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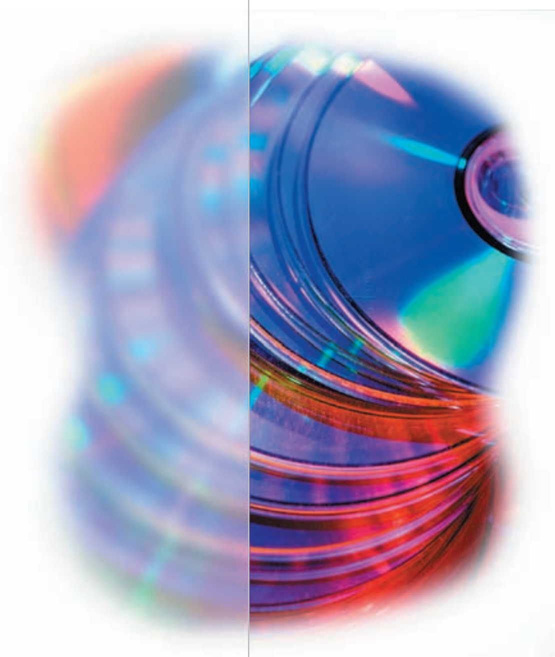
Uncharted territory ahead for the Media and Entertainment industry

Media and Entertainment (M&E) companies face daunting challenges as they prepare for the future media world. The combination of new technologies and economic pressure on core operations raises the stakes for making the right business decisions, as well as avoiding the wrong ones. As new devices and delivery formats offer more active, customized experiences to the end consumer, media firms have found that the traditional methods of creating value are insufficient to remain competitive. To succeed, companies must develop and implement a comprehensive digital media strategy that embraces the potential of fully integrated media.



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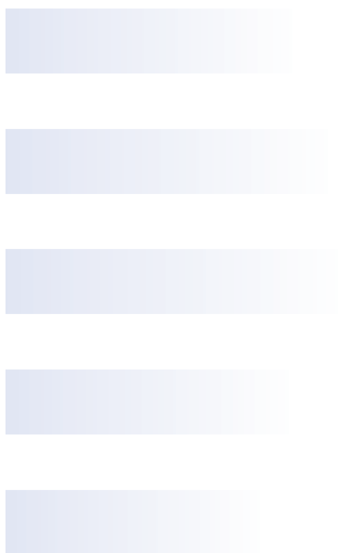


Study methodology

This executive brief is based on the findings of the "IBM Media and Entertainment Landscape and Playbook," a comprehensive study on the global media industry conducted by the IBM Institute for Business Value, IBM Global Services and IBM Research. The project included an analysis of the top 40 to 50 global media companies, and involved desk research, interviews with industry executives, media consultants and IBM technology experts in digital media, the purchase of proprietary economic research from Wilkofsky Gruen Associates, financial analysis and news analysis. The study was originally created to determine and analyze the key issues facing the media industry in the subsequent 12 to 36 months. After the initial landscape was completed, the findings of the study were structured around some clear business questions, with an emphasis on improving shareholder value. As a result, a Playbook was created that is designed to help media executives make strategic decisions about competing in today's media business.

The goal of the study was to understand the business issues facing integrated media firms with significant scale and operations across many segments, and firms with complex and evolving strategic and IT needs. Based on these findings, IBM determined a number of key recommendations for media firms that exhibit the potential to have the largest near-term market impact.

Multiple challenges: A view of today's playing field

The current playing field is shaped by four factors:

- Decline in financial performance
- Increase in the number of media properties
- Emergence of new technologies
- Change in the industry value chain and market structure.

Although leading M&E firms have been experiencing strong revenue growth since 1997, this was offset by both a declining return on assets and rising operating expenses that outstripped revenue growth (see Figure 1).

Figure 1. Leading media company year-over-year revenue and operating expense growth 1998 - 2001.

Source: Public filings; Morgan Stanley, Salomon Smith Barney and ABM AMRO industry reports; IBM Strategy and Change analysis.

The increasingly fragmented structure of media segments is a primary cause of these higher expenses because across all media, viewers and readership have not kept pace with growth in the number of properties. For example, the number of U.S. cable networks increased from 87 to 287 between 1992-2001, a 230 percent increase.[1] However, in that same time frame, the average hours spent watching television per day only increased 7 percent.[2] Competition between titles, brands and networks has made it more and more expensive to compete in specific markets, putting pressure on ratings and fragmenting the target market into smaller pieces.

At the same time, an array of new technologies is changing the way that content can be distributed to consumers; this is challenging the economics of the traditional M&E business. Technology allows consumers to be more specific about the media they want, and it allows customers (that is, business partners and advertisers) to establish specific operating criteria for their M&E investments. A threatening by-product of the new technology is the emergence of nontraditional competitors who seek influence and control over portions of the value chain that were traditionally dominated by the integrated media companies. Napster, for example, irrevocably changed the recording industry by popularizing peer-to-peer (P2P) file sharing of digital music. In 2001, the number of music CDs shipped in the U.S. declined 6.4 percent and the value of these shipments declined by 2.3 percent[3] – declines which, to some extent, were attributed to digital music file sharing.

Napster and other file-sharing applications highlight the fact that new business models can quickly and significantly undermine business models that have been entrenched for decades. Digital media will continue to provide opportunities for new entrants to create disruptive business models that attract consumer attention and revenues. Therefore, traditional M&E companies need to be more vigilant about these new businesses by maintaining enough flexibility themselves to create comparable offerings that protect their own consumer market share.

In combination, these occurrences are taking revenue away from traditional M&E companies as consumer spending is reallocated across this broader array of new products and services. Because consumers have a finite amount of time to spend on personal media consumption, traditional companies must protect and recapture market share by introducing their own digital offerings of equal or better value. Under these competitive circumstances, media business models will become more complex and data-intensive. Information about the content that is distributed and who consumes it will be the new strategic high ground. As a result, information technology (IT) and operational integration are critical components of a media firm's strategy.

What's been tried: Aiming for increased returns

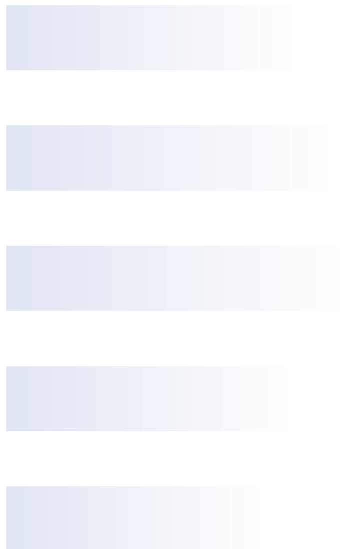
In response to these market dynamics, most M&E companies have pursued some combination of the following five cost-cutting or revenue-boosting actions:

- Mergers and acquisitions (M&A)
- Price increases
- Cross-channel brand extensions
- Layoffs
- Reducing business overhead.

These actions met with varying degrees of success, but in general, they have been ineffective in creating higher shareholder value. Even in cases where some firms had encouraging results, the effect of these changes wasn't enough to have a lasting, positive impact on the enterprise.

Media companies first engaged in M&A to acquire new platforms and develop new potential revenue streams, but many of the investments did not create the business opportunities or financial impact that were originally envisioned. A "hyper-M&A" environment created a handful of megamedia conglomerates, such as AOL Time Warner (AOL TW), Vivendi and News Corp. Instead of reaping profit from their mergers, AOL TW[4], Clear Channel[5], Vivendi[6] and News Corp.[7] reported close to US$104 billion in write-downs during the first two quarters of 2002, primarily as a result of goodwill adjustments for "Internet bubble" investments.

In addition, firms often failed to benefit from an expected core virtue of M&A – cost savings from operational integration. Many have not been successful at creating an integrated infrastructure for the merged entity because their technology systems had been modified so extensively. System complexity has created higher than anticipated M&A integration costs, with none of the economies of scale.

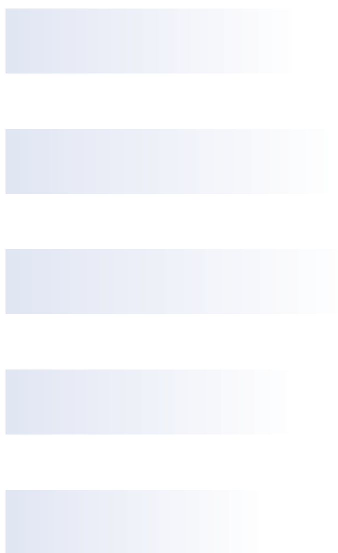


Another response to the market has been to raise prices on products and services. Although this helped to boost revenues in the boom times, it has proven to be an unsustainable strategy for revenue growth. For example, in the United States, the average box office ticket price increased 8.3 percent in 2000 and 3.7 percent in 2001.[8] Average monthly cable TV prices in the U.S. increased from US$28.66 to US$34.93 between 1998 and 2001, but higher numbers of competitors per market have diluted potential market share.[9] Merely charging a higher price in no way guarantees higher revenue. In fact, the opposite often proves true.

Media and Entertainment companies are doing everything they can to leverage content, legal and regulatory tools to slow down the introduction of new technology that fundamentally changes the status quo. However, the genie is out of the bottle—digital technologies already exist. The degree of security that is required to slow down digital piracy is at odds with the freedom that consumers require to experience media. Just as the open-standard MP3 won out over the proprietary Secure Digital Media Initiative, new Internet-based standards for collaboration and use of multimedia will continually evolve. These standards will trump M&E firms' efforts to control the distribution of digital content. At some point, M&E firms will have to figure out how to build profitable business models by balancing digital copyright security with consumer needs. They can't hold back the floodwaters forever.[14]

Industry consolidation in the late 1990s provided the opportunity to stretch media brands and assets across geographies and channels. The goal of brand extension is to generate as much revenue as possible from a given content asset by leveraging a range of properties for distribution. Although AOL TW's promotion of the movie *Harry Potter and the Sorcerer's Stone* was a great success,[10] cross-brand extensions have failed as often as not. Partnerships between TheStreet.com and Fox News Channel;[11] and CNN and *Sports Illustrated*; among others, were unsuccessful in extending their brand across channels.[12]

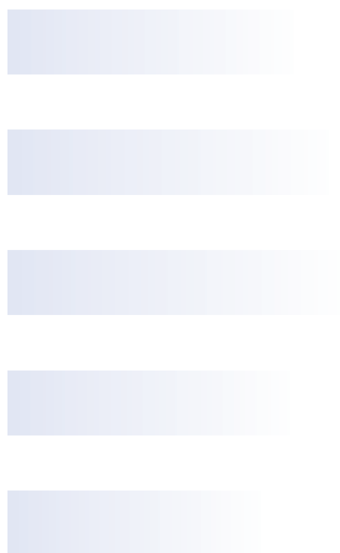
As in many other industries, M&E has used restructuring as one way to manage operating costs during the economic downturn. In an effort to cut operating expenses and improve financial performance for the year, nearly every major media organization announced layoffs in 2001 and 2002. AOL TW, Disney, NBC, the *New York Times*, McGraw-Hill, Viacom, Bertelsmann, Dow Jones, News Corp., Vivendi and Pearson collectively laid off over 24 000 employees, resulting in cost savings of over US$1.67 billion.[13] However, reducing headcount will only impact operating expenses in the short term because SG&A costs continue to grow.



Firms have reduced business overhead in various ways to cut costs and leverage economies of scale to lower the expense of maintaining their operational structure. Examples of consolidation efforts include:

- *Local broadcast duopolies*—Both News Corp. and Viacom developed local broadcast duopolies to consolidate cross-functional business areas.
- *Shared editorial processes and infrastructure*—Several news stations, including the *Los Angeles Times*, ABC, CNN and the *Tampa Bay Tribune*, all combined some elements of their newsgathering capabilities among their broadcast, Internet and print businesses. All of them used infrastructure sharing to reduce costs, such as maintaining newsroom office space and technology and satellite-uplink facilities.
- *Central casting*—Clear Channel, Allbritton Communications and NBC each used central casting to reduce the operations costs of their networks by originating programming from centralized facilities.
- *Supply chain streamlining*—All five major music labels, in various combinations, engaged in negotiations throughout 2002 to bring together their manufacturing and distribution facilities, consolidating the CD manufacturing business.
- *Corporate consolidation*—Some of the major companies used this approach to reduce corporate management costs between their own business units. Viacom consolidated CBS and UPN, and Sony consolidated Columbia TriStar TV Distribution with Columbia TriStar Television.

Despite significant efforts such as those described above, the Dow Jones Industrial Average has outperformed media stocks over the last four years (see Figure 2). With lukewarm results in the recent past, and challenging market conditions now, little shareholder value has been created. It's no surprise that many companies are wondering which way to turn next.



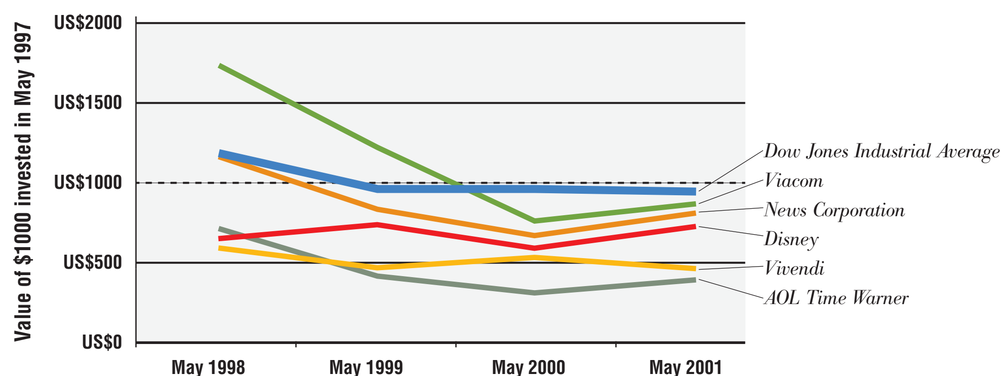


Figure 2. Major media company stock performance, May 1998 - May 2002.

Source: Public filings; Morgan Stanley, Salomon Smith Barney and ABM AMRO industry reports; IBM Strategy and Change analysis.

Key plays to build shareholder value

Cost management and integration clearly remain the most immediate challenges industry-wide. To compete effectively in today's complex environment, executives should focus on five strategic plays to improve shareholder value:

- Consolidate business unit and corporate overhead
- Integrate operations
- Optimize business customer offerings
- Drive direct-to-consumer relationships
- Prepare for integrated media.

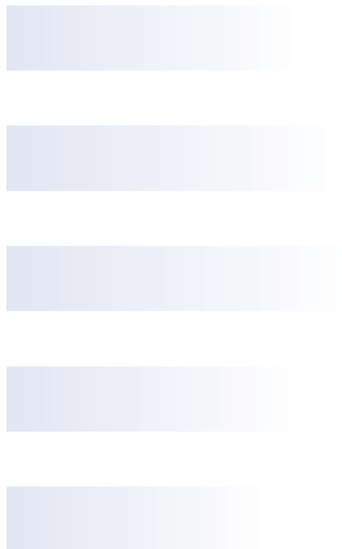
Consolidate business unit and corporate overhead—consolidating business functions at both the corporate and business-unit levels.

IBM Strategy and Change analysis indicates that SG&A is the second-fastest growing category of cost across M&E, surpassed only by the cost of programming. This is a clear indication that M&E firms have much room to pare down costs. Many firms are already pursuing consolidation. Knight Ridder, for example, created a shared services center for finance-related transaction processing. Beginning with newspapers and transitioning to other units, the service saves Knight Ridder about US$20 million annually.[15] And, Dow Jones now outsources its non-core subscription telemarketing business, saving US$1 million annually.[16]

Integrate operations—standardizing and integrating the technologies for content development and distribution.

Fusing back-end (that is, content creation and management) systems enables flexible content repurposing and eliminates redundant storage of media content systems. Back-end integration enhances content production, content distribution and storage, and overall distribution management. Media General successfully integrated the back-end operations of three news properties, including the *Tampa Tribune*, News Channel 8—WFLA-TV and Tampa Bay Online.[17] Its goals in initiating this business transformation were to increase the availability of news reporters, to provide cross-media credibility, content and promotions, and to boost TV ratings, newspaper circulation and online traffic.

Linking front-end systems (such as, content sales and distribution) supports optimum brand-portfolio leverage. Front-end integration requires a unified view of the customer and knowledge of his or her multimedia preferences. An integrated customer relationship management (CRM) strategy that combines both technology and business operations can lead to distinct competitive advantage. A deep understanding of the customer can result in strong cross-platform sales, making the firm much more appealing to the increasingly demanding advertiser. For example, Noggin designs its TV programming and online content in tandem. It uses a closed-loop process for children (its viewer and online audience) to provide programming feedback that can improve content.[18]



As much as companies need to better integrate their back- and front-end systems independently, they also need to integrate back-end with front-end. Interconnecting the front- and back-end provides a cross-enterprise view of consumers, customers and brands (see Figure 3). A tightly fused operation creates business intelligence for better executive decision making. Gathering and sharing knowledge across all segments provides a holistic view and enhances a company's ability to profit from content. In short, integration can result in more profitable revenue by streamlining processes, sharing information and consolidating systems. M&E firms that have integrated content-creation systems with content-distribution systems should realize better returns on their assets because they are in a better position to fully exploit their content rights.

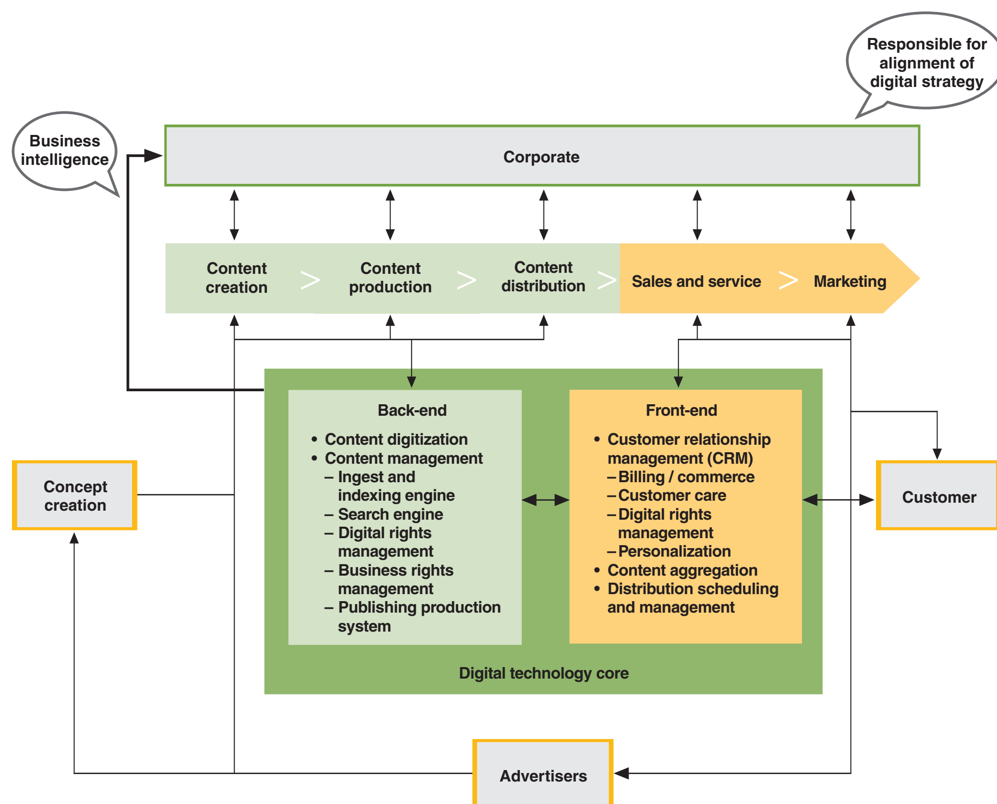


Figure 3. Digital strategy alignment requires a complex flow of data and communications through all the constituents of the ecosystem.

Source: IBM Institute for Business Value analysis.

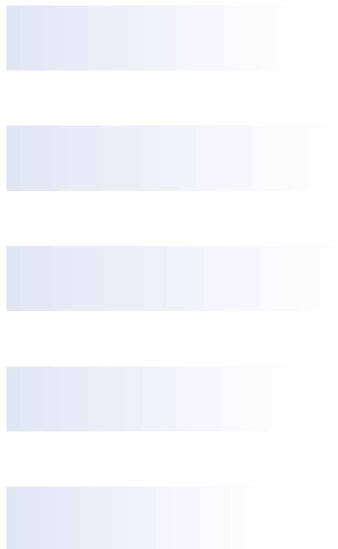
Optimize business customer offerings—creating better value for business-to-business (B2B) customers by improving their return on investments and providing opportunities to generate additional revenue.

Growing numbers of advertisers and M&E companies are leveraging cross-platform advertising sales. In April 1998, News Corp., with its News Corporation One, was the first major player to deploy a dedicated unit to focus on cross-platform ad sales. Disney, Viacom, AOL TW, and NBC all followed suit and now most major media firms have such units in place. These groups are slowly signing more valuable and more comprehensive deals. In the summer of 2002, Disney inked a US$1 billion cross-platform deal with OMD USA, the largest cross-platform deal to date.[19] Industry experts estimate that 20-25 percent of ad revenue will come from cross-platform advertising by 2006.[20]

Two companies that are providing value to media firms by offering innovative business services in supply chain content distribution are Handleman Entertainment Resources and Lightning Source. Handleman distributes prerecorded music products and provides category-management services to mass-merchant retailers.[21] Lightning Source offers digital fulfillment and printing services to the book industry, including print-on-demand and eBook services.[22]

Drive direct-to-consumer relationships—understanding the product and service needs of the consumer.

Multiple influences are empowering end users in how they consume media, thus providing business-to-customer (B2C) opportunities. First, emerging digital technologies, including content formats, distribution networks, mobile devices and software are providing users with new alternatives. Second, the expanding number of media properties provides consumers with new and different venues and contexts for consuming. Third, the Internet influences consumers' patterns related to digital content because they can now have direct access with more control over their own media experience, including how and when they receive media and how often they use it.



As media consumption branches out to various platforms and as digital media provides more interactive tools for its digital channels, companies must change their own paradigm regarding consumer interactions. In the past, media consumers were merely audiences with no distinct characteristics, other than basic demographic information provided by ratings organizations. In the future, these audiences can have much closer relationships with the content providers—individual needs and wants will be recognized instead of being "lumped together" with the entire audience. M&E companies will then have better opportunities for monetizing their consumer relationships by:

- Customizing media for individual consumers
- Creating active programming that allows users to interact with the content creator
- Delivering content to any network-connected device
- Developing individualized bundles of media content.

Prepare for integrated media—creating content that can be quickly repurposed and distributed over any media platform or network.

Integrated media provides distribution capability to any device, over any network, to any environment using digitized content. Current delivery formats can be broadcast, downloaded or streamed over any distribution platform to any media-capable device. One notable pairing is the integration of media and retail, such as a home-shopping network or in-store entertainment.

By delving into integrated media, M&E enterprises will enjoy a broader reach, expanded value networks (involving a wider range of business partners), more customer and end consumer touchpoints, a larger pool of potential revenue models, and new skills that complement and enable the other four plays. In sum, they will be able to translate consumers' attention more readily into sales for their business partners.

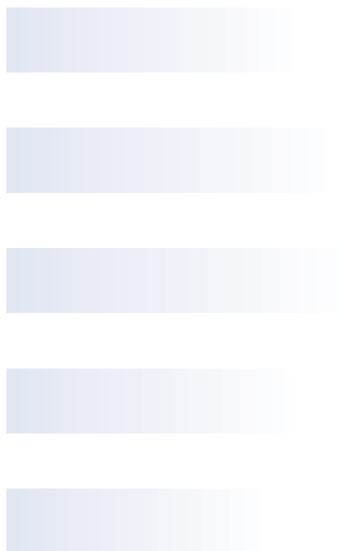
In addition, M&E firms must be aware of the changing competitive environment. Nontraditional competitors are arriving on the scene, seeking control over some value chain activities, especially user interface and distribution functions. Changing a business model is always somewhat disruptive to the status quo, but delaying this inevitable task will mean a greater revenue impact if the enterprise procrastinates, or worse yet, refuses to adapt. Over time, those who cannot increase their value to their customers are likely to be left behind.

Still another determinant of future success is how effectively a media organization competes or joins forces with selected allies to establish industry standards. So, it's likely that those same nontraditional competitors will also serve as collaborators in some instances. The mandate is clear—M&E companies must swiftly create a clear vision, identify and target near-term opportunities, then form and manage alliances.

All five strategic plays drive shareholder value by aggressively addressing material cost layers or by enabling incremental revenue streams. By determining which strategic moves to make within planned time frames, M&E executives can work to optimize shareholder value, to better enable secondary business imperatives and to prepare for future media opportunities.

Checkpoint for media companies: Where do you stand?

Using the following self-examination form, you can do a preliminary assessment of your firm's capabilities to execute any of the five strategic "plays." As you identify strengths, make note of what already works well, then determine what you can start doing now to bolster those capabilities in areas where you are currently lacking.



Score one point for every 'yes' answer in the following table (see Figure 4):

	Beginner	Intermediate	Advanced		
1. Consolidate business unit and corporate overhead	Have you consolidated the HR, finance, IT or PR functions within each division or business unit?	Have you standardized the technologies and business processes for HR, finance, IT and PR across divisions and business units?	Do you have one HR, finance, IT and PR business unit for your entire company?	______ row total	Use your row totals to assess your success in executing each of these **five specific actions:** • Score of one point indicates preliminary progress • Score of two points indicates moderate progress • Score of three points indicates significant progress
2. Integrate operations	Have you switched from an analog to a digital content production and development process?	Have you consolidated the content production and distribution processes for each media platform?	Have you developed any differentiators or efficiencies for developing and distributing content across media platforms?	______ row total	
3. Optimize business customer offerings	Can you readily consolidate revenues from every B2B customer at the corporate level?	Can you readily aggregate the money spent by each B2B customer for each demographic, over each property and over each media platform?	Do your B2B customers influence the production, distribution and content-design processes to better meet your audience needs?	______ row total	
4. Drive direct-to-consumer relationships	Do you have one firm-wide system (including technology and process) to support all customer services?	Do you have the capability to trace all content purchases (including retail) to individual end consumers?	Can you data mine your reserve of end-consumer data to understand emerging trends and develop new products?	______ row total	
5. Prepare for integrated media	Has your firm developed consistent and rich metadata for all of its digital media properties?	Do you have the capability to automatically transcode and distribute digital media files to current mobile and pervasive devices and technologies?	Does your business model have the flexibility to distribute digital content over any of the future media technologies?	______ row total	
		Divide total by 5 to calculate average		______	

Use your point average to assess how advanced you are in implementing a **companywide digital media strategy**:

- Average of one indicates preliminary progress
- Average between one and two indicates moderate progress
- Average between two and three indicates significant progress.

Figure 4. Preliminary assessment for M&E firms: Evaluate progress toward executing a digital media strategy.

Keep the momentum: Ask more questions

Now that you know where to look for possible starting points and you have some ideas for interim steps to keep you in the game, begin to pull it all together. IBM has developed a methodology for full-scale analysis and planning for success in the evolving digital world. Are you prepared to answer these types of questions?

- What is your employee staffing cost per 1000 Full-time Equivalents (FTEs)?
- Does each operating unit provide its own services?
- What is the average production duration for each type of content you produce?
- What percent of your marketing budget is targeted at your most profitable customers?
- What is the growth of your company's wallet share for each of your top five advertising and syndication customers?
- What is the expected revenue growth from direct consumer relationships over the next five years?
- From how many channels can end consumers purchase your content?
- How automated is your process to translate and reformat content to multiple devices?
- What percent of your IT budget is devoted to an advanced technology group and research and development?

It's clear that a detailed, thorough analysis of your current operations is imperative. Developing a customized digital media strategy means laying the foundation for improved shareholder value in the rapidly evolving M&E industry. To explore how our industry consultants can help you create a strategy that better positions you for competing in the digital world, contact us at *bva@us.ibm.com*. To browse additional resources for business executives, we invite you to visit our Web site at:

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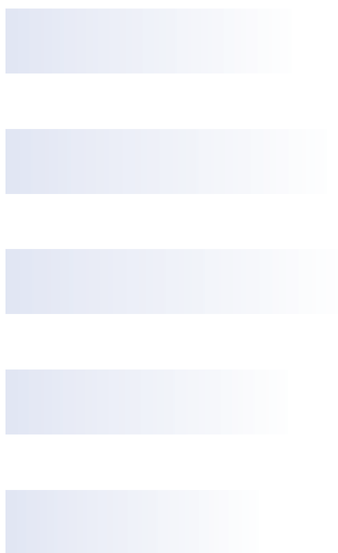

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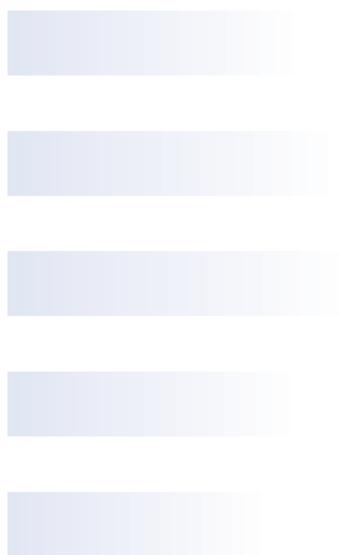

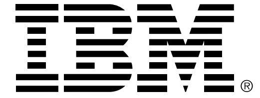

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