

News Consumption and the New Electronic Media

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Recently, the print and television news media have begun to question the future of their industries. From newspaper executives at the *New York Times* who have asked whether there will be a print version of their paper in ten years, to television news executives who openly speculate on whether there will be network nightly news, the stated cause for alarm is the competitive threat of the Internet. This article looks at the hypothesized shift of news consumption from the traditional media to the online news media. The hypothesized mass migration of news consumption behavior is not supported by the facts. Some migration from offline to online news consumption has occurred, but this number (12 percent direct substitution) is less than many believe. Another 22 percent of U.S. adults have substituted some online news for offline news, but for a substantial portion of this group, the online news media acts as a complement rather than as a substitute. Most significant is the fact that two-thirds of the U.S. adult population have not shifted to online news consumption and appear unlikely to do so. The author also examined the advertising markets for the traditional news media and for the online media and found that online advertising is an imperfect substitute for advertisers. Despite declining television viewership and newspaper circulation, advertising revenues are not only staying with the traditional news media but are also increasing, albeit slowly. The author has found no major impact on the economics of the news industry due to the online news media. This is not to say that pressures are not being felt, but they are not felt to an extent that warrants predictions of the demise of the traditional news media.

Keywords: *online; offline; media; consumption; Internet*

Much has been written about the state of the traditional news media and the effects of the Internet. Many media analysts and news media executives have claimed that the Internet is a threat to the traditional news media, most notably to network television news and to newspapers. Declines in the circulation

numbers of newspapers and the ratings of the nightly television network news indicate why so many industry watchers are predicting the demise of the traditional news media (see Figures 1 and 2).¹

Some pundits have gone as far as writing the epitaph of the American news media. The editors of the *Wilson Quarterly* wrote recently, "Collapse is not too strong a word to describe what has happened to America's major news media."² Terry Eastland, publisher of the *Weekly Standard*, says of the mainstream news organizations, "So it's time to write, if not an obituary, then an account of their rise and decline and delicate prospects amid the 'new media' of cable television, talk radio, and the blogosphere."³

The doomsday predictions for the traditional news media are not limited to media commentators. Philip Meyer, the Knight Chair and Professor of Journalism at the University of North Carolina at Chapel Hill, says of the threat to the newspaper industry: "the newest of the disruptive technologies, online information services, may offer the most dangerous product substitution yet."⁴

Meyer correctly identifies the Internet as a potentially disruptive technology to the traditional news media industry. Harvard Business School Professor Clayton Christensen distinguishes between two forms of new technologies. Most technology advances are what he calls "sustaining technologies," which improve product performance or increase productivity for existing products within historical markets. But occasionally, "disruptive technologies" emerge and "bring to a market a very different value proposition than had been previously available."⁵ For example, transistors were a disruptive technology to vacuum tubes, and the integrated circuit was disruptive to transistors.

Michael Porter outlines a model of competitive forces for the structural analysis of industries.⁶ The competitive force most impacted by disruptive or discontinuous technologies is the threat from product substitution. Technology often allows for the creation of new alternative (substitute) products. This is the case with the online news media. They can be seen as a substitute product threat. Porter suggests that the determinants of substitution threat are "relative price performance of substitutes, switching costs, and buyer propensity to substitute."⁷ Porter has also described the concept of the value chain as a collection of activities every business entity performs to "design, produce, market, deliver, and support its product."⁸

Often, evolutionary (sustaining) technology can give certain firms a first-mover advantage as they apply the technology at different points of the value chain to differentiate their product or to achieve efficiencies in productivity. These are only relative competitive advances in that they reposition existing firms within an industry and are ultimately copied by all firms within the industry, with parity eventually being reestablished. But occasionally a disruptive or discontinuous technology will arise that can completely change one or more of the links in an industry's value chain, or potentially change entirely, or even make

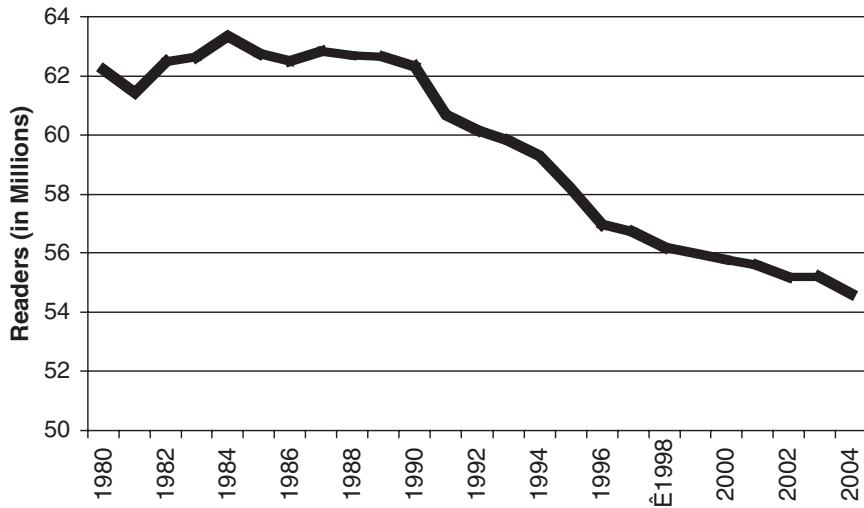


Figure 1
Daily Newspaper Circulation
Source: Newspaper Association of America, 2004. www.naa.org

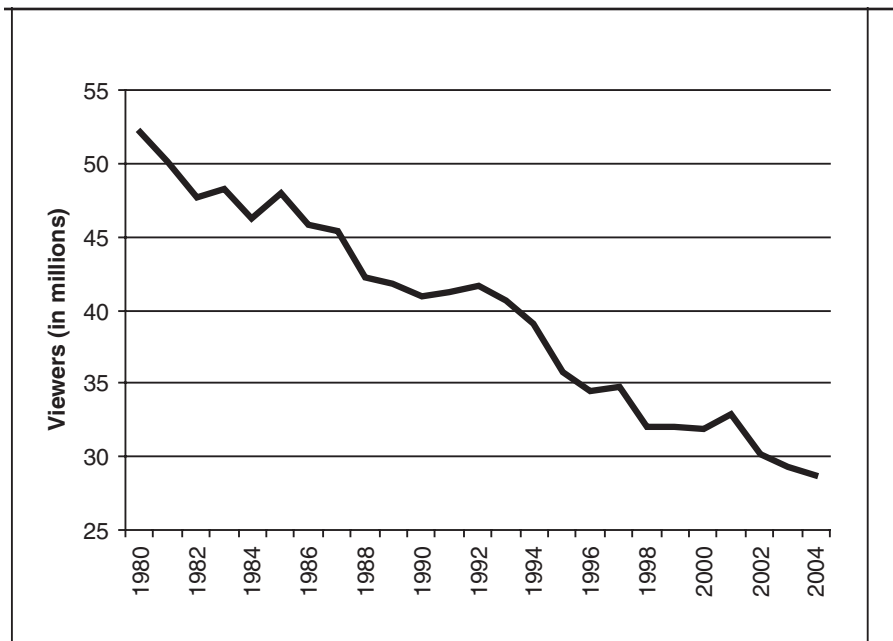


Figure 2
Evening Network News Viewership
Sources: Journalism.org, 2005; www.stateofthemedias.org

obsolete, the product itself. Porter describes the potential impact of disruptive technologies:

Technological discontinuity creates the maximum opportunity for shifts in relative competitive position. It tends to nullify many first-mover advantages and mobility barriers built on the old technology. Discontinuity also may require wholesale changes in the value chain rather than changes in one activity. Hence a period of technological discontinuity makes market positions more fluid, and is a time during which market shares can fluctuate greatly.⁹

There is a discontinuous cost differential between hosting an electronic newspaper versus the capital, labor, and material (newsprint) costs of printing a newspaper. The cost of producing the first copy remains equal between the media, but the online media has a near zero marginal cost for each additional copy (duplication), whereas newspapers and newsmagazines have a significant marginal cost for each additional copy.¹⁰ Television, like the Internet, has a duplication cost near zero.¹¹

Major disruptive change also occurs at the next (delivery/distribution) stage of the value chain. The cost of distributing an electronic edition again approaches zero in contrast to the high costs of physical delivery in the case of newspapers and newsmagazines, or via broadcast or cable for television and radio news. For example, the U.S. Department of Commerce has estimated that the printing and delivery costs for the newspaper industry represent 30 to 40 percent of total operating costs.¹²

In a perfect market, one would expect a shift to the new distribution technology. Since costs would be lower for firms using the new technologies to produce and deliver a news product, they would be able to offer the product to consumers at a substantially lower price than their old technology competitors. The new, lower cost technology would reduce barriers to entry and new entrants would appear. The traditional media, with large capital investments in the older technology and higher cost structures, would be disadvantaged. The competitive response strategy of the traditional media would be to offer online versions of their own products at a substantially lower operating cost. Over time, they would push their customers to use the lower cost channel in the same way that banks pushed customers to use ATMs and online banking. Hence, we could hypothesize an abandoning of the traditional news media by both consumers and producers in favor of a lower cost/lower price substitute product.

Product Substitution in the Consumer Market

Relative Price Performance

One of the bases of customer switching behavior is the relative price performance of the substitutes. To date, nearly none of the major online news sites

charges for access to their online news information. The price disparity between online and offline media could prompt customers to switch.

In the case of television, however, the price to the consumer is already zero, since the cost is borne by advertisers. In the case of newspapers, advertisers contribute 80 to 85 percent of the industry revenue, subsidizing the cost to consumers to below the media's marginal cost.¹³ Thus, the lower cost of producing news online cannot translate into a significant consumer cost reduction that favors the online substitute over the offline news product. There is still some cost to the consumer for the newspaper, even if it is below marginal cost. However, studies of the economics of media suggest that in monopoly markets, subscription price is optimized for both the subscriber market demand and the advertiser market demand. Pricing is optimized to the point where any further reductions do not generate significant additional readership.¹⁴ Reducing the price past the point of optimization produces diminishing returns of readership. It does appear that some substitution based on price will occur for newspapers and newsmagazines, but this effect will be significantly dampened due to the subsidized pricing in the consumer market.

Switching Costs

Theories of the adoption rate of new technologies have focused on two mechanisms that overcome the costs of switching. The first is if an immediate gain can be achieved by switching to the new technology. The second is if the new technology produces increasing returns to adoption. "Increasing returns to adoption are said to exist when the net benefit to the user of a technology increases as the degree of adoption of that technology increases."¹⁵ Switching to VoIP (voice over the Internet) telephony is an example of the first kind of benefit, as it produces an immediate cost saving and is not dependent on other users' adoption behaviors. On the other hand, switching to technologies like Skype (peer-to-peer IP telephony) only produce a benefit if enough other people also adopt that technology (a network effect). As more and more users switch, the returns on adoption increase.

Switching to online news does not produce a benefit that increases as the technology is more heavily adopted (no network effect exists). And survey data suggest that there is minimal perceived difference in immediate benefit between online and offline news media. Forty-nine percent of online news consumers say they do not care whether they get their information from the online news Web site or from the offline property of that same media brand.¹⁶ In a survey of online news site users, the only advantage indicated was the ability to find things faster (cited by 69 percent of users). On all other measures, the majority of respondents said the benefits were greater with the offline news media or that there was no difference between the online and offline news media (Figure 3).¹⁷

This would lead us to conclude that the traditional news media exhibit stickiness in the form of brand loyalty and habit. With data suggesting that consumers have greater preference for the offline media or see little difference, and in the absence of a major driver to overcome switching costs, we can predict a slow adoption curve or a failure to ever produce a mass market phenomenon.

Buyer Propensity to Switch

The concept of single media usage is fading. A more realistic picture of the media environment is one where people consume a varied diet of media. We distinguish between the simultaneous use of two media (“multitasking”) and the use of two different media at different times during the day (referred to as “multichannel” use). Approximately 25 percent of media use is overlapping (multitasking).¹⁸

Demographically, older audiences tend to do less media multitasking because this generation was raised in a linear environment that placed greater emphasis on print material. Younger consumers brought up in a nonlinear atmosphere use more visual media, such as the Internet and videogames.¹⁹

Multitasking is particularly prevalent for those who have been using the Internet for a number of years and who are comfortable with its use. For this group, 47 percent report listening to the radio while they are online, 33 percent watch TV while online, and 44 percent say that they typically talk on the phone at the same time that they use the Internet.²⁰

There is also abundant evidence of multichannel media usage.²¹ Many consumers utilize the online news media more as a complement than as a substitute. The Online Publishers Association conducted a survey of online users who visited online “media” sites that also had an offline version as print newspapers or magazines, or as TV stations or cable channels.²² The study revealed that our basic conception of news and information consumers as single media users is largely flawed. Consumers do not see a big online/offline difference. They view online and offline properties as being complementary rather than competitive. Sixty-four percent of online users said that they also used the offline media property occasionally or frequently (40 percent frequently and 24 percent occasionally). Only 17 percent said that they never used the offline media property.²³

The survey revealed that the fear of online media cannibalizing its offline sibling is unfounded. Instead, the two mediums complement each other. Twenty-one percent of users of online news sites say that they frequently use the online news site to follow up on something that they read in the newspaper; another 41 percent say they do so occasionally.²⁴ When asked about their attitudes toward the online and offline versions of the media brand, 49 percent said that they did not care which one supplied their information. Seventy percent said that the two

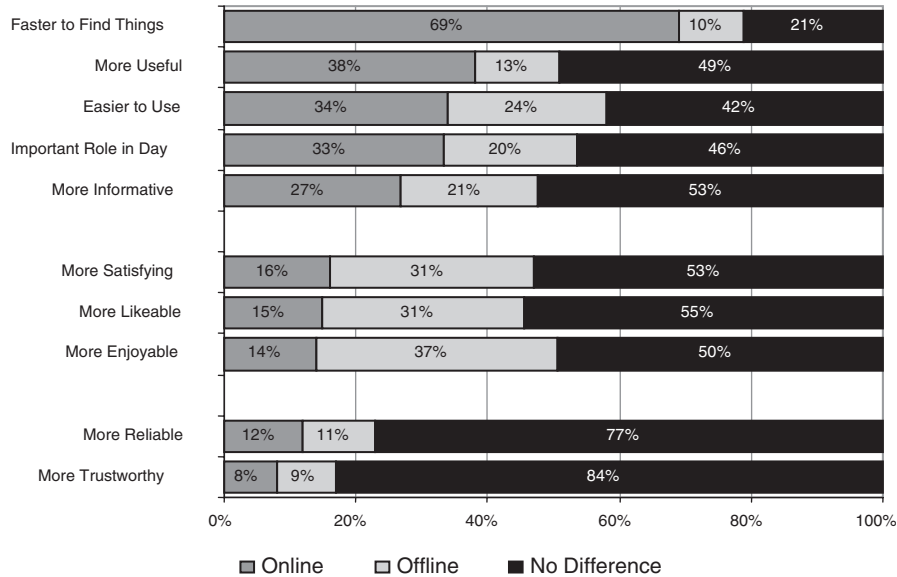


Figure 3
 Preferred News Media
 Sources: Frank Magid Associates, Online Publishers Association, “Multichannel Media Brands,” 2004. www.online-publishers.org

complemented each other, and only 9 percent felt that the online and offline versions competed for their attention.²⁵ The survey also showed that different people have different preferences as to how they get their information. Twenty-six percent of respondents say that they cannot live without the online version, another 27 percent cannot live without the offline version, and 29 percent are only happy if they can use both the online and offline properties.²⁶

A Customer-Centric Model of News Media Usage

In a customer market segmentation analysis for the Online Publishers Association, Frank Magid Associates suggested a customer model where news and information consumers segment themselves into one of four groups. “Online-only” users of news information account for 29 percent of online news consumers. “Multichannel” users account for 51 percent of news Web site visitors; they use offline (TV or print) as their news source in roughly equal proportion to the amount that they go online for their news. The third group is comprised of “dabblers.” They go online occasionally for news but rely on the offline media. Dabblers comprise 8 percent of online news site visitors. And finally, the “offline-only” segment (13 percent of users) prefers getting their news information from newspapers, news magazines, or television.²⁷

We can use this market segmentation model to think of news consumers as having consumption patterns that fall on a range of online usage from infrequent to frequent and on a second dimension of offline news media usage from infrequent to frequent. Thus, consumers fall into one of four quadrants (infrequent-infrequent, frequent-infrequent, infrequent-frequent, or frequent-frequent).

Looking at the profiles of each of the four segments, online-only news information consumers are 70 percent male versus 30 percent female. They are also slightly younger than the other segments with 40 percent aged eighteen to thirty-four and 60 percent aged thirty-five to fifty-four.²⁸ Seventy percent say they enjoy their time on the Web site; 53 percent feel they rely on the Web site; 67 percent think that it is easier to use than the offline property; 51 percent think the online media property is more satisfying than the offline property; and when both online and offline properties are available, 82 percent would prefer to use the Web site. Online-only users are routine users with 51 percent reporting that they visit the Web site throughout the day. They are also high-speed Internet users (64 percent have broadband access at home). They spend an average of twenty-one hours per week with the Internet, which is by far the most of any of the customer segments. But they watch the least amount of television, spending only fourteen hours per week watching TV²⁹ (the national average is thirty hours³⁰). The Internet dominates their media mix.

The largest group of online news site users is the multichannel segment, which uses both the online and offline versions of their favorite media brands. The concept of the consumers utilizing multiple media is not surprising in a world of media choice. Instead of choosing one medium, the majority of Americans choose "all of the above." A survey done by the USC Annenberg School found that 61 percent of adults say that the Internet is a very/extremely important source of information for them. But so too were books (60 percent), television (50 percent), newspapers (58 percent), radio (40 percent), and to a lesser extent magazines (29 percent).³¹ The media are additive, and the dominant consumer strategy is to use multiple media to get news information.

Multichannel news media users are evenly split male (51 percent) and female (49 percent). They skew slightly older than the online only segment but are younger than their more offline counterparts (33 percent are aged eighteen to thirty-four and 67 percent are aged thirty-five to fifty-four). Seventy-three percent say they enjoy their time spent with the news media Web site (slightly higher than the online only segment). Fifty-seven percent say they rely on the Web site (again slightly higher than the online only group). Fifty-four percent are comparably satisfied by the online property and the offline media property. But if both were available, 54 percent would prefer to use the offline property. They are just as heavy users of the online sites as the online only users with 51 percent reporting that they access the news Web site routinely throughout the day. Sixty-four

percent of them have broadband access at home, and they spend nineteen hours online per week and an average of eighteen hours per week watching television.³²

The dabblers are infrequent users of both online and offline news media. They are 53 percent female and 47 percent male with 35 percent aged eighteen to thirty-four and 65 percent aged thirty-five to fifty-four. More research needs to be done on this consumer segment, as the current available data show no distinguishing demographic characteristics other than the fact that they spend less time with media overall. They are online, with 57 percent reporting that they have high-speed Internet access at home. And they do spend eighteen hours online per week on average. But they are light consumers of television, averaging only fifteen hours of TV viewing per week.³³

The offline-only market segment is 66 percent female and 34 percent male. Only 30 percent are aged eighteen to thirty-four, and 70 percent are aged thirty-five to fifty-four. Of the offline-only segment, 77 percent feel that the offline property is easier to use than the online media property. Only 8 percent find the Web site to be more satisfying, and when both are available, 74 percent would choose to use the offline property. Only 5 percent visit the Web site throughout the day. They are not unwired users, as 59 percent report that they have broadband access at home and average seventeen hours per week spent online (doing things other than visiting online news sites). They watch the most TV of any of the segments, at an average of nineteen hours per week.³⁴

The data suggest that a consumer-centric model is an appropriate view of news usage behaviors across media. News consumers see media brands across media platforms as being complementary brand extensions. Their usage of offline and online media properties is related to convenience and, to some extent, a personal preference for one medium over another. Although some users gravitate to online-only usage and others to offline-only news consumption, the important discovery is the fact that the majority of online news consumers (51 percent) are multichannel users who are comfortable with both the offline and online media and who routinely use both media. Only 29 percent of users of online news sites are online-only (fully migrated). But to make the comparison with the traditional media it is important to examine online news users as a percentage of the total U.S. adult population, not just as a percentage of Internet news users (see Figure 4). Only 12 percent of adults in the U.S. are online-only news users. While 12 percent is a significant migration from the traditional media to the online news media, it is not as yet a mass migration. Multichannel users of the news are 22 percent of the total adult population. Thus, two-thirds of the total U.S. adult population are only infrequent users of online news sites or get their news entirely offline.

We conclude that due to lack of price incentives for consumers to switch, the buyer's propensity to switch is not shown for most of the news consumer

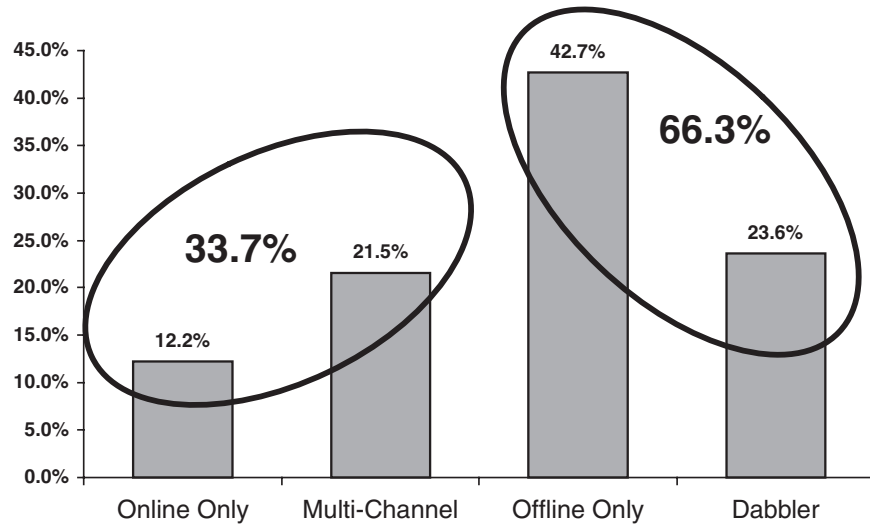


Figure 4
Online News Consumers as Percentage of Total Adult Population

market. Furthermore, the cost of switching (the effort and relearning involved in changing behavioral habits) appears too high for most U.S. adults.

Future Trends: Not Yet or Never?

There is some data that might suggest that a large-scale migration from traditional media to the online medium for news readership/viewership is merely a matter of time. These data warrant discussion.

The UCLA Internet Report 2004 states that new users of the Internet (online for less than a year) spend an average of nine minutes per week reading online newspapers, but very experienced users (online for six or more years) spend forty-eight minutes per week reading newspapers online.³⁵ New Internet users read print newspapers on average of four hours per week, whereas experienced online users spend only an average of three hours per week reading print newspapers.³⁶ These data suggest a decline in print readership and an increase in electronic readership, as users become more acclimated to the online world, but do not indicate a wholesale migration from the print medium to the online medium. It can be postulated that the lack of ease in connecting to the Internet via dial-up modem is a limiting factor in the migration of consumers to the online news media. The Carnegie Corporation suggests that "with over half of Internet users now connecting via high-speed broadband services, daily use of the Internet among all age groups is likely to climb."³⁷ Broadband has been

installed in more than 32 million households in 2004, compared with 10 million in 2001.³⁸ Jupiter Research predicts that the number will grow to 41 million households by 2007, which would represent 46 percent of all U.S. households.³⁹

Half of homes with dial-up access connect at least once a day versus 66 percent for homes with broadband.⁴⁰ The percentage of people who go online to get news, weather, or sports information does show a difference between homes with dial-up access and homes with broadband access.⁴¹ Only 22 percent of dial-up users report going online at least once a day to get news, whereas 40 percent of broadband users go online daily to get news.⁴²

Clearly, broadband access versus dial-up Internet access has an impact on online consumption of news information. Although an increase definitely exists, it does not represent a mass migration of households to online news consumption.

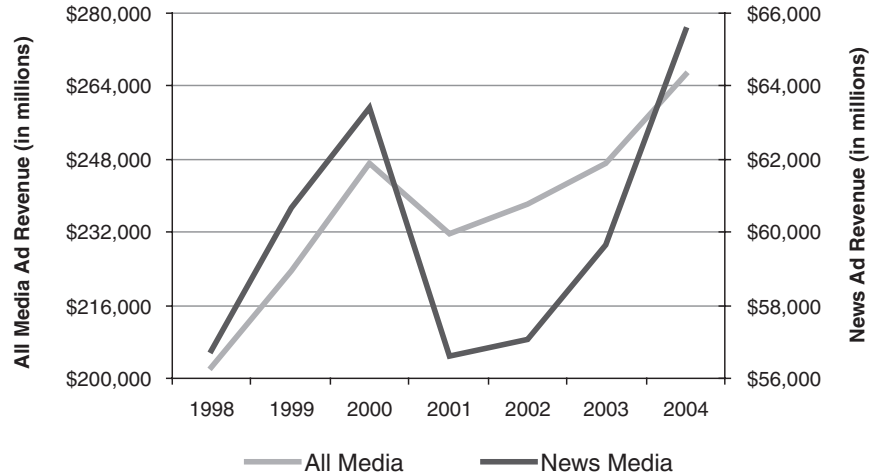
Substitution in the Advertiser Market

Advertising Revenue

Our customer segmentation analysis predicts that 12 percent of adult consumers have or will directly substitute online news for offline news. Our model also predicts that an additional 25 percent of the U.S. adult population have or will reduce their offline consumption of news media by 25 to 50 percent. We would expect to see these reductions reflected in the advertising revenues and operating margins of the media companies. However, despite falling ratings and circulation, advertising spending with the traditional news media has continued to grow. Between 1998 and 2004, news media advertising revenue increased by 15 percent despite a major advertising recession in 2001 and 2002 (ad spending across all media was down 9 percent in 2001 and had only 1 percent growth in 2002).⁴³ The recessionary fall-off in ad revenue for news media mirrored the rest of the media, with a slightly greater trough but a steeper recovery (Figure 5).

By the end of 2005, newspaper advertising revenues had returned to pre-recessionary levels, even when adjusted for inflation (growing 6 percent after inflation over the previous two years). And financial analysts anticipate that newspaper advertising revenue will grow at an annual compound rate of 5 percent through 2008.⁴⁴

The network TV morning news shows have seen revenue growth barely affected by the 2001 to 2002 recession, with a compound annual growth rate of 11 percent.⁴⁵ Revenues from local TV news accounted for 43 percent of total TV station revenues in 2005, up from 39 percent in 1999.⁴⁶ The network television evening newscasts have yet to recover from the economic downturn, but even here we see modest increase rather than precipitous decline.⁴⁷ On the other hand, cable TV news channels have shown compound annual growth of 14 percent from 1998 to 2004, largely due to the growth of Fox News.⁴⁸

**Figure 5**

News Media Ad Revenue versus All Media Ad Revenue

Sources: Newspaper Association of America, Universal McCann, TNS Media Intelligence, Interactive Advertising Bureau/PriceWaterhouseCoopers, BIAfn.

The online advertising market had a similar 2001 to 2002 recessionary decline.⁴⁹ Therefore, we can conclude that the declines in the traditional news media ad revenues during 2001 and 2002 were primarily due to economic conditions and not advertisers shifting their ad spending online.

News Media Profitability

The U.S. Department of Commerce ranks the newspaper industry as among the largest and most profitable U.S. enterprises, with newspaper operating margin percentages usually in the range of the low to mid twenties (see Figure 6).⁵⁰ Cable television news channel profits increased 380 percent between 1997 and 2004 and now average 32 percent.⁵¹

Local TV news, where profit margins of 45 percent to 50 percent are common, is generally twice as profitable as newspapers.⁵² According to the National Association of Broadcasters, local TV news accounts for 23 percent of TV station expenses but contributes 43 percent of the revenue. The exact profitability of network news divisions is rarely broken out, but network executives claim they are profitable.⁵³ And the morning network news shows are clearly profitable. For example, the *Today* show in 2004 produced \$250 million in operating profits on \$350 million in revenue.⁵⁴ Thus, while online news competition may have put some pressure on the bottom line of traditional media news organizations, they remain highly profitable

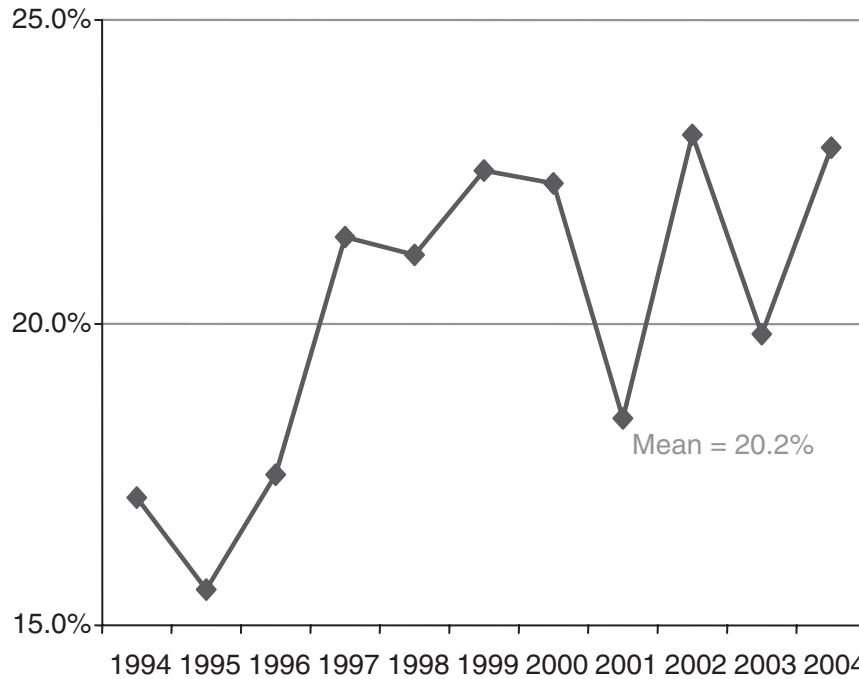


Figure 6

Newspaper Industry Operating Income Margin

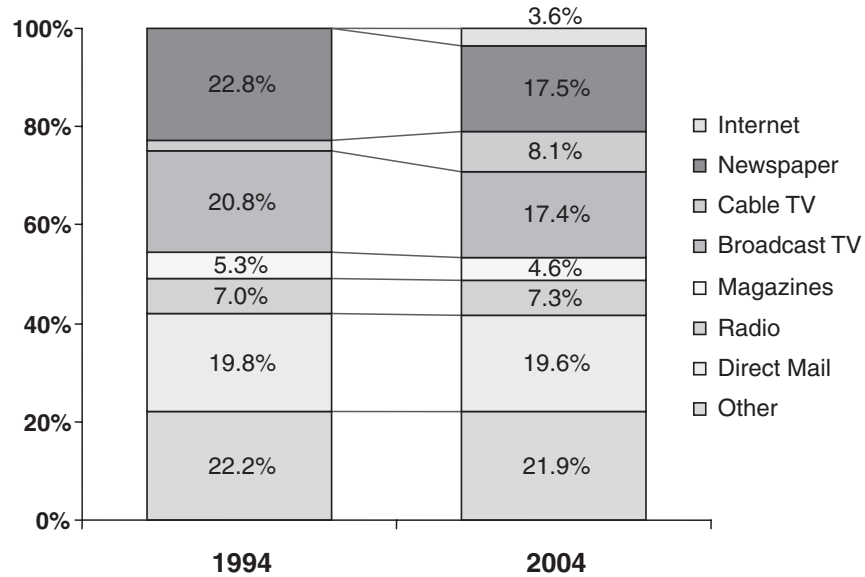
Sources: Merrill Lynch; Kannon Consulting; Newspaper Association of America, April 21, 2004. www.naa.org/horizon/biz.model/businessstrends.ppt/. And 2004 data from analyst Lauren Rich Fine at Merrill Lynch, April 2005. Includes Central Newspapers, E.W. Scripps, Gannett, Journal Register, Knight-Ridder, Lee Enterprises, McClatchy, New York Times, Pulitzer, Times Mirror, Tribune, and Washington Post.

Online Advertising Cannibalizing Traditional Media?

Online media do get a portion of total advertisers' budgets (Figure 7). Online advertising accounted for 4 percent of the total \$267 billion spent on advertising in 2004, in comparison with 25 percent going to television, 18 percent to newspapers, 7 percent to radio, and 5 percent for magazines.⁵⁵

Online advertising is by far the fastest-growing category of advertising (projected to grow at 22 percent in 2005), accounting for an estimated 4 percent of total ad spending by the end of 2005, and 9 percent by the end of 2008. Despite this growth, even by 2008, the vast majority (94 percent) of advertising dollars will reside with traditional media properties.

Moreover, the bulk of online advertising goes to "search" ads as opposed to online display or classified ads that are in direct competition with traditional media advertising.⁵⁶ Even projecting forward to 2008, when total online ad spending is forecast to be \$18 billion, the portion that will be directly competi-

**Figure 7**

Share of Ad Spend 1994-2004

Sources: Interactive Advertising Bureau/PriceWaterhouseCoopers, "IAB Internet Advertising Report: 2004 Full Year Results," April 2005. www.iab.net; Newspaper Association of America, June 2005. www.naa.org; Universal McCann, 2005. www.universalmccann.com

tive is \$8 billion, which is less than half of online advertising spending and a mere 3 percent of total ad spending across all media. Moreover, news sites are only attracting somewhere between 12 percent and 18 percent of all online advertising placements. Of the \$10 billion in online ad spending in 2004, only \$1 to \$2 billion are going to the online news sites (including Google News and Yahoo News). An additional \$2 billion was spent on online classified advertising. When totaled, all online news site and classified advertising is between \$3 billion and \$4 billion, which is far less than the \$70 billion of advertising spent in the traditional news media.

Online Competition in Classified Advertising

The industry segment where the Internet threat might be the greatest is the newspaper classified advertising market. The potential impact could be significant—classified advertising provides 36 percent of total newspaper advertising revenue.⁵⁷

Surveys indicate that Internet news site users rate the Internet better for finding information than the traditional media. Since classified ads are essentially things to be found, online real estate, employment, and auto sites might capture a significant portion of newspaper classified revenues. However, the numbers

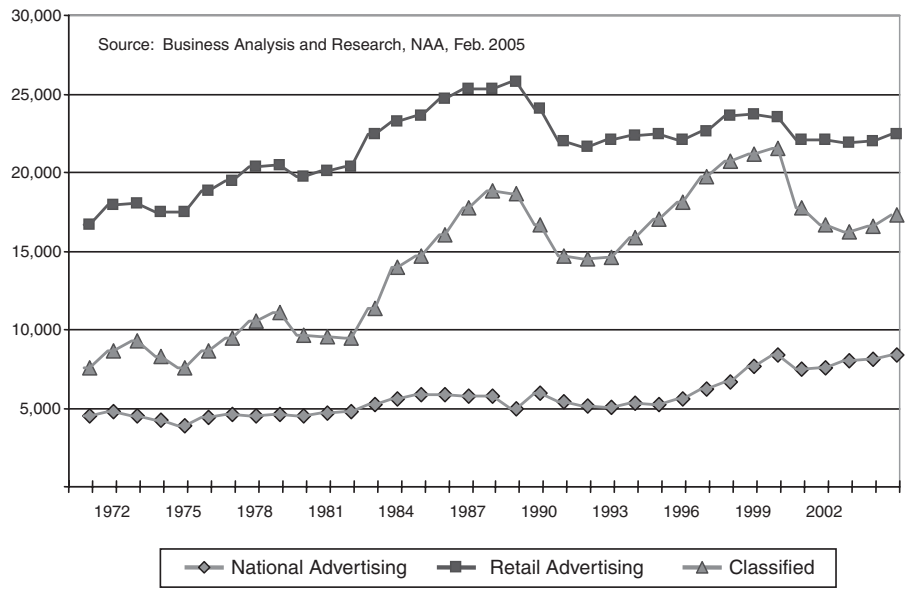


Figure 8
 Newspaper Advertising Revenues (in millions, adjusted to 2004 dollars)
 Source: Newspaper Association of America, 2005. www.naa.org

show that classified advertising in newspapers has been impacted only slightly. For example, from 2002 to 2004, the newspaper classified ad category had 5 percent compound annual growth (CAGR; Figure 8).

Jupiter Research projects that online classified advertising will more than double to \$4 billion by 2009 (Figure 9). This increase is staggering (CAGR of 17 percent), but it is still less than the \$2.5 billion growth that the newspaper classified business is projected to produce in the same period.

No doubt, the 9 percent of total classified ad spending that is now online has put pressure on newspapers. The 5 percent CAGR in print classified ad revenue from 2003 to 2005 would undoubtedly have been greater without online competition. Similarly, the 3 percent CAGR projected through 2009 would be greater. As the New York Times Company notes, “In recent years, Web sites dedicated to recruitment, real estate and automobile sales have become significant competitors of the Company’s newspapers and Web sites for classified advertising.”⁵⁸

An examination of subcategories of classified ad spending shows similar patterns. The Interactive Advertising Bureau estimates that online automotive classified ad spending was between \$225 and \$250 million in 2004, compared to \$5 billion in print.⁵⁹

Borrell Associates state that the entire online automotive advertising category (including display and rich media ads) was \$1.2 billion in 2004 and is projected

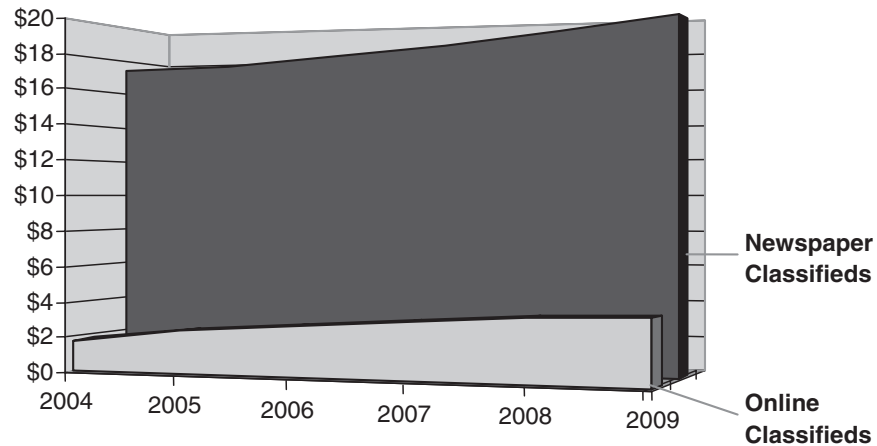


Figure 9

Projected Classified Advertising Growth, Online Classified Ads versus Newspaper Classifieds
 Sources: Jupiter Research, cited in *Investors Business Daily*, by Pete Barias, "Online Classified Ads Getting More Action," April 21, 2005; The Kelsey Group, eContext Electronic Newsletter, April 14, 2004. www.kelseygroup.com

to rise to \$2 billion by 2006. Borrell Associates points out, "While the numbers may seem big, they are still a drop in the bucket compared with the \$30 billion spent on all auto advertising in 2004, the Internet category captured a 4 percent slice of that pie in 2004."⁶⁰

The National Association of Realtors indicates that 53 percent of home buyers use the Internet as part of their home search and that Internet home searchers are more likely to retain a real estate agent.⁶¹ Borrell Associates predicts that 34 percent of all real estate advertising will be online by 2009. Newspapers are projected to have a 42 percent decline in real estate classified advertising from 2004 to 2009.⁶² Although Borrell Associates might well be correct, no such dramatic decline is as yet underway. The newspaper real estate classified advertising category has seen very healthy growth (outpacing GDP growth) every year since 2000 (Table 1).⁶³

Online job recruitment revenues increased at a rate of 15 percent in 2004 (a gain of \$170 million) to a total of \$1 billion.⁶⁴ Print employment ad revenue had the same percentage gain of 15 percent but on a higher base, growing \$600 million to \$5 billion.⁶⁵ Borrell Associates concludes,

Even if online recruitment revenues continued to grow and newspaper revenues remained flat, it would take a 30 percent annual increase in online recruitment spending (nearly twice the current rate of growth) over the next six years for it to reach the same level as newspapers.⁶⁶

Table I
Newspaper Real Estate Classified Ads

Year	Growth
2000	11.6 percent
2001	10.9 percent
2002	4.5 percent
2003	7.8 percent
2004	6.8 percent

Source: Newspaper Association of America, June 2005. www.naa.org

The above discussion assumes that 100 percent of the online ad revenues will go to competitors of offline media. In reality, however, newspapers recapture a portion of these revenues at their online classified advertising sites. For example, Knight-Ridder's online classified revenues in 2004 were \$84 million (more than double what they were in 2002), or 11 percent of their print classified revenues.⁶⁷

While a 10 to 15 percent shift in classified revenues (of which 9 percent has already been absorbed by the industry) may be minimal, it does account for low single-digit growth of print classified advertising revenues. If the growth of online classified advertising continues, we might anticipate a single-digit decline in print classified revenues, especially in the employment and real estate categories.

Overall, however, there is little sign of an advertising crisis in the traditional media industry. The industry is flat or growing slightly but still extremely profitable. Although the Internet and other factors have put competitive pressure on the industry, it is not heading toward extinction.

Media Adjusting to a Competitive World

The switching behaviors of the new consumer market will impact adversely on the traditional media, but the impact is more properly characterized as pressure on the industry rather than a threat to its existence. Moreover, online markets will provide traditional media companies with growth opportunities as they continue to leverage their brands and their customer bases into the new medium.

While margins have remained constant for newspapers and television news divisions, this has come from increased ad rates, subscription rate hikes (newspapers and magazines), and internal cost controls. Declining viewership and circulation puts downward pressure on advertising rates. Ad rates are unlikely to decline, but there is not much headroom for ad rate increases.

Cost control is thus one of the primary methods for maintaining margins. The New York Times Company's 2004 Annual Report claims, "a top priority:

controlling costs.” The company has been effective at keeping labor costs in control, with agreements reached with the Newspaper Guild at the *Boston Globe* and the Pressmen at the *New York Times* that hold wage increases to 2 percent per year.⁶⁸

Media chains have sought efficiency through consolidation. For example, the Tribune Company moved all of its newspapers to a single Washington, D.C., office.⁶⁹ Knight-Ridder, which operates thirty-one daily papers and fifty-three community papers, has also moved toward a greater degree of central management.⁷⁰

Industry consolidation through acquisition is a primary growth strategy for media companies. Expanding from regional markets to national or international markets (offline or online) could also be an effective growth strategy for some companies. For the *New York Times*, growth is taking the form of national and international expansion. For example, the *Times* plans to add four new U.S. print sites. It expanded its distribution from 266 cities in March of 2003 to 317 cities in March of 2004.⁷¹

NYTimes.com is another way the company has sought to extend the franchise to previously untapped markets. In March 2005, NYTimes.com achieved a record 555 million page-views, an increase of 17 percent over a year earlier. During March 2005, 15 million unique users visited the New York Times Web site (an increase of 10 percent from March 2004). This number was five times the number of readers of the *Times*'s print edition.⁷² Across the Web sites of Knight-Ridder's thirty-one daily newspapers, there are 10 million unique visitors per month (up 24 percent from 8 million unique visitors per month).⁷³

Media companies have expanded into new product areas that complement their existing lines of business or act as product extensions. For example, Knight-Ridder, Gannett, and the Tribune Company jointly own CareerBuilder, an online employment recruitment service. Knight-Ridder also owns Cars.com, Cox Enterprises owns a major share of Autotrader.com, and the New York Times Company recently acquired About.com, a heavily trafficked general information and popular culture Web site.

The online versions of most newspapers, television news shows and news networks, and local broadcast TV stations can be seen as product extensions of their existing news products. For most media properties, and especially for newspapers, the lines between online edition and offline edition are fading. Increasingly, media companies are looking to the online versions of their products as sources for revenue and margin growth. For example, total revenues from Knight-Ridder's newspapers were \$2.899 billion in 2004. Total revenues from their online division were \$114 million, or 4 percent of print revenues. While this is still a small percentage of the total, it is a significant source of overall revenue growth. For Knight-Ridder, online revenues in 2003 offset a 0.2 percent revenue decline in the newspaper division to produce an overall corporate revenue increase of

0.5 percent. The online contribution to overall corporate revenue growth was even more dramatic in 2004, when the newspaper division revenue grew at 1 percent but online revenue boosted corporate revenue growth to a total of 2 percent.⁷⁴

As online editions of traditional media properties flourish, the impact on the bottom line may be even more significant than to the impact on revenue growth. In 2004, Knight-Ridder reported \$36 million in operating income on \$114 million in revenue for their online division—this was a 32 percent margin. For their newspaper division, Knight-Ridder reported an operating income of \$595 million on revenues of \$2.9 billion—a 21 percent margin. Although online revenue contributed a mere 4 percent of Knight-Ridder's total revenue, it contributed 6 percent of total operating income margin.⁷⁵

The newspaper industry has its problems. The impact of the online news media is only one of them. Raw materials, primarily newsprint, account for approximately 11 percent of the costs of the newspaper industry. Consolidation in the Canadian newsprint industry (the primary supplier of newsprint) has led to paper mill closures and decreased capacity, which likely will raise the cost of newsprint over time.⁷⁶

Although newspapers have done a good job of holding labor costs in check, they will be challenged to keep cost increases in line with revenue growth. For example, the New York Times Company reported 5 percent revenue growth in 2003 with a total cost and expense increase of 6 percent. In 2004, the revenue increase was 2 percent and cost and expense increase was 4 percent.⁷⁷

Gannett, the largest newspaper chain in the United States (101 papers), has concerns about future cost pressures from rising labor and newsprint costs. In its newspaper division, for 2004, Gannett reported revenue growth of 9 percent with an expense growth of 11 percent. In 2003, revenue growth and expense growth were both at 6 percent.⁷⁸ Knight-Ridder has had a positive balance but only narrowly. It had revenue growth of 2.3 percent in 2004 while expenses rose 2.1 percent. In 2003, revenues increased a mere 0.65 percent while expenses rose 0.46 percent.⁷⁹

A major challenge to newspapers is the "Do Not Call List," which hampers subscription marketing efforts. Telemarketing has traditionally accounted for 40 to 60 percent of subscription sales. Newspapers and magazines both face a constant churn of subscribers. Their business model depended on using telemarketing sales to replace customers at a rate equal to or greater than the cancellation rate. The 2 percent drop in newspaper industry circulation for the six months ending in March 2005 appears to be attributable to the effects of the Do Not Call List rather than to a migration of news subscribers to the online media.

New entrants into the news industry such as Yahoo and Google are a source of concern. The good news for offline news media brands is that people who go online for their news tend to use media brands online that they know and trust

from the offline world. The New York Times Company estimates that it has a 25 percent overlap between its print newspaper customers and its online edition readers.⁸⁰ Given that the New York Times online gets more than 15 million unique visitors each month, the vast majority of these online visitors are new customers.

A growing concern is the media generation gap. Newspapers, newsmagazines, and television news are losing young consumers and are building business models that do not include them. Younger audiences have tuned out. Only 18 percent of eighteen to twenty-nine-year-old adults watch the nightly network news, and only 23 percent of them have read a newspaper within the past day.

Young adults have shifted to online sources. A fourth of this age group gets its news online. But some young adults have turned away from news altogether. In the short term, this will not pose much of a problem for the news industry (offline or online), but it is a major long-term concern. The effects will be felt in fifteen to twenty years as this cohort moves into middle age.

Conclusion

A close analysis of available industry data leads us to conclude that the hypothesized migration of consumers from the traditional news media to the online news media has not happened. At least it has not happened to a magnitude that could be characterized as the collapsing of the traditional news media. We can conclude that there is no indication that the industry is in free fall or that the doomsday talk is justified.

The online advertising component of the industry is smaller than it first appears. Most of the impact from online advertising is in the area of classified advertising, but even here we estimate the impact to be between 10 to 15 percent. The Internet also provides new revenue streams in the area of online classifieds, as traditional news media companies compete online to recapture a portion of the total online advertising revenues.

A customer segmentation model is a more appropriate way to view news consumption behaviors. There is not a one-size-fits-all pattern of news consumption. Instead, there is a broad range of news consumption behaviors. Some users will go online only for their news, others will never abandon the traditional news media, some will be light users of all media, and still others will embrace all media and be multichannel news consumers. For only a small group, the online news media will act as a substitute for the traditional news media. For the majority, it will act as a complement.

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