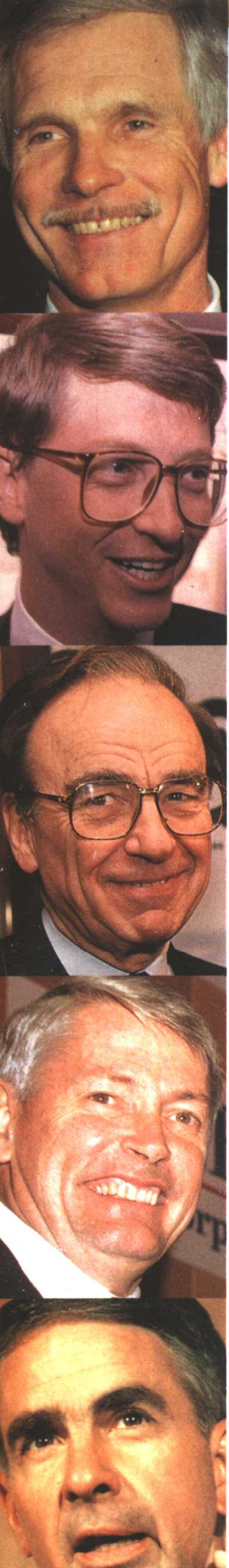

Megamedia Shakeout

The Inside Story of the Leaders and the Losers in the Exploding Communications Industry

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The Inside Story of the Leaders and the Losers in the Exploding Communications Industry

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To my grandfather,

Victor Baldwin (1908–1993),

who would've wanted to know all about megamedia, asking as only he could: "How does this gon don thing work, anyway?"

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PREFACE

This book is about character.

Megamedia is one of the great dramas in business. It is an explosion of technology and opportunities described in terms such as information highways, 500 channel TVs, multimedia and digital communication. They're all related and all on the same stage, but there is no word that embraces all of the exciting things that are happening across communication, information, computer, and entertainment industries. To make writing and talking about the big picture easier, I'm calling this new industry *megamedia.*

While megamedia is an explosion, it's also an implosion. Companies from all corners of business are converging into the same market, forming allies with one another, battling against new competitors that never before crossed their radar. AT&T, Disney, IBM, Viacom, Microsoft, TCI, and Sega are all now in the same industry.

Megamedia is the play; the companies are the players. In this book, you'll read about the character of those players.

I've tried to single out the important companies swooping into megamedia and describe their strengths and weaknesses, long-term strategy, and culture. Most importantly, this book looks at the ability of companies to handle the immense changes that are still to come.

The book also gives you a picture of the leaders of the companies because strong leadership and vision seem to be keys to success in megamedia. You'll meet John Malone of TCI, Robert Allen of

AT&T, Ray Smith of Bell Atlantic, and some less well-known CEOs such as Marc Porat of General Magic and Ed McCracken of Silicon Graphics. I've tried to paint colorful pictures of them so you can understand not just what they do, but how they think.

Why emphasize character? It's the only way to get a handle on who in megamedia might win and who might lose through the next decade. Megamedia is moving rapidly; just try following the daily headlines—who's talking to who, which products were announced, what company is merging with what other company. Wall Street analyst reports aren't much help. They focus on the next quarter and judge success by the price of a stock. *Character* underlies all the little day-to-day moves that pop up in the news. By understanding a company's character, you've got a good shot at understanding how a company will deal with megamedia, and what its chances might be in the long run.

This book is for everyone. It may be the only place where you can get a complete picture of megamedia and its players. Most reports focus on isolated industries such as telephones or cable, which is the way Wall Street and journalists have looked at these businesses for ages. But megamedia is so much more—many major industries all now interlocking and blurring and competing. For the past two years, I've had a chance to cross old industry lines to find the intriguing players coming to megamedia from Silicon Valley, from Hollywood, from the Rust Belt, or wherever. That perspective should help you understand a major change coursing through our economic system. Something new—megamedia—is emerging. This book offers you a way to see it happening.

Investors large and small can use this book to help sort out where they should put their money. People working in these industries can come away with a better understanding of players who might someday be partners, enemies, or employers. Entrepreneurs can use this book to help think about opportunities.

This book is written to help anyone grasp megamedia—because megamedia will most certainly effect us all.

A few comments on my approach are in order. Quotes are from one-on-one personal interviews, unless otherwise noted. Occasionally, first-hand quotes are from group settings, such as press conferences, where I was present. While researching this book, I talked to top executives at more than 40 companies and interviewed another dozen independent consultants and analysts. Basic information about companies has come from interviews, corporate documents, news reports, and other sources where noted.

My focus is overwhelmingly on U.S. companies. The reason is that the United States, in general, is far ahead of the rest of the world in megamedia. But you'll find profiles of some of the international companies that are becoming important to megamedia, such as British Telecom, Rupert Murdoch's News Corp., Sony, and Sega.

My caveat to readers is that this industry is changing quickly. Information included here is as up-to-date as possible, but I don't doubt that some other merger or major product will be announced even as you read this book. Companies' long-term plans and corporate character should prevail over the latest news events.

Finally, thanks to John Mahaney for taking a chance on this project and to Myles Thompson for seeing it through. Thanks to *USA Today* for being supportive, and to Jim Cox and Paul Wiseman, two colleagues who made it possible for me to do this book.

Thanks to my children, Alison and Sam, for keeping me sane by playing during my breaks, and to my wife, Janet, for her never-ending faith in me.

If megamedia somehow allows us to spend more time with our families, it will all be worth it.

KEVIN MANEY

Alexandria, Virginia
February 1995

CONTENTS

1
COMPANIES GONE MAD

John Malone and Ray Smith lurched through Manhattan in the back seat of a limousine. It was 5 P.M. and they were on their way to be interviewed together on the television show "Nightly Business Report." That morning—October 13, 1993—the two had announced that their companies would enter into one of the most breathtaking mergers ever. Malone was chief executive officer of Tele-Communications Inc. (TCI), the nation's biggest cable-TV company. Smith was chairman of Bell Atlantic, the number-two regional phone company. The merger would create one of the most powerful communications and entertainment companies in the world—a company designed to crank the development of interactive, high-tech information highways into overdrive. By the time Bell Atlantic would absorb TCI and all its debt, the deal would be valued at $33 billion, more than any merger in history.

As the limo nosed through rush-hour traffic, Malone and Smith answered interviewers' questions on a cellular telephone. The two had been on the downhill side of a roller-coaster all day, and the normally hard-edged Malone and savvy Smith were not acting themselves. Not at all. In fact, a casual observer might have said they were acting, well—goofy. Like they were about to start playing with the electric windows and eating the peanuts set out on the wet bar.

"I got up this morning and looked in the mirror and I noticed my head was taking on a vague bell shape," Malone said into the phone, poking fun at Bell Atlantic's Bell System heritage. Smith chuckled. He'd heard Malone use the line a number of times that day. "We thought maybe we'd merge Liberty Media into Bell Atlantic and rename it Liberty Bell," Malone continued. Liberty was another Malone-controlled company that would be included in the Bell Atlantic–TCI merger. Smith was laughing. Malone paused. "Well, that's all my one-liners," he told the reporter on the phone.

The rest of the communications industry was not amused that day. While Malone and Smith were drunk with delight over their deal, executives at regional phone giants Pacific Telesis and BellSouth, at media conglomerate Cox Enterprises, and at upstart TV programmer QVC Network were meeting to discuss how to respond to the new Bell Atlantic–TCI monolith—a force that could change everything about their businesses.

Companies across the communications, information, and entertainment industries had been caught off guard. They were aware of the industry transformation that had begun early in 1993. They were buzzing about "technological convergence"—the supposed melding of televisions, telephones, computers, and content into one technology, one industry. Phone companies were beginning to buy cable-TV systems. Cable companies were testing ways to carry phone calls. Computer companies were looking at ways to put video on personal computer (PC) screens. Hollywood was thinking about selling movies over phone lines.

But the announcement by Malone and Smith took the convergence idea to a whole new level. In the nearly two-hour press conference that morning, Bell Atlantic and TCI had thrown down the gauntlet. They said they were going to create and deliver in a hurry the next generation of communications: interactive, 500-channel television, and two-way video communication. They were mapping the lanes of the information highway, then only beginning to be talked about. "Video games by wire, video shopping, video 800 numbers," Malone said at the podium. "Entertainment, TV on demand." They could do it by combining the strengths of a telephone company with the strengths of a cable company. Phone companies had sophisticated networks and lots of cash to spend. Cable companies had wired America with fat, coaxial cables that could carry all the wild new services that regular phone lines couldn't handle, and they had a working knowledge of the entertainment business.

"The capabilities do not exist in any cable company or any telephone company to do this," Smith said at the press conference. Malone chimed in, "The principal asset this company has is leadership. I think we will lead."

Over the next four months, the Bell Atlantic–TCI announcement drove other companies to action. Pacific Telesis, the phone company on the West Coast, said it would spend $16 billion to build a video information network in California. Nearly every other phone company unveiled some similarly costly, high-tech push. Viacom, a major cable-TV and entertainment company, and QVC fought each other to buy movie studio Paramount Communications—a battle that Viacom won. The companies said they wanted to make the entertainment needed to fill the 500 TV channels of the future. Regional phone company Southwestern Bell announced a $4 billion-plus alliance with the cable-TV arm of Cox Communications. The information highway was suddenly being spliced together at blinding speed.

The many moves were changing the communications industry so much and so rapidly that, by early 1994, Bell Atlantic and TCI started looking differently at each other. It was like an engagement that had gone on too long, giving the couple time to think of reasons not to get married.

On February 23, 1994, Malone and Smith met at the New York offices of Skadden, Arps, Slate, Meagher & Flom, Bell Atlantic's lawyers. They had talked on the phone the night before, right after the Federal Communications Commission (FCC) had ruled that rates paid by cable-TV customers would have to be cut 7 percent. The rate change could make TCI worth less to Bell Atlantic, and Malone wasn't willing to take less. Of that phone conversation, Smith said later, "I think we both knew."

What they knew was that the dramatic Bell Atlantic–TCI merger was dead. Malone and Smith talked it out at Skadden, Arps, but, from the moment they sat down, both had bluntly said that the deal wasn't going to work. Publicly, Malone and Smith blamed the FCC for a rate cut that made it impossible for them to agree on a final price. But the deal tanked because, in the four months since Malone and Smith had ridden through Manhattan telling jokes, the world had changed.

At their final meeting, neither Malone nor Smith talked about the real reasons behind their actions that day. Bell Atlantic had decided it no longer needed TCI's cable lines to be able to deliver services it wanted to offer nationwide—at least not at too high a price mixed with too much regulatory uncertainty. Smith would have loved to have closed the deal, but the realities of the technology projects that had popped up in just a few months' time allowed him to walk away.

On the other side, TCI, always a from-the-hip cowboy company, decided it could do things by itself if the alternative was to sell out for too little. Deep down, TCI felt it couldn't afford to be slowed by being permanently hitched to giant, bureaucratic Bell Atlantic—not if it wanted to continue to lead the way to a new era of home entertainment.

"One person said that I wanted to get the superhighway built and this was the world's best head-feint," Smith said, long after quieting the furor over the deal's collapse. Announcing the end of his talks with Malone had hit Smith hard personally. He had worked his butt off to sell the benefits of the deal to Bell Atlantic employees, Congress, and the general public. But he didn't backpedal for long. By late 1994, Smith was spinning his new strategy ever faster. Bell Atlantic was preparing an $11 billion digital information and entertainment system called BAnet and an interactive programming service dubbed Stargazer. He was putting together a video production alliance with two other Bells and Michael Ovitz, Hollywood's most powerful agent. BAnet would deliver Stargazer in Bell Atlantic's region, and, with other companies planning to wire the nation with new supernetworks, Bell Atlantic could roll out Stargazer nationwide by forming alliances and renting space on those supernetworks. No need to spend $33 billion on a cable-TV company anymore. After meeting with Wall Street analysts to talk about the collapsed TCI deal and Bell Atlantic's future, Smith said: "I'm energized again. The adrenalin is flowing. We have so many plans afoot we can hardly remember the TCI days."

At TCI, Malone also felt rejuvenated and more sure of his course. "We can do a lot of things now that we couldn't if we were going to be a part of Bell Atlantic," he said. For instance, he could dig deeper into a relationship with Microsoft, a company that wasn't thrilled about teaming with a big phone company. TCI and Microsoft quickly started spinning out ventures: an interactive personal computer channel for TV, and a high-tech television system test that may equal anything Bell Atlantic tries. Malone immediately began talking deals with many of the biggest names in the industry: Sumner Redstone at Viacom, William Esrey at Sprint, Wayne Huizenga at Blockbuster, Barry Diller at QVC. Malone was boarding a bullet train for the information highway. He wasn't going to get off until he had built an international communication and entertainment conglomerate, allied in all corners with immensely powerful partners.

By that time, one fact was clear: Bell Atlantic and TCI were heading down separate and possibly competing paths. The convergence concept had taken on a lot of new meanings. The pace and sweep of change had gone nuclear, and they haven't yet let up.

Information highways, 500-channel TVs, multimedia, communications megamergers such as Viacom's $9.5 billion deal to buy Paramount Communications—those are the hottest topics in business.

Nothing else is more vibrant, more dramatic, or more perilous. Whole industries are betting their futures on this new wave. Says Tom Peters, author of *In Search of Excellence* (Harper & Row, 1982): "You'd have to be an idiot not to believe that we're at the very beginning of something really big."

It's all part of a communications revolution. Companies and technologies are coming together to form a new industry that throws its arms around everything from Discovery Channel documentaries to palm-size personal computers, creating new ways to link people to information and entertainment.

The industry doesn't even have a name yet. The Wall Street firm of Goldman, Sachs has gamely tried out "communacopia"—a label that sounds more like a sexually transmitted disease than a high-tech industry. For better or worse, around *USA Today* we started calling the industry and the concept "megamedia." It's easier to say than "information superhighway," and it means something broader—content and machines as well as wires. In this book, I call this new industry/business/revolution "megamedia."

The events of this revolution are happening in a thunderclap. In a little more than two years—late 1992 to early 1995—the perception of communications and all the companies that touch it changed completely. Those two-plus years marked a turbulent break from the past. Companies altered their strategies and set off in new directions. New leaders took over and visibly led the charge. No set of companies ever changed so much, so fast, and the changes haven't ended. Big mergers, better technology, and new services will light up megamedia before this book can even be reviewed.

At the start of 1993, telephone companies were boring voice-communications utilities that couldn't come up with anything more exciting than "call-waiting." Within a year, they had started efforts to become futuristic video and information companies. TV shopping went from a low-brow, bowling-crowd business to a high-profile media star. A handful of computer companies that once focused on business customers moved toward becoming makers of Jetsons-like consumer television sets.

Through 1994, the revolution spread to more industries. Newspaper companies started thinking about how they might become information highway software creators. Catalog retailers ventured into electronic shopping. Wireless phone companies started realizing they could reach a mass market and push their once-expensive wireless phone service into average consumers' homes, maybe replacing traditional telephones.

"People have realized that things that tech guys like me have been talking about for a long time are actually coming true," says Nathan Myhrvold, head of research and development for software giant Microsoft. "It's causing something of a stampede to prepare for that." In 1990, Myhrvold started nudging his company to develop software for interactive TV. Now, Microsoft has several alliances with TCI and is bringing TV products to market.

Technology is driving the revolution. Two important developments have made all the difference in the world. They go by the names of "digital technology" and "broadband networks."

In digital technology, devices simply read information as a series of 1s and 0s, the way computers do. The old way to create and store information is called analog, which is usually the method in use when a mechanical device, like a phonograph needle, reads a continuously varying wave on a vinyl disk. The new way can be found in the nation's 40 million personal computers and in the audio compact disk (CD) players now found in half of all U.S. homes. The growing popularity of such machines has helped push companies to create or convert games, books, magazines, music, and other products into digital form. Any kind of information can now be stored digitally: movies, TV shows, phone messages, school homework assignments. The key is that when something is digital, it can be rearranged, cut apart, and mixed with anything else that's digital. A mail-order retailer can create a digital catalog that can be called up on a home computer. A shopper can look through photo layouts like those in the printed version; or ask the digital catalog to display only the brown pants that are available, or to transmit a video of a model wearing a particular outfit or set of jewelry; or request more printed information about the fabric, fit, or price. A digital catalog can be that flexible.

Ed McCracken, chief executive of Silicon Graphics Inc., tells a story of how flexible digital information can be. His company makes some of the hottest products in megamedia: computers and software that can store and manipulate three-dimensional graphics or video at blinding speed. McCracken didn't even know that Silicon Graphics equipment was used to help make the Clint Eastwood movie *In the Line of Fire*. Later, he found out that the producers had filmed Bill Clinton's campaign in action in 1992, then fed the images into Silicon Graphics machines to digitize them. The producers removed President and Mrs. Clinton and put the actors from the movie into the scenes. (Watch the movie. You won't be able to tell that the images were ever altered.)

Another important feature of digital information is that it can be compressed—sort of freeze-dried, actually—and sent across lines or over radio waves in a minimalist form. That's what's opening up developments such as 500-channel cable-TV systems. Approximately 10 digitally compressed TV channels can fit in the space of one normal TV channel. GM Hughes Electronics, for instance, is now selling a 150-channel satellite TV service called DirecTv. The service uses two $200 million satellites to transmit compressed TV channels to viewers—eight channels in the space of one uncompressed channel. Were it not for digital compression, Hughes would have had to launch 16 satellites to start DirecTv—an impossibly huge investment. "Compression made this a business," says DirecTv President Eddy Hartenstein.

Digital information becomes especially powerful when married to the other key development: the spread of high-tech broadband networks.

Those two little telephone lines coming into your desk phone are considered "narrow band." They can't even carry enough information to make your voice sound like it sounds in person. Your phone lines can carry one channel of medium-quality video if the signals are doctored by computers—hardly enough to spark a communications revolution.

But over the past decade, cable-TV companies have snaked their coaxial cables into 60 percent of U.S. homes and businesses. Long-distance phone companies (AT&T, MCI, and Sprint) have strung fiber-optic lines across the nation. Both coaxial cable and fiber-optic lines are considered broadband—they can carry hundreds, or even thousands, of interactive video channels, plus phone calls and computer data, at very high speeds. One example: A single hair-thin fiber-optic line can transmit 45 copies of *King Lear* per second versus just a few pages per second over old phone lines.

Local phone companies are spending about $100 billion to build networks that combine fiber-optics and coaxial cable and connect to every home or building. Cable companies are upgrading their networks, too. By 2010, most U.S. homes and businesses are expected to be hooked to broadband networks.