	<i>plan</i>	
<b>INCOME</b>									
Book sales (transfer)	1,814,489	1,959,539	1,866,667	1,922,667	2,029,856	2,090,751	2,153,474	2,218,078	
Book sales (bought in)	777,638	839,802	800,000	824,000	848,720	874,182	900,407	927,419	
Gwales.com direct sales				0	20,000	25,000	30,000	40,000	
Margin on third party distribution				0	10,000	15,000	15,000	15,000	
Charges on debts	6,728	6,764	6,923	7,061	7,202	7,346	7,493	7,643	
Delivery service	6,538	4,926	5,024	5,124	5,226	5,330	5,437	5,546	
Other income	6,345	4,923	5,021	5,121	5,223	5,327	5,433	5,542	
	<b>2,611,738</b>	<b>2,815,954</b>	<b>2,683,635</b>	<b>2,763,973</b>	<b>2,926,227</b>	<b>3,022,936</b>	<b>3,117,244</b>	<b>3,219,228</b>	
<b>EXPENDITURE</b>									
Books purchased (transfer)	1,551,388	1,675,406	1,595,627	1,589,277	1,633,321	1,682,321	1,732,790	1,784,774	
Books purchased (bought in)	607,407	630,522	617,707	636,210	655,297	674,956	695,204	716,060	
Books purchased (gwales.com direct sales)				0	10,490	13,113	15,735	20,980	
Salaries, insurance, pension	256,388	268,890	265,000	284,600	305,130	315,210	324,370	333,800	
Running costs of vehicles	13,403	16,589	17,085	17,600	18,128	18,672	19,232	19,809	
Travelling, subsistence	9,710	10,792	11,116	11,450	11,794	12,148	12,512	12,887	
Carriage, post, packaging materials	90,964	95,589	90,000	97,000	115,000	118,450	122,000	125,660	
Purchase and maintenance of equipment	28,346	35,260	36,179	40,000	45,000	46,350	47,740	49,175	
Computer development				0	30,000	30,000	30,000	30,000	
Rates, heat, light, telephone	8,256	6,172	6,494	6,690	6,890	7,100	7,300	7,500	
Insurance, maintenance of buildings	5,833	6,956	7,500	8,500	8,750	9,000	9,250	9,500	
Printing, stationery	9,941	4,034	5,000	5,250	5,500	5,750	6,000	6,250	
Bad Debts	833	1,140	1,000	1,000	1,000	1,000	1,000	1,000	
Discount allowed	47,792	45,177	45,000	47,000	50,000	51,500	53,000	54,500	
Sundries	3,789	5,659	6,000	6,100	6,200	6,300	6,400	6,500	
Auditors' fees	1,700	1,700	1,750	1,750	1,800	1,800	1,850	1,850	
	<b>2,635,745</b>	<b>2,803,886</b>	<b>2,705,458</b>	<b>2,752,427</b>	<b>2,904,300</b>	<b>2,993,670</b>	<b>3,084,383</b>	<b>3,180,245</b>	
Surplus/ (Deficit)	-24,007	12,068	-21,823	11,546	21,927	29,266	32,861	38,983	