



We have seen media downturns come and go; the sector often bounces back faster than the overall economy. As we head into the New Year, however, it's clear that what we're facing this time is different. This downturn is not just cyclical. It is coming during a period of ongoing transformation across the media and entertainment industries.

Three fundamental issues facing media and entertainment companies make this downturn especially challenging. First, advertising spending is shifting from traditional media to digital media platforms that offer greater targeting, interactivity, and accountability. Second, marketing spending overall is shifting from advertising to other methods of building relationships with consumers: word-of-mouth, trial, loyalty, and ultimately transactions. As a result, the lines are blurring between media, agencies, and marketers at a time when new growth opportunities are opening up for companies that can better address marketers' and consumers' unmet needs. Third, entertainment is increasingly a retail-driven business (including sales of consumer electronics, DVDs, games, music, and books), with a resulting need to master pricing and promotion capabilities in an environment characterized by slowing consumer spending and greater retail concentration.

Companies are worried about the overall downturn in media and entertainment spending, and rightfully so. Advertising spending is flat or down, and in some categories it is shrinking by as much as 10 percent per year. Moreover, much of the spending growth is going to new players. Of course, the story isn't only about advertising-driven media. Event attendance, until recently growing at a double-digit rate, is also flat or declining. With a slowdown in consumer spending and concerns about when the next economic bell will toll, entertainment categories that depend on retail and gift giving are also facing significant strains. As retailers increase price pressure, these categories will be directly and negatively affected. This will have an immediate, outsized effect on profitability, given the contributions these products have made to profits for many diversified entertainment and media companies.

All these factors make this downturn likely to accelerate ongoing shifts and reduce the expected bounce-back for many traditional media and entertainment companies, unless they adapt to these new realities and build new capabilities. At the same time, companies must address their cost structures, as margins are certainly going to erode in the near term and will most likely decline in the long run.

However, making these adjustments requires significant investment and changes in operating models and capabilities. To afford the required investment and reposition their businesses for both short- and long-term value creation, media and entertainment companies need to use the current downturn as a catalyst to reshape themselves.

### **Pursuing Fundamental Cost Transformation**

Many media companies have already begun to pursue major cost transformation in order to free up resources to invest in opportunities within their changing markets. For those that haven't undertaken serious review and restructuring in this area, it's time to be critical about where money is spent, and how it can be redirected more efficiently and effectively to get more for less.

We know from experience with previous downturns that when better economic times arrived, many leading companies found themselves stronger. Why? They had not limited their efforts to quick fixes like across-the-board deep spending cuts or freezes. Rather, they had used the difficult environment to energize efforts to pursue new and innovative approaches and reshape their operating models. We see such cost transformation opportunities in seven primary areas:

#### *1. Rationalizing products and services to focus on growth*

Typically, in media and entertainment companies, just a few products deliver the majority of profit. Although many others fill out the portfolio, they contribute little to the bottom line. The poor performers are often older products and services that have become sacred cows; they may also be more recent launches that have not delivered despite initial high-growth prospects.

Media companies need to make tough calls to ensure that resources are not going to low-growth areas and absorbing an inordinate amount of management time and company resources. Examining the company's offerings and simplifying the product mix can streamline the business and boost profitability. Beyond the immediate financial impact – typically increasing earnings before interest, taxes, depreciation, and amortization by 10 to 20 percent – indirect benefits accrue from greater management focus on core businesses. It is time to take a scalpel to the business before the market or equity owners demand more draconian measures.

#### *2. Looking for new opportunities in outsourcing and offshoring*

Most media companies have tapped lower-cost labor resources, both in the U.S. and abroad, for areas such as back-office functions, saving as much as 60 percent. Because leading media companies have had good experiences with outsourcing, they are now pushing beyond the obvious areas and into core business activities such as editorial and content development, marketing, and sales. More and more companies are also exploring partnerships with players similar to them in order to grow scale. These trends are relevant to media and entertainment businesses as

varied as business-to-business information providers, magazines, newspapers, and video-game designers.

### *3. Centralizing or creating shared services*

Companies should root out services that are candidates for being centralized or shared as opposed to being left in various business units. Similar to outsourcing and offshoring, this practice has extended into all areas, even the most brand-defining ones, such as editorial or application development. If it is pursued with an eye toward efficiency, savings of more than 20 percent are typical, along with better demand management and greater scale. Only functions unique to a business or requiring very high levels of accountability and flexibility should remain decentralized.

### *4. Optimizing the footprint*

Whether they have retained locations from acquisitions or simply operated with more – or more expensive – space than actually needed, media companies can aggressively reduce and optimize their use of space. Doing so can cut costs as much as 40 percent without painful head-count reductions. Increasingly, business units and divisions are agreeing to share space in major cities. Work-at-home options are not only a cost-saving measure but an opportunity to bring new talent into the business. And tighter use brings down space-related costs substantially. Selling unused locations, moving functions outside major cities, subleasing, and pursuing new energy sources (e.g., solar panels) can also drive one-time and ongoing savings.

### *5. Streamlining the organization*

Organization redesign and pruning tends to be one of the first efforts companies make in a downturn. However, the changes often reflect a short-term orientation and do not involve a systematic restructuring that challenges compensation levels, title inflation, duplication within business units, and management spans and layers. As a result, the costs will return in time. When done well, streamlining can yield sustainable savings of 5 to 15 percent with improved organizational efficiency. More aggressive companies control people-driven costs by capping raises through 18-month review cycles and by better controlling promotions and raises even during good times.

### *6. Building world-class procurement capabilities*

Sourcing influences as much as 50 percent of the cost base in many media and entertainment companies, and that percentage continues to grow. Having a dedicated and skilled sourcing capability, closely examining procurement practices, and pursuing aggressive vendor restructuring can save 10 percent or more. If an organization has not pursued a major sourcing review and restructuring recently, it may be making staff reductions that could, in the near term, be replaced by lower purchasing costs.

### *7. Sharing best practices*

Leading companies are pursuing structured approaches for identifying, documenting, and disseminating best practices across the business. Best-practices programs can span areas including editorial and content processes, sales effectiveness, pricing and yield management, and human resources management. Although savings tend to be lower, at 5 to 10 percent, the long-term operational benefits from greater consistency will continue for years to come.

Given margin trends in today's cyclical and secular downturn, every cost must be highly justified and rationalized to the most granular level possible. Far too often, businesses complete rounds of reduction, only to end up where they could have gotten much sooner through aggressive cost transformation. We encourage media companies to take the money freed through cost transformation and invest at least a portion in opportunities for growth, while dropping some of the immediate benefits to their bottom line.

### **Reinvesting for Growth**

Consumers are no longer content to passively enjoy print, video, or other forms of entertainment and information. In today's search-driven world, consumers actively look for control, community, and interactivity related to content. They want information and entertainment on multiple platforms, including TV, print media, the Web, mobile devices, and events. They also want to share their experiences via communities built around the consumer or business-to-business media and entertainment they choose.

As the search-driven world creates seismic shifts in consumer demands and behavior, marketers are racing to keep up, moving away from one-way awareness building and toward two-way conversation. Our recent Marketing and Media Ecosystem 2010 study, conducted in collaboration with the Association of National Advertisers (ANA), the Interactive Advertising Bureau (IAB), and the American Association of Advertising Agencies (AAAA), asked marketers which partners would become more important to them in the future; more than half said media companies. We see this expectation building as media companies work with marketers to deliver greater targeting, engagement, and accountability, as well as more innovative advertising and marketing solutions. In many cases, media companies are extending their offerings beyond high-end selling efforts to drive better and more integrated content across platforms. In doing so, they are extending into new agency services and custom media offerings that blur the lines between media company, agency, and marketer. These include agency services such as Web-site development, branded content, database marketing, and lead generation.

To take advantage of these shifts propelled by both end-users and marketers, we have identified three main opportunities for media and entertainment companies:

- The new convergence: creating more targeted and interactive offerings through a marriage of content and applications
- New growth frontiers: building new businesses that position companies on the next explosive growth curve
- New global markets: focusing on pockets of opportunity without falling prey to historical challenges for profitability

Each of these three opportunities requires a new way of thinking about the company, extending its center of gravity beyond traditional media and entertainment businesses. Media companies are pursuing new content and technology partnerships to take advantage of these opportunities. They are also taking a hard look at how to accelerate these actions, even as markets remain highly uncertain. The need for short- and long-term revenue growth, and the buyers' market for talent and asset acquisition, make a compelling case for companies to take advantage of these opportunities now.

#### *1. The New Convergence*

Although content is still king for media and entertainment companies, today it shares the crown with applications. Consumers don't want to just read a static review of a travel destination; they want to know what their peers think, as well. They expect Web sites to provide meaningful recommendations and tools that fit their needs. They don't want to passively listen to a radio playlist or wait until they have access to a television to check sports scores or financial and business news: They want this data to be portable, customizable, and available immediately. They want access to a greater range of information from a variety of sources in ways that are convenient, easy to control, and personalized, and that link them to their network wherever they may be.

For business-to-consumer and business-to-business media companies, building a winning digital strategy requires both higher traffic volume and a greater quality of impressions. Digital strategies need to address the basics, such as easy site navigation and relevant tools to keep users coming back. Companies also need to deliver site experiences that build deeper relationships with the audience through carefully connected content and applications. The digital strategy needs to focus on the areas in which consumers or business professionals are most interested and where the company can build a clear competitive advantage. At the same time, search engine optimization, personalization, and collaboration need to draw in users and give the company greater insight into their characteristics and preferences.

The resulting larger and more targeted audience provides greater revenue opportunities. Ad-supported media companies need to take advantage of the full digital tool kit to build premium inventory, whether from targeted and tagged site

areas, in interest-specific electronic newsletters, or through registration-required applications, games, and contests. This allows media companies to migrate from serving impressions to building relationships. Beyond selling targeted advertising, such engagement allows media companies to migrate toward new relationship marketing opportunities linked to lead generation, loyalty programs, and transactions.

New digital strategies combining content and applications as well as relationship marketing capabilities also offer significant value to entertainment companies. Like media companies that use multiple touch points to attract audience members and keep them engaged, entertainment companies can use relationship marketing strategies to drive consumers into stores, theaters, bookstores, and e-commerce sites. They can build relationships directly with audience members, who, in turn, become further engaged and spread the word about specific entertainment franchises.

## *2. New Growth Frontiers*

The shift to digital is opening up substantial new arenas for media and entertainment companies. We see significant opportunities for them to build new businesses around solutions for marketers: These can go beyond traditional sales approaches that provide additional value as part of the sale, instead being structured on a fee-for-service model. This applies equally well to business-to-consumer and business-to-business media. Business-to-business media companies also have significant opportunities in data solutions driven by end-users that enhance workers' productivity by providing must-have information and applications in their workflow. Finally, we also see major growth frontiers opening up for new advertising models such as in-store advertising, mobile advertising, and video-game advertising.

Some well-known media players are successfully building distinct marketing-services businesses for clients that go beyond high-end selling efforts. A good example is Meredith Corporation's custom communications division. With a database of more than 60 million women and its high-profile consumer magazine brands as a foundation, the company acquired several agencies to develop capabilities in custom media, database marketing, and research. Meredith has kept that business largely as a stand-alone operation to preserve its focus on finding and maintaining fee-based business. However, Meredith actively cross-sells services between advertising and agency clients and pursues opportunities across business lines for key accounts. This strategy is paying off: Meredith is now the database marketing agency of record for Kraft.

The development of agency services provides an opportunity to deepen client relationships while tapping into new budgets beyond paid media. This is particularly important because below-the-line spending on marketing opportunities like Web sites, loyalty programs, promotions, and direct marketing now represents more than three-quarters of marketing spending in many

categories. Over the past few years, these areas have grown three times as fast as than traditional media. Moreover, we expect such below-the-line spending, which is more targeted, interactive, and accountable, to gain more marketing budget share during the current downturn.

Business media and information companies have a clear imperative to find new ways to grow. Booz & Company recently completed a study for American Business Media (ABM) and found that virtually all the growth in this market is coming from new revenue streams – and not just online advertising. Opportunities related to custom media, lead generation, agency services, and data solutions account for the lion's share of business-to-business media and information industry growth. With print ad pages declining at an estimated 6 percent for 2008 and events down this year after double-digit growth in the last few years, business-to-business media and information companies need to embrace these new areas to achieve profitable growth.

The ABM study also found that leaders have a primary focus on one of two distinct transformation paths: solutions driven by marketers and those driven by end-users. One path involves migrating from selling advertising impressions to providing a broader set of marketing services. The other path involves delivering high-value information and applications in the end-user's workflow and monetizing these directly from institutions and individual end-users as opposed to via ad-supported offerings. Leaders recognize that each path requires distinct capabilities, and they prioritize their investments and align their organizations accordingly. Choosing a path and moving forward aggressively has its reward: Leaders are significantly more likely to outperform their industry on growth (70 to 80 percent of leaders on each path outperform the industry versus even odds for those less far along either transformation path). Moreover, these leaders are gaining print spending share, growing their print business even as the sector as a whole sees print revenues fall.

Many companies are also pursuing several other high-growth strategies, including video-game advertising, mobile advertising, and in-store advertising and other place-based media. Among these options, in-store and place-based media are poised for especially rapid growth, in our view. Marketers and retailers are complementing static displays and in-store promotions with targeted, video-based advertising in the store that can activate the marketing message and serve as another element in an integrated ad campaign. With new metrics such as Nielsen's PRISM (Pioneering Research for an In-Store Metric) and better programming, creative content, and targeted ad formats, we expect in-store advertising to take off rapidly, even in a challenging market. In addition to broadcast players like NBC Everywhere and CBS Outernet that are aggressively pursuing this new

market, we see significant opportunities for other content players. National cable and magazine companies in categories such as gardening, food, home improvement, sports, and health can extend their brands and deepen their positions across multiple media platforms, while creating richer opportunities to develop integrated campaigns for advertisers.

### *3. New Global Markets*

Today, we see compelling new reasons for exploring growth globally. In China, India, South Korea, Brazil, the Middle East, and segments of eastern Europe, media and entertainment markets are growing much faster than in the United States and western Europe. A more relaxed attitude toward foreign ownership of and access to media and entertainment assets is emerging in some previously restrictive climates.

Of course, media companies have exported content overseas for decades while setting up country- and region-specific versions of their cable channels or print brands. Entertainment companies have set up in-market distribution arms for their films, TV shows, DVDs, music, and video games. In fact, we've already gone through a period of expansion and contraction. We saw an initial rush to expand the global footprint followed by a retrenchment to fewer country-specific offerings and more regional hubs and partnerships in order to share costs or, in some cases, to simply break even.

At the same time, significant untapped growth potential exists in many markets. The key is to choose the right pockets of opportunity based on the likelihood of profitable growth. Doing so requires a careful prioritization of promising sectors and markets, as well as the right market entry and expansion strategy. This may mean challenging some basic tenets of media and entertainment companies' operating models. For example, some companies may need to pursue licensing and partnership agreements rather than full production and marketing control. They may need to forge new partnerships to share costs and reach greater economies of scale. They may need to move beyond regional hubs to selectively wade back into local operations. For example, why serve Korea's television production or video gaming needs from a regional Asian hub when Korea is a leading market in each of these areas?

### **Moving Forward**

No one welcomes a recession, but media and entertainment companies can and will weather this storm, emerging with real opportunities for significant growth. We encourage media and entertainment companies to use what we have learned from the last downturn to position themselves strongly for the long term when the economy rebounds. It is time to take lessons from history and apply them with an

eye toward the future of digital and below-the-line opportunities, while examining fresh chances in new services and markets. Those learning opportunities will allow companies to tap into faster recovery and a sustained expansion. Pursuing aggressive cost transformation in the short term will help companies fund these longer-term and exciting new areas of growth.

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