

**TO: SECRETARY OF STATE FOR TRADE AND INDUSTRY**

**FROM: JOHN VICKERS  
CHAIRMAN  
OFFICE OF FAIR TRADING**

**31 October 2003**

## **OFT REVIEW OF UNDERTAKINGS GIVEN BY NEWSPAPER WHOLESALERS**

### **ISSUE**

1. Following the 1993 Monopolies and Mergers Commission Report<sup>1</sup> (the 'MMC report') into the supply of national newspapers, an industry Code of Practice (the Code) underpinned by statutory undertakings given by wholesalers was accepted by the Secretary of State in October 1994. Under section 88(4) of the Fair Trading Act (FTA) 1973, the OFT has a duty to review these undertakings to ensure that the undertakings remain appropriate to remedy the adverse public interest findings identified by the MMC.
2. We are advising you as to whether, by reason of any change of circumstances, the undertakings to comply with the Code are no longer appropriate and, if so, whether newspaper wholesalers should be released from the undertakings, or whether the undertakings should be varied or superseded.
3. We consider that some aspects of the Code have performed well. The obligation to supply retailers who purchase at least the minimum entry level amount has had a positive impact on the number and range of outlets selling newspapers.
4. However, the Code imposes many restrictions which appear to have significantly hindered the development of selling-on.<sup>2</sup> We consider that liberalising selling-on within a wholesaler's area of operation<sup>3</sup> would better remedy the adverse interest finding made by the MMC regarding wholesaler practices preventing the sub-retailing<sup>4</sup> of newspapers. Responses to consultation were broadly in favour of this approach.

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<sup>1</sup> *A report on the supply of national newspapers in England and Wales*, December 1993, Cm 2422.

<sup>2</sup> Selling-on occurs where a retailer (which we shall call the hub-retailer) sells or transfers titles to another retailer (a sub-retailer). In this way the sub-retailer is able to obtain titles from another retailer, as opposed to directly from a wholesaler.

<sup>3</sup> A wholesaler's area of operation is the postcode area defined by a newspaper's publisher or distributor in which the wholesaler is permitted to distribute that newspaper.

<sup>4</sup> The terms sub-retailing and selling-on are used interchangeably.

## **RECOMMENDATION**

5. We recommend that you amend the Code so that selling-on is liberalised within a wholesaler's area of operation. Our suggested changes to the Code are set out at Annex A.

## **TIMING**

6. Routine.

## **TRANSPARENCY**

7. We intend to publish this advice, including the Annexes, as soon as you announce your response to this recommendation.

## **BACKGROUND**

### **The reference and the Code**

8. The MMC report made two adverse findings in relation to the following wholesalers' practices:
  - (i) refusing to supply applicants when, in the wholesalers' opinion, an area was adequately served
  - (ii) requiring retailers to sell only by retail and only from specified outlets, thus preventing sub-retailing of newspapers
9. Under the threat of a statutory order to remedy these adverse findings, the industry was given the opportunity to come forward with remedies of its own. The industry took up this opportunity and eventually wholesalers each signed a statutory undertaking to comply with the Code (see Annex B). The Code includes the following features:
  - (i) It obliges wholesalers to supply retailers who agree to a guaranteed net weekly charge set at the Minimum Entry Level (MEL).
  - (ii) It defines a narrow range of circumstances under which retailers can sell on their titles to other retailers:
    - Retailers must sell newspapers for 18 months before they have an automatic right to sell on titles to other retailers.
    - Selling-on is not allowed across a wholesaler's area of operation.
    - A retailer must not sell on titles to another retailer that is more than 500 metres away in central urban areas and more than one kilometre away in other areas, other than at the wholesaler's discretion.
    - A sub-retailer must sell directly to consumers as opposed to selling-on its titles to another retailer.

- Retailers have freedom to sell on to sub-retailers only up to the MEL value.
- Sales or transfers of supplies with a weekly value in excess of the MEL must be sourced directly from the wholesaler.

### Scope of the review

10. The newspapers ('titles') that are the subject of this review are national newspapers in the UK. These titles were defined by the MMC to be '*those daily and Sunday newspapers of general interest which one might expect to find on sale at most retail outlets in England and Wales*'.<sup>5</sup> Although the MMC review relates to newspaper distribution in England and Wales and hence only the operations of wholesalers in these nations are bound by the Code, we understand that the Code of Practice has been voluntarily adopted by wholesalers in the rest of the UK. Therefore we expect that our final recommendation will affect newspaper wholesaling in the whole of the UK.

### Earlier reviews and consultations

11. Our first review of the Code was conducted in 1997.<sup>6</sup> The second review began with a consultation in January 2002.<sup>7</sup> We then set out our findings based on evidence gathered during this consultation exercise in December 2002 (our 'December report').<sup>8</sup> The December report also consulted on a provisional recommendation: to liberalise selling on within wholesaler areas of operation.<sup>9</sup> Our final recommendation is the same as our provisional recommendation.

### How successfully has the Code remedied the MMC's adverse findings?

12. We have considered how well the Code has remedied the adverse findings identified by the MMC. In some respects the Code has performed well. It appears that the Code was generally adhered to in England and Wales (and voluntarily adhered to in the rest of the UK). Furthermore, the obligation to supply has undoubtedly had a positive impact on the number and range of outlets supplied and so continues to be a good remedy for the first of the MMC's adverse findings. However, the Code has performed poorly with respect to the second of the MMC's adverse findings. Selling-on has not developed significantly as only two to three per cent of existing retailers provide sub-retailing services. This is largely as a result of the restrictions contained in the Code.

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<sup>5</sup> MMC report, at paragraph 3.2.

<sup>6</sup> *Review of the Industry Code of Practice for the Supply of Newspapers*, OFT (1997).

<sup>7</sup> *OFT review of undertakings given by newspaper wholesalers: a consultation paper*. January 2002, OFT 370.

<sup>8</sup> *OFT review of undertakings given by newspaper wholesalers: findings and consultation on provisional and alternative recommendations*. December 2002 (OFT 612).

<sup>9</sup> In the December report, we referred to this area as an exclusive territory since publishers allocated wholesaler areas of operation on an exclusive basis. In this report we refer instead to a wholesaler's area of operation: the recommendation applies whether the area of operation is awarded on an exclusive or on a non-exclusive basis.

### **Changes in circumstance which render some aspects of the Code no longer appropriate for remedying adverse findings**

13. We have considered whether there have been any changes in circumstance which mean that the undertakings to abide by the Code are no longer appropriate to remedy the two adverse findings identified by the MMC. We set out several relevant changes in circumstance in our December report (see part 5). These included findings that:
- (i) There is evidence that the market power of the three largest wholesalers<sup>10</sup> has increased and that, on aggregate, Carriage Service Charges (CSCs)<sup>11</sup> have risen faster than costs (which in turn have risen faster than retail price inflation) over the period 1995 – 2000. Selling-on would give retailers greater opportunity to switch to alternative sources of supply in response to higher CSCs.
  - (ii) Confectionary, Tobacco and Newsagent retailers (CTNs) are more likely than any other type of retailer to sell on. However, CTNs are declining as a proportion of total outlets. This trend suggests that selling-on will soon decline if the Code remains unchanged. However, with our recommendation in place, there could (according to wholesalers) be a doubling in the number of retailers involved in selling-on arrangements.
  - (iii) The industry would prefer fewer restrictions on selling-on.
  - (iv) There is evidence that not only would existing retailers take up opportunities to sell on, but new retailers would enter the market. This is important in light of evidence that, although the Code initially led to a surge in retail outlets, the number of retail outlets has now reached a plateau and may be starting to decline.
  - (v) Consumers are more likely to purchase titles later in the day than when the Code was put in place. This has opened up a greater window for selling-on. For example, convenience stores, supermarkets and petrol stations often do not require titles as early in the morning as CTNs.
14. In light of these changes in circumstance, our recommendation to liberalise selling-on within wholesaler areas of operation would better address the MMC's adverse finding on sub-retailing. It would allow retailers and the industry as a whole to react more effectively to meet fluctuations in demand and, more generally, to promote availability and convenience for consumers. These were two important benefits of sub-retailing that the MMC had originally envisaged.<sup>12</sup>

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<sup>10</sup> WHSmith News, Menzies Distribution and Dawson News.

<sup>11</sup> Carriage Service Charges are charges for delivery that wholesalers levy on retailers.

<sup>12</sup> MMC report, at paragraph 11.93.

15. Our recommendation that selling-on by retailers should be fully liberalised within a wholesaler's area of operation would:
- (i) remove restrictions on the maximum distance between a hub-retailer<sup>13</sup> and a sub-retailer within a wholesaler's area of operation;
  - (ii) remove time restrictions on how long a retailer has to have sold newspapers before it is permitted to sell on;
  - (iii) remove restrictions governing the maximum value or volume of newspapers that can be sold on;
  - (iv) remove restrictions on resale by sub-retailers who have bought titles from other retailers rather than wholesalers (i.e. so that they too can sell on titles and are not restricted to selling direct to consumers).

16. Furthermore, we expect our recommendation would have the following benefits.

#### MORE CHOICE FOR RETAILERS

17. Allowing retailers a fall-back option of being able to obtain their supplies from a hub-retailer (as opposed to directly from the wholesaler) should introduce alternative avenues of supply. If CSCs were excessive or wholesaler service poor, retailers might find mutually beneficial ways of obtaining their supplies at lower cost. If so, this would constrain the growth in CSCs and wholesale distribution costs and would encourage wholesalers to offer better service levels.
18. Several responses to the January consultation were in favour of relaxing the restrictions on selling-on. Relaxing distance restrictions received support from all levels of the industry. This would help overcome the problem of sub-retailers having to rely on a competitor as their source of supply. Responses also indicated that margins available from selling-on were low and that this had hindered its growth. This is not surprising given the restrictions contained in the Code. Liberalisation of selling-on would provide more scope to sell on in a profitable way (e.g. by permitting selling-on in higher volumes). It was also noted that fewer outlets than at the time of the Code needed newspapers very early in the morning and that this provided a greater time window for selling-on.

#### GREATER SCOPE FOR INNOVATION IN DISTRIBUTION

19. A liberal regime for selling-on would provide retailers with more freedom to devise new and viable ways of obtaining their titles at a lower cost in the face of rising CSCs or poor service. For example retailers could arrange to collect titles from a hub (e.g. a designated hub-retailer) as opposed to having the wholesaler deliver titles to each outlet and would have more opportunity to manage their own supplies. Wholesalers would benefit from retailer initiatives through delivering the same volume of titles over fewer drops. They would also have

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<sup>13</sup> A hub-retailer is a retailer that supplies titles to another retailer for resale. In the December report we referred to these retailers as 'source-retailers'.

greater freedom to innovate themselves and ultimately this should help to contain distribution costs. Furthermore, should retailers develop their own distribution networks, they may in time offer publishers a credible alternative to dealing with the existing wholesaler.

### **Industry views and OFT opinion**

20. In general, publishers and wholesalers welcome our recommendation. Retailers also favour liberalising selling-on but generally do not consider that our recommendation is sufficient to deal with their concerns about wholesalers' ability to raise CSCs and reduce service quality.<sup>14</sup>
21. While it is feasible that high CSCs or poor service quality could undermine the obligation to supply set out in the Code, our December report did not find evidence to suggest that high CSCs or poor service quality had adversely affected availability. We note that the Code has substantially enhanced the number and range of outlets selling newspapers and that, as set out above, our recommendation will provide greater choice for retailers in the event that they are dissatisfied with CSCs and wholesaler service levels.
22. Publishers and wholesalers caution that selling-on should not extend beyond territorial boundaries as this, in their view, would undermine the current system of exclusive territories that they favour.<sup>15</sup> In contrast, retailers believe that selling-on should extend beyond territorial boundaries and that exclusive territories are undesirable.
23. We have not considered exclusive territories as these are beyond the remit of this review.<sup>16</sup> Further, this review does not consider the position of exclusive territories in the context of domestic or European competition law.
24. Publishers, wholesalers and retailers raised detailed issues relating to the practicalities of selling-on. These are addressed at Annex C.

### **CONCLUSION**

25. The Code has worked well in promoting the availability of newspapers but has fared poorly in encouraging selling-on. We consider that liberalising selling-on within a wholesaler's area of operation would better remedy the adverse interest finding made by the MMC regarding wholesaler practices preventing the sub-retailing of newspapers.

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<sup>14</sup> Our December report found that CSCs have risen faster than costs (which in turn have risen significantly faster than retail price inflation) and that wholesalers' service quality has fallen.

<sup>15</sup> Publishers assign wholesalers the right to be the sole distributor of their titles within a certain area – this area is known as an exclusive territory.

<sup>16</sup> The MMC did not find the awarding of exclusive territories by publishers to wholesalers to be against the public interest. Our remit allows us to recommend changes in the Code only to the extent that such changes are necessary to address more effectively the adverse public interest findings identified by the MMC.

26. We therefore recommend that you amend the Code so that selling-on is liberalised within a wholesaler's area of operation.

**John Vickers**  
**Chairman**

## **ANNEX A: SUGGESTED CHANGES TO THE CODE**

Part 6 of the Code would be replaced by the following:

### **6. Sub-retailing**

The wholesalers shall not refuse to supply a retailer on the grounds that the retailer intends to sell or transfer newspapers to another retail outlet (known as a 'sub-retailer'). In order to maintain the effectiveness of the existing wholesaler's order reallocation systems, which are recognised as essential in order to maximise sales, minimise waste and optimise availability of the newspapers at retailer level, it is essential that sub-retailing is properly monitored.

The following conditions will apply:

- 6.1 The retailer intending to sell or transfer newspapers to another retail outlet shall notify the wholesaler, by way of an industry-standard form, of all sub-retail locations, including the name, address, postcode and type of outlet of the sub-retailer.
- 6.2 The retailer and any sub-retailers supplied by that retailer will not be permitted to sell or transfer newspapers to locations outside the wholesaler's area of operation as defined by the newspaper's publisher or distributor.
- 6.3 Payment for all supplies and compliance with the wholesalers' term and conditions of business and operational requirements shall be the sole responsibility of the wholesaler-supplied retailer.

## **ANNEX B: INDUSTRY CODE OF PRACTICE**

### **1. Uniform procedure and documentation**

In order that all applications for the supply are considered in an equitable and transparent way, wholesalers will undertake the following:

#### **1.1 STANDARD DOCUMENTATION**

The wholesaler shall provide, to any prospective newspaper retailer, an industry-standard form on which application for the full supply of national newspapers will be made.

#### **1.2 STANDARD PROCEDURE**

The wholesaler shall publish an industry-standard procedure which the wholesaler shall follow in processing any application; which application shall be acknowledged on receipt and dealt with within one calendar month.

#### **1.3 WHOLESALER AREAS**

The wholesaler shall not accept an application for supply of newspapers from an applicant located outside that wholesaler's area of operation as defined by the newspaper's publisher or distributor. Such applications shall be forwarded to the appropriate wholesaler and the applicant informed in writing accordingly.

#### **1.4 SPLIT WHOLESALE AREAS**

Where more than one wholesaler serves an area, any application for supplies shall be an application to all national newspaper wholesalers in the area. To assist applicants, wholesalers shall advise details of those other national newspaper wholesalers in the area.

#### **1.5 LIMITATION OF REFUSAL TO SUPPLY**

Applicants who meet the commercial and economic criteria as laid down within this Code of Practice shall be granted supplies of national newspapers.

#### **1.6 REGISTER OF APPLICATIONS**

Wholesalers will maintain records of all applications. This information will be maintained in accordance with the requirements of the Office of Fair Trading.

### **2. Minimum entry level**

In order to ensure that new retail accounts are provided with a wholesale service that meets the minimum commercial and economic requirements of the wholesaler, the following conditions will apply:

- 2.1 Applicants shall agree to a guaranteed minimum net weekly charge which shall be set at the Minimum Entry Level.

- 2.2 The Minimum Entry Level for each wholesaler area shall be published by the wholesaler and shall be half of the average value of the newspaper invoiced weekly to all existing retailers in the wholesaler's area, calculated as the average weekly newspaper invoice value for the six months ending 31 March 1994. Only those newspapers which the wholesaler is capable of supplying to the applicant shall be included in the calculation. The initial calculation shall have effect for the first two years following commencement of the Code and thereafter will be subject to annual review.
- 2.3 Where more than one wholesaler serves an area then such individually determined minimum entry level values shall be afforded to all applicants.
- 2.4 Wholesalers shall have the discretion to supply below this Minimum Entry Level.
- 2.5 Provided that the new retailer has sustained an order in excess of the Minimum Entry Level for at least six months, the wholesaler will extend Sale or Return facilities where they are made available and approved by the publisher or distributor, subject to the guaranteed minimum net weekly charge being maintained.

### **3. Credit risk control**

Successful applicants will be obligated to make a clear deposit equal to three times the wholesale's minimum entry level, which monies will be held in a separate interest bearing account. Such deposit shall entitle the retailer to receive interest, payable annually in arrears, at the National Westminster Bank Plc base rate, less an administration charge of 1.5 per cent calculated on the sum of deposit. The retention of the deposit will be reviewed after twelve months trading and refunded, subject to the account being maintained satisfactorily in accordance with the wholesaler's Terms and Conditions of supply. The holding of deposits beyond the twelve month period will be subject to review every six months.

Should any account be closed or transferred, any remaining deposit shall be refunded subject only to the retailer's account being cleared in full.

### **4. Carriage charges**

Carriage charges, which reflect the commercial and economic distribution costs of wholesalers in the handling of national newspapers, shall be determined by reference to the wholesaler's published tariff available at the time of application and as determined from time to time.

### **5. Market and quality standards for the retailing of national newspapers**

Successful applicants will be encouraged to adopt a selection of minimum quality standards for display, merchandising, publisher promotions, signage, hours of trading and for ordering, authorised returns, provision of marketing information support for the delivered copy and shop saves, as specified and published in the industry standard document 'Application for Supplies' and the wholesaler's own Terms and Conditions document. Wholesalers will use their judgement to allow reasonable flexibility to accommodate different types of outlet and/or location.

## 6. Sub-retailing

The wholesalers shall not refuse to supply a retailer on the grounds that the retailer intends to sell or transfer newspaper to another retail outlet (known as a 'sub-retailer'). In order to maintain the effectiveness of the existing wholesaler's order reallocation systems, which are recognised as essential in order to maximise sales, minimise waste and optimise availability of the newspapers at retailer level, it is essential that sub-retailing is properly monitored.

The following conditions will apply:

- 6.1 Retailers with less than eighteen months newspaper trading will not be allowed to sub-retail supplies other than at the wholesaler's discretion.
- 6.2 The retailer shall notify the wholesaler, by way of an industry-standard form, of all sub-retail locations, including the name, address, postcode and type of outlet of the sub-retailer.
- 6.3 The retailer and the sub-retailer will not be permitted to sell or transfer newspapers to locations outside the wholesaler's area of operation as defined by the newspaper's publisher or distributor.
- 6.4 Sub-retailing is understood to be appropriate, in order to respond sensibly to local consumer demand by transferring supplies over limited distances of a neighbourhood, within the following distances of the supplying retailer's premises (subject to 6.3 above):
  - Central urban areas – within a 500 metre radius
  - Other areas – within a one kilometre radius
  - 6.4.1 Wholesalers will define in their published terms and conditions which parts of their distribution areas are categorised as central urban. Any disputes on the wholesalers' categorisation may be subject of an appeal to the appeals body referred to below (paragraph 6.7).
  - 6.4.2 Wholesalers will have the discretion to extend these distances, and will give sympathetic consideration to applications beyond the distances stipulated from supplying retailers which would meet distinct social and community needs throughout the wholesaler's distribution areas, particularly in thinly populated areas.
  - 6.4.3 Where an outlet in such circumstances is unable to meet the Minimum Entry Level, wholesalers will also use their good offices to procure such supplies through a retail outlet in their area which is willing to provide supplies.
- 6.5 The retailer shall not permit a sub-retailer to sell or transfer newspapers to another retailer or sub-retailer.

- 6.6 It is recognised that retailers shall have the freedom to supply sub-retailers with firm sale supplies only up to the minimum entry value. Where a sale or transfer to a sub-retailer involving supplies with a weekly value in excess of the minimum entry level is reached, such sub-retailer shall be required to apply for a direct wholesale supply.
- 6.7 Payment for all supplies and compliance with the wholesalers' term and conditions of business and operational requirements shall be the sole responsibility of the wholesaler-supplied retailer.

## **7. Appeals**

- 7.1 The wholesalers shall retain their own published internal appeals procedure regarding application for supply. Upon lodgement of any appeal such procedures shall be processed within six weeks from the date of receipt thereof.
- 7.2 In the event that an applicant is unsuccessful, having exhausted the wholesaler's appeal procedure, the applicant may appeal to an external independent appeal body. All appellants shall lodge an amount of £150 on appeal towards the appeal body's costs; which sum shall be refunded by the wholesaler if the appeal is successful. Such an appeal will be heard within two months of receipt and acknowledgement of the complaint.

## **8. Date of commencement**

This Code of Practice, which will come into effect on 1 October 1994, will be subject to review as necessary.

## **ANNEX C: INDUSTRY VIEWS ON PRACTICALITIES OF SELLING ON AND OFT RESPONSE**

Respondents to the December report argued that the following practicalities would need to be addressed under our recommendation:

- ability of wholesalers and publishers to manage supplies
- administrative burden, terms and conditions
- magazine distribution arrangements
- cross territory sales.

### **Ability of publishers and wholesalers to manage supplies**

Two arguments were raised concerning the ability of publishers and wholesalers to manage supplies. First, publishers argue that commercial risk to retailers is minimised by a system of Sale or Return (SoR), whereby retailers are refunded for every copy that remains unsold at the end of each day. Therefore, the daily allocation of supplies to retailers must be appropriately monitored. Specifically, the daily supply to each retailer must closely match that retailer's daily sales in order to minimise waste, and hence cost to publishers, who fund the system of SoR.

Publishers argue that they have made considerable investments in developing supply management systems which use the flow of returns data to estimate demand and thereby inform publishers' printing plans and the allocation of supplies. They claim that figures on daily sales/returns from each retailer are vital for an efficient distribution system.

Publishers stress, therefore, that the liberalisation of sub-retailing should not undermine their ability, and that of wholesalers, to manage the supply of newspapers. Hence, they consider that hub-retailers should be required to provide their wholesalers with sales data per sub-retail outlet on a daily basis.

However, it is the role of *wholesalers* and not publishers to allocate supplies to the majority of retailers. Wholesalers have also invested in supply management systems and they argue that daily sales data for each sub-retailer is *not* vital. Wholesalers claim that information on hub-retailers' sales and the location of their sub-retailers is sufficient to allocate supplies appropriately. Furthermore, they point out that existing hub-retailers do not supply data on their sub-retailers and that a requirement to do so would raise administrative costs to both hub- and sub-retailers.

The second argument concerning the ability of publishers and wholesalers to manage supplies concerns the volatility of demand. One publisher's concern is that liberalising selling-on could lead to excessive and inefficient entry into the newspaper retailing sector. Although additional retail outlets would give consumers a greater choice of location, this benefit might be outweighed if greater consumer choice leads to greater sales volatility at each outlet.

The publisher considers that increased sales volatility may harm consumers by making it difficult for wholesalers to estimate retailers' daily demand within an acceptable margin of error. This in turn would lead to outlets running out of papers more frequently and/or consumers being unsure which outlets will or will not have papers at different times of the day. Ultimately, so the argument goes, consumers may suffer overall unless publishers increase supplies to all retailers potentially increasing the number of unsold copies and thereby their costs.<sup>17</sup>

### *OFT View*

Ultimately the issue of data collected by publishers and wholesalers is a matter for the industry. However, we believe that data on hub-retailers' sales and returns, combined with information on the location of sub-retailers will be sufficient to allow supplies to be appropriately managed. This is the practice at the moment between existing hub- and sub-retailers.

We consider that excessive administrative burdens on hub- and sub-retailers should be avoided. We expect that publishers and wholesalers can devise alternative, less intrusive ways to obtain further data if such data are required.<sup>18</sup>

With respect to the issue of demand volatility, it is possible that there will be a temporary increase in volatility as retailers and consumers adapt to the new conditions of supply. However, we believe that in the long run purchasing patterns should stabilise and so volatility would not increase significantly, while consumers would gain from greater choice.

Furthermore, selling-on may continue to be offered on a firm sales basis. This would mean that there is no SoR agreement and so there is no enhanced risk that publishers face higher returns and higher costs.

### **Administrative burden, terms and conditions**

Retailers argue that hub-retailers will have to undertake a number of extra activities, and hence incur extra costs. These may include sorting, counting, repacking, delivering, processing orders, allocating supplies, invoicing and collecting payment. Retailers also consider that SoR conditions should apply to sub-retailers and note that in this case a hub-retailer would also have to deal with collecting returns.

Retailers state that, as a consequence of these extra costs, there will be insufficient profit to allow selling-on to develop – especially given that delivery must occur during a limited time period. Therefore, argue retailers, wholesalers should contribute to any additional costs incurred by retailers; offer more generous terms of credit; and provide earlier delivery of titles to hub-retailers.

Wholesalers also caution that a minimum amount of administrative burden will be necessary for selling-on to work effectively and point out (as noted above) that the

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<sup>17</sup> Publishers argue that availability depends on whether copies of their titles are available in these outlets throughout the day.

<sup>18</sup> For example, wholesalers suggest that publishers could obtain sales data on individual sub-retailers by means of a bi-annual sales audit.

information requirements demanded by publishers would seriously undermine the attractiveness of selling-on. However, wholesalers consider that despite some additional costs involved, the number of retailers involved in selling-on arrangements might more than double (to 6-7% of all retailers, compared to 2-3% currently).

#### *OFT view*

Our recommendation does not force retailers to sell on; it simply allows retailers greater opportunity to do so. We believe that there will be sufficient profit margins for selling-on to develop further as selling-on already occurs at the moment, despite the current restrictive conditions of the Code. Our recommendation would ease these restrictions and therefore would make selling-on more viable.

We are encouraged by wholesalers' estimates that selling-on might double. Furthermore, we note that the wider scope to sell on would also benefit retailers that continue to obtain supplies directly from a wholesaler. For example, where retailers can credibly threaten to obtain supplies from a hub-retailer, a wholesaler might offer them better terms and conditions.

We consider that the specific terms and conditions of selling-on are a matter for retailers and wholesalers (and, where relevant, publishers). It is not for the OFT to offer prescriptive advice on the details of each selling-on agreement.

We do not consider that there should be a single model for selling on. Instead, it should develop to suit the circumstances of each case. For example, while wholesalers will sometimes re-evaluate hub-retailers' commercial delivery time requirements, on other occasions they may not due to the adverse effects it would have on other retailers for whom delivery time is equally important.

Likewise, whether wholesalers offer hub-retailers commercial support or whether SoR is extended to sub-retailers is not a matter for the OFT (provided, of course, that such arrangements do not infringe competition law). We note that one advantage of purchasing on a firm sale basis is that it would allow retailers greater control over the titles they receive (something that retailers tell us that they desire).

#### **Magazine distribution arrangements**

Retailers argue that the distribution systems for magazines and newspapers are significantly integrated because newspaper wholesalers also distribute magazines and practically the same system of wholesaler territories applies to magazine distribution. Therefore, they argue, unless selling-on of magazines is also permitted, there would be very limited take up of selling-on.

#### *OFT view*

Magazines are beyond the remit of this review. However, we agree that selling-on is more likely to be taken on if it is applied to magazines as well. We expect that liberalising the selling-on of magazines within wholesaler areas of operation would generally be beneficial, although we have not considered this issue as part of the

review. We note that wholesalers have already indicated to us that they would support the selling-on of magazines within their areas of operation.<sup>19</sup>

### **Cross territory sales**

Retailers argued that selling-on should be allowed across wholesaler areas of operation. First, if a publisher changed a wholesaler's territory, existing sub-retailing operations might also have to be altered as sub-retailers may find themselves outside their existing hub-retailers' territory. This possibility might make selling-on less attractive.

Second, selling-on is more likely to be viable the greater the area over which the retailer has scope to transfer or obtain titles. Thus, retailers on the edges of a wholesaler's territory may find selling-on less viable.

### *OFT view*

With respect to the first point, we consider that publishers do not make substantial changes to the boundaries of each territory very often and, when they occur, this is usually aimed at aligning boundaries with other publishers. This would tend to encourage selling-on.<sup>20</sup>

In relation to the second point, we accept that in some cases a potential hub-retailer may be prevented from taking up a profitable opportunity to sell to retailers in a neighbouring territory. However, this will generally not have an adverse effect on the latter retailers as they could still obtain supplies from a hub-retailer within their own territory.<sup>21</sup>

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<sup>19</sup> Magazine publishers in principle support the recommendation to liberalise selling-on within wholesaler territories but are concerned that increasing the number of outlets selling magazines may result in increased levels of waste. However, this possibility might be avoided where selling-on of magazines is allowed on a firm sale basis or by appropriately allocating in the number of titles supplied to hub-retailers.

<sup>20</sup> Where publisher A's territory is not the same as publisher B's, 'overlap' areas will exist in which the hub-retailer can distribute A's title but not B's or vice versa. Where territories become more aligned, this reduces the extent of 'overlap' and so may allow hub-retailers to distribute a full range of titles over a wider area.

<sup>21</sup> For example, suppose a retailer in territory A is prevented from selling on to five retailers in territory B. These five retailers in territory B may instead be supplied by a hub-retailer in territory B.