Media

A brand new era

Managing in a Downturn, Positioning for an Upturn in the media sector

A PwC perspective

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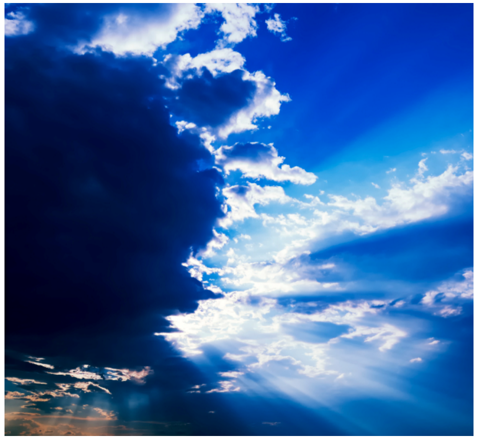
one

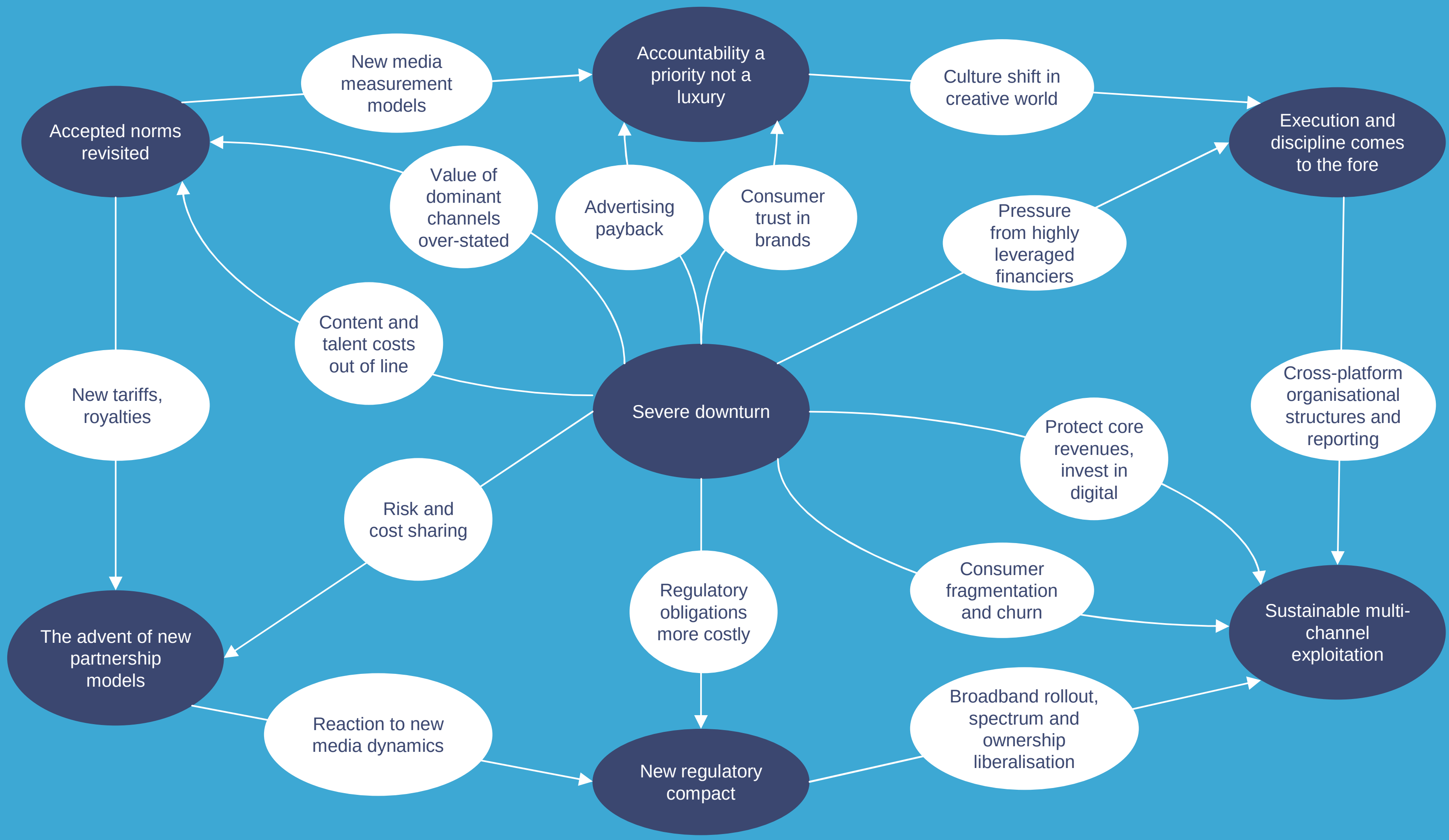
Media is facing both a cyclical downturn and structural transition



Advertising is in a severe cyclical downturn, the worst for decades. Traditional media advertising is in double digit decline, whilst online advertising is offering some glimmer of hope. Consumers are being very careful as to where to spend money, whether on subscriptions, downloads or events. Structural change from analogue to digital distribution and off-line to on-line migration presents significant threats and opportunities. Investment in broadband and digitisation of content are important enablers. Governments and regulators are focusing on where to intervene in a world in which public funding is stretched and companies are in distress. Regulatory burdens – from public service obligations to cross media ownership rules – are biting harder than ever.

A lack of corporate confidence is pervasive. Financiers are nervous, shortening their time horizons, calling in debts and becoming more active in the management of their assets. Pension fund liabilities are a pressing issue. Short-term preservation, through a relentless focus on cash generation, is the order of the day. Speed is of the essence. Medium-term, strategic investments are being scrutinised with more vigour and rigour than ever before. Digital assets that were acquired as an option for future gain move down, if not off, the priority list for all but those with financial clout and scale. For some, the internet has turned into a burden, not a prize.

The downturn requires media companies to focus on six imperatives



two

Short-term survival – weathering the storm

Media companies are responding to the downturn by driving through a series of cost-cutting measures. Production costs are being cut by taking a hard look at commissions, whether TV shows or print titles. Sales and marketing activities that do not demonstrate their return on investment, defined in hard financials, are been cut or restructured.

Many changes are long-overdue – the downturn provides the unavoidable urgency. Non-core, non-cash generating assets are being sold, where possible. The fortunate few look for cheap acquisition opportunities constrained by a difficult debt market. Assets are being sweated harder than ever wherever possible.

Incumbents look to preserve their 'old world' positions. Defining what to keep and where to invest in a world in which returns are ever more difficult to come by involves some hard choices. Some adopt an incremental approach – tactical activities in specific functional areas to reduce cost. Others take a more transformational approach involving organisational re-design.

'It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change.'

Charles Darwin

two

Many players were transforming their business prior to the recession, focusing on tackling issues common to organisations in other sectors:

- IT, finance and HR functions that no longer meet the needs of the business or could be delivered more effectively through some form of outsourcing;
- Long-standing projects that are over-running and generating little demonstrable value;
- Management structures that are inflated and/or include over-lapping roles; and
- Reward packages that do not incentivise the behaviours required to deliver success in a multi-platform environment.

Power often rests in the hands of those who created the power in the old world. Print production and advertising sales are two areas that have been left relatively untouched; the same goes for agreements and partnerships that were put in place a long time before the cyclical downturn and structural transition.

Often legacy assets have been bolted on to existing businesses in the hope of synergies or as a response to a market fad – online is the classic area.

Now is the time to reconsider the organisation afresh and identify which assets would benefit from consolidation in operational management.

The increasing role of private equity, pension trustees and other financiers has brought an increased focus on financial and operating discipline in a world where strategic or creative flair has been more openly recognised and rewarded within the corridors of power. With highly leveraged assets they are looking for an exit or radical improvements in operational performance.

Long-standing arrangements are beginning to come unstuck – some producers and distributors are in distress, threatening the revenues from distribution, and plurality in commissioning.

The downturn means that execution skills come to the fore. It means less talk more action. We see short-term plans focusing on the following key areas in order to generate cash:

- Contract management – enforcing the terms of agreements and renegotiating key terms (royalty and tariff payments), in order to collect cash more aggressively;
- Talent cost reduction – hiring and pay freezes, reduction in spend on L&D;
- Reducing capital expenditure or delaying capital expenditure programmes;
- Renegotiating financing arrangements;
- Seeking regulatory relief for onerous licence obligations or barriers to industry change;
- Cutting costs in finance and IT; and
- Disposals, where possible.

The challenge for senior management is to focus on these areas, whilst positioning for an upturn.

Media companies need to be agile to take advantage of opportunities as they emerge.

Hasty decisions that reduce cost and improve cashflows – firing key talent, squeezing key suppliers too hard or closing distribution assets - but reduce the ability of the organisation to react to an upturn could be disastrous.

Understandably, new media assets command a lot of attention. Often acquired at high prices, with little integration into the core business they may offer little immediate payback – however, they can be vital in generating consumer loyalty and building new business models.

Re-examining areas once considered immutable could offer greater gains in the short-term. Advertising sales models, the terms of content and talent contracts, royalty agreements and the structures and terms of partnerships and alliances spring to mind.

three

Imperatives for the brand new era

The winners from this downturn will have the confidence, agility and quality of decision-making to do what is required to survive, whilst adapting to the new environment in which they operate. The downturn provides the burning platform for change. This means a change in managing brands, characters, titles and talent across distribution platforms supported by new commercial models. Transformational change can be easier to position to internal and external stakeholders at a time of flux. Media companies which emerge from the downturn with a lower cost base and a differentiated business model will redefine the competitive dynamics in those sectors subject to changing consumer behaviour.

three

The themes underpinning the commercial imperatives we outline may be well known for some. Many media companies talk about a vision of putting customers at the heart of their everything they do, managing their IP across all platforms. This vision seems to be a given; differentiating the winners from the losers will be down to the decisions taken along the way, and the execution of the vision.

We set out opposite the transformation journey we believe a CEO or Board member of any media company should consider in order to both survive and thrive in this turbulent world, leveraging best practice we have seen across this sector and other relevant sectors.

Focus on IP profit maximisation across all channels

In most cases, media companies derive the majority of their revenue from a limited number of channels. As the migration to online and digital continues, so the re-balancing of portfolios will continue. This means re-allocating content commissioning, production, sales and distribution assets accordingly. The spoils from exploiting and protecting monopoly assets, from broadcast licences to print franchises, are diminishing; now the challenge is to attract and keep customers in a fragmented, multi-channel world.

Cross platform exploitation of brands, characters, titles, programmes or patents is the order of the day. In practice, this means investing in and managing assets across the portfolio in order to maximise overall profitability.

This involves hard-to-find investment in digitisation of the archive, rights negotiations and search functionality to ensure consumers can find the ‘Long Tail’ easily. It also means driving new content hard for mass market exploitation and protecting rights vigorously.

Change organisational structures, personal incentives and financial reporting to deliver this ambition

Brand managers have been appointed in many media companies; there is much talk about the role of ‘super brands’. That is a start. The next step is to translate statements of “anyplace, anytime, anywhere” models of content delivery into new organisational structures and day-to-day commercial decisions, based on an understanding of the total return on investment per brand.

Delivering this objective requires collecting, analysing and reporting financial information across all channels.

Understanding the interaction of brands across channels, particularly the potential for cannibalisation and synergies, is a priority as is willingness to pay and the factors driving uptake and churn. In practice, these interactions are often assumed or under-analysed even when new decisions are taken on which brands, services or platforms to invest in, close or reposition.

Treat accountability as a priority not a luxury

A cyclical downturn and an industry in structural transition means that ‘accountability’ takes on an enhanced importance. Technological change – through new optimisation models, usage metrics and search – has increased the expectation for accountability across the whole media sector. Data management becomes a new core competency – lessons from retail and financial services markets, further ahead than media, should be heeded.

In practice this means:

- Using technology to its full potential to use consumer data to the full – online video advertising seems to be an as-yet untapped opportunity, facilitated by the growth of IP platforms.
- Communicating the value of display advertising more effectively – demonstrating the value of advertising on brand values and long-term sales performance should be the focus.

- Being clearer about the measures used to incentivise cross-platform behaviours, particularly in commissioning and sales.
- Establishing the limits of accountability for fear of an invasion of privacy – consumer trust is hard to develop and easy to lose as some broadcasters have found. The development of self-regulatory codes of practice are a welcome step forward.
- Rethinking the effectiveness of sales teams – client account management takes on a new meaning in this environment.
- Identifying the value of content in driving other sales and hence the commercial arrangements that should be in place – examples include the impact of radio and TV exposure for content producers (audiovisual, music) on follow-on sales (TV programmes, CDs, downloads, events) and hence the tariffs charged.
- Identifying customer profitability by segment, leveraging research where appropriate.

Revisit fundamentals and accepted norms

In rebalancing the portfolio in response to the cyclical downturn and structural transition it is vital to reassess the fundamental value of IP. Historical legacies in old contracts require re-examination. Comparable deals used to justify pricing arrangements may bear little, if any, relation to the intrinsic value of the asset. Too often, pricing structures reflect the past, lagging the present. New measurement models will come to the fore to support and shape these new structures.

In practice this means:

- Protecting core assets by minimising revenue leakage and identifying new revenue streams.
- Re-examining the relevance of tariffs and royalty rates stated in existing contracts in light of current and future market conditions. Active consideration of how can profitability be increased, for example through renegotiation or more effective price discrimination, should be a priority.
- Assessing how advertising price premia can be supported in the digital era and what can be done to affect them.
- Evaluating how advertising sales models should develop, learning lessons across media, and exploring the role of product placement in new media. This will require more investment in the cross-media measurement required to support new models and platforms.
- Developing and applying new transfer pricing policies. Marginal cost based pricing for new media services may be difficult to justify in a world in which cross-platform exploitation is factored into content commissioning decisions from the outset.
- Re-assessing which activities can be shared with partners or outsourced, especially those with a historical legacy or deemed to be ‘core’ activities.
- Considering how regulatory restrictions – licence obligations (including content restrictions) and ownership rules to name but a few – should change in light of the changing industry dynamics and an adverse economic environment.

Adopt new partnership models

Partnerships and alliances abound in the media sector, in fact far more than other sectors according to our recent CEO survey (http://www.pwc.com/ceosurvey/). Partnership structuring is a high profile activity that often attracts top talent.

In a cash-constrained, risk averse environment it pays to adopt a systematic approach to partnership structuring that avoids the following common problems:

- Regulatory/legal hurdles identified too late, or insufficient attention paid at the early stages of the partnership structuring;
- A deal structure that is difficult to implement and monitor;
- Deal terms that turn out to be unattractive when the full cost of operating the partnership is uncovered; and
- Unintended consequences from partnership decisions that have an impact on other relationships in the sector – a holistic view of the impact of decisions can save a loss of trust and significant cost.

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