

Indicators of Financial and Economic Health of Media Firms

IN ORDER TO evaluate the operations of their firms and to compare performance over time or among firms, managers employ a variety of economic, financial, and corporate activity indicators to measure the health of their media firms.

INDICATORS OF ECONOMIC HEALTH

The economic health of media companies is exemplified by the state of their markets and consumers' desire for the products and services produced by those companies. Changes in these indicators of the health of companies and their industries can be observed to determine elements of their future and the potential need to alter company strategies to respond to those changes.

Market Share Change or Maintenance

By considering a company's share of the market for a particular good or service, one gains an understanding of its position in the market and whether that position is being maintained, improved, or degraded. Changes in market share indicate that competitiveness has been maintained, improved, or lost by firms or that the market structure is being affected by entry or exit or better competitiveness on the part of other firms.

An online portal whose web site receives 15 percent of the hits for portals that organize and provide access to content will work to maintain and expand that market share as evidence of its strength. If its market share declines to 13 or 14 percent, it is losing portions of the market to other competitors who are seen by portal users as better meeting their needs or providing better service or quality.

Market share is measured in terms of circulation for print media, in sales for consumer products such as audio cassettes, CDs, CD-ROMs, videos, DVDs, etc., and by ratings and share for most electronic media. As noted in chapter 5, most of the data regarding such items are provided by or audited by independent organizations that serve all media competitors and advertisers. These data make a good means for monitoring developments regarding market shares.

In the past a media firm was evaluated as healthy if its market share was growing. Today, with the proliferation of media, health tends to be evidenced in maintaining market share or growth within a small niche in which the firm operates.

Changes in Demand

Changes in demand for a product or service can rapidly affect the state of any industry, so it is important for managers to monitor changes in demand.

In many economic studies, price is typically illustrated as the dominant force on demand. Although there is truth to this view, media and other products are affected by a variety of demand factors for individuals including income, time for use of the product or service, requirements for additional purchases (such as software, CDs, DVDs, etc.), and skills required to operate products.

In addition, large-scale demand changes can be caused by the age of the users. In such cases, if the primary users of the product or service are older, they continue its use, but their numbers are reduced by mortality. In other cases, if the primary users are young people and birth rates decline, demand will be accordingly reduced in the future. Other cases of large-scale change include changes in linguistic needs of audiences caused by immigration, economic downturns, and the developments of new and more interesting products and services.

INDICATORS OF FINANCIAL HEALTH

It is important for managers to review the financial health of their firms regularly because financial data provide the key indicators of

whether a firm is becoming or remaining a viable business entity. Basic indicators that need to be reviewed regularly involve sales and cash flow, profitability, the status of working capital, and the condition of the balance sheet.

Indicators provide both short- and long-term indicators of financial health. Operating data, for example, tell what has occurred financially in the company during a given period, and this can be compared to previous periods. But such operating data do not tell about the strength of the firm and its continued viability, so additional information from company balance sheets is necessary to understand more fully its financial status and changes in that status.

Sales Revenue Growth or Decline

This measure is one of several financial growth measures that consider changes in financial performance. Firms whose sales revenues are growing are seen to have better relative health than those whose sales revenues are stable or declining. Sales revenues are indicators of the success that the company's products and services are enjoying in the marketplace and the economic condition of the marketplace itself.

To gauge performance, a firm's revenue and change in revenue are tracked and compared to a similar period in the past. One could compare sales revenue changes from month to month, but this would present a distorted picture because advertising revenue, in particular, is highly seasonal, and because use of certain products and services declines during holiday seasons. The months before Christmas, for example, are when most retailers achieve most of their sales. Consequently, department stores and other shops tend to spend most of their advertising budgets during that period. Similarly, telephone use tends to go down during summer months. As a result, media and communications executives compare revenues or change in revenue to the same period in previous years.

Because revenues are affected by inflation, current revenue amounts can be truly understood only if adjusted to account for the effect of inflation. A radio station that achieves revenue growth of 3 percent during a period of 2 percent inflation has actually

Basic Information You Need to Understand Media Industries and Firms

To comprehend the conditions and pressures on media businesses and media industries, one needs to have certain basic economic and financial information. At the industry level, data can be obtained from national statistics offices and industry associations. At the company level, information can be obtained from company registry information and annual reports.

Information is needed for the last year to obtain a contemporary view, but information is needed for the past five to ten years to obtain a basic view of trends.

Industry-Level Data

- How many companies operate in the field?
- What is the total turnover (revenue) produced in the industry?
- What amount comes from advertising?
- What amount comes from viewers, listeners, and readers?
- What amount comes from other sources?
- How has turnover changed?
- What is the media industry's share of total advertising?
- How has that share of advertising changed?
- What is the industry's share of total consumer expenditures for media?
- How has that share of expenditures changed?
- How many people are employed in the industry?
- How has employment in the industry changed?
- What is the value of imports and exports of products in the industry?
- Who are the main customers of firms in the industry?
- What social or economic changes are altering their purchasing and use choices?

Company-Level Data

- What are the firm's turnover (revenue) and its sources?
- What is the firm's share of the audience market?
- What is the firm's share of the advertising market?
- What is the firm's operating margin?
- What is the firm's net income before depreciation?
- What is the firm's net income before extraordinary items?
- What is the firm's equity ratio?
- What is the firm's relative indebtedness?
- What is the firm's quick ratio?
- What is the turnover per employee?

- What is the value added per employee?
- How much capital investment has been made?
- What are the assets of the firm?
- What is its share price?
- What are the dividends it has paid to investors?
- How have these indicators changed?

achieved a true growth rate of 1 percent. If the inflation rate were 3.5 percent, the station would have a negative growth rate of one-half percent.

Healthy companies evidence regular growth of sales revenues. These growth periods can be interrupted by economic downturns, short-term product failures, and other factors. However, a company that is not able to achieve revenue growth over time tends to stagnate, has insufficient resources for product development and reinvestment, and ultimately declines.

In periods in which revenue growth is not shown, managers need to determine the reasons for the lack of growth and respond with budget reductions, product improvement strategies, additional marketing, and other efforts to improve performance in the marketplace, depending upon the causes of the situation.

Change in Results

Results are indicators of profit and thus of the effectiveness with which firms use resources. These standard measures of performance are accounting-based figures that provide a view of what the company gained or lost due to its operations and other activities during a period of time. These are reported on operating statements.

Debt Growth or Decline

All firms carry debt in one form or another, ranging from invoices that have been received but not yet paid to money borrowed to purchase new facilities and equipment or to acquire other firms.

Managers must make a variety of strategies and choices regarding whether to incur debts and the amount of debt they are willing to carry. There are a variety of reasons for which it may be desir-

able to carry some debt at any given time. Managers, however, must manage and monitor the debt incurred, and this is typically done by tracking both short- and long-term debts.

A healthy firm ensures that the debt load it carries is well within its abilities to repay and that it can manage the debt even if there are downturns in revenues. Weak firms are often found to have used all the credit available to them and scramble to pay debtors merely the interest on debts.

Change in Asset Value

Assets represent those things of value that belong to a company. In healthy companies the value of assets outweighs the value of liabilities, and the value of assets grows over time. Company balance sheets indicate the kinds and values of assets that a firm possesses, and they compare (or balance) them with liabilities to show the financial strength of a firm. In a healthy firm assets exceed liabilities, and in weak firms assets are equal to or less than the liabilities.

If assets are not regularly increasing in value, managers need to consider the reasons and determine whether and what action is warranted. Asset values decline for a number of reasons, and these need to be understood so that one can interpret the changes in asset value reflected on a balance sheet.

First, fixed assets, such as equipment, lose value over time because their use creates wear and reduces the length of time they can be used. This loss is accounted for through depreciation of assets in company financial records. Reductions in the value of assets because of their use can be reversed only through the purchase of new assets that provide additional value. For example, a transmitter and related equipment lose some of their value over time because of the wear and tear of regular use. If a television station purchases equipment to upgrade or improve the transmission system, the capital expenditure adds value to the system in the financial statements.

The second reason that asset values decline is the effect of inflation in reducing the value of assets. If the assets were purchased and valued when currency was worth more, inflation produces a decline in that value.

Third, the value of assets will normally decline if a firm divests by selling existing properties and does not, or is unable to, use the proceeds to purchase replacement assets or to be held as cash.

A healthy company overcomes the natural decline in assets that takes place because of depreciation, changes in the general economy, and divestment. This is done through regular reinvestment through capital expenditures, acquisitions, and appreciation of assets. Because cash for the reinvestment is typically produced by profits, managers need to produce regular profits for reinvestment and to build cash reserves for large reinvestments.

The issue of assets in modern media and communications firms is particularly complicated because much of the value is in brands, copyrights, and the personnel that firms employ. Although methods have been created to assign a financial value to intangibles such as brand names and copyrighted material, the value of knowledgeable and creative employees as a collective is unmeasurable.

Reinvestment

Reinvestment is the return of profits to a firm to further develop the company and its activities. If profits are continually taken from a firm without reinvesting an adequate portion in the company, it is denied resources needed to help it improve its operations, grow, and remain competitive.

The largest portions of reinvestment come in the form of capital expenditures. These involve reinvestment to improve or acquire capital assets such as buildings and equipment or other firms. Although a certain amount of capital expenditures occur each year, the amount required by any firm varies from year to year depending upon the age and conditions of the company's most important machinery and buildings, the necessity of immediate investments in newly available technologies, and the annual financial performance of the company. Fluctuations in capital investments are illustrated by the Tribune Co., one of the largest broadcasting, publishing, and new media firms in the United States (fig. 12.1).

Changes in expenditures can also be viewed at the industry level. These fluctuations in capital investment are illustrated by the U.S. newspaper industry (fig. 12.2).

Figure 12.1. Capital Expenditures of the Tribune Co. (U.S.\$ Thousands)

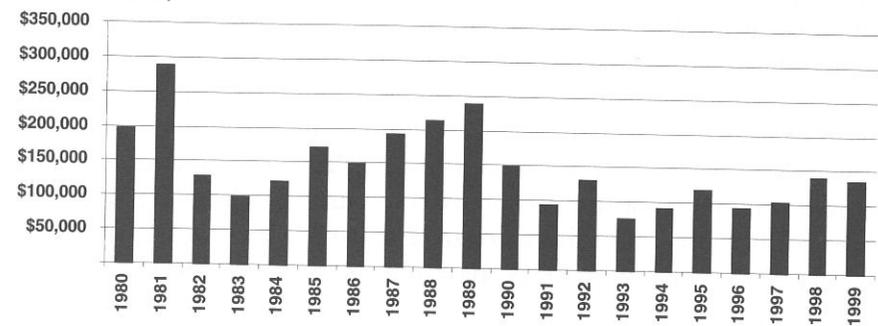
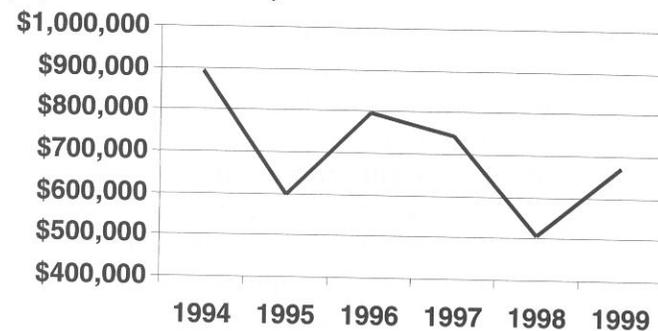


Figure 12.2. Capital Expenditures in the U.S. Newspaper Industry (U.S.\$ Thousands)



INDICATORS OF COMPANY INTERNAL HEALTH

Indicators of company internal health focus on factors that managers can control through strategic and operational choices. Important indicators include productivity, capacity utilization, employee turnover, personnel skills and knowledge, and innovation and product development.

Productivity

Productivity involves the effectiveness with which firms use resources in their operations. Measures of productivity are made by the amount of output created by use of inputs such as labor and capital. A higher measure of productivity indicates that a company is using resources more effectively in creating products or services.

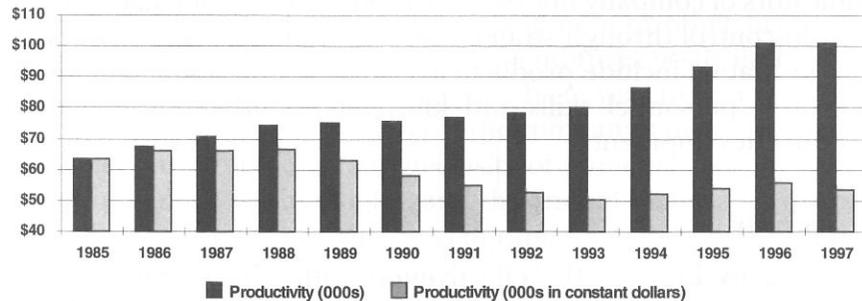
In media companies with well-established operations, the primary measure of productivity involves productivity of labor. There are several methods of measuring this productivity. The simplest is calculating productivity as turnover per employee. Using this method, total turnover is divided by the number of full-time equivalent employees. This method provides a measure of the amount of revenue (turnover) produced by the labor of the average employee. An increase in productivity is shown when the amount rises, a decrease when the amount declines.

A recent study of the U.S. newspaper industry used this measurement to reveal that although productivity appeared to have increased strongly since the early 1980s, it actually declined since the mid-1980s, and that increases in the mid-1990s were moderate (fig. 12.3).

Although this type of analysis is useful for industry, it lacks the precision of measuring productivity using value added per employee. The value-added measure is obtained by subtracting the costs of production from total revenue and then dividing by the number of employees. Managers can use this better measurement because this internal information is available within companies.

This type of data is useful in strategic planning. It can be employed to review performance of a single firm or department over time, or to compare the performance of one firm with other firms

Figure 12.3. Newspaper Industry Productivity (U.S.\$ Thousands, Turnover per Employee)



Source: Robert G. Picard. "Newspaper Industry Productivity Rises," in *Media Economics Research Monograph*, Department of Communications, California State University, Fullerton, June 1996.

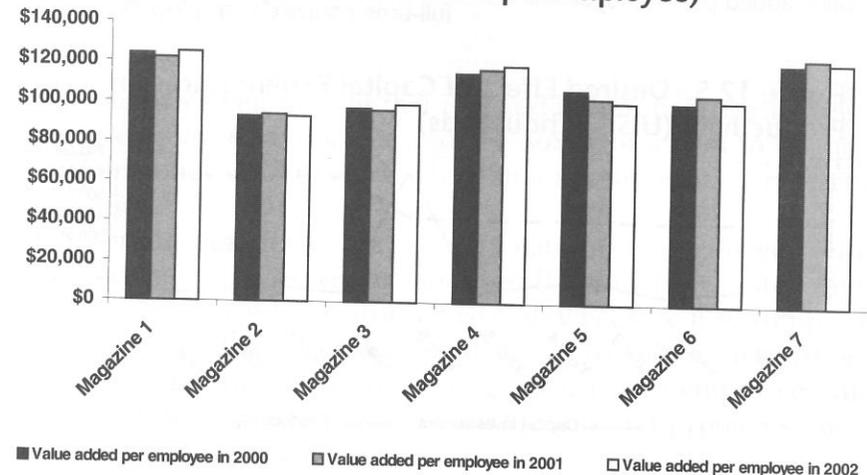
to determine which is more effective. A manager of a magazine company with multiple titles, for example, could regularly compare productivity among the titles to determine which are most effective. Using this information, efforts could be made to improve the productivity of poorer-performing titles or to determine whether they should be candidates for divestiture.

A magazine firm with seven titles might produce productivity results, as illustrated in figure 12.4. A manager reviewing the chart can immediately see that magazines 1, 4, and 7 achieve the highest productivity, that magazine 4 has achieved increases in productivity during the past three years, and that productivity has declined in magazine 5.

Productivity analyses can be combined with profitability analysis to gain a very powerful tool for engineering productivity and profitability. Productivity measurements can also be applied to individual employees but requires careful use in communications industries because mere output is not an appropriate measure of content production.

Investments in labor-saving equipment or equipment that increases production are often used by firms to increase productivity. These investments will increase productivity, however, only if the labor savings are higher than the investment and operating

Figure 12.4. Sample Productivity Display for a Magazine Company's Titles (in Valued Added per Employee)



costs for the new equipment, or if the equipment increases product output and produces additional income that exceeds the investment and operating costs.

The desired effect of investments is illustrated in figure 12.5. Managers of a firm that normally makes small regular capital expenditures may make a large investment in equipment to produce a sustainable increase in productivity.

Managers can also employ measures of capital productivity if they wish to compare the returns on investment in multiple products produced by their firm. This technique is useful for managers of media and communications companies. A cable television firm,

Measuring Productivity of Personnel

Productivity of personnel measures the output created by the use of employees. The measurement is meaningful for comparisons over time and between firms and industries.

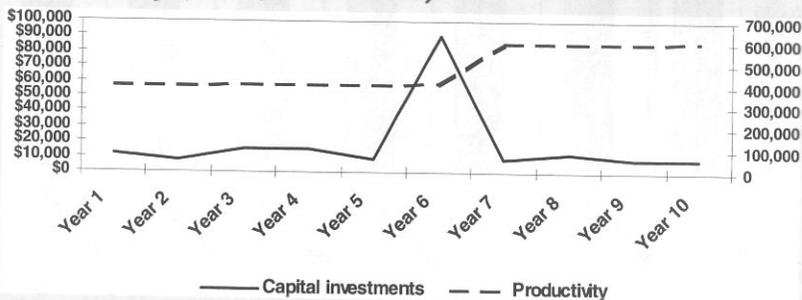
The easiest measurement is revenue resulting from labor in the firm:

$$\frac{\text{total operating revenue}}{\text{full-time equivalent employees}}$$

A better measurement of productivity is the value added to goods or services through the labor of employees. It is more precise because it adjusts for that portion of the revenue related to the value of the materials used in preparing the good or service:

$$\text{value added per employee} = \frac{[\text{total operating revenue} - \text{cost of materials}]}{\text{full-time equivalent employees}}$$

Figure 12.5. Desired Effect of Capital Expenditures on Productivity (U.S.\$, Thousands)



for example, might compare the returns on investment of various networks that it owns and operates. A radio station holding company might compare the effectiveness of the use of its capital in different stations, and an online media firm could use the measure to compare the effectiveness of its investments in different portals or other online services.

To make these kinds of capital productivity measurements, managers calculate return on investment in each firm and then make comparisons.

Capacity Utilization

When firms are involved in production of goods, more effective use of the manufacturing equipment that is required to produce them creates cost advantages to a firm that are indicative of higher health.

This is illustrated by magazine publishing companies that own printing facilities in which they produce their own publications and contract printing services to other publishers. If one company uses 60 percent of its production capacity and the other uses 85 percent of its capacity, the latter firm is spreading its fixed costs of the equipment and facilities better across its range of production.

Similar types of capacity utilization come into play in the manufacturing of recordings and videos, motion picture prints, advertising materials, and other physical communication products.

Employee Turnover

The number of employees that join and leave a firm are an indicator of employee satisfaction and the ability of a firm to maintain the personnel and knowledge base that are necessary for effective operation.

A certain amount of turnover is natural as employees retire, change plans, and move with spouses. If the turnover rate is high, however, the firm loses productive ability because it must operate with persons unfamiliar with the firm and its culture, it must bear significant recruitment and training costs, and its employees must cope with natural psychological disruptions and problems caused by integrating new employees.

Turnover rates for employees can be measured and compared over time and within and across companies. The basic turnover index is calculated as follows:

$$TTR = [S/N] \times 100,$$

where *TTR* is the total turnover rate

S is the number of employees separated in the time period and

N is the average number of employees in the unit in the time period.

The total turnover rate index does not provide an indication of why turnover occurred. This can be accounted for by using the same basic formula but substituting any of the following measures

or other measures for *S*:

F—number of employees who were fired in the time period

Q—number of employees who quit in the time period

R—number of employees who retired in the time period

D—number of employees who died in the time period.

Personnel Skills and Knowledge

The ability of personnel to carry out tasks is a critical factor in the success of companies, especially companies in rapidly changing industries. Because media firms exist in a knowledge production and technology environment, those firms whose employees have better skills in using digital and mechanical technologies and better ability to create and convey knowledge and entertainment gain competitive advantages.

Because of changing demands on media and communications firms, retraining and development of employees becomes a managerial choice. By monitoring the skills and knowledge of different types of employees, managers can assess the overall level of their employees and develop internal training programs or send employees to external training programs that increase their ability to contribute to the firm by making them more effective or preparing them for coming changes in the industry, the firm, and their markets.

Innovation (R&D, New Products/Services)

The degree to which a company pursues innovation affects its health by making it either a market leader or a market follower. Companies that invest in research and in developing new products and services are looking toward the future health of the company by ensuring that its products and approaches are contemporary, position the company for future growth, and provide mechanisms for that growth. Innovation is important because it increases demand and profitability and helps the firm develop further.

If companies become wedded to current operations, always doing things as they have in the past and producing the same products or services, they place themselves at risk through steady decline. This is especially true when innovations are introduced by firms outside the industry or by newcomers to the industry whose operations are not constrained by tradition and existing products. These types of innovators ultimately force other firms in an industry to change the way they operate or to face demise.

In order to protect against these possibilities and to ensure their position for the future, firms can choose to pursue internal innovation by rethinking and improving their products and services, developing new ones, and changing their ways of operating. In media firms content development, development of new operations, and finding new ways to benefit from content are key to innovation.

Most media firms do not have separate research and development departments as in many manufacturing and other types of firms, but the best firms engage in innovation by constantly researching their markets and customers, and strengthening their existing publications, broadcasts, and materials. They also test and launch new publications and programs and seek new uses for existing materials.

Resource Dependence

Organizations depend upon their environment for resources because they cannot generate all the resources and functions they need to operate. Resources include such factors as capital, supplies, labor, and revenue.

An organization's structure and behavior are to a significant extent dictated by the amount and locations of resources needed and those activities that are required to acquire the resources. In order to survive, organizations must be able to efficiently obtain external resources so they enter into transactions and relationships with other organizations to acquire them.

The degrees of dependence and interdependence on specific resources and on external organizations are also an indicator of the health of a firm. The performance of newspaper companies, for example, is dependent upon advertising income and newsprint availability and price. Television channels are also dependent upon advertising income but are highly affected by the prices for purchased programming.

A major problem of firms is uncertainty about future developments in the market and changes that may occur in the environment. This uncertainty is important, because when the environment changes, the ability to acquire resources may also change and harm a company. Because change is constant, organizations must be able to adapt to changes to solve the problems, or they cannot survive.

Most companies have some form of interdependence with other organizations and providers of resources that is promoted by scarcity of resources and specialization of firms. Coordinating activities between organizations and combining organizations can alter the degree of interdependence. Coordinating activities include market segmentation, joint ventures, interlocking directorships, and the exchange of information for mutual benefit. All of these are done to stabilize markets. When interdependence is high, organizations may seek to combine through mergers, vertical integration, and diversification.

When dependency on a particular resource is high, there is a greater likelihood of coordination. Thus, when capital is a critical resource, a firm will tend to have bankers, venture capitalists, or brokers on its board or as close advisors. If advertising is a critical resource, the firm's organization is likely to have representatives of major advertisers on a board or providing regular advice.

Organizations operating in a single product or geographic market are most vulnerable to change because they are often highly dependent upon resources in that market. Media companies that

operate in more than one market are less vulnerable to change because their risk is spread and they are less dependent upon developments in any one market for survival.

Dependency on resources takes several forms. Capital dependence develops when a company becomes dependent upon one capital source, one banking firm, etc. Revenue dependency occurs when large portions of revenue come from a single or only a few sources. Interfirm dependency develops when a single supplier provides other critical resources. This occurs, for example, when a television program producer becomes dependent upon one channel or network for sales or a newspaper becomes dependent upon one supplier for newsprint.

BENCHMARKING

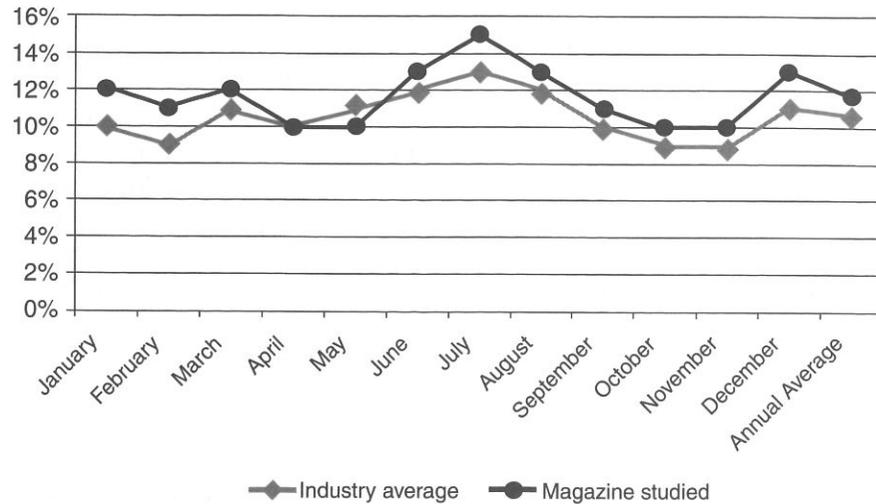
Benchmarking is a managerial tool used to compare the performance of a firm against a specified level of performance or the performance of competitors. The purpose of benchmarking is to provide managers a standard against which to gauge their performance in terms of any number of operational or financial variables, including those discussed earlier in this chapter.

Benchmarking can be undertaken when a trusted entity such as an industry association or research organization is asked to measure industry-wide criteria of success by identifying processes and factors critical to the success of firms in the industry. The organization then collects data on the performance of companies in the industry, permitting managers to compare their firm's performance against the average and best practices so that they can identify areas in which to seek improvement.

A magazine publisher, for example, might compare its percentage of unsold single copies against the average percentage of unsold single copies in the industry. By using the benchmark of the industry average, the publisher might find it was below the average, at the average range, or above the average.

Figure 12.6 illustrates this situation. It shows that during the last year a magazine consistently has more unsold single copies than the industry average. With a 12 percent annual average of unsold copies—compared to the industry average of 11 percent—the pub-

Figure 12.6. Example of a Magazine's Unsold Single Copies Compared to the Benchmark Industry Average



lisher has 9 percent more unsold copies than other publishers. This difference warrants consideration of the factors that may play a role to determine if changing the number of copies printed and distributed or changes in marketing may be warranted.

Benchmarking can also be used to compare performance to a set standard. A cable television system, for example, may have been experiencing problems with the reliability of service, implemented a program to improve service, and set a standard that there should be no more than 1 percent of customers making service calls annually. A manager can then view progress toward meeting that benchmark to determine whether the efforts are effective, as illustrated in figure 12.7.

This type of analysis becomes even more powerful if one is able to do financial benchmarking to compare items on a company's operating statement or balance sheet. One might, for example, compare costs of borrowed capital for a radio station against the industry average. In the case shown in table 12.1, the station's costs are lower, and increasingly lower than other stations in the industry, a sign that it is carrying lower debt or obtaining capital at better rates than the average station.

Benchmarking is useful for gauging the performance of one's

Figure 12.7. Performance of a Cable Company against the Stipulated Benchmark of Service Calls

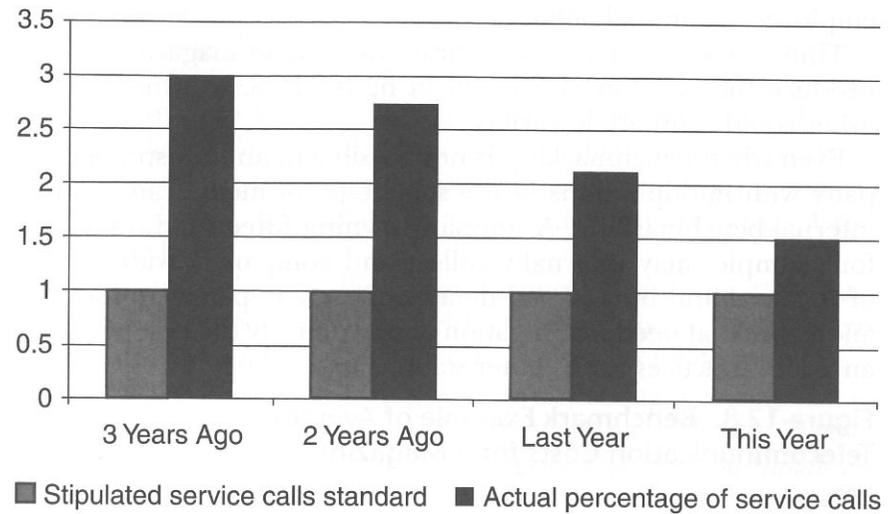


TABLE 12.1
BENCHMARKING OF CONTRIBUTION OF BORROWED CAPITAL TO OVERALL COSTS

	1998	1999	2000	2001	2002
Station Studied	1.8%	2.0%	0.7%	0.3%	0.4%
Industry Average	3.3	7.4	3.8	3.5	2.0
Difference in Station Studied	45.5% lower	73% lower	81.6% lower	91.4% lower	80% lower

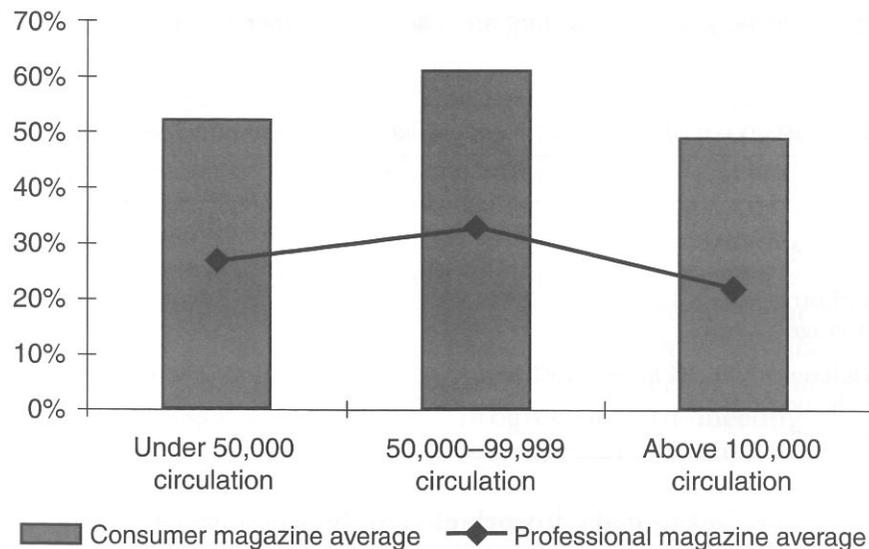
company, but to make it work effectively benchmarking requires managers to be willing to contribute their own data to benchmarking studies that are typically undertaken by industry associations or by researchers selected by those associations. The benchmarks improve as more companies take part in the studies and it becomes possible to break out data for different types and sizes of companies. For example, a study of newspapers might break data out by circulation categories, a study of television stations might break data out by network-affiliated and independent stations and by

population in the markets in which they operate, and a study of advertising agencies might break out the data by the number of employees or annual billings.

Thus, a study of telecommunications costs in magazines might produce the benchmarks shown in figure 12.8, to which a publisher could compare its own costs.

Even when benchmarking is not possible in an industry, a company with multiple units of the same type of media can conduct internal benchmarking. A company owning fifteen radio stations, for example, may internally collect and compare a wide variety of financial and operational data on those companies to look for anomalies that need investigation and to identify the best performance and practices for its other stations to emulate.

Figure 12.8. Benchmark Example of Average Telecommunication Costs for a Magazine



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