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# Anatomy of a Death Spiral: Newspapers and Their Credibility

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# **Anatomy of a Death Spiral: Newspapers and Their Credibility**

## Anatomy of a Death Spiral: Newspapers and Their Credibility

Editors have long believed in their hearts that the economic success of newspapers depends on their credibility. We find evidence to support this belief by examining 21 counties where newspaper credibility has been measured. The more people believe what they read in the papers, the greater the robustness of circulation penetration over a recent 5-year period. Unfortunately, both credibility and readership are falling in what appears to be a classic reinforcing process.

While newspaper editors have fretted about their credibility for decades, they have been unable to do much about it. Given limited resources by their publishers and owners, they remain mostly frozen at the wheel while both readership and confidence in the press decline steeply and consistently.

The surface evidence suggests a classic death spiral or reinforcing process.<sup>1</sup> Waning confidence in the press causes lower readership which reduces profits which limits the availability of resources for the editorial product, causing confidence to fall still more. The trend lines in Figure 1 and Figure 2 provide the evidence. According to the General Social Survey, expressions of “a great deal” or “some” confidence in the press have declined at 0.8 points per year. The proportion who read a newspaper every day has fallen a percentage point per year since the first measurement by the National Opinion Research Center in 1967.<sup>2</sup>

Figure 1: Percent with "a great deal" or "some" confidence in the press

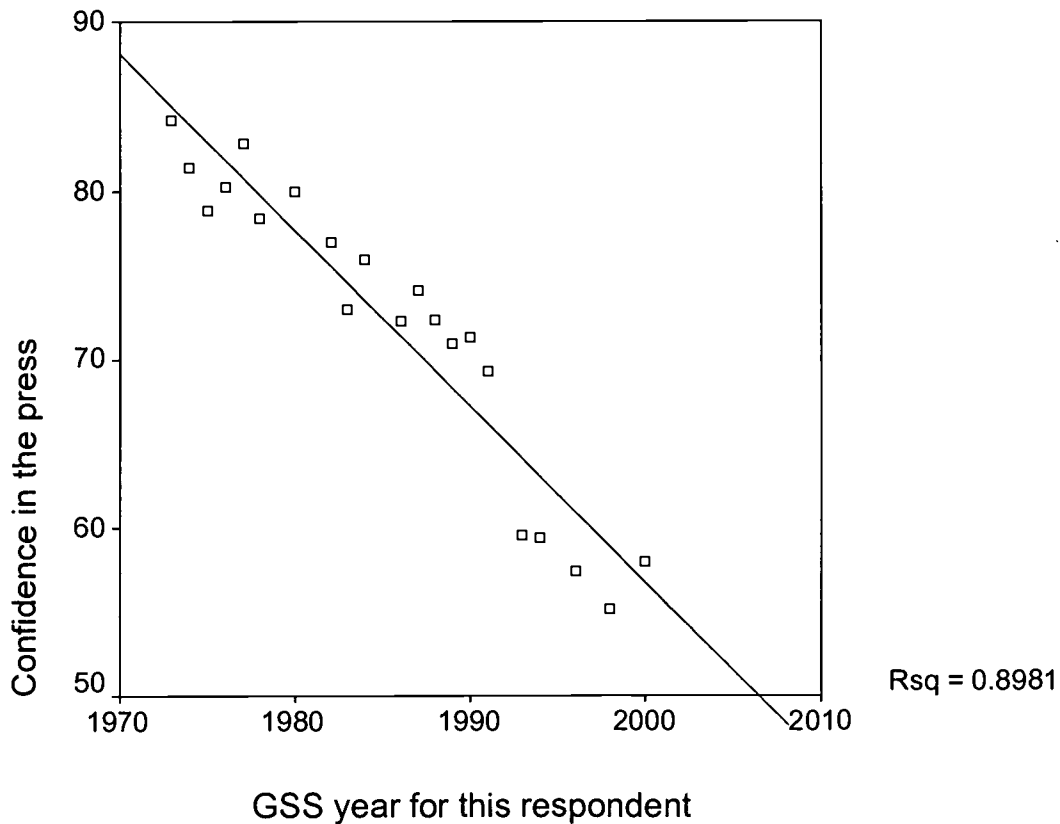
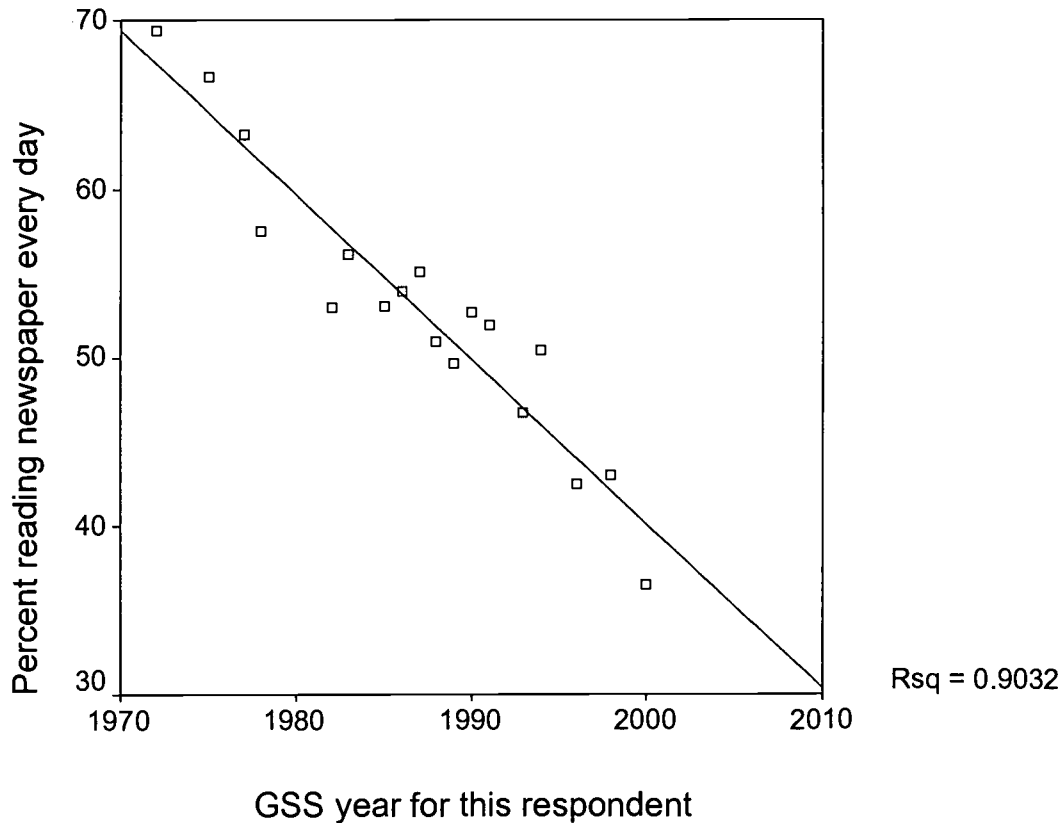


Figure 2: Percent who read a newspaper "every day" by year



However, it is imprudent to draw causal inferences from parallel changes across time. Both readership and confidence could be the result of some secular trend that affects everything in society. Textbooks abound with illustrations of spurious correlation over time, e.g., between liquor consumption and church attendance. (Both increase due to the growing population.)

To see if there is really a causal link between low confidence and low readership, we need an experimental design that holds time constant. Because the problem is too large for the laboratory, we need a natural experiment that can tell us whether confidence and readership covary within a limited time frame. This report describes such a natural experiment. It builds on work that others began as far back as 1985 when two major studies produced contrasting interpretations of the problem.

### Previous credibility research

The most alarming report came from Kristin McGrath of MORI Research, hired by the American Society of Newspaper Editors to do a national survey. “Three-fourths of all adults have some problem with the credibility of the media,” she wrote, “and they question newspapers just as much as they question television.”<sup>3</sup>

A contrasting report was issued early the following year by the Times Mirror newspaper after it hired The Gallup Organization to cover the same territory.

“If credibility means believability, there is no credibility crisis,” said this report, written by Andrew Kohut and Michael Robinson. “The vast majority of the citizenry thinks the major news organizations are believable.”<sup>4</sup>

Oddly, the data collected by the two organizations were not very different. Their varying question forms obscured close comparison, but 84% in the Times Mirror study gave a positive rating to their local daily newspaper on a scale where “4 means you can believe all or almost all of what they say, and 1 means you can believe almost nothing of what they say.”<sup>5</sup> The ASNE study used a 5-point scale, and 85% gave either a positive or neutral rating on accuracy of the newspaper with which they were the most familiar.

Another contribution to the conversation came in 1998 when Christine Urban, also working for ASNE, produced another report. Hers made no reference to the earlier work, but it did propose six major sources of low trust. Number one on the list: “The public sees too many factual errors and spelling or grammatical mistakes in newspapers.”

Two purely descriptive studies were published in 2001. News credibility was one of a very broad array of social indicators asked about in 1999 by the Knight Foundation which found that 67 percent believe “almost all or most” of what their local daily newspaper tells them.<sup>6</sup> A similar result was published at the same time by American Journalism Review, based on fieldwork in 2000 funded by the Ford Foundation. This study reported that 65 percent believe all or most of what they read in the local paper.

Designers of none of these studies made any effort to attain compatibility with previous work so that comparisons could be made over time. Still, American Journalism Review’s author declared, “newspapers seem to be rising in readers’ esteem.”<sup>7</sup>

Nor were any of the studies informed by any kind of theory that might help us understand how much credibility a newspaper needs, how much it costs to get it, and



whether the cost is worth it. As careful and detailed as they were, they generated little but description “waiting for a theory or a fire.”<sup>8</sup>

### **A proposed model**

Much of the variation in historical concern with the credibility problem may be based more on emotion than reality. The purpose of this inquiry is to find a more solid theoretical basis for assessing the problem. One untested theoretical assumption is that credibility has something to do with business success. It was expressed eloquently by a Knight Ridder executive a quarter century ago:

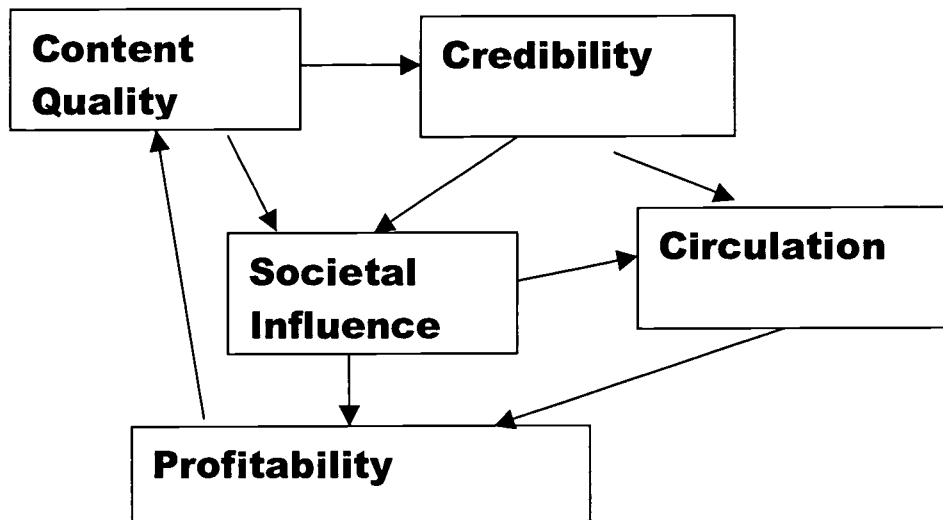
A newspaper's product is neither news nor information. We are in the influence business. We create two kinds of influence: societal influence (not for sale) and influence on the decision to buy (for sale). But they are related, because the former enhances the value of the latter.<sup>9</sup>

The appeal of the influence model is that it provides a business rationale for social responsibility. The way to achieve societal influence is to obtain public trust by becoming a reliable and high-quality information provider, which frequently involves investments of resources in news production and editorial output. The resulting higher quality justifies more public trust attributed to the newspaper and, not only larger readership and circulation, but influence with which advertisers will want their names associated.

Because trust is a scarce good, it could be a natural monopoly, as argued by Meyer.<sup>10</sup> Once a consumer finds a trusted supplier, there is an incentive to stay with that supplier rather than pay the cost in time and effort of evaluating a substitute.

It follows then that societal influence of a newspaper achieved from practicing quality journalism could be a prerequisite for financial success. Social responsibility in the democratic system supports, rather than impedes, the fulfillment of a newspaper's business objectives, through the channels of obtaining public trust and achieving societal influence, which then feeds back into further fulfillment of the public mission, thereby creating a virtuous cycle (see Figure 3).

Figure 3. Societal Influence Model for the Newspaper Industry



Reversing the argument, cutbacks in content quality will erode public trust, weaken societal influence, and eventually lead to losses in circulation and advertising dollars. But managers, under pressure from owners and investors, will do this anyway because reducing quality has a quick effect on revenue that is instantly visible while the costs of lost quality are distant and uncertain.

If those distant costs could be made more concrete and predictable, managers and investors might make different decisions. The purpose of this study is to reduce the uncertainty about the long-term cost of low credibility using individual communities as the level of analysis. Previous studies using communities have focused on editorial quality in general rather than specifically targeting credibility.

#### Community based studies

*The Washington Post's* coverage of the Pentagon Papers and the Watergate affair provided anecdotal evidence that good journalism could be profitable.<sup>11</sup> The success of *USA Today* proved that innovations in format and content could pay off in the form of circulation and advertising success.<sup>12</sup> Becker et al. studied 109 New England newspapers and found that circulation penetration (circulation divided by households) was related to news quality.<sup>13</sup> Stone et al. also reported positive correlation between newspaper quality

and circulation in a sample of 124 papers.<sup>14</sup> Using content analysis to judge quality, Lacey and Fico found that the level of newspaper quality in 1984 was positively related to circulation (with market size controlled) in 1985 for 106 daily newspapers.<sup>15</sup> Blankenburg examined quality-related variables such as staff size, number of news pages, and news-editorial budget in 149 newspapers, and found that these variables were highly correlated with circulation.<sup>16</sup> More recently, Lacey and Martin's case study of the Thompson papers found that they lost revenue and circulation during the 1980s when high profits goals were set.<sup>17</sup> Overall, most studies have found a positive relationship between quality and circulation. However, they are mostly dated and have not used direct measures of credibility as an indicator of quality. Today's pressing media environment calls for new empirical evidence, particularly in regard to the priorities newspaper industry has to take.

Our test of the model will be a very basic one: a search for a correlation between credibility and profitability. We need to be able to measure these two variables at the level of individual newspapers. Fortunately, a convenience sample is available.

### **The natural experiment**

The Knight Foundation keeps track of the 26 communities where John S. and James L. Knight operated newspapers in their lifetimes.<sup>18</sup> They range from large (Philadelphia and Detroit) to very small (Milledgeville, Ga., and Boca Raton, Fla.). This common history will make our findings less generalizable to the universe of all daily newspapers, but it carries an offsetting advantage. By removing some of the differences in corporate culture and history from the causal model, the choice of these communities reduces some possible sources of spuriousness. Like a laboratory experiment conducted at constant temperature, this inquiry holds aspects of corporate history and culture constant.

Our independent variable is credibility as measured in a social indicators study fielded in 1999 by the Knight Foundation.<sup>19</sup> The dependent variable is a little more complicated. We call it circulation robustness, and we measure it by comparing changes in newspaper household penetration as measured by the 1995 and 2000 county penetration reports of the Audit Bureau of Circulations (ABC). Penetration declined almost everywhere. We define penetration as robust when the 2000 figure is a high

proportion of the penetration in the 1995 report.<sup>20</sup> We eliminated two Knight communities where the survey geography was not defined by counties.<sup>21</sup>

This made it possible to match data from other sources, including the Audit Bureau of Circulations, in a clear and minimally ambiguous way.

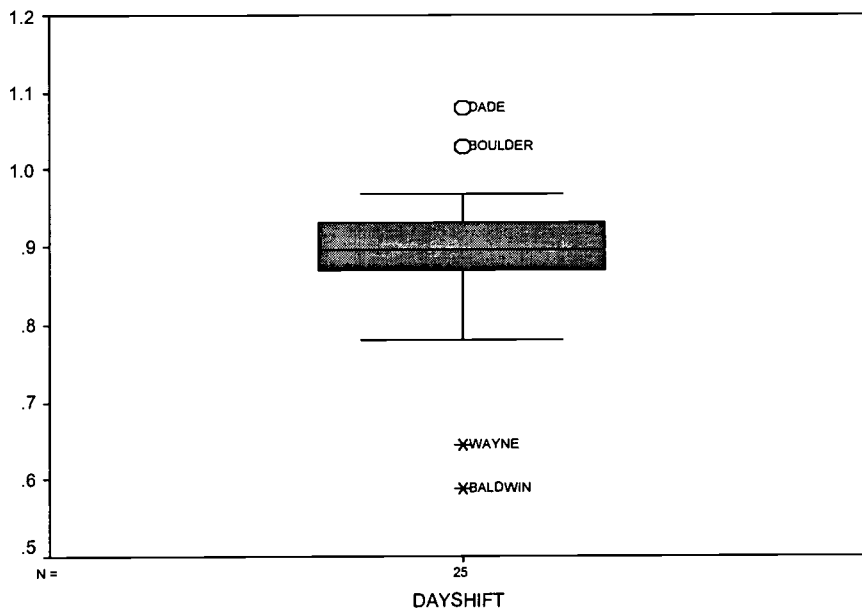
We are left with a sample of 24 markets. In two of them, Columbia, S.C., and south Florida, the Knight Foundation's historic relationship with the communities led it to define them by two counties rather than single counties. We have combined the data from other sources to match that design in the case of Richland and Lexington counties in South Carolina. In more heavily populated south Florida, we separated Dade and Broward counties and treated them as separate communities. Now we have 25.

Most of them have newspapers that are now, or have been, owned by Knight Ridder. Several have more than one strong newspaper. No attempt was made to isolate the effects of individual newspapers. These effects are self-weighting because circulation robustness is measured by the circulation of all ABC newspapers in each county, while the credibility question measures the paper with which respondent is "most familiar."

The percent who say they believe all or almost all of what they read in the paper ranges from 13 in Tallahassee to 30 in Grand Forks (mean = 21, S.D. = 3.9). Previous research has suggested that credibility, defined straightforwardly as believability, is a stable attribute.<sup>22</sup>

The same cannot be said for our dependent variable. It is based on circulation which can be subject to intense short-term fluctuations depending on local conditions.

Robustness, expressed by taking 2000 penetration as a proportion of 1995 penetration, ranged from .59 (Baldwin Co., Georgia) to 1.02 (Miami). The range was so vast in fact that a probe of the outliers was called for. Tukey's box plot makes the outliers visible. The box represents the interquartile range or middle 50%, and the outliers are cases more than 1.5 box lengths from the edge of the box (Figure 4).

**Figure 4. Tukey box plot showing outliers.**

Investigating each of the outliers in turn, we found:

**Dade County, Fla.** – *The Miami Herald's* explosive circulation boom was the result of an artifact, the unbundling of *El Nuevo Herald* from its mother ship. After the separation, ABC counted circulation of the Spanish language edition separately for the first time. We could think of no way to correct for this for a before-after comparison, and Dade County was dropped from the sample.<sup>23</sup>

**Boulder County, Colo.** – In the months before the creation of the joint agency by the owners of the *Denver Post* and the *Rocky Mountain News* in 2000, the two Denver newspapers were engaged in a bitter circulation war that saw the price of a newspaper drop to a penny per copy. This battle extended into neighboring Boulder County. While it cost the local paper circulation, total newspaper circulation in the county – the variable we are using to define penetration robustness – soared. Because of this extraneous cause, we dropped Boulder County.<sup>24</sup>

**Wayne County, Mich.** – Detroit, always a strong labor town, underwent a bitter newspaper strike that began in 1995 and led to many union members losing their jobs. In a display of sympathy and solidarity, enough working people in the home county stopped

buying the paper to cause a catastrophic circulation decline. We took Wayne County out of the sample.

**Baldwin County, Ga.** – The leading newspaper, the *Milledgeville Union-Recorder*, is not an ABC member. The precipitous loss of ABC circulation can be ascribed to the decision of the *Macon Telegraph* to close its Baldwin County bureau. Since our sample is defined by audited circulation, Baldwin County was removed from the sample.

That leaves 21 communities without obvious exogenous variables to mask the effect of credibility on circulation. Here's how we operationalized credibility.

The question in the Knight Foundation surveys was, "Please rate how much you think you can believe each of the following news organizations I describe. First, the local daily newspaper you are most familiar with. Would you say you believe almost all of what it says, most of what it says, only some, or almost nothing of what it says?"

We know from the previous reports of McGrath, Urban, and Stepp that two demographics, age and race, have a substantial impact on newspaper credibility. Blacks and older citizens are more suspicious of what they read in newspapers.

This difference is also found in the 1999 Knight data. In the total the sample, (N = 15,481), belief in the newspaper was negatively correlated with age ( $r = -.129$ ,  $p < .01$ ) and positively, although less importantly, with race treated as a binary variable where black = 1 ( $r = -.065$ ,  $p < .01$ ).

Because our counties differ in the proportions of blacks and older citizens, we chose to account for those effects before looking for the effect of credibility on penetration retention.

We leveled the playing field by running multiple regression with trust as the dependent variable and percent black and mean age – both from the survey data – as the independent variables. The unstandardized regression residuals represent each county's trust score with the effects of race and age filtered out (observed minus expected). For example, Grand Forks County's score of 7.8 means that the newspaper's credibility score was 7.8 percentage points above what the age and racial makeup of its citizens would have led us to predict.

Here are the counties with their credibility scores and 1995-2000 penetration robustness listed in order of their credibility.

County	Credibility (Adj.)	Robustness
Grand Forks ND	7.89	.96
Muscogee GA	4.83	.97
Broward FL	4.64	.87
Harrison MS	3.65	.90
Brown SD	2.17	.96
Lexington SC*	0.91	.84
St. Louis MN	0.58	.87
Centre PA	0.54	.84
Mecklenburg NC	0.44	.89
Manatee FL	0.23	.90
Philadelphia PA	0.06	.93
Bibb GA	-0.10	.91
Fayette KY	-0.68	.94
Allen IN	-1.04	.90
Horry SC	-1.13	.92
Ramsey MN	-1.72	.88
Palm Beach FL	-1.73	.88
Santa Clara CA	-1.84	.87
Summit OH	-4.71	.91
Sedgwick KS	-4.89	.84
Leon FL	-8.09	.78

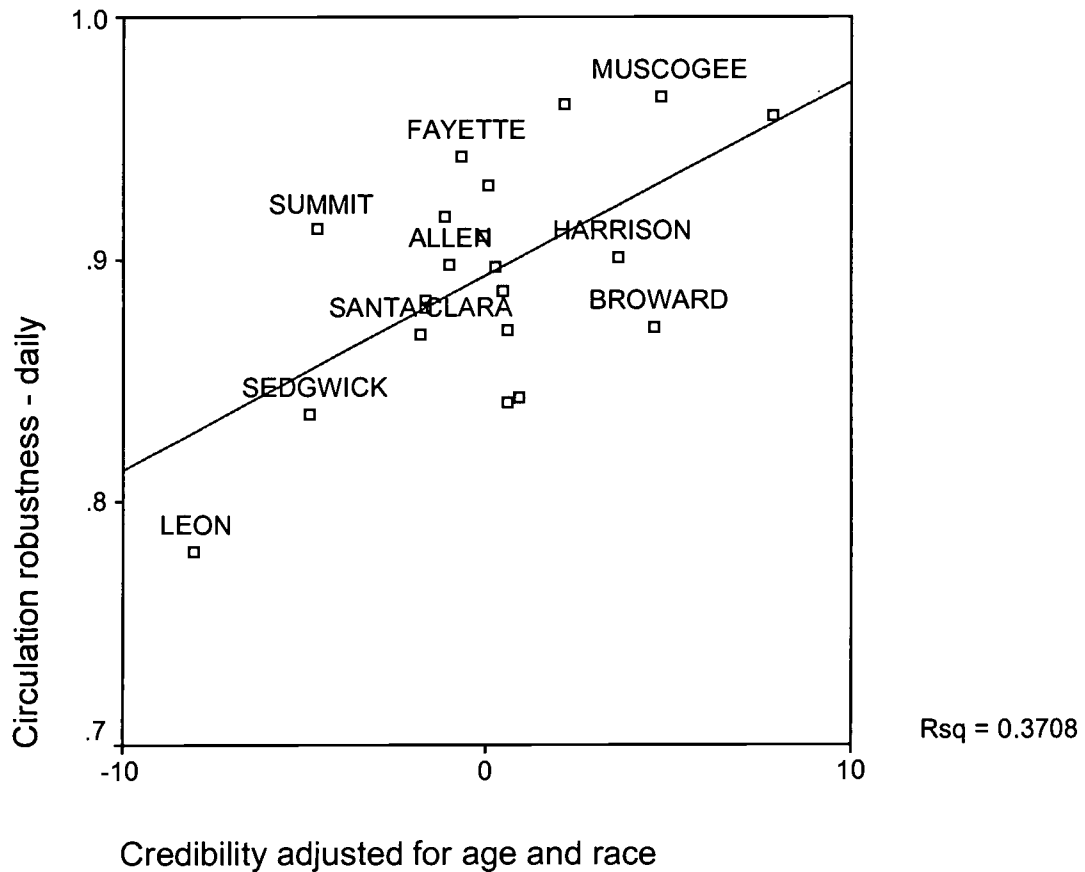
\*Includes Richland County

The correlation coefficient is .609, meaning that the credibility of a county's newspapers explains 37 percent of the robustness in their combined daily penetration.

The probability that this relationship is due to chance is less than one half of 1 percent ( $p = .003$ ).

When the robustness of Sunday circulation is used as the dependent variable, 38 percent of the variance is explained ( $r = .613$ ,  $p = .003$ ). The first link in the model in Figure 3 is established. Credibility is related to circulation. The relationship is clearer if we look at the scatter plot (Figure 5).

**Figure 5: Circulation robustness by credibility**





We now have the first quantitative measure of the benefit of credibility. The slope of the regression line is .008, meaning that circulation robustness -- the ability of a county's newspapers to hold their collective circulation in the face of all of the pressures degrading it -- increases by .8 of a percentage point for each 1 percent increase in credibility. And the finding is robust. When credibility is left unadjusted for age and race, the correlation is diminished only slightly and remains statistically significant.<sup>25</sup>

Correlation, of course, neither proves causation, nor establishes its direction. While it can be taken as evidence in support of the model in Figure 3, it does not tell us whether it is a picture of a virtuous cycle or a vicious cycle.

Stepp, who has the advantage of holding the most recent credibility data, argues that the news is good, that the public's faith in newspapers is improving. He bases this on weak evidence: one question in one survey in which respondents are asked to compare their present attitude with their remembered attitudes from the past. He is supported by an uptick in the NORC 2000 data -- from 58 percent who have a great deal or some confidence in the press, compared to 55 percent two years earlier. But the difference is within the range of measurement error. More data points are needed to overcome the gloomier picture painted by NORC's 30-year trend line on readership and confidence in the press.

### **Further research**

We need more thorough testing of the model. While the link between credibility and robustness of circulation may deserve the priority we gave it, there is also a strong need to test the link between content and credibility. The demonstrated value of credibility should motivate us to find how credibility can be created through content -- or whether content makes a difference at all.

An obvious variable to investigate is accuracy in reporting. Urban's 1999 study provided cross-section evidence at the level of the individual reader. But it is almost a tautology that people who perceive errors in the paper are less likely to believe it. To make Urban's finding convincing, we need evidence at the community level. Is a newspaper that is objectively more accurate also more believed? A replication of Mitchell Charnley's path-breaking accuracy study in each of the markets where trust is also measured could give us stronger evidence.<sup>26</sup>

Beyond content, the history of a newspaper's relationship with its community should be considered. David Loomis, looking at the same data we are using, noticed a striking difference in credibility between two similar southern newspaper markets, Columbus, Ga., and Tallahassee, Fla., and did some first-hand investigating in both communities.<sup>27</sup>

He found that the leading papers in the two towns had quite different histories from the civil rights movement. The paper in Tallahassee, before its acquisition by the Knights in 1965 was a die-hard supporter of segregation. The paper in Columbus took a mediating role in the community, and today Columbus is one of the few places where newspaper credibility is as high among blacks as whites. Perhaps no ordinary amount of content manipulation can overcome history.

Efforts are also needed to measure a newspaper's societal influence and its effect on both credibility and profitability. McGrath's study for ASNE led to some secondary analysis that suggested that credibility has a community affiliation dimension that interacts with simple believability.<sup>28</sup> Despite the intriguing opportunity this information offered for a theoretical basis for civic journalism, we know of no attempts to replicate or build upon that finding. However, an opportunity exists in both the Knight Foundation data and another recent set of community benchmark surveys organized by Robert Putnam for his Saguaro Seminar.<sup>29</sup> Both measure community involvement as well as trust in media. However, the Putnam survey asked about trust in media generally, rather than newspapers specifically as the Knight Foundation did.<sup>30</sup>

Because our model attempts to describe a string of causal relationships, time series studies are needed to clarify and validate it. Fortunately, the Knight Foundation has designed its community surveys for periodic measurement, and the second in the series entered the field in 2002.

We regret not starting this work years ago. The decline of newspapers is not likely to be halted or reversed until investors can see a measurable benefit from a newspaper's community influence, its social responsibility. Without such measurements, owners and managers will continue to regard quality as mere cost, and the self-reinforcing loop of the death spiral will continue.

- <sup>1</sup> Reinforcing processes are examined from a systems theory perspective by Peter M. Senge in *The Fifth Discipline: the Art & Practice of the Learning Organization*, Currency Doubleday, 1990. p. 81.
- <sup>2</sup> NORC first asked the newspaper readership question in 1967 as part of Sidney Verba and Norman Nie's Participation in America study. It became part of the General Social Survey in 1972,
- <sup>3</sup> *Newspaper Credibility: Building Reader Trust, a National Study Commissioned by the American Society of Newspaper Editors*. MORI Research, Inc., Minneapolis, April 1985.
- <sup>4</sup> *The People & the Press: A Times Mirror Investigation of Public Attitudes Toward the News Media Conducted by The Gallup Organization*. Times Mirror, January 1986.
- <sup>5</sup> *The People & the Press*, p. 20
- <sup>6</sup> *Listening and Learning: Community Indicator Profiles of the Knight Foundation Communities and the Nation*, Miami: Knight Foundation, 2001.
- <sup>7</sup> Carl Sessions Stepp, "Positive Reviews," *American Journalism Review*, March 2001, p. 58.
- <sup>8</sup> This phenomenon is not confined to media businesses. Ronald Coase, in a critique of early institutional studies in business administration, said, "Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory or a fire." Quoted by Oliver E. Williamson in Giovanni Dosi, Davide J. Teece and Josef Chytril, Eds., *Technology, Organization and Competitiveness: Perspectives on Industrial and Corporate Change*, Oxford University Press, 1998.
- <sup>9</sup> Hal Jurgensmeyer (1931-1995) in a conversation with the first author, Miami, Fla., 1978.
- <sup>10</sup> Philip Meyer, "Learning to Love Lower Profits," *American Journalism Review*, December, 1995.
- <sup>11</sup> Nancy H. Maynard, "Can Media Economics Match Its Aspirations?" *Nieman Reports*, 49 (2), 1995. p35-37.
- <sup>12</sup> John Morton, "Short Term Losses, Long Term Profits," *American Journalism Review*, 19 (7) 1997.
- <sup>13</sup> Lee B. Becker, Randy Beam, and John Russial, "Correlates of Daily Newspaper Performance in New England," *Journalism Quarterly*, Spring 1978, p100-108.
- <sup>14</sup> Gerald C. Stone, Donna B. Stone, and Edgar P. Trotter, "Newspaper Quality's Relation to Circulation," *Newspaper Research Journal*, Spring 1981, 16-24.
- <sup>15</sup> Stephen Lacy and Frederick Fico (1991), "The Link Between Newspaper Content Quality and Circulation," *Newspaper Research Journal*, Spring, p46-57.
- <sup>16</sup> William B. Blankenburg (1989), "Newspaper Scale and Newspaper Expenditures," *Newspaper Research Journal*, Winter, p97-103.
- <sup>17</sup> Stephen Lacey and Hugh J. Martin (1998), "Profits Up, Circulation Down for Thompson Papers in 80s," *Newspaper Research Journal*, Summer, p 70-76.
- <sup>18</sup> The John S. and James L. Knight Foundation promotes excellence in journalism worldwide and invests in the vitality of 26 U.S. communities where the communications company founded by the Knight brothers published newspapers. The Foundation is wholly separate from and independent of those newspapers.
- <sup>19</sup> *Listening and Learning*
- <sup>20</sup> Periods covered by these reports varied, but the audits generally fell in the year preceding the report.
- <sup>21</sup> Long Beach, California, and Gary, Indiana.
- <sup>22</sup> Philip Meyer, "Defining and Measuring Credibility of Newspapers: Developing an Index," *Journalism Quarterly*, 65:3 (Fall 1988) 567-575.
- <sup>23</sup> We appreciate the help of Armando Boniche, research manager of The Miami Herald, in sharing this history.
- <sup>24</sup> Barrie Hartman, former executive editor of the Boulder Daily Camera provided this background.
- <sup>25</sup> When credibility without the controls for age and race is the dependent variable, the variance explained is 35% and 30%, respectively, for daily and Sunday circulation robustness.
- <sup>26</sup> Mitchell Charnley, "Preliminary Notes on a Study of Newspaper Accuracy," *Journalism Quarterly*, 13:4 (December 1936), pp. 394-401.
- <sup>27</sup> David O. Loomis, *Tale of Two Cities: Connections Between Community, Corporate Culture, and Civic Journalism*, PhD dissertation, University of North Carolina at Chapel Hill, 2002.

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<sup>28</sup> Meyer, "Defining and Measuring Credibility of Newspapers." See also Mark Douglas West, "Validating a Scale for the Measurement of Credibility: A Covariance Structure Modeling Approach." *Journalism Quarterly* 71:1, Spring 1994, pp 159-168.

<sup>29</sup> Putnam's codebook was available in February 2002 at [www.cfsv.org/communitysurvey/docs/survey\\_instrument.pdf](http://www.cfsv.org/communitysurvey/docs/survey_instrument.pdf)

<sup>30</sup> We checked credibility as measured by Putnam against penetration robustness and found no correlation. When respondents are asked about "media," we suspect that they tend to answer in terms of television rather than newspapers.

A Case-Study Analysis of Divestiture Determinants  
& Strategies  
Of Major Media Firms,  
1996-2000

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### **Abstract**

The Telecommunications Act of 1996 has stimulated media firms to restructure their operations, relative to new opportunities. The deregulatory law has led firms to engage in extensive mergers and acquisitions. Nevertheless, media firms also have divested numerous operations. The goal of this exploratory research paper, therefore, is to ascertain what have been the divestiture strategies – and divestiture determinants – of major media firms since the Telecommunications Act of 1996. Divestiture strategies and motivations are reviewed and applied to recent media divestiture activity.

Media restructuring has accelerated since the Telecommunications Act of 1996 became law. Media firms have scurried to merge with – and acquire – one another, in hopes of capitalizing on the current deregulatory scheme. Time Warner and Turner Broadcasting System merged within the year. Walt Disney bought ABC. CBS merged into Viacom. Even several Baby Bells joined forces: Bell Atlantic and Nynex merged to create a new wireless organization in 1997. Two other Baby Bells, SBC Communications and Ameritech, completed their merger in 1999. Most recently, America Online has merged its new media operations with those of Time Warner's more traditional media.

Researchers (see Albarran, 2001; Chan-Olmsted, 1998; Gershon, 1999; Li, 2000; Tseng and Litman, 1998; Waterman, 2000) also have rushed to investigate the acquisition patterns and strategies of major media firms. The other side of restructuring, however, has been overlooked. Indeed, acquisition strategies only paint a partial picture of corporate-level strategy. No single company can continue to grow and acquire other businesses without the growth becoming of detriment to the overall success of the firm (Hitt, Ireland, and Hoskisson, 2000). In addition, no single firm has enough capital to successfully pursue such endeavors. Hence, firms restructure. Restructuring encompasses a change in the business or financial structure of a firm (Hitt et al., 2000). Vignola (1974) maintains, "A company lives by expanding and contracting, by growing and changing, by acquiring and divesting. These are the actions of a healthy, vital company, not a sick, dying company" (p. 8). Hence, both acquisitions and divestitures are vital components of the life cycle of a firm, in which it undergoes changes that are vital to its survival.

Perhaps the dearth of divestiture research is due to a belief that divestitures are merely reverse acquisitions and that the factors that play into acquisitions also relate to divestitures (Taylor, 1988). But divestitures are not merely reverse acquisitions. First, divestitures are not necessarily of acquired assets. Some divestitures can entail assets that were originated in-

house, not acquired. Moreover, as Taylor asserts, divestitures operate in a completely different milieu than do acquisitions. Divestitures “require different approaches, different kinds of information, different methods of analysis, and different management practices” (p. 8).

Nevertheless, divestitures have great implications for firms. First, divestitures influence and reveal the corporate-level strategy of a firm. Specifically, divestiture strategies determine the businesses in which the firm competes and how those businesses are managed. Moreover, divestitures affect the firm’s choice of business-level strategy and the firm’s position in the industry in which it competes. Divestitures isolate potential competitors and aid firms in determining how they will allocate resources to gain competitive advantage and above-average returns.

Media divestiture strategies are especially important to investigate. In 1992, the media industry was in the top ten most active divesting industries (“Divestiture Activity in 1992,” 1993, online). In 1999, the media industry stood as the sixth most active divesting industry, with 90 divestitures (“Divestiture Activity in 1999,” 2000, online). Currently, the media industry is in a state of transition, spurred by the deregulatory provisions of the Telecommunications Act of 1996 and the transition into a digital environment. As firms reorganize and reformulate corporate-level strategies, it is even more important to determine which businesses will allow a media firm to productively use its resources, capabilities, and core competencies to achieve competitive advantage in the new deregulatory and digital landscape. As companies restructure and firms adjust to new opportunities and threats, media firms will have to find their niche and place in the new environment. Chakravarthy refers to such strategies as flexible commitments, namely engaging in a “paradoxical blend of early commitments (so vital for competitive success) and timely exits (crucial for managing risks)” (1997, Introduction section – online). The goal of this exploratory research paper, therefore, is to ascertain what have been the divestiture strategies – and divestiture determinants – of major media firms since the Telecommunications Act of 1996.



Section I begins with an overview of the divestiture concept. Here, the relevant divestiture literature is reviewed. This section also defines divestiture and traces divestiture activity in general. Section II focuses on specific divestiture strategies. The divestiture strategies are categorized along several dimensions and explained. Section III follows with an overview of divestiture determinants, or motivations. Previous divestiture research reveals traditional motivations for engaging in divestitures. Section IV provides the methodology for this study and sets the stage for Section V, the case study analysis of eight major media firms. Section VI provides an overall discussion of divestiture activity among the major media firms.

### **Divestiture**

Various scholars have rendered definitions of divestiture. In its simplest terms, divestiture is the sale of a part of oneself (Coyne & Wright, 1986; Gaughan, 1999). However, others have ventured further, asserting that divestiture goes beyond selling a part of oneself. It also entails a termination of managerial and ownership control (Bing, 1978; Thomas, 1986). While all of these definitions are accurate descriptions of the essence of divestiture, it is imperative to note that divestiture need not consist merely of a *sale* of assets. The Bloomberg Financial Glossary defines divestiture as “a complete asset or investment disposal” (Divestiture, online). The main idea is that of dispossession, which does not limit divestiture to sale of property. Hence, even downsizing can be considered divestiture. Through downsizing, a firm eliminates – or dispossesses itself – of positions or jobs. Hence, any disposal of a part of a company may be considered a divestiture. It is a shedding of property, and that property may consist of any number of things, from businesses, products, facilities, and employees. (Buckley, 1991; Cascio, 1998; Cumming & Mallie, 1999; Vignola, 1974).

This dispossession of property is not a new phenomenon. As early as the 1950s, divestiture of business property was evident. At that point, the yearly divestiture rate had not reached the 100 mark. But by the mid-1960s, divestitures had risen to 150 per year. Between 1964 and 1971, yearly divestitures nearly tripled (Vignola, 1974). Nevertheless, firms

aggressively continued to acquire property, and the 1960s came to be known as the “Age of the Conglomerate.” A decade later, however, the value of conglomerate firms began to decrease. Firms then began to divest, and the 1970s soon was known as the “Decade of the Divestiture” (Buckley, 1991; Taylor, 1988). The 1970s was marked by a reconsideration of these expansion strategies. Changes in tax laws and regulation, in addition to the 1974 – 75 recession put a halt to the acquisition strategies of the 1960s. Firms began to divest themselves of property to increase cash flow and to raise funds. This trend has continued since the 1970s and is sometimes referred to as “deconglomeration”<sup>1</sup> (Gaughan, 1999; Taylor, 1988).

By 1993, 45.6 percent of all business transactions in 1992 were divestitures. These divestitures accounted for \$57.2 billion (Divestiture Activity in 1992). By 1999, divestiture activity had dropped to 29.4 of all business transactions, but their overall value was \$265.7 billion (Divestiture Activity in 1999). Divestitures have become the “new organizational reality,” whereby firms feel the need to change to survive. This new reality proposes a “growing by divesting,” whereby firms engage in “judicious business deletion and resource allocation” (Varadarajan, Jayachandran, & White, 2001, para. 5 - online).

### **Divestiture Strategies**

Divestiture encompasses a wide range of activities. Each divestiture strategy has unique characteristics, which can be developed into a typology of sorts. This typology of divestitures revolves around several elements: restructuring type, divestiture level, divestiture degree/grade, divestiture medium and consideration, tax status, and post-divestiture ownership status.<sup>2</sup> Each divestiture strategy lies along a continuum within these categories. Table 1 displays the divestiture strategies.

#### **Portfolio Restructuring**

Bowman, Singh, Useem, and Bhadury (1999) classified restructuring strategies into three groups: portfolio, financial, and organizational. Portfolio restructuring entails a change in a

firm's assets or operating businesses. Relative to divestiture strategies, then, portfolio restructuring includes strategies such as sell-offs, spin-offs, equity carve-outs, split-offs, and split-ups. Hitt et al. classify these downscoping strategies as those that tend to eliminate a firm's unrelated businesses, causing it to refocus.

Sell-off. The most common form of a divestiture is a sell-off (Cumming & Mallie, 1999; Gaughan, 1999). Hence, it also is the easiest and most straightforward divestiture strategy (Schmidt, 1990). Sell-offs consist of a sale of any part of a firm's property to an outside party. The level of divestiture in a sell-off can range from an asset to a product (Taylor, 1988) to a business unit (Coyne & Wright, 1986) to a division or subsidiary (Buckley, 1991; Gaughan, 1999; Schmidt, 1990; Taylor, 1988). A firm also may structure a divestiture as a sell-off by selling its stock or investment interest (Cumming & Mallie, 1999; Vignola, 1974). Most often, the sell-off is a discrete activity or a single transaction (Gaughan, 1999) and is a partial divestiture. That is, the parent firm usually does not sell all of its property (Buckley, 1991).

The consideration in a sell-off is usually cash (Schmidt, 1990). However, an exchange of assets also is considered a sell-off. Exchanges, however, are more complicated because of valuation issues. Nevertheless, the main advantage of a sell-off is the liquidity of the transaction. "The seller gains a liquid or near-liquid asset in exchange for primarily nonliquid, possibly loss-producing assets" (Schmidt, 1990, p. 144). In sell-offs, then, the firm has a "cash infusion" (Gaughan, 1999, p. 398), but the transaction is taxable (Cumming & Mallie, 1999).

Because the parent firm transfers its property to another entity, the sell-off is a permanent and severing transaction (Coyne & Wright, 1986). The parent firm has no ties to the divested unit; management and ownership are transferred to another firm (Steiner, 1997). Hence, a company wanting to sever relationships with a particular asset or business operation may achieve the desired results via a sell-off. In 1999, for example, multiple cable system operator Comcast Corporation severed all relationships to its cellular operations by selling the

division to telecommunications service provider SBC Communications for \$400 million (Comcast Corporation, 10-K Annual Report, 1999).

Spin-off. Spin-offs are slightly more complicated than sell-offs but are rising in popularity (Gaughan, 1999; Schmidt, 1990). Here, the parent firm takes a subsidiary or division and makes it into a freestanding legal entity. It then transfers ownership of the division to its shareholders on a pro rata basis. Spin-offs tend to be discrete, single transactions and are partial divestitures.<sup>3</sup> The divestiture medium in a spin-off is a distribution of stock in the form of a dividend; hence, unlike sell-offs, "spin-offs do not result in initial changes in parent company cash flows" (Gaughan, 1999, p. 423). Although the spun-off entity is a legal entity in its own right, it retains the same ownership as the parent firm because the new shares were distributed on a pro rata basis.

Unlike sell-offs, spin-offs can be tax-free. Although the Internal Revenue Service (IRS) classifies spin-offs as a dividend, it also establishes five criteria by which a spin-off can be nontaxable (Cumming & Mallie, 1999; Miles & Woolridge, 1999). Essentially, spin-offs maintain ownership interest in a firm's divested entity, but management and control of the entity remain with the entity itself. The divested unit is quasi-independent (Coyne, 1986; Coyne & Wright, 1986; Cumming & Mallie, 1999; Gaughan, 1999; Miles & Woolridge, 1999; Schmidt, 1990). Hence, a company that wants to maintain ownership in an entity but free up its managerial control may opt for a spin-off strategy.

Equity carve-out. An equity carve-out (ECO) is a variant of the spin-off. The parent firm establishes an independent entity and sells "equity in a subsidiary to the public in the form of an initial public offering (IPO)" (Miles & Woolridge, 1999, p. 1). Although the ECO is a discrete transaction, the parent may later spin-off the remaining shares to its existing shareholders (Carve-out, online). This type of divestiture results in a cash infusion advantage to the parent firm (Gaughan, 1999; Miles & Woolridge, 1999). Post-divestiture, the parent firm retains a significant majority interest. In fact, there are "significant tax advantages to retaining at least 80

percent control” (Miles & Woolridge, p. 37). Hence, a firm that needs a cash infusion but wants to retain some ownership in a business operation may opt for an ECO. In 1998, for example, The News Corporation established the Fox Entertainment Group, which holds the company’s American television, cable, film and sports-related businesses. It sold 18.6 percent of its interest in the new entity in an IPO, retaining more than 80 percent ownership and using the proceeds for general corporate purposes, including reducing its debt (Fox Entertainment Group Raises \$2.8 Billion Largest Ever Media IPO, 1998).

Split-off. The split-off grows in divestiture complexity and adds to the spin-off strategy. The parent firm issues new stock in a subsidiary in exchange for the shareholders’ stock in the parent company. The parent firm essentially repurchases its outstanding shares in exchange for transferring ownership in a division to the parent shareholders. (Cumming & Mallie, 1999; Gaughan, 1999). The transaction is tax-free if the firm meets the five tax requirements for a spin-off (Cumming & Mallie, 1999). Although the owners of the split-off subsidiary are the same as in the parent company, the split-off entity has no ties to the parent firm. Hence, a firm that wants to redeem some of its outstanding shares while severing ties to a business operation may opt for a split-off. Media giant Viacom reduced 4.1 percent of its outstanding common shares in 1996, for example, with the split-off of its cable operations (Viacom, 10-K Annual Report, 1996).

Split-up. A split-up strategy is a series of transactions and results in a total divestiture of a firm. Hence, the divestiture level of a split-up strategy is the entire firm via its subsidiaries. The parent firm distributes shares in two or more of its subsidiaries and requires an exchange of its outstanding common shares for the shares of its subsidiary(ies). The end-result is that the parent firm no longer exists. All of its operating divisions have been spun-off (Cumming & Mallie, 1999; Gaughan, 1999). The proceeds from the sell-offs or spin-offs “are returned to the creditors and shareholders as a liquidating distribution” (Buckley, 1991). The split-up can be tax-free if the parent company meets specific criteria established under Section 355 of the Taxpayer Relief Act of 1997 (Company split-up, 1997).

### Financial Restructuring

Leveraged buyout. The relevant divestiture strategy that entails a major restructuring of finances is the leveraged buyout (LBO). In financial restructuring, the parent firm undergoes a drastic change in its capital structure (Bowman et al., 1999). The divestiture level of a leveraged buyout is either at the subsidiary level or at the whole firm level. Nevertheless, the LBO is usually a discrete transaction. However, it may become a partial divestiture or a total divestiture. In a partial LBO, a subsidiary is sold to a party who then takes the entity private. If the LBO is structured as a total divestiture, in which the entire firm is taken private, it is considered a whole-firm buyout (Hitt et al., 2001). The consideration in an LBO is the entire ownership interests (stock) of the entity. Tax implications vary, but Newbould, Chatfield, and Anderson (1992) claim "there is a payment of capital gains taxes levied at the target level" (Tax background section, online).

An LBO need not be to an outside party. When shareholders sell their interests in a division to the management of that division, a management buyout (MBO) occurs. And when shareholders sell their interests to employees of the division or the firm itself, an employee buyout (EBO) occurs. This is most often done via an employee stock ownership plan (ESOP) through the employees' pension fund (Hitt et al., 2001; Bing 1978). In all instances, however, ownership changes hands, and the entity is privatized.

### Organizational Restructuring

Downsizing. The organizational restructuring strategy relevant to divestiture is downsizing. The divestiture level in downsizing is the employee or human asset and involves elimination of said asset. Downsizing may be a discrete activity, or it may be series-oriented. That is, downsizing may be a one-time occurrence, or it may be part of a significant restructuring strategy. Nevertheless, downsizing remains a partial divestiture strategy in which some, not all, of the human capital, is eliminated. Despite contractual obligations and severance packages, the parent company ultimately has no ties to the former employees. Tax

implications, however, vary. “The tax provisions typically brought into play by reassignments and terminations are as follows: [t]emporary versus indefinite assignments, [m]oving expenses, [o]ther employer-provided relocation assistance, [r]elocation and bridge loans, [o]utplacement services, [s]everance pay, and [d]istributions from employee benefit plans” (L. Knight & R. Knight, 1996, p. 34). America Online, for example, incurred substantial contract termination payments in its downsizing of 400 and 850 employees in 1998 and 1999, respectively (America Online, Annual Report to Shareholders, 2000).

Based on the aforementioned strategies, then, the following research question is raised:

RQ1: What are the divestiture strategies of major media firms?

The major media firms in this study may engage in most previously mentioned divestiture strategies. As these firms work quickly to establish their position in the new deregulated and digital environment, it is likely that the sell-off strategy may be the most expeditious way for these media firms to dispossess themselves of operations or investments. These major media firms are the industry leaders, hence, it is unlikely that they will be the objects of leveraged buyout strategies in which poor-performing companies are bought and taken private. Further, as the media industry continues its conglomeration and merger trends, the downsizing strategy also is a possible strategy to reorganize and restructure operations.

### **Divestiture Determinants**

Before the company executes the divestiture, it must arrive at the divestiture decision. Based on the available literature, divestiture determinants can be categorized along four external dimensions: compulsory, technological, economic, and sociocultural; and three internal dimensions: financial, strategic, and avoidance. Figure 1 highlights the divestiture determinants. The large circle represents the company. The smaller concentric circle represents the asset in question. The arrows within the company – and extending into the asset – represent internal determinants that can arise either from the business level or from the corporate level. Similarly,

the arrows outside of the company represent external divestiture determinants. The curved arrows represent the dynamic nature of all the forces, possibly working with each other to influence the divestiture decision.

### External Determinants

External determinants are those that arise from the firm's external environment. These include compulsory, technological, economic, and sociocultural forces.

Compulsory. Compulsory divestitures are forced divestitures. The firm does not originate the idea of selling an asset. Instead, the government – usually the Department of Justice (DOJ) and/or Federal Trade Commission (FTC) – decrees the sale of a firm's assets (Schmidt, 1990). This is usually done in the context of antitrust policy (Bing, 1978, Kaplan & Weisbach, 1992; O'Brien, 1986; Vignola, 1974). In such situations, the government believes a firm has a high degree of market power and can engage in anti-competitive behavior either to form a monopoly or substantially to lessen competition (Barkow & Huber, 2000). The government can force the firm to sell a subsidiary, or it can force the company to break up. The 1984 divestiture of AT&T is the landmark illustration of a compulsory, government-decreed split-up.

Compulsory divestitures also can proceed from regulatory agencies. Regulatory agencies – such as the Federal Communications Commission (FCC) – have the authority to require a firm to divest its assets. In addition to relying on the DOJ's competitive analysis, the FCC also utilizes a public interest guideline by which to judge potential mergers and acquisitions. Regulatory rulings, therefore, can decree divestitures (Gaughan, 1999; Paulson & Huber, 2001). In the case of the FCC and the media industry, the Telecommunications Act of 1996 was indeed a deregulatory law; however, regulations are still in effect that constrain the degree to which media firms can merge and acquire other media firms. The seller's objective, as a result of a compulsory divestiture decree, is "to comply with authorities by divesting, but at a convenient time and for an attractive price" (Bing, 1978, p. 4). Clear Channel complied with



government directives in its merger with Jacor Communications in 1999 by selling 12 radio stations in three markets for \$205.8 million. The FCC forced Clear Channel to divest again in 2000 in relation to the merger with AMFM: Clear Channel sold 39 radio stations for \$1.2 billion (Clear Channel, 10-K Annual Report, 2000).

Technological. Technological advancements also may serve as determinants for divestitures. The company may have to adjust to new technology (Burke & Nelson, 1998); its technological operations may not be competitive, as a result of technological advancements (Vignola, 1974). Burke and Nelson reveal that a company may choose to divest to accommodate for product, technological, or plant obsolescence. Vignola found that 15% of several hundred surveyed firms chose to divest because of constraints in operations (1974). Any number of product-market issues may influence a company to divest assets (Coyne & Wright, 1986). But Paulson and Huber maintain that the decision to divest because of technological changes varies, "depending on its [firm's] position with respect to the technological changes in effect" (2001, p. 19).

Economic. Economic determinants for divestiture include tax implications, analyst and stakeholder influence, market fluctuations, and investee restructuring. As previously mentioned, divestiture strategies can be classified according to their tax status. Hence, tax implications also serve as a determinant for choosing divestitures. The firm may structure the divestiture so that the tax effects are large. For example, structuring the divestiture as a sell-off yields minimal tax advantages; whereas, structuring the divestiture as a spin-off may yield large tax advantages (Cumming & Mallie, 1999). Essentially, the firm can structure the divestiture in a number of ways "to minimize tax payments to the government" (Miles & Woolridge, 1999, p. 11). Multiple system operator Cox Communications, for example, sold its Central Ohio cable television system in 1997 for a gain of \$26.4 million. "For tax purposes, Cox accounted for the disposition as a like-kind exchange. Tax rules allow Cox to defer a substantial portion of the

related tax gain on this transaction upon the reinvestment of the net proceeds in qualifying future acquisitions” (Cox Communications, 10-K Annual Report, 1997, p. 36).

Firms also may engage in divestitures because of external pressure, be it from analysts or from stakeholders. Hitt et al. suggest firms restructure to “gain the support of financial analysts” (p. 298). Firms also may experience pressure from stakeholders to divest non-core assets (Miles & Woolridge, 1999). Doing so should “release internal values that are unrealized in the company’s stock price” (Gaughan, 1999, p. 408) and allow “greater access to capital markets. The combined corporate structure may be more difficult for investors to categorize” (Gaughan, 1999, p. 403). In a 1998 press release, The News Corporation revealed an objective underlying the ECO of its Fox Entertainment Group: to “enable the investment community to better value the various entertainment assets and businesses” that the company owns (News Corporation Announces Plans, 1998, online). The ECO would allow investors to assess the performance of the company’s sole entertainment assets. Beyond investors, creditors also may pressure firms to divest assets (Taylor, 1988).

Firms also may divest assets in response to market fluctuations. Research (Hitt et al., 2001) shows that the economy in which a firm operates affects firm and industry performance. If an industry is in a downturn, the individual firms will be forced to restructure to accommodate. Such was the case for The Walt Disney Company in 1998, when it downsized and closed certain Asian operations, in response to the Asian economic crisis (Walt Disney Company, 10-K Annual Report, 1998). Similarly, investee restructuring may play a role in the divestiture decision. That is, changes in an affiliated company may also influence the actions of the parent firm. Hitt et al. refer to this notion as mutual interdependence: “strategic competitiveness and above-average returns result only when companies recognize that their strategies are not implemented in isolation from their competitors’ [or investee’s] actions and responses” (2001, p. 191). Hence, an investee that undergoes restructuring efforts may influence divestiture decisions of the investor. Radio giant Clear Channel Communications transferred its investment

in American Tower Corporation, for example, when the investee merged with another entity, American Tower Systems, in 1998 (Clear Channel, 10-K Annual Report, 1998).

Sociocultural. Sociocultural determinants of divestitures reflect the overall climate in which firms operate. Varadarajan et al. (2001) reveal that the influence of the external sociocultural climate has gained strength. “A decline in the perceived legitimacy of conglomerate structure [has] influenced the divestiture behavior of conglomerate firms” (Drivers of Deconglomeration section, para. 1 – online). The 1970s saw such a shift in the sociocultural climate. Whereas, the 1960s saw a wave of mergers and conglomeration, by the 1970s, the conglomerate mentality had devalued.

This sociocultural determinant may play an important part for those companies that operate globally, such as major media firms. The sociocultural environment of the home country may not be equivalent to the sociocultural environment of the target country (Hitt et al., 2001). This may serve as a major determinant to divest if the company does not know how to manage and adapt to such sociocultural climates.

### Internal Determinants

Internal determinants are those that arise from within the firm. These include financial, strategic fitness, and avoidance.

Financial. Internal financial determinants arise from either the business-level or the corporate level. The firm may be losing money at the corporate level (Burke & Nelson, 1998; Steiner, 1997). The firm may be under financial duress or in a state of financial emergency and needs to sell valuable assets to adequately continue operating (Gaughan, 1999; Ravenscraft & Scherer, 1987). At the business-level, the subsidiary might be performing poorly (Gaughan, 1999; Schmidt, 1990; Taylor, 1988; Steiner, 1997). Twenty-six percent of several hundred surveyed firms in Vignola’s study (1974) cited poor performance of a business unit.

Other financial determinants include a desire to cut costs (Burke & Nelson, 1998). Downsizing often is used for this reason: “the firm expects improved profitability from cost

reductions and more efficient operations" (Hitt et al., 2000, p. 298). Similarly, a firm may choose to divest to reduce its debt (Gaughan, 1999; Schmidt, 1990; Steiner, 1997). Taylor found that a firm uses divestitures to pay for debt incurred in previous acquisition or growth strategies. Kaplan and Weisbach found that firms claimed to have used divestitures to finance other acquisitions; likewise, Paulson and Huber (2001) maintain the parent firm can fund other operations with the money the firm receives from a sell-off. Sometimes, however, the firm simply needs money to meet its financial demands (Bing, 1978; Kaplan & Weisbach, 1992; Paulson & Huber, 2001). Divesting may be the last resort if all other forms of debt and equity sources have been tapped out (Cumming and Mallie, 1999).

Strategic fitness. Strategic fitness determinants arise out of an incompatibility between the company and the divested unit. Twenty-three percent of firms in Vignola's study claimed the firm had changed its strategy or objectives and, hence, decided to divest its non-strategic assets. Operations that no longer correspond to the new strategy are divested (Gaughan, 1999; Miles & Woolridge, 1999; Taylor, 1988).

Fitness determinants may be structural, cultural, or managerial. The structural variety of a firm may influence divestiture. Varadarajan et al. (2001) found managers whose companies operated in several international markets could not handle profitably the variety and complexity of their unrelated businesses. Sometimes, a lack of strategic fit in conglomerate firms is partly due to integration difficulties, especially after a merger or acquisition (Cumming & Mallie, 1999; Gaughan, 1999). Difficulties among divisions also can be cultural, "especially when the spun-off subsidiary's industry is subject to excessive operating volatility" while the remainder of the firm is in a relatively stable environment (Cumming & Mallie, 1999). Divestiture, Schmidt found, even can be precipitated by personality conflicts among managers. Taylor reveals similar findings, namely "political-social difficulties between the unit and the corporate" (1988, p. xviii).

Avoidance. Firms also engage in divestitures to avoid risk, uncertainty, takeovers, or significant investments of resources. Avoiding risk, for example, can be related to excessive

operating volatility of the subsidiary. By divesting, companies can reduce their exposure to risky businesses (Gaughan, 1999; Thomas, 1986). They also may use divestitures as a shield from potential downturns in the market or economy (Cumming & Mallie, 1999). Firms that divest to avoid uncertainty do so because the company is unsure of the growth opportunities in the subsidiary's area and wants to avoid future losses (Bing, 1978; Paulson & Huber, 2001).

Companies also use divestitures to avoid making significant investments into a subsidiary or division, thereby diverting resources to areas that are more desirable. It is an attempt "to free up resources" (Varadarajan et al., 2001, online). Vignola found that 19 percent of firms in his divestiture study revealed capital investment avoidance was a major reason for divesting. Subsidiaries that require excessive resource maintenance are prime targets of divestitures. A substantial input of capital into a subsidiary "may be beyond the means of the owner and he will attempt to divest the subsidiary" (Bing, 1978, p. 97).

Still, companies may engage in divestitures as a defensive mechanism, namely to avoid takeovers (Kaplan & Weisbach, 1992; Steiner, 1997). By divesting, the company hopes to "make them less attractive to the bidder" (Gaughan, p. 409). This is especially the case in management buyouts, where the firm sells its assets to management to offset corporate raiders (Taylor, 1988).

Based on the aforementioned determinants, then, the second research question asks:

RQ2: What are the divestiture determinants of major media firms?

Several external determinants are likely to influence the divestiture decisions of the major media firms in this study. As previously mentioned, the Federal Communications Commission's role to ensure companies operate in the public interest is likely to play a part in determining which companies divest what operations. Economic determinants, namely investee restructuring, is likely to influence the divestiture decision, especially due to the increasing connections between relatively few media behemoths (Who Owns What, online). Similarly, sociocultural determinants

may play a role in influencing these media firms to divest due to their global reach as multimedia conglomerates.

Nevertheless, the impact of technological determinants is ambiguous, for two reasons. On the one hand, technological determinants may play a limited role in the divestiture decisions of the major media firms in this study. Paulson and Huber (2001) reveal the impact of the technological changes varies with the firm's position relative to the changes. Despite the fact that media companies are heavily reliant on technology and the changes therein, the major media firms in this study are market leaders in their respective fields. Technological changes are likely to have more of an impact on second and late movers in the industry, which are not examined for the purposes of this exploratory study. Conversely, research also reveals a difference between pioneers and early leaders, whereby the former are more likely to fail and the latter "assume market leadership during the early growth phase of the product life cycle" (Tellis & Golder, 1996, Introduction section – online). As such, the impact of technological determinants is uncertain.

In contrast, all internal determinants previously mentioned are likely to influence the divestiture decisions of major media firms. As media firms adapt to the changing environment, they will adapt their strategies accordingly. Hence, the fitness of operations to the new strategy is of increased importance to the media firms in this transitional state. Similarly, financial determinants are likely to influence how firms allocate resources in light of new opportunities and threats. New opportunities – especially online operations – are likely to influence the performance of such operations. In the same way, avoidance determinants may play a significant role as firms attempt to free up resources and avoid significant capital investments as they refine their strategies.

## Methodology

### Design

Divestiture strategies in the media have been heretofore unstudied. Hence, this paper is exploratory in nature and utilizes the case study methodology. A qualitative research method is employed because, unlike quantitative methodology that seeks to predict behavior, qualitative methodology is suited for understanding a particular topic from a specific perspective. "Here, an explanation of the constitutive meanings of a phenomenon is sought. How an event occurs, how it functions in social contexts, and what it means to participants are all issues addressed from a cultural-hermeneutical, or interpretive, perspective" (Lindlof, 1995, p. 9). Qualitative research seeks to understand a particular phenomenon by asking, "What is going on here?" This approach is especially useful when prior research on a particular area is unavailable and the researcher wants to gain an understanding of the topic.

### Cases

Major media firms were selected from Variety magazine's listing of top global media companies, based on their 2000-2001 revenue. The firms are: AOL Time Warner<sup>4</sup>, Walt Disney, Viacom, The News Corporation, Comcast, AT&T, Cox Communications, and Clear Channel Communications. These companies were selected because they are the market leaders. Their market conduct often influences the conduct of other firms within their respective markets. Research also shows their conduct tends to set strategic trends. (Ferrier, Smith, & Grimm, 1999).

### Procedure

A major turning point in the media industry was the passage of the Telecommunications Act of 1996. It has affected almost every aspect of media, including cable system operators, telcos, and broadcasting. Much of the subsequent restructuring actions stem from the following provisions: abolishment of barriers to cable system operators offering telecommunications services; repeal of the telco-cable cross-ownership ban; clearance for public utility companies to enter telecommunications services; clearance for local exchange carriers to enter long distance

market; elimination of the broadcast/cable cross-ownership restrictions; elimination of the television ownership cap; and elimination of the national radio ownership cap (Summary of the Telecommunications Act of 1996, 1996). The Act has initiated an increase in competition and activity among these markets, namely M&As and divestitures. Hence, this research project focuses on the divestiture strategies of major media firms after the Telecommunications Act of 1996.<sup>5</sup>

Data on the media firms' divestiture strategies – and their respective determinants – were gathered from company annual reports and Securities and Exchange Commission (SEC) 10-K filings. In addition, company and industry news were gathered to provide additional information and background on the specific divestitures. This type of document – or artifact analysis – serves as another approach to capture the events and processes surrounding divestiture among major media firms. Lindlof (1995) says documents enable researchers to investigate and reconstruct “ongoing processes that are not available for direct observation” (p. 208). This method, then, is ideal for this transitional state into a deregulatory and digital media landscape, as it captures, certifies, codifies, tracks and explains the strategic actions of these major media firms. These documents are analyzed with an eye for common categories and themes regarding divestiture strategies and determinants, respectively.

For purposes of this study, divestiture referred to the aforementioned categories: sell-offs, spin-offs,<sup>6</sup> equity carve-outs, split-offs, split-ups, leveraged buyouts,<sup>7</sup> and downsizing. In addition, closure or termination of operations were also considered divestitures, for they entail a dispossession of property. Divestiture determinants also were classified according to the aforementioned internal and external categories.<sup>8</sup> Major divestiture determinant themes were those that a major media firm revealed in its annual reports and SEC filings repeatedly and more often than other themes, which were classified as minor.

### **Case Studies**



Divestitures for the five years (1996-2000)<sup>9</sup> totaled 261. Company divestitures ranged from 21 to 40. Table 2 reveals the divestiture activity by company and by year. The Walt Disney Company had the fewest divestitures in the study; whereas AT&T had the most. Major company patterns are discussed.

### The Walt Disney Company

The Walt Disney Company concluded the five years with five operating segments: media networks (including Broadcasting), studio entertainment, theme parks/resorts, consumer products (including creative content), and Internet and direct marketing. In the five years, Disney divested 21 times. Its Internet and Direct Marketing segment incurred the most divestiture activity, with seven divestitures. The Broadcasting/Media Networks and Creative Content segments followed, each with six divestitures. Studio Entertainment incurred only one divestiture in the five years. At the corporate level, Disney divested on one occasion, namely by issuing stock.

Strategic Refocusing. Disney's primary divestiture determinant theme emphasized the strategic refocusing of its operations under the Disney and ESPN brands. In its recent online pursuits, for example, Disney sold those operations in which it was difficult for it to market its consumer-oriented core business. Although one of Disney's youngest segments, the Internet segment incurred the most divestiture activity, which may be an indication of Disney's ongoing attempts to adapt to the newness and fast cycle nature of the online industry.

This refocusing emphasis also revealed itself in Disney's Broadcasting/Media Networks segment. The sales of Scandinavian Broadcasting System, Fairchild Publishing (which it acquired as part of ABC), and Eurosport, a European sports channel, all portray Disney's motivation to refocus and to gather operations under the Disney and ESPN brands. These sales also show Disney's possible attempts at limiting foreign investment in organizations that are not brand-oriented. It may not indicate a total abandonment of said foreign markets, but it may suggest Disney's preparation to introduce its own brand into the area. Such was the

motivation, for example, in Disney's divestiture of Eurosport: "We have decided to focus our resources on the establishment of the ESPN brand in Europe across a broad portfolio of businesses" (ESPN dumps Eurosport, 2000, online). This refocusing determinant corresponds with previous research (Gaughan, 1999; Miles & Woolridge, 1999; Taylor, 1988) that has found a lack of correspondence of the divested unit to the firm's overall strategy to be a primary divestiture determinant. For Disney, these investments were possibly viewed as incompatible with a unified Disney brand.

Financing mechanism. Disney's Internet and Broadcasting segments also exhibited a theme of divestiture as financing mechanism, in which Disney exchanged stock to finance acquisitions, mergers, or joint ventures. In the Internet division, for example, Disney exchanged stock to acquire Internet technology firm Starwave, portal Infoseek, and Socccernet.com. In its Broadcasting segment, Disney employed the same strategy, namely in its acquisition of ABC. Such use of divestitures as financing mechanism is consistent with Kaplan and Weisbach's (1992) findings that reveal firms divest to finance concurrent or subsequent endeavors.

Performance-Induced. Poor performance determined several Disney divestitures. Disney's Creative Content/Consumer Products segment suffered most from such inefficiencies. It incurred six downsizing and closures of its stores. The 1998 cutbacks focused on the consumer products operations in Asia, where retail operations were performing poorly, partly due to the Asian economic crisis. Financial reasons also were cited for the downsizing and closure of Disney's German stores, Disney's five Club Disney locations (family play centers), and the three ESPN stores in the U.S. Disney conceded, in the ESPN store closures, that it could sell its sporting merchandise more effectively through regional centers and via the Internet. In 2000, one of its online operations went into bankruptcy, and Disney was forced to downsize and close the e-tailer. Disney's Studio Entertainment division also recorded a downsizing and closure, primarily to improve efficiencies by consolidating its production and distribution operations. A possible reason for Disney's use of downsizing and terminations – as

opposed to other divestiture alternatives – stems from the relatedness of the operations to the Disney brand itself. Such knowledge-based and content-oriented resources are difficult to transfer to other companies (Das & Teng, 2000), which possibly suggests Disney's termination of said businesses, rather than the utilization of another strategy.

Compulsory. Although not a major divestiture pattern, Disney also divested to comply with federal regulators. The Broadcasting segment was the only segment to undergo an FCC-decreed divestiture. The FCC required Disney to sell its Los Angeles station KCAL-TV to obtain approval for the ABC acquisition in 1996. Disney would have acquired another station in the Los Angeles area as part of the ABC acquisition, putting it in violation of the FCC's regulation forbidding ownership of more than one station in a market.

Overall, Disney employed the simplest divestiture strategies to dispose of non-Disney and ESPN-branded investments. Investments that Disney perceived to aid in its refocusing efforts, Disney acquired via the exchange of its stock as a financing mechanism for said acquisitions. Those businesses, however, that continuously performed poorly and inefficiently, Disney downsized, closed, and consolidated into other operating segments.

### Clear Channel

At the end of the five years, Clear Channel Communications operated under three business segments: Broadcasting, Outdoor Advertising, and Live Entertainment. In the five years, Clear Channel divested 23 times. At the corporate level, Clear Channel divested eight times. At the business level, the Broadcasting segment incurred the most divestiture activity, with ten divestitures. Its Outdoor Advertising segment accumulated only four divestitures. And Live Entertainment divested only once. Clear Channel's overall divestiture activity exemplifies a two-fold strategy: divestiture as capital generation and divestiture as financing mechanism. Two minor determinants include compulsory divestitures and divestitures as result of investee restructuring.

Capital Generation. Clear Channel's sales at the corporate level all entailed stock issuances or public offerings of stock. The company employed this strategy to increase its access to capital for additional acquisitions, to reduce debt, and for general corporate purposes. From 1997 to 1998, Clear Channel acquired more than \$2.1 billion of cash from these offerings. In 1999 alone, proceeds exceeded \$513.7 million. Such sell-off activity corresponds with previous research (Bing, 1978; Kaplan & Weisbach, 1992; Paulson & Huber, 2001) that reveals the parent firm's use of sell-offs for the generation of capital with which the firm can fund other operations or meet other financial demands.

Financing mechanism. All three operating segments were chief exemplars of the divestiture strategy as a financing mechanism. The Broadcasting segment exchanged stock on three occasions to finance three separate mergers, namely with Jacor Communications in May 1999, Dame Media in July 1999, and AMFM in 2000. The Outdoor Advertising segment also issued and exchanged stock to finance its acquisitions of Eller Media in 1997 and Universal Outdoor in 1998. The single divestiture in the Live Entertainment segment employed an exchange of stock to finance the merger with SFX, promoter, producer, and presenter of live entertainment events. This strategy implies a possible reluctance to actively divest assets. Instead, the company issued its stock as a secondary activity with which to finance its aggressive acquisition efforts.

Compulsory. However, Clear Channel's aggressive acquisition efforts have led the FCC and the DOJ to decree divestiture of assets in both the Broadcasting and Outdoor Advertising segments. Under its Outdoor Advertising segment, Clear Channel was forced to exchange 1,426 advertising display faces in specific areas for 1,489 advertising display faces in other areas across the country. This was done to comply with a settlement Clear Channel reached with the DOJ for its merger with Universal Outdoor. In the Broadcasting segment, Clear Channel sold 12 radio stations to obtain approval for the Jacor Communications merger in 1999. It also sold 39 radio stations in its 2000 merger with AMFM. Clear Channel also was forced to

comply with the FCC's cross-interest policy<sup>10</sup> in the merger of Clear Channel investee Heftel Broadcasting and Tichenor Media. The merger included the largest and the third largest Spanish language radio broadcasting companies. Clear Channel owned stock in both companies. In compliance with the FCC, Clear Channel's ownership interest in Heftel was reduced. Clear Channel also converted its Tichenor stock into stock of the new merged entity. This impact of the Federal Communications Commission on broadcasters' activity is unique to the communications field. Whereas other industries have the oversight of the DOJ only, media companies also are subject to local, state, and federal regulations.

Investee Restructuring. The Heftel/Tichenor Merger and Clear Channel's divestiture of partial ownership in the entity also exemplifies the passivity with which Clear Channel divests ownership in its investments and affiliates. Clear Channel divested in response to its investee's restructuring. This divestiture was not self-initiated. This minor pattern also was evident in a divestiture in the Outdoor Advertising segment in which Clear Channel investee American Tower Corporation merged with another entity. The investee restructuring resulted in Clear Channel's transfer of its investment to American Tower Systems, Inc., the new entity. Previous research (Hitt et al., 2000) documents such mutual interdependence of firms.

Overall, Clear Channel's divestiture activity reveals a financial mind-set. The sell-offs and exchanges were employed either to generate capital or to finance other acquisitions. The remaining divestitures also reveal the company's possible reluctance to dispose of assets, unless government-decreed or as a result of investee restructuring.

#### Viacom Inc.

Viacom Inc. completed the five years with seven operating segments: Cable Networks, Television, Infinity, Video, Entertainment (including Theme Parks), Publishing, and Online. In sum, Viacom divested 25 times in the five years. Its Networks segment had the most

divestitures, with 14. The Entertainment segment followed, with 10 divestitures. Publishing added one divestiture.

Viacom's overall divestiture strategy follows two directions, namely strategic refocusing and debt reduction. The three segments that divested in the five years – Networks, Entertainment, and Publishing – all exhibited this two-fold approach. A minor determinant revealed Viacom's use of divestitures as a financing mechanism.

Strategic Refocusing. Viacom aimed its strategic refocusing efforts at fostering and increasing growth in its core entertainment businesses. In the Networks segment, the Paramount Station Group (PSG) revealed a strategy of exchanging stations that were not affiliated with UPN. Viacom also sold its ten radio stations and satellite retail operations to focus on entertainment. In its only divestiture in the five years, the Publishing segment sold its educational, professional, and reference publishing businesses, while retaining its consumer-publishing unit. This strategic move was an effort to capitalize on the synergies between consumer publishing and entertainment, a synergy that was not available with the academic publishing units.

The Entertainment segment engaged most in strategic refocusing. Viacom subsidiary Spelling disposed of its non-core interactive game business. Spelling Films also announced it would cease its motion pictures productions in 1998. The goal was an effort to focus on television business operations, where it saw more growth and profit potential. As part of this strategic refocusing, Viacom downsized 250 employees whose positions management classified as redundant. The company also downsized and closed operations of its Viacom Entertainment store in Chicago and its Nickelodeon stores. These, the company claimed, were not critical to its entertainment operations. Viacom's Blockbuster stores also underwent strategic refocusing, shifting its operations only to video rentals. By eliminating superfluous, non-core products in the Blockbuster operations, management also would avoid spending excessive amounts of time and resources on any non-core operations.

Debt reduction. Viacom also made its Blockbuster operations an object of its debt reduction efforts. Blockbuster exited the German market, after its stores were consistently performing poorly. In addition, Viacom closed 50 of the Blockbuster Music stores and downsized 650 employees in 1996. Closure was in response to poor performance. It later sold all of the music store operations to Wherehouse Entertainment in order to pay down the debt the stores had incurred. In late 1999, Viacom conducted an equity carve-out of its Blockbuster stores. It sold 31 million shares to the public, representing approximately 17.7 percent of Blockbuster's common stock. Viacom retained 82 percent of Blockbuster and used the proceeds from the IPO to pay down debt under its credit facility. The additional sell-off of Viacom's 50 percent interest in Cinamerica Theatres reduced Viacom's debt.

These debt reduction efforts also revealed themselves in the Networks segment in the company's sell-off of its 50 percent interest in USA Networks and the Sci-Fi Channel to Universal Studios, Inc. Viacom used the proceeds from this sell-off to reduce debt. The 1996 cable television system split-off to shareholders further reduced Viacom's debt and reduced the number of its outstanding common shares. Viacom also closed and ceased operations of its German Nickelodeon program services. This was the result of external and internal determinants, whereby the company claimed the German children's advertising market was saturated, and as a result, continuing the operation did not justify the costs associated with the channel and the increases in debt.

Financing mechanism. Accompanying the debt reduction and the strategic refocusing efforts was a minor divestiture trend. This one, however, was confined to the Networks segment and included exchanging stock to finance M&As. This strategy was evident in five separate transactions, including the acquisitions of CBS and Infinity, Waterman Broadcasting, and Black Entertainment Television. Viacom also contributed all Internet music assets to acquire a 90 percent interest in a music television joint venture.

Overall, the multimedia giant undertook divestitures with two main reasons – to refocus and to reduce debt. This pattern follows a deconglomeration trend (Gaughan, 1999; Taylor, 1988), whereby firms engaging in multipoint competition have begun to harvest operations under a single – or relatively fewer – interrelated areas. The goal is to reduce debt that unrelated businesses have incurred. Nevertheless, the refocusing and debt reduction efforts do not do away with acquiring related businesses. In Viacom’s case, it continued its acquisition efforts via the exchange of its stock as financing mechanism for related operations.

### Comcast Corporation

Comcast finished 2000 with three business segments: Cable, Commerce, and Content.<sup>11</sup> Comcast also held investments in cable television, networks / other programming, and infrastructure. In the five years, Comcast divested 27 times. At the corporate level, Comcast divested three times. At the business-level, the Cable (i.e., Wired) segment generated the most divestitures, with 11. Comcast also divested nine of its investments. The Wireless segment incurred three divestitures. The Content segment divested only once. Two major patterns emerged from Comcast’s overall divestiture strategies. These included divestiture as capital generation and financing mechanisms.

Capital Generation. The capital generation determinant was especially evident at the corporate level, where Comcast issued and sold stock on three separate occasions. Comcast used the proceeds from these stock offerings for general corporate purposes, including paying down debt. The recurring determinant also emphasized a desire to monetize certain investments. These included the sales of Comcast’s interests in Time Warner, Birmingham Cable, TCGI, Sprint PCS, and Nextel Communications. The capital generated from these transactions was used for various purposes, including paying down debt, enhancing deployment of broadband services, and funding corporate pursuits.

Financing mechanism. Similarly, the other determinant theme underlying Comcast’s divestiture activity focused on divestitures as financing mechanisms, namely for mergers,



acquisitions, and other endeavors. This strategy entailed an exchange of the company's stock to fund the proposed activity. Comcast's Cable segment divested with this motivation extensively. Specifically, Comcast sold its interest in Comcast UK Cable to NTL in exchange for shares of NTL common stock. Comcast also exchanged stock to finance the acquisitions of the cable television operations of E.W. Scripps Company, Lenfest Communications, Greater Philadelphia Cablevision, and Jones Intercable. Comcast's Content segment incurred one divestiture utilizing this strategy to complete the acquisition of a sports venture.

Investee Restructuring. A minor determinant theme emerging from Comcast's Cable and Wireless segments included divestitures as a result of investee restructuring. The company relinquished its interest in an investee upon the investee's restructuring in exchange for shares of the new restructured entity. This was the case for Comcast when Time Warner and TBS merged, when TCGI restructured its Teleport Joint Ventures, upon Sprint PCS' reorganization, and upon TCI's merger into AT&T.

Structural Consolidation. Structural consolidation also emerged as a minor determinant, mostly within the Cable segment's clustering activities. These exchanges mostly revolved around Comcast's efforts to dispose of non-consolidated cable television systems. Comcast exchanged systems with Time Warner Cable in 1999, and with AT&T and Adelphia Communications in late 2000/early 2001. This strategy of clustering cable systems illustrates the general trend in the cable television industry to group systems into regional operations. Clustering improves economies of scale and aids in coordinating activities in a matrix structure. Similar activities are conducted in one central location, thus minimizing duplicative personnel and reducing operational costs.

In all, Comcast utilized a single strategy: the sell-off (including the sell-off/exchange combination). Comcast was the only major media firm in this study to utilize a single divestiture approach. Indeed, Comcast used the sell-off strategy to withdraw completely from the wireless

industry in 1999, when it sold its Cellular segment to SBC Communications, claiming it could not compete effectively with other global and national cellular service providers.

Nonetheless, financial motivations determined most of Comcast's divestiture activity. Comcast divested largely with two motivations: to generate capital and to finance other ventures. Such activity corresponds with research that emphasizes the benefits of the sell-off strategy (Gaughan, 1999), namely the liquidity of the transaction, and the prevalence with which financial determinants lead to divestiture of assets (Kaplan & Weisbach, 1992; Paulson & Huber, 2001). On several occasions, however, Comcast was forced to divest as a result of investee restructuring, further exemplifying the increase of mutual interdependence of firms in the media industry. This interdependence impacts the competitive dynamics of media firms, namely in the manner in which media firms execute strategy. Comcast, for example, utilized a strategic clustering strategy that determined which cable systems were divestiture targets.

### The News Corporation Limited

The News Corporation Limited (News Corp) operated under seven business segments at the end of 2000: Television, Cable and Satellite Television, Filmed Entertainment, Book Publishing, Newspapers, Magazine and Inserts, and Other Operations (including Technology and Investments). From 1996 to 2000, News Corp divested 30 times. Its Cable and Satellite segment led the divestiture activity, with 10 divestitures. The Other Operations segment followed, with six divestitures. Magazine and Inserts incurred four divestitures. The Technology and Television segments each incurred three divestitures. Book Publishing and Filmed Entertainment each generated two divestitures in the five years.

Strategic Refocusing. By far, News Corp's overall divestiture strategy emphasized a strategic refocusing approach. This strategy permeated five of the seven divesting segments. The Cable and Satellite Television mainly sold off assets it deemed non-core and non-strategic. In several instances, the company reconfigured its business strategy to exit certain businesses.

These sell-offs included a desire to refocus the company's energies, efforts, and resources into other areas.

In the Other Operations segment, News Corp sold its ownership interests in Australian airlines, airline leasing, and other non-core assets. The Book Publishing segment similarly initiated a sale of its educational book division in 1996. In 1998, it sold the remainder of the academic market assets to focus on consumer publications. In the same way, the Television segment sold its interests in Vox (a German television broadcaster), its Australian television company, and radio and television stations it had acquired in the Heritage Media acquisition. In 1997, News Corp also sold all of its 40 percent interest in PMP Communications, claiming it had shifted its strategy to include leaving the Australian magazine publication field. All of these assets were deemed non-essential to News Corp's core operations and strategic reorganization.

Structural Consolidation. News Corp similarly utilized divestitures to consolidate operations. The equity carve-out (ECO) of News Corp's Sky Global Networks, an entity that includes all of the company's satellite platforms and related assets, is a prime example of such consolidation efforts. This IPO was structured to consolidate satellite operations and to set the stage for possible strategic partnerships. News Corp also carried out an equity carve-out of its Filmed Entertainment segment in 1998. The Fox Entertainment Group (FEG) consolidated the company's television, cable, film, and sports assets. The company's use of equity carve-outs to consolidate operations under quasi-independent entities further corroborates the advantages of the divestiture strategy: collecting similar operations under one umbrella while reducing redundant operations, such as managerial and functional tasks.

Minor patterns. Three other patterns – all minor – emerged in News Corp's divestiture activity. These included debt reduction, valuation efforts, and divestiture as financing mechanism. Divestiture to reduce debt mainly took the form of sell-offs, in which the money raised was used for debt reduction. Several downsizing efforts and proceeds from ECOs were

used to reduce debt. However, News Corp maintained the main impetus for the Technology segment's NDS (digital technology systems operations) ECO, and the Cable segment's 1999 ECO of Fox Kids Europe all centered on unlocking the value and growth potential of each of the operations. News Corp's further utilization of divestitures to finance M&As or interest acquisitions was evident in the Cable, Other Operations, and Magazine segments. In all instances, the company exchanged its stock to acquire another entity or to acquire an equity or partnership interest in a venture.

The main divestiture determinant for News Corp was a desire to refocus its operations and its investment holdings. News Corp's utilization of divestitures as a strategic refocusing mechanism followed the current deconglomeration trend. Taylor (1988) documented this reconsideration of conglomerate expansion strategies as early as the 1970s. Accompanying the strategic refocusing theme was an emphasis on consolidating similar operating units and three other minor divestiture determinants, all financially-motivated. Research shows divestitures used to reduce debt readily accompany strategic refocusing determinants, especially when firms divest to reduce debt of unrelated operations (Gaughan, 1999; Taylor, 1988). This gathering of operations under a single umbrella has repercussions, however, namely valuation difficulties, where investors are not readily able to categorize and analyze the performance of a specific business operation within a company. News Corp exhibited this theme as a divestiture determinant and possibly exemplified a financial difficulty of engaging in multipoint competition. Nevertheless, News Corp continued to expand its holdings by exchanging stock to finance the acquisition of other entities.

### Cox Communications

Cox Communications started 1996 with three operating segments: U.S. Broadband Networks, Cable TV Programming, and U.K. Broadband Networks. In 1997, Cox downgraded to a U.S. Broadband Network Operations segment. It also held Investments in all media and

telecommunications areas. Cox has retained this structure, while renaming its main operating segment, Broadband Communications. Throughout the five years, Cox divested 33 times. At the corporate level, Cox incurred only two divestitures. Its main operating segment, Broadband Networks Operations, generated 18 divestitures. Cox also divested specific investments on 13 occasions.

Structural Consolidation. Cox's primary divestiture pattern was based on efforts to consolidate operations under few interrelated areas, namely Broadband Communications. Cox engaged in strategic divesting of nonconsolidated cable television systems that did not correspond to any of Cox's established clusters. Cox either sold these systems or it exchanged them with other multiple system operators. Cox also engaged in numerous divestitures of non-consolidated investments, such as its interests in Telewest, Sprint PCS, and Cox PCS. The company's consolidating activities also resulted in the downsizing of 202 accounting and staff positions. Such emphasis of gathering operations further corroborates previous research findings that emphasize the deconglomeration trend (Taylor, 1988).

Capital Generation. In addition to the structural consolidation theme, Cox also demonstrated a capital generation motivation underlying its divestitures. This method mostly entailed monetizing investments, especially of non-core operations, but also included monetizing on the sale of non-strategic cable television systems. In its investment sell-offs, Cox addressed the need to generate capital with which it could strengthen its balance sheet and fund future acquisitions. This monetization and cash generation approach was the reasoning behind Cox's 1999 stock issuance. The company generated \$350.3 million, with which it would fund other activities.

Minor patterns. Despite its attempts to generate capital, however, Cox's divestiture activities revealed several minor determinant patterns, namely divestitures as financing mechanism, as a result of investee restructuring, and divestiture as avoidance. Cox employed divestitures as a financing mechanism, which called for Cox to issue and exchange stock to

fund mergers and acquisitions. This method was used in the acquisition of TCA in 1999, and in the acquisition of a Las Vegas cable system, for example.

Cox also relinquished its interest in several investees after the investee underwent significant restructuring. In exchange, Cox received stock in the newly restructured entities. Such examples included Cox's interests in PrimeStar Partners, TCGI, Sprint PCS, and Telecorp. Whereas Cox's core business centers on wireline communications, its investments in wireless operations demonstrate the mutual interdependence of firms in the media industry. Similarly, avoidance divestitures involved Cox's desire to prevent significant capital investments into specific operations, namely PrimeStar and Sprint PCS. While Cox acknowledged the assets were valuable, it maintained that it wanted to redeploy its resources into core operations and core investment opportunities. Sales of other investments also addressed this avoidance approach, corresponding with previous research (Bing, 1978; Varadarajan et al., 2001) that reveals firms divest assets to free up resources and to avoid significant capital investments into certain operations.

Cox's overall divestiture strategy revolved around its motivation to consolidate activities. It also evidenced a motivation to generate cash by monetizing investments and operations. In the instance when cash was not readily available, Cox employed divestitures as financing mechanisms. Nevertheless, Cox's investments made it a target for divestitures as a result of investee restructuring. In other divestiture instances, Cox plainly revealed its desire to avoid significant deployment of resources into non-core operations. These minor divestiture patterns all worked to further Cox's overall strategy of strategic consolidation.

### AT&T

AT&T started 1996 with four operating segments: telecommunications, financial services, transaction-intensive computing, and communication systems and technology. In 1997, however, AT&T focused its operations in two segments: communication and information

services. From 1998 through 2000, AT&T categorized its primary businesses as business services, consumer services, AT&T Broadband and Internet services, and Wireless services. It also had an Other Businesses segment, which included local services, network management and professional services, international operations/ventures, and AT&T WorldNet. Throughout the five years, AT&T divested 40 times. At the corporate level, AT&T divested three times. At the business level, the Broadband and Internet segment incurred the most divestitures, with 13. The Telecommunications segment followed, with seven. Other Operations generated five divestitures, and the Wireless segment generated four. The Business Services segment had three divestitures. Overall, AT&T's divestiture pattern followed two parallel directions: strategic refocusing and cost-cutting.

Strategic Refocusing. AT&T restructured in 1996 and underwent a "trivestiture" by separating into three independent, publicly-held companies. Although traditionally heralded as "the largest voluntary break-up [i.e., split-up] in the history of American business" ("A Brief History," online), these series of transactions more accurately resemble ECOs and spin-offs in that AT&T remained a substantial – albeit a considerably restructured – company, retaining multiple core business lines after each transaction. In this "trivestiture," AT&T conducted an ECO of its communication systems and technology division, Lucent Technologies. It made Lucent into a public, free-standing entity and in its IPO, AT&T sold to the public 17.6 percent of Lucent shares. This ECO was conducted as part of an overall restructuring, whereby the new AT&T would shed operations to focus on telecommunications and financial services. AT&T later followed the Lucent IPO with a complete spin-off to shareholders. This was a tax-free transaction and severed all ownership ties between the two companies.

The other significant divestiture of 1996 also was in conjunction with the aforementioned restructuring plan. The object of this divestiture was the transaction-intensive computing segment, namely NCR. Here, AT&T spun-off NCR to its shareholders and followed the same strategic plan of severing all ties to the company. The overarching goal of this restructuring plan

was to separate the companies so they could focus on their respective core businesses. Thus, the new AT&T ended the 1996-year with two operating segments – telecommunications and financial services.

Nevertheless, AT&T's strategic restructuring efforts did not conclude with the Lucent and NCR spin-offs. It has extended through 2000 and has entailed a refocusing of all its operations. The Broadband and Internet segment – along with the Telecommunications segment – have divested with this motivating factor underlying disposal of such non-strategic assets as its satellite services, its submarine systems, its international wireless joint ventures, and its investment in DirecTV. The Financial Services segment also sold its majority interest in its leasing services business and its Universal Card Services in efforts to refocus on the company's core strategy. By disposing of non-essential operations, the company fulfilled an underlying avoidance objective: that is, to avoid binding up vast amounts of resources and assets into the non-essential operations, thereby precluding redeployment of resources into strategic investment opportunities.

AT&T's refocusing strategy best exemplifies the drastic restructuring changes that accompany changes in corporate-level strategy. When a firm changes its strategic direction, operations that no longer correspond to the firm's new strategy are divested (Gaughan, 1999; Miles & Woolridge, 1999; Taylor, 1988).

Cost-cutting. Accompanying this strategic refocusing pattern was the cost-cutting emphasis. While AT&T wanted to avoid the costs associated with non-strategic operations, it also wanted to cut the costs associated with running internal businesses. On three separate occasions, AT&T downsized its workforce. In 1998, there were 20,000 fewer employees. The following year, 2,800 employees were separated, and in 2000, AT&T downsized 7,300 additional employees. The Telecommunications segment also employed downsizing and cost-cutting efforts: in 1996 and 1997, six thousand employees (management and occupational) were terminated. Moreover, AT&T decided in 1997, to terminate its resold local service. This



was a financial decision aimed at cutting the costs associated with such efforts. AT&T claimed this decision was due to the “limitation on ILEC’s [incumbent local exchange carrier’s] ability to handle anticipated demand and because discounts AT&T receives from ILECs on the sale of such service are insufficient to make resale a viable long-term method of offering [local telephone] service” (AT&T 10-K 1996, p. 97). AT&T’s downsizing to cut costs supports previous research (Hitt et al., 2000) that shows the downsizing strategy often is used to improve profitability by reducing the costs associated with operations.

Financing mechanism. AT&T also employed a pattern of utilizing divestitures to finance mergers and acquisitions. AT&T issued and exchanged stock to finance its acquisitions of Teleport Communications Group, Inc., TCI, and MediaOne. It also exchanged stock to acquire interests in United Video Satellite Group, Bresnan Communications, and Midcontinent Communications. In another instance, AT&T exchanged cable television systems to redeem its stock from a competitor.

Compulsory. As a result of its acquisition efforts, AT&T was required to divest certain other operations. In 1999, AT&T disposed of specific international businesses that would have directly competed with AT&T’s Concert, a joint venture with British Telecommunications. Moreover, in compliance with the DOJ’s consent decree regarding AT&T’s acquisition of MediaOne, AT&T (together with its partner, Time Warner) were forced to dissolve the Road Runner joint venture, which provided connectivity to numerous broadband and Internet services.

Overall, AT&T engaged in a variety of divestiture strategies to advance its strategic refocusing and cost-cutting initiatives. The extensive provisions of The Telecommunications Act of 1996 promoted increased activity and competition mostly among telecommunications firms, allowing local and long-distance companies to enter each other’s heretofore prohibited areas. As the firm with the most divestitures in this study, AT&T possibly took advantage of such provisions in the Act but encountered situations in which unrelated, costly ventures forced the company to reevaluate its operations in conjunction with new strategy and resources. Graddick

and Cairo (1998) suggest the changes at AT&T reflect numerous forces that had accumulated throughout the years.

AOL Time Warner<sup>12</sup>

America Online. For two years after the Telecom Act, America Online operated under three segments: AOL Networks, AOL Studios, and ANS Communication. In 1998, American Online purchased CompuServe, adding it to its AOL Studios segment. It also added a new segment, AOL International. AOL Networks concurrently was renamed AOL Interactive. In 1999, the company renamed two of its divisions and added the Netscape Enterprise Group. America Online operated under these four segments throughout 2000.<sup>13</sup> From 1996 to 2000, America Online divested 36 times. At the Corporate level, America Online divested eight times. Its AOL Studios segment (later renamed Interactive Properties Group) generated the most divestitures, with 14. Its AOL Networks segment (later renamed, AOL Interactive and then Interactive Online Services) incurred nine divestitures. The Netscape Enterprise Group divested three times, and AOL International divested only once. Moreover, the ANS segment was the object of one divestiture.

Financing mechanism. America Online's overall determinant theme utilized divestitures as a financing mechanism. At the corporate level, America Online used stock in exchange for acquiring entities, such as Light Speed Media, in 1997. This exchange of stock strategy also was the method employed in the acquisition of Time Warner in late 2000/early 2001. The Interactive Properties Group segment utilized this strategy in nearly all of its divestitures, including an exchange of stock to finance acquisitions or mergers of ImagiNation, KIVA Software Corp., Nullsoft, Spinner, When, Inc., Tegic, Moviefone, Prophead Development, MapQuest.com, Quack.com, iMaze, Inc., and LocalEyes Corporation. The AOL Networks segment (later renamed AOL Interactive and then Interactive Online Services) followed this similar theme in its M&As of Johnson-Grace Company, Portola Communications, DigitalStyle Corp., Actra, AtWeb, PersonaLogic, Personal Library Software, Inc., and Net Channel, Inc. The

company also utilized this strategy in its acquisition of Netscape and in its divestiture of its ANS Communications segment in 1997. The company exchanged ANS to WorldCom for all of the online services business of CompuServe. Similarly, the AOL International operating segment incurred one divestiture, in which it exchanged half of its ownership interest in a joint venture for a combination of cash and services from its European partner, Bertelsmann AG.

Structural Consolidation. The company underwent strategic reorganization and consolidation in response to the aforementioned M&As. America Online downsized 300 employees in 1997. The AOL Studios segment also utilized a downsizing and closure strategy as a result of the integration and consolidation of aforementioned companies. In 1998, the company downsized 160 employees; 70 employees were eliminated in 2000. Following the Netscape acquisition, strategic consolidation efforts led to the 1998 elimination of 400 employees and closure of certain facilities. In 1999, America Online restructured the Netscape Enterprise Group again by eliminating 850 positions. America Online's integration and consolidation efforts validate previous research (Cumming & Mallie, 1999; Gaughan, 1999) emphasizing the lack of strategic fit resulting from previous mergers and acquisitions.

Capital Generation. A minor divestiture pattern also revealed America Online used stock issuances to generate capital. On several occasions, the company sold stock to acquire capital with which to fund general corporate activities and to increase liquidity for future investing.

These divestiture patterns exemplify the manner in which the company possibly perceives the divestiture concept itself, namely as a secondary activity to aid it in its efforts to acquire other organizations or to generate capital. Overall, America Online's approach toward divestitures revealed a reluctance to dispossess itself of operations. Instead, the company utilized sales of its stock to fund other ventures. As a result of such acquisitions, America Online increasingly had to integrate and consolidate operations of newly acquired operations, resulting in, at least, six downsizing and closure strategies.

Time Warner Inc. From 1996 to 1998, Time Warner Inc. operated under four business segments: Entertainment, Cable Networks, Publishing, and Cable Systems. In 1999, Time Warner added two segments, Music and Digital Media. It also renamed its Entertainment segment, Filmed Entertainment, and retained these six operating segments through 2000. Time Warner garnered 26 divestitures in the five years.<sup>14</sup> At the corporate level, Time Warner incurred only two divestitures. Its Cable Systems segment generated 14 divestitures. Its Entertainment segment generated four divestitures. The Publishing segment incurred three divestitures, and Cable Networks, two. Digital Media, the newest segment, divested only once. Time Warner's divestiture themes revolved equally around three areas: structural consolidation, divestiture as debt reduction, and divestiture as financing mechanism.

Structural Consolidation. Time Warner's divestitures were structured to aid in consolidating operations within operating segments, namely in the publishing and cable systems divisions. In efforts to consolidate its publishing operations, for example, the Publishing segment divested its professional publishing division to gather its operations into its general trade book publishing division. The Cable Systems segment also utilized divestitures as clustering mechanisms, namely in its system exchanges with various other operators, such as Fanch Communications, MediaOne, and AT&T. These divestitures aimed at discarding systems that were non-strategic to existing cable clusters. The Cable Systems segment also underwent a reorganization and consolidation of facilities in 1996 to integrate operations after its acquisition of TBS. In efforts to consolidate its cable business telephony operations, the company initiated an ECO in 1998, maintaining the equity carve-out would increase operational efficiencies by combining all of the company's cable business telephony operations. Time Warner separated the entity and named it Time Warner Telecom.

Debt Reduction. The company also conducted the Time Warner Telecom ECO as a debt reduction mechanism. The goal was to form a free-standing entity that was completely self-financing, thereby avoiding significant capital investments by the company. In 1999, Time

Warner executed the second half of the carve-out with an initial public offering. With this part of the ECO, the company also used the proceeds to reduce debt. Similarly, the Entertainment and Cable Systems segments each sold assets and cable television systems, respectively, to reduce their debt. In efforts to reduce debt incurred by the poor performance of its music retail stores, the company closed and sold all its music retail stores in 1996. Debt reduction efforts also originated at the corporate level. The company itself issued stock on two separate occasions in 1996, the proceeds of which it used to reduce corporate debt.

Financing mechanism. Because the company used proceeds from sell-offs or ECOs to reduce debt, it issued and exchanged stock to finance its mergers and acquisitions. The Cable Systems segment, for example, exchanged stock to acquire remaining interests in cable systems and to finance numerous joint ventures. The Publishing segment utilized the same strategy to finance joint ventures with Bertelsmann's Doubleday book club, for example. Likewise, the Cable Networks segment utilized a similar strategy in its acquisition of TBS in 1996.

Overall, Time Warner's divestiture activity followed a motivation to refine both operations and finances. Research shows consolidation and financial restructuring determinants tend to go hand in hand (Taylor, 1988). Hence, the company's divestiture activity follows a traditional approach to deconglomeration into more streamlined and interrelated areas that increase operational and financial efficiencies.

### Discussion

This paper endeavored to explore the divestiture determinants and strategic patterns of major media firms. First, the paper traced divestiture activity in general, revealing that the frequency and transaction value of divestitures has increased throughout the past three decades. The paper also defined divestiture and formulated a typology into which the divestiture strategies were categorized. It revealed the seven common divestiture strategies:

sell-off, spin-off, equity carve-out (ECO), split-off, split-up, leveraged buyout, and downsizing; and related characteristics of each, including divestiture level, tax status, divestiture degree, divestiture medium and consideration, and the post-divestiture ownership status.

### Divestiture Strategies

It was expected that the major media firms in this study would engage in most of the aforementioned divestiture strategies. Indeed, the sell-off was the most common divestiture strategy used among the firms, accounting for 84 percent of total divestitures. The overwhelming use of the sell-off strategy reinforced the expectation that these media firms would be similar to other industries in this regard, using the most expeditious way to dispossess themselves of operations or investments. This finding is consistent with previous research that suggests sell-offs are the easiest (Schmidt, 1990) and hence, the most common divestiture strategy (Cumming & Mallie, 1999).

Despite previous research that highlights the complexities of sell-off/exchange combinations (Schmidt, 1990), half of the sell-offs in this study were structured as exchanges. The prevalence of exchanges in these media firms suggests three possibilities: (a) the relative ease with which media firms – especially multiple system operators – may place value on their assets. For example, MSOs may exchange systems based on subscriber counts or by homes passed. (b) The value of broadcasting stations – as determined by the price paid for the license to broadcast, the designated market area (DMA), and the station's reach. (c) The stock market price as indicator of value of the company or divested unit.

Major media firms with similar characteristics tended to use sell-off strategies. For instance, major media firms that have holdings in broadcasting – either radio or television – tend to use the sell-off strategy in their broadcasting segments more often than other divestiture strategies. The respective broadcast segments of Walt Disney, Clear Channel, Viacom, and News Corp all exhibited this pattern. It may be that the nature of the regulations surrounding broadcasting necessitates simple transactions by which broadcasting stations may be traded

and sold. Moreover, with the deregulation of the ownership cap, it is possible that the sell-off provided the easiest and most expeditious means by which to reorganize broadcast stations. Nevertheless, these firms – although utilizing the sell-off strategy the most within their broadcast divisions – are the firms with the fewest overall divestitures.

Conversely, multiple system operators tend to engage in sell-off strategies more often than major media firms that do not have holdings in cable or broadband systems. Moreover, major media firms that have holdings in cable or broadband systems tend to use the sell-off strategy more often than other divestiture strategies. Indeed, this sell-off strategy entails common use of exchanges of systems. Again, this may be indicative of the relative ease with which MSOs may be able to sell or trade systems among each other, as opposed to broadcast regulations that may place limits on such activities.

Not as prevalent was the use of equity carve-outs, accounting for a handful of divestitures. Although ECOs provide firms with a cash infusion, it is possible that the major media firms relied on the easier divestiture strategy – the sell-off – for the cash infusion, instead of the more complex divestiture strategy. Nevertheless, major media firms that are heavily diversified into multiple interrelated business segments tend to consolidate related operations using the ECO strategy. News Corp and Time Warner both utilized this strategy to consolidate content-based and telecommunications operations, respectively.

As expected, the major media firms utilized the downsizing strategy in increasing numbers. This finding also was consistent with research (Slocumb, Morris, Cascio, & Young, 1999) that shows this strategy as a viable and increasing alternative in restructuring efforts. Downsizing strategies tend to be more common among two types of major media firms: those that rely heavily on content and those whose aggressive M&A activity and/or entrance into new businesses results in overlapping positions and increased costs. For instance, Disney's Creative Content / Consumer Products, Viacom's Entertainment, and Time Warner's Entertainment and Digital Media segments utilized this downsizing and closure/termination

strategy the most. The intangibility of these knowledge-based resources is relatively difficult to transfer to – and implement in – other media firms, thus the downsizing and closure strategy may be more cost-effective and prudent than attempting to transfer inimitable intangible resources to other firms that may, in the long run, cause potential harm to the original company's branded content.

Similarly, major media firms who engage in aggressive M&A activity and/or enter into new businesses tend to engage in downsizing strategies more often than those major media firms that do not engage in aggressive M&A activity or enter into new businesses. America Online engaged in multiple downsizings throughout the five years, in response to integration and consolidation activities that resulted in thousands of overlapping positions. Similarly, AT&T's entrance into operations that were restricted prior to the passage of the Telecommunications Act resulted in increased costs that prompted the company to undertake multiple downsizings of thousands of employees.

Of the seven divestiture strategies, the leveraged buyout and the split-up were the only strategies not observed. This was as expected, however, for the emphasis of the leveraged buyout strategy in this study was on the object of the buyout – not on the acquiring firm itself. As such, these major media firms were not the objects of leveraged buyout strategies in which poor-performing and “poorly-managed” companies are bought and taken private. Similarly, the split-up possibly was not evidenced due to the superior operations management and performance of these market leaders.

### Divestiture Determinants

This paper also synthesized the available research on divestiture determinants and categorized the most common divestiture determinants into four external and three internal categories. External determinants included economic, sociocultural, compulsory, and technological factors. Internal determinants included financial, strategic fitness, and avoidance factors.



External. Several external determinants were expected to influence the divestiture activity of the major media firms in this study. The Federal Communications Commission's role to ensure companies operate in the public interest did, in fact, play a part in determining which companies divested what operations and under what circumstances. This determinant, however, was not as readily apparent as expected. It is possible that the current deregulatory environment may have been a factor in determining the extent to which the FCC decreed divestitures during this period. Hence, it is possible that in a deregulatory environment, major media firms will undergo fewer compulsory divestitures than in a heavily regulated environment. Nevertheless, this assertion is speculative because this research project did not investigate divestiture activities before the passage of the Telecommunications Act of 1996.

Investee restructuring heavily influenced the divestiture activity of the major media firms. The increasing connections between relatively few media giants possibly contributed greatly to the degree to which these media firms divested. As their investees restructured to adapt to the current deregulatory and digital transition environment, investors also were impacted due to their mutual interdependence. Only three major media firms – Clear Channel, Comcast, and Cox – exhibited this theme. These major media firms that have invested and/or initiated secondary operations in unrelated areas (such as Outdoor advertising for Clear Channel and Wireless/PCS for Cox and Comcast) tend to experience divestitures as a result of investee restructuring more than those major media firms whose investments and secondary operations are interrelated and have been long-established.

Sociocultural determinants were expected to play a role in influencing these media firms to divest due to their global reach as multimedia conglomerates. However, the major media firms did not mention sociocultural factors as contributing directly to their divestiture decisions. Nevertheless, the media companies did divest foreign operations. Moreover, the firms often cited poor performance of the divested units. It is unclear to what degree sociocultural determinants indirectly influenced the poor performance of foreign operations. However, these

factors may be unlikely to emerge in public documents for a variety of reasons, from strategic to political concerns. Hence, future research should investigate the similarities between the parent and foreign country and their relationship to the divested units, while conducting in-depth research (either by a review of the business or trade press) into the sociocultural factors at play in said countries.

As previously mentioned, the impact of technological determinants was ambiguous at the outset of the study. Either the major media firms would not undertake divestitures as a result of technological obsolescence or they would be forced to divest due to their status as ailing pioneers in the media industry. In the end, the major media firms did not attribute any of their divestiture decisions to technological determinants, such as product obsolescence.

Internal. As expected, all internal determinants influenced the divestiture decisions of major media firms. Strategic fitness and financial determinants, however, were more influential than avoidance determinants. Financial determinants were most cited and included divestitures as capital generation, debt reduction, valuation efforts, and cost-cutting. These determinants reveal some of the difficulties that conglomerate firms encounter. Despite economies of scale and scope, firms engaging in multipoint competition require significant capital with which to operate, incur large amounts of debt, and face potential devaluation of assets. The changing multimedia environment compounds these financial factors, forcing companies to evaluate their internal capital markets, generating capital from various sources while cutting costs and reducing debt accordingly.

One financial determinant - the utilization of divestitures as a financing mechanism for mergers, acquisitions, and joint ventures – emerged as a pattern across all major media firms in this study. Instead of acquiring other firms with cash, all of the firms utilized their stock to finance M&As. Loughran and Vijh (1997) suggest a possible explanation; they maintain “the acquirer’s managers are likely to choose stock payment when their stock is overvalued and cash payment when it is undervalued” (p. 1789). Hence, it is possible that major media firms

whose stock is overvalued engage in an exchange of stock to finance mergers, acquisitions, and joint ventures, as opposed to those major media firms whose stock is undervalued. This assertion, however, is speculative. While this study is the first in exploring media divestitures and did not investigate the stock valuations of these major media firms, this question of valuation should be a future line of research into media divestitures and acquisitions.

Results also revealed poor performance did not play a major role in the divestiture decisions of major media firms. Previous research (Bing, 1978; Taylor, 1988; Paulson & Huber, 2001) suggests poor performance as a primary influence of most divestitures, but this study reveals otherwise. In fact, only one firm – Walt Disney – revealed a pattern of performance-induced divestitures. A possibility for the lack of stated poor performance determinants may be that the “marketing-oriented” nature of some annual reports to shareholders may have not revealed poor performance of specific business operations unless the division was performing well below expectations.<sup>15</sup> Furthermore, the marketing of poorly performing business divisions may have made it more difficult to find a potential buyer.

Although market leaders are not immune to poor performance factors, Disney’s performance-induced divestitures may suggest another possible explanation. Bing maintains, “Some corporations have policy objectives requiring all operations and subsidiaries to produce a minimum return on investment or pretax profit on sales. A subsidiary not meeting these objectives may be profitable and easily equal or exceed the performances of its competitors, but it still would not meet the objectives of the parent” (1978, p. 97). Whereas the performance of specific Disney operations may have exceeded expectations for other firms, it is possible that the operations did not perform to objectives required of all operations and subsidiaries in the Walt Disney family.<sup>16</sup>

Strategic determinants also influenced divestitures across media firms. Two determinant themes emerged; these included strategic refocusing and structural consolidation. Four of the major media firms exhibited the strategic refocusing determinant as their primary motivation to

divest assets. In fact, three of the four firms were multimedia giants engaged most in multipoint competition: Walt Disney, Viacom, and News Corp. It is possible that the opportunities heralded in the Telecommunications Act of 1996 incited these multimedia giants to reconsider unrelated operations and refocus accordingly. Indeed, the divestiture activity of these firms clearly validates Taylor's (1988) and Varadarajan et al's (2001) findings on the deconglomeration trend encompassing firms in multiple industries. The fourth firm to exhibit a refocusing theme as a dominant divestiture pattern was AT&T. After years of engaging in telecommunications, financial services, transaction-intensive computing, and communication systems and technology, AT&T decided to downgrade operations, adapting to the changing environment by reformulating strategy according to opportunities, threats, strengths, and weaknesses.

The second strategic determinant theme emphasized a structural consolidation motivation. Three of the firms – Comcast, Cox, and Time Warner – utilized this approach. Their common characteristic as cable service providers probably corroborates this finding. Multiple system operators (MSOs) structure their systems in regional clusters, thereby eliminating duplicative personnel and profiting from economies of scale. This consolidation of operations was not restricted to MSOs, however. Multimedia giant News Corp also displayed this determinant pattern, most notably in its equity carve-outs of its entertainment group and its satellite platforms. Similarly, America Online consolidated operations, mostly as a result of its aggressive M&A activity. Previous research (Varadarajan, 2001) documents the complexities of managing multiple business operations such as those of these major media firms. Hence, major media firms that engage in multipoint competition and pursue aggressive M&As are more likely to undertake divestitures that consolidate operations than those major media firms that have a single business operation and that undertake few M&As.

Avoidance determinants were cited infrequently as motivations for the divestiture decisions of major media firms. While some firms, such as Cox, explicitly announced their motivation to avoid significant capital investments into specific operations, it is possible that the

avoidance determinant is generally understood as influencing the divestiture decision.

Specifically, when a firm decides to exit a business or to dispossess itself of an operation or asset, it implicitly reveals its strategy to avoid operating in said sector(s), thereby freeing up resources and avoiding significant investments into said operations. Nevertheless, specific avoidance determinants have been found in previous research (Bing, 1978; Gaughan, 1999; Paulson & Huber, 2001), especially in industries that require excessive resource maintenance (Varadarajan et al., 2001; Vignola, 1974). It is possible, however, that the major media firms in this study failed to reveal specific avoidance determinants because they were implied in the divestiture action itself, because other determinants were more influential in the divestiture decision, or possibly due to the sensitive nature of the information, i.e. the potential disclosure of the company's valuable strategic information.

### **Conclusion**

To my knowledge, this paper was the first to investigate the divestiture activity of major media firms. It found that major media firms indeed have restructured by engaging in divestitures since the Telecommunications Act became law. The sell-off was by far the most common divestiture strategy, but firms divested based on various determinants and motivations. Some firms divested only to further their brand. Some used divestitures as mechanisms to generate capital and to reduce debt. Others clearly used divestitures to refocus on their core operations and to cut costs. Few underwent compulsory divestitures.

The findings signal the importance of divestitures in corporate strategy. Specifically, divestitures determine the businesses in which the firm competes and how those businesses are managed. Thomas (1986) reveals the greater implications of the divestiture strategies, citing "considerations as where a group seeks a presence, on what scale, and for what purpose" (p. 43). Such considerations are especially important in the media industry, as it is in a state of transition, spurred by the deregulatory provisions of the Telecommunications Act of 1996 and

the transition into a digital environment. Firms have adjusted and restructured to new opportunities and threats, attempting to find their niche and place in the new environment.

Concurrently, this paper has opened up a wealth of avenues for further investigation. The exploratory nature of this research has set a foundation upon which future research may build. The nature of this qualitative interpretation yields unique results:

The intimate knowledge gained of ... organizations ... is written in a way that discloses the author's insight. The scope of this analysis is called idiographic (contrasted with nomothetic). One does generalize in qualitative research, but not in a way that tries to attain the scope of a universal law. Instead, the richness of the particular elements that are documented and the patterns or themes they exhibit allow the researcher to generalize to other cases of the same problem in the larger culture. By expanding the meanings of the case to historical and other frames of reference, one can compare interpretations of meaning and action from one culture to another. (Lindlof, 1995, p. 57)

Future research should seek to incorporate this qualitative approach with other quantitative methods to gain a better understanding of the divestiture activity of media firms. Specifically, research may explore the conditions under which specific divestiture strategies are chosen. In addition, researchers should seek to ascertain, as Porter (1996) suggests, the position of the divestiture in the chain of causality. Specifically, what factors prompted firms to refocus their strategy? Or, what factors influenced poor performance (and hence, divestiture) of foreign operations? Future research also should focus on the interrelationships between media acquisitions and divestitures. To gain an accurate picture of the growth and contraction of a firm, it is necessary to investigate the differences between the operations the firm acquires, relative to the operations the firm divests. Research also should investigate the divestiture activity of media firms in general. This study explored the divestiture activity of major media firms; hence, its findings are not generalizable to other media firms. What are, for example, the divestiture strategies of small to mid-size media firms? In addition, empirical research should be conducted to ascertain whether associations exist among the divestiture variables and whether the associations are indeed significant.

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**Table 1: Divestiture Strategies**

<b>Restructuring Type</b>	<b>Divestiture Strategies</b>	<b>Divestiture Level</b>	<b>Tax Status</b>	<b>Divestiture degree/grade <sup>(a)</sup></b>	<b>Divestiture medium and/or consideration <sup>(b)</sup></b>	<b>Post-divestiture ownership status</b>
<b>Portfolio Restructuring</b>	Sell-off	Asset → Subsidiary	Taxable	Discrete & Partial	Cash, stock, or exchange	No ties
	Spin-off	Subsidiary	Can be tax-free	Discrete & Partial	Dividend via Stock	Some ties
	ECO	Subsidiary	Can be tax-free	Discrete & Partial	Cash & Stock	Close ties
	Split-off	Subsidiary	Can be tax-free	Discrete & Partial	Exchange stock	No ties
	Split-up	Entire firm	Can be tax-free	Series & Total	Exchange stock	Parent firm does not exist
<b>Financial Restructuring</b>	Leveraged buyout	Subsidiary / Division	Varies	Discrete & Partial/Total	Stock	No ties
<b>Organizational Restructuring</b>	Downsizing	Employees	Varies	Discrete & Partial	N/A	No ties

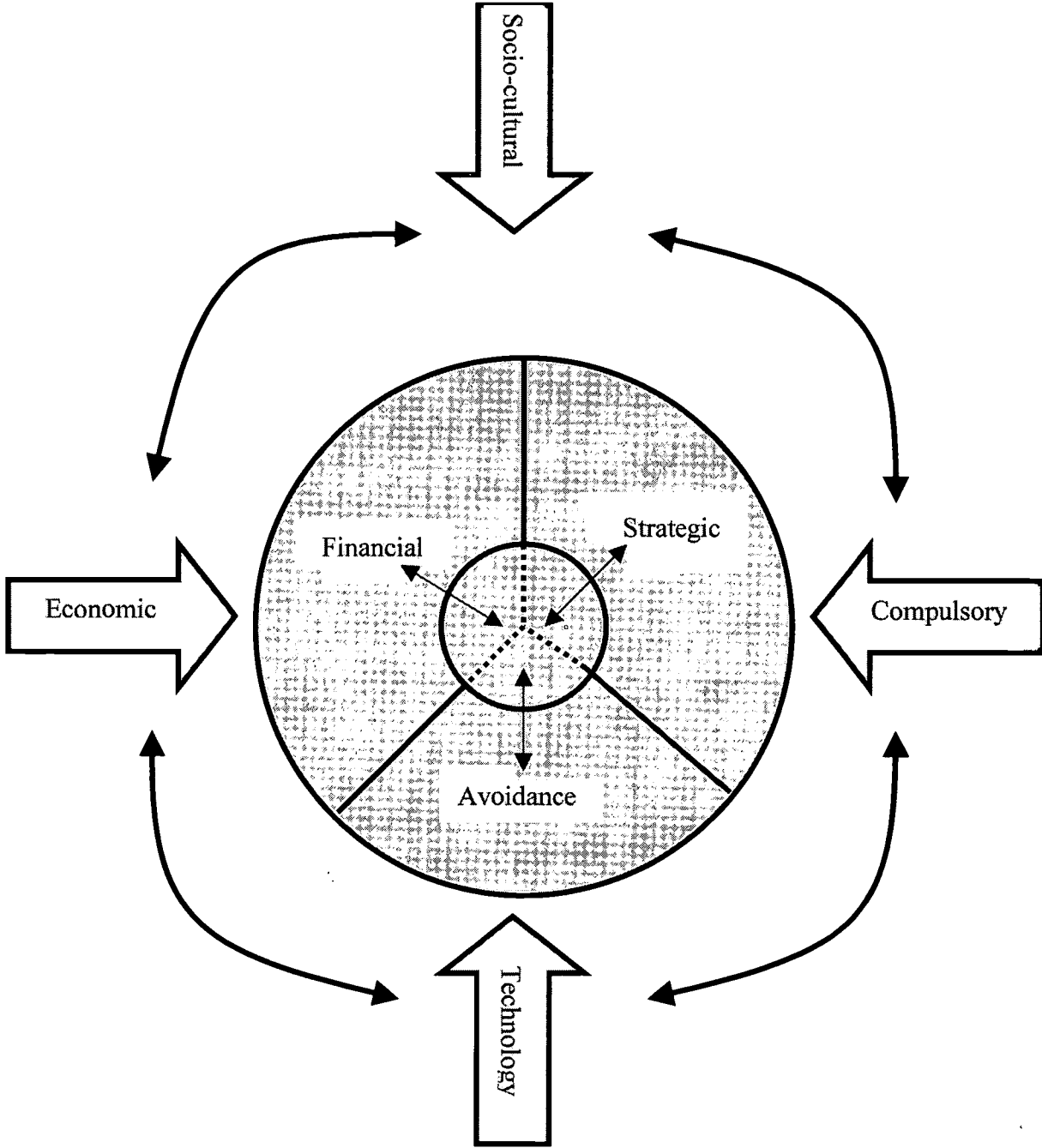
(a) Degree refers to whether the divestiture is partial or total, namely whether the parent firm retains other businesses (Buckley, 1991), and whether the divestiture is a discrete activity or a series of transactions (Gaughan, 1999; Vignola, 1974).

(b) Divestiture medium refers to what the parent company divests (most often stock); whereas divestiture consideration refers to what the parent company receives in exchange for its divestiture.

**Table 2: Divestiture Strategies of Major Media Firms,  
by Company and Year**

<b>Company</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>Total Divestitures</b>	<b>Divestiture Types</b>
Walt Disney	3	2	5	5	6	<b>21</b>	Sell-offs (15x) Exchanges (3/15) Downsize/Closure (6x)
Clear Channel	0	5	9	5	4	<b>23</b>	Sell-offs (22x) Exchanges (9/22) Downsize/Closure (1x)
Viacom	4	7	6	4	4	<b>25</b>	Sell-offs (18x) Exchanges (10/18) Downsize/Closure (6x) Split-off (1x)
Comcast	6	4	5	4	8	<b>27</b>	Sell-offs (27x) Exchanges (16/27)
News Corp	4	5	4	10	7	<b>30</b>	Sell-offs (23x) Exchanges (5/23) ECO (4x) Downsize/Closure (3x)
Cox	5	11	6	8	3	<b>33</b>	Sell-offs (32x) Exchanges (17/32) Downsize/Closure (1x)
AT&T	5	6	8	9	12	<b>40</b>	Sell-offs (31x) Exchanges (14/31) Downsize/Closure (6x) Spin-offs (2x) ECO (1x)
America Online	5	6	10	6	9	<b>36</b>	Sell-offs (31x) Exchanges (25/31) Downsize/Closure (5x)
Time Warner	7	3	6	7	3	<b>26</b>	Sell-offs (21x) Exchanges (10/21) Downsize/Closure (3x) ECO (2x)
Totals	39	49	59	58	56	<b>261</b>	Sell-offs (220x) Exchanges (109/220) Downsize/Closure (31x) Spin-off (2x) ECO (7x) Split-off (1x)

Figure 1: Internal and External Divestiture Determinants



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## Endnotes

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<sup>1</sup> A firm need not be a conglomerate to divest itself of property.

<sup>2</sup> The phrase “post-divestiture ownership status” was first introduced by Coyne & Wright (1986).

<sup>3</sup> However, spin-offs can be part of a series of transactions and can evolve into total divestiture of a firm, in which case the spin-off is classified as a split-up.

<sup>4</sup> America Online and Time Warner merged in early January 2001. Because this study focuses on divestiture activity from 1996 through 2000, their case study analysis details the divestiture activity of the separate entities in the given period.

<sup>5</sup> Due to the increasing M&A activity, a number of firms that were in existence independently in 1996 either have merged or been acquired by other media firms. Hence, it is difficult to follow their activity after being acquired or merged. This study focuses on the current major media firms and their activity backwards toward 1996. For example, AOL Time Warner merged early 2001. To track the divestiture activity of this firm, this study looks at the divestitures of America Online from 1996 to 2000 and Time Warner from 1996 to 2000.

<sup>6</sup> Tracking stocks were not considered as divestiture activity in this study. Tracking stock “differs from a traditional spinoff in that the business represented by the tracking stock remains wholly within the parent company” (“Tracking Stock,” <http://spinoffstocks.com>). Tracking stocks “exist alongside regular common stock but don’t include voting rights and don’t represent any claim on the asset of the company” (“Tracking Stock,” <http://www.investorwords.com>). Further, the “company that sets up a tracking stock still owns all the assts associated with the businesses being tracked, but some of its economic interest – both the risks and benefits – in that unit will be sold to investors” (Chang, 1999, online). However, a public offering (initial or secondary) or issuance of any other kind of stock – common or preferred – is included because it does signify a change in ownership.

<sup>7</sup> For the purposes of this study, the emphasis of LBO activity is on the object of the LBO, not on the company undertaking the LBO. Specifically, a company may be classified as an object of an LBO if it is the company bought out or taken private. As mentioned previously, this is not likely for the major media firms in this study.

<sup>8</sup> Some companies did not provide motivations for their divestiture decisions. Hence, companies that provided motivating factors to divest were categorized along aforementioned divestiture determinants.

<sup>9</sup> Some divestitures fell into early 2001, as company annual reports and 10-K reports are filed ninety days after a company’s fiscal year. The only way in which these were included in this study was if the divestiture had been completed as of the filing date.

<sup>10</sup> The FCC’s cross-interest policy prohibits ownership interest in more than one broadcast, cable, or newspaper property in the same area.



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<sup>11</sup> These business segments varied somewhat from Comcast's business segments in 1996. Comcast entered 1996 with three operating divisions: Wired, Wireless, and Content Provision. Comcast renamed these segments in 1997: Cable, Cellular and PCS, and Content Provision. In 1998, however, Comcast dropped down to a Cable division and a Programming Content division and added the Commerce segment the following year.

<sup>12</sup> America Online and Time Warner merged in early January 2001. Because this study focuses on divestiture activity from 1996 through 2000, the following discussion details the divestiture activity of the separate entities in the given period.

<sup>13</sup> The Interactive Services Group "develops and operates branded interactive services"; the Interactive Properties Group "is built around branded properties that operate across multiple services and platforms"; the International Group "oversees the AOL and CompuServe services and operations outside the United States"; the Netscape Enterprise Group focuses on providing businesses a range of software products, technical support, consulting and training services" (Annual Report to Shareholders, 2000).

<sup>14</sup> The 2000 Annual Report and 10-K filing for Time Warner was incorporated into America Online's 2000 Annual Report. The information in the 2000 Annual report was mostly relevant to America Online, as the acquiring company. Another SEC report, entitled a Transition filing also was used to acquire information on Time Warner's divestiture activity for the 2000 year. However, it is unclear as to how complete the transition report is in regard to Time Warner's divestiture activity during the transition period before the transaction was completed. The information generated from the two reports revealed Time Warner divested three times in 2000.

<sup>15</sup> However, this research utilized 10-K filings wherever possible to offset this potential marketing slant.

**Managing Innovation:**  
**U.S. Newspapers and the Development of Online Editions**

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## Managing Innovation:

### U.S. Newspapers and the Development of Online Editions

#### Abstract

Media managers in the 21<sup>st</sup> century will need to constantly assess and respond to emerging technologies that have the potential to disrupt the industry. This project examined the innovation-management processes that the newspaper industry used to respond to the Internet, using an analytical framework of recommended innovation management techniques derived from previous research. The study found that newspapers' innovation-management processes were generally haphazard and that industry executives should be better prepared in the future to manage innovation. From a theoretical perspective, the study also found that organizational responses to emerging technology were related to the senior executive's perception of the nature of the technology. The paper concludes that future innovation management research should control for variances in the technology's perceived nature.

One of the primary challenges facing media managers in the early 21<sup>st</sup> century is the constant influx of emerging, potentially disruptive technologies into the marketplace. Disruptive technologies are defined as “science-based innovations that have the potential to create a new industry or transform an existing one” (Day & Schoemaker, 2000). In the media industry, these can take the form of a technology that changes how existing media are produced or promoted – such as High Definition Television (HDTV) -- or they can be a wholly new technology-based information product that threatens the very existence of current media. The problem for media managers is to identify those technologies that are potentially disruptive and to respond to them in an appropriate and timely manner.

Doing so is no easy task. Management research shows that firms usually must decide whether and how to engage an emerging technology before its future role and likely impact on an industry are clear (Day & Schoemaker, 2000). However, organizational research has identified some processes that firms can use to minimize the risks of new technology adoption and maximize the likelihood that the firm will have a positive outcome from the process (Wheelwright & Clark, 1992).

This study sought to examine the degree to which newspaper managers were using the types of systematic technology-evaluation and adoption processes recommended by management experts as the newspaper industry faced emerging and potentially disruptive technologies. The study examined the processes daily newspaper managers in a Southeastern state in the United States used over the past decade to evaluate the Internet as an emerging technology and to decide how their organizations were going to respond to it.

#### Literature Review

As the pace of global innovation increases, the study of innovation management is rapidly growing in importance. While some industries are more affected than others by the gale force of new technologies, few organizations in the 21<sup>st</sup> century will completely escape the impact of innovation. Thus, being able to manage emerging technologies is becoming essential to organizational success (Day & Schoemaker, 2000).

The study of innovation management is, of course, not new. Management research has long focused on the issues and processes of new product development, and the literature in that area is robust. In traditional management research, an industry's approach to innovation management is considered an element of market conduct and is seen as key to helping industries and organizations maintain their competitive edge (Abernathy and Dunlop, 1995).

Industrial/organizational research has argued that firms need to conceptualize innovations as fully as possible so that the design reflects customer needs, market structure, technological capability and the firm's unique competencies (Dougherty, 1996). How a firm approaches organizing for, and managing, emerging technologies affects subsequent organizational performance. Rogers (1995) noted that in organizations, the implementation of new technologies or processes amounts to mutual adoption in which both the innovation and the organization change in important ways. Thus, management scholars have been concerned with finding the appropriate adoption and development strategies for firms. However, innovation management research has tended to focus on individual projects, small organizations and best practices (Dougherty, 1996), and has remained largely prescriptive and atheoretical.

Within the media management and mass communication literatures there has been even less focus on innovation management as an area of study, despite the rapid changes that have

overtaken media production and distribution technologies in recent years. Indeed, Day and Schoemaker (2000) identified the media industry as one of those that was most affected by technological innovation in the 1990s. However, most research on media organizations' responses to emerging technologies has focused on the effects of those technologies on employee job satisfaction (Daniels & Hollifield, in press; Russial, 1994; Stamm, Underwood & Giffard, 1995). This gap in understanding of innovation management exists in the media management literature despite the industry's negative experience with Videotext in the 1980s, a spectacular failure that made newspaper executives wary of investing in similar new technologies (Day & Schoemaker, 2000).<sup>1</sup>

One of the factors driving current interest in innovation management research is the recognition that many emerging technologies are, in fact, potentially "disruptive" to organizations and industries. Disruptive technologies force industries and organizations to continuously adjust to a changing environment and threaten their very existence. In 1994, Day and Schoemaker of the Wharton School of Business launched a comparative study of innovation management across multiple industries that had been confronted with potentially disruptive technologies during the late 20<sup>th</sup> century (Day & Schoemaker, 2000). The purpose of the study, which looked at the media, biotechnology, retailing, pharmaceuticals, and computer industries among others, was to identify common issues managers and industries face during periods of significant technological change.

Among the issues the study found to be critical for managers to successfully deal with

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<sup>1</sup> Videotext was greeted with much enthusiasm by the newspaper industry, which viewed it as a new distribution system for its news product. However, the technology for videotext proved to be a disappointment and the market virtually non-existent among consumers (Schoemaker & Mavaddat, 2000).

when faced with emerging and potentially disruptive technologies were: 1) evaluating the technology; 2) deciding whether, when and how aggressively to commit to it; 3) deciding how to develop a new technology-based product for an entirely new market; and 4) deciding how to design the organization to accomplish these tasks in such a way as to ensure that the organization would stay competitive in the new environment created by the technology.

Studies of innovation management and new product development, in general, have identified steps in the organizational-adoption process that appear related to improved likelihood of success when a company engages a new technology. These steps include: 1) conducting a pre-adoption technology-assessment-and-forecasting investigation; 2) conducting a market-assessment-and-forecasting investigation, and; 3) developing specific organizational objectives for the innovation development or adoption process (Wheelwright & Clark, 1992). Following these three steps, the research suggests that organizations should then develop an aggregate project plan and translated it into a defined strategy for project management and execution. The final step in successful innovation management is a post-project assessment and learning process (Wheelwright & Clark).

Also key to the success of the innovation process is the use of multi-functional, cross-departmental teams that tap the full range of knowledge in the organization (Atuahene-Gima & Li, 2000; Bonner, 1999; Wheelwright & Clark, 1992). Karlsson and Ahlstrom (1997) found that when an organization's product development strategies closely matched needs in the marketplace, innovation became a formidable competitive weapon for organizations. Other research has shown that new product development is improved when customer- input was sought, (Bonner, 1999; Souder, Sherman & Davis-Cooper, 1998; Xie & Song, 1995), when marketing and technical

teams had equal influence on the development process (Atuahene-Gima & Li, 2000; Bonner, 1999), when there were good interdepartmental relationships among those on the development team (Bonner, 1999), and when senior management was involved in the development effort (Karlsson & Ahlstrom, 1997; Ruekert & Walker, 1995). Senior management's success in setting specific and realistic guidelines for development also was found to be strongly related to the development team's ability to meet both budget and deadlines.

Within the innovation management literature, however, "emerging technology" has generally been considered a monolithic concept. Scholars have not examined whether organizational innovation-management responses are shaped by the nature of the technology itself – that is, by whether the technology is disruptive or perceived to be potentially disruptive by the organization. This study seeks to fill part of that gap in the literature by examining media organizations' responses to the emergence of the Internet.

#### The Internet as a Potentially Disruptive Technology for Media Companies

For media firms, the Internet as an emerging technology posed a particular dilemma because of the industry's experience with Videotext in the 1980s (Day & Schoemaker, 2000). When the Internet emerged as a publicly accessible communication system in the early 1990s, newspaper executives had to decide whether it was simply a new production technology, a new product that eventually might replace traditional media, some combination of the two, or the next videotext sinkhole.

Unlike Videotext, however, the Internet was not a proprietary technology. And, as a public access, text-based communication technology, it posed specific dangers to the newspaper industry's classified advertising revenue by providing a vehicle through which non-newspaper



companies could sell and distribute classified ads. No other form of media had ever mounted a serious competitive threat for classified advertising (Schoemaker & Mavaddat, 2000). The Internet also created new competition for local banner advertising sales (Fratik, 2001), and attacked the editorial side of newspapers' markets by providing a vehicle for TV and radio stations, cable systems and independent journalists to provide on-demand news stories in print. Industry experts predicted that eventually national online news providers such as *cnn.com* and *yahoo.com* would begin providing local news online (Schafer, 2001).

Despite these potential threats, most media firms were optimistic about the Internet. Nine out of 10 newspaper publishers believed that online newspapers would not replace print dailies, but rather would open new avenues for the newspaper industry (Peng, Naphtali & Xiaoming, 1999). Publishers said they started online editions in order to reach new readers, gain an advantage over the competition, and stay on the cutting edge of technological development. Other research showed that traffic for local online dailies came from their existing readers, while the national newspapers reached mutually exclusive readers in their online and print editions (Chyi & Lasarosa, 1999).

### Research Problem

This study examined the innovation management processes used by daily newspaper managers when faced with the emergence of a disruptive technology in the 1990s: the Internet. The study sought to fill the conceptual gap in the innovation-management literature by examining whether newspaper executives' views of the Internet as either potentially disruptive or non-disruptive were related to the innovation-management process that the organization used. Specifically, the project looked at the relationship between the publisher's conception of the

technology as potentially disruptive or non-disruptive, and the resources the newspaper put into new media, the way the newspaper organized its online development project, and the degree to which the organization perceived those efforts were successful in meeting organizational goals.

Additionally, the study sought to assess the degree to which executives in the newspaper industry used the innovation management strategies that previous research has suggested lead to more successful outcomes in technology adoption. The study used the Wheelwright and Clark model (1992) to assess the technology development strategy used by newspapers. The following hypotheses were tested:

**H1:** Newspaper publishers who viewed the Internet as potentially disruptive will

- a) have invested more resources in the development of online operations
- b) have been more likely to have used audience feedback during development of their online operations
- c) have been more likely to have used cross-functional teams in the development of their online operations
- d) have been more likely to have created a comprehensive new product as measured by the number of features they had on the Web site

than will have newspapers with publishers who viewed the Internet as a less-significant, non-disruptive innovation from the standpoint of the newspaper industry.

**H2:** Newspapers that used a model similar to the one recommended by Wheelwright and Clark (1992) for developing their online operations will be more likely to describe their online operations as successful, according to internal company standards.

## Method

To answer the question and hypotheses, a comparative analysis of the development processes that morning daily newspapers had used in creating their online editions was undertaken. The study was based on a telephone survey of publishers of morning daily newspapers in a single large state in the Southeastern United States. A standardized survey instrument was used to conduct the interviews. The researchers interviewed the newspaper publisher in all but three cases. In those cases, the publisher referred the researchers to an individual in the newspaper who was better able to respond to the specific questions asked in survey. Generally, those referrals were made because the publisher had not been with the newspaper at the time that the online edition was developed.

In all 13 publishers who oversaw 20 morning daily newspapers in the state were interviewed. Additionally, at three newspapers, the editor was surveyed instead of the publisher on the publishers' recommendations. Where a publisher was responsible for more than one morning daily newspaper, the respondent was asked to address the development processes used at the different newspapers as individual cases. The interviews were conducted in spring 2001.

There were 32 morning dailies in the selected state at the time of the project, constituting the majority of the daily papers in that state (Editor & Publisher, 2000). Using the newspaper as the unit of analysis, a census was attempted. A total of 23 newspapers agreed to participate, for a response rate of 72%.<sup>2</sup> The papers were mostly small and medium-sized: 44% had a circulation of less than 10,000, 35% had a circulation between 10,000 and 25,000. Only 9% had a circulation

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<sup>2</sup> No major regional newspapers were respondents, so the responding newspapers were all roughly comparable to one another and consistent in size, scope and resources with the majority of newspapers in the United States.

between 25,001 and 50,000, while 13% had a circulation between 50,001 and 100,000.

The main independent variable for the study was newspaper publishers' perceptions of the Internet as either a potentially disruptive or non-disruptive technology for the local daily newspaper industry. The variable was operationalized as newspaper publishers' responses to questions about whether they thought the Internet eventually would be more popular, as popular, less popular or generally unpopular as a source of news with consumers as compared to traditional media. Publishers who thought the Internet would eventually be as popular or more popular than local daily newspapers with consumers as a news source were coded as considering the Internet to be a potentially disruptive technology for the local daily newspaper industry.

The dependent variables included resource allocation by a firm for the development of the online edition, use of audience feedback and cross-functional teams in the development process, creation of a comprehensive new online product, the use of a model similar to the Wheelwright and Clark model (1992), and the publishers' perceptions of the success of the organization's Internet edition.

Resource allocation was operationalized as the number of personnel assigned to the development of the online edition. The study also asked the publishers about the size of the financial commitment they had made to their online editions. However, the measure proved to be flawed and the data are not reported. Audience feedback was measured as whether newspapers had sought input from readers in developing their Web presence. Use of cross-functional teams in the development of the site was measured by the formal roles played by the editorial, marketing and technical department in the creation of the online edition. The site as a comprehensive new product was operationalized as the number of interactive and other features that the Web site

provided. Each newspaper's Web site was visited to independently confirm the information provided in the survey interviews about site content.

Because the study used a census as opposed to a random sample, tests of significance could not be used to determine whether or not the hypotheses had been supported. Therefore, prior to data analysis, it was determined that a moderate correlation would be the benchmark for determining support for the hypotheses. The study used the scale developed by Elifson, Runyon and Haber (1990), for correlation testing. According to that scale, a correlation between .01 and .3 is classified as "weak;" a correlation between .31 and .7 is "moderate;" and a correlation between .71 and 1.0 is "strong."<sup>3</sup>

To test hypothesis 2, open-ended responses to the dependent variables of perception of success were coded by three coders. Inter-coder reliability was measured using Holsti's (1969) composite coefficient of reliability and was higher than .80 for all the questions. Thus, intercoder reliability levels were satisfactory.

### Findings

Analysis of the data suggested that the innovation-management process used by newspapers as they adopted the Internet was relatively haphazard, involving low-levels of research, resource commitment, involvement by the editorial department, or use of cross-functional teams. Moreover, the data showed that few of the responding newspapers were attempting to fully utilize the unique properties of the Internet. In short, few of the newspaper executives surveyed had used the types of processes identified by innovation management

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<sup>3</sup> A reviewer of a different manuscript that used a similar standard noted that use of a moderate correlation as defined on this scale as the benchmark for hypothesis support is conservative, particularly in a study with a small N. The authors agree, but prefer to be conservative in their claims of support or non-support for hypotheses.

research as being related to successful organizational adoption of emerging technologies.

At the time of the survey, all the respondents had online editions except two, both of which were in the process of launching such operations. One newspaper had been an early adopter of the Internet, having started planning its online edition in 1993 before the Internet was widely available to the public. However, 67% of the newspapers had launched their online editions in 1998 or later.

Based upon the number of publishers citing a reason as either “very important” or “important” to their decision to go online, the need to protect classified advertising revenue was the driving force behind decisions to develop online editions, followed by the desire to reach new readers, to sell banner advertisements, and to help existing readers get information more quickly. The study also found that newspapers’ parent companies had influenced the decision to launch an online edition in almost half the papers. Interestingly, 80% of the publishers who responded saw the Internet’s potential to attract new readers as being far more important than its potential to improve service to existing readers. Only 28% of the publishers said they went online to gain a competitive advantage over other local media.

The majority of publishers (63%) reported that their online editions had initially been designed and developed in-house (not shown in tables). Only 5% had had their online editions developed for them by their parent company, while almost one-third (30%) had outsourced the development of their online editions to professional Web design companies. However, after the initial in-house development of the Web site, more newspapers turned to their parent company or an outside design firm for further changes. By the time of the survey, fewer than half of the sites

(47%) were being managed in-house, and a number of the executives at those newspapers expressed concern both about the loss of local control of those operations and, in some cases, the loss of the online editions' uniquely local look and feel as the result of the use of parent company or external design templates.

**H1a:** The hypothesis was supported. A moderate correlation (.631) was found between publishers' feeling that the Internet was a potentially disruptive new technology and the number of employees they had initially assigned to work on the development of the online edition (Table 1). Closer examination of the data showed that nearly half of the newspapers (45%) had not assigned any employees full-time to developing the online edition during startup, although nearly one-third had had up to two full-time employees working on the edition (Table 2). At the time of the survey, 43% of respondents still did not have a single full-time employee exclusively assigned to the online edition, but as many newspapers had one or two full-time employees working on the electronic operations. Some papers reported having as many as 20 full-time employees working on the online editions, which may reflect more centralized management of electronic operations by the parent company.

**H1b:** This hypothesis also was supported (Table 1). A moderate correlation (.430) was found between publishers' perception of the Internet as a potentially disruptive technology and their use of audience feedback during the design process for their online editions. Although not hypothesized, moderate correlations also were found between the publishers' views of the Internet as disruptive and their application of several other recommended steps in the innovation management process, such as the use of research on consumer adoption of the technology (.449), research on likely target market for their online editions (.496), and the use of goal-setting as a

step in the development process (.386). Interestingly, however, only a weak correlation (.111) was found between publishers' views of the Internet and their use of technology forecasting, that is, research on how Internet technology might develop or change in the near and mid-terms (not shown).

Further examination of the data showed that while there was a moderate correlation between publishers' views of the Internet as potentially disruptive and their use of audience feedback, use of such feedback was still relatively rare. Only slightly more than one-third (37%) of newspapers consulted their readers during the development process (Table 3), despite research that shows customer feedback is a crucial element of successful new development of new technology-based products (Bonner, 1999; Souder, Sherman & Davis-Cooper, 1998; Wheelwright & Clark, 1992; Xie & Song, 1995). More than half of the newspaper publishers interviewed (55%) had engaged in some form of market forecasting during their planning process by seeking out projections on general consumer adoption patterns for the Internet. However, less than one-third (29%) had researched their specific target markets. This finding is particularly interesting given that many of the daily newspapers in the study were small and serving relatively rural areas where previous research has shown that Internet adoption among consumers significantly lagged adoption among urban consumers through most of the 1990s (U.S. Department of Commerce, 1999). Similarly, only about one-third of the respondents (32%) had invested in technology forecasting (Table 3).

Most publishers (73%) reported that they had set goals for their online editions before launch. However, the majority also said their goals were non-specific and non-measurable such as "to be the site for the local community as well as for those outside (the state) who want news



about the town.”

Following the initial analysis, newspaper circulation size was controlled in a reanalysis because larger newspapers would be expected to have more personnel and financial resources and, therefore, to be better able to undertake pre-development assessment and research. However, only weak negative relationships were found between circulation size and use of audience feedback (-.178), research on consumer adoption of the Internet (-.285) and the use of target market research (-.128) during the online development process (not shown in tables). It seems that large papers were less likely to undertake pre-development assessment. However, a moderate correlation (.510) was found between circulation size and use of technology forecasting research.

**H1c:** H1c also was supported. Newspapers run by publishers who believed that the Internet might, in fact, become a disruptive news-distribution technology were more likely to have used cross-functional, multi-departmental teams when developing their online editions, as recommended by the innovation management literature (.614) (Table 1).

However, only 10% of publishers responding to the survey said they had formally involved all of the newspapers' departments in the development process (Table 4). Of the departments that publishers reported had formally served on the online edition development team, fewer than half (48%) named the editorial department, although another 28% reported that the editorial department had been involved through “informal” discussions or meetings. Publishers were as likely to say that they had formally (43%) or informally (19%) involved the marketing and graphics departments in the process.

No correlation was found between circulation size and use of multifunctional teams (-.020).

**H1d:** Hypothesis 1d was not supported. The relationship between publishers' attitudes towards the potential of the Internet as a replacement news product and the number of features or interactive services provided online was in the direction hypothesized but did not meet the pre-set standard of significance established for this study (Table 1). Only a weak correlation (.213) was found between publishers' views of the Internet and the total number of different features that were offered through their online editions. Similarly, a weak correlation (.236) also was found between publishers' views and the number of interactive services available on the site (not shown).

One possible explanation for the fact that the relationship was in the direction hypothesized but not strong enough to be judged significant is that some newspapers may initially have launched limited Web sites and added features over time. It was not possible to measure the number and types of features that had been available when the sites were first launched. It can be speculated that differences among the Web sites may have been greater at the time of initial development.

In general, publishers reported that they were uploading relatively little of their newspapers' content to the Web. Two-thirds of respondents reported that their newspapers made less than 25 percent of the day's news stories available online, while only 15 percent reported that they were uploading about half of the paper's daily news content (Table 5). The trend was similar for pictures. This suggests that newspapers feared that if they made available their content from the print edition to the online edition, it might lead to a drop in circulation.

The study found, however, that newspapers were using the Internet to provide some new forms of content not normally provided in their traditional format (not shown in tables). More

than three-quarters (76%) were providing weather updates or links to sites that would give current information about the weather in the town/county, and almost all the sites (90%) provided information about the town/county for visitors and local job listings.

Use of the interactive and real-time capabilities of the Internet was more mixed among respondents. Less than one-quarter (24%) were providing online news updates, while none provided traffic updates. More than three-quarters of the sites had a search engine and more than half (57%) provided a feedback forum for readers' queries and comments. However, only 14% provided a message board for readers and only 14% provided chat sites. None of the sites provided links to related stories, while only about 10% provided links to related sites. Few newspapers seem to have tapped the revenue potential of their archives, with only 19% providing public access to news archives.

In summary, the study found that more than 70% of the newspapers with online editions offered readers four or fewer of the types of interactive features or instant information services made possible through Internet technologies.

**H2:** Hypothesis 2 also was not supported. No correlation (-.048) was found between newspapers that used an innovation management process similar to the one recommended by previous research (Wheelwright & Clark, 1922) and their assessment that their Web sites were successful (not shown). All of the publishers reported that they viewed their Web sites as being at least somewhat successful. Consequently, there was little variance on the measure of Web-site success.

Finally, no correlation was found between circulation size and use of most or all of the recommended steps in the innovation management process, based upon an index created to

measure the use of the process (-.048). This suggests that following a more complex innovation management process did not depend on the size of the newspaper.

#### Discussion and conclusion

The study found that managers in the newspaper industry had approached the process of assessing and adopting the Internet as an emerging technology in a relatively haphazard fashion when the development processes used by respondents were compared to the new product assessment and development processes identified in previous research as enhancing the likelihood of success. Few of the newspapers surveyed had engaged in technology forecasting or target-market research before launching their online editions, and few had sought reader feedback during the development process. Only a handful had fully tapped the expertise in their own organizations during the development process by setting up formal, multi-departmental development teams. Only a minority had formally involved the editorial department -- the primary production unit of a newspaper organization -- in the formal assessment and development process, although the majority had made at least informal contact with the editorial staff at some point during the process. Finally, virtually none of the newspapers had set specific, measurable goals for their online editions that might have served as guides to a decision as to whether to increase or discontinue their investments.

The failure to conduct systematic technology strategy and development processes increases a firm's risk when facing emerging and potentially disruptive technologies. It increases the likelihood that a firm will invest at the wrong time or in the wrong technology, such as the U.S. newspaper industry did with Videotext in the 1980s. Interestingly, circulation size was not a predictor of having used a more systematic approach to the development of online editions, even

though larger newspaper organizations might be expected to have more personnel and financial resources to use for technology assessment and development.

Finally, from a theoretical perspective, the study's findings suggest that the perceived nature of an emerging technology does influence an organization's response to it. Specifically, the study found that newspapers publishers who believed the Internet had the potential to be a disruptive technology for their industry had used a more systematic and comprehensive process for developing an online edition and had developed a slightly more comprehensive online product than those who had not viewed the Internet as potentially disruptive to their industry or organization. This finding suggests that future research on innovation management in both the media and other industries needs to use the perceived nature of the innovation as a variable. Past innovation management research has not done this, so the findings in this project suggest a new line of inquiry for future scholarship.

This project had a number of limitations. It used a census of newspapers in a single state in the United States, and while the response rate was high, the sample size was small. Additionally, the study of newspapers in a single state means that there is potential for systematic bias in the data because geographically proximate organizations may influence each other through formal and informal contacts. Additionally, industry consolidation and clustering meant that there was co-ownership and joint management across some of the papers in the sample. Although the findings indicated that circulation size was not related to sophistication in innovation management, the papers in the study were generally small and medium-sized papers, and the possibility cannot be ruled out that a study which included large metropolitan dailies, regional papers, nationally distributed papers, or papers published in countries other than the United States, might have

different results. It also must be noted that the measures used in this project were based upon self-report, which can present a problem particularly given the time-lag between the survey date and the events many respondents were asked to recall. Their present knowledge of the Internet might have shaped their memory, and hence their responses.

In general, however, the findings of this study suggest that newspaper organizations need to pay more attention to the processes they use to assess and engage emerging technologies. They also suggest that newspaper companies should provide senior managers with more formal training in innovation management. The media have been identified as one of the industries most significantly affected over the past decade by the emergence of disruptive technologies (Day and Schoemaker, 2000). The continued rapid pace of development in the computer and telecommunications industries make it highly likely that media executives will be confronted with other new and potentially disruptive technologies in the foreseeable future. Given the amount of investment that often is needed to address such emerging technologies, and the risks that organizations face when they fail to do so successfully, innovation management is a skill set that newspaper organizations should seek to develop more fully within their executive teams.

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Table 1: Correlations between publishers' initial perception of the Internet as a potentially disruptive technology and the use of systematic innovation management process in developing the Online edition.

	Perception of Internet as a disruptive technology	Initial no. of employees	Audience feedback	Consumer research	Target market Research	Multi-functional develop. team	Number of features on Web site	Goals
Perception of Internet as a disruptive technology	1.00							
N	(23)							
Initial no. of employees	.631	1.00						
N	(20)	(20)						
Audience feedback	.430	.687	1.00					
N	(19)	(19)	(19)					
Consumer research	.449	.231	.651	1.00				
N	(22)	(20)	(19)	(22)				
Market research	.496	.467	.889	.548	1.00			
N	(21)	(20)	(19)	(21)	(21)			
Multi-functional develop. team	.614	.690	.807	.556	.660	1.00		
N	(21)	(20)	(19)	(21)	(21)	(21)		

	Perception of Internet as new product	Initial No. of employees	Audience feedback	Consumer research	Target market research	Multi-functional develop. team	Number of features on Web site	Goals
Number of features on Web site	.213	.548	-.072	.033	-.216	.356	1.00	
N	(21)	(20)	(19)	(20)	(20)	(20)	(21)	
Goals	.386	.412	.456	.671	.354	.484	.038	1.00
N	(22)	(20)	(19)	(22)	(21)	(21)	(20)	(22)

107

Table 2: Percentage of newspapers by number of full-time employees working on online edition at startup and time of survey

Number of Employees	At Startup	During Survey
	%	%
0	45	42.9
1	3	14.3
2	30.4	28.6
5	4.3	0
8	0	4.8
10	0	4.8
20	0	4.8
N	20	21
Total	100	100

Table 3: Newspapers' Use of Recommended Technology Development Processes

	Use of Audience Feedback	Research on Consumer Adoption of Internet	Research on Technology Forecasting
	%	%	%
Yes	37.0	54.5	68.2
No	63.0	45.5	31.8
N	19	22	22

Table 4: Percentage of newspapers that included different departments in the development team for their online editions

	<b>Editorial</b>	<b>Marketing</b>	<b>Technical</b>
	%	%	%
Part of team	47.6	42.9	42.9
Formal meetings	9.5	9.5	9.5
Informal meetings	28.6	19	23.8
Not involved	14.3	28.6	23.8
N	21	21	21

Table 5: Percentage of newspapers by percentage of stories and pictures from the print edition were uploaded

	<b>Stories uploaded</b>	<b>Pictures uploaded</b>
	(%)	(%)
Less than 25 percent	66.7	76.2
Between 26 and 50 percent	9.5	4.8
Between 51 and 75 percent	14.3	9.5
Between 76 and 100 percent	9.5	4.8
All	0	4.8
N	21	21
Total	100	100

# Change and Stability in the Newspaper Industry's Journalistic Labor Market

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# Change and Stability in the Newspaper Industry's Journalistic Labor Market

## ABSTRACT

Among the common assumptions made about the journalistic labor market is that is hierarchical, with entry-level hiring done almost exclusively by smaller organizations. Individuals are thought to be able to gain employment at larger media organizations only after they have served time in smaller ones. The assumed normal career progression for a newspaper journalist is from a small newspaper, perhaps even a weekly, to a larger one and on up the chain, with employment at larger organizations open only to those who have served their time at the lower levels of the employment chain. It generally is assumed that these patterns of employment have remained relatively stable across time.

This paper draws on an unusual data source consisting of surveys of daily newspaper editors in 1986 and every five years after, with the most recent survey conducted in 2001. Questions on each of the instruments provide basic data on hiring in the newspaper industry the year before.

Analysis of these data shows that most entry level hiring is done by smaller daily newspapers. There are exceptions, however, with some larger organizations also hiring journalists with no prior journalistic experience. The analysis shows that this pattern has not changed markedly over the last 20 years. It also shows that membership in a newspaper group impacts hiring.



## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Journalistic labor markets are commonly assumed to be hierarchical, with entry-level hiring done almost exclusively by smaller organizations. Individuals are thought to be able to gain employment at larger media organizations only after they have served time in smaller ones. This assumption is thought to hold for both print and broadcast media.

As a result, the normal career progression for a newspaper journalist is expected to be from a small newspaper, perhaps even a weekly, to a larger one and on up the chain, with employment at larger organizations open only to those who have served their time at the lower levels of the employment chain. For example, Lacy and Simon (1993, p. 270) discuss "the newspaper tradition of hiring entry-level journalists at low wages, especially in small markets, expecting them to move up to better paying newspaper organizations."<sup>1</sup> Relatively little cross over from other journalistic organizations to the newspaper industry is thought to take place.

It generally is assumed that these patterns of employment have remained relatively stable across time, even though there have been dramatic changes in the daily newspaper industry itself, and that the patterns have not been influenced greatly by changes in the larger labor market or even the overall economy.

Despite these assumptions, there is little more than anecdotal data to support them. Little systematic research on hiring in the daily newspaper industry exists. Almost nothing has been done to delineate the characteristics of the labor market that exists.

This paper draws on an unusual data source consisting of surveys of daily newspaper editors in 1986 and every five years after, with the most recent survey conducted in 2001. Identical questions on each of the instruments provide basic data on hiring in the newspaper industry the year before.

Analysis of these data shows that most entry level hiring is done by smaller daily newspapers, consistent with the assumption. There are exceptions, however, with some larger organizations also

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<sup>1</sup> Lacy and Simon (1993, p. 270, 279) argue this pattern hurts the quality of smaller newspapers. The effect of hiring on quality is a subject worthy of research. However, the question is beyond the scope of this study.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

hiring journalists with no prior journalistic experience. The analysis shows that this pattern has not changed markedly over the last 20 years. It also shows that membership in a newspaper group impacts hiring.

### **The Daily Newspaper Industry**

The daily newspaper industry is characterized by a large number of relatively small organizations spread geographically around the country. The large metropolitan dailies that have national or even regional reputations are the exceptions, rather than the norm, in the daily newspaper industry. Most newspapers are monopolies in their markets, and, as such, they are the only possible employers for daily newspaper journalists in those communities.

Traditional assumptions about the progression of newspaper careers and the large number of smaller dailies suggest that the larger papers can focus on hiring those with more experience or skills. The distribution of newspaper size in the United States is consistent with this assumption. In 2000, about 85 percent of 1,480 U.S. dailies had a circulation of less than 50,000 (American Newspaper Publishers Association, 2001). This distribution has remained almost consistent since 1970. There were only 223 newspapers larger than 50,000 circulation in 2000, but 53 percent of those had 100,000 circulation or less (American Newspaper Publishers Association, 2001).

The structure of newspaper competition is also consistent with traditional assumptions about journalists moving up in the industry. Newspaper markets are defined geographically by the extent of a paper's circulation, and the core of those markets is usually the city or county where the paper is located. Head-to-head competition exists only in a handful of newspaper markets. Most daily markets have either a monopoly newspaper or indirect competition between different layers of newspapers (Lacy & Simon, 1993, p. 112-115). The so-called umbrella model suggests regional metropolitan dailies, one layer, compete with satellite-city newspapers that emphasize local coverage, a second layer. Regional dailies may also compete with suburban dailies, which are a third layer. A fourth layer of competition includes weeklies, shoppers and specialized newspapers. National dailies are a fifth layer of competition, and group-owned suburban newspapers make up a sixth layer (Lacy & Simon, 1993,

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

p.114). Empirical studies support this model (Lacy, 1984, 1988; Lacy & Dalmia, 1993; Lacy & Davenport, 1994).

A second major trend in the newspaper industry also appears consistent with employment as a progression from smaller to larger papers. Independent daily newspapers are increasingly rare. Most newspapers are members of a group. Newspaper Association of America data show that 20 newspaper groups with the largest circulation accounted for 67 percent of all daily circulation in the United States in 2000 (American Newspaper Publishers Association, 2001). However, these 20 groups owned just 38 percent of U.S. newspapers.

Newspaper groups of all sizes also use a strategy of assembling clusters of commonly-owned newspapers in geographically adjacent markets, in part to share resources such as newsroom personnel (Lacy & Simon, 1997; Martin, 2002). A third of all U.S. dailies were part of a cluster in 1998 (Martin, 2002).

Lacy and Simon (1993, p. 279) suggest groups can rapidly move young, promising employees from smaller to larger newspapers. The dominance of groups in the newspaper industry, and resource sharing strategies such as clustering, suggest that if traditional hiring patterns exist they may also work internally in groups.

In other words, if there is no umbrella competition in a particular market, the local daily newspaper will be the local daily newspaper labor market. In markets with clustered newspapers, the commonly-owned papers may also dominate the newspaper labor market. In such cases, an individual employee may move within that labor market only by moving within the single newspaper company. Journalists who leave a newspaper in search of another daily newspaper job would have to move to a geographically different labor market.

But if a local group owns newspapers of differing sizes, then journalists could move up within the group without changing overall employers. The labor market of the single employer would cut across individual newspapers and across geographically separate communities.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Labor markets are the site of exchanges involving individuals and organizations. Such exchanges are governed by institutions, or rules for social relationships and actions. Labor market interactions could therefore be addressed from a variety of theoretical perspectives. For example, some sociologists argue that institutional rules become taken-for-granted understandings about possible states of the world. These understandings then determine and constrain the range of options that individuals believe are available when making employment decisions (Powell & DiMaggio, 1991). Other researchers (Coverdill & Finlay, 1998) have concluded that employment decisions are only partly based on a candidate's education, skills and experience. Another key variable in hiring is a candidate's fit, or "compatibility with a particular organization's culture, norms, and strategies ... [and] with the hiring authority and interviewers" (p. 122.). A third perspective (Granovetter, 1995) argues that personal contacts "are of paramount importance in connecting people with jobs" (p. 22). Granovetter argues that the best paying, most satisfying, and prestigious jobs are often found this way.

Each perspective contributes to understanding labor markets. The most basic characteristics of such markets, however, are exchanges of labor in return for pay. Economics is the study of exchanges and their outcomes. Exchanges in labor markets must resolve conflicts between preferences of the parties involved. Tradeoffs are required to make resolution possible. Wachter and Wright (1990) argue that economics is particularly suited to the study of tradeoffs in the Internal Labor Markets (ILMs), which are the focus of this study. This is because tradeoffs in ILMs "are similar to the tradeoffs that economists analyze in their study of resource allocation, [therefore] the economic model can be used to illuminate the precise tradeoffs as well as to describe the choices made by particular firms and workers" (Wachter & Wright, 1990). Doeringer (1986) also discussed the importance of sociological variables for the development of ILMs while incorporating these variables into an economic analysis. For example, stable social relationships contribute to the development of increased bargaining power among workers, and to agreement about the distribution and pace of work (Doeringer, 1986). Therefore, this paper adopts an economic perspective for the analysis of internal labor markets.

### **Hiring as Process**

## Change and Stability in the Newspaper Industry's Journalistic Labor Market

Descriptions of newspaper labor markets are consistent with more general theoretical discussions in the economics and organizational literature. Economists model hiring as a process of matching vacant jobs with people qualified to fill them (Petrongolo & Pissarides, 2001, p. 392).<sup>2</sup> Firms search for employees and employees search for jobs, but matches are not always efficient. Mismatches result if there are "large differences" (p. 399) between worker skills and job requirements. Mismatches also result if workers are located in one market and jobs are located in another (p. 400). Other factors affecting job matches are the intensity of job searches<sup>3</sup> and competition between unemployed and employed job seekers (p. 416-418). For instance, workers earning less than their desired wage may search for better jobs during economic expansions, and employers may respond by opening more vacancies that are attractive to those workers (p. 418).

The inefficiencies, or frictions, in job matching offer a framework for the traditional view of newspaper job markets. Employers and employees both want to reduce the probability of mismatches. Newspapers may generally hire from those educated for or active in the industry to reduce the probability of hiring someone with the wrong skills. Journalists can reduce search costs by focusing on newspapers considered appropriate to their level of experience. For instance, college graduates may look first at smaller newspapers. As journalists accumulate experience and can command higher wages, they move up to larger newspapers that are willing to hire them because their record helps predict their future performance.

Uncertainty about the performance of workers after they are hired is another variable influencing job matching. Hiring means making a contract.<sup>4</sup> Neoclassical economics suggests contracts are

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<sup>2</sup> A simple formal model of this matching function is  $M=m(U,V)$ , where  $M$  is the number of jobs at a given time,  $U$  the number of workers looking for jobs, and  $V$  the number of vacant jobs. If markets are efficient, the probability that workers find jobs is  $m(U,V)/U$ . The probability a vacant job is filled is  $m(U,V)/V$  (Petrongolo & Pissarides, 2001, p. 392).

<sup>3</sup> Intensity is defined as the "number of 'units' of search supplied by a given individual" (Petrongolo & Pissarides, 2001, p. 403). There is a cost associated with each search unit, so individuals provide different numbers of units based on their search costs, the costs of being unemployed, and their expected return from finding a job.

<sup>4</sup> Contracts do not have to be formalized; any agreement to terms of employment is a contract.

## Change and Stability in the Newspaper Industry's Journalistic Labor Market

intended to control costs associated with economic transactions (Williamson, 1985; Williamson, 1979).<sup>5</sup>

Contracts control transaction costs by specifying each party's obligations and how disputes will be settled.<sup>6</sup>

Transaction cost analysis identifies two other sources of inefficiency (Williamson, 1985) that are relevant to job matching. The first is uncertainty, because neither the potential employee nor the potential employer can predict all contingencies that may arise after someone is hired. The second is specificity, or the degree to which employee skills are specialized so they cannot easily be replaced.<sup>7</sup> These dimensions interact, because employees with widely available and more general skills easily can be replaced. Therefore, uncertainty about their performance is less important when negotiating their employment. However, as skills become more specialized employees are harder to replace. For example, newspaper groups may reduce frictions by hiring from within, promoting employees whom managers already know quite well. Friction can also be reduced, and productivity can increase, because employees are used to working together. Stable work groups tend to agree on the distribution of both work and income (Doeringer, 1986, p.49-50).

Martin (1997, p. 12-13) argued that transaction cost analysis suggests an individual newspaper has little incentive to make substantial investments in employees with skills that are widely available in the newspaper industry. However, a newspaper has incentives to make such investments in employees

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<sup>5</sup> Williamson (Williamson, 1985) describes transaction costs as separate from the costs associated with production of a good, such as a newspaper. Transaction costs are the "economic equivalent of friction in physical systems" (p. 19).

<sup>6</sup> Two assumptions underlie the argument that firms use contracts to control transaction costs (Williamson, 1985, chap. 2). First, economic actors have limited rationality, and cannot anticipate all the contingencies likely to arise in an economic relationship. Second, economic actors want to satisfy their own interests and will do so "with guile" (47).

<sup>7</sup> Formally, specificity is the degree to which assets or parties to a contract are unique (Williamson, 1985, chap. 2). As specificity increases, it becomes harder to find substitutes. Uncertainty suggests parties cannot predict the probability that contracts will be fulfilled for unanticipated contingencies. Specificity and uncertainty interact because if there are surprises involving nonspecific assets, those assets easily can be replaced. However, as uncertainty and specificity increase, more complex contracts are needed to manage the costs of ensuring that investments in the specific assets are recovered. As governance of the relationship becomes more complex, governance costs increase. So a third important dimension is the frequency of transactions between the parties. The cost of complex governance structures cannot be recovered unless transactions occur often enough to justify the investment.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

with specific skills or knowledge, such as editors with intimate knowledge of newsroom operations. This analysis can be extended to internal hiring across newspaper groups with similar results.

### **Internal vs. External Labor Markets**

Economic theory, then, suggests newspapers may hire from either external or internal labor markets. Newspapers compete with other firms in external labor markets. Newspapers that fill jobs by hiring from within have internal labor markets (ILMs). Doeringer and Piore (1971) offered the standard definition of ILMs:

"The internal labor market, governed by administrative rules, is to be distinguished from the *external labor market* of conventional economic theory where pricing, allocating and training decisions are controlled directly by economic variables. These two markets are interconnected, however, and movement between them occurs at certain job classifications which constitute *ports of entry and exit* to and from the internal labor market. The remainder of jobs within the internal market are filled by the promotion or transfer of workers who have already gained entry. Consequently, these jobs are shielded from the *direct* influence of competitive forces in the external market" (p.2).

Pinfield (1995, p. 12) lists five structural elements of an ILM as (1) limited ports of entry, (2) job ladders, (3) administrative criteria for promotion and cutbacks, (4) stringency of rules limiting managerial discretion, and (5) a compensation system. Employees enter ILMs at ports of entry, typically the least demanding in a progression of increasingly demanding and rewarding jobs. This progression of jobs is called a job ladder.

Neoclassical economic theory suggests employers with ILMs might compete for employees with other firms that are part of the External Labor Market (ELM). External employers would compete for the firm's employees by offering better wages. Doeringer and Piore (1971), however, noted that when employers surveyed wages at competing firms, the results had little influence on wages at the firm conducting the survey. Wages were primarily determined by the firm's internal job classification system.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Doeringer (1986) subsequently described ILMs as "highly resistant to competitive influences" (p. 48). This resistance can generally be overcome only by competition from new products or changes in the structure of the external labor market. Neoclassical models of wage competition do not apply to ILMs because those models assume (a) there are no fixed costs of employment and (b) workers can easily transfer from one firm to another (Doeringer & Piore, 1971, p. 74). If this is the case, workers earn wages equivalent to the amount they could earn elsewhere. Prevailing wages also equal a worker's marginal product, which is the increase in output from hiring the worker. In this model, wages are a variable cost.

The model does not apply if there are fixed costs--such as training costs--associated with employment. In such cases, each worker's marginal productivity must equal those fixed costs plus the variable wage she or he is paid (Doeringer & Piore, 1971). The worker, however, may not immediately produce enough to cover those costs. This means training or other investments cannot be recovered if the worker leaves, resulting in "job immobility...If workers were to switch jobs or firms were to discharge workers, the sunk investments would be lost" (Wachter & Wright, 1990, p. 243).

This does not mean external economic pressures are entirely absent. Rather, wage competition is "rechanneled" (Wachter & Wright, 1990, p. 245) to jobs that are ports of entry into the ILM. Employees in an ILM have bargaining power because the firm must recover its investment. This allows them to negotiate arrangements with the firm to divide the surplus--or gains in productivity available from their firm specific knowledge--with the firm. If workers are more risk averse than their employers they will at times accept wages that are less than their marginal productivity in the expectation of later earning wages that are higher than their marginal productivity when the firm's investment in the worker begins to pay off (p. 246-247). The contracts that allow firms and workers to share the risks and rewards available from ILMs can be quite complex. Detailed discussions of these issues can be found in Doeringer (1986), Doeringer and Piore (1971) and Wachter & Wright (1990).

Job ladders are a key variable in the structure of ILMs (Baron, Davis-Blake, & Bielby, 1986, p. 256; Cohen & Pfeffer, 1986, p. 12). These researchers argue job ladders allow organizations to select



## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

employees according to hiring standards determined by the technical requirements of the job. Job ladders also allow groups such as managers or professionals to exercise organizational power by imposing such standards (Baron et al., 1986, p. 270 ; Cohen & Pfeffer, 1986, p. 20).<sup>8</sup>

Baron et al. (1986, p. 256-257) list four characteristics of job ladders. First, ladders must be long enough to avoid dead-ends at the top, ensuring employees can be promoted and retained over long periods. Second, jobs should not be concentrated at the bottom of a ladder because that limits opportunities for promotion and fails to separate employees according to seniority. Third, jobs above the lowest rung on the ladder should mostly be closed to outsiders to protect skilled workers from outside competition. Fourth, links between jobs should be clear to employees so they know exactly what set of jobs they might be promoted into next. Baron et al. (1986, p. 252) note that transaction cost analysis suggests the location of jobs on a ladder are determined by the jobs' characteristics. In other words, job ladders exist not at the organizational level, but arise within organizations to select employees who are both qualified for and can be depended on to perform specific jobs.

The theoretical description of ILMs and job ladders is consistent with suggestions that newspaper groups may form their own labor markets. Groups could be expected to do this to reduce job mismatches. For instance, larger dailies in groups might search first for new hires at smaller dailies in the group because that reduces time spent identifying a pool of qualified candidates. However, groups will have much stronger incentives to create ILMs if they have jobs that require highly specific skills and knowledge. In such instances, the creation of job ladders both within and across daily newspapers helps the group enforce standards for hiring into those jobs. Job ladders also reduce the probability that employees will fail to perform as expected. Employees, on the other hand, benefit from knowing what is

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<sup>8</sup> Both studies (Baron et al., 1986; Cohen & Pfeffer, 1986) test alternative perspectives about the function of job ladders and ILMs. Cohen & Pfeffer (1986, p. 2-3) describe four perspectives. The first is technical; ILMs screen workers to meet hiring standards. The second argues hiring standards in ILMs are used to control employees, ensuring they are reliable and conform to organizational norms and values. The third is institutional, arguing ILMs meet normative expectations about the right way to handle personnel matters. The fourth is political, arguing ILMs enable groups within the organization to benefit from the enforcement of standards that serve their interests. As noted, results support the first and fourth perspectives.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

required to obtain promotions and what will be expected once they are promoted. For example, a group that has a highly developed set of qualifications for newsroom managers can be expected to create an ILM for managers.

Pinfield (1995, p. 19-20), however, argues that ILMs are unlikely to be entirely closed to outsiders. Job ladders only approximate the overall structure of jobs within an organization because (1) organizational systems are rarely stable and closed, (2) job performance is not independent of the persons assigned to jobs, and (3) job performance is not independent of the ways in which other jobs are performed.

Pinfield notes jobs are filled through vacancy chains. These are similar to job ladders, but vacancy chains can exist without upward movement. When an employee vacates a job, someone else generally at the same level or below must fill the position. If the job is filled, the position of that employee becomes vacant in turn. This creates another job that must be filled, hence the idea of a chain.

However, Pinfield (1995, p. 19) points out, "Arrangements of positions and jobs are not static, but change in reaction to and anticipation of internal and environmental exigencies." Managers sometimes take advantage of vacancies to reorganize departments, adjusting to changes in the organizational or external environment.

Therefore, even newspaper groups with ILMs may not always rely on them to fill jobs. There may be times when the group will seek external candidates in response to changing conditions.

### **Empirical Findings**

Althauser (1989, p. 144) reviewed research into ILMs, finding a lack of agreement about the defining characteristics of the ILM concept and a variety of measures or indicators of ILMs. Studies disagreed about whether ILMs include all or just some of the jobs in a firm, and whether ILMs arise from particular occupations or from organizations (p. 144-149). The disagreements were partly rooted in

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

different theoretical justifications for ILMs (p. 151-155).<sup>9</sup> However, Althauser reported there is empirical support for an argument that ILMs provide firms with "renewable supplies of otherwise scarce, highly skilled workers" (p. 154).

Despite theoretical disagreements over the reason for ILM's, there is little disagreement about their existence. Pinfield (1995) reports a case study of a company with three regional units handling (a) marketing and distribution, (b) packaging, and (c) corporate affairs. The company had 68 geographically separate divisional subunits, most with fewer than 50 salaried employees. Managers at the company preferred internal job candidates because they were familiar with the firm's operations and with their co-workers, and learned new jobs faster than external hires (Pinfield, 1995, p. 321). Managers also were less uncertain about how current employees would perform in a new job. "Other factors being equal, the appointments of inside candidates were judged to have lower associated risks than those of external candidates" (p. 321). Internal promotions also created incentives for employees to learn new skills.

Cohen and Pfeffer (1986, p. 9) examined data from interviews with personnel officials at a random sample of 306 San Francisco area organizations.<sup>10</sup> Regressions were significant for a scale measuring ILM practices--whether companies had promotion from within policies and followed them--among clerical, skilled, and unskilled workers. The dependent variable was a scale measuring requirements for selecting workings in those occupations.

Baron et al. (1986, p. 254 ) examined data for 1,883 jobs at 100 establishments in California.<sup>11</sup> Factor analysis measuring the presence of job ladders showed 84 of the establishments had at least one ILM (p. 258). Results from this study also showed "tremendous diversity in how broadly or narrowly" (p. 272) ILMs were defined by various establishments. The authors argued that workers in professional or

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<sup>9</sup> Althauser (1989, p.151-155) reported little support for the theoretical arguments that ILMs are derived from markets or sectors of the larger economy. Other perspectives suggested (a) ILMs arose from struggles between workers and management, (b) were a consequence of formal bureaucratic controls in organizations, or (c) resulted from the need for training on the job and firm specific skills. Another perspective suggested ILMs provide employers with a renewable source of skilled workers.

<sup>10</sup> The interviews were conducted from 1966 to 1968 (Cohen & Pfeffer, 1986, p. 9).

<sup>11</sup> The data was collected from 1965 to 1979 (Baron et al., 1986, p. 254).

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

craft labor markets can advance by moving from firm to firm instead of climbing internal job ladders. This is because such jobs mostly require general knowledge and skills that are useful across different organizations (p. 249-250). Results did show a lack of job ladders for craft labor markets, including a radio station (p. 258). Job ladders also were less likely for professional jobs requiring "complex informational skills" (p. 265) such as television news director. Baron et al. (1986) found that even if non-manufacturing jobs were in ladders, those jobs could sometimes be entered from outside the firm.

Baron et al. (1986) also found that labor markets within organizations had diverse characteristics. Larger firms, and firms that were part of larger organizations, were more likely to have ILMs than their smaller or independent counterparts. The study reported "in many instances, internal and external labor markets may co-exist in a given line of work" (p. 266) as a response to market conditions. One constant associated with many ILMs was the need for firm-specific knowledge. These results suggest that if ILM's exist in newspapers, they may not be present for all jobs.

Easily transferable skills, such as reporting jobs, may not be part of an ILM or may be part of an ILM that also allows entry from outside the organization. Jobs that require firm-specific knowledge, however, such as some management jobs, are likely to be part of an ILM. The characteristics of the firm also will affect the presence of an ILM. Smaller newspapers, or independent newspapers, will be less likely to have ILMs than their larger, or group-owned counterparts.

Baker and Holmstrom (1995, p. 255) examined relationships between wages and promotions over more than a decade at two major firms.<sup>12</sup> The study examined white-collar jobs, in contrast to ILM research into blue-collar jobs. Results showed both firms had well-defined job ladders and there was "some evidence that workers are shielded from external market forces" (p. 258). However, there was less evidence of clearly defined points of entry -- entry into and exit from the firms occurred at all levels of the ILMs. Most significant, the researchers argued, was the association between higher than average

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<sup>12</sup> The study used 20 years of data, and about a half million records, from a U.S. manufacturing firm. About 80,000 records from 13 years of data from U.S. service firm also were used (Baker & Holmstrom, 1995, p.255).

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

wage increases and subsequent promotion. Baker and Holmstrom (1995, p. 257-258) argued the higher wages were given to more productive workers. Ability, not administrative rules for promotion, may be a key variable in white-collar ILMs, the study concluded (p. 259).

Another study examined how firm-specific skills affect job turnover (Glenn, McGarrity, & Weller, 2001). This study did not include a variable for ILMs. However, the study is relevant to arguments that ILMs protect skills specific to a firm. Glenn et al. (2001) examined trades of professional baseball players in positions, such as catcher, who must work closely with teammates. These trades were compared with players, such as outfielders, whose productivity is not so dependent on other members of the team. Results from 92 years of data showed players in positions requiring team-specific knowledge were less likely to be traded. This study supports arguments firms place a higher value on retaining employees with firm specific skills (Glenn et al., 2001).

Van Buren (1992, p. 316-317) examined relationships between organizational size, organizational growth<sup>13</sup> and ILMs. The study used survey responses from 154 businesses. Results supported predictions that organizations linked to larger firms, which have more opportunities to move employees from place to place, are more likely to have ILMs (p. 322). Results also supported predictions that firms with higher growth rates are less likely to have ILMs because growth outstrips their capacity to promote employees. However, Van Buren (1992, p. 324-325) cautioned the regressions had low predictive power,<sup>14</sup> possibly because the study did not measure differences within organizations.

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<sup>13</sup> Size was measured as the natural logarithm of total employees in an organization. Growth was measured using the natural log of an index based on percentage changes in the number of employees (Van Buren, 1992, p. 316-319).

<sup>14</sup> The  $R^2$  for regressions was 0.16 (Van Buren, 1992, p. 324).

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Therefore – setting aside the theoretical disputes over ILMs<sup>15</sup> – there is considerable empirical support for their existence. Results also suggest hiring in ILMs is contingent on several variables, including the degree to which specific skills are required and the availability of those skills in external labor markets.

For instance, a daily newspaper that hires from other newspapers with different owners is using the external labor market. The newspaper uses internal labor markets, however, when it promotes a reporter to a more desirable reporting job, or moves a reporter to assistant city editor or city editor. The creation of a newspaper group may expand this internal labor market. Newspaper groups have the potential to integrate internal labor markets across communities, allowing any given newspaper to reduce the chance that it must seek employees outside the internal labor market of the group to fill a vacancy.

### **Hypotheses**

The existing literature suggests that the distinction between an Internal Labor Market and an External Labor Market is meritorious and that the labor market of the daily newspaper industry can be profitably viewed in these terms.

The literature suggests that not all hiring will be done from within the ILM. Internal as well as external forces should play a role. It seems reasonable to expect, for example, that hiring from outside the Internal Labor Market would be greater in times of economic prosperity and low unemployment, as workers would have many opportunities, making the boundaries of the ILM more porous. The level of hiring from the External Labor Market under these circumstances should be greater than under

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<sup>15</sup> Baker and Holmstrom (1995) write, "That firms employ internal labor markets, in which wages and careers are partly shielded from the vagaries of external labor markets, seems well accepted" (p. 255). Labor economics textbooks, however, give ILMs little attention because transaction cost and information search models are considered sufficient to explain their existence. Baker and Holmstrom (1995, p. 255) said a seminal study of ILMs did not offer a theory to explain its findings. Doeringer (1986), one author of the seminal study, has responded to this criticism. He argues a focus on competition for jobs and efficiency fails to account for important characteristics of ILMs. Social groups form ILMs to reduce outside competition for jobs, distributing those jobs among their members (Doeringer, 1986, p. 50-51).

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

circumstances of a weaker economy and higher unemployment. This can be stated as the following format hypothesis:

*H1: Daily newspapers should engage in more hiring from the External Labor Market when the economy is robust and unemployment is low than in periods of a weakened economy with high unemployment.*

Consistent with the literature, it is reasonable to expect that the longer the set of vacancy chains in an ILM, the greater the protection of internal candidates from the competition from the ELM. For this reason, it is reasonable to expect fewer hires from the ELM if the vacancy chain is long, as it would be the case in a developed ILM consisting of several newspapers of differing sizes integrated via a common personnel policy. In other words, ILMs would be larger and vacancy chains longer in newspaper groups with papers spread across different circulation sizes. It also is reasonable to expect vacancy chains to be more reflective of what happens in newspapers than ladders, which are more rigid than what seems likely in a newspaper.

One of the consequences of the merger or assembly into a single company of daily newspapers of differing sizes is the potential to create an Extended Internal Labor Market. In fact, it could be that creation of an Extended Internal Labor Market is a reason for assembly of this type of newspaper company. The advantages of such a grouping of newspapers into an Extended Internal Labor Market is less exposure to the External Labor Market, better use of staff resources (human capital), and better return on investment in that personnel (training).

This expectation can be summarized in the following formal hypothesis:

*H2: Daily newspapers that are part of an Internal Labor Market cutting across several newspapers of differing sizes should be less likely to hire from the External Labor Market than daily newspapers with a less sophisticated Internal Labor Market.*

## **Methodology**

To test these expectations, secondary analysis was undertaken of data from four mail surveys of daily newspaper editors, conducted in 1986, 1991, 1996 and 2001. In each survey, editors were asked

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

questions about hiring the year earlier, specifically in 1985, 1990, 1995 and 2000. The questions were identical in the last three surveys and very similar across all four surveys. In the tables and the text that follows, these surveys will be referred to by the dates for which data were reported, 1985, 1990, 1995, and 2000, rather than the field dates.

The 1985 survey was conducted by the Dow Jones Newspaper Fund and was a replication of surveys conducted by the Newspaper Fund at irregular intervals beginning in 1970 to provide a widely cited statistic in journalism education, namely the percentage of entry-level hires by daily newspaper that hold journalism degrees. (See Becker, Vlad, Papper & Gerhard, 2001, for a report on these data over time.) In the 1985 survey, results were obtained after two mailings from 471 (28.1%) of the 1,676 daily newspaper editors in the country.

The 1990 survey was conducted for the Dow Jones Newspaper Fund by the School of Journalism at the Ohio State University (Becker, Stone & Graf, 1996). Editors at 1,590 daily newspapers in the United States were sent a questionnaire in January of 1991. After two mailings, 704 (44.3%) responded.

The 1995 survey was conducted at the Ohio State University (Hollifield, Kosicki & Becker, 2001). Mail surveys were sent to all 1,539 daily newspapers in the 1995 edition of *Editor and Publisher International Yearbook* in early 1996. After three mailings, a total of 735 (47.8%) of the editors returned a questionnaire.

The 2000 survey was conducted in the James M. Cox Jr. Center for International Mass Communication Training and Research, a unit of the Grady College of Journalism and Mass Communication at the University of Georgia. In February of 2001, mail surveys were sent to the 1,464 editors of daily newspapers listed in the 2000 *Editor and Publisher International Yearbook*. After three additional mailings, 605 editors or 41.3% had returned questionnaires. Telephone interviews were conducted with an additional 133 editors, resulting in completed survey data from 738 newspapers, or 50.4% of the total in the population. Telephone contacts were selected among the refusals by circulation



## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

size and then probabilistically. The final sample of returned questionnaires was representative of daily newspapers in the United States in 2000 in terms of circulation size.

Each of the four surveys asked editors to report on hiring during the calendar year covered by the survey. Editors were first asked to indicate the total number of newsroom hires in the calendar year and then to indicate how many of these hires came from the following sources: Other Newspapers, Other Media (radio, television, etc.), Non-media Jobs, and Directly From College. (The 1985 survey instrument did not include the category of Non-Media Jobs.) Editors were next asked to indicate how many of those hired directly from college had journalism and mass communication degrees versus another college major. As noted, the survey was initiated by Dow Jones to provide this oft-cited statistic. (See Becker, Vlad, Paper & Gerhard, 2000, for a report on this statistic from 1970 to 2000.)

A precise measure of hiring from the External Labor Market would require more specification than these measures allow. Specifically, it is necessary to know if the hiring of individuals from other newspapers was from daily or weekly newspapers and from newspapers within the newspaper group or outside it. What is possible with the available data, however, is to measure how much entry-level hiring the daily newspaper did. Hiring directly from college or from non-media jobs can be treated as an indicant of such entry-level hiring.

Because large daily newspapers are expected to hire from smaller papers, large papers would not be expected to do much hiring of entry-level journalists. This is consistent both with the assumptions made about daily newspaper hiring and the literature that underlies the statement of the two formal hypotheses. Large daily newspapers would be expected to do more entry-level hiring in times of economic prosperity and low unemployment than in other periods. Under all circumstances, large daily newspapers not a part of a group with an Extended Internal Labor Market consisting of several newspapers of differing sizes would be expected to do more entry-level hiring than newspapers in such groups.

### **Findings**

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Table 1 contains the responses of the daily newspaper editors regarding the sources of journalists hired in 2000. Only newspapers that actually did some hiring are included, and they are broken into six standard circulation categories. The unit of analysis is the newspaper, and the percentages represent the percent of newspapers in a given circulation category that hired at least one person from the sources listed on the left hand side of the table.

Daily newspapers larger in circulation are more likely to have hired journalists from other newspapers than are smaller newspapers, excepting that the very small newspapers are a bit more likely than those a bit larger in circulation to have hired from another newspaper. Most likely, this hiring at the smallest newspapers was from a weekly. (Statistical tests are not applied, since the data are approximately a 50% sample, and the standard tests would greatly overstate error estimates. The data are treated descriptively and the focus is on the pattern of the responses.)

Large newspapers are less likely than small newspapers to have hired journalists from non-media jobs or directly from college. The pattern is not perfect, but the general picture is consistent with the expectation that ports of entry to the field generally are at the smallest daily newspapers.

The data in Table 1 are insensitive to the number of hires by any given newspaper. Table 2 looks at total number of hires for newspapers in each circulation group combined. In general, most hiring is of journalists who have worked at other newspapers, but this is most dramatically the case at the large newspapers. Of those hired at newspapers with circulations of 100,001 or larger, 79.2% had worked at other newspapers. Of those hired at dailies with circulations of 5,000 or less, only 39.3% had worked for another newspaper. The figure is 31.7% for newspapers in the 5,000 to 10,000 range.

Of those hired at the smallest dailies, 24.4% came from non-media jobs and 24.0% came directly from college. These figures are 5.1% and 11.4% respectively for dailies with circulations of greater than 100,000. Entry-level hiring isn't unheard of at the larger newspapers, but it certainly isn't so common and isn't as common as it is at the smallest dailies.

The national economy in 2000 was robust. Unemployment was 4.0 percent, the lowest it had been since 1969. (Bureau of Labor Statistics, 2002). Inflation was 3.4%, low in historical terms (BLS,

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

2002). Annual Newspaper Advertising Expenditures were up 5.1% from the year earlier (Newspaper Association of America, 2002).

The unemployment rate was considerably higher in 1995 (5.6%), inflation was lower (2.5%), and growth in advertising expenditure was about the same (5.8%). In 1990, unemployment also was 5.6%, inflation was higher (6.1%), and advertising growth was negative (-0.03). In 1985, unemployment was higher still (7.2%), inflation was 3.8%, and newspaper advertising was 7.0% greater than a year earlier.

If the labor market had any impact on the hiring from outside the internal labor market, it should be possible to see this by examining data from these earlier years. If the advertising market and consequent revenues had an impact, it should be possible to see this by examining 1990 particularly.

The data shown in Table 3 for 1995 are not consistent with the expectation that entry to the daily newspaper industry journalistic labor market would be more restrictive in a period of high unemployment than in a period of low unemployment, such as 2000. In fact, there is no consistent pattern in terms of hiring of college graduates dependent on circulation size if the unit of analysis is the daily newspaper.

The data in Table 4, however, which are at the level of the individual hire, do show this pattern, though it is no less pronounced in this period of higher unemployment than it had been in the lower unemployment year of 2000.

Much the same can be said for 1990, when unemployment was equally high. The newspaper unit data in Table 5 are not consistent with the hypothesis, while the individual level data are. Clearly the percentage of hires among the newspapers that is directly from college declines as circulation size increases.

Unemployment was highest in 1985, but the percentage of daily newspapers hiring journalists directly from college at even the largest newspapers was high, and circulation size is not related to this hiring decision, if the daily is the unit of analysis (Table 7). At the individual level, however, it is clear that circulation size is related to the hiring of college graduates. A lower percentage of those hired by daily newspapers in the 100,001 and up circulation group came directly from college than is the case for newspapers in the smaller circulation groupings (Table 8).

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

If the labor market had any impact on the hiring from outside the internal labor market, hiring from college should have varied across the years. It did not. If the advertising market and consequent revenues had had an impact, it should have altered hiring in 1990 particularly.

The daily newspaper industry is dominated numerically by small newspapers and dominated in terms of visibility by large ones. About four in 10 of all daily newspapers in 2000 had circulations of 10,000 or less, with nearly one in five having a circulation of under 5,000. Less than one percent of the dailies had circulations of more than 500,000, and only 7% had circulations of more than 100,000.

The average number of employees of a daily newspapers in 2000 was correspondingly small. The median number of employees was 77, and the median number of newsroom employees was 18. In other words, only half the papers employed more than 18 individuals in their newsrooms.

This picture of the newspaper industry is informative, but it also is a little misleading. In 2000, only 17% of the daily newspapers were listed as fully independent, though many were part of relatively small newspaper groups. The largest group that year in terms of number of daily newspapers was Community Newspaper Holdings, with 94 properties, followed by Gannett with 73 and Liberty Group Publishing with 63.

One potential outcome of creation of a newspaper group, as noted above, is expansion of the Internal Labor Market. If the newspaper group integrates or even coordinates the hiring of personnel, the Internal Labor Market could be expanded to cover all or major parts of the group. Though the extent of personnel integration in the industry has never been studied, some of the groups, notably Gannett, Cox and Knight-Ridder, are known to manage and control newsroom personnel movement within the group to at least some extent.

Integration of personnel practices and movement makes most sense in a group that is configured in such a way as to allow for efficient movement of personnel from smaller newspapers to larger ones as the individual's expertise grows. An individual might be sent back "down" to a smaller paper in the group hierarchy as she or he changes assignments, only to be brought back "up" as skills in the news assignment grow. An individual might move into management, for example, from a larger

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

paper to a smaller one, only to be able to return to the larger paper once sufficient skills have been acquired.

This notion suggests that there might be such a thing as an "ideal" type of expanded or Extended Internal Labor Market in which movement up through the group could flow most efficiently. Two indices were created to reflect this idea.

Each index of an Extended Internal Labor Market was created at the level of the group. Each newspaper in the group was assigned a score reflecting the group index. In each case, newspapers were classified first by circulation into one of five groups: (1) up to 25,000, (2) 25,001 to 50,000, (3) 50,001 to 75,000, (4) 75,001 to 100,000, and (5) 100,001 and more.

Analysis of the 2000 data showed that raw circulation is correlated highly with the number of employees in a daily newspaper and with number of newsroom employees. (In the former case, the Pearson Product Moment Correlation Coefficient was .81, while in the latter it was .96.) This suggests that using circulation as an indicant of newsroom size is appropriate. Newsroom size was not available for newspapers that did not return the survey.

In the simple index of Extended Internal Labor Market, each newspaper group was assigned a score from 1 to 5 based on the number of circulation groupings in which the group had newspapers. If the group had at least one paper in each group, it received a score of 5. If it had a newspaper on two groups, it received a score of 2. Newspapers not in groups received a score of 1.

The second index reflected whether the total circulation for group newspapers in each category of circulation was equal. Groups were penalized for having different circulation totals in different categories. This was done using what is termed a Frechet technique (Wilansky, 1964). This formula compared the total circulation in a lower category with the total circulation within the next higher category. For example, if one category was twice in size of another category, the size of the reduction would be .33 by the Frechet weighting, and hence, the score would be .66. If the difference was four time, then the reduction increased to .43 and the score is .57. If the two amounts were equal, the group would earn a score of 1. The size of the deduction from 1 increased as the inequality increased.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

Once the group score was calculated for both indices, that score was assigned to each newspaper in the group. In fact, the correlation between these two measures was extremely high, .974 (Pearson Product Moment Correlation). The simple index of Extended Internal Labor Market was correlated .28 with the number of hires the daily newspaper made from other newspapers, while the more complex measure was correlated .27. The simple index was correlated .24 with number of hires directly from college, while the more complex measure also was correlated .24 with the number of journalists hired directly from college.

Table 9 compares the top 20 newspaper groups in terms of total circulation on these two indices of Extended Internal Labor Market to see if the variability made sense on its face. Gannett scored high on both indices, Community Newspaper Holdings scored low, despite its large number of papers. In general, the variability seemed consistent with the concepts.

Table 10 compares four newspaper groups with roughly the same number of papers, but papers of different circulation sizes. The four groups, Copley Press, Pulitzer, Hollinger International, and Howard Publications, produced different scores on both measures of Extended Internal Labor Markets, with the largest group in terms of circulation and number of papers (Howard) getting the lowest scores on each index. This was the case because Howard Publications' papers are clustered in three of the five circulation categories, while Copley, with six fewer papers, has a better spread of those papers across all five circulation groups.

Table 11 repeats the analyses shown in Table 2 for the 2000 data, but here newspapers are broken into five categories, based on the simple measure of level of development of the Extended Internal Labor Market. Those newspapers without the potential to have a fully developed Extended Internal Labor Market (because they do not have papers in any but a single circulation category) are shown in the first rows with a score of 1 on the index. Those newspapers with a score of 5 on the index are shown at the bottom. Newspapers also are classified by circulation size (using the original category scheme). The data are at the individual level.

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

While the pattern is not perfect, as expected, large independent newspapers (with circulations of 100,001 or more) are considerably more likely to have large numbers of new employees come directly from college than is true for large newspapers with the potential for having created a fully developed Extended Internal Labor Market. In general, size of the newspaper doesn't matter in terms of percentage of hires coming directly from college if the score on the measure of group integration is 1. In general, it matters more at the newspapers with higher scores on the integration measure, consistent with the expectation.

### **Conclusions**

The data presented in this paper provide the first empirical test of the common assumption that the labor market of the daily newspaper is hierarchical, with most entry-level hiring taking place at small newspapers. These newspapers, in this view, are the common ports of entry for the market. Job applicants should not waste their time trying to enter the market higher in the hierarchy of newspapers, for few if any jobs for entry-level applicants exist.

The data are supportive of this general view, but they are not wholly consistent with it. For all four years for which data are available, large daily newspapers hired entry-level applicants. Certainly entry to the occupation of daily newspaper journalist is not only at the smallest newspapers.

On the other hand, a considerably smaller percentage of hiring done by large newspapers is at the entry-level than is true for small newspapers. The larger daily newspapers concentrate their hiring at the level of the experienced employee, hiring relatively fewer journalists who lack any daily newspaper journalism experience.

This pattern is rather robust, holding across four different years for which data are available, 1985, 1990, 1995 and 2000. Contrary to expectation, the pattern appears to be relatively unaffected by the national economy. The final year of the survey, 2000, was one in which unemployment was quite low, yet the pattern was much the same that year as in the three earlier ones, when unemployment was higher. It seems that the newspaper industry is, in this sense, relatively immune to the ebb and flow of

## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

the labor market. Why the fundamental forces of supply and demand do not seem to influence this basic pattern of employment is, at this point, not clear.

Consistent with expectations, the creation of an Extended Internal Labor Market across members of newspaper groups has influence on hiring. Those large newspapers that were not part of an Extended Internal Labor Market in 2000 were no less likely than smaller papers to hire entry-level journalists. It seems that, lacking access to the Extended Internal Labor Market, they were forced into the External Labor Market and to hire entry-level employees to compensate for the lack of access to job candidates from their internal system.

These findings are significant for a number of reasons. First, the data for the first time present a picture of the labor market of the daily newspaper industry. This picture is partly consistent with common assumptions about the market, but not completely. The data also are consistent with the notion that this labor market can be profitably viewed in terms of use of internal versus external labor markets. One of the two independent variables—membership in an Extended Internal Labor Market—to hiring from outside the Internal Labor Market as expected. The idea of an Extended Internal Labor Market is only hinted at in the economics literature and, based on the data gathered here, worth further exploration.

The data suggest that those interested in the characteristics of journalists and in bringing about change in that labor force should concentrate their attention at the ports-of-entry, which are more likely to be at small newspapers. To create a higher quality workforce, for example, in terms of cultural, gender or ethnic diversity or in terms of education and training, one has to recognize that control of entry rests disproportionately with the smaller daily newspapers.

The data also suggest that small dailies are likely to be interested in investment in their human capital only to the extent that the capital remains with the newspaper or moves to a newspaper that is linked to it in some way. Managers at small newspapers cannot be expected to invest in diversification or education and training if they know their employees will soon move to other organizations unless they will somehow be compensated. Only in an integrated labor market, where their efforts can be recognized by their superiors, is this likely to be the case.



## **Change and Stability in the Newspaper Industry's Journalistic Labor Market**

The data presented here are limited. They do not provide for the ideal measure of hiring from within or outside of the daily newspaper Internal Labor Market. What they do show, however, is quite suggestive of the importance of this theoretical perspective on the industry's labor market. The findings they provide offer suggestions for newspaper managers, those inside and outside of the industry interested in personnel change, and for those interested in developing fuller theories of the labor markets of media industries.

## Change and Stability in the Newspaper Industry's Journalistic Labor Market

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Table 1  
Percentage of Newspapers Hiring from Different Sources 2000

Source of Hiring 2000		Circulation						Total
		Under 5,000	5,000 to 10,000	10,001 to 25,000	25,001 to 50,000	50,001 to 100,000	100,001 plus	
Other Newspapers	Count	62	78	152	107	57	41	497
	%	67.4%	52.3%	79.6%	93.9%	98.3%	93.2%	76.7%
Other Media	Count	12	20	28	24	14	8	106
	%	13.0%	13.4%	14.7%	21.1%	24.1%	18.2%	16.4%
Non Media Jobs	Count	38	73	97	51	25	16	300
	%	41.3%	49.0%	50.8%	44.7%	43.1%	36.4%	46.3%
College	Count	40	95	140	85	40	28	428
	%	43.5%	63.8%	73.3%	74.6%	69.0%	63.6%	66.0%
Other	Count	7	13	19	14	5	5	63
	%	7.6%	8.7%	9.9%	12.3%	8.6%	11.4%	9.7%
<b>Total</b>	<b>Count</b>	<b>92</b>	<b>149</b>	<b>191</b>	<b>114</b>	<b>58</b>	<b>44</b>	<b>648</b>

Table 2: Allocation of Daily Newspaper Hires in 2000 by Origin

Circulation	Number of hires came from other newspapers	Percent of hires came from other newspapers	Number of hires came from other media	Percent of hires came from other media	Number of hires came from non-media jobs	Percent of hires came from non-media jobs	Number of hires came directly from college	Percent of hires came directly from college	Number of Other Hires	Percent of Other Hires	Total Number of Hires
Under 5,000	95	39.3%	16	6.6%	59	24.4%	58	24.0%	14	5.8%	242
5,000 to 10,000	156	31.7%	27	5.5%	124	25.2%	163	33.1%	22	4.5%	492
10,001 to 25,000	457	44.5%	45	4.4%	174	17.0%	317	30.9%	33	3.2%	1,026
25,001 to 50,000	547	52.3%	39	3.7%	114	10.9%	307	29.3%	39	3.7%	1,046
50,001 to 100,000	489	65.4%	26	3.5%	62	8.3%	148	19.8%	23	3.1%	748
100,001 plus	905	79.2%	17	1.5%	58	5.1%	130	11.4%	33	2.9%	1,143
<b>Total</b>	<b>2,649</b>	<b>56.4%</b>	<b>170</b>	<b>3.6%</b>	<b>590</b>	<b>12.6%</b>	<b>1,123</b>	<b>23.9%</b>	<b>164</b>	<b>3.5%</b>	<b>4,697</b>

Table 3  
Percentage of Newspapers Hiring from Different Sources  
1995

Source of Hiring 1995		Circulation						Total
		Under 5,000	5,000 to 10,000	10,001 to 25,000	25,001 to 50,000	50,001 to 100,000	100,001 plus	
Other Newspapers	Count	39	104	175	110	56	50	534
	%	50.6%	65.4%	83.7%	93.2%	100.0%	98.0%	79.7%
Other Media	Count	14	15	32	17	2	16	96
	%	18.2%	9.4%	15.3%	14.4%	3.6%	31.4%	14.3%
Non Media Jobs	Count	31	67	74	39	19	25	255
	%	40.3%	42.1%	35.4%	33.1%	33.9%	49.0%	38.1%
College	Count	42	97	127	67	39	31	403
	%	54.5%	61.0%	60.8%	56.8%	69.6%	60.8%	60.1%
Other	Count	3	5	14	7	3		32
	%	3.9%	3.1%	6.7%	5.9%	5.4%		4.8%
<b>Total</b>	<b>Count</b>	<b>77</b>	<b>159</b>	<b>209</b>	<b>118</b>	<b>56</b>	<b>51</b>	<b>670</b>

Table 4: Allocation of Daily Newspaper Hires in 1995 by Origin

Circulation	Number of hires came from other newspapers	Percent of hires came from other newspapers	Number of hires came from other media	Percent of hires came from other media	Number of hires came from non-media jobs	Percent of hires came from non-media jobs	Number of hires came directly from college	Percent of hires came directly from college	Number of Other Hires	Percent of Other Hires	Total Number of Hires
Under 5,000	62	34.6%	14	7.8%	46	25.7%	54	30.2%	3	1.7%	179
5,000 to 10,000	215	41.5%	23	4.4%	99	19.1%	171	33.0%	10	1.9%	518
10,001 to 25,000	536	55.1%	36	3.7%	113	11.6%	263	27.0%	25	2.6%	973
25,001 to 50,000	409	62.4%	20	3.1%	60	9.2%	148	22.6%	18	2.7%	655
50,001 to 100,000	373	75.7%	8	1.6%	34	6.9%	73	14.8%	5	1.0%	493
100,001 plus	849	78.5%	55	5.1%	80	7.4%	98	9.1%	0	0.0%	1,082
Total	2,444	62.7%	156	4.0%	432	11.1%	807	20.7%	61	1.6%	3,900



Table 5  
 Percentage of Newspapers Hiring from Different Sources  
 1990

Source of Hiring 1990		Circulation						Total
		Under 5,000	5,000 to 10,000	10,001 to 25,000	25,001 to 50,000	50,001 to 100,000	100,001 plus	
Other Newspapers	Count	30	74	148	109	68	63	492
	%	58.8%	53.6%	70.5%	87.9%	98.6%	98.4%	75.0%
Other Media	Count	7	27	45	31	29	33	172
	%	13.7%	19.6%	21.4%	25.0%	42.0%	51.6%	26.2%
Non Media Jobs	Count	27	68	104	52	35	39	325
	%	52.9%	49.3%	49.5%	41.9%	50.7%	60.9%	49.5%
College	Count	30	76	127	78	48	44	403
	%	58.8%	55.1%	60.5%	62.9%	69.6%	68.8%	61.4%
Other	Count	3	3	17	5	5	9	42
	%	5.9%	2.2%	8.1%	4.0%	7.2%	14.1%	6.4%
<b>Total</b>	<b>Count</b>	<b>51</b>	<b>138</b>	<b>210</b>	<b>124</b>	<b>69</b>	<b>64</b>	<b>656</b>

Table 6: Allocation of Daily Newspaper Hires in 1990 by Origin

Circulation	Number of hires came from other newspapers	Percent of hires came from other newspapers	Number of hires came from other media	Percent of hires came from other media	Number of hires came from non-media jobs	Percent of hires came from non-media jobs	Number of hires came directly from college	Percent of hires came directly from college	Number of Other Hires	Percent of Other Hires	Total Number of Hires
Under 5,000	42	31.6%	7	5.3%	37	27.8%	47	35.3%	4	3.0%	133
5,000 to 10,000	131	31.7%	35	8.5%	120	29.1%	127	30.8%	4	1.0%	413
10,001 to 25,000	386	44.3%	61	7.0%	176	20.2%	248	28.5%	32	3.7%	871
25,001 to 50,000	407	53.6%	47	6.2%	102	13.4%	204	26.8%	9	1.2%	760
50,001 to 100,000	459	63.1%	50	6.9%	90	12.4%	128	17.6%	8	1.1%	727
100,001 plus	1,108	73.9%	115	7.7%	121	8.1%	156	10.4%	38	2.5%	1,500
Total	2,533	57.5%	315	7.2%	646	14.7%	910	20.7%	95	2.2%	4,404

Table 7  
 Percentage of Newspapers Hiring from Different Sources  
 1985

Source of Hiring 1985		Circulation						Total
		Under 5,000	5,000 to 10,000	10,001 to 25,000	25,001 to 50,000	50,001 to 100,000	100,001 plus	
Other Newspapers	Count	14	54	102	80	47	39	336
	%	42.4%	58.7%	74.5%	87.0%	97.9%	97.5%	76.0%
Other Media	Count	4	17	37	37	16	21	132
	%	12.1%	18.5%	27.0%	40.2%	33.3%	52.5%	29.9%
College	Count	17	67	94	64	31	33	306
	%	51.5%	72.8%	68.6%	69.6%	64.6%	82.5%	69.2%
Other	Count	12	23	38	29	18	13	133
	%	36.4%	25.0%	27.7%	31.5%	37.5%	32.5%	30.1%
<b>Total</b>	<b>Count</b>	<b>33</b>	<b>92</b>	<b>137</b>	<b>92</b>	<b>48</b>	<b>40</b>	<b>442</b>

Table 8: Allocation of Daily Newspaper Hires in 1985 by Origin

Circulation	Number of hires came from other newspapers	Percent of hires came from other newspapers	Number of hires came from other media	Percent of hires came from other media	Number of hires came directly from college	Percent of hires came directly from college	Number of Other Hires	Percent of Other Hires	Total Number of Hires
Under 5,000	21	30.0%	5	7.1%	30	42.9%	14	20.0%	70
5,000 to 10,000	85	34.8%	20	8.2%	113	46.3%	26	10.7%	244
10,001 to 25,000	239	42.9%	46	8.3%	220	39.5%	52	9.3%	557
25,001 to 50,000	282	52.1%	59	10.9%	157	29.0%	43	7.9%	541
50,001 to 100,000	253	59.3%	32	7.5%	102	23.9%	40	9.4%	427
100,001 plus	483	69.8%	57	8.2%	106	15.3%	46	6.6%	692
Total	1,363	53.9%	219	8.7%	728	28.8%	221	8.7%	2,531

Table 9: Top 20 Newspaper Groups in Terms of Circulation, with Indices of Extended Internal Labor Market

Group Name	Total Circulation	Number of Papers	Index of Integrated Extended Labor Market	
			Frechet Index	Number of Classes
Gannett Co. Inc.	5,948,037	73	3.48	5
Knight Ridder	3,890,071	32	2.91	5
Advance Publications	2,786,684	22	3.54	5
New York Times Co.	2,387,031	21	3.82	5
Times Mirror Co.	2,374,795	9	1.51	2
Dow Jones & Company	2,309,967	20	3.23	5
Hearst Newspapers	1,752,342	13	2.72	4
MediaNews Group Inc.	1,728,990	46	3.45	5
E W Scripps Co.	1,400,305	20	3.17	5
McClatchy Co.	1,323,291	11	2.64	4
Tribune Co.	1,268,321	4	1.52	2
Cox Newspapers Inc.	1,120,329	15	2.22	3
Thomson Newspapers	1,082,733	54	2.83	4
Freedom Communications Inc.	946,398	27	2.13	3
Belo	937,295	8	2.32	3
Washington Post Co.	816,563	2	1.5	2
Media General Inc.	802,623	21	2.06	3
Central Newspapers Inc.	767,692	6	2.1	3
Community Newspaper Hold.Inc	752,915	94	1.1	2
Morris Communications Corp.	723,446	28	2	3

Table 10: Four Newspaper Groups Comparable in Size, with Indices of Extended Internal Labor Market

Group Name	Total		Number of Papers	Circulation					Frechet Index	Number of Classes
	Circulation			Class 1	Class 2	Class 3	Class 4	Class 5		
Howard Publications	453,908		16	165,213	110,483	0	178,212	0	2	3
Pulitzer Inc.	597,957		14	122,911	78,505	93,227	0	303,314	3	4
Hollinger International	716,435		15	106,259	29,677	112,329	0	468,170	2	4
Copley Press Inc.	718,281		10	62,928	64,295	129,773	84,681	376,604	4	5

Table 11: Allocation of Daily Newspaper Hires in 2000 by Origin and Level of Market Integration

Circulation	Number of hires came from other newspapers	Percent of hires came from other newspapers	Number of hires came from other media	Percent of hires came from other media	Number of hires came from non-media jobs	Percent of hires came from non-media jobs	Number of hires came directly from college	Percent of hires came directly from college	Number of Other Hires	Percent of Other Hires	Total Number of Hires
<b>Integrated Group Score: 1</b>											
Under 5,000	61	41.2%	4	2.7%	38	25.7%	35	23.6%	10	6.8%	148
5,000 to 10,000	68	25.4%	14	5.2%	61	22.8%	113	42.2%	12	4.5%	268
10,001 to 25,000	170	42.2%	29	7.2%	74	18.4%	120	29.8%	10	2.5%	403
25,001 to 50,000	74	44.8%	6	3.6%	27	16.4%	41	24.8%	18	10.6%	165
50,001 to 100,000	83	53.5%	10	6.5%	15	9.7%	44	28.4%	3	1.9%	155
100,001 plus	79	69.3%	1	0.9%	3	2.6%	29	25.4%	2	1.8%	114
<b>Total</b>	<b>535</b>	<b>42.7%</b>	<b>64</b>	<b>5.1%</b>	<b>218</b>	<b>17.4%</b>	<b>382</b>	<b>30.5%</b>	<b>55</b>	<b>4.3%</b>	<b>1,253</b>
<b>Integrated Group Score: 2</b>											
Under 5,000	15	40.5%	10	27.0%	6	16.2%	6	16.2%	0	0.0%	37
5,000 to 10,000	32	32.0%	5	5.0%	34	34.0%	22	22.0%	7	7.0%	100
10,001 to 25,000	61	48.8%	4	3.2%	17	13.6%	38	30.4%	5	4.0%	125
25,001 to 50,000	61	66.3%	1	1.1%	6	6.5%	24	26.1%	0	0.0%	92
50,001 to 100,000	49	67.1%	2	2.7%	12	16.4%	10	13.7%	0	0.0%	73
100,001 plus	176	94.6%	4	2.2%	3	1.6%	3	1.6%	0	0.0%	186
<b>Total</b>	<b>394</b>	<b>64.3%</b>	<b>26</b>	<b>4.2%</b>	<b>78</b>	<b>12.7%</b>	<b>103</b>	<b>16.8%</b>	<b>12</b>	<b>2.0%</b>	<b>613</b>
<b>Integrated Group Score: 3</b>											
Under 5,000	13	35.1%	0	0.0%	11	29.7%	12	32.4%	1	2.7%	37
5,000 to 10,000	24	42.1%	3	5.3%	14	24.6%	13	22.8%	3	5.3%	57
10,001 to 25,000	48	31.6%	6	3.9%	32	21.1%	62	40.8%	4	2.6%	152
25,001 to 50,000	116	51.3%	5	2.2%	30	13.3%	65	28.8%	10	4.4%	226
50,001 to 100,000	80	62.5%	0	0.0%	10	7.8%	35	27.3%	3	2.3%	128
100,001 plus	192	71.1%	1	0.4%	10	3.7%	53	19.6%	14	5.2%	270
<b>Total</b>	<b>473</b>	<b>54.4%</b>	<b>15</b>	<b>1.7%</b>	<b>107</b>	<b>12.3%</b>	<b>240</b>	<b>27.6%</b>	<b>35</b>	<b>4.0%</b>	<b>870</b>
<b>Integrated Group Score: 4</b>											
Under 5,000	3	33.3%	0	0.0%	2	22.2%	4	44.4%	0	0.0%	9
5,000 to 10,000	27	60.0%	3	6.7%	7	15.6%	8	17.8%	0	0.0%	45
10,001 to 25,000	62	50.8%	5	4.1%	17	13.9%	35	28.7%	3	2.5%	122
25,001 to 50,000	83	60.6%	5	3.6%	15	10.9%	29	21.2%	5	3.6%	137
50,001 to 100,000	70	87.5%	3	3.8%	3	3.8%	4	5.0%	0	0.0%	80
100,001 plus	114	89.1%	3	2.3%	7	5.5%	4	3.1%	0	0.0%	128
<b>Total</b>	<b>359</b>	<b>68.9%</b>	<b>19</b>	<b>3.6%</b>	<b>51</b>	<b>9.8%</b>	<b>84</b>	<b>16.1%</b>	<b>8</b>	<b>1.5%</b>	<b>521</b>
<b>Integrated Group Score: 5</b>											
Under 5,000	3	27.3%	2	18.2%	2	18.2%	1	9.1%	3	27.3%	11
5,000 to 10,000	5	22.7%	2	9.1%	8	36.4%	7	31.8%	0	0.0%	22
10,001 to 25,000	116	51.8%	1	0.4%	34	15.2%	62	27.7%	11	4.9%	224
25,001 to 50,000	213	50.0%	22	5.2%	36	8.5%	148	34.7%	7	1.6%	426
50,001 to 100,000	207	66.3%	11	3.5%	22	7.1%	55	17.6%	17	5.4%	312
100,001 plus	344	77.3%	8	1.8%	35	7.9%	41	9.2%	17	3.8%	445
<b>Total</b>	<b>888</b>	<b>61.7%</b>	<b>46</b>	<b>3.2%</b>	<b>137</b>	<b>9.5%</b>	<b>314</b>	<b>21.8%</b>	<b>55</b>	<b>3.8%</b>	<b>1,440</b>

**Ownership and Barriers to Entry in Non-metropolitan Daily Newspaper Markets**

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## ABSTRACT

### **Ownership and Barriers to Entry in Non-metropolitan Daily Newspaper Markets**

**By**

**Stephen Lacy, David C. Coulson and Hugh J. Martin**

This exploratory study found that private ownership of dailies was negatively associated with the number of weekly newspapers and with the penetration of paid and all weeklies within the county. This is consistent with the prediction that privately held newspapers keep prices and profits lower and quality higher than publicly held dailies. The strategy of lower prices and higher investment in quality could discourage weeklies from starting and would lower weekly penetration.

## **Ownership and Barriers to Entry in Non-metropolitan Daily Newspaper Markets**

As advertising revenues plunged during 2001, the impact of profit margins on newspapers in general and publicly held newspapers in particular received extensive attention in the trade press.<sup>1</sup> Media scholars have expressed concern that high profit margins demanded by publicly owned newspaper corporations can lower the quality of newspapers. When editorial quality suffers, the information value of the newspaper to the community is seriously jeopardized.<sup>2</sup> Other media scholars have expressed concern that a newspaper providing lower quality news coverage would not only harm the community but would damage the newspaper economically.<sup>3</sup>

Economic theory predicts that customers will substitute another product for one that consumers perceive is declining in quality.<sup>4</sup> Therefore, newspapers with declining quality would be more likely to attract competitors for readers and advertising, while newspapers with high quality would make it difficult for competitors to get a foothold in a market. Factors that lower the probability of new firms starting in a market are called barriers to entry.<sup>5</sup>

This exploratory study aims to examine the relationship between type of ownership and barriers to entry in newspaper markets. More specifically, it will examine whether counties with privately owned daily newspapers contain fewer weekly newspapers and have less penetration by these weeklies than do counties with publicly held dailies located in them. Such a finding would be consistent with privately held dailies

creating higher barriers to entry for weekly newspapers. No published empirical research was found that tests this proposition.

### **Economic Theory**

Economic theory and models concerning barriers to entry for newspapers address newspaper pricing strategies and product quality. The first part of this section will deal with pricing and the second with quality.

#### **Pricing**

Neoclassical economic theory assumes that in competitive markets, firms keep producing additional goods until the marginal cost of producing the last unit equals the price of the good.<sup>6</sup> If a firm raises prices above this marginal cost, new firms enter the market and offer their products at lower prices. However, if barriers prevent the entry of new competition, firms can sustain an increase of prices above costs.<sup>7</sup>

Newspaper markets have long been considered difficult to enter because of substantial entry barriers associated with economies of scale. Economies of scale exist when a firm's long-run average cost per unit declines as more goods are produced. Unit costs continue decreasing as production increases until costs reach some lower limit, called the Minimum Efficient Scale (MES).

Empirical studies beginning with Rosse<sup>8</sup> have found evidence that newspapers enjoy scale economies.<sup>9</sup> This enabled the dominant newspaper to capture enough of the overall market to reach the MES. Competitors who trail the dominant newspaper could not produce enough copies to reach the MES by serving the remaining portion of the

market and are, therefore, more likely to go out of business. The entry barriers created by scale economies should allow dominant newspapers to raise prices above costs. As competition decreases, and the market moves toward monopoly, the dominant newspaper can increase prices even more.

However, economic theory also distinguishes between short-run and long-run price changes and their effects. Industrial organization theory suggests that in the long run, economies of scale are not sufficient to prevent the entry of new competitors into newspaper markets. This theory argues instead that dominant firms that raise long-run prices too high eventually will attract new competitors into their markets.<sup>10</sup> The habits of consumers used to buying a particular product usually moderate the effect of short-run price increases. However, over the long-run “there is nearly always some combination of price and other features at which custom will shift away from one possibility and toward another.”<sup>11</sup>

Therefore, dominant newspaper firms face a choice. They either can raise prices to maximize profits and allow competitors to gain market share, or they can constrain price increases to earn more profits over the long run. The newspaper’s choice will depend on the amount of future profits it anticipates earning if prices are constrained, and how much it discounts those additional profits when compared with current earnings.<sup>12</sup>

A strategy of limiting price increases may be effective against small-scale, or fringe competition. Fringe competitors are so small relative to the overall market that their price and output decisions do not affect the dominant firm’s price and output.<sup>13</sup> For instance, weekly newspapers might be fringe competitors if they only attract advertisers who are

unwilling to pay prices set by the dominant daily. In such instances, the daily could set its advertising price just below the lowest unit cost that fringe firms can reach given their level of output.<sup>14</sup> This deters fringe entry and expansion by existing fringe firms. The dominant daily can maintain this strategy so long as it realizes sufficient economies of scale to keep its price above its cost.

Current models of newspaper competition are consistent with limit-pricing models. The umbrella model states that indirect competition occurs between layers of newspapers, as defined by publication cycle and geographic distribution.<sup>15</sup> Newspapers in this model are not perfect substitutes but can compete in overlapping geographic areas for readers and advertisers. This model, which has empirical support,<sup>16</sup> is consistent with the argument that even dominant newspapers may face competition on the fringes of their markets.

A recent reconsideration of the umbrella model argues competition does not just exist between, but also within different layers.<sup>17</sup> Newspapers compete for advertising, their “major revenue source”<sup>18</sup> both across and within layers, this study argues. The study states that technological and structural changes in the newspaper industry justify reconfiguring the model to accommodate the idea of dynamic, intralayer competition. The study suggests weeklies may compete within any layer of the model.<sup>19</sup>

Because daily newspapers often face competition from other dailies in neighboring counties and from weeklies within their market, they might be inclined to keep prices low to discourage the growth of such competition and the entry of new newspapers. Whether they take such an approach reflects the short-run and long-run goals of the owners.

## Quality

Prices are not the only variable affecting elasticity of demand and consequently rates of entry. Limit-pricing theory also argues that reducing elasticity of demand by differentiating a product in the eyes of consumers produces “advantages ... analogous to unit cost advantages in their operation as entry barriers.”<sup>20</sup>

In a model of news demand, Lacy hypothesized that a newspaper's demand function with respect to quality is kinked. The kink is at a point of minimal acceptable quality for large numbers of readers.<sup>21</sup> Above the kink, demand is inelastic because most readers are satisfied with the level of quality. However, below the kink, demand becomes sharply elastic with readers leaving the paper in large numbers as quality declines.

Although this model was applied to markets with two daily newspapers, the concept of the kinked demand curve could apply to any newspaper market. For a newspaper to retain circulation in a market, it must meet the expected level of quality held by the majority of its readers. There has been no direct test of the kinked demand curve, but a study of Thomson newspapers found that its dailies lost circulation and penetration much more quickly during the 1980s than a control group of non-Thomson dailies.<sup>22</sup> The company's CEO called the Thomson newspapers low quality newspapers in 1993. This more rapid decline in demand for low quality newspapers is consistent with the model of the kinked demand curve.

This model is related to ownership and barriers to entry in two ways. First, publicly held corporations' need for high profit margins during the short run results in

lower newsroom budgets that could harm quality.<sup>23</sup> The consequence would be dissatisfied readers who would look elsewhere for their news. This would lower barriers for other newspapers, particularly weeklies with their relatively low start-up costs. Second, privately held newspaper companies that have a long-run commitment to serving the community and to maintaining their market share with high quality are more likely to invest in quality. This would make it more difficult for other publications, weeklies and dailies, to find enough dissatisfied readers to gain a foothold in the market.

### **Literature Review**

This section will examine whether dailies and weeklies can be acceptable substitutes for enough readers to affect the likelihood of weeklies existing in a market. In addition, it will review the research concerning the relationship of ownership to newspaper conduct.

### **Competition between Dailies and Weeklies**

Whether or not a company's conduct will create barriers to entry for weeklies depends on the degree of competition among dailies and weeklies. At least three published studies have empirically examined this type of competition.

A study published in 1985 surveyed newspaper executives to measure the levels of competition in 13 Southwestern metropolitan markets.<sup>24</sup> The managers at weeklies perceived small dailies as being more competitive with their newspapers for readers than

vice versa. However, 59% of the small daily and weekly managers said competition between these two types of newspapers would increase during the next 10 years.

Two studies of non-metropolitan counties found a negative relationship between the penetration of weeklies and non-metropolitan dailies. The first found a strong negative relationship between the penetration of all non-metropolitan dailies and the penetration of all weeklies within Michigan counties outside of Detroit.<sup>25</sup> As the penetration of weeklies increased, the penetration of dailies decreased and vice versa. The intensity of this competition grew during the 1980s. However, the study had only limited control and used ordinary least squares multiple regression with recursive variables. The latter limitation can result in biased estimates.

A 2002 study used 381 randomly selected counties in a national sample and used two-stage multiple regression to reduce the biased estimate due to the recursive relationship.<sup>26</sup> Lacy, Coulson and Cho found the strongest competition among newspapers in different layers was between non-metropolitan dailies and weeklies, but the strength varied with type of weekly (paid or free). The degree of intensity also varied considerably from county to county. However, the data supported the conclusion that in some markets competition between dailies and weeklies for readers can be intense.

Overall, research supports that dailies and weeklies can be intensely competitive for circulation in counties outside of metropolitan areas, which are the counties explored in this study. If demand for an alternative to a daily develops within a county, it is more likely a weekly, rather than a daily, will attempt to serve this demand. Weeklies have much lower start-up costs than do dailies.<sup>27</sup>



There is limited evidence that this lower start-up cost leads to more entry and exits from markets by weekly newspapers. An examination of entry and exit of weekly newspapers in Michigan from 1987 to 1990 found that 14 new weeklies entered Michigan markets and 20 weeklies exited Michigan markets during that time period. Markets were defined as counties.<sup>28</sup> Although the numbers of start-up and closing weeklies were not large, they numbers were high enough to indicate that starting new weekly newspapers is a possibility if dailies do not serve their readers.

### **Public versus Private Ownership**

Meyers and Wearden researched the impact of public ownership during the 1980s by surveying newspaper financial analysts, publishers, editors and newsroom staff at public and private dailies to see how they evaluated newspapers. No difference was found between journalists at public and private newspapers with regard to how they evaluated newspaper performance.<sup>29</sup> A 1984 newspaper content analysis of 114 newspapers compared publicly held dailies and privately held dailies and found few differences in the content.<sup>30</sup>

In a 1992 study, Matthews surveyed publishers at privately and publicly held daily newspapers and reported that publishers at privately owned newspapers had more managerial autonomy than did publishers at publicly owned newspapers. She also concluded that publishers at publicly owned newspaper faced corporate control and more pressure to increase revenues than those at privately owned newspapers.<sup>31</sup>

Blankenburg and Ozanich looked at the association between outside control of stock in newspaper corporations and found the degree of outside ownership was correlated with the companies' financial performance.<sup>32</sup> They reported that as outside ownership increased, profit margins increased.

In a 1996 replication of the Blankenburg and Ozanich study, Lacy, Shaver and St. Cyr also reported that increased percentage of stock controlled outside the corporation (degree of public ownership) was correlated negatively with increased profit margins.<sup>33</sup> In addition, they concluded that competition mediated this effect by increasing newsroom budgets. A recent study by Martin found similar results for 1988 and 1998. As inside control of publicly held groups decreased, profit margins increased.<sup>34</sup>

In 2001, Granberg, Bezanson and Soloski presented a list of potential effects of public ownership on newspaper performance.<sup>35</sup> They concluded that publicly held newspaper corporations are far more concerned with increasing profits than with newspaper quality. However, they did not include controls for variables such as competition.

Publicly owned dailies are usually required to have higher profits because these companies must react to the short-run expectation of the stock market, where investors are interested in financial performance such as stock prices and profit margins.<sup>36</sup> Martin's 11-year study of publicly-owned newspaper company earnings concluded economic profits were "far in excess of both low-risk alternatives and of publishing companies."<sup>37</sup> The only way to guarantee these high profits is to control cost, and the

newsroom is a high cost area. Quality on the other hand is related to newsroom expenditures.<sup>38</sup>

Although studies specifically relating public ownership to pricing behavior could not be found, scholars have examined the relationship between group ownership and advertising prices. A study based on a national sample of about half of the U.S. daily newspapers concluded that small group ownership was associated with higher daily national and retail cost-per-thousand rates and that large group ownership was associated with higher Sunday national and retail cost-per-thousand rates.<sup>39</sup>

In a case study that compared 54 dailies owned by Gannett, a publicly held group, with the same number of independent dailies, Blankenburg found that the Gannett papers charged higher advertising prices in 11 of 12 categories.<sup>40</sup> In another study, Blankenburg reported that Gannett had been aggressive in increasing circulation prices during the 1970s.<sup>41</sup>

The tendency of publicly held newspaper companies to emphasize profits and of group newspapers to be more aggressive in pricing advertising suggests managers may discount future profits at higher rates than their counterparts at private newspapers. If this is the case, then these newspaper companies will be less likely to use limit-pricing strategies to deter entry or expansion by weekly newspapers. These companies will tend to maximize short-term profits even if that accelerates the entry of new competition.

### **Hypotheses**

Theory and research suggest the following hypotheses:

H1: *Counties with privately held daily newspapers will have fewer weekly newspapers than counties with publicly held daily newspapers.*

H2: *Counties with privately held daily newspapers will have lower levels of paid and combined weekly penetration than counties with publicly held daily newspapers.*

Most publicly held dailies tend to spend less on their newsroom than do privately held dailies because of the company's need to produce high short-run profit margins that satisfy the demands of the stock market. This reduced spending suggests that publicly held dailies are more like to have lower quality. The higher quality of privately held dailies keeps more readers satisfied and reduces the likelihood that readers will turn to weeklies to get their news.

Publicly held dailies are more likely to take a short-run strategy toward prices setting, keeping their circulation and advertising prices high in order to maximize short-run profits. The long-run result is to raise the potential of competitors taking advantage of the resulting abnormal profits. The result would be more weeklies trying to take advantage of readers and advertisers who would leave the high priced daily for lower priced weeklies.

Consequently, counties with only privately held dailies are less likely to have weeklies. If weeklies do exist in these counties, they likely will have lower penetration than in counties with publicly held newspapers.

## Method

The data used in this study came from a previous study of competition among weekly and daily newspapers in counties outside of metropolitan areas.<sup>42</sup> The unit of analysis was the county. Daily newspaper markets often exceed the boundaries of their home county. However, the county is an appropriate geographic market definition for a non-metropolitan newspaper because most of its circulation falls within the county, and the county usually is the largest political entity covered on a regular basis by the newspaper's staff. The definition has been used in other studies.<sup>43</sup>

The data were a randomly stratified national sample of 381 counties from 1997, excluding those that had metropolitan dailies headquartered in them. The stratification was based on the proportions of all U.S. counties in a state. The proportion of a state's counties in the sample equaled the state's proportion of all U.S. counties.

Ordinary least squares multiple regression was used to analyze the relationship between the ownership of daily newspapers in a county and the number of weeklies and the penetration of the weeklies in the county. In addition, the number of households in the county and the total penetration of dailies headquartered in the county were used as control variables. These two variables were found to be related to weekly penetration in earlier studies.<sup>44</sup>

The ownership of dailies within the counties was identified through *Newspaper Circulation 1998*<sup>45</sup> and *Editor & Publisher International Year Book 1998*.<sup>46</sup> The former publication lists dailies that circulate in individual counties, and the latter lists the names of the dailies' owners. Whether a newspaper was owned by a publicly held group, which

was defined as a corporation whose stock could be bought by the general public, was determined by consulting *Taking Stock: Journalism and the Publicly Traded Newspaper Company*.<sup>47</sup>

The number and circulation of weeklies came from state press association directories, *Editor & Publisher International Year Book 1998* and *Bacon's Newspaper Directory 1998*.<sup>48</sup> Penetration was determined by dividing total circulation by number of households in the county. The number of households and the penetration of dailies within a county came from *Newspaper Circulation 1998*.

The data were broken into two sets for analysis. The first data set included two types of counties: One type had no daily with 10% or more penetration in the county, and the second type included counties that had only one daily headquartered in it and no other dailies that reached a minimum of 10% of the county households. The first type will be labeled non-daily counties, and the second type will be labeled daily monopoly counties.

These counties were examined because they presented fairly clear-cut choices for readers. In non-daily counties, weeklies faced no daily competition, and in monopoly daily counties, readers could select from the monopoly daily or weeklies. This subset included 188 counties. Two dummy variables were created. One represented counties with a publicly held daily monopoly paper and the other represented counties with a privately held daily monopoly paper.<sup>49</sup>

The second data set started with all 385 of the counties in the original data set. Two dummy variables were created. The first was all counties with one or more privately

held dailies that reached at least 10% penetration and no public dailies that reached 10% or more penetration. The second dummy variable was for all counties containing one or more publicly held dailies that reached at least 10% of all households. This larger sample in effect compares counties with just privately held papers against those that include just publicly held dailies or a mixture of publicly and privately held newspapers.

Three dependent variables were examined: the number of weekly newspapers in the county, the total paid weekly penetration in the county and the total combined weekly penetration in the county. Initially, the penetration of free weeklies in a county was examined, but it was dropped because of extreme skewness that could not be adequately reduced without significant changes in the data set.

The number of weeklies variable measured the number of weekly newspapers headquartered in the market. Conduct of the dailies was likely to affect this variable with higher numbers of weeklies associated with lower barriers to entry and vice versa.

The total penetration figures for weeklies in a county were used because they represent how well competing firms are performing in the market. Higher barriers would be associated with lower penetration levels. Weekly paid and combined penetrations were used because they have been found to be associated with different variables in these types of markets.<sup>50</sup>

All weekly newspapers distribute some free copies, so a paid weekly was defined as a weekly distributing 5% or less of its circulation for no charge. This definition came from a previous study.<sup>51</sup> Total market coverage products published by daily newspapers were excluded.

The data for the smaller set was examined for violation of the assumptions of regression analysis. Number of households in the county, number of weeklies in the county and combined penetration in the county all had skewness figures that exceeded 2.5, which reflected outliers. In order to adjust for these problems, the natural log of households in the county was used. Eleven cases with extreme numbers of weeklies were dropped as were three cases with extreme levels of combined weekly penetration. This reduced all of the skewness figures to under 1.25 for all the variables.

The data in the smaller sample fit the assumptions of normality, linearity and homoscedasticity of residuals. Correlations among independent variables were checked to avoid multicollinearity before running the regression analysis. The variables were not highly correlated. The data set also adequately fit the assumptions of variables to cases. Because of these adjustments and missing data, the final sample size equaled 174 cases.

The larger sample had similar problems with skewness and outliers, but because of the size of the sample, the decision was made to drop extreme cases in an iterative process. This was not done with the smaller sample because it would have drastically reduced the case-to-variable ratio. This process involved dropping cases greater than three standard deviations from the mean. The comparison was made, cases dropped and a new comparison of cases to the means was done. This process was repeated three times, dropping the total sample from 385 to 334. Because of missing data with some variables, the sample was further reduced to 318 for the regression analysis of number of weeklies and penetration of paid weeklies. Skewness problems persisted for penetration of combined weeklies in the county, so all cases with combined penetration greater than



200% were dropped, which left the total number of cases for the combined penetration dependent variable at 303.

The data in the larger sample also fit the assumptions of normality, linearity and homoscedasticity of residuals. Correlations among independent variables were checked to avoid multicollinearity before running the regression analysis. The variables were not highly correlated. The data set also adequately fit the assumptions of variables to cases

### Results

In the smaller set, 33.3% of the counties had monopoly privately held dailies, and 12.6% of the counties had monopoly publicly held dailies. In the larger set, 27% of the counties had just privately held dailies headquartered in them, while 25.7% had public dailies headquartered in them or reaching 10% household penetration. Table 1 presents the summary data from the small and large sets.

INSERT TABLE 1 ABOUT HERE

As one would expect, the larger set tended to have lower means and standard errors compared to the smaller set of data. The one exception was the mean for total number of weeklies in the county, which was 2.61 for both data sets, although the standard error dropped from .14 in the smaller data set to .098 in the larger data set.

Hypothesis 1 states that counties with privately held daily newspapers would have fewer weekly newspapers than counties with publicly held daily newspapers. Data from the first column in Table 2 support this hypothesis. These are from the subsample of counties with no dailies headquartered in them or with a monopoly daily. The

regression coefficient for counties with privately held monopoly dailies equaled -1.171 (beta = -.305) and was statistically significant at the  $p < .05$  level. The coefficient indicates that a county with a privately held monopoly daily had about one fewer weekly newspaper than did other counties.

INSERT TABLE 2 ABOUT HERE

The hypothesis is further supported by the non-statistically significant and considerably smaller regression coefficient of -.316 (beta = -.062) for counties with publicly held monopoly dailies. The smaller coefficient for counties with publicly held monopoly dailies indicates that these dailies probably have lower barriers to entry relative to counties with privately held monopoly dailies. This result has even stronger support from the sample of 318 counties represented by data in Table 3.

INSERT TABLE 3 ABOUT HERE

The negative relationship between private ownership and number of weeklies remained in the larger data set, although the regression coefficient was smaller than that found in Table 1, equaling -.825 (beta = -.151). This indicates that counties with privately owned dailies had .8 fewer weeklies in them than did all other counties. This relationship was significant at the  $p > .01$  level. The relationship between publicly held dailies and number of weeklies in a county failed to reach statistical significance in the larger data set just as it did in the smaller set of data.

Overall, Hypothesis 1 was supported. Counties with only a privately held daily were more likely to have fewer weeklies than counties with publicly held dailies or no daily at all.

Hypothesis 2 states that counties with privately held daily newspapers would have lower levels of paid and combined weekly penetration than counties with publicly held daily newspapers. The data in tables 2 and 3 support this hypothesis.

The regression coefficient in Table 2 for penetration of paid weeklies in monopoly counties with a private daily equaled -49.26 (beta = -.328) and the regression coefficient for monopoly counties with a publicly held daily equaled -26.91 (beta = -.118). The relationship with privately held dailies is statistically significant at the  $p < .01$  level, but the relationship with publicly held dailies is not statistically significant. The coefficients indicate that the total penetration of paid weeklies in counties with monopoly dailies was at least 21 percentage points lower in counties with privately held dailies than in counties with publicly held dailies.

A similar pattern was found with the total penetration of all weeklies, but the difference between counties with privately held dailies and those with publicly held dailies was less than with the penetration of paid weeklies. The regression coefficient for counties with privately held dailies equaled - 46.39 (beta = -.303,  $p < .05$ ), while the coefficient for counties with daily monopolies by publicly held dailies equaled - 30.66 (beta = -.132, not significant). The total weekly penetration in counties with monopoly dailies that were privately owned was at least 14 percentage points lower than the total penetration in counties with monopoly dailies that were publicly owned.

Again, similar relationship patterns were found with the larger data set in Table 3, but the relative association between private ownership and weekly paid and total penetration was weaker than in Table 2.

The regression coefficient for the association of counties with privately held dailies and the paid penetration of weeklies in the county equaled - 20.26 (beta = -.159,  $p < .01$ ), and the coefficient for publicly held dailies was - 5.16 (beta = -.038, not significant). The combined penetration of paid weeklies in counties with privately held dailies was at least 15 percentage points lower than the penetration of paid weeklies in counties with just publicly held dailies or a combination of publicly and privately held dailies.

The larger data set showed a similar pattern for penetration of all weeklies. The regression coefficient for counties with only privately held dailies was - 24.13 (beta = -.220,  $p < .01$ ), and the coefficient for counties with publicly held and mixed dailies was - 5.29 (beta = -.045, not significant). The total penetration of all weeklies in counties with just privately held dailies was at least 19 percentage points lower than in counties with publicly held and mixed dailies. Overall, data in tables 1 and 2 support hypothesis 2.

## CONCLUSION

As hypothesized, this exploratory study of the relationship between ownership type and barriers to entry found that private ownership of dailies was negatively associated with the number of weekly newspapers and with the penetration of paid and all weeklies within the county. This pattern is consistent with the prediction derived from theory and research that privately held newspapers would be more likely to keep prices and profits lower and quality higher than publicly held dailies. Lower prices are

likely to discourage new weeklies from starting, and lower profits would allow dailies to invest in content and quality, which would keep the penetration of paid weeklies low.

Although these results are consistent with the hypotheses and existing research, the relationships are only correlations. The study did not specifically test for variations in pricing and quality, and only two control variables were used. It is impossible to say from these data that the managers of privately owned dailies are pursuing a strategy of limiting price increases and quality investment to limit fringe competition in the long run. It may be that their conduct reflects a commitment to quality performance of their news staff that is not based on economics but on community commitment. This would be consistent with Busterna's findings that owner-managers at 37 weeklies and five small dailies showed less interest in profit maximization and more interest in quality and ethical performance than did managers who did not own their newspapers.<sup>52</sup> Interviews with newspaper managers would help determine the motivation behind these statistics.

In addition, even though the sample included about 10% of all counties in the United States, the data showed great variance. This variation could reflect levels of variance in the population, the size of the sample, or both. A longitudinal study of markets would allow for the study of variations in pricing and quality; and a larger sample with more control variables might reduce the variance found in this sample.

Despite these limitations, the data patterns found here are consistent with the hypothesis that ownership type of the dailies in non-metropolitan markets affects weekly barriers to entry and survival. Because existing research supports at least some

substitutability of weeklies and dailies in counties outside of metropolitan areas, type of ownership appears to influence the levels of competition a daily faces in its county.

If these findings hold up under replication, managers at publicly held newspaper corporations need to consider the long-run economic impact of increases in competition that can result from their pricing conduct and budget decisions. The presence of alternative weekly news sources could lead to a reduction in penetration and a corresponding loss of advertising lineage if readers become dissatisfied with the price and quality of the daily.

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#### Notes

<sup>1</sup> Greg Mitchell, "Poll finds profits rule," *Editor & Publisher*, April 9, 2001, p. 16.

<sup>2</sup> David C. Coulson, "Impact of Ownership on Newspaper Quality," *Journalism Quarterly* 71 (summer 1994): 403-410; and Gilbert Cranberg, Randall Bezanson and John Soloski, *Taking Stock: Journalism and the Publicly Traded Newspaper* (Ames, IA: Iowa State University Press, 2001).

<sup>3</sup> Stephen Lacy and Hugh J. Martin, "Profits Up, Circulation Down for Thomson Papers in '80s," *Newspaper Research Journal* 19 (summer 1998): 63-76.

<sup>4</sup> Edward H. Chamberlin, *The Theory of Monopolistic Competition*. 6<sup>th</sup> ed. (Cambridge: Harvard University Press, 1950).

<sup>5</sup> In perfect competition, there are no barriers to firms entering markets. However, in monopolies, oligopolies and monopolistic competitive models, a variety of factors can affect a firm's ability to enter a market. These can include economies of scale, pricing practices and various other activities. See Barry Litman, "Microeconomic Foundations," Press

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Concentration and Monopoly, Robert G. Picard, et al., eds. (Norwood, NJ: Ablex, 1988), 3-34.

<sup>6</sup> This is the case when firms produce homogenous products and have identical production costs. Walter Nicholson, *Microeconomic Theory: Basic Principles and Extensions*, 6th ed. (New York: The Dryden Press, 1995), 462-63.

<sup>7</sup> A firm's cost includes the owner's opportunity cost of not investing capital elsewhere. Firms earn positive economic profits if they offer a return on capital larger than the return the owner could receive from the alternative of investing elsewhere. These positive economic profits are what convince new competitors to make the investment of entering a market. Nicholson, *Microeconomic Theory*, 462-63..

<sup>8</sup> James N. Rosse, "Daily Newspapers, Monopolistic Competition, and Economies of Scale," *The American Economic Review* 57 (May 1967): 527-29.

<sup>9</sup> William B. Blankenburg, "Newspaper Scale & Newspaper Expenditures," *Newspaper Research Journal* 10 (winter 1989): 100; James N. Dertouzos and William B. Trautman, "Economic Effects of Media Concentration: Estimates from a Model of the Newspaper Firm," *The Journal of Industrial Economics* 39 (September 1990): 12; James M. Ferguson, "Daily Newspaper Advertising Rates, Local Media Cross-Ownership, Newspaper Chains, and Media Competition," *Journal of Law and Economics* 26:3 (1983): 645; Stephen Lacy and Todd F. Simon, *The Economics and Regulation of United States Newspapers, The Communication and Information Science Series* (Norwood, N.J.: Ablex Pub., 1993), 72; R.S. Thompson, "Product Differentiation in the Newspaper Industry: An Hedonic Price Approach," *Applied Economics* 20 (1988): 372.

<sup>10</sup> F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance*, 3rd ed. (Boston: Houghton Mifflin, 1990), 353-56.

<sup>11</sup> Scherer and Ross, *Industrial Market*, 353.

<sup>12</sup> Scherer and Ross, *Industrial Market*, 359.

<sup>13</sup> Scherer and Ross, *Industrial Market*, 224.

<sup>14</sup> Scherer and Ross, *Industrial Market*, 358, 78.

<sup>15</sup> Lacy and Simon, *The Economics and Regulation*, 95, 112-15.

<sup>16</sup> One study of 900 suburban communities failed to support the umbrella model Walter E. Niebauer Jr. et al., "Central City Market Structure's Impact on Suburban Newspaper Circulation," *Journalism Quarterly* 65 (autumn 1988): 730-31. However, five other studies supported the umbrella model. A survey of newspaper editors, and a second study of competition at 114 newspapers both supported the model Stephen Lacy, "Competition among Metropolitan Daily, Small Daily, and Weekly Newspapers,"

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*Journalism Quarterly* 61, (autumn 1984): 640-644,742; Stephen Lacy, "The Impact of Intercity Competition on Daily Newspaper Content," *Journalism Quarterly* 65 (summer 1988): 402-05. A third study examined the number of U.S. counties with multiple dailies in different layers of the model Stephen Lacy and Lucinda Davenport, "Daily Newspaper Market Structure, Concentration, and Competition," *The Journal of Media Economics* 7:3 (1994): 38. A fourth study found competition between weeklies and satellite dailies in non-metropolitan counties in Michigan; Stephen Lacy and Shikha Dalmia, "Daily and Weekly Penetration in Non-Metropolitan Areas of Michigan," *Newspaper Research Journal* 14 (summer-fall 1993): 30. The Michigan study was extended throughout the United States using a random sample of 381 counties. The fifth study also found competition between weeklies and non-metropolitan dailies; Stephen Lacy, David C. Coulson, and Hiromi Cho, "Competition for Readers among U.S. Metropolitan Daily, Non-metropolitan Daily and Weekly Newspapers," *Journal of Media Economics* 15:1 (2002): 32-4.

<sup>17</sup> J. A. Bridges, B. R. Litman, and L. W. Bridges, "Rosse's Model Revisited: Moving to Concentric Circles to Explain Newspaper Competition," *Journal of Media Economics* 15:1 (2002):3-19.

<sup>18</sup> Bridges, Litman, and Bridges, "Rosse's Model Revisited," 17.

<sup>19</sup> Bridges, Litman, and Bridges, "Rosse's Model Revisited."

<sup>20</sup> Scherer and Ross, *Industrial Market Structure and Economic Performance*, 360.

<sup>21</sup> Stephen Lacy, "A Model of Demand for News: Understanding the Impact of Competition on Daily Newspaper Content," *Journalism Quarterly* 66 (spring 1989): 40-48, 128.

<sup>22</sup> Lacy and Martin, "Profits Up, Circulation."

<sup>23</sup> William B. Blankenburg and Gary W. Ozanich, "The Effects of Public Ownership on the Financial Performance of Newspaper Corporations," *Journalism Quarterly* 70 (spring 1993): 68-75; Stephen Lacy, Mary Alice Shaver and Charles St. Cyr, "The Effects of Public Ownership and Newspaper Competition on the Financial Performance of Newspaper Corporations: A Replication and Extension." *Journalism & Mass Communication Quarterly* 73 (summer 1996): 332-341; and Cranberg, Bezanson, John Soloski, *Taking Stock*

<sup>24</sup> Lacy, "Competition among Metropolitan Daily."

<sup>25</sup> Lacy and Dalmia, "Daily and Weekly."

<sup>26</sup> Lacy, Coulson and Cho, "Competition for Readers."

<sup>27</sup> Lacy and Simon, *The Economics and Regulation*.



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<sup>28</sup> Hugh J. Martin, "Factors Affecting Entry and Exit in Weekly Newspaper Markets: the Importance of Economies of Scale," Unpublished manuscript, The University of Georgia, 1996.

<sup>29</sup> Philip Meyer and Stanley T. Weardon, "The Effects of Public Ownership on Newspaper Companies: A Preliminary Inquiry," *Public Opinion Quarterly* 48 (1984): 564-577.

<sup>30</sup> Stephen Lacy, "The Effects of Ownership and Competition on Daily Newspaper Content," doctoral dissertation, University of Texas at Austin, 1986.

<sup>31</sup> Martha Matthews, "How Public Ownership Affects Publisher Autonomy," *Journalism & Mass Communication Quarterly* 73 (summer 1996): 342-353.

<sup>32</sup> Blankenburg and Ozanich, "The Effects of Public."

<sup>33</sup> Lacy, Shaver and St. Cyr, "The Effects of Public."

<sup>34</sup> Hugh J. Martin, "A Study of How a Strategy Creating Clusters of Commonly-Owned Newspapers Affects Prices, Quality and Profits," doctoral dissertation, Michigan State University, 2001, 119-20.

<sup>35</sup> Cranberg, Bezanson and Soloski, *Taking Stock*.

<sup>36</sup> Cranberg, Bezanson and Soloski, *Taking Stock*; and Lacy and Simon, *The Economics and Regulation*.

<sup>37</sup> Hugh J. Martin, "Measuring Newspaper Profits: Developing a Standard of Comparison," *Journalism & Mass Communication Quarterly* 75 (autumn 1998): 512.

<sup>38</sup> Lacy and Simon, *The Economic and Regulation*, 21,105.

<sup>39</sup> James M. Ferguson, "Daily Newspaper Advertising Rates, Local Media Cross-Ownership, Newspaper Chains and Media Competition," *Journal of Law and Economics* 28 (1983): 635-654.

<sup>40</sup> William B. Blankenburg, "A Newspaper Chain's Pricing Behavior," *Journalism Quarterly* 60 (summer 1983): 275-280.

<sup>41</sup> William B. Blankenburg, "Newspaper Ownership and Control of Circulation to Increase Profit," *Journalism Quarterly* 59 (autumn 1982): 390-398.

<sup>42</sup> Lacy, Coulson and Cho, "Competition for Readers."

<sup>43</sup> Lacy and Davenport, "Daily Newspaper Market;" and Lacy, Coulson and Cho, "Competition for Readers."

<sup>44</sup> Lacy and Dalmia, "Daily and Weekly Penetration;" and Lacy, Coulson and Cho, "Competition for Readers."

<sup>45</sup> *Newspaper Circulation 1998*. (Willamette, IL: Standard Rate and Data Service, 1998).

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<sup>46</sup> *Editor & Publisher International Year Book 1998*. (New York: Editor & Publisher, 1998).

<sup>47</sup> Cranberg, Bezanson and Soloski, *Taking Stock*.

<sup>48</sup> *Bacon's Newspaper Directory 1998*. (Hightstown, NJ: Primedia Information, Inc., 1998).

<sup>49</sup> In creating the publicly held daily monopoly counties, these counties were assigned a one, and counties with privately held dailies and no dailies were assigned zeros. In creating the privately held daily monopoly counties, these counties were assigned a one and counties with publicly held dailies and no dailies were assigned zeros.

<sup>50</sup> Lacy, Coulson and Cho, "Competition for Readers."

<sup>51</sup> David C. Coulson, Stephen Lacy and Jonathan Wilson, "Weekly Newspapers -- Solid Industry with Many Variations," *Newspaper Research Journal* 22 (summer 2001): 16-29.

<sup>52</sup> John Busterna, "How Managerial Ownership Affects Profit Maximization in Newspaper Firms," *Journalism Quarterly* 66 (summer 1989): 302-307, 358.

Table 1  
Summary Statistics for Two Data Sets

<u>Variables</u>	Small Data Set (n = 174)		Large Data Set (n = 318)	
	Mean	Standard Error	Mean	Standard Error
Households in the county	22,987	3,001	19,236	1,364
County daily penetration	20.51%	2.01%	6.16%	1.30%
Number of weeklies in county	2.61	.140	2.61	.098
Paid weekly penetration in county	83.43%	5.39%	75.98%	3.16%
Combined weekly penetration in county	100.36	5.49%	87.93%	3.19%

Table 2

## Impact of Private Ownership on Weeklies in Counties with One Daily

<u>Independent Variable</u>	<u>Dependent Variable</u>		
	No. of Weeklies	Paid Weekly Penetration	All Weekly Penetration
Households in the county (natural log)	.753 <sup>d</sup> .539 (.133)	-24.71 <sup>d</sup> -.452 (.4.21)	-24.17 <sup>d</sup> -.435 (4.933)
County daily Penetration	.014 <sup>a</sup> .206 (.008)	-.047 -.017 (.226)	.279 .102 (.312)
Public Ownership (dummy)	-.316 -.062 (.599)	-26.91 -.118 (18.91)	-30.66 -.132 (22.17)
Private Ownership (dummy)	-1.171 <sup>b</sup> -.305 (.518)	-49.26 <sup>c</sup> -.328 (16.37)	-46.39 <sup>b</sup> -.303 (19.19)
Adjusted R-Square	.247 <sup>d</sup>	.509 <sup>d</sup>	.363 <sup>d</sup>
Degrees of Freedom	4, 169	4, 169	4,169

Note: The first statistic in the column for each variable is the regression coefficient. The second is the beta weight, and the statistics in parenthesis is the standard error of the regression coefficient.

a =  $p > .1$

b =  $p > .05$

c =  $p > .01$

d =  $p > .001$

Table 3  
Impact of Private Ownership on Weeklies in All Counties

<u>Independent Variable</u>	<u>Dependent Variable</u>		
	No. of Weeklies	Paid Weekly Penetration	All Weekly Penetration
Households in the county (natural log)	.810 <sup>d</sup> .501 (.103)	-27.98 <sup>d</sup> - .534 (2.66)	-16.88 <sup>d</sup> - .374 (2.58)
County daily Penetration	.0054 .070 (.006)	-.246 <sup>a</sup> -.097 (.150)	-.263 <sup>a</sup> -.123 (.143)
Public Ownership (dummy)	.015 .004 (.227)	- 5.16 -.038 (5.86)	-5.29 -.045 (5.66)
Private Ownership (dummy)	-.825 <sup>c</sup> -.151 (.307)	-20.26 <sup>c</sup> -.159 (7.92)	-24.13 <sup>c</sup> -.220 (7.55)
Adjusted R-Square	.195 <sup>d</sup>	.489 <sup>d</sup>	.377 <sup>d</sup>
Degrees of Freedom	4,313	4,313	4,298

Note: The first statistic in the column for each variable is the regression coefficient. The second is the beta weight, and the statistics in parenthesis is the standard error of the regression coefficient.

- a = p > .1
- b = p > .05
- c = p > .01
- d = p > .001

RUNNING HEAD: Must-Carry: An Economic Consideration

**Must-Carry: An Economic Consideration**

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**ABSTRACT**

In *Turner Broadcasting System v. FCC* (1994 & 1997), the US Supreme Court justified and affirmed the constitutionality of the “must-carry” restrictions of the Cable Act of 1992 by citing the cable operators’ “bottleneck, or gatekeeper control over most of the television programming.” However, an economic analysis focusing on the current conditions for competition, relevant market analysis, and concentration and vertical integration data suggests that the Court’s ruling was based on inappropriate rationale.

## Must-Carry: An Economic Consideration

### **Introduction**

In *Turner Broadcasting System, Inc. v. FCC* (1994 & 1997), the US Supreme Court justified the restrictions on the First Amendment rights of cable operators by referring to the operators' "bottleneck, or gatekeeper, control over most of the television programming that is channeled into the subscribers' home" and affirmed the constitutionality of the "must-carry" provisions of the Cable Television Consumer Protection and Competition Act of 1992. The Court argued that forcing cable systems to carry broadcast signals free of charge would reduce the cable industry's anticompetitive conducts, protecting broadcasters' profits and promoting the viability of broadcast programming (*Turner Broadcasting v. FCC*, 1997). The ruling appears to be a large success for small broadcasting stations and a defeat for the cable industry, because it does not allow cable operators to replace local television stations with the possibility of more lucrative cable networks (Kim, 1999). Also, as we leap rapidly into the "Information Age," the *Turner* cases could become an important precedent for all new communication technologies as they struggle to retain their autonomy from government regulators (Ugland, 1995, p.802).

Since the Court's decisions, however, there have been some controversies regarding the characteristics of cable television and competition in the marketplace. Also, as digital television takes off, the issue of the must-carry rules has been evoked again in the digital environment.

In this regard, this paper tries to test the rationale of the Court's decisions from an economic perspective. Although the *Turner* cases are based on the principles of the First Amendment, it is necessary to investigate economic logics behind the scene in order to understand the implication of the must-carry restrictions in terms of competition between broadcasters and cable operators. It means that if we can show the changes regarding competition in the marketplace and disprove the economic rationale used in the *Turner* cases, then we may have more room for reconsideration of the must-carry rules.



For this purpose, this paper will examine the characteristics of cable television and economic rationale for the must-carry rules in the Court's decisions. Then, the current conditions in the marketplace will be examined, because there have been several factors to be considered since the decisions, which have changed the nature of the market in terms of competition. Also, economic factors in the must-carry will be investigated to test the rationale of the *Turner* cases. Finally, the effect and proper policy choice of the must-carry rules for the future competition in the video market will be suggested.

### **Must-Carry: A Brief Overview**

On October 5, 1992, the US Congress passed the Cable Television Consumer Protection and Competition Act of 1992 (hereafter, The Cable Act). The Act promises improved customer service, ensured public access, and lower government-controlled rates among other things. However, the so-called "must-carry" rules, which were the issue in the *Turner* cases, require cable system operators to set aside a certain portion of their channel capacity for retransmission of local commercial and public broadcast signals<sup>1</sup> (The Cable Act, section 534 & 535). As soon as the must-carry rules passed, Turner Broadcasting System filed suit in federal district court challenging enforcement of the rules. Turner Broadcasting argued that the must-carry rules interfered with their editorial discretion to control the content of their systems, violating their First Amendment rights (*Turner Broadcasting v. FCC*, 1994).

The Court decided in 1994 (*Turner Broadcasting System, Inc. v. FCC*, 1994: "Turner I") that "the must-carry regulations are not based on content, but on the manner in which

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<sup>1</sup> Specifically, the must-carry rules obligated cable systems with more than 12 channels of video programming to set aside up to one-third of their capacity for the retransmission of all commercial VHF and UHF stations broadcast in the local market; carry non-commercial stations (Public Broadcasting System affiliates); and carry up to two low-power TV stations broadcast locally where less than one-third of channel capacity was filled by commercial full-power stations. A cable system with twelve or fewer channels was required to carry at least three broadcast channels. An operator with fewer than 300 subscribers was exempt from the provision, and all operators were free to choose among broadcasters when demand by stations exceeded the supply of required channels (The Cable Act, section 534).

programmers transmit their messages” (*Turner Broadcasting v. FCC*, 1994). The Court also held that the differential treatment applied to the different media was not motivated by an interest in the content of particular messages, but by the fact that the broadcasting industry was in economic peril and needed special assistance (*Turner Broadcasting v. FCC*, 1994). Moreover, the Court said that any special burdens imposed on the cable industry were justified by the “special characteristics” of cable, namely, its supposed ability to exercise the “bottleneck, or gatekeeper control” over broadcasting programming (*Turner Broadcasting v. FCC*, 1994). The Court also recited the governmental interests of the Cable Act: (1) preserving the benefits of free, over-the-air local broadcast television, (2) promoting the widespread dissemination of information from a multiplicity of sources, and (3) promoting fair competition in the market for television programming (*Turner Broadcasting v. FCC*, 1994). Finally, the Court remanded the case back to the district court panel to determine whether the must-carry rules actually advance the government’s asserted interests and whether or not they are more restrictive than necessary to serve those interests (*Turner Broadcasting v. FCC*, 1994).

The Court’s 5-4 majority ruling in 1997 (*Turner Broadcasting System, Inc. v. FCC*, 1997: “Turner II”) upheld the constitutionality of the must-carry rules identifying that “it is undisputed that the government has an interest in eliminating restraints on fair competition..., even when the individuals or entities subject to particular regulations are engaged in expressive activity protected by the First Amendment” (*Turner Broadcasting v. FCC*, 1997). The Court found that Congress acted on its belief that, lacking must-carry, “the economic viability of free local broadcast television and its ability to originate quality local programming will be seriously jeopardized” (*Turner Broadcasting v. FCC*, 1997). For four members of the majority (Justices Kennedy, Souter, Stevens and Rehnquist), the economic incentives were key to the decision (Hazlett, 2000, p.147). They concluded based on the Congress’ data<sup>2</sup> that cable operators used

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<sup>2</sup> The Court in *Turner II* was far more willing to accept the data as truth than in *Turner I*, thereby concentrating less on the quality of the evidence itself (Pliska, 1998, p.460).

their market power to exclude local broadcast stations from carriage, limiting broadcasters' ability to compete for local advertising revenues and thereby increasing cable systems advertising (and profits) (*Turner Broadcasting v. FCC*, 1997). Also the Court argued that forcing cable systems to carry broadcast signals free of charge would mitigate this anticompetitive conduct, protecting broadcaster profits and promoting the viability of broadcast programming (*Turner Broadcasting v. FCC*, 1997). According to the Court, the reason for the enforcement is that importantly the 40% of US households that depend on over-the-air broadcasting for their TV programming would enjoy these benefits<sup>3</sup> (*Turner Broadcasting v. FCC*, 1997).

### **Characteristics of Cable Television and Economic Rationale for the Must-Carry**

With passage of the Cable Act and confirmation of the must-carry rules in the *Turner* cases in 1994 and 1997, the cable industry's future rests directly in the hands of the federal government (Ugland, 1995, pp.800-801). The *Turner* cases were the Supreme Court's first attempt to answer a question that had confused observers for many years about the constitutional status of cable<sup>4</sup>: Is cable television like broadcasting, which is subject to government regulation due to the scarcity of the broadcast spectrum (broadcast model)<sup>5</sup>, or is it more akin to the newspaper industry, which is almost free from government intervention (print model)<sup>6</sup>? In the *Turner* cases, the Court chose a third alternative. Instead of relying on the old analogies, it chose a new one: the cable operator as the "bottleneck or gatekeeper" of the televised images received by subscribers. Under this approach, government authority to regulate is justified by the absence of competition and the supposed ability of cable systems to work as a "bottleneck" to diverse sources of video

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<sup>3</sup> This is the figure the Court used in *Turner II*, but it is actually much greater than correct number in either in 1997 or now. The percentage of households subscribed to a multichannel video programming distributor (MVPD) such as a cable system or direct broadcast satellite (DBS) in 1996 was 74.61%, as of December 1996 (Hazlett, 2000, p.147). According to FCC (2002), 86.42% of households subscribe to an MVPD service as of June 2001 (p.4). Therefore, the Court's argument of 40% over-the-air television viewership was overestimated.

<sup>4</sup> For the history of regulation on cable television, see Parsons & Frieden (1998), pp.257-294.

<sup>5</sup> See *Red Lion Broadcasting Co. v. FCC*, 1969.

<sup>6</sup> See *Miami Herald Publishing Co. v. Tornillo*, 1974.

programming (Prostick, 1997, p.183). The Congress argued in the *Turner* cases, and the Court agreed, that “because most television households subscribe to cable,<sup>7</sup> the only practical way for broadcasters to reach viewers is via a cable system.” Cable system operators, therefore, have a competitive advantage over broadcasters (*Turner Broadcasting v. FCC*, 1994). Furthermore, they have both the ability and the financial incentive to exploit this advantage (*Turner Broadcasting v. FCC*, 1994). Based on that characterization, the Court recognized that “the must-carry provisions are content-neutral regulations<sup>8</sup> that further an important governmental interest and which are narrowly tailored to advance that interest ” (Adelman, 1996, pp.1551-1552).

As a rationale for choosing the “bottleneck” model, the Court emphasizes the different characteristics between broadcasting and cable. In broadcasting, on the positive side, the programming is a public good and is therefore available to everyone without cost. On the downside, signal quality can be affected by distance and other forms of signal interference (Pliska, 1998, p.449). Cable systems, by contrast, depend on a physical, point to point connection between a transmission facility and the television sets of individual subscribers (*Turner Broadcasting v. FCC*, 1994). Thus, the two primary benefits of cable are a lack of signal interference and the ability to provide subscribers with many more programs. Also, cable companies are usually given a virtual monopoly in a certain geographic area. For these reasons, the Court maintained that the application of a broadcast model to cable might not be appropriate (*Turner Broadcasting v. FCC*, 1994).

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<sup>7</sup> It is contradictory to the Court’s argument that 40% of US households depend on over-the-air broadcasting.

<sup>8</sup> Content-neutral regulations are those that do not target particular subjects or viewpoints and the burden on speech caused by these regulations is incidental to some other government objective. Content-neutral regulations are typically subject to an intermediate level scrutiny whereby the government must show that: (1) the regulation furthers an important or substantial government interest, (2) the burdens on speech caused by the regulation are unrelated to the suppression of speech, and (3) the restriction on speech caused by the regulation is no greater than necessary to advance the government’s interest (*United States v. O’Brien*, 1968). Unlike content-neutral regulations, content-based regulations are those that restrict the expression of particular subjects or viewpoints. These types of regulations violate the First Amendment unless the government can show that they are necessary to serve a compelling governmental interest and that they are no more restrictive than necessary (*Carey v. Brown*, 1980). Although the *Turner* cases also raise important First Amendment issues (Ugland, 1995, p.801, Pliska, 1998, p.453), this paper focuses on economic impact of the cases.

The Court acknowledged that daily newspapers, as well as cable systems, might enjoy a monopoly status in a given locale. The majority, however, thought that a cable operator could thereby exercise control over video programming in the home and, in particular, could diminish competition in a way that a daily monopoly newspaper could not dominate the print media (Winer, 1997, p.48). As the Court also rejected to adopt a print model for which cable operators had argued, the cable industry has been subjected to government regulation.

In *Turner II*, the majority opinion's conclusion was the confirmation of monopoly power of local cable systems, strong cross elasticity of demand between cable programming and broadcast programming, numerical superiority of cable programming, mutual dependence on and competition for advertising support, past evidence of adverse broadcast carriage decisions, and continued growth in the cable market (*Turner Broadcasting v. FCC*, 1997). The majority opinion viewed the cable industry as a vertically integrated monopoly that produced, distributed and controlled access to a plethora of programming options (Whitmore, 2001, p.194). Based on these arguments, the Court's economic analysis concluded that mandatory carriage was necessary to prevent financial harm to the local broadcasters and thus constituted a substantial governmental interest that the Cable Act was designed to address (Whitmore, 2001, p.194).

However, the dissenters (Justice O'Connor, Scalia, Thomas, and Ginsburg) argued that the majority opinion advanced a "highly dubious economic theory" at the expense of the First Amendment freedoms (*Turner Broadcasting v. FCC*, 1997). In her dissenting opinion, Justice O'Connor argued that "the principal opinion misapplies the analytic framework it chooses, exhibiting an extraordinary and unwarranted deference for congressional judgments, a profound fear of delving into complex economic matters, and a willingness to substitute untested assumptions for evidence" (*Turner Broadcasting v. FCC*, 1997). Also, the dissenting opinion takes issue with the fact that "the principal opinion offered no explanation regarding the type of anticompetitive conduct in which cable operators engaged" (*Turner Broadcasting v. FCC*, 1997). The dissenters argue that the must-carry provision is not a measured response to congressional

concerns about monopoly power and the principal opinion's discussion on this point is irrelevant or even if it were relevant, it is incorrect (*Turner Broadcasting v. FCC*, 1997). When the dissenters talk about competition in the marketplace, they maintain that growing use of Direct Broadcast Satellite (DBS) also tends to undercut the notion that cable operators have an inevitable monopoly over video services entering cable households (*Turner Broadcasting v. FCC*, 1997). Finally, the dissenters argued that the "must-carry simply cannot be justified as a response to the allegedly substantial problem of vertical integration" (*Turner Broadcasting v. FCC*, 1997). As an illustration, they maintain that even if advertising revenues would be of increasing importance to cable operators as subscribership growth began to flatten, it does not necessarily follow the quest that advertising revenues supply cable operators with incentives to engage in predatory behavior, or that must-carry is a reasonable response to such incentives (*Turner Broadcasting v. FCC*, 1997).

This line of reasoning of the dissenters seems much more logical than that of the majority opinion in terms of economic analysis of the must-carry rules and thus provides a sound economic explanation. Following the dissenters' arguments, an economic analysis of the must-carry rules will be employed in the section below.

### **Economic Analysis for Must-Carry**

Economic analysis can best help us make more informed choices of appropriate government action and assess the range of policy influences and effects. Also, economic analysis of the linkage among industry structure, conduct, and performance will lead to discussion of the need for public policy reformulation (Gomery, 1998, p.46). Therefore, an appropriate investigation of broadcasting and cable industries' structures and conducts based on a clear economic reasoning will provide us with much more significant policy implications regarding the must-carry rules. For this purpose, current market conditions for competition, relevant market analysis, and concentration and vertical integration of broadcasting and cable industry will be examined below.

## 1. Competition in the Video Programming Distribution Market

Recent developments in new technology coupled with changes in law have altered the competitive landscape of the marketplace. The rise of digital satellite systems and the Internet has largely eroded the gatekeeper status of the cable operators and undermined the Court's justifications for applying mandatory carriage policy (Adelman, 1995, pp.1558-1559).

According to an FCC report (2002), although cable television is still the dominant technology for the delivery of video programming to consumers in the marketplace, its market share continues to decline (p.4). As of June 2001, 78% of multichannel video programming distributors (MVPD) subscribers, which is approximately 69 million, received their video programming from a franchised cable operator, compared to 80% a year earlier. Between June 2000 and June 2001, however, the number of DBS subscribers grew from almost 13 million households to about 16 million households and now they represent 18.2% of all MVPD subscribers (FCC, 2002, p.4). In addition, in terms of growth rate, it is nearly two and a half times the cable subscriber growth rate (FCC, 2002, p.29). Figure 1 shows the change in the market shares of each player in MVPD market.

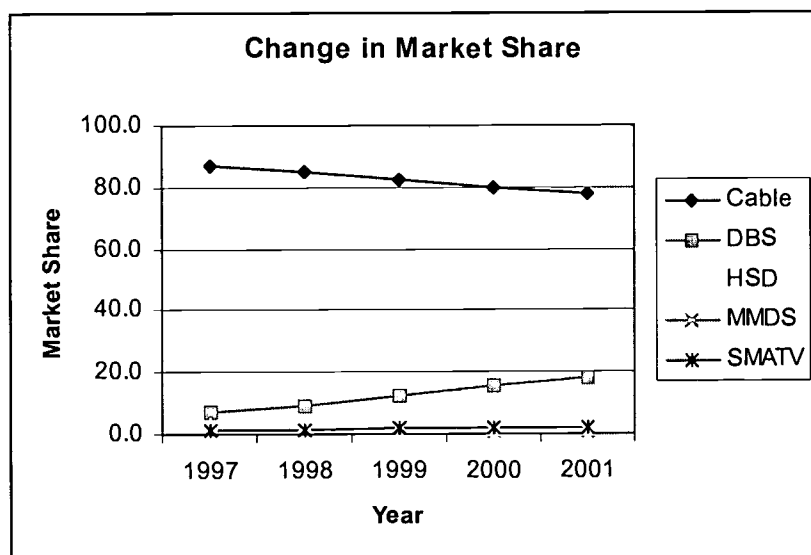
As seen in Figure 1, DBS is, at present, the largest competitor to cable in the MVPD market, and analysts predict continued growth. Paul Kagan Associates predicts that total DBS subscribership will increase to almost 26 million in 2005 and to over 28 million in 2010, a compound annual growth rate of 7.1% (Paul Kagan Assocs., 2000, p.5). Paul Kagan Associates also predicts that total DBS industry revenue will triple from \$8.8 billion in 2000 to nearly \$26 billion in 2010 (Paul Kagan Assocs., 2000, p.6). Furthermore, DBS players DirecTV and EchoStar are currently the third and sixth largest distributor of the MVPD market in terms of subscribership, respectively<sup>9</sup> (FCC, 2002, pp.29-30). Furthermore, if the pending merger

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<sup>9</sup> DirecTV had over 10 million subscribers and EchoStar 6 million as of June 2001 (FCC, 2002, p.30). For the top 10 distributors and their number and percent of subscribers, see Appendix 1.

between DirecTV and EchoStar is approved, it is obvious that DBS will hold a strong position in the market in the future. That is, although the Court in the *Turner* cases said that cable might have its potential for the “bottleneck” or “gatekeeping” control, it is hard to argue such rationale, considering the strong competitor, DBS, which holds a strong position gained in just a few years. In addition, as National Cable Telecommunication Association (NCTA) argues, cable’s dominance of the market for distribution of video programming is not an indication of the absence of competition in the market. NCTA states that DBS, cable’s primary competitor, has the capability to distribute “a good substitute” for cable to consumers in any geographic market, thus constraining cable’s ability to exercise market power (FCC, 1999).

Figure 1. Change in Market Share



Source: FCC, 2002, p.95. Reorganized.

Further down the road, the Internet will be another competitor to cable, although currently large-scale access to video programming through the Internet is not feasible due to the state of technology (Adelman, 1996, p.1559). The availability of real-time and downloadable video over the Internet has increased greatly. As of July 2001, an estimated 58% of all



Americans had Internet access at home and 41 million residential Web users had accessed streaming video (FCC, 2002, p.42). Although the Internet is still not generally seen as a direct competitor to traditional video services, Internet users continue to download and use software for accessing Internet video, and websites dedicated to streaming video continue to proliferate<sup>10</sup> (FCC, 2002, p.42). The amount of video programming content on the Internet also continues to grow and traditional television programmers are offering Internet video versions of their broadcast or cablecast programming or supplemental webcast programming<sup>11</sup> (FCC, 2002, pp.43-44). Hence, there is no reason to believe that the Internet will not catch up in a few years.

In addition to the lack of competition argument, Congress and the Court presume that all video programming must come to be viewed via cable, and if a local broadcast station does not get its signal on that cable system, it will not survive (*Turner Broadcasting v. FCC*, 1994). However, this line of reasoning is flawed because it is obviously not true that all video programming must come through cable. Local broadcast signals can be received by DBS, home satellite dishes (HSD), multichannel multipoint distribution service (MMDS), and satellite master antenna television systems (SMATV), and where these options are not actually or practically available, most viewers can always receive broadcast signals via an antenna (Ugland, 1995, p.822). Therefore, the Court's argument that regulation is necessary to correct the "competitive imbalance" (*Turner Broadcasting v. FCC*, 1994), is a flawed rationale.

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<sup>10</sup> For example, Nielsen Net Ratings estimates that Microsoft's Windows Media Player, which recently overtook RealNetworks as the dominant software program for accessing Internet video, has over 24.7 million users. It also estimates that RealNetworks' RealPlayer has more than 24.4 million users (InternetNews.com, Sep.24, 2001, at [http://www.internetnews.com/streaming-news/article/0,,861\\_889881,00.html](http://www.internetnews.com/streaming-news/article/0,,861_889881,00.html)).

<sup>11</sup> For example, MTV plans to launch a channel designed specifically for access via the Internet. The channel will be called MTV Live, and will draw heavily from its library of live performances by various acts (Gold, 2001). Also, five movie studios, MGM, Paramount, Sony Pictures, Universal, and Warner, announced a joint venture to distribute movies on-demand over the Internet in August 2001. Disney is independently pursuing its own video-on-demand service (Lyman, 2001).

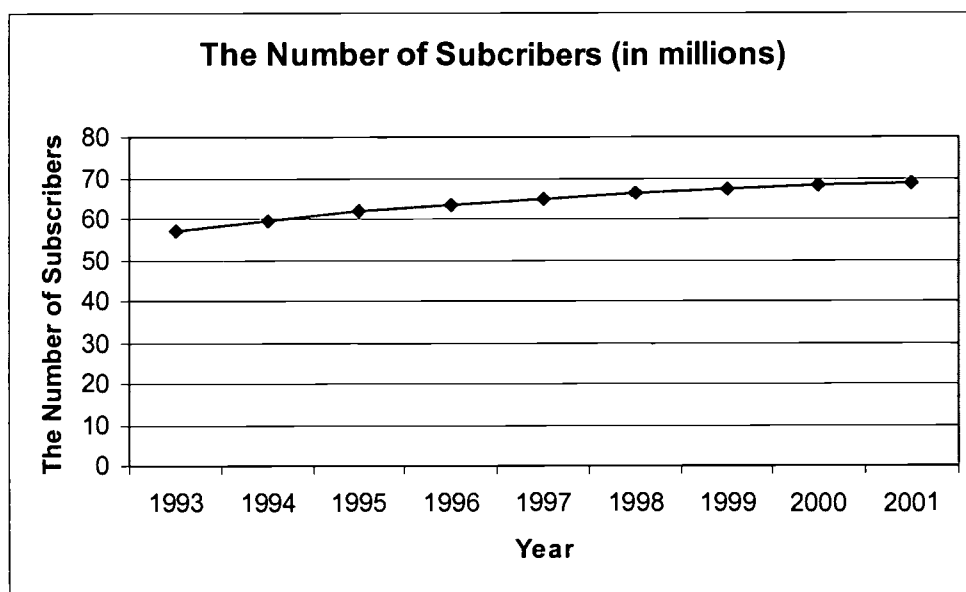
## 2. Relevant Market for Competition

It is important to understand what relevant market is for competition in broadcasting and cable market in order to determine market concentration. Based on economic theories, the relevant market should include those products and geographic areas that are close substitutes and thus directly compete for the consumer dollar (Litman, 1998, p.267). A clear determination of the relevant product and geographic market must precede any charge that any concentrated market fosters anticompetitive conduct among its dominant firms (Gellhorn & Kovacic, 1994, p.97). The most commonly used measure of assessing relevant markets is that of cross elasticity of demand, i.e., whether two products are close substitute goods for each other such that an increase in price of one good triggers an exodus of business to the unaffected product whose price has not changed (Litman, 1998, p.302). In the process of measuring relevant product market, all products should be included in the relevant markets that fit the description of close substitute products and excluded all products that are weak substitutes or unrelated (Litman, 1998, p.302).

When the concept of relevant market is applied to the competition between broadcasting and cable, however, it is hard to say that broadcasting and cable are in the same relevant market and they are close substitutes for each other because of the lack of cross elasticity of demand (Whitmore, 2001, p.208). That is, the number of subscribers in cable has increased despite the rise of subscription fees, while broadcast transmission is almost free and constant. Figure 2 represents the growth of the number of basic cable subscribers. Furthermore, even if we assume that broadcast and cable are in the same relevant market following the Court's reasoning, there is no reason not to include DBS in the same relevant market. DBS appears to attract former cable subscribers and consumers not previously subscribing to other services. The continued growth of DBS is partly attributable to DBS operators' distribution of local broadcast television stations in their local markets by the Satellite Home Viewer Improvement Act of 1999 (FCC, 2002, p.4). As described above, between June 2000 and June 2001, the number of DBS subscribers grew from 13 million households to about 16 million households (FCC, 2002, p.4). Although this number of

subscribers is somewhat small compared to 69 million households of cable (FCC, 2002, p.4), it is significant enough to be considered together with cable subscribership and broadcasting viewership. In fact, cable operators' direct competitor in terms of consumers they serve is not broadcasting but rather DBS.

Figure 2. Growth in the Number of Basic Cable Subscribers (in Millions)



Source: Paul Kagan Assocs., 2001a, p.10.

Although the relevant market among mass media goods and services is not easily defined and disagreement is expected over the degree to which all media products are substitutes for each other (Picard, 1989, p.22), the analysis of relevant market here does not support the Court's assumption that broadcasting and cable are head-to-head competitors. Also, if we include local newspapers, local magazines, and even the Internet in the same relevant market for the analysis of competition in local advertising revenues, it is hard to say that cable operators enjoy monopoly power in a given market, when considered the emerging communication technologies and multimedia environment.

The Court's bottleneck or monopoly model is based on a narrow assessment of competition between broadcasting and cable industries and excludes market conditions in the information and entertainment industry as a whole by erroneously assuming that the information provided via cable is unavailable through other means (Ugland, 1995, pp.823-824). There is simply no single predominant voice in any given media market and cable operators are facing ever increasing competition from DBS, as discussed in the above section, as well as other information technologies so that the average media consumer has a plethora of additional information and entertainment sources available (Emord, 1991, p.251). Therefore, whether broadcasting and cable are included in the same relevant market or not, the Court's decision is based on faulty or, at least, out of date reasoning.

### **3. Concentration and Vertical Integration in the Programming Market**

In the *Turner* cases, the Court said that the cable industry, which had become increasingly vertically integrated into cable programming, had every reason to drop broadcast stations from the cable systems in order to promote the cable programming in which the cable industry had an equity interest (*Turner Broadcasting v. FCC*, 1994). The principal opinion in the *Turner* cases mentioned strong cross elasticity of demand between cable programming and broadcast programming, numerical superiority of cable programming, and mutual dependence on and competition for advertising support (*Turner Broadcasting v. FCC*, 1994). It seems that the Court here views the broadcasting programming and the cable programming markets are operated independently. However, the programming market should be regarded as one relevant market unlike the broadcasting stations and the cable operators market. Because broadcast and cable television transmit the same or virtually the same type of product, these two mediums have become intertwined (Pliska, 1998, p.450). Moreover, in many cases, broadcast networks and stations also are suppliers of programming for distribution by cable operators and other distributors.

In the programming purchase market, the top four purchasers of programming for distribution to the household are AT&T Broadband, Time Warner, Comcast, and Charter.<sup>12</sup> (FCC, 2002, p.64). To compare and assess the potential for market power resulting from concentration in the market for the purchase of programming from June 2000 to June 2001, if we use CR<sub>4</sub> and CR<sub>8</sub> based on the percentage of subscribers in Appendix 1, they are 47.67% and 66.1%, respectively.<sup>13</sup> These numbers represent moderate concentration (Litman, 1998, pp.269-270) unlike the Court's argument of being highly concentrated. If we employ the Herfindahl-Hirschman Index (HHI) including DirecTV and EchoStar, the DBS players in the top 10, it is 905 (FCC, 2002, p.65) and can be considered "unconcentrated" under the Merger Guidelines.<sup>14</sup> Also, the HHI for 2001 is 49 points lower than that of 954 for 2000 (FCC, 2002, p.65). Moreover, since DBS is now available nationwide and has virtually unlimited capacity to expand to a larger number of customers, it has the ability to constrain or eliminate market power of larger cable multiple system operators (MSOs) (Economist Inc., 1999). Therefore, it is difficult to argue that the cable industry is highly concentrated to the extent which it wields market power over the programming purchase market as the Court feared.

In terms of vertical integration between cable operators and programmers, the proportion of vertically integrated channels in 2001 is the same as in 2000, after several years of decline. In 2001, there were 294 national programming networks, and of the 294 networks, 104 networks,

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<sup>12</sup> The top 8 purchasers include Cox, Adelphia, Cablevision, and Insight (FCC, 2002, p.98).

<sup>13</sup> CR<sub>4</sub> or CR<sub>8</sub> means Concentration Ratio and this measures the aggregate market shares of the largest four or eight or even twenty firms. If CR<sub>4</sub> is above 50% or CR<sub>8</sub> is above 75%, it is considered to be highly concentrated and CR<sub>4</sub> is between 33% and 50% or CR<sub>8</sub> is between 50% and 75%, it means moderate concentration. If CR<sub>4</sub> is below 33% or CR<sub>8</sub> is below 50%, it is considered as monopolistic competition. Since the larger firms have the most influence and wield the greatest market power, the idea is to focus on their control rather than worry about smaller fringe firms (Litman, 1998, pp.269-270).

<sup>14</sup> The HHI is a measure of concentration that is calculated by summing the squared market shares of the sellers in the market. It is a measure of concentration that takes account of the entire firm size distribution. The HHI increases when there are fewer and unequal sized firms in the market, because it is sensitive to both differences in the number of firms in an industry and differences in relative market shares as well (Litman, 1998, p.270). The US Department of Justice and Federal Trade Commission consider markets with HHI below 1000 as "unconcentrated;" markets with an HHI between 1000 and 1800 as "moderately concentrated;" and markets with HHI above 1800 as "highly concentrated" in their Merger Guidelines (FCC, 2002, p.65).

representing approximately 35%, were vertically integrated with at least one cable MSO (FCC, 2002, p.66). Four of the top eight cable MSOs hold ownership interests in national programming networks. One or more of these companies has an interest in 52 of the 104 vertically integrated programming networks. These four companies are AOL Time Warner, which has an ownership interest in 39, or 13% of all programming networks; Cox Communications, which has interests in 24, or 8% of all national programming networks; Comcast, which has ownership interests in 17 networks, which account for 6%; and Cablevision, through its programming subsidiary, Rainbow Media, which owns ten programming networks, just over 3% of all national programming networks<sup>15</sup> (NCTA, 2001).

However, vertical integration is not only associated with the largest MSOs. Currently, nine of the top 20 video programming networks (ranked by subscribership) are vertically integrated with a cable MSO as described in Table 1. But it appears that a significant amount of video programming is controlled by 14 companies, including cable MSOs, broadcasters, and other media entities<sup>16</sup> (Paul Kagan Assocs., 2001b, p.4). Almost all (i.e., 18) of the top 20 programming networks in terms of subscribership are owned by one or more of these 14 companies (Paul Kagan Assocs., 2001b, p.10). It is important here to notice that among these 14 companies, some companies such as AOL Time Warner, Disney, General Electric, News Corporation, and Viacom also have interests in both broadcasting and cable business at the same time as well as other media businesses.

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<sup>15</sup> AT&T Broadband also had interest in the programming network, Liberty Media. But, recently AT&T Broadband separated Liberty Media from its subsidiaries.

<sup>16</sup> The 14 companies are: AOL Time Warner, Cablevision, Comcast, Cox, Disney, E.W. Scripps Co., General Electric, Hearst, Liberty Media, MGM, Newhouse, News Corp., Viacom, and Vivendi (Paul Kagan Assocs., 2001b, p.4).

Table 1. Programming Services by Subscribership

Rank	Programming Network	Number of Subscribers (Millions)	Ownership Interest in Network (%)
1	TBS	82.0	AOL Time Warner (100)
2	Discovery Channel	81.7	Liberty Media (49), Cox (24.6)
3	TNT	81.6	AOL Time Warner (100)
4	ESPN	81.0	Disney (80)
5	USA Network	81.0	Liberty Media (21)
6	ABC Family Channel	80.5	ABC (100)
7	A&E	80.4	NBC/ABC/Hearst
8	TNN	80.1	Viacom (100)
9	Lifetime	79.9	Disney (50), Hearst (50)
10	Nickelodeon/Nick at Nite	79.8	Viacom (100)
11	CNN	79.7	AOL Time Warner (100)
12	C-SPAN	79.4	
13	The Weather Channel	78.9	
14	TLC	78.0	Liberty Media (49), Cox (24.6)
15	MTV	77.3	Viacom (100)
16	QVC	77.0	Comcast (57), Liberty Media (43)
17	CNN Headline News	76.2	AOL Time Warner (100)
18	CNBC	76.0	NBC (100)
19	AMC	75.9	Cablevision (75)
20	VH1	74.2	Viacom (100)

Source: NCTA, 2001, pp.22-23, Rathbun, 2001, pp.59-80. Reorganized.

For example, the largest media company in the US<sup>17</sup> is AOL Time Warner and it owns a broadcasting network, The WB, and the second largest cable operator, Time Warner Cable. Also, it has a movie studio, Warner Bros. and cable networks such as CNN, TBS, HBO, and Cinemax as well as co-owns a cable network, Comedy Central with Viacom (Rathbun, 2001, pp.59-64). The second largest media company, Disney, also owns a broadcasting network, ABC, and cable networks such as ESPN, E! Entertainment Television, Disney Channel, ABC Family, and Lifetime, which is co-owned with Hearst (Broadcasting & Cable, 2001b, pp.48-56). Viacom, the fourth, owns broadcasting networks, CBS and UPN, cable networks such as TNN, Country Music

<sup>17</sup> The trade journal *Broadcasting & Cable* provides data about top media companies. It specifies top 25 media companies (04/27/2001), top 25 television groups (04/23/2001), top 25 networks (11/26/2001), and top 25 MVPD operators (06/04/2001). For more specific information, see Appendix 2 to 4.

Television, MTV, Showtime, and 50% of Comedy Central (Rathbun, 2001, p.62). Fox, the fifth, also owns Fox Television Network, Fox News Channel, FX, 34% of Outdoor Life, 33% of Golf Channel, Fox Sports Net, and 49.5% of Fox Kids Net (Rathbun, 2001, p.60). NBC, which is owned by General Electric, also has cable networks such as CNBC and MSNBC (with Microsoft), and A&E Television Network (joint venture with ABC and Hearst-Argyle)<sup>18</sup> (Rathbun, 2001, p.66).

Therefore, the huge amount of programs that are provided to cable subscribers are mostly from six broadcast networks and their cable programming networks. Also, even if broadcast networks have been losing their ratings due to abundant cable programming, they can offset their losses through gains in cable programming they own. In addition, the fact that during the year 2000, broadcasters' advertising revenue was above \$8 billion and advertising prices for network scatter inventory was up 20 to 30% than previous year (*Broadcasting & Cable*, 2000), indicates that broadcast networks have not actually been losing advertising revenue.<sup>19</sup> As evident in Table 2, which shows the top 20 programming services by prime time rating, together with the huge number of subscribers in Table 1, large media companies can compensate their losses in broadcasting ratings by cable programs' success. Thus, they can generate substantial advertising revenue from cable programming, which is enabled by the symbiotic relationship between broadcasting and cable industry. Therefore, although the Court said that "vertical integration in the cable industry has little interest in assisting, through carriage, a competing medium of communication," it neglected to consider the degree to which the broadcasting and the cable industries are integrated with each other (Whitmore, 2001, p.218).

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<sup>18</sup> National reach of each network is provided in Appendix 3.

<sup>19</sup> Due to the economic downturn of the US, the advertising revenue might be reduced in the following years.



Table 2. Top 20 Programming Services by Prime Time Rating

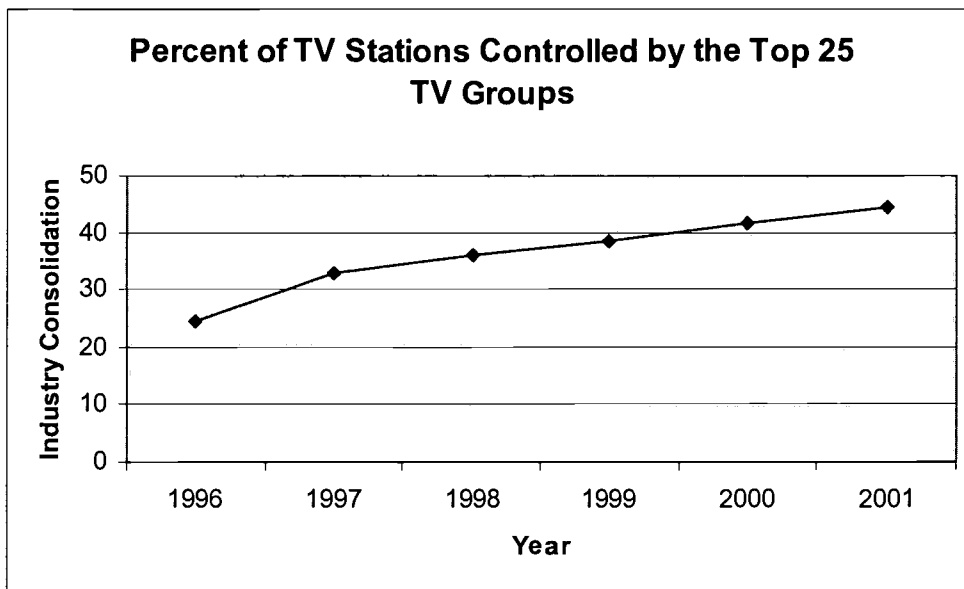
Rank	Programming Service	Ownership Interest (%)
1	Lifetime	Disney (50), Hearst (50)
2	USA Network	Liberty Media (21)
3	TNT	AOL Time Warner (100)
4	Cartoon Network	AOL Time Warner (100)
5	TBS	AOL Time Warner (100)
6	Nick at Nite	Viacom (100)
7	A&E	NBC/ABC/Hearst
8	Discovery Channel	Liberty Media (49), Cox (24.6)
9	WGN-C	
10	TNN	Viacom (100)
11	History Channel	
12	ESPN	Disney (80), Hearst (20)
13	TLC	Liberty Media (49), Cox (24.6)
14	MTV	Viacom (100)
15	FX	Fox (100)
16	Sci-Fi	Liberty Media (19.7)
17	Fox News	Fox (100)
18	TV Land	
19	BET	
20	HGTV	E.W. Scripps (100)

Source: Paul Kagan Assocs., 2001a, p.6, Rathbun, 2001, pp.59-80. Reorganized.

In the current media landscape, large media conglomerates such as AOL Time Warner, Viacom, and Disney must be positioned to spread the risks of new ventures across a wider, much more diverse playing field for economies of scale and scope. This adaptive strategy includes greater ownership and control of resources such as content, and equally important, a means to distribute that content. A broadcast network that insures an outlet for a company's media content and diversifies the opportunities into other markets needing branded products is vital (Collette, 1998, p.139). As an indicator of this phenomenon, the top 25 television groups own many television stations in addition to other media interests,<sup>20</sup> and their control in the broadcasting market has increased in recent years as seen in Figure 3. It is obvious that these media conglomerates will expand their market power if the pending ownership cap of the 35% limit in FCC disappears, which Fox, Viacom, or other media groups vehemently challenge.

<sup>20</sup> See Appendix 4.

Figure 3. Percent of TV Stations Controlled by the Top 25 TV Groups



Source: Rathbun, 2001, p.59.

According to the Court's decisions, mandatory carriage is needed to preserve independent broadcasting, and therefore, maintain competition with the broadcasting industry. However, the Court failed to consider that about 90% of broadcasting stations remain in the hands of large group owners<sup>21</sup> (Walker & Ferguson, 1997, pp.84-85) or account for the extent to which independent broadcasters have become affiliated with national networks and become dependent on the provision of programming from those vertically integrated networks (Whitmore, 2001, pp.210-211) as new networks such as WB and UPN broaden their national coverage. Hence, the goal of Congress and the Court, assuring the public's access to a multiplicity of information sources, cannot be achieved with the must-carry rules. For instance, the biggest beneficiaries during the implementation of the must-carry rules were home shopping channels and Pax TV which used UHF channels.<sup>22</sup>

<sup>21</sup> See Appendix 4.

<sup>22</sup> For details in this matter, see Hazlett (2000).

As described above, the large media conglomerates enjoy realizing economies of scale and scope and increasing the degree of market power and control not only in the cable industry but also in the media industry in general including local broadcasting stations, cable operators, and program production and distribution.<sup>23</sup> Hence, it is a weak rationale for the Court to say that “the structure of the cable industry gives cable operators the ability and incentive to drop local broadcast stations from their systems” (*Turner Broadcasting v. FCC*, 1997).

### Conclusion

The majority opinion in the *Turner* cases was based upon the substantial evidence that indicated that significant numbers of local broadcast stations were set to fail altogether or deteriorate greatly (*Turner Broadcasting v. FCC*, 1994). The response to broadcasters’ economic concerns, the justices agreed, was the must-carry rules of the Cable Act. However, the Court accepted, without meaningful scrutiny, Congress’ findings, in connection with the Cable Act, concerning the “bottleneck” characteristics of the cable industry with the need for the must-carry provisions (Whitmore, 2001, p.177). In this regard, this paper has attempted to determine whether cable systems enjoy monopoly power in the current marketplace and to test if the results support the reasoning of Congress and the majority in the *Turner* decisions. The current situation in the market, discussed in the analyses of competition, relevant market, and concentration and vertical integration of media companies, has indicated that the Court’s decision in the *Turner* cases was based on a weak economic rationale and that the market situation has ever-increasingly changed. The Court’s reference to the cable operator’s “bottleneck monopoly power” is therefore a mere informal characterization of the state of the television market (Adelman, 1996, p.1556).

As examined above, the current marketplace is competitive and surpasses anything that Congress or the Court could have imagined in 1992 or even in 1997. The de facto monopoly that most cable operators have historically maintained in their service areas—a prerequisite to the

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<sup>23</sup> See Appendix 4.

Court's bottleneck analysis—may soon be a thing of the past (Adelman, 1996, p.1552). Given the fact that the proliferation of converging yet competing technologies for the exchange of information of all kinds may well create channels of communication in the ever-changing media landscape, each actor in the marketplace should be nurtured with economic incentives and not frustrated with the effect of government intervention. The must-carry provisions are obviously a favor to broadcasters guaranteed by Congress and the Court, sacrificing cable's opportunities in the market. It is the time to revisit the issue of the must-carry rules and repeal the statute encouraging mutual prosperity without damaging one party in favor of the other.

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Appendix 1. Number and Percent of Subscribers in MVPD Market

Rank	Company	Number of Subscribers (Million)	Percent of Subscribers
1	AT&T Broadband	15.9	16.44
2	Time Warner	12.8	14.35
3	DirecTV	9.8	11.32
4	Comcast	7.73	9.53
5	Charter	6.35	7.35
6	Cox	6.2	6.98
7	EchoStar	5.72	6.87
8	Adelphia	5.7	6.51
9	Cablevision	2.97	3.40
10	Insight	1.41	1.54

Source: FCC, 2002, p.98.

Higgins. J.M. & Flynn, G., 2001, p.30. Reorganized.

Appendix 2. Top 25 Media Companies and Their Revenue

Rank	Company	Revenue (Billion \$)	Rank	Company	Revenue (Billion \$)
1	AOL Time Warner	36.2	14	Tribune	4.9
2	Disney	25.4	15	USA Networks	4.7
3	Vivendi Universal	24.3	16	McGraw-Hill	4.3
4	Viacom	20.0	17	Cablevision	4.1
5	News Corporation	13.8	18	Hearst	4.1
6	AT&T Broadband	9.6	19	Charter	3.6
7	Sony	8.2	20	New York Times	3.4
8	Comcast	6.7	21	Adelphia	2.9
9	NBC	6.2	22	Bloomberg	2.5
10	Gannett	5.3	23	Washington Post	2.4
11	Clear Channel	5.3	24	Echostar	2.3
12	Cox	5.2	25	E.W. Scripps	1.7
13	Hughes	4.9			

Source: *Broadcasting & Cable*, August 27, 2001, p.17.

## Appendix 3. Top 25 Networks

Rank	Network	Revenue* (Million \$)	Revenue Change (%)	Ownership	TV Homes Reached
1	NBC	4,355	-9	General Electric	99.9%
2	QVC	3,600	+11	Comcast/ Liberty Media	81 M
3	CBS	3,483	-0.05	Viacom	99.9%
4	ABC	3,397	-22	Disney	99.9%
5	ESPN	2,090	-0.05	Disney	85.3 M
6	HBO	1,860	+15	AOL Time Warner	37 M
7	FOX	1,850	+7.6	News Corporation	97.63%
8	Home Shopping Network	1,555	+22	USA Networks	83 M
9	TNT	1,064	-0.10	AOL Time Warner	84 M
10	Nickelodeon	1,006	-4	Viacom	84 M
11	Showtime	905	+6	Viacom	29.6 M
12	USA Network	823	+3	USA Networks	85 M
13	MTV	760	+4	Viacom	82.6 M
14	Disney Channel	753	+35	Disney	77 M
15	CNN	745	-4	AOL Time Warner	85 M
16	TBS	741	-8	AOL Time Warner	86.2 M
17	Lifetime	715	+30	Disney/Hearst	83.8 M
18	Discovery Channel	615	+10	Discovery Communications	85.3 M
19	WB	611	N/A	AOL Time Warner/ Tribune	88%
20	Univision	575	+22	Univision Communications	97% (Hispanic Homes)
21	Fox Sports Net	565	-4	Fox Entertainment/ Cablevision's Rainbow Media	70 M
22	CNBC	544	+4	General Electric	81 M
23	A&E	540	+3	Hearst/ABC/NBC	84 M
24	Cinemax	500	+15	AOL Time Warner	37 M
25	Starz!	460	+10	Liberty Media	N/A

\* Estimated.

Source: *Broadcasting & Cable*, Nov. 26, 2001, pp.46-56. Reorganized.



## Appendix 4. Top 25 Television Groups

Rank	Network	Media Interests (Broadcasting and Cable only)
1	Fox	31 TV stations; Fox Television Network; Fox Television Entertainment Group (Fox Entertainment, Fox Television Studios, 20 <sup>th</sup> Century Fox Television, Twentieth Television); Cable channels: Fox News Channel, Health Network, FX, 34% of Outdoor Life, 33% of Golf Channel, Fox Sports Net, 49.5% of Fox Kids Network
2	Viacom	38 TV stations; CBS, UPN; CBS Enterprises, Paramount Domestic Television; Cable channels: TNN, Nashville Network, Home Teams Sports, Country Music Television, MTV Networks (MTV, VH-1, Nickelodeon), Showtime, 50% of Comedy Central (co-owned with AOL Time Warner)
3	Paxson	69 TV stations; Pax TV network
4	Tribune	23 TV stations; 25% of WB Television Network (majority owned by AOL Time Warner); Tribune Entertainment, 29% of Food Network
5	NBC	13 TV stations; NBC; NBC Enterprise; Cable channels: CNBC, MSNBC (with Microsoft), A&E Television Networks (joint venture with ABC and Hearst-Argyle)
6	ABC	10 TV stations; ABC; ABC Entertainment TV Group; Cable channels: Disney Channel, ABC Family Channel, Toon Disney, 80% of ESPN, 50% of Lifetime (with Hearst-Argyle), 39.5% of E! Entertainment Television, A&E Television Networks (joint venture with NBC and Hearst-Argyle)
7	Univision	25 TV stations; Univision (Spanish-language TV network); Cable channel: Galavision
8	Gannett	22 TV stations
9	Hearst-Argyle	33 TV stations; Hearst Entertainment and Syndication; 50% of Lifetime (with ABC), 20% of ESPN, A&E Television Networks (joint venture with NBC and ABC)
10	Sinclair	62 TV stations
11	Belo	19 TV stations; Five local or regional cable news channels including Northwest Cable News, Texas Cable News, 50% of Arizona News Channel (joint venture with Cox)
12	Telemundo	10 TV stations; Telemundo (Spanish-language TV network: 33% owned by Sony Pictures); Cable channel: Gem TV (Spanish-language channel)
13	Young	13 TV stations; 51% of BayTV cable channel
14	Cox	15 TV stations; 18 cable systems; 24.6% of Discovery Communications, 10.4% of E! Entertainment Television; 10% of Primestar
15	E.W. Scripps	10 TV stations; Cable channels: Home & Garden TV, Food Network, Do It Yourself, SportSouth
16	Meredith	12 TV stations
17	Raycom	34 TV stations
18	Pappas	20 TV stations
19	Post-Newsweek	6 TV stations; CableOne (cable system)
20	Entravision	18 TV stations
21	Shop at Home	5 TV stations
22	Media General	26 TV stations
23	Emmis	15 TV stations
24	Granite	10 TV stations
25	LIN TV	24 TV stations

Source: Rathbun, E.A., 2001, pp.59-80. Reorganized.

AMTE

Switching Radio Stations While Driving.  
Magnitude, Motivation and Measurement Issues

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## Abstract

## Switching Radio Stations While Driving.

## Magnitude, Motivation and Measurement Issues

Rather than examining the factors that motivate audiences to tune a radio station, this study looked at what motivates audiences to turn away. Among the findings of a general public survey of over 350 people were that (a) while driving, there is considerable station switching occurring within a mere quarter-hour listening span and (b) avoidance of commercials (or zapping) was by far the most influential motivator. In light of these findings, the article discusses the limitations of conventional Arbitron quarter-hour methodology to measure station switching and explores how the company's experimental electronic Personal People Meter (PPM) can offer a welcome solution to this problem.

## Switching Radio Stations While Driving.

### Magnitude, Motivation and Measurement Issues

The business of commercial radio is the selling of audiences to advertisers. An underlying assumption of the radio business model has been that while audiences listen to program content, they are exposed coincidentally to inserted commercial messages. Researchers have found that people listen to the radio for a variety of reasons, including the desire for information, companionship, relaxation and mood enhancement. To date, there has been far more research on why audiences tune in than why audiences tune out. One particular motivation for switching stations that threatens the underpinnings of the radio business model is the deliberate avoidance of commercial interruptions, often referred to as *zapping*.

To measure the size and demographic composition of radio audiences, the industry for over three decades has relied on the personal diary methodology of the Arbitron Company. The basic unit of analysis has been the *quarter-hour*. Many critics have questioned the accuracy of diary entries, particularly while respondents are driving a car or truck. Additionally, the protocols used to assign quarter hour listening credit to stations have a tendency to mask the magnitude of station switching. In recent months, Arbitron has embarked on a radically new venture using passive electronic meters to measure radio and television listening. If accepted by the industry, this new research technology will have a profound effect on audience measurement.

The purpose of this study was three-fold. First, the researchers wanted to ascertain to some degree the magnitude of radio station switching while driving, particularly within a typical 15-minute time span. The second goal was to evaluate the plausible motivations for switching stations, with special attention paid to the notion of commercial avoidance. Finally, in light of the findings, the researchers wanted to disclose the limitations of conventional Arbitron quarter-hour methodology to capture accurately station switching and how the company's experimental electronic Personal People Meter (PPM) may offer a practical solution.

While there is considerable published research on channel switching and commercial zapping on television, little attention has been paid to radio. However, the limited research that does exist on radio is quite good and it was not the intent of this study to plow old ground. Rather, the researchers wanted to add to the body of the existing knowledge by approaching these topics with a different slant. In particular, other studies have not looked at commercial avoidance in relation to other motivations for switching stations. Furthermore, earlier studies have not focused on the quarter-hour measurement issue and its implications for the buyers and sellers of radio audiences

### Background and Literature Review

Barnow (1970) maintains that since radio's inception in the 1920s, the notion of using program content to expose audiences to embedded advertising messages has proven to be a winning business model. Radio's contribution to the successful marketing of consumer products and services has been well

documented by industry organizations, such as the Radio Advertising Bureau (RAB Website, 2002). While the desired objectives of this model have not changed over the years, there have been major changes in execution.

The first commercial advertising strategies were program sponsorships, where the sponsor's name and products were integrated into the fabric of the program. During the early years of radio, many programs were limited to a single sponsor. For three decades, radio prospered with highly structured long-form programming, such as soap operas, dramas, comedies, quiz shows and live big band concerts. However, with the advent of television, radio audiences dwindled and radio operators were compelled to find new ways to attract audiences. By the mid 1950s, conventional long-form programming on radio was essentially extinct. Its highly successful replacement was music format programming that did not burden the listener with having to tune to a particular program at a scheduled time. Instead, listeners could "join in progress" (JIP) and not feel disoriented with the continuity of the programming (Barnow, 1970; Alexander, 1997).

Coinciding with this change in programming was a change in commercial placement. Pure sponsorships with limited and unobtrusive interruptions gave way to today's modular spot announcement clusters, where many advertisers can "participate" in a single program or daypart. In addition to affording the advertiser more selection and flexibility, this multi-spot placement configuration enabled radio stations to make more money by airing more commercials (Tanel and Williams, 1998).

### Radio Today:

Today, in large markets, where dozens of radio stations compete for the same target audience, listeners often find that several stations broadcast highly similar content and that one station can be substituted easily for another (Alexander, 1997). In a desperate effort to cultivate station loyalty and discourage switching, radio operators have introduced myriad marketing tactics, such as contests, promotions, celebrity guests and advertising in other media. (Buchman, 2002).

Scheduling radio commercials has become a highly sophisticated enterprise. Knowing that too many commercials can drive audiences away, station sales managers must deal with a *limited inventory* of commercial opportunities. For most radio stations, morning and afternoon "drive times" generate the most listeners and therefore the most revenue from commercials. For the past five years, a common complaint among many advertisers and media buyers is that poor inventory control on the part of the broadcaster results in *commercial clutter*, a situation of commercial overload where advertising messages allegedly lose some of their effectiveness on audiences. An undesirable outcome from clutter is zapping; the deliberate avoidance of commercials accomplished by switching stations or channels (AAAA, 2002; Elliott, M. T., Speck, P. S., 1998).

### Theoretical Concerns

From a business perspective, Alexander (1997) maintains that the primary goal of radio programming is to maximize the size of an audience targeted by

advertisers and the only way to accomplish this goal is to satisfy the needs and wants of that audience. "Uses and gratifications" has long been a popular approach to understanding audience motivations for tuning to radio and television programming. The underlying presumption is that audiences are not passive nonjudgmental receivers of media but rather, active seekers of program content that will satisfy specific needs. From practical considerations, such as wanting information about traffic congestion to more abstract psychological desires, such as relief from emotional stress, listening patterns are determined by each person's expectations of how well different media or programs will gratify their needs (Rubin and Perse, 1994).

In many respects, radio listening can be compared to retail consumer behavior. That is, audiences "consume" certain brands of media content in a manner similar to how people consume branded packaged goods. The concepts of audience gratification and consumer satisfaction are essentially synonymous.

Facing unprecedented competition and fragmenting audiences, radio and television broadcasters in the 1990s began to embrace the jargon of *brand management* (Buchman, 2002; Belamy & Trout, 2000; Dickey, 1994; McDowell and Batten, 1999). A 1998 editorial from Broadcasting and Cable magazine proclaimed, "...*branding* is threatening to supplant 'synergy' or 'convergence' as the queen bee of TV buzzwords" (Editorial, 1998).

Media professionals and the trade press began to make references to branding, brand identity, brand image, brand loyalty, brand extensions, and the most muddled of brand management notions, brand equity.



Brand equity is the added value a brand name gives a product or service. One particular aspect of consumer-based brand equity theory that can be applied easily to radio station switching behavior are the notions of *positioning* and *substitutability*. In simple terms, brand positioning is the art and science of differentiating a brand from its competitors. According to Keller (1998), successful brands with strong brand equity are those that exhibit favorable, strong and unique images or brand associations. They are “positioned” in the consumer’s mind as special and superior. Along the same lines of thinking, substitutability looks at how well one brand can be substituted for another without any discernable change in consumer satisfaction. Taking this audience-based brand theory perspective, we can see that radio station switching can be explained through three simultaneous processes

1. Dissatisfaction with the expected content provided by a particular brand of station.
2. Knowledge that there are alternative brands offering highly similar content that may be more satisfying.
3. A predisposition that these alternative brands can be substituted readily with no substantial risk (no loss of program continuity).

As mentioned earlier, this final component has become a double-edged sword for radio programmers in that most contemporary program formats are designed to be joined in progress. While this tactic facilitates the welcoming of new audiences at any time, it also opens readily the door for audiences to leave.

Unlike most television programming, radio programming permits audiences to move about the programming landscape without risk of losing a “storyline.”

Based on the outcome of two focus group projects, which will be elaborated later in this article, the researchers found that among the several motivations for switching stations, *avoiding commercials* was ranked the highest. Of course station switching is based on the premise that alternative station brands provide similar levels of satisfaction.

The primary common denominator underlying all brand management principles and practices is *competition*. As the number of similar products or services in the marketplace increases, the need for highly differentiated brands becomes more acute. According to Keller (1998) increased competition stimulates a similar rise in the speed and sophistication of measuring tools. For broadcasting, evidence of this phenomenon can be found in the recent people meter experiments conducted by Nielsen and Arbitron.

In coming years, as media competition becomes more fierce and advertiser demands become more sophisticated, the issues of radio station switching and commercial avoidance will become ever more important. At the core of these issues is the need for better audience measurement.

#### Arbitron Audience Measurement

The Arbitron Company, the largest provider of radio audience information, utilizes a personal diary methodology to ascertain radio listening in several hundred markets. Diary-holders are asked to record by hand pertinent information, such as the exact times of listening, call letters and location of

listening. Obviously, it is nearly impossible to fill out an Arbitron diary in detail while driving a car. Instead, most diary-keepers complete this task after the conclusion of the trip, relying on short-term memory. Comparing tape-recorded listening versus conventional diary entries Abernathy (1989) found significant differences up to 6.5 percent for station listenership and 8.5 percent for daypart listenership. The inherent problems of accurate diary keeping are well recognized in academia and the private sector.

The standard Arbitron market report provides subscribers with data on individual station performance across several dayparts and demographics. In most cases, audience behavior is reported using a *quarter-hour* unit of analysis. While this quarter-hour format is certainly convenient and universally accepted by the industry, it is important to scrutinize the precise definitions of several commonly used terms. Whether dealing with total persons, ratings, shares or cumes, Arbitron's average quarter-hour (AQH) audience data are all configured according to estimated number (or percentage) of persons who listen to a station for a *minimum of five minutes* within a reported daypart. One should remember, that this 5-minute threshold is not necessarily five *continuous* minutes of listening but the aggregate of time spent listening (Arbitron Methodology, 2001). For example, within a 15-minute time span, a listener can switch back and forth among several stations and still accrue the necessary five minutes of listening to give quarter hour ratings credit to a certain stations. Similarly, A person can listen continuously for the first five minutes of a quarter hour and leave, and the station will receive a full 15 minutes credit.

Advertisers and media planners use Arbitron quarter-hour ratings to derive complex reach and frequency objectives. Frequency refers to the average number of times an audience member is supposedly exposed to a commercial. The key word here is “exposed”. The presumption has been that an audience member needs to see or hear an advertising message a specified minimum number of times before the message is totally assimilated (Hall, 1996; Webster, Phalen and Lichty, 2000). However, the reality of this situation may be that because of commercial zapping, a message needs to be *broadcast* several times before an audience member is actually *exposed* even once.

Keeping in mind the potential problems with the reliability of diary entries and quarter-hour measures, there is one rudimentary measure of station switching using Arbitron ratings called audience *turnover*. By dividing a station's Cume audience by its AQH audience, this index does offer some measure of audience retention or loyalty (Webster, Phalen and Lichty, 2000)

Another section of a typical Arbitron Report addresses *Cume Duplication*. Here, the reader can learn what stations share or duplicate audiences. One could speculate that a station that shares its audience with many competitors also suffers from considerable station switching in that listeners perceive several formats as equivalent substitute brands. Comparing this data with the above-mentioned audience turnover index offers some circumstantial evidence concerning the vulnerability of a station to switching.

Radio program directors have found ways to exploit Arbitron's quarter-hour measurement protocols by clever scheduling of commercials and music

segments. For example, one tactic is to schedule no commercials during the first five minutes of any quarter hour in hopes that audiences will linger with the station for at least the minimum number of minutes. A more conspicuous strategy involves scheduling continuous commercial-free music for three of the initial four-quarter hours within a clock hour followed by a surplus of commercials (i.e. clutter) during the final quarter hour. The assumption here is that the station is willing to alienate audiences for one quarter in exchange for holding them for three.

#### Arbitron's Proposed Personal People Meter (PPM)

In recent months, Arbitron has been experimenting with an electronic device that ultimately would eliminate conventional diaries, enabling a far more precise measurement of station switching. Coined a Personal People Meter or PPM, the pager-sized device detects automatically inaudible codes that radio and TV broadcasters, as well as cable networks, have embed in the audio portion of their programming. At the end of each day, the survey participants place the meters into base stations that recharge the devices and send the collected codes to Arbitron for tabulation. Unlike Nielsen TV meters, which must be attached to a TV set within the home, the PPM is completely portable. Nielsen Media Research is providing financial support and has an option to join Arbitron in the commercial deployment of the Arbitron PPM in the United States. (Arbitron website, 2002;

Moss, 2002) The implications of this device are presented in the discussion section of this article

### Station Switching and Commercial Avoidance Issues

Acknowledging that audiences switch stations while listening to the radio is not a major revelation, but attempting to measure accurately this phenomenon has been a challenge. An extensive review of prior research found that aside from a 1999 Arbitron study, only a handful of academic studies have looked into this topic and almost all have dealt exclusively with television. For example, Ching Biu Tse and Lee (2001) found that nonzappers revealed better brand recall than zappers. Zhao (1997) discovered in a TV clutter study that the number and position of commercials within a commercial break could influence brand recall, recognition and advertisement liking. Zufryden, Pedirick and Sankalingam (1993) discovered that households subscribing to cable tended to engage in more channel switching than households without cable, suggesting that more program choice results in more switching.

The Arbitron Company in conjunction with Edison Media Research (Arbitron Study, 1999) conducted a large telephone survey of over 1000 Arbitron diary-keepers. Among the stated goals of this "spot load" study was to probe listener perceptions toward radio advertising. Because Arbitron has a vested interest in the overall success of radio as an advertising medium, the wording of many questions and the presentation of many findings have an obvious positive spin. Among the relevant findings were that the vast majority of respondents believe that listening to commercials is a "fair price to pay for free programming

on the radio." On the other hand, a less publicized finding was that one third of the total sample would be willing to pay five dollars a month for commercial free programming. This study also concedes that young people (ages 12 to 24) are more likely to switch stations due to commercial avoidance. The Arbitron study does provide some important insights, but there is a clear agenda permeating the entire project. The obvious intent was to place radio in as good a light as possible and not dwell on chronic problems. While switching due to commercials was recognized, there was no attempt to actually quantify its magnitude except by using imprecise phrases such as "rarely" and "sometimes." Additionally, other plausible motivations for switching stations were not investigated.

Abernathy (1991) provides one of the few significant studies addressing radio station switching. Assuming that proximity to the radio while in a car encourages listeners to change stations, Abernathy (1991) used an elaborate setup of portable tape recorders and diaries distributed among one hundred young respondents (ages 19 to 24). An on-air sample of the radio stations involved was also recorded as a comparison benchmark. Station switches and commercial zapping were detected by scrutinizing the recorded sounds on each tape. Among the results were that only half of the scheduled commercials were exposed in their entirety to the sample audience. The researcher was also able to determine that commercials that were placed first in a cluster or pod were far more likely to be exposed than the commercials placed deeper into the cluster.

This ingenious study is a forerunner of Arbitron's new PPM device and offers much insight from a behavioral perspective but it does not touch on

attitudinal questions, such as the motivations for switching. One assumes that the underlying motivation for switching stations during a commercial break is commercial avoidance (zapping) but we cannot be assured absolutely with this circumstantial evidence. Furthermore, Abernathy (1991) did not delve into other plausible motivations for switching stations. Also, the study's sample base was "demographically homogeneous" group of young student volunteers. Based on the findings of other studies, young people tend to change stations more often than older people. Finally, the findings are more than a decade old and it is possible that radio listening habits have changed over the past decade.

Based on the above literature review and the voids in knowledge that remain unexplored, the researchers crafted a study to reinvigorate the discussion on switching stations.

### Research Questions

The following research questions are worth considering.

RQ1: While driving, how much radio station switching occurs within a typical 15-minute interval?

RQ2: While driving, what motivates people to switch radio stations?

RQ3: Does station switching exhibit any discernible patterns?

### Methodology

#### Sample Design and Administration

A pencil and paper self-report survey was administered in person to a sample of 373 adults representing a cross section of a large southeastern



city. Because of the complexity of the questionnaire, particularly question number four, the researchers avoided telephone and mail techniques in favor of self-reports where respondents are recruited and supervised in person. Furthermore, this approach usually generates high response rates (Babbie, 2002). Recognizing that obtaining a generalizable sample from a large diversified population can be a daunting task, the researchers opted for a sampling technique that is similar in concept to that used by Arbitron and Nielsen, namely cluster sampling (Babbie, 2002).

The first stage was a cluster sample of 34 randomly selected geographical locations within the city. A trained research associate was assigned to each location. As suggested by Babbie (2002), stratification was used within the clusters to enhance reliability. The first stratum was sex (male and female). The second stratum was age (under 24, 25-40 and over 40). Thus, the sample equally represented different areas of the city, sexes, and age groups. This strategy yielded 386 completed surveys with an 84 percent response rate. Seventeen surveys were pulled because the respondents did not listen to the radio while driving. An additional 12 surveys were eliminated due to various response errors. This yielded a final sample of 356 usable surveys. One could argue that the results were derived from a convenience sample. However, it was a convenience sample of people who happen to be at one of 34 locations and fit a needed demographic profile. The diversity of collection points and additional strata help reduce selection bias and insure respondent diversity.

### Survey Instrument Design

The first question was a screening device intended to acquire only participants who listen to the radio while driving.

(1) While driving in your car, do you sometimes listen to the radio?

Yes/No.

Respondents who claimed that they did not listen to the radio under these circumstances were excluded from answering the remaining questions.

The second and third questions addressed station switching. Because Arbitron uses average quarter hour (AQH) as its basic unit of measure in market reports, respondents for this survey were asked to describe their switching habits with a typical 15-minute time period.

(2) While driving, during a typical 15-minute time period, on average how many times do you change stations (including going back and forth among the same stations)?

(3) Over the same 15-minute time period mentioned in question #2, on average how many different radio stations do you listen to?

The fourth question addressed the motivations for changing stations. Respondents were asked to rank their top three reasons. Prior to the creation of this quantitative survey instrument, the researchers conducted a pilot study and two subsequent focus groups to arrive at an understandable, exhaustive and mutually exclusive list of plausible reasons to change stations.

Suspecting a possible order effect bias, a reliability check was initiated where a random sample of 35 of the distributed surveys had the "commercial

interruptions" option moved from the first to the fifth position on the list. Results indicated a perfect correspondence between the results of the test group and the larger database (i.e. exactly 84% of each group mentioned commercial interruptions)

(4) Below is a list of possible reasons for changing stations while listening to the radio. Please rank your top 3 reasons by placing the numbers #1, # 2 and #3 next to the best three reasons.

- (a) Commercial interruptions
- (b) A song I do not like
- (c) Annoying announcers or program guests
- (d) Boring conversation topics
- (e) Unimportant or repetitive newscasts
- (f) A Passenger wants to change stations
- (g) Other \_\_\_\_\_

The fifth question focused exclusively on the issue of commercial interruptions.

(5) On a scale of 1 to 5, with "1" meaning you disagree completely and "5" meaning that you agree completely, please indicate how much you agree with the following statement.

While driving, as soon as I hear the beginning of a commercial on the radio, I immediately change stations?

Questions six and seven explored the notion that perhaps listeners that profess having a favorite station would be less likely to change stations and more tolerant of commercial interruptions

(6) While driving, do you listen to one radio station more than all others? In other words, do you have one favorite station? Yes/No.

(7) Assuming you have one favorite station, on a scale of 1 to 5, with "1" meaning you disagree completely and "5" meaning that you agree completely, please indicate how much you agree with the following statement.

I am less likely to change stations during commercial interruptions when I am listening to my favorite station, than when I am listening to another station.

The final two questions dealt with sex and age.

(8) Are you Male? or Female?

(9) In what year were you born?

## Results

Question one was merely a screening device to acquire an appropriate sample of people who listen to the radio while driving. A total of 356 usable surveys were analyzed. At the conclusion of the survey, questions nine and ten collected demographic data for age and gender. The sample was 56% male with the remainder female. Respondent age ranged from 15 to 78 with a mean age of 33 (SD 12.8).

Response to Research Questions

RQ1: How much radio station switching occurs while driving?

In this study, subjects reported significant station changes while driving (see Table Two). Only 7.2% (n=25) reported that they did not switch the radio during a typical 15-minute period. Median changes were 4.0 (mean= 5.9, mode=3). This compares to Abernathy (1991) who reported 7.9 changes in 15 minutes. The results were highly skewed (skew= 4.5). Several subjects (n=23) reported 15 or more switches in a period. Some results were hard to believe, but it was reasonable to believe that subjects changed the radio constantly. In fact, two subjects, not included in the data for this question, simply responded "all the time" or "a lot." To control the effects of outliers, the data was reduced to four categories for later analysis. In addition, data reduction was justified since most of the rest of the data was ordinal or nominal.

Table 1

Distribution of Station Changes and Stations Heard  
Changes per Quarter Hour

Changes Per Quarter Hour		Stations Per Quarter Hour	
0	7%	1-2	34%
1-2	21%	3-4	41%
3-4	30%	5-6	20%
5-6	19%	7+	7%
7+	23%		
N=354, Standard Error= 0.4		N=351, Standard Error= 0.1	

Similar results were found in responses to question three -- number of stations. In all, 11.4% (n=40) of the subjects reported only one station. Subjects reported a median of three stations used (mean=3.5). Again, some extreme

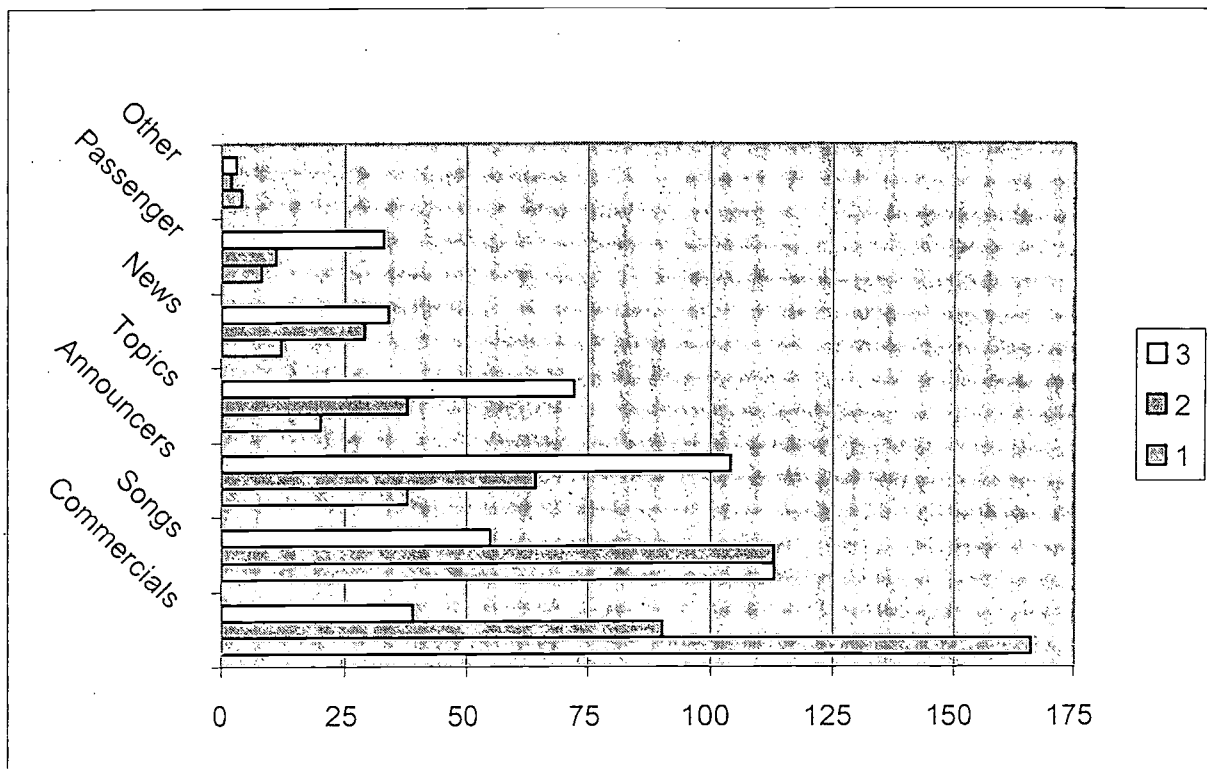
results were reported (skew=2.1). A group of 19 (7%) subjects reported using seven or more stations. Again, the data was reduced to three categories (See Table Two). The most common group was three or four stations representing 41% (n=146) of the subjects. An additional 34% (n=121) of the subjects reported listing to only one or two stations in 15 minutes.

RQ2: What motivates people to switch radio station while driving?

The remaining questions looked at the reasons why a person switches stations. Question four asked for the top three reasons. By far, the most common motivation cited was commercial interruption with 82.9% (n=295) subjects reporting this as one of the top three reasons and 46.6% (n=166) reporting it as the top reason. Next, song selection was important with 78.9% (n=281) choosing it and 31.7% (n=113) making the top reason. The third most popular reason, "program announcers or guests," was different. It was the third most mentioned (by 57.9%, n=206) but was most commonly listed as the third reason for switching (29.2%, n=104). As seen in Figure One below, the remaining reasons were all less important and most often ranked third. The order for these were "boring topics" (36.5%, n=130), "newscasts" (21.1%, n=75), and "passenger desire" (14.6%, n=52). The pattern suggests that there may be an important second reason for station switching. The "other" category was chosen by only nine subjects and most often involved not listening to the radio at all. Figure one summarizes the results of this question.

Figure 1

Why People Switch Stations



The next question asked subjects if they were likely to change stations at the beginning of a commercial. 59.2% (n=209) of the subjects agreed with this while 20.1% (71 disagreed). There was an overall mean of 3.65. If a subject had a favorite station (73% did, n=261), 54.7% (n=143) agreed that they would be less likely to change from that station for a commercial while 30.6% (n=64) disagreed with a mean score of 3.47. Table two summarizes the results of questions five and seven. A regression analysis between the desire to change on a commercial (independent variable, question 5) and the number of changes in 15 minutes (dependent variable, question 2). The relationship was significant

( $F=14.9$ , significance 0.000) although not particularly powerful (adjusted R square = 0.04). This means that, while commercial avoidance helped predict station switching; it was not a strong predictor. A more complex relationship exists.

Table 2

Willingness to Change on Commercial

Will change on commercial						
	Disagree					Agree
	1	2	3	4	5	
Mean						
3.65	24	47	73	95	114	
	N=353, Standard Error = 0.07					
Will change from favorite station.						
	Disagree					Agree
	1	2	3	4	5	
Mean						
3.47	30	34	56	68	75	
	N=263, Standard Error = 0.08					

RQ3: Does station switching exhibit discernible patterns?

The regression analysis above suggests that in order to understand station switching, additional intervening variables needed to be examined. Two demographic areas where the data were logically ripe for further investigation were age and gender. Furthermore, the researchers were curious to see if there were any systematic relationships among the six specified motivations presented in question number four. It should be noted that the seventh motivation category in question four of "other" received only a few responses (eight), thereby validating the 6-motivation questionnaire design. In fact, the majority of "other"



responses dealt with turning the radio off or opting for CDs, neither of which motivates station switching.

Analysis of the age and sex variables took two forms – Pearson correlation and chi-square. There was a high correlation between number of stations and number of changes per quarter hour (Pearson  $r = 0.53$ , significance = 0.000). Effectively, the more changes per quarter hour reported by the subject, the more stations they reported using. Since there is a strong correlation, further analysis will only consider changes per quarter hour. Eliminating the extra variable reduced the possibility of type II error.

The Pearson  $r$  revealed a high correlation between age and (a) station switching, (b) commercial avoidance, (c) song selection, (d) boring topics, and (e) newscasts (See Table Four). Not supported were relationships between age and announcer avoidance or passenger desires. In addition, the correlations were negative for station switching, topic, and news. This suggests that compared to older persons in this study, younger respondents were (a) more likely to switch stations (b) more likely to avoid commercials and (c) avoid an undesirable song. On the other hand, there was also support for the idea that older people tended to avoid announcers and newscasts. Chi-squares were also run using reduced values for age. The chi-square confirmed exactly the findings of the correlations. Given space limitations, the results of the chi-square were not included.

Table 3

Pearson Correlations for Age

	Changes	Comms	Songs	Announcers	Topics	News	Passenger
Pearson's r=	-0.25	0.30	0.24	-0.71	-0.27	-0.18	-0.05
Significance	0.00	0.00	0.00	0.19	0.00	0.00	0.37

Sex was tested using the same variables. In this case, only a chi-square was used to test the variables. While the stereotype assumption might be that males would change stations more than females, there was no support for a relationship between sex and any of the variables. In effect, these data did not support an effect of sex on switching. In fact, looking at the subjects that reported the most station switching (20 or more changes in 15 minutes), the decisive majority (14 out of 20) were female.

## Discussion

Conclusions

This study had several interwoven components. The first was a survey to assess to a reasonable degree the magnitude of station switching today. The second component was an attempt to assess the motivations for switching, particularly, commercial avoidance. The final component was an evaluation of Arbitron methodology to measure accurately station switching and commercial avoidance.

Based on the statistical findings of the self-report we conclude the following. First, the magnitude of station switching within a 15-minute interval was sizable, implying quick dissatisfaction with program content and the desire to

seek a more satisfying “brand”. These findings are consistent with Abernathy (1991) who used a tape recorder methodology.

Second, the dominant motivation for switching radio stations was the desire to avoid commercials or zapping. Tied to this behavior was the tendency to abandon a commercial break almost immediately - even when listening to a “favorite station”. Again, these findings are consistent with Abernathy (1991) who found that the first commercial in a break had a better chance of being exposed than later commercials within a cluster.

A third conclusion is that Arbitron’s diary-based surveys, including its arbitrary 15-minute unit of measure and 5-minute listening credit rule, can disguise station switching and provide a false sense of listening stability. Calculations of turnover ratio offer some insight but all of this quarter-hour information is predicated on the dubious assumption that the diary keeper is conscientious, entering by hand the details of every single switching episode.

A related conclusion is that Arbitron’s experimental PPM device has the potential to revolutionize audience data collection and in turn, change the way radio stations are programmed and audiences are sold. Instead of burdening the diary-keeper with the disagreeable duty of entering precisely by hand every change in listening behavior, this passive listening device is intended to record these changes with ease and accuracy. Unlike Abernathy’s (1991) cumbersome tape-recorder methodology, where the coders had the daunting task of listening and interpreting each tape, the PPM utilizes foolproof electronic encoding to identify almost instantaneously the appropriate stations.

Whether Arbitron will maintain its 5-minute rule and quarter-hour reporting format is still under discussion. Considering that the device is capable of reporting *minute by minute listening* (similar to Nielsen's home meters), one would hope that this data would be made available to subscribers. However, radio industry executives may not be pleased with these findings. Presuming our study exhibits even modest reliability, the implications from adopting the PPM device may be unsettling to those who buy and sell radio audiences. Minute by minute electronic tracking would render many quarter hour programming strategies obsolete and uncover commercial avoidance by listeners. Conversely, advertisers will probably find the PPM a desirable diagnostic tool for finding stations with loyal and attentive audiences. To date, the radio industry has given the PPM a disappointing reception, mainly because compared to conventional diaries, the electronic device appears to underestimate overall radio listening. Ironically, the television industry has given the identical device much better grades because, compared to conventional Nielsen diaries, overall television viewing appears to be up!

#### Limitations

A limitation to this study is its external validity. It is difficult to predict how different the results of our single market "general public" study would be compared to a pure random sample of the entire radio market. However, most of the results from this study are so dramatic, it seems unlikely that a wider study would reveal significantly different results. Another possible limitation is the accuracy and integrity of the responses. It is possible that there is a difference

between self-reported activity and actual radio listening. There was no way to test whether the estimates of station switching and claimed motivations for switching were truthful. The only counter argument the researchers can make is that there was no obvious reason or benefit from providing dishonest answers. Additionally, data reduction techniques used in the analysis reduced the effect of exaggeration. Therefore, we assume that the essential findings were genuine.

### Implications and Future Research

It would be naive to presume that media brand switching and advertising avoidance happen only in radio. To the contrary, these problems can be found across all advertising-based media. Whether the communication medium is electronic or print, advertising is seen often as an unwelcome intrusion. For radio, this obvious aversion has been disguised somewhat by diary-based methodology, but with the introduction of Arbitron's PPM, a new era of audience measurement is upon us. By adopting brand management principles and practices and regarding audiences as active *consumers* of radio content, programmers have a conceptual framework from which to make enlightened management decisions.

This study opens the door for future research. One area that is ripe for more investigation is the relationship of program formats to station switching. Are audiences that prefer a certain type of music or announcing style more tolerant of commercial interruptions? Could long-form programming of the "golden years" of radio make a come back? Additionally, more work can be done in the area of advertising clutter. For example, can commercial break structures be manipulated to raise or lower audience

perceptions of clutter? Regardless of the short-term repercussions of a PPM device, a more precise understanding of station switching and commercial avoidance will lead ultimately to better radio for advertisers and audiences.

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Student Paper

Digital Cinema Goes to Hollywood: The Economic Effects of  
Digital Technology on the Motion Picture Industry

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Digital Cinema Goes to Hollywood: The Economic Effects of  
Digital Technology on the Motion Picture Industry

**Abstract**

Situated within economic and industrial contexts, this research aims to examine how digital technology differs from other preceding film technologies and to assess the economic effects of digital cinema at this stage of development by utilizing some secondary statistical data. It also pays specific attention to the technical and economic barriers that inhibit digital cinema's rapid diffusion. Finally, a possibility of the Internet as a new film exhibition venue is briefly discussed.

### **Introduction**

Today we are observing a rapid technological expansion in the motion picture industry by virtue of digital technology. Indeed, every phase of the motion picture industry has been influenced by digital technology, with film using digital cinematography, digitally manipulated imagery and special effects, and even distribution via satellite and exhibition on the Internet. Current transition, regardless of its pace, to digital cinema will have certain effects on both the macro-level of the motion picture industry and the micro-level of our film viewing experiences. Therefore, it would be timely and appropriate to examine digital cinema's economic effects on the motion picture industry at this stage of development in order to obtain a glimpse of its future direction.

To do so, it will be necessary to inquire into all the aspects of film production, distribution, and exhibition since these three stages are inherently interdependent and sometimes it is hard to examine a specific stage without considering the others. Nonetheless, this research is

limited in terms of research scope and angle. Situated within economic and industrial contexts, it examines how digital technology differs from other preceding film technologies and proceeds to explore what economic effects it has on the motion picture industry, including both Hollywood and independent sides. Furthermore, a possibility of the Internet as a new film distribution and exhibition venue is briefly discussed. Research questions can be broken down as follows:

1. In what ways does digital technology alter the film production?
2. What roles does digital technology play in changing the ways of film distribution and exhibition?
3. How does an ongoing transition to digital cinema affect the structure of the motion picture industry?
4. What are the advantages of digitization in the film industry? And what kinds of technical and economic barriers exist that inhibit digital cinema's rapid diffusion?

In answering these questions, this research begins with some preliminary thoughts on the relationship between cinema and technology and the definition of the term digital cinema. Then, it inquires into what kind of

economic effects digital technology has on the motion picture industry and finally assesses the overall economic influences of digital cinema at this stage of development.

### **Cinema and Technology**

This section defines the term digital cinema and briefly discusses its unique characteristics that are different from those of other previous technologies. In general, digital cinema indicates a general trend of digitization in the motion picture industry. More specifically, it often refers to the digital distribution and exhibition of films, with the aid of such digital carriers as satellite, fiber-optic network, digital film storage and control center, and digital film projector that are currently under development and at an early test market stage. While digital cinema means a general trend of digitization in the motion picture industry, another term digital filmmaking indicates production-specific technologies: the use of digital cinematography -- Digital Video (DV), High Definition (HD) camera, other digital production equipment, Digital Audio Tape (DAT), computer graphic and special effects, and non-linear editing tools.

Unlike prior mechanical reproductions, digital cinema, which is stored and processed in simple binary codes, can

perfectly reproduce image and sound without any degeneration. This is the very theoretical and technical basis of digital technology application to cinema (Morley, 1998, p. 5). In fact, the various terms for new forms of cinematic medium such as digital video, online cinema, interactive media, digital projection, and so forth, regardless of their differences, share this core principle. Therefore, Wyatt (1999) defines digital cinema: "As patterns and dynamics of information are moving images, they are cinematic. As they are computer generated they are digital. And the result is digital cinema" (p.365).

Another unique attribute of digital cinema is the possibility of digital delivery of moving image content. Although cinema has been influenced by different technological development at various points during its history, those influences have not changed the very means of film distribution and exhibition. As Morley (1998) states, "film as a distribution media for motion pictures has held center-court for one hundred years and without major changes during that time" (p.2). In fact, this changing way of film distribution and exhibition marks one of the most fundamental differences between digital technology and other preceding technologies.

**Film Production: Hollywood vs. Digital Video (DV)****Filmmaking**

Recently, numerous Hollywood blockbusters have been driven by special effects, aiming to maximize their target audiences by offering spectacles by virtue of digital technology. In fact, new forms of digital technology seem to have greatly benefited mainstream Hollywood filmmaking, making possible such box office successes as *Forrest Gump* (1993), *Independence Day* (1995), *The Lost World* (1997), *Titanic* (1997), *Matrix* (1999), *Star Wars Episode I - The Phantom Menace* (1999), *Dinosaur* (2000), and *Gladiator* (2000), just to name a few.

To assess the impact of new digital technology on the film production, Fink (1997) examines the production process of a TV program, *American Gothic* (CBS) from scripting to on-line editing. According to his findings, one of the most significant advantages of digital technology is that it can reduce the cost of production, while increasing filmmakers' artistic choices. Not only does digital technology reduce production costs, but also lower the cost of pre-production assisted by various software and digital communication tools. Since the cost of film production is closely related to the amount of time



consumed, time savings, associated with the seamless management of production process, enabled by digital technology appeared to bring about cost-effective filmmaking (p. 15).

Moreover, regarding the digital technology's impact on jobs, Fink maintains, "digital technology causes some convergence and overlapping of job assignments that were more rigidly delineated in the past" (p. 13). This, in turn, is supposed to have cost saving effect, enabling fewer production staff, specifically smaller number of editing jobs due to the diffusion of non-linear editing tools.

However, unlike these optimistic expectations, empirical data indicates that the advancement of digital technology has brought about a rapid increase in total production costs as can be seen in Figure 1. Compared to the average negative cost of 26.8 million dollars in 1990, that of 2000 shows a twofold increase, amounting to 54.8 million. Obviously, this economic trend goes against the assumption of digital technology's cost-saving effects. There may be several explanations for that. First, an introduction of digital technology to the film production might have incurred a huge capital expenditure on the installation of digital production equipment including non-

linear editing tools and workstations for special effects. Regarding this, an interesting point is that after 1997 the pace of production cost increase turned to be kind of steady, which may reflect the fact that all the major studios finished investing on digital technology around that year. Second, as Litman (1998) pointed out, this tendency is related to "the monopoly power for the actor". According to him, the "tendency to bid for the rights of popular stars has led to a tremendous inflation in negative costs over the last several years" (p. 46). In short, it would be safe to say that the cost-effectiveness of digital technology has not been fulfilled yet.

Furthermore, industry employment trend also indicates that the total number of employees (especially in production & services) in the film industry has been increasing rather than decreasing as can be seen in Table 1. This trend may indicate that the introduction and application of digital technology to the film industry necessitated another pool of digital crew.

More specifically, in the film production sector, ranging the years from 1990 to 1994, there was a slight shrinkage (from 2.48 to 2.01) in "the number of new films released per thousand employees" (PR<sub>1</sub>; for detailed

information about productivity in the motion picture industry, see Litman, 1998, pp. 57-58). When we consider the fact a full-scale application of digital technology began during the early '90s', this productivity measurement confirms that digital technology thus far has no significant impact on the film industry in terms of cost-effectiveness and productivity.

Therefore, it would be reasonable to argue that until a certain point at which digital cinema is fully practiced from pre-production to the final exhibition, this trend may persist, although the modest cost saving effects will be more and more prominent as one-time huge investments on digital equipment diminish, with a relatively smaller amount of investment on upgrade and maintenance of digital equipment.

In contrast to big-budget Hollywood films proven to be profitable mainly because of their spectacles aided by digital special effects, independent filmmakers are exploring more innovative filmmaking through the use of affordable digital video (DV) filmmaking and online distribution of their works. DV filmmaking is cost-effective not only in terms of cheap videotape stock, but also in terms of a smaller size of crew as can be seen in

the cases of *The Last Broadcast* (1998) and *The Cruise* (1998). The cost-effective DV filmmaking would benefit more independent filmmakers than those who have affiliation with major studios. Because, in low-budget filmmaking, expenses related to film stock purchase, film development and processing are a large portion of whole budget, whereas, in Hollywood big-budget films, those expenses only occupy a smaller percentage compared to huge salary for star director and cast, and the massive number of staffs.

As can be seen in Table 2, there are several features that enable cost-effective filmmaking: light-weight digital video, non-linear editing tool, portable lighting package, and so forth. This is indeed the most significant advantage for independent filmmakers who have not been able to afford expensive film cameras, film stock, and postproduction expenditure.

As a result, recently, there have been many independent films that are shot on digital video, and then blown up to 35mm for theatrical release. Among them, *The Last Broadcast* clearly exemplifies the potential of digital technology in cost-effective filmmaking. The film was entirely shot on digital video and edited entirely on a consumer-based desktop PC. It became the first DV feature

film that is distributed to the local theaters across the U.S. via satellite. The whole budget for the film was just \$900 as we can see the detailed budget breakdown in Figure 2. The filmmakers produced their movie for \$900 and earned \$ 18,000 as of the end of 1998. If shot on 16mm film and edited in the conventional way, it would have cost \$200,000(Conlin, 1998).

Another benefit of DV filmmaking is that a director can take enough footage so as to experiment various ways of filmmaking. A conventional standard of shooting ratio has been assumed as 3:1 or 4:1. However, with cheap digital video stock, a director can increase the ratio up to 10:1, which is, of course, dependent upon filmmaker's financial ability. For instance, the director Bennett Miller obtained eighty hours of original footage for his final of eighty minutes. With the abundant footage, he could create a new way of film aesthetics, which can be called "digital cinema verité." The breakthrough of DV is the "accessibility of quality" says Jonathan Miller (Parks, 1999).

Eduardo Sanchez and Daniel Myrick's *The Blair Witch Project* (1999) is another interesting example of the new wave of digital cinema, especially in terms of its

marketing strategy through the Internet. The film suggests a model for independent filmmakers how to compete in the film marketplace, even with a minimal budget. The film, which was completed for \$35,000, grossed \$140 million in a couple of months after the public screening in 1999 (Tatsuno, No date).

Despite all the benefits of DV filmmaking described above, a fundamental problem for independent filmmakers exists: Considering the fact that digital format is not a industry standard for theatrical release, how to distribute their films to the local theaters? Because of that, independent DV films still need to be printed on 35mm film for a final print in order to reach massive audiences.

In summary, the economic impact of digital technology on the production stage indicates that it has distinctively different effects on the mainstream and independent film industries. One of the fundamental difference is that Hollywood films have tended to increase production costs due to the enormous demand or pressure for digital special effects, whereas independent filmmakers have lowered their film production costs with the aid of more affordable and accessible DV filmmaking package.

### Digital Distribution and Exhibition

The economic impact of digital technology goes beyond the mere creation of digital special effects or cost effective DV filmmaking. The application of digital technology in the motion picture industry has an even greater impact on the film distribution and exhibition as experimented in several Hollywood films in recent years. Some film festivals such as Sundance have also incorporated digital projection ("Sundance selects," p. 36).

Digital projection enables movie studios to save money in that it eliminates "high cost of making and distributing prints" while preserving original picture qualities. By replacing traditional projection system with digital projection, movie studios can save about \$800 million annually (Sabin, 2000). Figure 3 illustrates how digital distribution of moving image works.

However, if we look at this from a different angle, one fundamental question arises: Who is going to finance the replacement cost? Given the price of digital projection system goes up fivefold and considering the fact that movie theater industry has fallen into financial morass due to the excessive amount of capital expenditure

on building new fancy multiplexes, theater owners are not likely to replace current projectors (Prinstin, 2000).

The over-expansion of screens rooted in the overbuilding of multiplexes can be easily noticed by looking at the number of screens per theater (See Table 3). As can be seen in the table, the number of screens per theater was significantly increased from 3.96 to 5.03, although the total number of cinema sites has been slightly decreased.

Interestingly, a billionaire, Philip Anschutz is acquiring "theater chains that have landed in bankruptcy" in the hope that he can utilize his Qwest Communications to distribute entertainment contents to the local theaters nationwide. There might be specific reasons for the billionaire to enter the theater industry that suffer from the recent financial crisis. Not only does he intend to operate the theaters acquired at bargain prices at a profit, but also he will look for a possibility to distribute movies to the theaters by using his fiber-optic network (Flanigan, 2001).

However, Flanigan's assumption about the future of digital distribution is kind of naïve when he states, "in the next five years, digitally recorded movies will be



beamed to theaters via the Internet." In 1995, *Variety* made an almost same prediction: "Sony isn't alone in seeing filmless delivery of motion pictures as viable within the next few years" (p. 9); "A couple of the major players are pretty close" (p. 16). Yet the reality contradicts this optimistic prediction. A full-scale application of digital projection is not happening yet. Moreover, fiber-optic distribution is just one of the many possible options for digital movie distribution. Nobody knows what the standard format for digital projection would be.

However, if there is no major competitor in the theater industry, it may be possible that Anschutz himself determines a standard format for digital film distribution. But more probably, a standard digital projection format would emerge as a result of industrial power dynamics among major studios, distributors, exhibitors and digital projection system vendors (e.g., Kodak, Texas Instruments, JVC, Sony, etc.).

Meanwhile, Morley (1998) argues that the primary expense of the digital film distribution system is "one-time capital expense," whereas traditional distribution has a "high variable cost associated with the number of copies needed for each motion picture" (p. 12). The major expense

for the digital cinema system is the equipment needed at the local theater for the reception, control, storage, and projection of the digital programs.

A cost comparison between traditional film distribution and digital distribution can be made on a "per screen" basis. According to Morley's research based on the MPAA statistics for 1997, there is a great cost gap between the digital distribution and the traditional method. The average print cost for 231 major films released in that year was over \$3 million, which is up by 14.7% from the previous year. The average print cost for theatrical release was \$22,400 per screen. In contrast, digital distribution, assuming a satellite-transmission based system, costs only about \$225 per screen (Morley, p.12). In this regard, the replacement of traditional projection system with digital projection can counterbalance the replacement cost, even if the digital projector prices over traditional 35mm projector, costing \$100,000 compared to \$30,000 (Dixon, p. 228).

Now a fundamental question arises: Why a rapid diffusion of digital cinema has not happened yet? Today the number of theaters that are equipped with digital projection system in the U.S. only numbers around 20 (MPAA

2000 US Economic review). Some might argue that it is due to digital medium's lack of richness and depth compared to film look, while others maintain that the lack of cost-effective digital projection system and theater owners' financial disaster. In short, it seems that digital projection will not radically replace traditional 35mm screening in the near future because of the all the economic and technical problems described above.

Meanwhile, regarding the influences of digital distribution on the independent film industry, Butler (2000) argues that in line with a general trend of digitization in the motion picture industry, film festivals and digital theaters provide independent filmmakers with new revenue opportunities and contribute to the evolution of digital cinema. For digital cinema manufacturers, film festivals can be good places to have their new products evaluated by a pool of top-notch directors, producers, film critics, actors, and audiences. A key advantage of test marketing is that it is possible to evaluate a new product without launching nationally and incurring a large amount of expenditure on promotional activities. Therefore, in a sense, technology vendors' beneficiary gifts to film festivals are nothing but a strategy to cultivate a

potential market for a new product. Butler did not go further to discuss about the reasons for the slow diffusion of digital cinema. It is unreasonable to maintain without any reservation: "digital will elevate the industry and will in fact create ... the most diverse range of theatrical venues in exhibition's history." To me, it sounds like to claim that a garage-band can be a superstar overnight by virtue of MIDI and MP3.

In my view, even if the test of digital projection has been successful in independent film festivals, it is still not clear whether film festivals can be representative to the whole motion picture industry since audiences at film festivals tend to pay more attention to novice directors' creativity and/or films' uniqueness instead of picture and sound qualities.

#### **Digital Cinema Online**

Another noticeable technological expansion in the world of digital cinema is the advent of a variety of web sites aimed at the distribution of moving image content. In the past few years, the promise of direct distribution of films to massive viewers lured many independent film production companies to the Internet (e.g., AtomFilms.com, Dfilm.com, Sightsound.com, and so forth). As can be seen in Table 6,

there has been increasing consumer demand for Internet access, surpassing that of movie in theaters in 2000. However, one of the most serious drawbacks of current film distribution via the Internet is that most audiences do not have the broadband technology to make watching downloaded short films enjoyable experiences. In fact, online cinema has to struggle with several technical barriers in order to compete in an era of entertainment abundance. Some of challenges for online cinema may include: "greater capacity at lower cost," "standardization across online cinema applications," and faster connections by broader bandwidth (Goldman, 2000, p.26).

Another research also maintains that online entertainment sites (video content provider in particular) are facing two major problems that keep them from becoming lucrative "mass-market" media. First and foremost, it is impossible to distribute high-quality streaming content without broadband connection. Second, entertainment sites are suffering from the decline of advertising and subscription rates ("Survey: E-entertainment," 2000).

In my view, for online entertainment sites, the most efficient and practical way of reaping profits from the market is to develop unique and high quality content for

the exclusive distribution on the web since people will not likely to pay money only to see what are already available on their TVs.

### **Conclusion**

Unlike other preceding film technologies, the complete adoption of digital cinema will require an industry-wide restructuring, including all the three stages of film production, distribution and exhibition. There are many other issues to be explored in order to understand an ongoing transition to digital cinema in a more comprehensive way. Those may include: "secure content protection," "worldwide compatibility," and "open standards" (See Hunt, 2000).

Overall, at this stage of development, digital cinema does not have any significant impact on the structure of motion picture industry. The introduction and diffusion of affordable and accessible DV technology have feeble effects on the motion picture industry, specifically in terms of theatrical showings. The Internet showed a possibility as another film exhibition venue. However, no significant amount of profits has been earned from the Internet yet. Theater chains' financial problems have negative effects on the diffusion of digital cinema. Among main players in the

three levels of the motion picture industry, distributors are most willing to accept digital cinema. There are some conflicts between distributors and exhibitors over the issue of financing the replacement cost for digital cinema. Therefore, a full transition to digital cinema is not likely to happen in the near future unless the conflict between two main players, movie studio and theater chain, resolve in certain ways.

In conclusion, my prediction is that the diffusion of digital cinema will slow until it reaches a critical mass point. The diffusion of digital cinema may have strong effects on the motion picture industry structure if a company or conglomerate can take the market initiatives in deciding a standard format for digital cinema distribution and exhibition.

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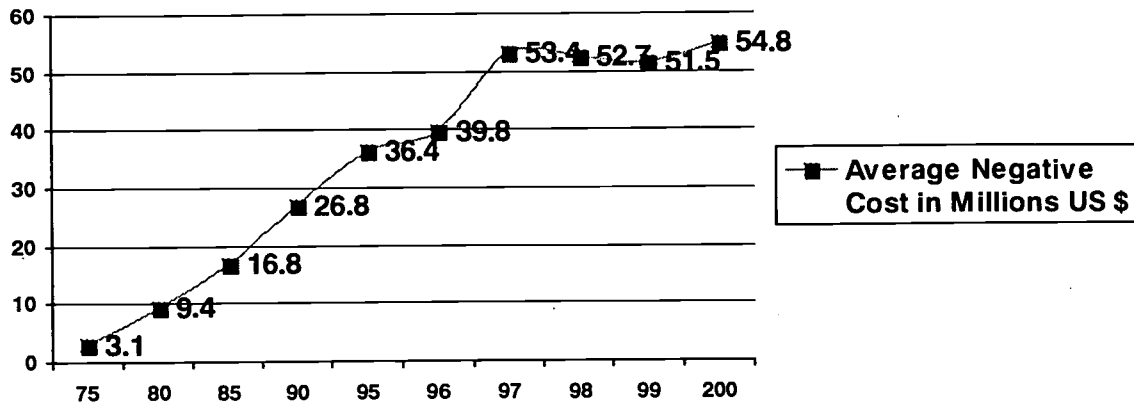
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Appendix: Tables and Figures

Figure 1: Average Negative Costs<sup>1</sup>

(Source: MPAA US Economic Review)

Table 1: Employment Trends in US Motion Picture Industry

Year	Total	Production & Services	Theaters	Video Rental	Other
2000	630.8	296.2	132.2	184.4	18.0
1999	609.8	278.3	138.2	175.7	17.6
1998	576.0	255.4	136.8	166.7	17.1
1997	550.4	237.4	133.0	160.9	19.1
1996	524.7	222.5	123.9	155.1	23.2
1995	487.6	200.7	118.7	146.1	22.1

(Source: MPAA 2000 US Economic Review)

Figure 2: Budget Breakdown of *The Last Broadcast*

<sup>1</sup> In general, negative cost refers to the total production cost including preproduction, production (shooting), postproduction (editing and special effects) and above the line cost (the artistic expenses of a production and salary for producers, directors, writers, actors, and the purchase of rights to a story or script) (Alexander et al., 1998, p. 287). In this case, MPAA statistics included "production costs, studio overhead and capitalized interests" (MPAA 2000 US Economic review).

**Production**

DV tape stock 20 @ \$12	\$240.00
23 VHS tapes	25.00
8mm tapes 4 @ \$8	32.00
Set design	81.57
Food	155.00
Gas and travel	90.00
Audiotapes	6.75
Miscellaneous production expenses	50.00

**Post-Production**

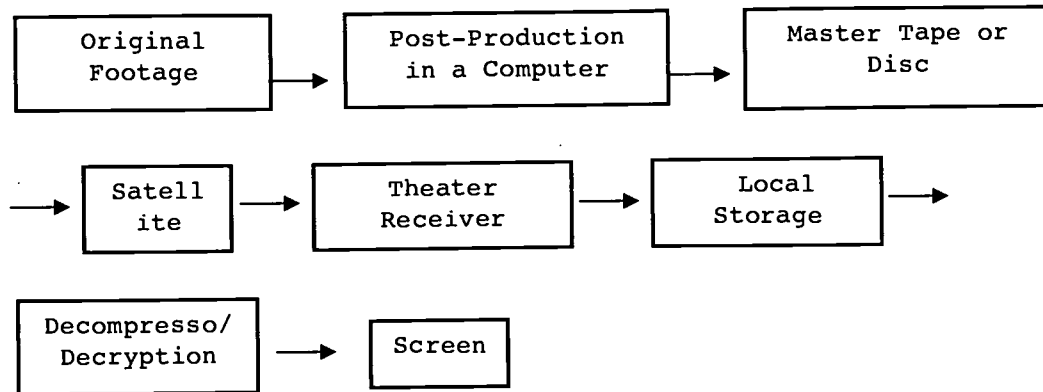
Editing done on team's desktop	0.00
Beta tapes for mastering	120.00
Beta deck (donated)	0.00
Publicity materials	99.68

**GRANDTOTAL****\$ 900.00**(Source: Conlin, Sam Goldwin on \$900, *Forbes*)Table 2: Sample Package for Digital Filmmaking

Item	Price
Mini DV Camera (Sony VX 1000, Canon XL-1) with Some Accessories	\$ 4,000
DAT Recorder/ Microphone	\$ 2,000
A Few Small Lights (even No Light)	\$ 500
Powerful PC with Video Capture and Editing Softwares	\$ 4,500
Total	\$11,000

(Source: Trade Magazines such as *Digital Video* and *Millimeter*)

Figure 3: Digital Distribution System



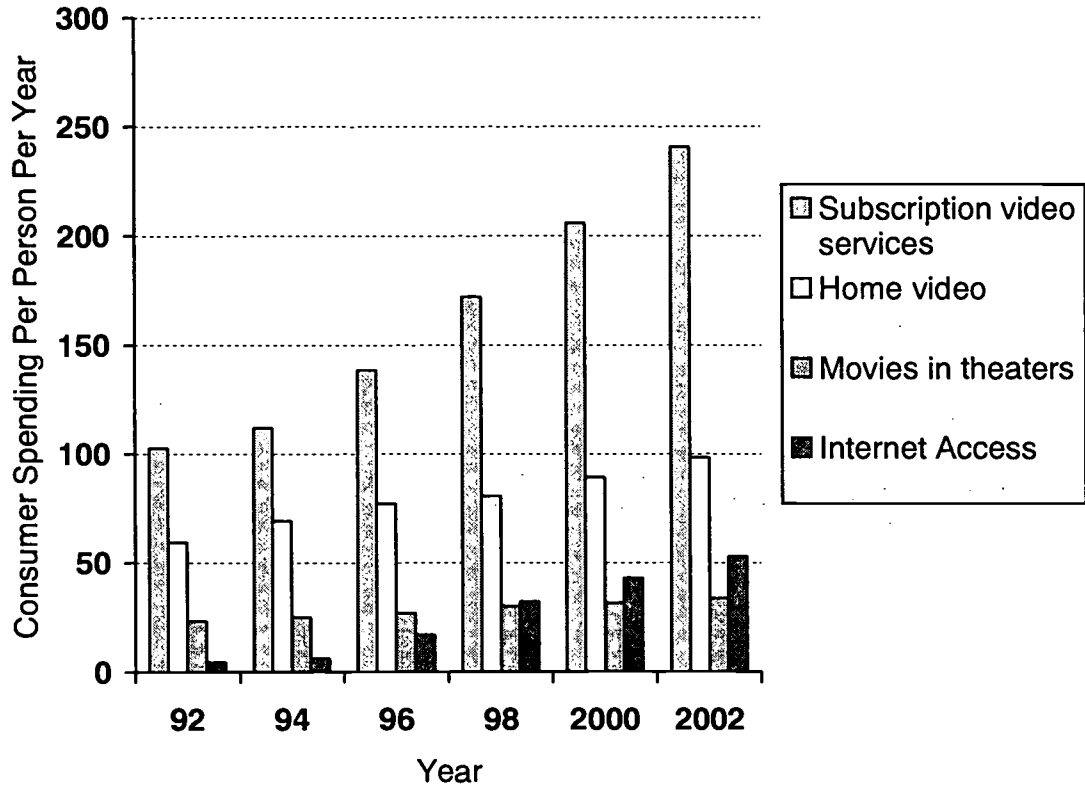
(Source: Morely, 1998)

Table 3: Number of US Theaters and Screens

	Number of Theaters	Percent Change	Number of Screens	Percent Change	Number of Screens per Theater	Percent Change
1995	7,744		27,805		3.96	
2000	7,421	- 4.17 %	37,396	+ 34.5 %	5.03	+ 27.0 %

\* Raw data is obtained from MPAA US Economic Review

Figure 4: Media Usage and Consumer Spending: 1992 to 2002



\* Raw Data is obtained from Veronis, S. *Communication Industry Report*, Retrieved from Lexis-Nexis Academic Universe.



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