Circulation Loss vs. Cash Flow Gain – Let's Make a Deal

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Many media executives feel there is no solid analytical data to help them determine the costs and benefits of adding and eliminating new products and services. But one large publishing company found a way to measure a variety of relevant data to confidently change its business strategy.

Would you be willing to forego 8.8% of your circulation, if it guaranteed your newspaper an annual improvement of nearly $650,000 in annual cash flow? While some newspapers might jump at this opportunity, others might be more cautious and turn down this chance. But what if the offer improved to better savings of $900,000 annually, but with a much more favorable circulation loss of only 3.5%? Many newspapers who hedged on the first offer might jump at the second offer, and those who accepted the first offer might kick themselves for having squandered the chance for even greater savings. But what if the stakes were raised even higher, such as 12.7% circulation loss but for annual savings in excess of $1.6 million? Perhaps that feels too risky, but perhaps your newspaper needs more savings upside than the first two options offer, which might make the circulation risk worthwhile.

> *The goal is to find the one scenario that optimizes the tradeoff between "top line" (i.e., circulation loss) and "bottom line" (cash flow gain.)*

When it comes to optimizing a newspaper's subscriber acquisition activities, the goal is to find the one scenario that optimizes the tradeoff between "top line" (i.e., circulation loss) and "bottom line" (cash flow gain.[1]) In other words, the newspaper should strive to maximize cash flow while minimizing circulation loss. Optimal targeting of starts limits the circulation impact yet improves "bottom line" metrics – not only from reduced acquisition expense but also from reduced net margin losses and higher productivity through avoidance of the worst performing starts.

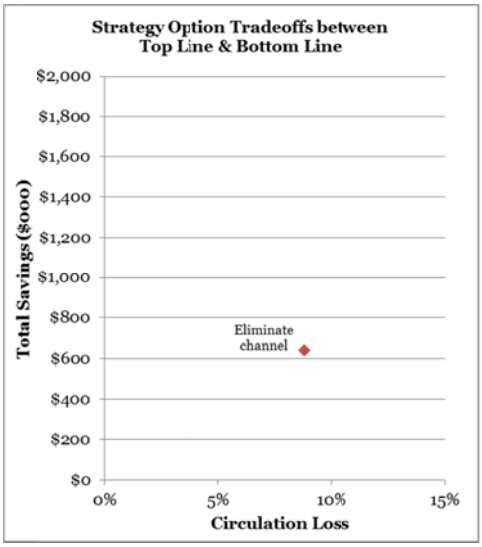
Many newspaper executives feel they have no choice but to estimate these types of elements, using collective experience, guesstimates and intuition. As a result, a lack of empirical confidence causes some executives to do nothing and simply maintain the status quo. However, for one top 50 newspaper client, which was spending $2.5 million annually in subscriber acquisition, the three options outlined above were among the actual options available to them, as a result of a detailed analysis to determine exactly which options would boost bottom line cash flow derived from acquisition, but to do it in a way that minimized the loss in circulation. By explicitly quantifying these options, this newspaper had the ability to pinpoint exactly which single option represented the best tradeoff between cash flow gain versus circulation loss.

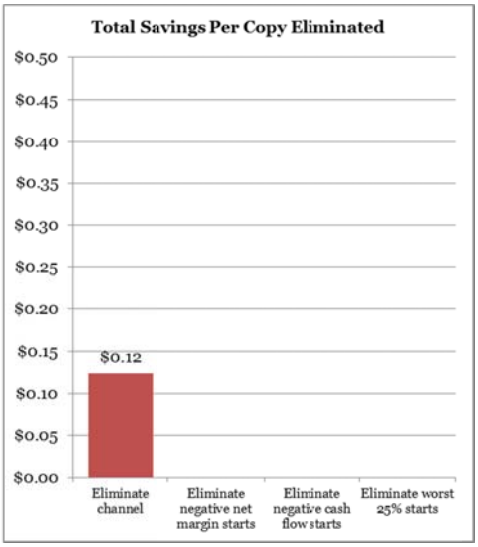
[1] Cash flow = [(weekly circulation revenue + weekly preprint revenue – weekly delivery expense – weekly newsprint & ink expense) x number of weeks retained] – acquisition expense

Among the many options considered, four of them are outlined below. Each option was unique in its strategy, with a corresponding economic and circulation impact that was also distinct. These results were then plotted on a scatter, with circulation loss on the x-axis and total savings on the y-axis. The goal of this optimization was to find an option that landed as close to the upper left hand corner of the chart as possible, which would imply maximum savings with zero circulation loss.

Option #1: Eliminate the worst performing subscriber channel. One common strategy often considered by newspapers is to identify the worst performing channel and simply exit that channel. For this newspaper, the worst performing channel was fairly easy to identify, since the pricing of new starts in this channel was far inferior to every other channel, which was reflected in an abundance of starts that generated negative net margin, i.e., incremental delivery and newsprint & ink expense exceeded incremental circulation and preprint revenue, even before accounting for acquisition expense.

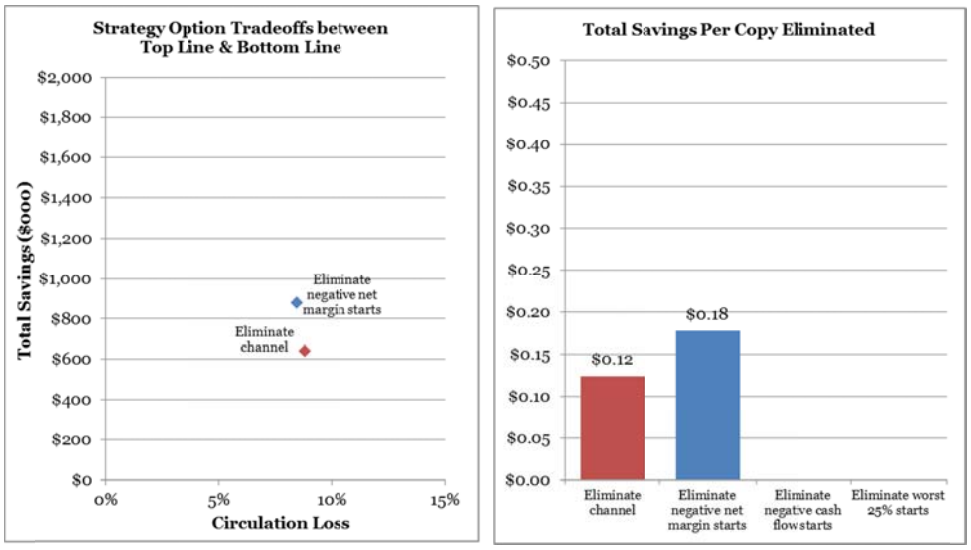
In this option (depicted in red below), this newspaper was expected to save $642,000 annually, through a $186,000 (7.5%) reduction in acquisition expense and $456,000 in avoided negative net margin. However, the circulation loss was projected to be 8.8% (14,100 copies daily), due to the fact that the channel still had many positive starts that would be lost through the exit of the channel. Dividing this aggregate savings by the copies lost, this option was projected to generate a net savings of $0.12 for every copy eliminated under this strategy. Although this seemed like a reasonable value-generating option, were there other options that fell closer to the upper left hand corner of the scatter? Or was this the best one available option for this newspaper?





Option #2: Eliminate all individual negative margin starts across all channels, regardless of impact on circulation. Another area where newspapers typically look for improvements is to identify and eliminate their worst performing starts, regardless of channel. While this is often an improvement over the "channel exit" strategy, as it allows the newspaper to hold onto higher performing starts, pursuit of this mandate does not necessarily minimize circulation loss or maximize circulation expense reduction – it simply finds and eliminates negative net margin starts, regardless of circulation impact.

For this newspaper, avoidance of these negative net margin starts (depicted in blue below) was projected to yield up to $880,000 in annual savings, in the form of $335,000 in targeted reductions in acquisition expense (across all channels) plus an additional $545,000 in avoided negative lifetime net margin from the starts, with a corresponding circulation loss of 8.4% (13,500 copies daily.) This translated to $0.18 per eliminated copy – with a 37% gain in total cash flow and slightly better circulation loss, this was certainly better than Option #1. But was it the best available option?



Option #3: Eliminate all starts with negative cash flow. A more comprehensive approach to managing the bottom line is to focus on cash flow rather than net margin, while at the same time unitizing the metric to explicitly take into consideration the number of copies generated for each dollar of investment. Many starts have positive net margin but negative cash flow (i.e., their projected lifetime net margin is positive but less than what it cost to acquire the start in the first place), so this type of strategy is often much larger in potential – but often with greater risk in circulation loss – than Options #1 or #2. Depicted in purple below, Option #3 was projected to save up to $1.6 million annually, but with a circulation loss of 12.7% (20,400 copies daily.) This translated into a net savings of $0.21 for every copy eliminated under this strategy, yet one step better than Options #1 and #2, but with a substantial dip in circulation in absolute terms.

However, unlike the first option, Options #2 or #3 does not have to be an "all or nothing" option. Yes, the strategy can be the pursuit and elimination of <u>all</u> negative cash flow starts, but it does not have to be pursued that way. Every starts segment has a different performance

profile, which means that eliminating one segment will have a different economic impact – both in terms of cash flow and circulation – than eliminating another segment. The purple point is just one strategy scenario on the purple curve, which demonstrates a spectrum of options. Said differently, this newspaper could conceivably choose any point on the curve and make that the basis for a new acquisition strategy. But which segments to pursue and which to ignore for maximum impact?

To address this question, it is critical to recognize that the opportunities represented on the curve are not placed in some haphazard order. In fact, the segments on this curve (all of which have negative cash flow until the apex of the curve is reached, which is at the aforementioned $1.6 million in savings against 12.7% circulation loss) are sorted from worst performing to best performing on a "top line-to-bottom line" basis. Sorting the segments by net margin surplus per copy eliminated allows the newspaper to generate the maximum "bang for the buck." Graphically, this can be seen by the slope of the curve, which is extremely vertical in the first 5% of circulation loss (which depicts a higher savings potential for relatively little circulation loss), and begins to flatten out before becoming completely horizontal at its apex. Thus, the crucial implication is that no matter what cash flow gain-circulation loss point that this newspaper decides to pursue on this curve, it will do so knowing that it is maximizing the optimal performance ratio so long as it targets and eliminates the identified segments that fall to the left of whatever point it selects on the curve, which represent the least efficient segments that offer the greatest savings per copied eliminated.

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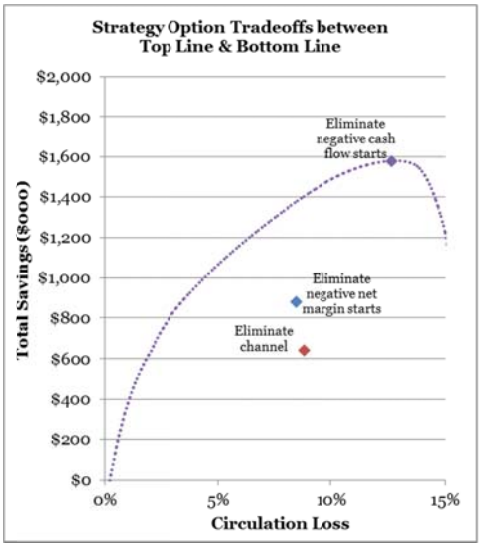
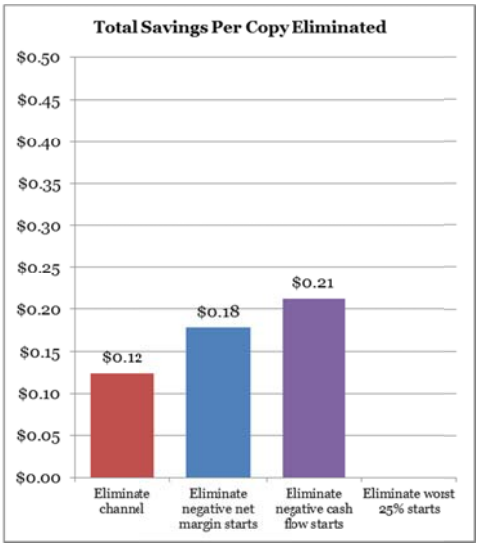
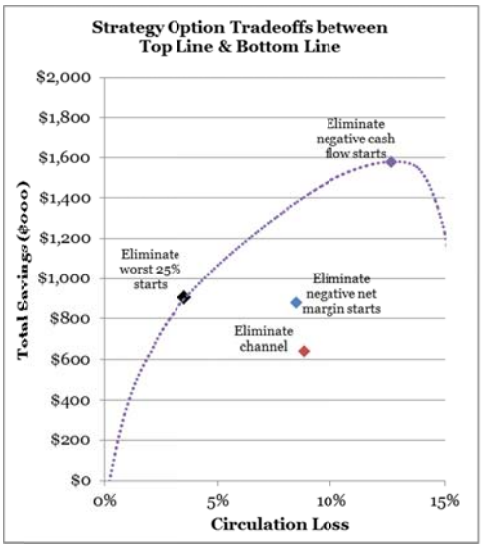


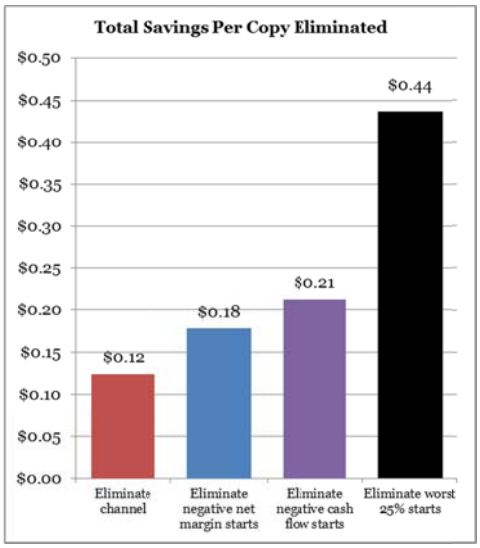


Option #4: Eliminate worst 25% of segments with negative cash flow, which enables the minimal impact on circulation for every dollar saved. With all of the aforementioned dynamics in mind, this newspaper can select anywhere on the purple curve

that it deems as the optimal combination of cash flow gain versus circulation loss. For example, targeting the least efficient 25% of the draw generated by all paid starts (i.e., all of the circulation to the left of the black point on the purple curve) was projected to boost annual cash flow by $906,000, but with a circulation loss of only 3.5% (5,700 copies daily.)

This resulted in a potential net savings of $0.44 for every copy eliminated under this strategy, far better than any of the other options considered. Through proper targeting of the worst performing segments, this newspaper could save the same amount of money (roughly $900,000 annually) as Option #2, but with a circulation loss that is more than 50% lower.





Based on this analysis, this newspaper selected Option #4, which yielded the highest average savings per copy lost. It is currently undertaking the steps needed to eliminate the worst performing segments (i.e., those segments that resided to the left of the black dot on the purple curve,) through a variety of tactical initiatives and policy changes. And it has successfully made the case to senior management that $900,000 in annual cash flow savings is well worth a planned circulation loss of 3.5%.

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