Paper cuts

by Michael Caruso
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Before making an investment in the newspaper business, investors should be aware of the industry's challenges and initiatives that will enable them to maximize profit and return on investment.

Historically, newspapers have been among the most lucrative segments of the media industry, with strong cash flows and little leverage. However, fundamental changes are occurring that may motivate newspapers and their investors to reduce costs and improve profits. In spite of generally strong overall economic growth in the past decade, profits in the newspaper industry have decreased.

According to the Project for Excellence in Journalism, publicly traded newspaper earnings declined 10% in 2007 due to several long-term trends, such as the displacement of local retailers by national chains. In these cases, advertising revenue generally decreases because local shops are more likely to purchase newspaper advertising. In addition, newspapers now face greater competition from niche and direct-mail publishers, as well as an increase in "image" advertising from companies such as **Target Corp.** This type of advertising focuses more on a company's brand than on price and is less likely to rely on newspaper advertising.

One way to help bridge the gap is to examine advertising rates and discount policies by segments — e.g., retail, automotive and real estate — to determine the least profitable categories. In addition, newspaper investors can improve costs and customer service through more effective ad-servicing methods, such as high-commission-based sales plans, detailed revenue monitoring per sales representative and increased electronic processing.

Another major challenge faced by the newspaper industry is the rise of the Internet, which directly competes for advertising revenue as well as readership. According to data gathered by the Project for Excellence in Journalism, newspaper readership is down from previous years for all age groups. This is compounded by the fact that younger generations tend to obtain news from sources other than newspapers. As the baby boomer generation gets older, experts predict readership will diminish even further as more people turn to online media sources.

Publishers have attempted to compete with Internet companies by offering their own online products, but they have not sufficiently replaced lost cash flow. Online revenue represents less than 5% of total newspaper revenue, and growth is slowing — down to 20% in 2007, from more than 30% in prior years.

Advertising revenue and profits closely follow the economic cycle, so the economic downturn will have a devastating impact on an already beleaguered industry. Fortunately, there are numerous cost reduction and profit improvement opportunities available.

If a newspaper is in a turnaround situation, significant value may be gained by pursuing a sale to a neighboring newspaper or a strategic partnership. The strategy

behind many recent acquisitions has been clustering neighboring newspapers and consolidating production, distribution and administrative operations to reduce costs.

There are many initiatives that can be employed, whether a company is in a turnaround situation or not. Circulation is one of the first areas that should be examined. Many newspapers have gone to great lengths to keep overall circulation volumes as high as possible, despite the lack of a quantifiable link between circulation volume and advertising rates. Discounted or free subscriptions to hotels and schools may increase circulation numbers for a time, but they can be a heavy drain on cash flow and they usually do not include the paper's core customers. Newspaper professionals should focus on their core customers to get the best readership rates and most effective return on their advertisers' investment, a strategy that is likely to reduce printing and delivery costs and allow advertising revenue to remain stable.

With innovations in desktop publishing, printing press, collation and truck-routing technology, production and distribution expenses have already decreased for many publications. A good way to supplement this is to apply product improvement techniques. One recent example of this is the Fort Worth Star-Telegram. Since its purchase by the **McClatchy Co.** in 2006, the Star-Telegram has made several changes to the print edition and online operations in hopes of improving reader satisfaction, increasing revenue and decreasing costs.

The Star-Telegram announced in a June 16 press report that it is making further changes to its business model, streamlining operational costs and raising revenues by combining certain sections of the print edition, which will reduce printing, material and distribution costs; increasing the cost of a home-delivery subscription, which will improve revenue; and making a work force reduction, which should enhance operational efficiency and decrease overhead.

General improvement techniques such as these are not rare in the newspaper industry. They are a good starting point, but as the economy continues to weaken, more publications will utilize business process improvement methodologies such as Lean and Six Sigma to become more profitable. These techniques focus on reducing cycle times and defects with an overall reduction in costs. They are data-driven methods that carefully define and measure an operation before making improvements. Although they originated in manufacturing operations, methodologies such as these have been used successfully in many different organizations and are a proven, time-tested means of lowering costs. They are the backbone of world-class operations such as **Toyota Motor Corp.**, **Motorola Corp.** and **General Electric Co.**

Lean and Six Sigma techniques can be applied to all aspects of the newspaper business, and the editorial department is a good place to start. In large newsrooms, the editorial staff generally is isolated from business operations — particularly information regarding advertising revenue — in order to avoid potential conflicts of interest. While this is often a necessary precaution, it distances newsrooms from cutting-edge process-improvement techniques.

Lean and Six Sigma can be applied without creating a conflict of interest. A disciplined approach to process improvement should yield significant cost savings and ultimately improve the editorial product. For instance, the Chicago Tribune recently announced new reporter productivity metrics, an excellent but rare example of process-

improvement efforts within a newsroom.

Measurement, while critical, is only a small part of the process. A good full-improvement effort begins with defining and setting tangible goals, determining what to measure, mapping the process for achieving those goals, measuring each step and analyzing the data to determine variations and patterns. This allows the company to find the root cause of the problem. After this is determined, a comprehensive improvement plan and control process should be developed and implemented.

It is too early to speculate whether the improvement techniques of the Chicago Tribune will be successful or not, but most likely, the publication will employ additional initiatives to complement its efforts.

One initiative the Chicago Tribune and other publications can explore is cost-saving opportunities in general and administrative expenses. Process improvement efforts in the finance and IT departments can lead to significant savings and an immediate reduction in costs. A few examples include improving collections, refining purchasing procedures and outsourcing.

The pre-eminent market and journalistic position of the newspaper industry has enabled it to avoid the extreme competitive pressures that have impacted many other industries. As it now faces long-term structural decline, dwindling readership and a cyclical economic downturn, newspaper investors must closely examine their businesses and the improvement techniques available to maximize value. n

Michael Caruso is a managing director of CRG Partners Group LLC, a certified public accountant and a certified Six Sigma black belt.