Media Economics

Third Edition

Theory and Practice

Edited by
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James Owers
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Preface

The importance of media economics became apparent as the massive business reorganizations of the 1980s and 1990s became the failures of the new century. Due to regulatory, technological, and financial changes, media became the target of takeovers, breakups, mergers, and acquisitions. Media economics became much more than understanding cash flow within a single business organization. This book is designed to focus on the principle of economics in the business sector and to apply it to specific media industries.

This volume examines the process of decision making in media economics through an exploration of such topics as industrial restructuring, regulatory constraints on media operations, and changing economic value. Because the structure and value of media industries have changed so rapidly over the last decade, it is important to understand the mechanics of such change so as to provide insight into the processes reproducing contemporary trends in media economics, rather than simply documenting historical patterns.

Part I of this book focuses on the concerns of media economics, the techniques of economic and business analysis, and overall characteristics of the rapidly changing media environments. Chapter 1, by James Owers, Rod Carveth, and Alison Alexander, is designed to provide a framework of reference in economics and business. This chapter should enable the reader without a background in these areas to appreciate the overall structure, conceptual content, and application of economics to media business. For the reader with a strong background in economic and business studies, this chapter serves as a brief review and introduction to the application of these disciplines to media firms. Chapter 2, by Robert Corn-Revere and Rod Carveth, provides a context for understanding the recent regulatory changes for media industries, particularly the Telecommunications Act of 1996. From the vantage point of Corn-Revere, a communications lawyer for more than a decade, the authors produce a view of the legal structures that guide public policy toward electronic media. Chapter 3, by Gary Ozanich and Michael Wirth, considers business combinations in the media industries through an analysis of the amount and types of restructuring within the communications industries and as related to the whole of the U.S. economy. The authors closely detail those transactions to consider thoroughly how mergers and acquisitions are employed in changing the structure of media firms. The final chapter in Part I reviews changes in international media economic practices. Ann Hollifield argues that the 1990s were a decade of globalization as coventures and global integration of media industries became the norm.

Part II examines economic practice within specific media industries. Chapter 5 (Robert Picard), chapter 6 (Al Greco), chapter 7 (Doug Ferguson), chapter 8 (Ben Bates and Todd Chambers), chapter 9 (Doug Gomery), chapter 10 (Al Albarran), chapter 11 (Eric Rothenbuhler and Tom McCourt), chapter 12 (Mary Alice Shaver), and chapter 13 (Rod Carveth) illustrate contemporary business practices in the newspaper, book, magazine, television, cable, movie, radio, advertising, music, and online industries. Picard predicts that despite a decline in readership, newspaper companies will remain healthy by adopting technological innovations in adapting to the lifestyle changes of their readers. Greco outlines the health and challenges of both the book and magazine industries. Ferguson argues that if the current television networks are to remain financially viable, they are going to have to find a market niche with their programming rather than continuing their present strategy of attempting to reach a mass market. Bates and Chambers note that the cable industry is at a crossroads, with impending competition creating new opportunities and new dangers. By contrast, Gomery sees no end to the domination of the movie industry by the current Hollywood oligopoly, noting that the industry has successfully adapted to recent changes. Albarran explores the interdependence of media economic resources, noting the changes that have occurred historically with the advent of new technologies, and their implications for the contemporary radio industry. Rothenbuhler and McCourt overview the recorded music industry, with particular attention to the structure of the industry and the strategic decision-making techniques that record companies use to address the characteristic uncertainty in the music business. Shaver details the operation of the advertising industry, with particular attention to function of agencies. Carveth assesses the challenges of the online industry in the era after the dot-com crash.

For those who wish to pursue issues further, suggested readings are provided at the end of each chapter. A glossary is also provided. Two appendices are provided online for those interested in financial media management.

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—Alison Alexander
—James Owers
—Rod Carveth
—C. Ann Hollifield
—Al Greco

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Economic Value and Structure

Chapter 1

An Introduction to Media Economics Theory and Practice

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MEDIA ECONOMICS AS A FIELD OF STUDY

Media economics may never have been more important for the industry than at the present time. The past several years have been a tumultuous period for media firms. In addition to the financial stresses and volatility faced by firms in general, media firms have been encountering the forces of technological and organizational change as they seek ways to maintain viability in a rapidly changing business and social environment. Perhaps the most prominent example of the challenges manifests itself in the ongoing travails of AOL Time Warner, Inc. Heralded by its proponents in January 2000 as a masterful organizational development to address the challenges of technological change and the financial demands of investors, within 2 years this combination was considered to be a failure from most perspectives. Many of the key players are gone, and further exits and organizational change, some of which may essentially "undo" the combination, will likely continue. Many of the ongoing series of strategic initiatives announced by the firm are greeted with skepticism and investor evaluation of the firm is pessimistic.

The widely cited example of AOL Time Warner, Inc. reflects the challenges faced by media firms in general. The changing technological, economic, and organizational environments and demands of the various constituencies of media firms place such firms under tremendous pressure. This clearly implies the need for ever-more efficient management of such firms. Practices that may have sufficed in less challenging times might now lead to untenable levels of operating and financial stress for media firms. The material on media economics addressed in this book appears to have reached a new level of importance for those involved in the operation and management of media firms.

What Is Media Economics?

The field of media economics is often seen as a subspecialty of both media and economics. However, as events over the past two decades have indicated, media economics has become an identifiable new field of study and practice. It combines principles of both the study of media and communications with the examination of economic principles and their application in managing firms in the sector.

The study of media and communications concerns itself with issues of freedom of speech, access to the media, the social impact of media content, and the effects of new communication technology. All these areas involve a discussion of economic principles to some degree. The introduction of TiVo technology provides a classic example of the interaction between media and economics attributes of an activity. From media and communication perspectives TiVo technology provides the powerful potential for more efficient personal viewing and content management by parents for their children. But the implication for an advertising-based medium such as TV is dramatic. TV executives are on record as noting the seismic implication for the present economic model of widespread adoption of such technologies. In the music industry, the Napster example has clearly illustrated how media economics often plays out with guidelines from the legal establishment when conflicts arise and regulatory guidelines are silent in an area.

Whether most or all citizens will enjoy universal access to the new telecommunications technologies will depend on how information service providers are able to recover their costs and make a profit within the confines of the contemporaneous legal framework. A. J. Leibling once said, "Freedom of the press belongs to whomever owns one." Although this may be a cynical quote, ownership of a mass-media vehicle requires substantial capital investment, linking economic means to the information in the media environment.

Economic principles must be embraced by media sector industries if viable firms are to continue in an ever more demanding economic context. In his landmark introductory text, Samuelson (1976) defined economics as:

> The study of how people and society end up choosing, with or without the use of money, to employ scarce productive resources that could have alternative uses, to produce various commodities and distribute them for consumption, now or in the future, among various persons and groups in society. (p. 3)

Thus, economics is concerned with *what* is produced, the technology and organization of *how* it is produced, and *for whom* it is produced. For example, a firm produces outputs it expects will sell to its target client groups (*what*) and it will employ the most efficient technology and effective organization as possible (*how*). The proceeds of selling the output will be distributed to employees, suppliers, and (if there remains a profit) owners and shareholders (*for whom*).

Media economics is a term employed to refer to the business operations and financial activities of firms producing and selling output into the various media industries.[1] Firms in particular industries have obvious similarities, and when an industry reaches sufficient scale it typically spawns a field of study focusing on the unique operating and financial attributes of firms in that industry. There are fields of study examining the unique attributes of banking, real estate, airlines, dot-coms and high technology, and almost all major lines of business. It is within this context that media economics reflects an industry that has long since reached the scale where it has its own field of specialized industry analysis and knowledge regarding firms operating in the various media industries. The operations of these firms are undertaken in the context of given market conditions, technological alternatives, the regulatory and legal environment, and their anticipated financial implications. Media economics is concerned with how the media industries allocate resources to create information and entertainment content to meet the needs of audiences, advertisers, and other societal institutions (Picard, 1990).

The context of scarce resources, technological and organizational constraints, responses to preferences of consumers, and the distributional aspects of whose tastes and preferences will dominate is pervasive in all economic analysis. Media economics focuses on the consideration of the genre of goods and services comprising the media segment of the economy. The media industries are generally very visible segments of the economy. The major firms in these industries are known to almost all adults as a result of their pervasive products. Viacom/CBS, Disney, Gannett, and AOL Time Warner are examples of well-known media firms. Although the general nature of prominent firms is familiar, structurally the media industries are complex. Many media firms have interests in several major media industries. For example, the 1996 merger of Turner Broadcasting with Time Warner resulted in a company with major interests in film and television production, magazine and book publishing, pay-cable programming, and cable TV system ownership. Subsequently, the AOL Time Warner merger in 2000 added the overlay of online services. It is an interesting fact of very large-scale firms that they frequently generate structural conflicts such as when some of their units (in distribution) compete with firms that might also be customers (for the production units). It is attributes such as this that underlie the economic and organizational attribute of firms where by bigger is not always better. Nevertheless, in the media industries there has been a general trend toward larger firms integrating production assets and distribution. This is well illustrated by Rupert Murdock's News Corp, Disney, AOL Time Warner, and Viacom/CBS. However, the financial travails and dismal investment performance of Disney and AOL Time Warner in the new millennium illustrate that the trend toward larger organizations is not a guarantee of subsequent economic and financial success.

In addition to the classic media companies, some firms not usually categorized as involved in media industries nevertheless have major media interests (e.g., General Electric, the corporate owner of the NBC television network). These attributes are not unique to the media industries—they are longstanding features of industrial organization in most well-established industries. Questions related to "who owns the media" are substantially complicated by this ubiquitous characteristic of industrial organization.

This chapter of the book identifies and describes the basic principles of micro- and macroeconomics. Without considering the detailed particular focus of specific types of media firms, the overall relation of each function to media operations is outlined. Specific examination of how they apply to particular media industries is in subsequent chapters. Two appendices are provided online for those interested in accounting and financial management in the media industries. The URL for the book is: https://www.erlbaum.com/shop/tek9.asp?pg=products&specific=0-08058-4580-1. Directly above the description of the book will be a link that says View Appendices for the Book.

Thus it is the role of this chapter to develop first the economic and then the corporate contexts within which media economics is practiced. The economics section first considers *macroeconomics*—the overall functioning of the economy as a context for all industries and firms. The second part of the economics section considers the specific economic functions and behaviors of firms and individuals, an analysis known as *microeconomics*. The functional dimensions of all firms are identified and described in the third section, and the dynamics of how firms change is the subject of the final section.

The remaining chapters in Part I of this book explore in more detail important economic elements such as structure, value, resources, utility, and regulation. Part II considers the application of media economic principles to particular media industries.

MACROECONOMICS

As indicated previously, macroeconomics refers to aggregates in the economy and how the economy works as a system. An important macroeconomic aggregate is gross domestic product (GDP). This refers to the total output of goods and services (in a particular year). The components of GDP are consumption (C), investment (I), and government expenditures (G).[2] Hence

$$GDP = C + I + G$$

Consumption

Not surprisingly, the consideration of what influences the amount of consumption of a particular product or service is labeled *demand analysis*. Such factors are analyzed under microeconomics. In macroeconomics, the primary influences on aggregate consumption are the level of income, growth in income, the inclination (*propensity*) to save, and expectations regarding the future course of the economy.[3] The marginal propensity to save refers to how much of an extra dollar of income will be saved. Consumption expenditures are those outlays for which there is little realizable (saleable) remnant at the end of the year. In contrast to the macroeconomic use of the term *investment* considered in the following section, consumption is an intuitively straightforward concept. Some income goes toward meeting nondiscretionary expenses such as income taxes and social security taxes. The component of our income that is not subject to legal disposition by way of charges such as taxes is known as disposable income (DI).[4] An important aspect of total consumption expenditure is the division of disposable income into consumption and saving (S):

$$DI = C + S$$

The consumption expenditures of households (a term that includes any domestic unit, regardless of the nature or size of the "family")[5] on media products and services is part of consumption expenditures. In an overall manner, the proportion of consumption dollars going to media expenditures has increased. In 1920, the percentage of DI spent on broadcast media was 0. The relation between technology, product development, and patterns of consumption expenditures is important. When a new media product or service becomes technologically feasible, it competes with other potential uses of consumer purchasing power. The outcome of such a competition turns on whether the new products are substitutes or complements for existing products in the marketplace. TV has significantly reduced the market potential for radio (they are partially substitutes), whereas the availability of VCRs has increased the potential for film studios (they are complementary products in the marketplace). Cable news programs are obvious substitutes for the traditional broadcast evening news programs and the long-term decline in audience for the traditional broadcast news programs was to be anticipated.[6] Implications regarding the need for adaptability to changed technological and regulatory contexts are clear.

The contribution of the media industries to GDP is substantial. In 1982, the contribution of these industries to GDP was 2.6%. By 1986, it had grown to be 2.9% of GDP. The increasing role continued into the late 1980s. Although the economy as a whole grew at an average compound rate of 7.4% in the 1981–1986 interval, media industry spending grew at an average rate of 11.2%. It should be noted that these growth rates are high relative to historical growth rates which are typically in the range of 3% to 4%. After the recession of the early 1991s, the U.S. (and many other world economies) experienced a prolonged boom until 2000. Again, the growth rates were, by historical standards, unsustainable. Growth rates of the order of 5% to 7% per year were experienced for much of the decade of the 1990s. This halcyon interval was of course followed by a prolonged downturn starting in 2000. During the booming 1990s, new technology meant that in aggregate the media industries grew at rates even above the economy as a whole, increasing both their absolute size and relative importance in the economy. It is not inevitable that the share of the economy held by the media industries will continue to grow, as evidenced by the dramatic reversal of fortunes for those media firms in the so-called "dot-com" segment.[7]

One of the most important factors affecting consumption (C) is demography. From the period of 1946 to 1964, the United States underwent a major demographic shift commonly referred to as the "baby boom," the oldest members of which are now in their mid-50s . During this period, live births in this country reached 4 million per year. Following 1964, the birth rate leveled off to slightly more than 2 million births per year, with a significant rise during the 1980s and the peak of the baby "boomlet" at 4.2 million births in 1990.[8] Hence, although the youth market drove marketing and media decisions during the 1970s, the 1980s witnessed a dramatic decline in that cohort group. For example, the number of teenagers amounted to almost 21 million in 1980, and declined to about 16.5 million in 1995. This decline in the youth market meant changes in terms of program content (*Happy Days* replaced by *thirtysomething*) and media consumption (teens represent about 50% of theatrical box-office receipts). But demographic cycles are very predicable and must be managed. As the 1980s baby boomlet progresses, it will result in the largest ever high school class in 2009. Clearly demographics are both important and changing. There is also a regional element as the sun-belt gains in relative (and in some areas absolute) terms vis-à-vis the snowbelt.

There were 74.9 million baby boomers born from 1946 to 1964. The Generation Xers (1965–1981) numbered 58.5 million. The Millennials or Generation Ys number 78.2 million from 1982 through 2001. The cyclical patterns are marked and will affect society in a major way. Nevertheless, the baby boomers will affect directly and indirectly many of the media decisions for the next 4 decades (until around the year 2039, when the youngest "boomer" will be 75). If recent trends hold, entertainment expenditures will continue to remain at approximately their current levels into the 21st century. Individuals aged 35 to 44 historically spend approximately 50% above average on entertainment and twice the average for video accessories and audio equipment. If the presently 25- to 34-year-old cohort group (the "gen-Xers") spend in a similar manner, then entertainment expenditures might well decline in the coming decade. This would be due to the impact of a smaller group of then 35- to 44-year-olds spending less on entertainment.

Thus demographics in the United States have some interesting patterns that will provide significant challenges to media and other industries. Although the number of teens in the United States had declined somewhat, there is now an increase in the number of younger children and early teens, resulting in a median age in the United States of 26 years. Yet the longevity factor means that the fastest growing age group in the United States is the elderly. From 13% of the population in 1980, people over the age of 55 will constitute 20% of the U.S. population by the year 2005.[9] This means that between 1990 and 2020 the number of people over the age of 50 will increase by 74%, whereas the number of those under 50 will grow by 1%. This shift will be meaningful in terms of media content and marketing, as older people tend to read more and consume television more than other age groups.

In addition, an increasing number of women continued to enter the workforce. By the year 2000, more than 80% of women aged 25 to 54 were in the labor force, and most of the rest will be out of the workforce only temporarily. At the same time, decisions to have children are being put off to a later date, and the number of households with married couples is declining.[10] For television, this means a decreasing number of viewers for daytime television, both for adult shows (soap operas) and children's program (such as Sesame Street and cartoons).

The demographics also show that society has become more multicultural. Immigration is growing at a greater rate than the "natural increase" (growth defined as the number of births minus the number of deaths). Currently, 1 in 10 baby boomers were born outside the United States. By the year 2000, one employee in four was from a minority group. The Hispanic market has already become increasingly important to advertisers, as approximately 37 million Americans can be considered to belong to this ethnic group.[11] This growing market has significant implications for advertisers, as well as Hispanic directed broadcast and cable services and