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The media company of the future: The revolution goes on

1.1 Introduction

This white paper tackles two fundamental questions:

- How can traditional media organizations transform their business models to meet the challenges posed by technology disruption and massive structural change?
- What new skills and organizational structures will the transition demand and how can legacy assets be used and adapted?

The paper is published at a pertinent time: Paid content and marketing budgets are recovering after the ravages of the recession, the digital technology revolution continues unabated and media companies are asking themselves how they can take advantage of this environment.

For the purpose of this document, "media companies" / "media organizations" are defined as traditional print publishers of newspapers, consumer magazines and business-to-business magazines. The term “user” refers to both readers in print and online users depending on context.

1.2 Executive summary

- Digital technology has fundamentally and permanently transformed the environment in which traditional media companies operate. In the new world, user and marketer needs are becoming ever more sophisticated and competition is intensifying
- The huge structural disruption demands a wholesale re-invention of how traditional media companies do business: New business models, new skills, new structures and, fundamentally, a change in culture are required
- An honest and rigorous appraisal of the relevance of traditional media company assets in the digital world is required: What content has value, which brands are sustainable, which audience segments can be monetized?
- Media organizations must constantly experiment with new offerings and business models as they seek to keep pace with changing user and marketer needs, remain relevant and generate new revenue streams
- New skills are required to execute new business models. The media company of the future will exhibit three core skills:
  - An ability to gain a level of insight into user and marketer needs never seen before, coupled with execution against those needs
  - Endemic organizational comfort with technology and the ability to harness its potential
  - Management of rising complexity within both the organization and markets
- The corporate center will be a catalyst for initiatives that create a new way of working and support the execution of new skills and business models at brand level:
  - Corporate technology and product development functions will focus on incubating new ideas and spreading best practice throughout the organization
  - Management will adopt a human capital strategy that breeds a more sophisticated workforce
  - A clear and centralized acquisition strategy will be used to plug specific capability gaps and to support the overall organic growth strategy
- A cultural shift towards collaboration lies at the heart of this new way of doing business. Management is challenged to create a culture where employees work across silos, exchange ideas and share a common spirit of innovation and technical literacy

1.3 The media company of the past: Some brief history

Until the mid-1990s, the role of the media company was to produce and physically distribute content targeted at a particular audience. Revenue and profit were driven by the creation and aggregation of proprietary content, its distribution and ultimately monetization through a combination of copy, subscription and advertising sales. The number of participants in any given market was limited because total spending on copies, subscriptions and advertising could not cover the physical printing and distribution costs of multiple publishers. As a result, physical distribution meant that a variety of content was bundled in single publications, advertising was relatively untargeted but valuable to the publisher, and power was concentrated among the small number of publishers who controlled this "closed" distribution model.

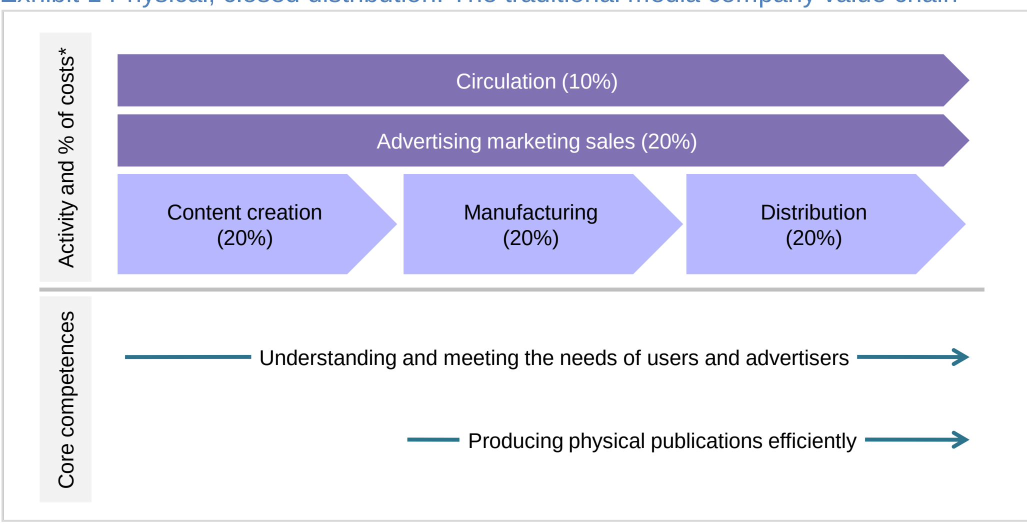
The skills, costs and organizational make-up of traditional media companies reflected the significance of physical distribution to their business models. Resources were concentrated in creating content that was aggregated, printed, packaged and distributed to readers at fixed time intervals. As Exhibit 1 shows, the core skills of a traditional media company were understanding and meeting the needs of readers and advertisers and efficient physical manufacturing and distribution.

Physical distribution was the foundation of the old print world

User expectations have changed and traditional business models are weakened

Digital technology has created massive structural disruption in print

Exhibit 1 Physical, closed distribution: The traditional media company value chain



* % do not equal 100 because other costs (IT, admin, other) are not shown (Source: AMR)

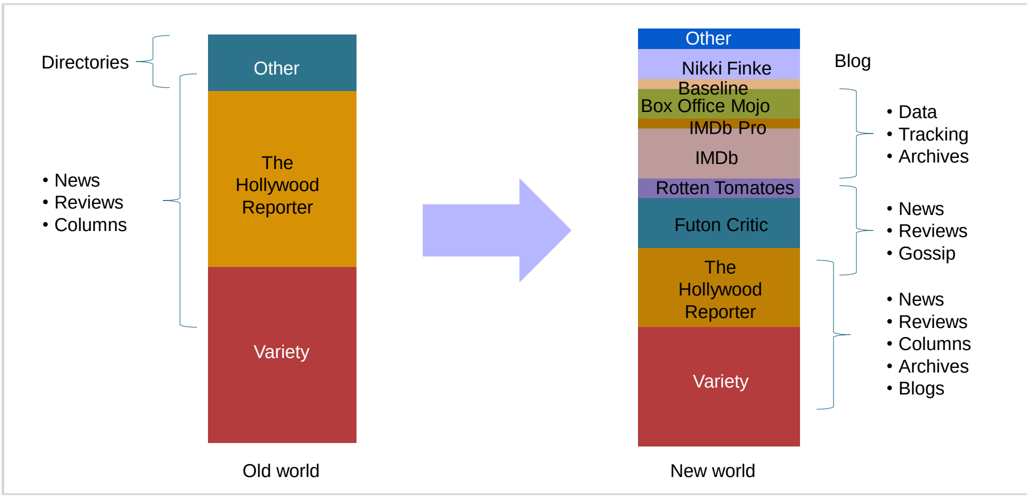
1.4 The digital revolution: Farewell to a golden era

Digital technology has disrupted the old world of physical distribution and forced an unbundling of content, audiences and advertising on traditional media companies. Unbundling is profound, ongoing and driven by the creation of digital alternatives to physical distribution. Whereas the old world favoured strong incumbents with distribution infrastructure and exclusive access to a particular audience, the new world permits any number of participants to publish content online for any audience. Fundamentally, digital technology has shifted distribution from a closed to an open model and content from linear to dynamic. Today, content is not constrained by time or format; it is interactive and updated around the clock.

Unbundling has cut through the business models of traditional media companies. Consumers and business people now have access to a broader, deeper and more targeted array of content. This proliferation of choices has driven a step change in user expectations; as a result, the value of traditional content has often been eroded or commoditized.
In many cases, much of it is available for free or is replaced by peer-to-peer dialogue. Unbundling also means marketers can reach better defined audiences in a host of new ways and are moving closer to precision one-to-one marketing.

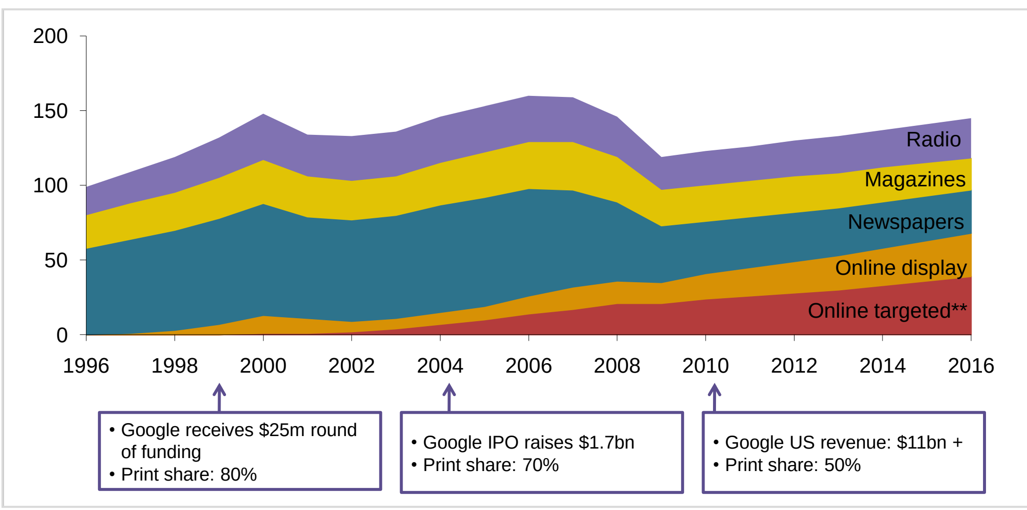
Exhibit 2 shows how unbundling has caused traditional, relatively un-focused trade publications in the film and TV market to lose share of user eyeballs to new, more focused players. Today, the film and TV information market is no longer a duopoly between Variety and The Hollywood Reporter. Exhibit 3 shows how marketers have switched spending from traditional broad-brush display advertising in newspapers and magazines to, first, internet display and, then, to ultra-targeted search advertising.

Exhibit 2 From closed to open: The impact of digital distribution on share of user time spent with film and TV industry sources (100% stack)*



* Based on analysis of circulation data and website traffic (Source: AMR)

Exhibit 3 A sharper, more precise tool: Historical development of $100 of US advertising (1995 = 100)*



* TV and out-of-home have gained share since 1999 and are not included;
** Search, lead generation, internet yellow pages (Source: MAGNA, AMR)

The changes heralded by digital technology will continue to shape the destiny of media companies. Although the shape of future innovation and technology cannot be predicted, there are new realities that media companies must confront (see Exhibit 4). In short, the new world has improved the efficiency with which users are matched to content, and buyers and marketers can connect; in doing so it has undermined the model of the traditional media company.

Exhibit 4 A new, more efficient, reality: Comparison of old and new media worlds

	Old world	New world
Distribution	Physical, fixed intervals, limited number of channels	Digital, around the clock, proliferating number of channels
Content	Mixed, bundled, limited choice	Focused, unbundled, proliferating choices
Audience	Consolidated	Fragmented
Advertising	Blunt, inefficient	Targeted, efficient
Brand power	Dominant print brands	Individuals increasingly powerful, commoditization of content

Media companies now operate in an environment of constant change

(Source: AMR)

1.5 Media company evolution: A work in progress

Open distribution and unbundling are forcing traditional media companies to re-invent themselves with enhanced or new business models, acquire new skills and develop new organizational paradigms. Two questions lie at the core of the re-evaluation:

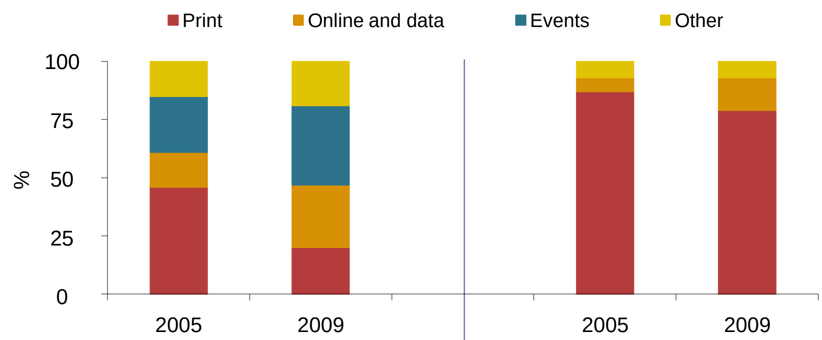
- First, do we have, or can we generate, content that is differentiated or valuable enough that users are willing to pay for it?
- Second, do we provide superior access to an audience, or segment of that audience, in a medium that marketers value?

The re-evaluation means that media companies are experimenting with, and introducing, new business models. Exhibit 5 shows how a business-to-business publisher decreased its share of print revenue from almost 50% to less than 25% between 2005 and 2009 while online, data and events grew to more than 60%. The shift at an example newspaper publisher has been less dramatic: Print's share declined from 87% to 79% between 2005 and 2009. Unsurprisingly, the business-to-business publisher's revenue growth and share price have outperformed the newspaper publisher over the period.

Media companies have begun to re-invent themselves

New revenue streams are being introduced

Exhibit 5 Finding new ways to serve customers: Media company revenue mix development – example companies*



Publisher type	B2B	Newspaper
CAGR 05 – 08	8	- 3
Growth % 08 – 09	- 5	- 17

Businesses are becoming more complex

*Includes acquisitions (Source: Annual Reports, AMR)

The proliferation of revenue streams means organizations are becoming more complex and core skills are evolving (see Exhibit 6):

- Unbundling and changing user expectations are forcing media companies to get ever closer to their users and marketers
- Physical manufacturing and distribution is becoming less critical, is a drag on margins and can often be outsourced
- Technology is playing an increasingly important role:
  - Sales and audience marketing teams must be equally well-versed in print, digital and other non-traditional products
  - Editors and content producers must be equally comfortable with print and social media
  - IT departments must be able to support products at the cutting edge of user needs

Exhibit 6 The revolution in action: Evolution of media company core competence delivery

	Old world	New world
Understand and meet the needs of users and advertisers	• Understand a particular audience and advertisers trying to reach it • Research and write quality and differentiated editorial for publication at fixed intervals	• Understand sub-audiences and marketers trying to reach them • Update content around the clock; ambidexterity in print and digital media
Produce physical publications efficiently	Manufacture and distribute print publications	Understand and harness the ability to technology to meet user and marketer needs

(Source: AMR)

Cost structures have not been fundamentally re-evaluated

Media company cost structures have not evolved as rapidly as core skills. Cost cutting has protected margins, but few organizations have transformed the make-up and distribution of costs. In too many cases the emphasis has been on defending the print castle rather than fundamentally re-evaluating where investment is made. As Exhibit 7 shows, production costs as a percentage of revenue have only declined slightly since 2005 across newspaper, consumer and business-to-business publishing. Furthermore, digitization has often led to an explosion of content and publishers must challenge how much of the new volume is valued or monetizable and what implications it has for margins.

Exhibit 7 A delayed revolution: Indicative media company cost base development – example companies

	Publisher type	B2B	Newspaper	Consumer
% change	Revenue	12	- 25	17
	Costs	9	- 25	19

(Source: Annual Reports, AMR)

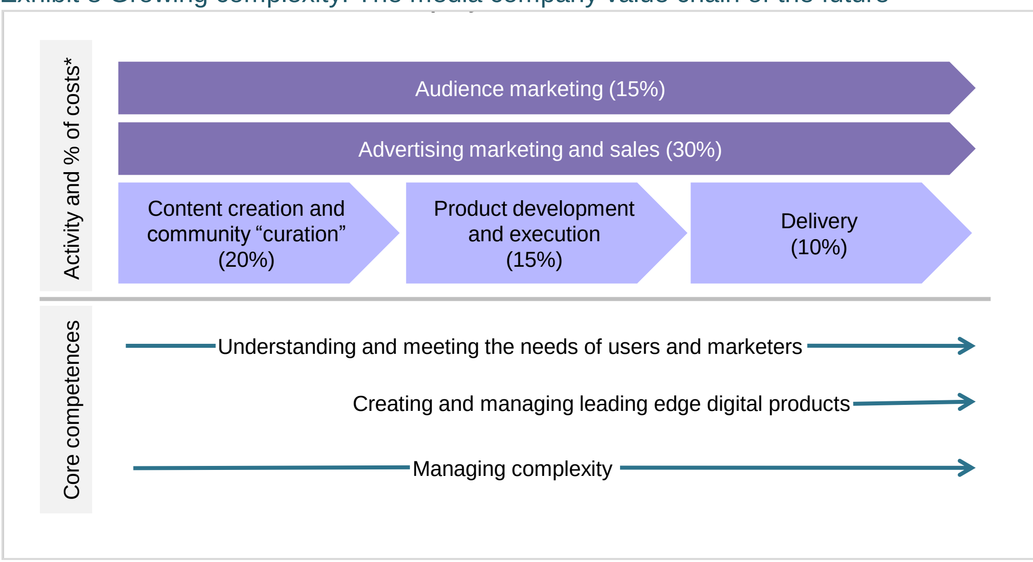
The forces of change have yet to run their course and will likely herald a state of perpetual change. Media companies must ask themselves if they can change fast enough and far enough to meet the changing expectations of their traditional users and marketers. Otherwise, Google heralds the new breed of competitors that will happily eat their breakfast, lunch and dinner.

1.6 The core competences of the future: Deeper customer insight, endemic technology skills, managing complexity

To keep pace with the digital revolution, media company must change what they do and change their core skills. Developing, executing and delivering leading digital products will replace manufacturing and distributing physical publications as key activities; editors will no longer simply create content, they will curate user-generated content and manage communities. In the future, a well-equipped organization is likely to have the following core competences (see Exhibit 8):

1. The ability to gain ever deeper insight into user and marketers needs and to meet those needs
2. Creation and management of leading edge digital products and services based on endemic comfort with technology throughout the organization and the capability to harness its potential
3. The ability and flexibility to manage the increasing complexity created by 1 and 2

Exhibit 8 Growing complexity: The media company value chain of the future



Keeping pace with change is vital

The skills required to drive success are changing

Deeper customer insight than ever before is required

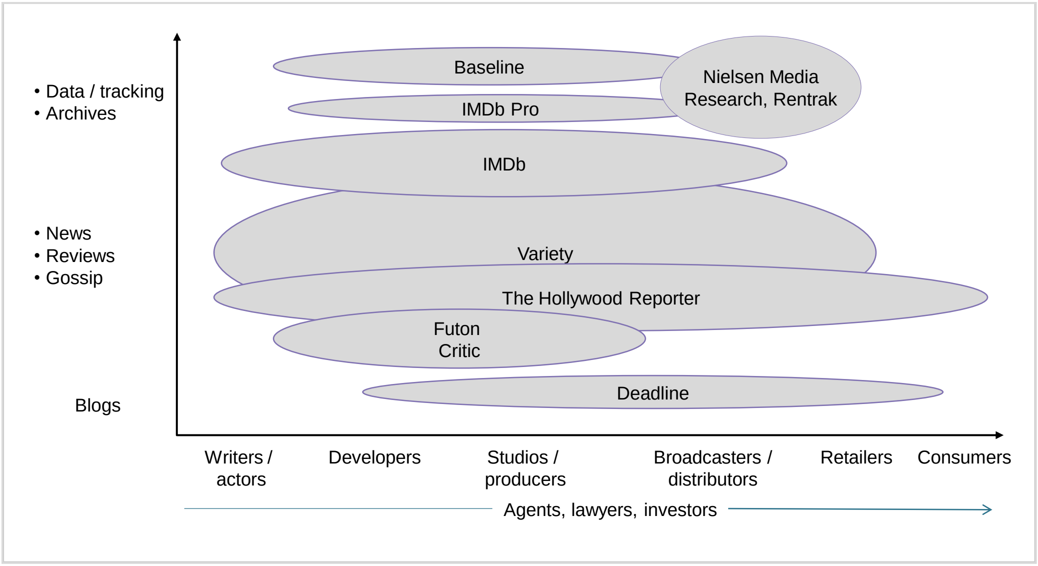
* % do not equal 100 because other costs (IT, admin, other) are not shown (Source: AMR)

Deeper customer insight is prerequisite of the new world:

- It is now economical for media owners to serve the specific needs of smaller and more clearly defined audiences than was possible in the physical era
- Competition is intensifying as new channels emerge; this offers users yet more choices. Understanding user and marketer needs in ever greater depth is the only way to stay ahead of the pack
- Technology allows media companies to gain insight into customers through the collection of data and the monitoring of behavior. For example, business-to-business publishers have had particular success gathering data on members of registration-only communities

The example of the film and TV industry illustrates the need to move closer to audience segments (Exhibit 9). In the past, the readership of Variety or The Hollywood Reporter could be treated as a reasonably homogenous group, but today niche competition means the needs of, for example, writers and producers must be considered separately.

Exhibit 9: The unbundling of content and splintering of audiences: The requirement to gain deeper insight into users in the film and TV industry



(Source: AMR)

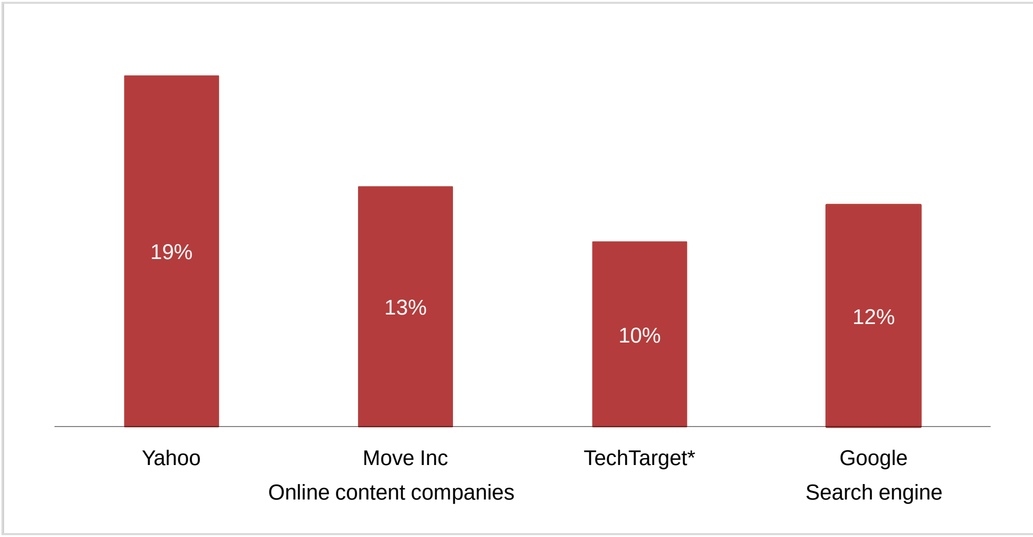
Understanding the needs of users and marketers is the starting point for offering a broader range of products and services, and operating a range of business models. The focus will not be on any particular platform or channel, but on building the capability to communicate with users wherever they may be found. Business models may be either user-paid or marketing budget-funded, but technology will be at the heart of almost all of them. Each media organization will find that some models will be non-starters for its customers, others will gain moderate traction, while one or two may be winners. Some will be achieved organically, some by partnership and others by acquisition.

Whatever the mix of business models, channels or platforms and growth strategies, media companies will become more complex. Strong and sophisticated business development and product development functions are necessary to manage this complexity. The center will determine strategy and may act as an incubator for new products, but much of the execution will happen at brand level. As Exhibit 10 shows, all-digital businesses spend up to 20% of revenue on product development. Although product development will at first be driven from the center, it will not reach its potential unless there is a culture of innovation, risk sharing and idea sharing throughout the organization.

The range of business models is expanding

Co-ordinated product development is becoming necessary

Exhibit 10 The importance of product development in the digital world: Product development / research spending as a % of revenue – example digital businesses



* 85% digital revenue

(Source: Annual Reports, AMR)

Exploiting technology is integral to relevance in the new world

1.7 Making the transition: Harnessing the power of technology

To remain competitive in the era of open distribution, media companies must place technology at their center: New products must constantly be developed and new versions of existing products launched. Focusing on technology does not mean media companies will become hardware or software companies; instead they will focus on using technology to meet the needs of both users and marketers. For example, a leading media company must have the capability to launch, manage and update a cutting edge mobile app or virtual event.

There are four fundamental ways in which technology can help media organizations drive revenue and profit:

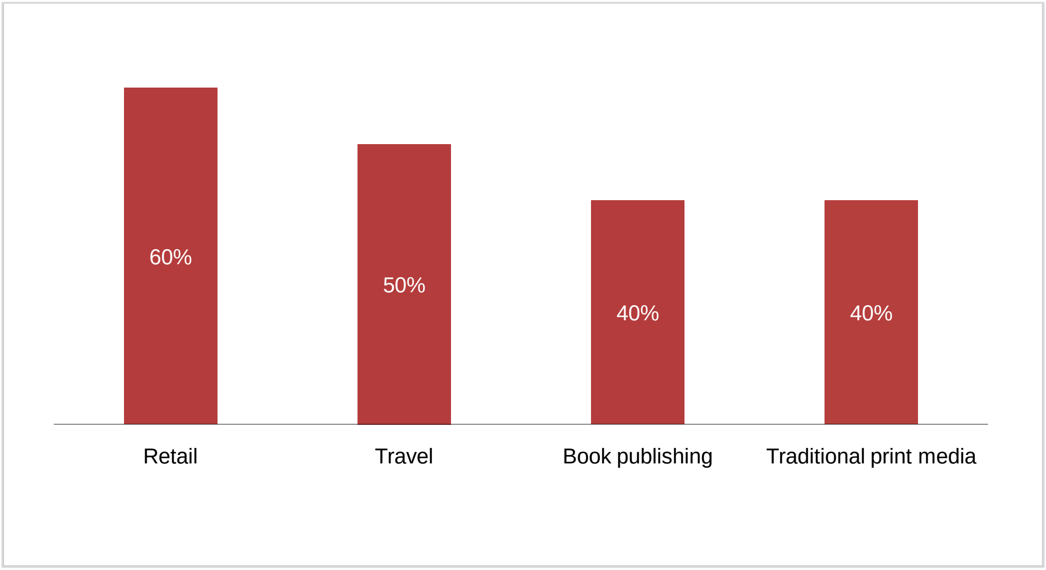
- Make distribution more targeted and simultaneously lower its cost
- Deliver a better user experience by making content more relevant, dynamic, interactive or accessible
- Create a wider range of options for marketers to reach or interact with their audiences
- Employ data and metrics to:
  - Provide marketers with more targeted and measurable services and to refine offerings to match the audience needs of particular marketers
  - Understand user behavior and adapt products to better meet their needs

The value of technology demands clear thinking about how to manage it. Once user or marketer needs are established, the decision can be made as to whether the technology should be created internally. Management's focus will not necessarily be on developing leading edge technology, but rather understanding it, harnessing its potential, ensuring its quality and continuity and managing its cost. New products should not be developed on a project by project basis; rather, product development will be constant as in a software company. This will ensure brands can meet the ever-evolving needs of users and marketers.

Technology is placing new demands on management

To keep pace with technology, media companies often require a more sophisticated central technology capability. As Exhibit 11 shows, media companies are less likely to have a devoted technology role at senior management level than other industries that have faced technology-led disruption.

Exhibit 11 Depth of technology expertise: % of companies with technology roles in senior management team by industry*



* Analysis based on sample of major market players in each industry (n = 10 + for each industry). Includes technology, digital, information and interactive roles (Source: Annual reports, company websites, AMR)

Exactly how an organization builds its technological capability will depend on its size and market. In medium and large-sized companies, independent brands may be supported by a centralized technology department. The technology department is able to incubate new projects and perfect – or cancel – them before they are rolled out at brand level.

Larger organizations are more likely to build infrastructure for the production of digital editions, apps and virtual events in-house. Data service and workflow tool providers will operate powerful internal servers. Joint ventures are also likely. For example, Next Issue Media, a consortium of five consumer publishers (Condé Nast, Hearst, Meredith, News Corporation and Time Inc), is exploring ways "to create a universal digital platform for the distribution, sale and consumption of paid digital content". Media companies will forge deeper relationships with hardware and software companies to build understanding of the technology being placed in users' hands.

Internal collaboration will be critical to the success of technology strategies: IT specialists and customer-facing staff must work together to ensure what is being developed is relevant to customer needs; everyone must ensure the best ideas are shared throughout the organization. So the whole organization speaks a common language, management may choose to institutionalize technical literacy. For example, 50% of the workforce of one business-to-business media company is qualified in search engine marketing and optimization.

There is no set formula for building technical expertise

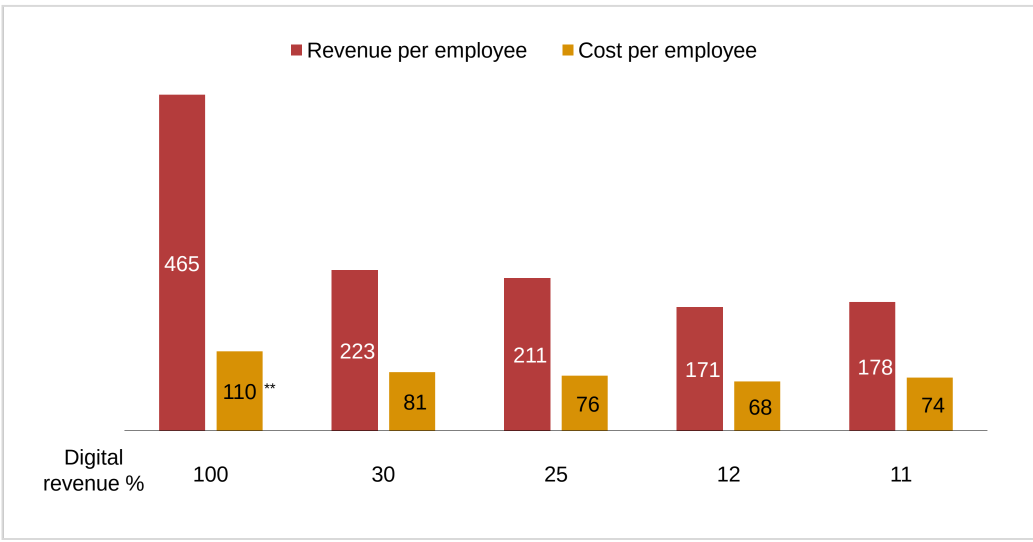
Collaboration and technology go hand-in-hand

1.8 *Making the transition: Human capital and culture*

The growing complexity of user and marketer needs, business models and core skills demands an increasingly sophisticated workforce. At the brand level, sales and editorial staff must be equally adept in print, digital and other non-traditional offerings. At the corporate level, teams focusing on technology and product development will be required to manage and support the growing complexity of the organization. New hires will be required to demonstrate technical literacy and be capable of collaborating across disciplines. In the short and medium term, the average age of employees may fall as organizations seek a technically literate, yet affordable, workforce.

In the medium to long term, average revenue per employee will rise, driven by a smaller number of more qualified, better paid employees (see Exhibit 12). Media companies with a relatively high share of digital revenue tend to have relatively high compensation levels per employee accompanied by high average revenue per employee. These organizations have used technology to create highly efficient mechanisms to deliver content to audiences or to match buyers with suppliers. Contrastingly, organizations with a relatively low share of digital revenue have lower average revenue per employee and lower compensation levels.

Exhibit 12 A revised compensation model: Average revenue and compensation per full time equivalent employee compared to share of digital revenue – example companies ($000s)*



An increasingly sophisticated workforce is required

* Wages and benefits for full time equivalents; ** Estimated (Source: Annual Reports, AMR)

Media companies have traditionally considered that they have had a close understanding of their audience and their marketing customers. However, they now need to challenge whether this has really been the case and how to place the needs of users and marketers at the heart of their culture.

In the future, successful organizations will sharpen their customer focus by embedding collaboration and technology in their culture. Collaboration between brands, within brands and between the center and brand will be strong; traditional silos will be broken down as technology is piloted, ideas are shared and new products are tested. As brand strategies become even more important, brands will require the independence to remain as close as possible to the needs of users and marketers, but will work with the center to ensure they have the tools to meet those needs. Collaboration on technology, product development, acquisition strategy and recruitment strategy will be particularly important.

Collaboration is the key to a sharpened customer focus

Management will drive the cultural shift. The organization will require a simple statement of its mission and the relative role of its center and brands; this statement will be communicated frequently and with purpose. Where possible, brands should be physically close to the corporate office. Central teams should not work in isolation; they should promote individual brands as centers of excellence and facilitate execution at brand level. Compensation structures may be aligned with wider corporate goals and reward collaboration. A litmus test of cultural strength will be the success of "shared services" such as technology and product development.

Management must drive a cultural shift

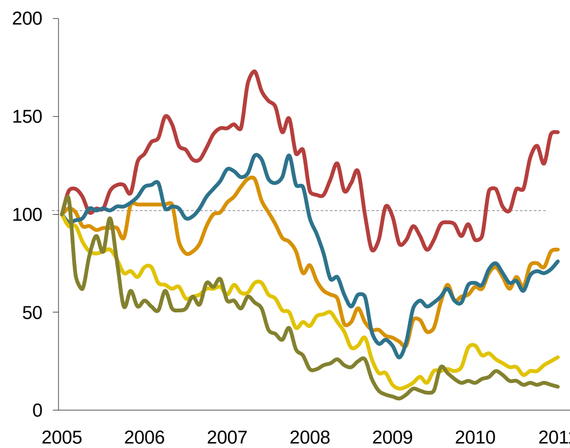
1.9 Making the transition: The importance of an acquisition strategy

History shows that organic growth initiatives are often not enough to keep pace with digital technology. In fact, the share prices of companies that adopt a disciplined acquisition and disposal strategy tend to perform better than those who lack this kind of approach. Exhibit 14 shows that between 2005 and 2009, the cash UBM paid for acquisitions represented 60% of its average revenue for those two years; the equivalent ratio for the New York Times Company was 17%. Between 2005 and the start of 2011, UBM's share price consistently outperformed the NYTCO.

History shows the importance of acquisitions

Daily Mail and General Trust (DMGT) is an example of a traditional newspaper publisher that has transformed itself. It paid out 36% of its average revenue on acquisitions between 2005 and 2009 and saw its share price consistently outperform NYTCO and Gannett.

Exhibit 13 Transformation through acquisition: Media company share price performance compared to spending on acquisitions, 2005 – 2009 (January 2005 = 100)



	Cash paid as % of revenue*	Number of acquisitions
UBM	60%	66
DMGT	36%	27
Meredith	38%**	10
NYTCO	17%	8
Martha Stewart Living Omnimedia	19%	1

* Cash paid for acquisitions 2005 – 2009 as % of average 2005 and 2009 revenue. Does not include deferred considerations; ** Two thirds of cash paid relates to 2005 acquisition of G+J Consumer titles

(Source: Annual Reports, AMR)

A clear acquisition strategy will aim to support the business's overall organic growth strategy; it will accelerate the path towards a mix of products and services that is relevant to users and marketers. The strategy is centrally co-ordinated and will strengthen the competitive position of brands with their users and marketers. Acquisitions may be originated centrally or at brand level, in keeping with the culture of collaboration. Needless to say, many acquisitions will be new media businesses as organizations expand into areas which go beyond their traditional comfort zone.

A clear acquisition strategy is a pillar of transformation

The time for re-evaluation and re-invention is now

Individual acquisitions can serve a number of purposes. Reed Elsevier's purchase of LexisNexis in 1994 is an early example of a "missing link" acquisition that brought transformational scale; at a stroke, the acquirer's share of electronic revenue rose from 2% to 14%. Other acquisitions may be smaller, but add a competence that was previously absent: Reed Business Information acquired BuyerZone in 2006 with the aim of spreading lead generation capabilities throughout RBI's other brands. Other competence-related acquisitions have taken place in consumer publishing: Hearst Corporation acquired iCrossing in 2010 to boost its digital marketing services capabilities. Meredith has made a string of smaller acquisitions to steadily build its digital presence, although more than 50% of the cash it paid for acquisitions between 2005 and 2009 was for a stable of consumer titles.

1.10 The media company of the future

The future of media is certain and uncertain in equal measures: Digital technology and user expectations will continue to evolve, but the shape of that evolution is unknown. This new reality compels media companies to re-evaluate and revise their business models, core skills and organizational structures.

The long term trend may be towards media companies operating fewer brands, but more business models. Digital technology is eroding the benefit of scale to media companies: As print circulation declines, the cost savings generated from centralized production and distribution decline. The trend away from multiple served markets has already played itself out in business-to-business media with the breakup of Reed Business Information and Nielsen Business Media in the US. At the same time, diverse and overlapping business models are proliferating as digital technology evolves. Media companies may eventually settle on a number of defining business models which suit the needs of their users and marketers; but for now, the emphasis is on keeping pace with rapidly changing user expectations and testing business models that fit ever-developing user needs.

Media companies are redefining their skills in order to remain competitive in the new world. Sales and marketing teams must have ever-deeper insight into the preferences of users and a skill set that reaches far beyond selling a page of advertising or a banner ad. Creating, managing and constantly iterating leading edge digital products is becoming more important than managing physical manufacturing and production efficiently. Legacy print brands remain an important asset and must be exploited in the fight for user attention.

The complexity inherent in these changes creates fundamental challenges for top management:

- How do we manage an organization that is becoming more complex?
- How do we get in the mindsets of our customers and measure and track their evolving needs?
- How can we build a culture and structure that accommodates collaboration, flexibility and experimentation?
- Which new technologies and products should we invest in and experiment with?
- How do we identify, recruit, develop and retain better qualified people with broader skills?
- Which non-core functions should we outsource?
- Which acquisitions can drive the transformation?

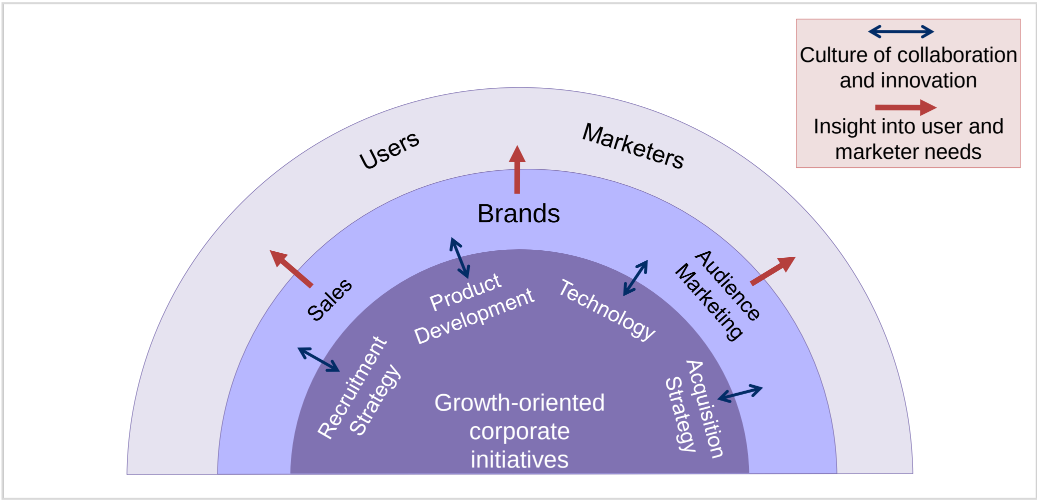
Core skills will continue to be re-defined

Management faces new challenges

The media company of the future's organizational structure will reflect its size, business models and competences. A dynamic center will manage overall performance, act as a catalyst for new initiatives and equip brands with the best toolkit possible to serve the evolving needs of users and marketers. It will increasingly be the spur for growth-oriented activities rather than a source of overhead.

The center will also act as an incubator and testing ground for new ideas, some of which will die and some of which will be rolled out and executed at the brand level. Brands will be independent, exploit their reputation and focus on achieving an ever deeper level of customer insight. Editors, sales people and marketers will be equally adept across the organization's full product and service offering. A dynamic culture of collaboration and technical literacy will bind the organization.

Exhibit 14 The media company of the future: Organizational structure*



A dynamic center will be a catalyst for the growth of independent brands

* Only non-traditional and growth-oriented functions are shown (Source: AMR)

About AMR International

Founded in 1991, AMR International Consulting Inc. (AMR) is a strategy consulting firm that specializes in media and publishing. AMR's mission is to help clients develop superior, customer-driven strategies by putting customer insight at the heart of all its work. AMR supports major public and private media groups in developing their strategies. We have also assisted numerous strategic acquirers and private equity investors evaluate acquisitions and other investments in media. For information please contact denzil.rankine@amrinternational.com; gil.ozir@amrinternational.com

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