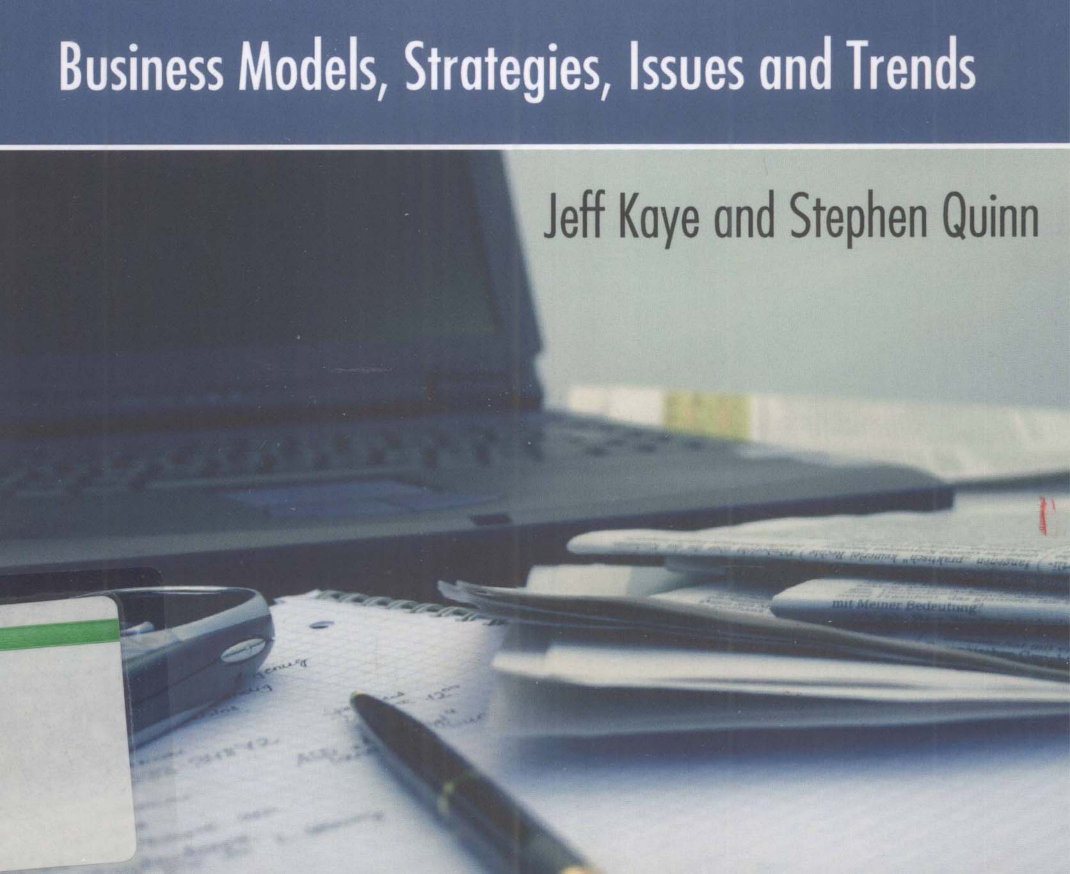
FUNDING JOURNALISM IN THE DIGITAL AGE

Business Models, Strategies, Issues and Trends



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To Alex, Hannah, Jackson and Nathan

To John Tidey, friend and colleague.

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Introduction

Pay walls versus free access, hyperlocal coverage, search engine optimization, niche content – the discussion about how the news industry will survive in the digital age grows more intense as the speed of its financial decline quickens. Is Google devil or angel? Will Amazon and other makers of electronic readers resurrect the paid subscription model for news? If they do, will they grab an unfair share of the profits?

In newspapers and blog postings, at seminars and webinars, wherever journalists discuss their profession, the talk is of survival. How will journalism be funded when the business models that sustained it for centuries are crumbling?

The onset of the global financial crisis in 2008, and the dramatic drop in revenue that followed, raised the level of industry turmoil as news organizations slashed staffs and budgets to cut costs.

But not everything is doom and gloom – there is plenty to be optimistic about too. Advances in technology have enabled journalism to flourish in remarkable ways – from instant global distribution to community participation and more powerful storytelling techniques. And there are already instances where readers have shown they are prepared to pay for digital news content.

It's worth remembering too that despite these massive upheavals in business models and technology, the centuries-old perception remains widespread that an informed public is an intrinsic social good.

With these changes crowding into one another, we felt there was a critical need for a book about finding new ways to fund journalism's key role in fostering democracy.

In the following chapters we attempt to place these developments in their historical and economic context. We provide an overview of where we are now and look at new ideas and practical solutions that are being developed throughout the world.

Chapters 1 through 3 provide a context for the current dilemma. The first chapter explores the issues and challenges media companies face in trying to fund journalism as the industry makes the transition to primarily digital distribution. Chapter 2 examines how the commercial side of the news business developed, early attempts to move beyond "ink and paper" to electronic news distribution, why newspapers give away their content for free online and the rise of Web 2.0 and social media. Chapter 3 discusses business models that news organizations have used in the past and are using today – with varying degrees of success. Among the models and issues addressed are paid content, classified advertising, aggregation, hyperlocal news, search engine optimization, dayparting and the emerging concept of distributed media.

Chapters 4 through 9 explore new business models to fund journalism that are already being tested around the world. From microfinancing in San Francisco to massive citizen participation in South Korea to passion "blips" in London, we provide case studies of experimental commercial practices. Among other topics included are sponsorship, non-profit organizations, trusts, industry-university partnerships and strategies for creating valuable niche content. We also look at why online users appear more willing to pay for digital content that exists outside of web browsers – on iPhones or PlayStations for example – than on web pages.

The final section of the book, Chapters 10 to 14, looks at how we can adapt and create new products, services and operational methods that could help support journalism. Chapter 10 examines relevant economic concepts that could be used as tools to develop a greater commercial infrastructure for journalism, such as versioning, bundling and unbundling, price discrimination, network effects, switching costs and lock-in. In Chapter 11 we look at how e-commerce offers untapped revenue possibilities for news organizations, why so many online users are unable or unwilling to use current payment systems – and how that can be overcome. We also examine how media companies are engaging their online users and building transactional relationships with them.

Chapter 12 discusses the importance of innovation in driving businesses, why news organizations have been slow to innovate and how that is changing. We provide case studies of innovative practices at media companies around the world. Chapter 13 focuses on electronic reading devices – e-readers, such as Amazon's Kindle – and the effects this form of distribution may have on journalism. E-reader owners will pay for digital content, and the number of users is rising steadily. But questions remain about how to split the revenue fairly between content providers and e-reader manufacturers and whether news companies will be able to build their own transactional relationships with customers who subscribe via e-readers.

Finally, in Chapter 14, we highlight key issues and trends we believe will help shape how journalism is funded in the digital age.

1

The challenges of paying for journalism

Summary

The value of news media companies around the world has crashed since the global financial crisis started to bite in 2008. In America alone, newspapers lost $64.5 billion in market value that year. Traditional news organizations are struggling to survive. But the economic downturn has only speeded up a process that has been underway for decades. Emerging technologies and changing social trends began to disrupt established media business models and practices long before the latest crisis on Wall Street. The news industry is making a transition away from print and broadcast distribution to primarily digital platforms. But the advertising and subscription business models that supported traditional media companies in the past appear unable to do so in the digital age. Massive competition to attract online advertisers, and an expectation among audiences that web content should be free, are two of the biggest factors behind the current crisis. Quality journalism is expensive to produce – so how will it survive as traditional sources of revenue shrink? This chapter outlines the issues and challenges that media companies face in trying to fund journalism. It should be read in conjunction with the next two chapters, which consider the business models that have sustained journalism in the past.

The economics of journalism are not straightforward. Most other businesses operate with a simple formula: they offer products and services for sale and people choose to buy them or not. But journalism has mainly been paid for through indirect means. Newspapers and magazines usually charge for a single copy or a subscription, although some publications are given away free. But even for the ones that charge, the sales revenue is unlikely to meet the cost of production. The real money has usually come from selling advertising space. The news content attracts an audience and advertisers pay to get their message in front of that audience. So, in truth, news publications do not generally receive the bulk of their income from their readers – they get it from advertisers. Therefore, the notion that consumers have been "paying" for news is somewhat misleading. Consumers have been funding only a fraction of the cost of producing quality journalism. Yes, the income from single copy sales and subscriptions has been substantial and an important component of the news industry business model. But that is only part of the story behind journalism's financial crisis. The bigger picture is that print newspaper readership has been declining for years, that readers have been turning to online sources for news, that there is far greater competition for advertising revenue online than in print and that advertisers pay only a fraction for online space compared with what they pay for print and broadcast ads.

By the second half of the twentieth century America's newspapers, like many newspapers around the world, relied largely on advertising for their income. Professor Robert Picard of Jonkoping International Business School in Sweden, one of the world's most eminent media economists, noted that advertising rose significantly during that time as a proportion of total newspaper revenues. Advertising sales accounted for 71 percent of newspaper income in 1956 compared with 82 percent by 2000. The category proportion of advertising also changed. Professor Picard noted that in 1950 retail advertising made up 57 percent of advertising revenue, national advertising 25 percent and classified advertising 18 percent. Half a century later, retail and classified were nearly equal in terms of their contributions (44 percent and 40 percent respectively) and national advertising provided only 16 percent of total advertising revenue. "These shifts made newspapers more dependent on classified employment, automobile, and real estate advertising that tend to be more cyclical and respond more to changes in the economy than brand advertising that makes up the bulk of television advertising," he wrote in a paper headlined *Evolution of revenue streams and the business model of newspaper: The US industry between 1950–2000.*

Newspaper advertising is cyclical and affected by the business cycle and other changes in the economy, and newspapers' revenues mirror these trends. "Although circulation income increased in real terms by more than a third in the half century, that growth rate stopped in the 1980s, and circulation revenue has been flat since that time. Part of this revenue trend is the result of declining numbers of newspapers and their circulation and partly due to the reluctance of newspapers to raise their prices," Professor Picard wrote. "The newspaper industry was dependent upon advertising for the bulk of its income across the five decades but that dependence grew stronger during the final quarter of the century." Newspapers have often used the cover price as a tool to manipulate circulation figures and advertising rates. So they have always been reluctant to raise the cover price for fear of losing readers and having to charge lower ad rates. Circulation at US newspapers peaked at 63.3 million in 1984. By the end of 2008, US weekday newspaper circulation had dropped to a combined 48.6 million. "The declines in print newspaper circulation, which had begun to accelerate alarmingly in late 2003, only became deeper in 2008," noted the Project for Excellence in Journalism in its 2009 *State of the News Media* report.

The global financial crisis

The full horror of the global financial crisis that started in 2007 emerged in 2008, and by the end of that year had crippled the mainstream media's primary source of income – advertising – in many countries around the world. This loss of income accelerated many changes that would have taken longer to occur, such as decline of print newspapers and magazines, and decisions to produce online-only editions or outsource content. In the US, advertising revenue plummeted between 2007 and 2009, marking the first three-year decline since the Great Depression of the 1930s. In 2008 American newspaper advertising revenue dropped 16.4 percent to $37.9 billion. And eMarketer estimated another $10 billion of advertising income would disappear by 2012, leaving the industry half the size it was in 2005.

With print and broadcast news companies losing audiences and advertising income, and online news providers so far unable to develop business models to support comprehensive, quality news coverage, the questions arise: How will journalism be funded in the long term? Will traditional news media companies remain viable? Alternative methods of reporting and distributing the news are already popping up with great frequency. But how will they be funded?

The global financial crisis reduced the options media companies had for borrowing money to expand, and forced them to cut costs to repay debt. "The perfect storm has arrived," noted Earl Wilkinson, executive director of the International Newsmedia Marketing Association, in INMA's eighth annual forecast, published in February 2009. In 2007 Rupert Murdoch paid almost $6 billion for Dow Jones, owner of *The Wall Street Journal*. By the end of 2008 the value of media companies had dropped so dramatically that the amount he paid was more than the market capitalization of Gannett, the *New York Times* Company, McClatchy, Media General, Belo and Lee Enterprises combined. By the middle of 2009 you could have added a few more media companies to the list.

Professor Jay Hamilton of Duke University, another noted media economist, observed that by the start of 2008 the market value of America's publicly traded newspaper companies had dropped by 42 percent, to about $23 billion, relative to the end of 2004. In 2004 newspapers attracted 44.1 percent of local online advertising revenues, but by 2007 non-newspaper Internet companies enjoyed 43.7 percent of local online ads while newspapers garnered only 33.4 percent.

Job cuts followed the decline in revenue and market valuation. In 2000, there were about 56,400 newsroom workers in the US. But that number fell by more than 15,000 between 2006 and early 2009 because of layoffs. The number of full-time journalists in Australia fell 13 percent between 2001 and 2008, from just under 8,500 across all media to about 7,500. In October 2008 the Australian Journalists' Association published a report on the future of journalism, *Life in the Clickstream*. The report quoted Emily Bell, director of digital content for British newspaper *The Guardian*, who warned: "This is systematic collapse – not just a cyclical downturn. Even the surviving brands will have to go through a period of unprofitability." The report said the "disruptive and destructive difference" was new technology. "It is fragmenting audiences and stealing advertising, especially the classifieds – once rivers of gold for Australia's largest mastheads. Free-to-air TV is seeing subscription TV eat into advertising, audiences fragment and migrate online as time-shift technology lets viewers skip TV advertisements. In radio, podcasts act as time-shift technology, while the audience is spoilt for choice."

The ability of online content to reach a global audience means that the increased competition among news sites publishing stories on the same topics is driving down the value of news. Said Chris Anderson, editor of *Wired* magazine and author of *Free: The Future of a Radical Price*, "Abundant information wants to be free. Scarce information wants to be expensive." Most general news sites do not charge subscription fees, and revenue must come from advertising or another source. At the same time, the low cost of producing alternative online content sources such as blogs and niche websites has intensified competition.

"Traditional news providers are competing for attention with outlets offering personality, partisanship and passion," Professor Hamilton of Duke University said. Advertising dollars once destined for newspapers now go elsewhere. Many of the advertising functions served by newspapers, such as connecting workers with jobs or drivers with cars, are being performed by websites such as Craigslist and Monster. The issue has become most acute for regional newspapers that previously enjoyed monopolies or near monopolies on classified advertising revenues in their geographical area. Anyone wanting to advertise a job, a house or a service traditionally turned to the local paper. These were hugely profitable enterprises.

Concern about the commercial viability of news organizations is about much more than a business dilemma, of course. The deeper issue involves the impact a shrinking news industry will have on journalism's vital social role of acting as the fourth estate. Citizens need quality news media to help them make decisions, and numerous studies have shown the correlation between reading newspapers and people's involvement in democratic processes. People who read newspapers vote in all forms of elections more often than non-readers. It is important to note that the newspaper business is just one form of journalism and that journalism exists in other forms – and that many more methods of producing and distributing journalism will emerge over time. But for now, newspapers, along with other traditional news providers such as broadcasters and wire services, are the main source of serious, credible newsgathering and production.

Newspapers' online sites have generally employed a commercial strategy that basically followed the print business model – build the biggest audience it can under the theory that the bigger the audience, the more that site can charge for advertising. But that model has problems in the digital realm: low online advertising rates and the small fraction of users who click on the ads (click-through ad rates are another advertising revenue model). Newspapers, in many cases, have been attracting huge numbers of readers to their online sites – far greater numbers than they ever attracted in print. But with the content mainly given away for free, and the online advertising rates far lower than in print, the revenue earned online has not been enough to make up for the drop in earnings on the print side.

News organizations are not the only content providers trying to come to terms with the problem. Social networking giant Facebook, for example, has a huge audience – it claimed more than 300 million regular users in 2009. But as an advertising platform it has been ineffective and revenue has been feeble in relation to the size of its audience. Likewise, YouTube has a massive following – accounting for 40 percent of the online videos played in the US in August 2009 – with its closest competitors barely in single figures. Yet it is still struggling to match that popularity with revenue and is effectively a loss leader for its owner, Google. YouTube is losing somewhere between $180 million and $470 million a year, according to various industry analysts. Twitter, which launched in 2006, was probably the most talked-about social media site in 2009. It had 54.2 million monthly visits in February

2009, the third highest of any social media site worldwide, and an estimated 10 million users. But it had yet to attract virtually any revenue at the time of publication and its executives were still exploring potential business models.

Free content online

Why did newspapers opt to put their content online for free? In November 2003 then Tribune Company president Jack Fuller gave the keynote address at the annual conference of the Online News Association in Chicago. Perhaps the most stupid thing the American newspaper industry had ever done, Fuller said, was to give away content on the web for free. With hindsight, many would argue he was right – although this is subject to some debate. But as the saying goes, you cannot put the toothpaste back in the tube once it is out. Would news organizations be suffering financially now if their websites had started charging for content when they first went online? We don't know. Is it possible to turn back the clock and start again? No. So what are the options? Media companies will have to start again and think about the newspaper, broadcast and online businesses in very different ways. Those companies will need to become more innovative and entrepreneurial. And ultimately, media organizations in the twenty-first century will become less profitable and hence smaller. This means business models will have to adjust, which is one of the themes of this book.

Writing in *The Wall Street Journal* in February 2009, *Free* author Anderson argued for the model that gave his book its title. "Over the past decade," he wrote, "we have built a country-sized economy online where the default price is zero – nothing, nada, zip. Digital goods – from music and video to Wikipedia – can be produced and distributed at virtually no marginal cost, and so, by the laws of economics, price has gone the same way, to $0.00. For the Google Generation, the Internet is the land of the free."

The global financial crisis may be helping to spread the "Free" business model. Anderson says that when money is tight, people look for free options – a bit of logic that is hard to argue against. "After all," he wrote in the *Journal*, "when you have no money, $0.00 is a very good price." He predicted an accelerating shift to free open source software and free web-based productivity tools such as Google Docs. Consumers are trying to save money by playing free online games, listening to free music on Pandora, canceling basic cable and watching free video on Hulu, and killing their landlines in favor of Skype. "The web has become the biggest store in history and everything is 100 percent off."

Anderson is correct when he notes that distribution costs are nearly non-existent on the Internet. But production costs are not. Quality journalism is expensive. Anderson argues the free concept will remain, especially while the economy is in recession. "The psychological and economic case for it remains as good as ever – the marginal cost of anything digital falls by 50 percent every year, making pricing a race to the bottom, and 'free' has as much power over the consumer psyche as ever." But Anderson admitted free was not enough: "It has to be matched with paid. Just as King Gillette's free razors only made business sense paired with expensive blades, so will today's web entrepreneurs have to not just invent products that people love, but also those that they will pay for." Anderson said free was a great marketing tool. "Free may be the best price, but it can't be the only one."

Connecting with the audience

People who love news and journalism delude themselves into believing that this is a widely held sentiment, according to Professor Picard. "The reality," he said, "is that the average member of the general public has never been highly interested in news and has never been willing to pay for it. Those most interested in news have always been the most economically, politically and socially active members of the community." Does this suggest a stronger market for the quality end of the demographic spectrum?

Figures from the *State of the News Print Industry in Australia 2008* report released by the Australian Press Council show that between 2006 and 2008 the Monday to Saturday circulation figures of the "quality press" – *The Australian, The Australian Financial Review, The Age* and *The Sydney Morning Herald* – held up against population growth. But the circulation of almost all the metropolitan Monday- to- Saturday tabloids declined about 3 percent. Many advertisers are interested in the A-B demographic the quality press reaches because of their purchasing power. Among broadsheet newspaper readers in Australia about 42 percent had household incomes higher than $70,000 a year and only 12 percent of broadsheet readers had annual household incomes of less than $35,000. Conversely, only 29.6 percent of tabloid newspaper readers had a household income in excess of $70,000, while 52 percent claimed a household income of less than $70,000.

Yet tabloid newspapers generally have higher print circulations than broadsheet newspapers, and in many cases higher online viewing figures. And tabloids also have been just as profitable, if not more so, than the quality press. So the