Questions on Chapter 10 in *Competition Demystified* and Fox's Strategy were posted: http://wp.me/p1PgpH-AK

As a review, this case is important to study for ***how a company enters under barriers to entry****. If you can find such a company in the early stages of building a competitive advantage, you can earn huge returns as an investor. It ain't easy, but one way to start is to study this case. Also, instructive in how incumbents respond.* For those who don't have a digital copy of the book, you can email me at aldridge56@aol.com and write (ONLY) **BOOK i**n the subject line. I will email you the PDF within 24 hours. The PDF lacks the graphs and tables but has the text**. I suggest you splurge on the $12 to $13 with shipping for a second-hand book through www.Amazon.com.**

QUESTION 1: Describe how the three networks (ABC, NBC, and CBS) played the prisoner's dilemma game in the 1960s and 1970s in regarding to advertising, pricing, advertising inventory, purchasing of shows, and hiring of talent.

As it evolved in the three decades after the end of WWII, the network broadcasting business was only one segment of the complete industry that brought news, sports entertainment, and advertising—which paid for the rest—into the American home.

The three networks enjoyed competitive advantages and barriers to entry, thanks to captive customers, government regulations, and significant economies of scale.

The government licensed, but did not own or directly control, the airways. The ultimate revenue stream of the entire industry came from advertisers, who bought time in which to air commercials.

The production of "content" was split among the networks, production companies, and local stations. The networks and the local stations produced national and local news, sport events, and a range of other shows. There was no shortage of creative talent creating show concepts to the networks.

Government regulation limited the number of local stations a network could own. When we look at the networks, we need to treat their owned and operated local stations and probably even their affiliates, as part of the same segment (broadcasting per se) of the industry. But the rest—the production firms, the syndicators, and the advertisers-were clearly in *separate* portions of the overall industry, no more tied than a publisher is to a book merchant or a fructose grower to a beverage manufacturer. The industry was protected by barriers to entry.

The competition between networks was more like country club golf *(not based on price competition)*. All were headquartered in New York City. All had backgrounds in radio broadcasting.

Advertising Arrangements

The networks' revenues came from selling time to sponsors. They took care never to offer this time at discount prices. First, most advertising time was pre-bought by the sponsors under long-term contracts Time was available closer to the actual broadcast date in a spot market; the spot rates were higher than

the contract rates. Contracting was done by all three networks during a limited time period, which restricted bargaining by ad buyer. The networks did not undercut one another on price.

Second, they restricted the supply by limiting the number of advertising minutes in prime time under the mantel of a public interest cost of conduct. When the ads were sold, they came with an estimate of the size of the audience that would be reached. If actual viewers fell short of the estimate, the networks made good on the advertising contract by offering the sponsor more ad slots at no charge. This "make good" practice used more of the precious minutes, tightening supply just at those times when, due to failure to deliver, demand might have fallen. If there were not enough buyers at an acceptable price, the networks either ran ads for their own shows or they broadcast public service announcements. They did nothing to encourage sponsors to wait until the "For Sale" signs were posted. The net result was that network advertising prices continued to rise steadily even as their joint market share of viewer eroded.

Purchasing Programs

They did not vigorously compete with one another for news shows. Program ideas were shopped during a two-week period, so if one network expressed an interest, there was not enough time for a program's producers to see if another would outbid it. When a pilot episode had been filmed, the network retained the right to turn it down, and the studios were left to shoulder the expense. These decisions also took place within two weeks, when the networks were putting their schedules together. This time-limited competition kept the networks from bidding against one another for programs that looked like winners.

Nor did the networks try to woo established programs from one another. When a series did shift networks, like Taxi, which moved from ABC to NBC in 1982, it was because it had been canceled by its original network, not enticed by its new one. The cooperative stance of the networks toward programming also worked in their handling of sporting events. ABC created Monday night football to get its share of the pie while the other two networks, ABC and NBC, worked with the NFL.

Affiliating with the Local Stations

The networks did not steal one another's affiliated stations. Government regulations permitted only one affiliate per network in a given market, so there was room for all. Also, regulations made it difficult to shift a license from one local station to another, another constraint on network poaching. Still, the genteel attitude of the networks toward one another did as much as the regulatory environment to temper their competitive zeal. **Murdoch played the entry/preemption game.** He made it clear to the incumbent networks that it would be cheaper for them to let him into the club than to try to strangle him in the cradle. Fox succeeded in establishing itself as a fourth network where previous entrants had failed.

How did Fox influence the other networks' responses to its efforts to get behind their barriers to enter their market?

Murdoch needed a way to gain admission to the club without having to batter down the gates and undermine the value of a membership for him and for the others. He had to let the Networks know that his intentions were more or less *harmonious* with their interests. He had to make them realize that letting him enter peacefully would serve them better than a scorched-earth defense. He needed to send them signals that he knows how to play their game.

Local Stations

Murdoch bought six independent stations from Metromedia. He left the Network affiliates alone. The $1.65 billion he spent on them was considerably more than their current cash flow would justify, and he financed his purchase with debt. His plan to make them the heart of his new network would, he felt, justify the premium he had paid. To the networks, the fact that **he had not tried to steal their affiliates** was reassuring, as was the debt he had taken on to get into the business. He was less likely to begin price wars on advertising or programming with his formidable competitors with **so much debt hanging** over his company.

Fox would be starting with a small base of viewers and a small share of the prime-time audience. He was not viewed as a threat.

Advertising

Murdoch followed the lead of the established networks in subscribing to the code of conduct that put a limit on the number of advertising minutes for each half hour of prime-time broadcasting. He established his price at 20 percent below what the networks were charging per rating point. This discount was only marginally aggressive. By **pegging his prices to those of the network**, although at a discount, **he signaled that he intended to cooperate, but he also let them know that they could not match him on price.** If the lowered their rates, he would maintain the 20 percent discount and lower his. Since their advertising revenue would dwarf his for the foreseeable future. **The pain they would feel would be much greater.** On the other hand, if they raised rates, he would go along. Albeit at his 20 percent discount. He would not be an impediment to their continued exercise of pricing power.

Programming

Fox did not confront the networks head-on. It started with a limited schedule or original programs. Fox went down market in programming so it reduced direct competition with the other networks. If their programming was going to win fox an audience. It was more likely to come from independent stations audience that had no established viewing habits and was more easily attracted.

The manner in which Fox secured local stations, priced its advertising, and it filled its time slots with entertainment sent strong signals to the networks that it was not going to make trouble. It did not appear checkbook in hand to steal any of their established programs or stars or woo their local affiliated. Its advertising, though offered at a discount, was still pegged to the network rates, and it did not intend to expand supply by reserving more time for ads.

How effective was Fox's strategy of having synergistic media businesses?

Not successful. The intended lynchpin of Murdoch's strategy had been integration, the idea that Fox Broadcasting, including the Twentieth Century Fox studio, the network, and the owned and operated stations, would have opportunities for additional profits because of their right relationships with one another and the other parts of the News Corporation's media holdings.

However, what added benefits were to be realized by putting companies in the supply chain under the same ownership? If the industry is protected by barriers to entry, the firm is already earning superior returns on capital. **If the industry is competitive, then contracting with a sister company adds nothing to either firm's earnings.** In either case, it is hard to identify any gains from putting the two firms under the same ownership. **Beware the allure of the Synergy Trap.** Money might be moved from one corporate pocket to another, but the net gain to the corporation would be zero.

There were **no barriers to entry in the production segment** of the business. Networks had found it less costly to let the studios do the production work rather than themselves.

Free advertising on a poorly watched network could not have been the source of Murdoch's synergy strategy. Fox's other supposed source of synergy was the ability to syndicate the studios programs to international outlets. Here again, the issue was whether anything was to be gained by doing the syndication in a sister company of the same corporation, or going to outsiders. If international syndication was a competitive industry, there was no joint benefit in keeping syndication in-house.

If the various links on the supply chain are in markets where there are no barriers, there is simply no extra profit to be extracted from a common ownership structure.