How Media Giants Are Reassembling The Old Oligopoly

by Martin Peers
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Two years ago, Mattel Inc. gave CBS a choice. The network had refused to broadcast the toymaker's movie "Barbie in the Nutcracker" in prime time. So Mattel threatened to pull millions of dollars of advertising from the Nickelodeon cable channel — owned by CBS parent Viacom Inc.

Viacom, which had spent a decade bulking up with acquisitions, now wielded its new clout, according to people familiar with the situation. If Mattel made good on its threat, Viacom said, it would be blacklisted from advertising on any Viacom property — a wide swath of media turf that also includes MTV, VH-1, BET, a radio broadcasting empire and even billboards. Mattel backed down, and the Barbie movie ended up running during a less-desirable daytime period.

Neither company will comment on the scrape, but Viacom says Mattel remains a "valued advertising partner." More generally, President Mel Karmazin in an interview is blunt about his company's strategy: "You find it very difficult to go to war with one piece of Viacom without going to war with all of Viacom."

Viacom and its big media peers have been snapping up cable channels because they're one of the few entertainment outlets generating strong revenue growth these days. More broadly, the media giants have discovered that owning both broadcast and cable outlets provides powerful new leverage over advertisers and cable- and satellite-TV operators. The goliaths are using this advantage to wring better fees out of the operators that carry their channels and are pressuring those operators into carrying new and untried channels. They're also finding ways to coordinate promotions across their different holdings.

Entertainment giants such as Viacom, NBC parent General Electric Co. and Walt Disney Co., which owns ABC, now reach more than 50% of the prime-time TV audience through their combined broadcast and cable outlets. The total rises to 80% if you include the parents of newer networks — such as News Corp.'s Fox and AOL Time Warner Inc.'s WB — and NBC's pending acquisition of Vivendi Universal SA's cable assets, estimates Tom Wolzien, an analyst at Sanford C. Bernstein & Co.

The big media companies are quietly re-creating the "old programming oligopoly" of the pre-cable era, notes Mr. Wolzien, a former executive at NBC. Of the top 25 cable channels, 20 are now owned by one of the big five media companies.

The idea of owning broadcast networks as well as cable channels is "comfortable for people like ourselves," says Bob Wright, chairman of NBC, which two weeks ago signed a preliminary agreement to acquire Vivendi Universal's USA and Sci-Fi cable channels, along with the Universal film studio, bolstering a stable of cable channels that includes Bravo, MSNBC and CNBC.

For the past several years, Viacom and other media companies have pressed the Federal Communications Commission to relax restrictions on owning local TV stations. One of their main arguments: Their audience is shrinking as cable booms and the TV audience fragments. The original three broadcast networks now capture only 33.7% of the prime-time television audience, down from 69.3% in 1985-86. Cable now boasts a 49.3% share, compared with 7.5% in the mid-'80s, according to a Cabletelevision Advertising Bureau analysis of data from Nielsen Media Research.

But with the wave of consolidation and the increased reach of the media giants, some cable systems are fighting to keep restrictions on TV-station ownership in place. Cox Enterprises, parent of the fourth-biggest cable operator, Cox Communications, has argued that the big broadcasters are abusing protections granted them under federal law. The broadcasters, Cox argues, are using those protections to charge cable systems more for their cable channels. Cox and others have complained to the FCC that media companies make them accept less-popular cable channels in exchange for carrying their broadcast networks.

Media companies counter that their consolidation only puts them on a level playing field with cable operators, who are themselves merging into giants. Comcast Corp.'s acquisition of AT&T Corp.'s cable division last year gave it a reach of more than 21 million homes, for instance, almost 30% of homes served by cable. Comcast has already begun to tell cable channels it wants to save money on what it pays for programming, setting the scene for increasingly contentious negotiations with big media companies.

"There has been so much consolidation" among the distributors that "unless you are equally big … you risk a situation where you can be marginalized," says Viacom President Karmazin.

Following the Money

In buying up cable channels, the media conglomerates are simply following the money. The music business is shrinking rapidly as piracy eats into sales. Universal Music Group, the world's biggest, is now thought to be valued at $5 billion to $6 billion, less than half what it was a few years ago. The film business is volatile, with a quarter's performance dependent on whether movies bomb or not. The publishing business is steady but grows at a slow pace. Broadcast television's audience is shrinking, and its business model is entirely dependent on advertising revenue, a cyclical business.

Cable channels are gushing cash because they generate revenue from two sources — subscriptions and advertising. The subscriptions don't come directly from customers, but through cable-TV services, which operate the vast array of wires and pipelines connected to homes, and through satellite-TV services that beam the signal. For the right to carry the programming on their systems, these cable-operating companies pay a range of monthly fees, from 26 cents a subscriber for VH-1 to more than $2 for ESPN. These fees, for the most part, increase every year, providing a steadily rising annuity for the channel owners.

As cable viewership has increased, so has advertising. Since 1980, cable-channel ad revenue has risen from practically nothing to $10.8 billion in 2002, according to the Cabletelevision Advertising Bureau. Some channels, meanwhile, are cashing in on strong brand names. Nickelodeon, for one, is a merchandising powerhouse, with products including Dora the Explorer backpacks and SpongeBob SquarePants videogames.

The result has been an explosion in profits. MTV earned just $54 million in 1989, estimates Kagan World Media, but is expected to make more than 10 times that much this year. QVC, the home shopping channel, generates so much money that Liberty Media recently agreed to buy full ownership of the channel at a value of about $14 billion — the same value put on all of Vivendi Universal's film and TV assets.

Cable channels' surging profits have transformed the bottom lines of their parent companies. E.W. Scripps Co., the 125-year-old Cincinnati newspaper publisher and TV-station owner, now relies on its cable division for much of its profit growth. In 1994, Scripps launched the Home and Garden channel on the initiative of a TV executive, Ken Lowe, amid widespread skepticism. One Scripps newspaper publisher approached Mr. Lowe at the time to complain "a lot of the cash that I'm making here is being shipped to you…. You better know what you're doing," Mr. Lowe recalls.

Nine years later, HGTV has become one of the most popular cable channels, with shows such as "Design on a Dime" and "House Hunters." Scripps added a controlling stake in the Food Network in 1997. In the second quarter of this year, the impact of cable channels, including the Home and Garden channel and the Food Network, was clear: Newspaper and broadcast-TV profits both fell, while cable-channel profit jumped 70%, helping Scripps's net profit more than double. Scripps stock is trading near its 52-week high of $90.65, up almost 30% for the past 12 months.

The publisher who had complained about the cable-channel investment recently thanked Mr. Lowe, now Scripps's CEO, noting that the rise in Scripps's stock price would put his three children through college, Mr. Lowe says.

Since 1990, almost half of the top 50 cable channels have changed hands. Among the big deals: Disney's $19 billion acquisition of ESPN's parent, Capital Cities/ABC, and Time Warner's $6.7 billion purchase of CNN parent Turner Broadcasting, both negotiated in the summer of 1995. In 2001, Disney bought the Family Channel from News Corp. for $5.2 billion.

Last year, NBC bought Bravo for $1.3 billion. CBS, owner of The Nashville Network (now Spike TV) and Country Music Television, itself was gobbled up in 2000 by MTV's longtime parent, Viacom. Viacom has since added channels such as BET and Comedy Central.

Mr. Karmazin recently boasted to investors that the company's broadcast and cable outlets reach 26% of the nation's viewers in prime time, a significantly bigger share than any other company. Having such a big market share is "real important for lots of reasons, in terms of dealing with advertisers and our cable partners," he told investors.

Ad sales and marketing executives from the CBS and MTV Networks divisions meet regularly to share information and plot cross-promotional opportunities. In January 2001, MTV staged the halftime show for the Super Bowl, which was broadcast on CBS, featuring performances from Aerosmith and Britney Spears.

Last fall, CBS helped stem a slide in young women viewers of its reality blockbuster series “Survivor” with a documentary on the series that ran repeatedly on MTV before the new season of Survivor premiered. The premiere episode of “Survivor” on CBS saw a 23% jump in its young female audience, says George Schweitzer, executive vice president of marketing for CBS. CBS promoted its sitcom “King of Queens” through a special last Friday on Viacom’s Comedy Central cable channel.

Protecting One Another

The broadcast and cable sides of Viacom generally don’t try to sell ads jointly, but the common ownership allows them to protect each other’s flanks. At a presentation to advertisers last spring, MTV executives compared the audience reach for most of MTV Networks with ABC, NBC, Fox and WB — but CBS’s figures weren’t included in the breakdown, so that MTV didn’t siphon ads from its corporate cousin.

Meanwhile, Disney’s ownership of both ABC and ESPN allows it to spread out the cost of expensive sports packages such as its deals with the National Football League and the National Basketball Association. ABC Sports is, in fact, overseen by the same executive who runs ESPN, George Bodenheimer, and the two operations regularly promote each other’s programming and share talent.

Joint ownership of cable and broadcast is particularly valuable in negotiations with cable operators. A 1992 law allows broadcasters to regularly renegotiate the price for carrying TV stations’ signal on cable. While broadcasters could charge a cash fee, they usually offer the broadcast stations free in exchange for carrying a new cable channel they’ve launched. Few viewers would subscribe to cable if ABC, CBS or NBC weren’t on the channel line-up, so the cable operators have little leverage.

The strategy lets broadcasters add more cable channels, including many narrowly focused networks. Since 1993, big media companies have launched at least 35 new cable channels by bartering the right to carry their broadcast stations, estimates George Callard, an attorney with Cinnamon Mueller, a law firm that is counsel to the American Cable Association.

Using such a strategy, cable operators say, Disney has shoehorned its Soapnet cable channel, which features reruns of soaps such as “General Hospital,” into services reaching 33 million homes. Disney argues that fewer than half of those homes have the channel as a result of a barter arrangement.

Cox Enterprises complained in a filing with the FCC in January that Cox Communications had to agree to carry Soapnet nationally in exchange for the right to offer ABC stations in just a few of its markets. A Disney spokesman says Cox is a “savvy negotiator” that “wouldn’t have signed the deal unless they found value in it.”

Catalina Cable, a cable-TV operator on Catalina Island off the California coast, has only 1,440 customers. Ralph Morrow, Catalina’s owner, says he was asked to carry Soapnet when he tried to renew his right to carry a Disney ABC affiliate for the beginning of 2000. He says he suggested paying cash for ABC instead. Disney’s response was that the cash fee for ABC would be “really high,” he says. “They made it clear to me” that he didn’t have that option “at a reasonable price.” A Disney spokesman says Mr. Morrow mischaracterized its offer, noting that Disney offers operators “multiple options, including a stand-alone cash offer which we believe to be a fair offer and fair value.”

Mr. Morrow, who says he doesn’t see the need for a soap-opera channel, now pays Disney 11 cents a subscriber for Soapnet. Disney responds that surveys of viewers have shown Soapnet to be popular. The channel drew 97,000 viewers in July and August, according to Nielsen. In the same period, HGTV — which is available in about two and a half times as many homes — averaged 457,000 viewers.

–Joe Flint contributed to this article.

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