MEMO

Capitol EMI-Manhattan Angel

Date: June 23, 1988

To: Dennis White

Office: President

From: Dave Kronemyer

Office: Director, Business Affairs

Subject: Business Affairs Conference -- Summary

Among the numerous issues discussed at the recent Business Affairs Conference, there were several that I wanted to brief you on specifically, hence this memo.

A. <u>Matrix Exchange Agreement: Base Price</u>

Most of the time in London was spent discussing issues arising between the US and UK companies under the Matrix Exchange Agreement ("MEA"), the main one of these issues being base price. The MEA specifies payment on actual retail price. Most CRI artist contracts specify payment on suggested retail price (except for CDs), whereas UK contracts uniformly specify dealer price. [As you know, the UK means something different by "dealer price" than we do; the best translation is our subdistributor price.]

Use of retail price under the MEA has lead to several problems. First, it is a contrived amount; CRI recently commissioned a $175K survey of retail outlets to find out what it actually was. [I have asked O'Neill for a copy of this study and am surprised that CEMA apparently was not involved.] Second, conceptually, it bears no relationship to record company activity, all of which is structured around the record company's prices to its customers. Third, there are a host of translation problems at the MIS level between us and the UK when it comes to remitting payments.

Arguments in favor of retail price are as follows. First, the artist community is used to retail price contracts, and a shift to dealer pricing might undermine the administrability and intelligibility of our accounting processes. Second, while dealer prices change every six months or so, retail prices (especially "manufacturer's suggested" as opposed to "actual") change more slowly. If artist contracts were based on wholesale prices, royalties payable would tend to creep upwards.

My perspective is in line with the UK's on this point; I think we should do away with retail prices as a contracting device altogether. Under examination, both of the arguments advanced in their favor are flawed. For example, as you know, we don't have them for CDs, and several of our competitors have eliminated them for analog configurations, as well. Every one of our artist contracts has a provision that would enable us to

Signed:

convert from a retail price base to a wholesale one, and the problem has been addressed for CDs by applying the retail percentages to an "attributed" retail price that is 130% of the wholesale price (less a 25% packaging deduction).

The second point conceals a significant un-reserved royalty liability that will mature when "suggested list" suddenly is changed to a higher number. We have been camouflaging the overall economic effect of increases in "dealer price" because even our best-selling product constantly is on deal. As dealer price increases and approaches list price, the extent and magnitude of such deals necessarily will have to increase in order to preserve customer margins, making it extremely difficult for the record company to capture any savings based on using a retail price for royalty accounting purposes. Concomitantly, I suppose that eventually a "critical mass" of wholesale price increases could be achieved, enabling us to make the jump and pay a higher royalty on a higher list price. At that time, however, in order to keep the price-royalty equation in balance, all deals would have to cease -- an unrealistic expectation, given the competitive demands of today's marketplace.

Notwithstanding, both Berman and Young reliably are reported to be in favor of adhering to a retail price base for artist contract purposes.

After much discussion it was decided that each territory would continue to pay its artists however they wish, but all royalties would be remitted inter-company on 100% of a wholesale base price. In order to preserve roughly same-pennies parity as at present, the 19% MEA royalty obviously will have to be adjusted, but the extent and magnitude of any such modification wasn't discussed.

B. <u>Matrix Exchange Agreement: Sales Base</u>

Attempting to give some allowance for free goods, discount programs, etc., the MEA now provides that payment will be based on 100% of units sold but at 90% of retail price. It generally is perceived that this isn't enough to cover the full cost of these inducements. Attached is a memo from John Ray that attempts to analyze this problem, <u>see</u> paragraph B.(i) at p. 3. Unfortunately the discussion of "automatic free goods" is confusing because it implies that CEMA routinely deals 15% free goods, when in fact we don't. I think that what John was trying to say here is that because of our (apparently) different accounting practice of billing our customers only for full-priced units, whereas our competitors (apparently) recognize on their statements the implicit price discount effected by frees, it is necessary to take some kind of enhanced allowance for frees from our artists for royalty purposes.

Following discussion, it was agreed to do away with the 90%

of retail price concept and instead base MEA payments on 85% of net units reported.

I then brought up the subject of discounts. I argued that CEMA required greater marketing discretion to deal product. The present cumbersome system of clearances produced delays and deprived us of this needed flexibility. There was considerable sentiment that even a limited form of "preapproved" allowance might derogate from each label's proprietary control over its own repertoire, and this suggestion was rejected. However, it was agreed that cash discounts would be applied to reduce the wholesale price base for MEA reporting purposes. In other words, we would report on a number somewhat lower than our subdistributor price, taking into account the effect of discount programs. [Note this could involve some cost to the UK, as all of their contracts apparently provide for payment of foreign royalties on dealer price gross of discounts.]

C. Inter-Company Joint Ventures

Significant problems have been created by what have come to be referred to as "inter-company joint ventures" -- where one affiliate originates the act, but for various reasons (such as lack of budget) another funds it. Exchange differentials, timing of payments, mis-allocation of charges to incorrect accounts, and local issues such as tour support apparently have combined to create significant accounting difficulties.

Methods were discussed to solve this problem; for example, two separate, non-crossed deals with the artist. This was the protocol adopted for Robert Palmer. Another alternative is a contract in one territory but with a special override for the originator, which is what happened with Crowded House. The activities of Simon Potts, whom the UK apparently views as somewhat of a "poacher," came under special scrutiny. To solve the problem, Berman was reported to have agreed to a 50/50 split of all net revenues with Rupert Perry on acts that Potts originates.

The way this really ended up is that there are a number of separate deals between the various companies totally outside of the MEA. These introduce significant accounting complexity and reduce the MEA to a kind of "starting point" for further discussion on complex transactions.

D. Other London Subjects

Other topics discussed in London included the following: packaging deductions and special packaging costs, TV-advertised product (common in the UK), record clubs, recoupability of re-mix costs for different edits, audits of foreign licensees, controls on ex-fee records, payments on delete records, treatment of CDV and DAT, mid-price and budget records, royalty payment periods, practices with regards to mechanical royalties, Personics, restricted territories, merchandising rights and product endorsement rights, leaving members, video clauses, the best forum for dispute resolution, reserving practices, distribution deals, copyright aspects of digital sampling, record rental, California's 7-year rule, and computerization of data briefs.

Discussed with considerable discretion was the apparent reluctance of some UK acts to contract with EMIR if Capitol or EMIM is the US company. I firmly believe that any such concern on the part of UK artist representatives is based more on perception than reality. Still, tales of woe spread by top-selling UK acts such as the Pet Shop Boys inevitably carry some influence. I spent considerable time talking about CEMA, who we were and what we were doing. The advent and growth of CEMA was perceived in the best possible light, because it indicates a corporate commitment to marketing professionalism. The labels are perceived to best concentrate on repertoire origination and promotion. Your personal credibility smoothed the way to present this case clearly and persuasively.

E. EEC Issues

The conference then shifted to Lake Majeure, a resort outside of Milan. The US and UK delegates were joined by our counterparts from a number of other foreign affiliates, including France, Germany, Holland, Italy, Canada and South Africa. It was pleasant to meet these people personally, whom I had dealt with only by fax. Trading practices in each territory briefly were reviewed with respect to issues such as free goods, reserves, delete records, record clubs, royalties on sales of CDs, the advent of DAT, synchronization income, merchandising rights, mechanical royalties and controlled composition clauses, video exploitation, CDV, piracy, royalty payment periods and re-recording restrictions, record rental and blank tape levy, and various trademark issues.

One of the main points of discussion -- which struck me as being of the greatest interest -- was the abolition, in 1992, of trade and tariff restrictions between countries that are members of the European Economic Community. This presents a number of perils and opportunities for a company of EMI's global stature.

To begin with, it is apparent that contractual provisions which are sensitive to territory quickly will become obsolete. For example, if a contract provides for one royalty in one territory and a lower one in another territory, it seems obvious that sales will gravitate towards the lower territory for almost immediate, duty-free trans-shipment into all others. Licensing restrictions based on territory will become meaningless, particularly if they are based on a premise of exclusivity. This in turn implicates contractual devices such as so-called favored nations clauses. There will be significant copyright problems, for example, if a title is out of copyright in one territory (Holland provides for a bare 20 years) but still copyrightable in others. Finally, almost inevitably, there will be movement towards a single European price.

It seems to me that it would be in EMI's best interests to anticipate all of this by consolidating manufacturing and distribution facilities throughout Europe so as to facilitate central order fulfillment. While I can envision continued local promotion for local-language repertoire, much (perhaps most) European repertoire is English-language. Why can't Europe be divided into various promotion regions, just like the US, to facilitate the procurement of maximum radio play? A good argument can be made that English-language product should not be subject to parochial territorial differences. Of course the convoluted political, economic and cultural history of the various European countries may render the pan-European concept of post-1992 somewhat problematic, but it remains an intriguing vision nonetheless.

DEK:rg

Dovzk

cc: Mansfield
McFadden
Palacio
Vallot
Reynolds

MEMO

Capitol EMI-Manhattan Angel

Date: October 21, 1988
To: Dennis White
Office: President

CONFIDENTIAL

From: Dave Kronemyer
Office: Director, Business Affairs

Subject: Washington D.C. Sales Meeting -- Observations

I attended the Washington D.C. District sales meeting on October 13-14, 1988. The purpose of this memo is to report on some of the matters that were discussed with business affairs and/or legal implications. You may be apprised of some or all of these issues from other contexts; one point of interest in and of itself is the extent to which they are of concern to, and are discussed by, the field sales staff. Generally I am of the opinion that it's their job to sell, and, without unnecessarily demeaning their critical capacities, not to do too much thinking about it. Nonetheless, I firmly believe that input from the field is critical to (if not determinative of) the success or failure of most projects. In no particular order,

A. Orpheus Records

Some degree of confusion attends the EMI-Hush transaction re Orpheus Records. Apparently EMI has decided to funnel everything through Ira. Without debating the wisdom of this strategy, EMI also wants for Walter to have the prerogative to call DMs (and even sales personnel) direct. Inevitably this is going to lead to confusion and possibly conflicting instructions and priorities.

Although EMI is striving mightily to work against it, an impression remains that Orpheus is "just another distributed label;" relatively poor coordination on its initial release (e.g., it's not in the November book) has done nothing to dispel this belief. I perceive that it will take a couple of hits for Orpheus to become fully established as an independently viable concept for the field.

B. Solar

Massive and unresolvable confusion as to what's going on. The 10-day "hold" on Midnight Star and poor coordination with promotion caused significant loss of momentum. That notwithstanding, questions remain as to under what label product is going to be promoted; whether or not Solar still will have promotional responsibilities; whether the deal only is for Midnight Star, or for all other Solar product. Capitol promo was unable to answer these questions.

Signed:

My personal belief is that it would be a serious mistake to "do away with" the Solar identity, and that to some extent Solar will require its own promotional team. While I could be wrong, I think that a lot of black stations add Solar titles "just because" it's Solar, and they might be less receptive if it is a Capitol promo man that comes calling.

C. EMI Pricing

At $9.98 most EMI product is overpriced. This is particularly true in the case of new artists such as National Velvet. "Evelyn King needs a 20% deal to start moving."

EMI's "meet competition" pricing is perceived to be tremendously destabilizing for all of the reasons we previously have discussed. I have grave reservations as to whether or not Ira is in fact obtaining competitive invoices, the necessary prerequisite to "meeting competition." In fact, several of the people with whom I spoke basically laughed at me when I explained the necessity of competitive invoices, stating that their customers would not turn over information like that under any circumstances.

Documentation aside, I perceive that Ira may not be close enough to the marketplace to make correct judgments as to when a deal should be cut and when it would be more advisable to back off. E.g. a recent Stanley Jordan deal for The Wiz definitely created a lessening of enthusiasm for this project among the field sales staff while soliciting other accounts.

EMI also has a concept of "regional deals" which would apply only in certain parts of the country. Given the interconnected nature of the national marketplace, I'm not sure the extent to which this concept makes sense; it could result in serious price discrimination problems, especially for customers with outlets on each side of one of the regional "borders," i.e. some get the deal and some don't. To me it makes far more sense deal product by type of customer, or on a "meet competition" basis, rather than in certain parts of the country and not others.

D. Other EMI Issues

Varnell Johnson spoke of a "new" promotional strategy he's going to try with their Sarah Dash project, which is soliciting play but not reports. Query how much good this does you.

Also, big complaints about not enough EMI advertising. Ron described it as a "chess game." The situation's particularly difficult because right now EMI has some hot product out, but there isn't enough advertising to support it adequately. E.g. extensive WEA advertising on the "Cocktail" soundtrack has effectively moved Bobby McFerrin to the back of the store at many locations. Photo attached was taken at Sound Odyssey in Cherry

Hill, NJ and is illustrative.

From a logistical standpoint, advertising is committed too late. A lot of criticism, particularly in the case of print media which requires longer lead times.

E. Distributed Labels

A big problem with too much product and not enough label support. Without exception it was felt that a system should be adopted limiting the number of releases a label could have each month, and requiring some minimum sufficient level of performance on previous releases before additional releases would be permitted. Specific problems for individual labels are:

1. Enigma. We need to provide for a variance in customer advertising allocations. Enigma apparently is taking the position that if there is a discrepancy between the authorization and the final billing, the differential is on CEMA. It is difficult, however, to administer advertising with such precision.

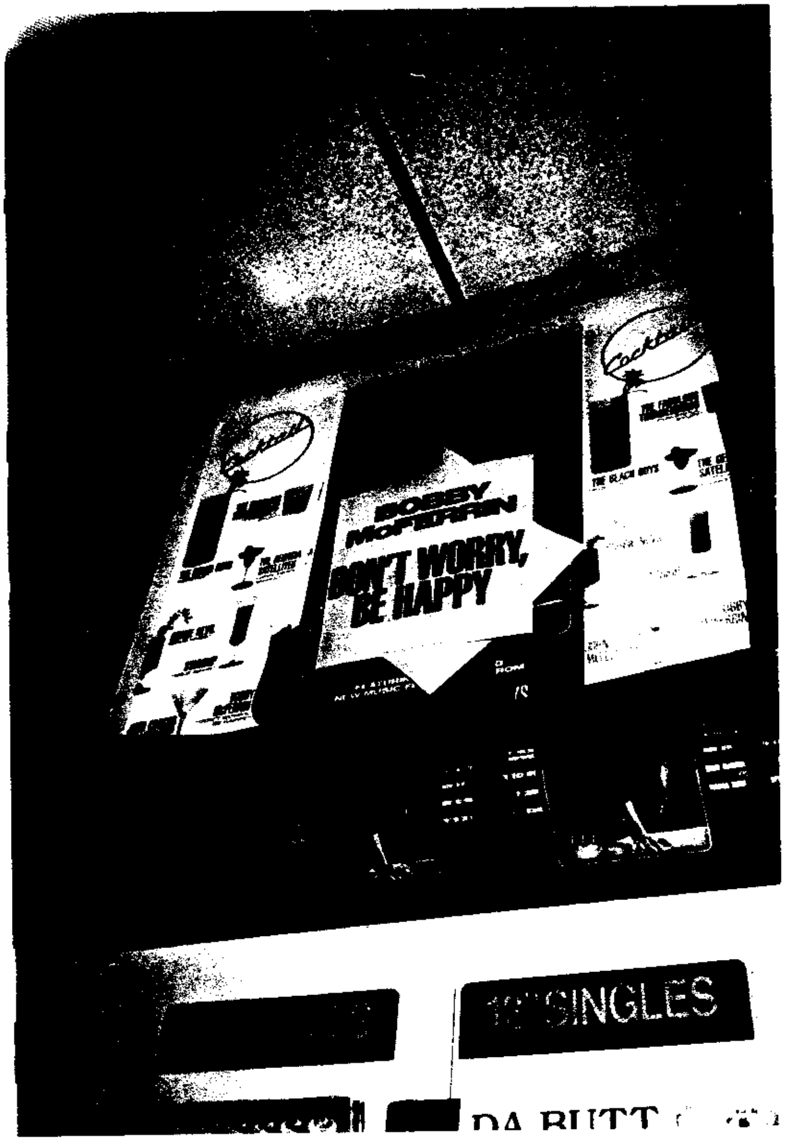
Enigma also apparently has been sending money directly to the districts for advertising which has not been requested. This results in ads running at the wrong time, double placement, and a slower and more time-consuming auditing process.

Tour support and ticket allocation are completely bogged down, Enigma is not responsive, resulting (e.g.) in commitments being made for tickets to retail which don't materialize.

Enigma's classical line has too many titles by "no name" artists. The releases are poorly paced with customers being solicited for new titles in the line before they have sell-through experience on previous items.

2. Rhino. No re-orders being experienced on 3" CDs except for most popular titles. Considerable confusion how and where to display and sell this configuration at retail. This confusion isn't unique to Rhino; e.g., previous A&M titles in the CD3 configuration also hit the wall. Probably there is a market for some of these titles, but not necessarily in the CD3 configuration. There are too many titles; while it was a novelty at first, customers now are experiencing an "erosion of interest." Again, problems with soliciting for new titles in the series when sell-through on previous releases has fallen dramatically. Lack of adapter packaged with CD has hurt.

Rhino's Billboard series now is being advertised on TV with Silver Eagle Records. I pointed out that while it may help to support the product, we earn zero revenue from mail-order sales. Query, does the spot say "available by mail order only" as with most Silver Eagle ads?


BOBBY
McFERRIN
DON'T WORRY,
BE HAPPY
12"SINGLES
DA BUTT

Rhino's 78-RPM series is expected to achieve zero sales.

Rhino's new "One Way Up' compilation series is perceived as causing confusion in the marketplace, especially in light of their other compilations such as Billboard.

3. Chameleon. Even one-stops no longer are interested in Chameleon product because it isn't being worked by the label. There is no consumer demand for many of these titles. Zero units are being sold in many cases; in others, 100% returns are predicted. This ties in with earlier complaint that we are putting too much product into the system.

Chameleon is perceived as being on its way to becoming another Birthright.

The new Childrens Series is way over-priced and should be offered at $4.98. Again, a problem with soliciting the November releases before the October ones even have shipped.

4. Apache. John Brannen is "having babies on the way back." Zero interest in Hollywood Underground.

5. Allegiance. Same comments as with Chameleon; deal is widely perceived as disastrous, no credibility in the marketplace.

F. Angel Records.

Selling a lot of Showboats. Problem with unfulfilled back orders apparently now resolved. Placement of product proving to be critical especially in light of insufficient advertising.

WEA competition with Teldec and Virgin classical lines is heating up. WEA is committing significant advertising and also cutting a lot of "meet competition" deals to get the product into the stores and placed advantageously. WEA is perceived as realizing that it's late in entering the marketplace, and is doing everything that it can to catch up.

G. Blue Note.

Previous dump now has sold through. Lower price is key to moving this line, especially in light of fact that customers now are used to lower price point. Too many titles being offered; e.g. only Tower will order full line. Releases should be spread out over longer time period.

No stock on Eliane Elias despite many orders. This compounds difficult in obtaining #1 reports as requested by label.

Blue Note CDs need to go on deal to achieve any significant unit movement.

H. Billing Problems.

End-of-month ship dates are perceived as depriving customers of 60-day dating. E.g. 11-22 street date is treated as November business therefore invoice is due 12-31 giving 39 days for payment instead of 60.

Problems when $8.98 product is renumbered (but not deleted) for sale at $6.98. Returns are being refused at Jacksonville and sent back to customer with no credit issued.

Timing of transition to mid-price is sometimes handled poorly resulting in customer animosity because no opportunity to stock balance.

New prefix system is perceived as being confusing. In some cases the identical product bears 3 different prefix numbers. To the extent prefixes are being relied upon for billing and crediting of returns, they are unreliable.

Big problem developing with failure to give deals at Central Billing level, even though product is solicited with deal in place. Note, this also will lead to a LOFI problem when it comes to crediting any returns. It also has developed into a serious customer relations issue at some accounts. They want to talk about billing errors before placing an order.

Picking and input errors, double shipments, and mis-allocation of charges are increasing at the Bethlehem DC. Two other current fulfillment problems are: incorrect drilling of units as promo when they should be clean, and a build-up of orders on Monday which makes it impossible to get through on the telephone. Some have taken to faxing orders in, often using a competitor account's machine!

I. CEMA Pricing/Trade Issues

Every single salesman insists that his Central Warehouse Retailer customers get a subdistributor price. I said I don't see how this is possible. Our new proposed Customer Classification system will go a long ways towards eliminating inequities and latent price discrimination problems in the way our product presently is being sold.

Any reduction in standard free goods on 45 RPM singles likely will kill the configuration. By the same token, there is tremendous account interest in the cassette single, which generally is being well displayed. A better deal on cassette singles would encourage the hold-outs. I said "we're looking at it."

Much emphasis on contests at Tower locations. We need to make sure that other customers have access to contests and promotions on a basis that is "proportionately equal" to their contribution to our turnover. We can't just focus on Tower to the exclusion of other accounts.

Some question as to the usefulness of repeated retail advisory mailings, esp. to non-customer dealers. Sending 3-5 pieces of a single title to such accounts is perceived as being wasteful, the product ends up being sold instead of listened to and we earn zero revenue.

In light of previously expressed concerns re Billboard reporting, should the salesman reviews have efficiency in obtaining such reports as one of the criteria upon which they are graded? This could make it look as though we're condoning potentially questionable behavior. Sales personnel with whom I spoke expressed that they frequently were uncomfortable with the "ethical" aspects of what goes on.

J. CEMA "Confidential"

Currently available 12" product should have a separate page in the Confidential. Also, there should be a section for 12" catalog, to the extent such a catalog exists.

The Confidential also should feature a broader selection of recent Distributed Label product, preferably broken down by label.

The Confidential could be made more graphically appealing. Note, the MacIntosh computer is ideal for this type of exercise, possibly it would be to our advantage to get one and implement our own "desktop publishing" system.

The monthly Distributed Label book was praised as the "best on the street." The checklist for each label at the back of that month's offerings was the only tool used by most to solicit Distributed Label product.

DEK:rg

Dave K.

cc: Mansfield
McFadden
Davis
Ron Hughbanks

MEMO

Capitol EMI-Manhattan Angel

Date: December 19, 1988
To: Dennis White
Office: President

CONFIDENTIAL

From: Dave Kronemyer
Office: Director, Business Affairs

Subject: Atlanta District Meeting
December 15-16, 1988

I attended the Atlanta District Meeting on December 15-16, 1988. The purpose of this memorandum is to report on several matters of particular interest.

A. <u>EMI Regional Sales Staff</u>

Considerable uncertainty attends the precise role and function of EMI's recently-installed regional sales personnel. Their efforts are perceived as being naive and uninformed at best and, at worst, as confusing and destabilizing the marketplace. Example: a recent $3600 time-buy for a 4-store Atlanta account that maybe will do 250 pieces on the project. Such activity should be conducted, if at all, only by knowledgeable CEMA representatives.

Poor coordination aside, the EMI reps are seen as hanging around with a lot of time on their hands, not really knowing what their job is, and having a poorly-defined function even within the EMI group (as opposed to the more problematic issue of liaison with CEMA). In my opinion, the only possible utility for a structure such as this is EMI's emerging aspiration to establish a sales capability independent of CEMA.

Anecdotal reports also suggest that the relationship between EMI promotion and CEMA sales is less facile than that between Capitol promotion and CEMA sales, though I have no evidence to corroborate this.

B. <u>Mediocre Presentations</u>

Perhaps reflecting lack of repertoire this month, EMI's presentation was embarrassingly poor, in my view adversely reflecting on its local credibility with the field sales staff. In contrast, I thought that the Capitol presentation was well-organized and upbeat.

C. <u>3" CDs</u>

As opposed to our national experience, many district territories are experiencing strong 3" CD sales. The success of this format is seen as depending primarily on effective retail

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merchandising, placing the product with CDs rather than singles.

D. Solar & Hush

Independent marketing and promotional efforts by both of these companies have created confusion in the marketplace. E.g. requesting different reporting priorities than those established by CEMA, especially when such requests are supported with inducements such as cleans.

E. Regional Autonomy

I briefly outlined our new concepts on customer classifications, pricing and returns penalties, which were well received. To complement this structure, I believe we should grant the DMs the flexibility (in consultation with National Sales) to implement deals with individual customers on a meet-competition basis. It goes without saying that each market is different, some titles are strong in certain regions whereas others are not, the quality and extent of competition varies. We need to be in a position to react to these exigencies as they occur in order to achieve maximum sales.

F. Priorities and Objectives

The main issue that concerns me after the meeting is a systems problem: how many different titles can CEMA effectively sell? Many distributed label product presently is being thrown into the marketplace with little or no marketing or promotion. Unfortunately, this also is true with some proprietary material, as well. Clearly, not every record is going to be a hit, and we need excess capacity to buffer the records that don't make it. This elimination process is a natural and wholesome part of the business.

However, it seems inevitable that eventually some kind of "saturation point" is reached. Sales personnel get to the point where they make no genuine effort to sell titles (or lines) they perceive as underperforming. This in turn affects the outlook of CSRs, who stop servicing the product. It quickly can become a self-fulfilling prophecy as the customers pick up on CEMA's own attitude or orientation.

If viewed in isolation, this would mean only the demise of individual titles (or, at the worst, labels). However, the problem is that CEMA has finite capacity and efforts spent on unsuccessful titles (or titles with no hope of ever becoming successful) detract from the quantity of effort we can put into titles with a good or even outside chance of making it.

This is most dramatically illustrated by the related problems of priorities and objectives. One remark I heard over and over was that there are "too many priorities." We're "going to the well too frequently" and "calling in favors we're not owed" to get records sold, placed or reported. The simple fact of the matter is that if everything becomes a priority, nothing is a priority. I think we need to seriously re-examine the entire question of priorities, and what criteria are used to designate a record as a priority. In my opinion, our continued use of this term in inappropriate contexts is starting to have adverse and potentially serious repercussions, detracting from our efforts when there really is a genuine priority.

Another common complaint has to do with unrealistic objectives. Our recent discussions notwithstanding, there is considerable confusion in the field as to whether objectives are out-of-the-box at street date, or if they permit a 30-day post-release sales window. That aside, the objective numbers are widely perceived as being completely artificial. Not only are they set without reference to the label's own marketing and promotional efforts (actual or contemplated), but the number itself is made up. "Who says that 25 thousand units is the right coverage, why not 15 thousand instead?"

To a large extent these comments simply may reflect the natural orientation of a sales staff that, like all sales staffs, would prefer to sell the hits. Nonetheless, in my opinion, they reflect a need to re-examine the criteria for setting objectives, particularly if CEMA is going to commit itself to fulfilling them on shipment. What happens, e.g., if we don't?

DEK:rg

cc: Mansfield
McFadden
Davis
Brackenridge

MEMO

CEMA Distribution

Date: February 15, 1989
To: Russ Bach
Office: President

From: David Kronemyer
Office: Director, Business Affairs

Subject: Cleveland Meeting

I attended the Cleveland Sales Meeting on February 9th and 10th. The purpose of this memo is to identify and discuss various problem areas which were brought up at the meeting with business affairs implications.

A. <u>Returns Procedure</u>

On 1-27-89 CEMA announced a change in its returns procedure. No longer will it be necessary for the sales representative to prepare a "Returns Authorization" or RA. Rather, the customer will prepare its own list, setting forth product designated for return by label, selection number and quantity. The sales representative will review the list; approve it; and supply an RA number. The customer then will forward its approved list, together with the product being returned, to CEMA's Returns Center. Simultaneously, the sales representative will forward a copy of the approved list to the Returns Center, as a means of cross-check.

If we accept the proposition that we now are able to budget and forecast returns (based on historical experience) with some high degree of accuracy, the inevitable question is: why even go through this intermediate step? In economic effect, our sale of records to a customer really is a consignment sale, in that the customer can return whatever product remains unsold for full credit against its applicable price (subject to our system of purchase credits and returns charges). Given this, should CEMA attempt to act as a buffer or filter against product coming back in?

An argument can be made that pre-approval serves some useful function. For example, there is general agreement that product should not be returned within 90 days after ship date. Furthermore, even though an account may have sufficient supply, we typically don't want it to return so-called "priority" product (in practice, that identified as such in the Confidential). The issuance of an RA may assist an account with credit difficulties to order more product; or perhaps even could be consideration for some favor, such as a store report.

I believe that all of these worthwhile objectives could be implemented in better, more direct ways. For example, we simply could propound revised terms of sale to our customers that

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prohibit return of "priority" product (a previous but dated customer letter set forth such a policy for product less than 90 days after shipment). Credit and reporting problems should be addressed forthrightly; use of RAs camouflages the real issue and introduces unnecessary distortions into our financial reporting.

In summary, again accepting the hypothesis that we do not authorize returns as a means of budgeting or forecasting their arrival, the new system may prove to be largely unnecessary. While an improvement, it still requires significant sales representative time and attention. Furthermore, it is unnecessarily cumbersome for "small" returns (say, those of less than 500 units). In such case, even the objectives identified above are not being implemented, because the number of units at issue simply is too small to make an impact. As a transitional step, we might consider doing away with the envelope system for small returns in this category.

B. Use of Dating

Present label policy, based on a recent review of competitor practices, is not to offer extended dating on new releases. Some question exists as to the sufficiency of that survey, as (so I am apprised) several of our competitors do offer dating on new releases. If so, this could put us at a disadvantage in the marketplace.

Obviously dating has to be examined in the context of other inducements being offered, for example, an invoice discount. It frequently is said that 30 days dating is the functional equivalent of one discount point. If this is true, then a 7% program should be equally as attractive from the customer's standpoint as 6% + 30 days. However, there is a sense in which the dating might sell more records than a discount. For example, on new release product, it would give a central warehouse retailer more time to move the product from its central warehouse out to its individual retail locations. Furthermore, dating gives the customer more time to pay in the expectation that label promotional efforts will be successful during the extended period, increasing the likelihood of sell-through. For a title with a proven sales history, on the other hand, I think that a straight discount with no dating would be the preferable alternative.

In either event, it is not strictly true that the two are equivalents, and thought should be given to (a) reinstating dating programs particularly for new releases; or (b) giving accounts a choice, if possible from an MIS standpoint. E.g. 7% or 6% + 30 days.

C. Greenline Pricing

There is no sympathy in the field for a proposed price increase on Greenline titles. There is little doubt in my mind but that from a consumer standpoint, this product is price-driven. The consumer does not go into a record store specifically desiring to acquire a Greenline title. Rather, he sees it properly displayed at an attractive price, and makes an impulse purchase. Given this, in economic terms, if the product's marginal cost significantly exceeds its (already minimal) marginal utility, consumer demand quickly will become inelastic. The problem is exacerbated by inadequate repertoire included in this series.

D. 7" Vinyl Singles

One aspect of the 1-27-89 policy letter was a change in CEMA's purchase discounts and returns charges for 12" disc LP albums. Discussed in connection with the preparation of that letter -- but not acted upon -- was the implementation of a system of purchase discounts and returns charges for 7" vinyl singles.

7" vinyl singles are notoriously unprofitable. On the cost side, our WEA Manufacturing price is $.195 plus figure about $.02 for a generic sleeve (color sleeves, which often are used, run as high as $.05 each). Total manufacturing cost: approx. $.215. Add in another $.10 for mechanical royalties and (approx.) $.15 for artist royalties, for a total of approx. $.465 on each net unit sold.

On the revenue side, our bulk price is $1.29, but our "automatic" free goods policy reduces the bulk price down to $1.032 ($1.29 x 80/100). The labels invariably authorize an additional 10% invoice discount program, further reducing the price to $.9288. This leaves approx. $.4638 gross margin on each unit, before application of SG&A and other overhead cost centers.

All of this is fine as far as it goes, but it ignores two critical facts. First, system-wide, our 7" pop singles returns are approx. 46.1%. While mechanical and artist royalties are not payable on returned product, fabrication costs are incurred. This actually results in a lower effective cost per unit:

"Sold" units:	$.465 cost x 53.9% sell-through =	$.2506
"Returned" units:	$.215 cost x 46.1% returns =	$.0991
Total effective cost per unit:		$.3497

Second, the $.9288 effective price vastly overstates our revenues because much of this product is given away by the labels (for promotional purposes) or by CEMA (for, e.g., store reports). While the true volume of this activity only could be measured by a detailed analysis of units manufactured against net sales and historical inventory levels, a generally accepted figure is that about 50% of the product simply is given away. This reduces our effective revenue per unit to approx. $.4644 which, when the total effective cost per unit of $.3497 is subtracted, leaves a gross margin of only $.1147 per unit. This meagre margin quickly is absorbed by other SG&A and overhead cost centers.

I believe, and contend, that our automatic free goods program, when coupled with massive give-aways of 7" product, has tended to contaminate the marketplace. It has tended to devalue the worth of the 7" single, and promoted a high level of product obsolescence with associated costs. We considered this in connection with the discussions leading up to the 1-27-89 policy letter, but basically decided to defer to the labels, possibly exercising moral suasion to attempt to induce them to release fewer 7" singles. It is not clear to me if this can or will work, and the labels might be looking to CEMA to exercise a leadership role.

I therefore think we should re-examine the issue of a purchase discount and a returns charge for 7" singles, calibrated for break-even effect at some mutually-agreed upon point, possibly as low as 25% returns. I doubt this would have much consequence for the serious singles buyer (e.g., Mobile One-Stop in Pittsburgh), whereas it would tend to discourage use by the very accounts where we don't want the product to begin with, e.g. Handleman. Although I realize that for a variety of reasons the labels can't simply do away with the 7" single at present, serious consideration should be given to plans (say) one year hence. In that connection, Jack Reynolds recently entered into a licensing deal with a company called American Pie for 7" singles only. The transaction calls for a significant advance and royalty. Our license margin on 7" singles under such a scheme well might exceed (I would say probably exceeds) the margin if we do it ourselves, and consideration should be given to this approach for all 7" product.

E. <u>Changing Role of the CSR</u>

At the CEMA Convention held in March 1988, a new CSR job description was propounded (copy attached). Experience in the last 12 months has demonstrated, however, that CSR priorities must be re-evaluated in light of changing market conditions.

In particular, CSRs are spending way too much time attempting to influence dealer reporting. Increased emphasis on this fundamentally unnatural activity has tended to detract from other equally or more important objectives. Our relative success in influencing dealer reporting also has created anomalous situations where we have a record reported at a relatively high chart position, which is unaccompanied by corresponding retail activity. This in turn creates false expectations at the labels (of sales which never materialize), ultimately damaging CEMA's credibility.

Dealer reporting also has grown more difficult as we request higher reports for relatively marginal titles. The inordinate amount of attention devoted to such projects may derogate from our potential success when a genuine "hit" comes along. Spending too much time on titles that aren't going to make it has two consequences. Not only is time inefficiently allocated to the failed project, but also time is not spent on projects that stand a reasonable chance of success. As a result of this diffusion of attention, other matters equally worthy of CSR time are slighted.

Billboard's proposal to tighten up its chart methodology (reference our 2-13-89 meeting with Noonan et al.) may help solve this problem. A possible interim strategy on our part would be to adopt what might be referred to as an "honesty" approach -- encourage the reporter to report the title exactly where it should be, based on sales. While this might result in lower chart positions for a while, it will solve both the inflated expectations and the efficient use of time problems. Such a step undoubtedly would help CEMA to improve its customer relations. Finally, it would be a chance for CEMA to take the lead in trying to reform what remains a troublesome problem at retail. Like our stance with independent promotion, individual company action can make a difference.

Another CSR issue is displays. It is a well-known fact that many accounts are inundated with POP, some to the point where rules have been propounded governing who can put up what. Other than making it available to the right accounts in the right quantities, too much CSR attention is being spent on displays.

Finally, an inordinate amount of attention is being devoted to "alternative" product. Part of the reason for this is dissension between Cathy Lincoln and Faith Henschel over who does what. The CSRs are being asked to file reports on local activity directly with each of them. This creates a confusing scheme of alliances and loyalties, not to mention overlapping and duplicative effort. For example, a recent conference call was alleged to have lasted 4 hours, discussing what essentially are regional records incapable of being coordinated nationally. Another example, CSRs are being asked to devote considerable effort on written comments and feedback re various marketing proposals, which requires too much time.

Alternative product has an important niche in the market. However, the amount of CSR time that is being spent on it is not commensurate with its contribution to CEMA turnover. This activity needs some review and evaluation, particularly with regards to appropriate label functions as opposed to appropriate CEMA functions.

F. Programs

Perhaps the most common complaint that I've heard is that CEMA has too much product on deal. This not only deprives the labels of margin which otherwise might be captured and retained, but also results in loss of impact when product does go on deal.

If there are points of consensus, they are as follows:

1. Catalog deals (i.e., all titles by an artist) have more impact than deals on individual titles.

2. CEMA has too much variation in its deals. Consideration should be given, e.g., to putting out all new releases on the same deal; or having one big program each quarter, rather than a lot of small ones.

3. As a variant of 3., deals are too confusing. They would be easier to sell, e.g., if they started and ended on the same day, perhaps a Friday. Furthermore, there is poor synchronization with customer open to buy, which typically decreases as the month progresses.

4. There is poor synchronization with label promotion on many deals. E.g. the deal expires before any radio activity occurs.

5. There is poor synchronization with the DCs on many deals. E.g. product is solicited on deal but then not available for shipment.

6. Consideration might be given to volume-tier deals (really, a volume discount for purchase of a given number of units); and regional deals. On this latter point, it almost goes without saying that records happen at different times in different places, and more margin could be captured by recognizing this phenomenon on a territory-by-territory basis rather than one national deal. Possible trade regulation problems with both of these proposals are resolvable.

DEK:rg

cc: Mansfield
McFadden
Davis
Spitler

Dvorak

MEMO

Date: April 18, 1989
To: Russ Bach
Office: President

From: David Kronemyer
Office: Vice President, Business Affairs

Subject: New York Label Meeting
April 13, 1989

The purpose of this note is to summarize what took place at the Label Meeting sponsored by CEMA which was held in New York on April 13, 1989. Present on behalf of CEMA were: Russ Bach, Joe Mansfield, Joe McFadden, Dave Palacio and Dave Kronemyer. Present on behalf of Capitol were: Ron McCarrell, Bill Meyerchak and Lou Mann. Present on behalf of EMI were: Ron Urban, Robert Smith and Ira Derfler.

I. CEMA Organization

Russ reviewed CEMA home office and branch organization. Particularly noteworthy re the latter, (a) Sales Reps now report directly to the Sales Manager instead of to the Branch Manager, who consequently will be able to devote more time to planning and marketing; (b) the office staff now reports to an Administrative Assistant; (c) the FMRs now report to a Senior FMR; and (d) the label promotion staff has "dotted-line" reporting responsibility to the Branch Manager.

An organization chart distributed at the meeting will be updated periodically.

II. Department Review

A. Alternative Marketing

1. Perceptions of the Department: "positive," particularly in light of recent personnel changes.

2. Status of Independent College Representative ("ICR") Program: basically in "good shape," however in need of rationalization in light of changing market conditions.

a. Presently 26 ICRs located at various campuses. Unknown if this is too few or not enough; locations require review in light of whether or not a trend-setting market, presence of an influential radio station, or heavy retail activity.

b. Program should be evaluated on its merits as

Signed:

opposed to a potential "training ground."

c. Alternative no longer is a "fringe" market, but rather a breeding ground for material with major market potential. Main focus of activity therefore should be retail-oriented marketing.

d. Some question as to whether it is realistic to expect this position to function properly on a part-time, reimbursement for expenses only basis; perhaps a greater financial commitment is required.

B. Catalog Development

1. Perception of the Department: substantial questions as to whether or not it is cost-justifiable as presently constituted, and whether or not more appropriately a label function, possibly using outside contractors. The labels feel that they are in the best position to evaluate the most appropriate marketing strategies in light of cost and image. No question but that some commitment to the market is both necessary and desirable; e.g., midline and budget (the "K-Mart middle aisle") now accounts for some 30% of Handleman's business, with approx. 5% returns. Titles must be selected carefully, however; e.g. against last year's $4.6M in gross billings, Capitol incurred significant costs for artwork, components and obsolescence.

2. Role of Special Markets: Perhaps because of diminishing front-line profitability, CEMA Special Markets should assume jurisdiction over more of this material at an earlier stage in its product life cycle. This of course would require some adjustments in that Department.

3. Clearance and Royalty Problems: Obtaining clearances from label business affairs to release at midline and budget remains a cumbersome process. Furthermore, corporate's outdated royalty system is unable to cope with new releases at these price points: all of the royalties from last year's Capitol midline and budget releases remain "unapplied."

C. Black Marketing

1. Perception of the Department: definitely necessary; Earl Jordan is thought of as having good ideas and being good at set-ups, though poor at follow-through.

2. Radio/Retail Relationship: The problem here is that singles shoot up fast at black radio without a similar level of retail activity. To dispel this, (a) better label promotion-CEMA coordination is necessary, and (b) labels must develop more realistic and effective promotional strategies.

3. Store Reports: Some sympathy for having Earl solicit store reports.

4. Possible Expansion: With growth in this repertoire area, additional specialized field personnel possibly will be required.

D. National Retail Marketing

1. Perception of the Department: effective, but in need of reorganization in light of changing market conditions. Per Lou Mann: consider assigning coordinators by label for better targeting and direction; also, consider moving coordinators into the field. This would help them build relationships and better know their market.

2. Focus of the Department: is it tracking, soliciting store reports, or generally building retail awareness? Mission needs to be defined more clearly.

3. Publications: While the weekly retail rap-up is useful, the book is "untimely, badly compiled, poorly distributed and hard to use." It no longer will be published.

4. Telemarketing: Sophisticated software now is available for a more professional, computer-driven telemarketing approach, which should be investigated and acquired.

E. Marketing Services

1. What Does This Department Do? Updates the catalog; prepares and disseminates program checklists; maintains and updates the customer master file; maintains inventory of and disseminates POP to the field.

2. POP Fulfillment: Presently some is shipped directly to accounts; most is shipped to the branches. This leads to inefficiencies because the POP must be repacked and reshipped. The main factor preventing direct customer fulfillment previously has been lack of DC personnel; however, direct POP fulfillment should begin approx. 12-31-89.

3. POP Utilization: Allocations between branches need to be reviewed for most appropriate coverage. Research also necessary as to what type of POP is effective; Russ Bach to propose a joint study with WEA. Lou Mann to furnish a copy of an MCA study. Considerations include: many accounts producing their own POP; limited end-cap and counter-top space; small store size; and high cost to produce.

F. National Account Manager: based in Minneapolis, will service only four customers (Handleman, Lieberman, Target and Musicland). CEMA perception is that central focus will lead to better customer satisfaction thus more business.

G. FMR Job Description: a new one is in preparation.

III. Pricing and Related Issues

A. $8.98 v. $9.98: CEMA's perception is that, for most markets, $8.98 sells no more than $9.98, and unnecessarily forfeits margin. Country: still at $8.98, but should be moving soon. Black: layout should not be affected with a $9.98 price and higher discount. CEMA recommends that all existing $8.98 repertoire be left at that price point until it is reduced to $6.98; most new releases should be put out at $9.98. To the extent customer resistance is encountered, a larger discount is the appropriate solution.

B. $6.98 with Guaranteed Returns: This incentive structure does not stimulate sales for new artists. CEMA's recommendation is that this program be abandoned.

C. Competitor Pricing

1. Box Lot/Loose: CEMA intends to replace its present system of customer classifications based on functional discounts with a box lot/loose price available to all customers regardless of whether they are wholesalers or retailers. This transition will take place approx. 7-1-89. This not only will make CEMA competitive with the practices of other major distributors, but also address potentially troublesome legal questions which have arisen with the present system. CEMA intends to retain the differential between the loose price and the box lot price to compensate it for the additional marginal cost of fulfilling loose shipments; therefore, all labels will be accounted to on the basis of the box lot price. This will result in a neutral revenue effect to the labels, while properly recognizing CEMA's actual costs.

2. Price Increases: CEMA proposes the following price increases from its current bulk or lowest wholesale price to the new box lot price:

Suggested List	Present Bulk	New Box-Lot
LP/Cassettes		
6.98	4.03	4.07
8.98	5.22	5.23
9.98	5.79	5.82
CDs		
Budget	6.77	6.85
11.98	7.85	7.85
13.98	9.08	9.13
15.98	10.24	10.27
Singles		
1.99	1.03	1.03
2.49	1.29	1.29
4.98	2.85	2.85

CEMA proposes to add a $.15/unit loose charge.

3. Minimum Order Policy: WEA is at $500; possibly we should consider a minimum order policy in connection with implementation of box lot pricing system.

4. Transition from Vinyl: Ron Urban: a lower purchase discount with LPs sends the wrong signal. EMI is experiencing minimal reorders and probably will dump most existing inventory. Ron McCarrell: LP buyers, which acquire product early in its life cycle, provide significant momentum for future sales activity.

IV. Singles

A. 7" Black Vinyl: In light of dramatic sales declines and diminished profitability, use should be reviewed carefully. Some doubt as to whether this still is an independently viable market; perhaps it exists at this point only in an ancillary capacity to label promotional efforts, and e.g. in the black community.

B. Cassette Singles: Definitely the trend of the future; all product should be released in this configuration (simultaneously with 7" black vinyl, if used).

C. Licensing: The possibility of Special Markets licensing 7" vinyl singles should be considered for specialty users, e.g. juke boxes.

D. A&M Pricing/Returns Policy: Consensus against this.

E. 4-Color Sleeves: EMI no longer doing. Capitol still doing, particularly for U.K. artists. Unnecessarily expensive and leads to obsolescence problem.

F. RCRC For Cassette Singles: Should be implemented while still doable, with a high break-even point. Query as to impact on store reports.

G. Singles Specialists: At WEA, they actually sell all singles product exclusively. This leads to better turnaround in response to radio and retail activity. CEMA suggests implementing singles specialists at each branch. Position obviously will liaison closely with each label. Russ Bach will make recommendation to Joe Smith.

H. "Single of the Week:" Initially, the purpose of the single of the week was to affect Billboard reporting. Now, however, it has transitioned into a product introductory device. Presently thought to be overutilized. Possibly develop a point of sale display for cassette singles.

I. New Release Discounts: Initially granted out of the box, but a second shot may be necessary in many cases to realize fully the product's promotional value. Any such discounts would be recommended by the singles specialists.

J. LOFI: CEMA recommends that LOFI apply to all singles configurations; labels agree.

K. Oldies Cassette Singles: Capitol presently rolling out a 12-title test; EMI has 18 titles cleared. Labels to cooperate in developing a generic jacket.

V. Dealer Reporting

A. Interaction with Label Promotion: Ira Derfler: "There is not enough label promo staff input to establish local priorities." Possibly consider changing branch meeting schedule around release of local and Billboard chart numbers. Consider also, though, that meeting should not be held until all chart positions (both local and Billboard) are in; and also, Friday meetings do not detract from sales efforts as much as would a mid-week meeting.

B. Time Burden: Increasing, particularly in light of the fact that there are fewer influenceable accounts and more and more stations are doing their own call-out research.

C. Billboard: Again, considerable time spent on a diminishing number of influenceable accounts with proportionately reduced effect. FMR time devoted to this activity detracts from other important tasks. Cost of a #1 report is considerable; singles used to lube the market either displace legitimate sales or end up as returns. Consider giving the reporter the singles only after it is confirmed that the record has been reported at #1.

VI. New Release Scheduling

A. Present System: Mistakes have resulted because product is scheduled too far in advance of actual release. Label presentations at sales meetings have been poor because the promo staff itself hasn't been apprised of the product's essential qualities in sufficient detail.

B. Proposed Revisions

1. Sales Tools: The monthly books (both for proprietary and third-party labels) probably will be eliminated. A weekly publication will replace them, combining all releases from whatever source (precise format to be decided). Among other beneficial consequences, this will result in additional lead-time and also permit greater scheduling flexibility. Label reception to this was favorable.

2. Order Fulfillment: Instead of the present system where proprietary product is shipped one week, distributed product another week, and Angel a third week, all product will ship whenever it's ready to go. This way product requiring rescheduling (for whatever reason) will slip only a week instead of an entire month.

3. Sales Meetings: Travel meetings will not be held routinely, only when required in light of label release schedule. Consider use of inexpensive video presentations for better impact.

VII. Programs

A. Generally: Programs require better organization and more advance planning. E.g., all necessary business affairs approval should be obtained in advance of commitment. Programs should not be set at end of month because of adverse impact on DCs. Consider programs with options; e.g. 6% + 30 or 7%, which permits greater customer flexibility. Dating should not be granted routinely, but may be necessary if the release comes during the last week of the month to prevent billing inequities.

B. Matrix Exchange Agreement: Under recent revisions, labels bear entire cost of frees + discounts, unless a special arrangement has been negotiated in advance with the repertoire proprietor. CEMA will assume all necessary business affairs approvals are in place.

VIII. Midline/Greenline

A. Philosophical Direction and Costs: Perceived as an earning asset; however, for many titles with lower sales, marginal revenue is more than offset by marginal costs. Consider transferring jurisdiction over these titles to Special Markets; at the same time enhancing the line with new titles which now are inappropriately sold at higher price. Also, transfer better-selling releases to $6.98 midline. What this comes down do is more sensitive attention to the product life cycle of individual releases.

B. Price Protection Problems on Price Change: Can be solved by offering a 3-4 month program to enable the customer to stock balance; or by offering a buy-in program based on the previous 3-4 months' purchases.

C. Name Standardization: Consider a label-wide generic name at this price point, e.g. CBS' "Nice Price," WEA's "Super Savers."

IX. Office Space: Branches inevitably will expand with greater volume. Labels need to accurately predict their future needs (e.g., promo and regional staff) for better advance planning and optimal space utilization.

X. "Basic Coverage:" The worksheet distributed is for an unknown act with little or no tools; comprises mainly "A" chain stores and one-stops. CEMA to furnish back-up for each territory. Coming: jazz, classical and pop minimal coverage standards. Also coming: the "next plateau" of coverage, which will show how many more units are in the field with a corresponding commitment on behalf of the label.

XI. Advertising

A. Present System -- Problems: Two significant issues surfaced at FY89 closing, which were: Minneapolis overspent beyond allocations, and some question existed as to CEMA commitment authority for EMI repertoire. Funds no longer will be committed without specific written authorization.

B. Recommendations.

1. Advertising Manager: CEMA intends to staff such a position, which will have both a marketing and an accounting focus.

2. New Release Plan: WEA has for every new release title where the objective exceeds 300K units. One aspect of Joe Mansfield's new responsibilities is to develop analogous plans for CEMA, in consultation with labels. This will result in better budgeting and more "bang for the buck."

3. Allocations: CEMA presently receives 4/10 of 1% for discretionary purposes, 2/10 of 1% of which funds CMA audit/payment service. The rest is used for occasional overages and in connection with Midline and Greenline. This is insufficient and deprives CEMA of necessary autonomy to structure effective programs. WEA, on the other hand, receives approx. 3%.

4. EMI: Present EMI system of flowing all discretionary advertising funds through regional representatives is cumbersome and ineffective. (a) Slows down reaction time on the street when the regional representative can't be located to provide written authorization. (b) Deprives branches of autonomy; the branch becomes less effective to the extent it always must return to the label for authorization. (c) Too many authorizations requested for $200-$300 ads, which detracts from other field efforts and is an inefficient utilization of scarce personnel resources. Key is sharing of responsibility within certain pre-approved commitment ranges.

XII. Operations and Other Issues

A. Distribution Centers: On the basis of current configuration mix, DCs have a capacity of 21-1/2M units; a "strained" capacity of 23.7M units; against approx. 27M units of inventory on hand. New High Point facility plus the LA D.C. will store 25.1M units; an ancillary facility will accommodate 3-1/2M more. Outside space, of course, entails significant additional costs. Inventory levels therefore must be pruned, particularly in light of pending move to High Point.

B. Generic CD Boxes: EMI must resolve mis-placed bar code, which fails to show through on generic CD boxes. Consider a CEMA-wide generic box for midline CD titles to be used in connection with a new common name for this line; Capitol and EMI marketing departments to cooperate and devise.

C. Customer Returns

1. Present System: New "envelope" procedure became effective 2-1-89. Experience has proven the need for a cover-sheet, which will be designed and furnished.

2. Returns Forecasting: Not possible on a title-by-title basis; among other factors, customers aggregate returns by distributor, and not by label (or title). Labels therefore must use previous sales data to devise their own forecasting models.

Significant accounting issue exists between Capitol and EMI as to how returns should be recognized on their respective income statements; CEMA requires a single, unified approach. Dave Palacio to resolve.

D. Music Videos: CEMA will commence distribution as another pre-recorded music configuration. Price and RCRC suggestions handed out.

E. Retail Growth: Tremendous consolidation among CEMA's customer account base.

F. MIS: Present system is inflexible and under examination with a 2-year project time-frame.

G. "CEMA:" No longer possible to construct a precise anagram; however, considerable customer recognition makes it undesirable to change. "Team CEMA" concept.

XIII. NARM Review

A. Booth: Should be eliminated; a waste of product and personnel resources.

B. Presentation: Addition of more labels will require different time allocation. Better continuity necessary to maintain viewer interest. Live presentations came across well.

C. "The Suite:" Too many people in the room, possibly intimidating customers. Too many account meetings, making it impossible to attend other functions. Possibly better for CEMA to visit the customer at the customer's place of business, which is far more conducive to accomplishing results.

XIV. Sales Manager/Branch Manager Meeting

Scheduled for May 6-9, 1989 at Palm Springs.

DEK:rg

cc: Mansfield
McFadden
Palacio

Dave Kreverenger

M E M O R A N D U M

TO: Russ Bach
President, CEMA

FROM: David E. Kronemyer
Vice President, Business Affairs, CEMA

RE: Branch Managers/Sales Managers Meeting
May 7, 1989, Palm Springs

DATE: May 13, 1989

The purpose of this memo is to report on topics discussed at the Branch Managers/Sales Managers Meeting which was held on May 7, 1989 at Palm Springs.

I. Branch Sound and Video Equipment

The current status of branch sound and video equipment is being investigated by Dave Palacio with a view towards replacing defective or obsolete items. Branch managers requiring dictation equipment are to submit their requirements to Dave P. Cassette players should have a "search" feature.

II. Artist in Town Policy

CEMA's "Artist in Town" Policy exempts up to 100 units from RCRC; CEMA also pays freight on the return. The policy originally was designed to insure that goods were in the store when a developing artist was on tour, it being felt that the customer might not order otherwise. A secondary objective, addressing the same concern, was to support in-store appearances by developing artists. Some branches use the policy; others don't. Users felt that it aids in price + positioning and helps implement valid label product placement objectives. Two proposals were discussed:

A. Among users, 100 units was felt to be an insufficient quantity; consider raising this to 500 units.

B. Among non-users, considerable sentiment for doing away with the policy entirely on the following grounds:

1. Having been apprised of the fact that the artist is on tour in his market, it's the customer's business to order goods on CEMA's usual terms of sale. The policy unnecessarily forfeits margin, and customers may come to expect similar concessions on highly viable, front-line product, thus breaking down the fiber of our relationship with the account. Furthermore, it induces artificial customer demand. If units are placed in the field beyond realistic coverage requirements, they simply will end up as returns. To the extent the policy implements a valid objective, it might be fulfilled better by an appropriate modification to the RCRC system.

2. Due to a number of factors (such as poor promoter coordination w/ CEMA branches), the policy is difficult to implement with precision. It's difficult if not impossible to "trail" a tour in the manner which the policy suggests.

3. Considerable doubt attends the use of in-stores as a means of selling records (as opposed to valid promotional and publicity considerations).

4. It appears that in some cases, the policy has been used with stores which are not CEMA accounts. If so, this could implicate potentially serious price discrimination issues.

Dave Palacio will quantify the number of units involved. Branch managers will address their use of the policy in a memorandum to Joe Mansfield. A decision will be taken following review of these materials.

III. Branch 800 Numbers

Each branch presently has an 800 number. Branch managers are to evaluate its use in light of the following:

A. To the extent the 800 number is used by customers, there is considerable sentiment for having the customer bear this cost.

B. To the extent the 800 number is used by field personnel, will the proposed branch VMX systems replace it?

C. To the extent the 800 number is used by label promotional staff, is this an appropriate CEMA (as opposed to label) expense? Are we allocating costs back to the labels now?

D. Consider use of a "regional" 800 number, which is less expensive than a "national" 800 number.

IV. Listening Parties

Generally felt to be ineffective, with the cost outweighing the benefit. Consider requiring the labels to fund, if at all.

V. Branch Personnel Headcounts

Branch managers are to devise new floor plans in light of expanded branch staff, including Chrysalis, SBK and Orpheus promo reps and Capitol and Enigma sales reps. Several possible outcomes for those branches with insufficient space, including (a) leasing adjoining space; (b) negotiating with lessor to trade current premises for premises with more space; (c) early termination of lease, if legally possible and financially feasible; and (d) doubling-up on offices for selected staff.

VI. Tower Records Inventories

Tower presently has 53 domestic stores; CEMA incurs significant cost to inventory, which Tower requires as a condition of getting the order in most cases.

Terry Sautter reported that 23 stores are located within his branch. Inventory clerks are paid approx. $6-$7/hour. It takes approx. 4 days to conduct a complete inventory (including classical, which takes approx. 2 days in and of itself); this is done about once per month per store. Cost of taking inventories in FY89 was approx. $30K, paid for with label advertising funds. Sales reps also independently check stock of advertised goods, "Pulse"-advertised goods, tour support items, new release items, and priority items. The inventory must result in an order to be cost-justified; each store orders its own goods within parameters established by its budget, open-to-buy, etc.

Fuzzy Swing went on to observe that the CEMA catalog is not useful for taking Tower inventories, in that it does not correspond to the layout of the typical Tower store (separate sections for pop, jazz, etc.). Conforming to Tower operating procedures should result in additional business. Fuzzy to provide Mansfield with copy of BMG catalog which was re-formatted with this problem in mind. Michael Rodin to break down the CEMA catalog by section and develop proposed Tower checklist by approx. July 1st..

Consider compensating inventory clerks on a per-store basis, rather than an hourly basis, thus rewarding efficient performers. Query, though, if they would cut corners and do an incomplete job.

Advent of scanners will automate this task significantly. Eventually it should be possible to match the store's actual inventory against an "ideal" product layout for that store; and then transmit the variance by computer directly to the order desk at the DC. This will be particularly useful in the case of classical and other 1's and 2's business; it also emphasizes the necessity of making sure that all goods properly are bar-coded.

Trade regulation implications: the Tower inventory is like a discount, and we perform this service for few other customers. Other customers, however, don't require the inventory as a condition of getting an order for the product not in stock. Thus this phenomenon is unique to Tower and probably will stay that way in view of its specialized merchandising focus.

VII. Music Video

CEMA to commence distribution mid-July or thereabouts with EMI's Queensryche compilation. Music video is to be sold simply as another product configuration. Unlikely that CEMA will distribute to video-only outlets; distribute theatrical video; or take on esoteric product lines (e.g., Rhino video). It being felt that these are not CEMA customers, and that some investment in specialized personnel would be required in order to service adequately. Consider pre-selling before manufacture of finished goods to ensure 100% fill on release date.

VIII. Branch Office Identification

Branch managers are to ensure that proper signage appears throughout the branch, on directories, etc. Branch managers are to advise vendors to bill as CEMA, not Capitol.

IX. Enigma Singles

Enigma has complained re lack of spread and depth on 7" vinyl and cassette singles. BMs observed that while CEMA was "label blind," its customers weren't, and that in many cases it was felt that Enigma wouldn't promote the product properly, resulting in a smaller order. BMs also report that delayed availability of cassette single in several cases has hurt the project; esp. when coupled with customer's lack of desire to take in significant quantities of 7" vinyl product.

X. Credit

Joe Mansfield reported that Central and Eastern credit are being consolidated at the new High Point DC; Dennis Wilkins to be in charge. New ideas and approaches re this important function will be coming soon. A common perception is that CEMA is low on the payments hierarchy, which will be solved by increased credit manager visibility and more frequent travel to customers.

Tom Tilton: quicker turn-around is necessary on new account numbers for chain retailers. He's been receiving poor advice re when affected customers are taken off of "hold." Also, in several instances a "referral" customer has purchased goods at program price, but approval is granted too late and the merchandise is shipped at full price. Other BMs advise of a related problem, which is when orders are "placed" but not "entered" until after the program expires; and back-orders which are incorrectly charged at full price instead of the program price. All of which results in considerable (and unnecessary) invoice adjustments.

This situation is to be addressed by inputting the program to continue until close of business on the following Tuesday in all instances, thus permitting for delayed receipt of orders. Customers, of course, will be advised that the program expires on the previous Friday.

XI. Branch Manager/Sales Manager Compensation Package

Present split is 80% salary/20% incentive. Query whether compensation should be all salary, or a greater incentive %; discussion of pros and cons re various alternatives.

The former system of quarterly reviews for incentive compensation is to be discontinued on the grounds that it is time-consuming and too subjective. It will be replaced with a new system of incentive compensation based on measurable criteria. BMs and SMs solicited for input re an appropriate mechanism; leading candidate is actual v. budgeted contribution margin. CEMA Executive Committee will review alternatives and decide.

FY90 budget distributed; considerable discussion re identifying and properly isolating relevant cost centers on a branch level. BMs in significant disagreement with allocations to contact Dave P. for resolution. In that connection,

a. "Product cost" reflects a mix between the distribution fee to proprietary, joint-venture and third-party labels.

b. "Eastern and Western Staging" are returns which are re-distributed to the branches using a ratio based upon BPI. Product will continue to be funnelled through Eastern and Western Staging until further notice. Dave P. will make adjustments on a manual basis until he can automate the system. Consider adjusting on a monthly rather than a quarterly basis in order to stabilize sales rep commissions.

c. Query re impact of recent change in mileage allowance.

d. Query re proper allocation of cost centers between CEMA and labels. Presently CEMA pays for all space, including that occupied by label promotional and regional sales personnel; this not envisioned to change. BMs advised not to get into arguments over who pays for minor items.

XII. Concert Tickets

While CEMA presently has a budget for proprietary labels, non-owned labels fund tickets entirely. This is not felt to be equitable. Therefore, funds budgeted for this purpose will be reverted to the affected labels, and this function will become wholly a label responsibility. Russ Bach to advise Joe Smith.

XIII. Customer Advertising

A new position of Customer Advertising Coordinator ("CAC") will report to Joe Mansfield. Among other functions, the CAC will devise, implement and maintain uniform procedures among all CEMA-distributed labels. Until the position has been filled, Joe McFadden will continue to coordinate all requests from the branches for customer advertising funds. New allocation forms are being devised; importance of obtaining advance label approval emphasized in all instances, even if delays result in missed opportunities. Further front planning by each branch will result