

## **PATCH – AOL’S HYPERLOCAL EXPERIMENT INSTRUCTORS’ NOTES**

**Alan Eisner, Pace University**  
**Helaine Korn, Zicklin School of Business**  
**Casey Frid, Pace University**  
**Dev Das, Pace University**

### **CASE DESCRIPTION**

The primary subject matter of this case concerns corporate growth strategies and the importance of analyzing the business models for growth. This case can be targeted as a strategy case, specifically a module dealing with corporate level strategy. After completing this case, students should recognize corporate growth strategies and the interconnection between strategic goals and market conditions, how scale impacts the effectiveness of an initiative, and the impact of ignoring scale effects, positive or negative, in strategic management.

The case of AOL – Patch shows the challenges of growing a hyperlocal news web operation in a changing market landscape. AOL acquired Patch in 2009 and, within 3 years, expanded the operation to more than 800 sites nationwide without proving the profitability of the business model at any level. At the corporate level, AOL invested up to \$300 million into the expansion of the Patch operation during this time period, with most of the expenses related to human resource acquisition. During this time, the hyperlocal news marketplace experienced intense change, mostly attributed to the decline of print media and the emergence of new distributors of local news. By the end of the case, after multiple years without profitability, the Patch operation was forced to reduce in size, laying off many workers and shutting down 30% of the Patch sites.

### **CASE SYNOPSIS**

*Patch was AOL’s attempt to capitalize on the changing local news market in the U.S. The decline of print media has caused many of the local daily and weekly publications to close their doors, leaving an opportunity for digital methods of news dissemination to step in and provide the service to communities. Despite failed attempts from established news organizations such as the New York Post and Washington Post to operate hyperlocal news networks profitably, AOL remained committed to Patch and invested heavily. The primary driver attracting these high-powered organizations to local news is the estimated \$20 billion opportunity in local market advertising throughout the US. The traditional business model for a hyperlocal operation is buoyed by advertising revenue. The outstanding question is how to find harmony between the operational model and the business model required to fund it. On the surface, it doesn’t seem that the revenue generated by standard online advertising mechanisms is sufficient to support continued operations of small independent sites or large regional or national networks of sites.*

## RECOMMENDATIONS FOR TEACHING APPROACHES

### Case Objectives

This case is intended for use in a strategic management course. The case fits particularly well with a lesson on corporate diversification strategy or corporate growth strategies. The learning outcomes of this case are a better understanding of corporate growth strategies and the potentially negative effects of rapid corporate growth. After completing this case, students should recognize corporate growth strategies and the interconnection between strategic goals and market conditions, how scale impacts the effectiveness of an initiative, and the impact of ignoring scale effects, positive or negative, in strategic management.

In terms of its length, writing style, and content, the case is appropriate for undergraduate juniors and seniors, as well as graduate students. The case was written in a style that provides the background and context of the business problem while avoiding presenting solution alternatives or strategic direction. The information presented allows the instructor to adjust the class discussion to accommodate students with a broad range of abilities and specializations. Specifically, instructors can engage students, including graduate students, to reason through a situation where uncertainty exists and speculation may be required.

### Suggested Position in Course: Market Analysis, Growth Strategy

Subject case can be introduced as a corporate strategy case involving a diversification opportunity (i.e. for AOL) but primarily can be considered an entrepreneurial strategy case, helping students to understand the various issues associated with implementing and managing a new business model in an established but changing industry. After completing this case, students should recognize the interconnection between internal resources, strategic goals and market conditions, how scale impacts the effectiveness of an initiative, and the impact of ignoring scale effects.

On the surface, the case of AOL – Patch shows the challenges of growing a hyperlocal news web operation in a changing market landscape. However, there are lessons to be learned for any corporate diversification or entrepreneurial effort that involves the introduction of a new business model in an established industry. When viewed through this lens, the case is more representative of many online businesses that are challenging their larger, more established brick and mortar counterparts e.g. online retailers. AOL acquired Patch in 2009 and, within 3 years, expanded the operation to more than 800 sites nationwide without proving the profitability of the business model at any level. At the corporate level, AOL invested up to \$300 million into the expansion of the Patch operation during this time period, with most of the expenses related to human resource acquisition. During this time, the hyperlocal news marketplace experienced intense change, mostly attributed to the decline of print media and the emergence of new distributors of local news. By the end of the case, after multiple years without profitability, the Patch operation was forced to reduce in size, laying off many workers and shutting down 30% of the Patch sites. However, this appears to have been a necessary albeit difficult learning opportunity to figure out the magic formula for success and sustenance. The company appears to have eventually figured out how to manage its resources more effectively to manage costs and differentiate/focus its offering (see Epilogue section).

The case can be used to augment commonly used strategy textbooks such as Wheelan & Hunger's *Concepts in Strategic Management and Business Policy* (2014), chapters regarding corporate strategy formulation, and especially chapters regarding implementation and associated change; David's *Strategic Management: Concepts* (2014), the chapter regarding types of strategies and the chapter on implementation, matching structure and strategy, and management of change; Dess, McNamara & Eisner's *Strategic Management: Creating Competitive Advantages* (2015), chapters regarding corporate-level strategy, entrepreneurship; and possibly as an augment to Grant's *Contemporary Strategy Analysis: Concepts, Techniques, Applications* (2013), the chapter regarding the resources, capabilities and organizational structural decisions.

### TEACHING PLANS

Given the competitive environment within the hyperlocal news market and Patch's inability to achieve profitability with its operational model, ask students to focus on how the firm could further optimize its resources as well as its strategic options. The key macro-level question is "What should AOL do with Patch?" The micro-level question is to explore how profitability is attainable in the hyperlocal arena.

The level of detail used in course discussion is left to the discretion of the instructor. The course provides information that sets the stage for discussion centered on AOL's corporate strategy, the scalability of a hyperlocal news organization, and the dynamics of the hyperlocal news market.

### ASSIGNMENT QUESTIONS

Substantial opportunity exists to trigger forward thinking. Specifically, students have the opportunity to digest the environmental factors and make long-term recommendations concerning the Patch business. More experienced students will base their analysis on market forces and financial implications. The questions presented below cannot be fully answered without some consideration of the above and a considerable amount of speculation. Each response below is accompanied by a response direction and the interpretation of the author.

### SUMMARY OF DISCUSSION QUESTIONS

1. After multiple years of failing to attain profitability with Patch, what strategic direction should AOL pursue?
2. Is profitability a realistic goal for a large-scale Internet operation in hyperlocal news?
3. What are some positive and negative scale effects that hold the key to success or failure in the hyperlocal news market?

4. What other companies have faced similar challenges, i.e., a new entrepreneurial business model being tested in an established environment? What can AOL learn from these experiences?

## DISCUSSION QUESTIONS AND RESPONSES

1. *After multiple years of failing to attain profitability with Patch, what strategic direction should AOL pursue?*

Small, independent, hyperlocal operations offer glimpses into what is required for success in this space with a business model dependent on local advertising revenue. The case discusses ARLNow, an independently owned and operated hyperlocal news internet site based in the Washington, DC suburb of Arlington, VA. The site has been successful operating with a limited expense structure and a human resource pool featuring one local news editor and one advertising sales professional. Both have deep roots to the Arlington community and are recognized members of the community. They also utilize content from local bloggers.

AOL can achieve profitability with Patch by reducing the number of sites to only lucrative ones and reducing staffing to minimal staffing levels of one local editor and one local advertising sales professional. These employees should be selected carefully; they must have the community roots and respect to flourish in the local business environment. Also, benefiting from economies of scope by sharing content with other AOL content based sites will allow Patch to continuously provide original content. Advertising sales relationships should be managed by the local sales professional, and backend processing should benefit from shared corporate services.

AOL can also explore the opportunity to use a local service like Patch to create an emotional bond with its customers. A large number of companies risk being perceived as corporate entities that are not in touch with their core customers. A local based news operation provides great access and opportunity to build emotional equity and relationships.

2. Is profitability a realistic goal for a large-scale Internet operation in hyperlocal news?

Based on the experiences of existing and past hyperlocal operations to date, the answer to this question would appear to be “no.” Large -scale operations contain layers of management that erode the slim margins existing in hyperlocal news. Exhibit 3 illustrates the lack of padding in the margin of the Patch operation. Organizations that have been successful have done so with low-end expense structures and bare bones staffing models. The intermediate management layers required in integrating a hyperlocal news operation into a corporate entity would make profitability an unattainable goal. To achieve profitability, the Patch site will have to increase page views without increasing expenses. It will need to reinvent news content and delivery to increase site appeal with existing or fewer resources. Financial analysis should include scenarios displaying the various relevant cost and revenue scenarios

3. What are some positive and negative scale effects that hold the key to success or failure in the hyperlocal news market?

An interesting class discussion might ensue from a provocative statement about how scale can harm a business. AOL's basic premise was that more local advertisements and a larger number of sites overall would correspond to more profits.

AOL expanded an untested model rapidly to 800 sites in 3 years. One could argue that this was too fast and the resulting losses were multiplied due to negative scale effects. A more positive approach could have been employed wherein AOL first piloted the model in a handful of sites (e.g., 5-10), and scaled up only after figuring out how to achieve a profitable and sustainable business model.

AOL could also have done more of its homework before its rapid expansion efforts. It was unable to capture the expected rents per Patch Site as the advertising revenues from national accounts were lower than expected due to significant competition. Further, even hyperlocal advertisers took advantage of lower rates by placing Google advertisements rather than purchasing display advertisements from Patch.

4. What other companies have faced similar challenges i.e. a new entrepreneurial business model being tested in an established environment? What can AOL learn from these experiences?

Emerging online retail businesses present an example of new companies with untested business models that are challenging existing brick and mortar giants. The key strategic advantage here is all about achieving efficiencies with lower real estate and staffing costs. Scale efficiencies are achieved with centralized warehousing and streamlined shipping services. AOL could capitalize on the learnings from players like Amazon and eBay and leverage the internet and crowdsourcing for more productivity i.e. more output at lower operating costs.

## EPILOGUE

Early in 2014, AOL divested Patch and sold majority ownership to Hale Global. Hale was an investment company that specialized in turning around troubled companies through technological innovation. The communicated intention of Hale was to keep operating all of Patch's 600 active sites. No financial terms of the deal were disclosed, but the deal was that Patch would become a limited liability company operated and majority owned by Hale, removing Patch from AOL's financial books. AOL did stand to benefit as a minority stakeholder in the event that Hale was able to make Patch profitable.

Patch appears to have turned profitable in 2014 after executing a number of changes to its staffing, reporting, and advertising strategies.

- Employee count came down from over a 1000 to a mere 123, which included mostly editorial staff.
- Reporting content has been improved to forge a better emotional connection with local populations. The staff thinks the sweet spot has been found with quick, high impact posts. For instance, the team employs a SWAT team, overdrive approach to finding lost

pets – a local priority that would not ordinarily be covered in national and regional coverage.

- The company has also started courting advertising from larger companies with deeper pockets. This was a radical change from the past when the company spent a lot of time engaging with smaller, less profitable mom & pop operations. The company successfully obtained advertising buys from larger, more reliable buyers like Bank of America, Home Depot, and Disney, which provided a big boost to the company's financial situation.

With the above changes, the company appears to have finally figured out a magic formula to finally break into profitability.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.