

The Double Bottom Line (DBL) Media Industry *An Analysis of Investment Opportunities*

A Report by the Investors' Circle Foundation

Executive Summary

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EXECUTIVE SUMMARY

The DBL Media Industry's Capitalization Gap

The mass media market is a growing business sector that has a profound impact on all aspects of our lives. From broadcast television to newspaper publishing, magazines to video games, mass media influence our perceptions of the local, regional and global communities of which we are a part. The media companies that reach the most people have significant global scale and scope, and operate within an intensely competitive and often lucrative business climate. This mainstream market dictates that most media companies prioritize maximization of short-term profits over concern for social responsibility and the needs of “non-mainstream” segments of the population. It is no surprise, therefore, that their primary concern is to stay ahead of the competition and to keep shareholders satisfied.

Many investors and interested observers, however, are wary of the long-term effects that such fundamental market conditions have on our communities and culture irrespective of profit. In this context, some philanthropic organizations and private companies are increasingly paying attention to media companies that attend to their social impact *as well as* their financial bottom line. We call these organizations “double bottom-line” (DBL) media companies.

Recently, some of these DBL media companies have had notable financial success and have helped to illustrate that the competitive business climate does not foreclose the possibility for social responsibility. In most cases, however, DBL media companies are trapped in a cycle of undercapitalization that limits their scale and growth. For these underresourced companies, the traditional sources of philanthropic funding are vital but insufficient to compete with conventionally financed and more mature for-profit companies. DBL media companies nevertheless have not yet fully exhausted the various innovative equity and debt financial tools used by other financial market entities. We believe that these untapped and underdeveloped investment resources can close the capitalization gap that occurs at the essential early stages of business development. Supporting the growth of an efficient capital market is essential to making the DBL media industry more effective, vibrant and self-sustaining.

Mindful of this present climate, in the fall of 2004, Investors' Circle's research team completed the first draft of this report with sponsorship from the Ford Foundation and in collaboration with the Calvert Social Investment Foundation. The report intends to provide preliminary insights into DBL media companies as well as DBL media funders and investors. We found a significant number of DBL media companies across every industry sub-segment. Many of these companies, however, do not have the necessary access to capital to grow or be self-sustaining. We found that many investors perceive additional risk in this kind of venture. But our research of investors and funders helped us to identify the affirmative ways in which foundations and investors can meet the capital needs of DBL media companies and manage this risk appropriately. We believe

this report addresses perceptions of risk by providing details underlying the following three chief conclusions:

1. The so-called “DBL media industry” represents a rich collection of niche areas with strong opportunities for growth within the larger generalized “media industry”;
2. To achieve long-term sustainability, DBL media companies can (and perhaps must) continue to rely on philanthropic grant-making, but, more pertinently, must begin to look and prepare themselves for market-oriented financing, including debt and equity financing; and
3. To achieve social impact and long-term viability, the DBL media industry requires basic “rationalization” to improve its information and capital efficiencies. Significant capital and infrastructural gaps need to be filled in order for the most promising DBL media companies to be able to grow effectively and reach financial and social success.

The report ultimately advocates a substantial long-term initiative to help build a viable DBL media market. This initiative will require the collaboration of interested investors, funders, trade groups and entrepreneurs. The report is based on the lessons learned from our preliminary case studies, surveys and interviews with knowledgeable entrepreneurs, funds and foundations. In its conclusion, the report enumerates a set of specific next steps and reflects on factors critical to the success of DBL media investment and growth.

Identifying DBL Media Companies

For the purposes of this report, DBL media companies have the following three broad characteristics, which are distinct but sometimes overlapping: **minority-oriented, independent, or social mission-focused media**. Each characteristic is framed and measured separately:

Minority-oriented media companies have as their central mission the representation, support and targeting of a particular ethnic or other demographic minority group. We look to the composition of audiences, ownership, management and editorial/creative staff, as well as content to determine whether a company’s focus falls into this category.

Independent media companies do not allow a profit motive to subordinate their creative or production processes. For this category, we evaluate the composition of ownership, management and focus of the creative (i.e., editorial and programming) staffs to determine whether a company falls into this category.

Social mission media companies focus primarily and often explicitly on the achievement of specific social, political or cultural goals unrelated to profit. For

this category, we look to the company's mission, attention to financial returns, and philosophy of management, as well as content.

All three types of companies are alike in that they seek, fundamentally, to have a positive social impact in ways that mainstream media do not. Of course, each individual entrepreneur and investor determines for himself or herself whether a particular company is socially valuable. In addition, while the content focus of many of the companies that we observed have a progressive political perspective, we believe that a company's underlying mission and value characteristics – not its political orientation – are essential to the development of a vibrant DBL media market.

For the purposes of this report, and in keeping with many other media industry analyses, we have divided the industry into the following 11 consumer- and advertising-driven segments: broadcast, cable and satellite television; broadcast and satellite radio; film, DVD, video and video game entertainment; newspaper, magazine and book publishing; the Internet; and one specialty market segment central to all other media segments -- advertising services. In 2003, these segments together represented about \$405 billion out of \$648.3 billion in total media industry revenues. The three categories of DBL media we identify above are active in all segments.

Media Segment Highlights

The report explains that there are DBL media companies in every segment of the industry. Some preliminary insights relating to those segments addressed in the report are the following:

- The television segment is consolidated and, for smaller DBL companies, difficult to penetrate. Investments in infrastructure or programming need to be substantial. Public television and radio distribute a great deal of social mission programming, but very few of these succeed commercially after initial distribution. For example, the report briefly features **Urban TV Networks**, a media production company that produces and distributes African-American-focused content. The content currently reaches 22 million urban households via 77 affiliate stations and is already coming close to breaking even.
- The radio segment and small local broadcast stations, in particular, offer lower cost structures than television. Examples featured in the report are **Air America Radio (AAR)**, a recently established progressive talk radio network that provides an alternative to conservative talk radio through syndication and affiliation content deals across the country, and the **Spanish Broadcasting System (SBS)** which owns 19 stations and, thus, is the largest Latino radio broadcasting company in the United States. Low-power FM radio stations also offer micro-financing opportunities, but are limited to non-profit ownership.
- Publishing has lower cost structures for production and distribution than television or radio. This segment is one of the most promising for successful DBL investment, especially for aggregation plays of content and distribution.

The report cites several notable companies as examples, including: **Publishers Group West (PGW)**, one of the largest marketing and distributing companies in North America for independent book publishers, generated about \$165 million in revenue in 2000, and **Media Properties**, an African-American company that owns and operates community newspapers for African-American and Latino communities in the Los Angeles area that has generated between \$4 million and \$5 million a year in revenues over the past several years.

- The entertainment segment is competitive and driven by individual “hits.” It remains one of the riskiest segments for investment even as independent film may have matured enough for a portfolio approach. **Participant Productions**, a social mission film production company founded with significant capital resources and mature distribution relations, stands out as a notable exception in this space.
- The Internet segment has the lowest content creation and distribution costs of any media segment. However, in general, revenues do not yet cover sales and marketing costs. DBL investors should remain mindful that new technologies in this segment could help create new models of distribution and marketing. One company featured in the report is **Globalvision Media**, a recently created global news service that purchases and aggregates print and broadcast content from more than 350 local news organizations in 125 countries to deliver diverse and unique news and information.

Research: Surveys and Interviews with DBL Media

The lack of comprehensive investment research into the DBL media industry makes it difficult to develop an accurate portrait of, let alone draw firm conclusions about, the landscape of early-stage, privately held companies that might attract investors. Thus, we began to develop and distribute nationally across the industry admittedly unscientific surveys designed to elicit preliminary demographic and financial information about such companies.

The primary survey targeted 5,907 DBL media companies through 13 trade groups including, for example, the Association of Hispanic Advertising Associations, the Independent Press Association, the National Black Programming Consortium, and New America Media (formerly New California Media). The survey generated more than 641 responses nationally (an 11% response rate) from trade groups across every industry area. We also conducted surveys and interviews with DBL media leaders, fund managers and investors and completed three case studies on investment models in current use. While more careful analyses are needed for a complete understanding of DBL media companies, the report makes several preliminary conclusions, including the following:

- DBL media companies are predominantly small companies, as measured by employees and revenues;
- they are highly motivated by their social missions;
- 88% were for-profits and 12% were non-profits;
- 65% were either breaking even or profitable;

- 75% have an interest in outside financing;
- 40% have a three- or five-year financial model;
- one-third are willing to consider selling their company; and most content producers are decisively committed to maintaining creative control.

The report reviews the tools and structures available to DBL media companies to make recommendations about how best to fill the capitalization gap.

Financing DBL Media Companies

We learned from our research that, traditionally, DBL media companies have looked to philanthropic as well as informal investment sectors for financing. As the entire media market continues to become more competitive and actively financed through investment capital, philanthropic sources of funding are simply not sufficient to sustain DBL media. The report explains that, in this climate, both private, for-profit sources of innovative equity and debt financing, as well as non-conventional deployment of debt- and equity-like grant instruments are critical to achieving long-term sustainability of DBL media in the private market. Indeed, the present state of affairs is not merely a function of DBL media companies' (im)maturity, but also a reflection of the paucity of capital investors and instruments especially attuned to the capital needs and limitations of emergent media companies that are themselves unsure about next steps.

Private Equity – A Good Vehicle but Limited in Volume

Private equity firms and funds generally invest in companies at all stages of development if they have stable underlying assets and intellectual property, or high-growth potential. Private equity finance sources include strategic large media corporations, general buy-out firms, specialty media buy-out firms, venture capital firms, and angel investors. All of these entities generally consider the financial bottom line paramount in making investments.

Nevertheless, some angel investors and equity funds have begun to make specific investments in social mission media companies. Known social mission angel investors represent approximately 1% of all angel investors and invest infrequently in the media industry. (Investors' Circle, the sponsoring organization of the report, is a network of such angel investors focused exclusively on social mission companies.) The Columbia Business School's RISE Capital Market Report was able to survey approximately \$1.9 billion of capital invested in 2002, in social and environmental deals, or about .6% of capital invested by venture capital funds. Further, RISE found that the total number of deals completed by DBL funds represented about 6.2% of venture capital (VC) deals, signifying an orientation toward a greater number of smaller deals. These DBL funds include the following four types: mainstream VC funds that have devoted some portion of its capital to DBL deals; highly focused DBL industry niche funds that focus on specific issues such as charter schools or alternative energy; funds that emphasize increasing opportunities of ownership/management of underrepresented groups; and funds or fund activities embedded within philanthropic foundations and public charities.

Researchers have estimated that these equity fund investors have between \$2 billion and \$6 billion available for investing in DBL companies, a small portion of which will be media.

Debt Markets: A Good Vehicle with Significant Hurdles

The average debt-to-equity ratio for all publicly traded media companies (.61) is significantly lower than that for the entire “services” industry (.82) and even lower than the average debt-to-equity ratio across *all* industry sectors (.89). The mass media tend to be much more cash-flow-oriented than asset-backed. This makes lending difficult since debt investors generally perceive risk in lending to enterprises that have limited hard assets. As a result, media companies need to obtain adequate equity in order to gain investor confidence. What is more, most emergent DBL companies rarely have sufficient assets to gain the access to the same sources of debt financing to which mainstream media companies do. DBL media companies accordingly have looked to two specialized sources of financing: revolving loan funds (RLFs) and program-related investments (PRIs). RLFs are exclusively debt instruments, but PRIs can be structured either as debt or equity.

Revolving Loan Funds and Program-Related Investments: Specialized Vehicles with Promise

Revolving Loan Funds (RLFs) are debt vehicles that loan an amount, recoup that amount with interest over a short period of time, and then re-lend those funds going forward. They have historically been non-profit organizations with specific social missions that essentially act as intermediaries for investors or donors wishing to reach enterprises’ capital needs in a sustainable manner. Two DBL media debt funds, the Independent Press Development Fund (IPDF) and the Media Development Loan Fund (MDLF), are organizations that successfully operate such funds.

Program-Related Investments (PRIs) are investments made by public charities or foundations to support activities which align with their own grant-making priorities and from which they expect a below-market return of capital within a certain period. PRIs include financing instruments commonly associated with banks or other private investors, such as loans to non-profit organizations as well as loans and equity investments in mission-related for-profit organizations. Foundations commonly make PRIs to supplement their existing grant programs, many of which focus on the very social concerns addressed by DBL media. The U.S. Internal Revenue Service has sanctioned PRIs as a specific means of stimulating investing in social enterprises that exist in the private market, but which could not obtain capital investment from conventional sources. While PRI program activity has been on the rise, it has not increased significantly for media directly. Yet, the scale of the capital gap, and the substance of the social mission of many DBL media companies appear to line up significantly with the strategic goals of PRI programs of many foundations. In an emerging market that requires innovative leadership, such PRI financing can provide an essential element to a more efficient and effective capital market for DBL media.

Market Infrastructure: Fragile and Fragmented

The capital market for DBL media companies is represented by only a few important, but mostly fragile emerging trade groups and even fewer financial intermediaries. Most of these intermediaries have limited financial service offerings if any at all. Trade associations, particularly in publishing, are attempting to address market inefficiencies in distribution and financing. But they have limited resources to do so. The community of independent DBL investors is also in the early stages of development and its support organizations have limited resources.

Recommendations: Rationalizing the DBL Media Industry

Investors interested in DBL media companies generally want to support specific social agendas across several media segments. Almost all such investors wish to invest in companies that are likely to survive, grow and achieve some level of financial returns. Our research leads us to make the following generalizations about the investors that may have an interest in DBL media:

- Most institutional investors with an interest in the DBL media industry invest in larger companies, particularly in emergent ethnic minority broadcast television;
- Pension funds, banks and government funds have invested in minority-focused media funds in increments of \$1 million to \$5 million. These minority-focused funds tend to invest in high-return, expansion stage (often larger) media companies rather than smaller, high-risk DBL media companies. These funds and their institutional limited partners often do not self-identify as DBL investors, even though they recognize the added social value to certain profit-centered investment areas, including media;
- Most DBL media investors are individuals and foundation PRI programs set to invest between \$100,000 and \$2 million per deal directly or through media funds;
- Most DBL media investors are particularly motivated by important social issues and, therefore, this group of investors is unique in the investment community;
- DBL media investors recognize that their investments are intended for stable, long-term revenue and profit growth, with an understanding that this includes lower to medium growth over time. While the community has no real DBL performance benchmark as guidance, it appears more “patient” and accepting of below-market rates of return;
- Lack of collateral on the balance sheets makes equity investments, rather than debt, the appropriate (and exclusive, if not lead) instrument for growth and expansion finance for DBL companies in most cases;
- Debt instruments are a good investment tool for DBL media companies in two cases: first, when a company needs to launch sales and marketing campaigns for

reliable, subscriber-based cash flows; and, second, when a company requires completion gap financing for a creative product that is near completion and that has secured distribution; and

- DBL media investors understand that they are financing, in part, the development of a unique market. Since DBL media companies go public or get acquired at a lower rate than industry average, such investors must be willing to tie up capital for longer periods of time.

On the basis of these assumptions, the report finds that a necessary financial planning exercise for the DBL investor is to create an explicit set of performance expectations – including reasonable expectations for financial return – for their investments in DBL media. The report recommends seven basic guidelines to help generate a worthwhile financial return, mitigate risk, and help to expand the DBL media market:

1. Distribute Investment Risk: Invest in funds or other similar vehicles that apportion risk across multiple DBL media companies and that emphasize diversification of businesses and follow-on investment. This is particularly necessary for investors participating in fragmented, undeveloped markets such as the DBL media industry.
2. Insist on Business Fundamentals: Investors should choose DBL media companies that employ standard business fundamentals to drive their businesses. Unique DBL characteristics, in and of themselves, are not sufficient investment criteria.
3. Design for Scale: Investors should consider DBL companies with clear opportunities to scale revenues and market share.
4. Aggregate: As in Recommendation Three above, invest in the aggregation of several DBL companies into a larger business platform that can benefit from scale but still protect the mission focus.
5. Leverage Dominant Players: Consider companies that have a proven track record in establishing deals for distribution or production, including strategic partnerships with the larger players.
6. Plan for Exit: Most investors with long-term horizons (i.e., “patient investors”) must consider exit strategies. Therefore, it is important to screen for DBL companies that have a credible plan for and demonstrated ability to manage, for example, a private sale, recapitalization during an expansion round or an initial public offering.
7. Provide Technical Assistance & Support Capital Market Intermediaries: Infrastructure needs to be built to offer services for both institutional and individual investors who wish to invest in DBL media. Infrastructure entities also will assist DBL media companies to secure capital. Creating a series of linked capital market intermediaries and syndicate networks of investors can facilitate the financing of a range of mission-based media projects.

The report recommends that proponents of this market collaborate to develop financial service intermediaries to help with the following: create important information and transactional efficiencies through ongoing research and education, as well as network exchanges; produce industry financial reporting and deal services; and create DBL investment vehicles for pooling capital under management. Investment vehicles and intermediaries that allow for more aggressive and integrated social mission priorities will help to “rationalize” an industry that appears in desperate need of it. At this stage, collaborative thinking among potential funders and investors will be crucial in growing a commercially sustainable DBL media market.

The DBL Media Report’s Contents

The report that follows is in three parts:

Part One of this report is an overview of the **DBL media industry**, and contains three sections. In the first section, we examine the landscape for double bottom-line investing, define and identify what we mean by “social mission” or “double bottom-line” media companies, and share the results of our research into the needs and status of these companies. In the second section of Part One, we explore the financing options available to DBL media companies and analyze the overall health of the financial marketplace. The third section contains highlights of the DBL media industry by sub-segment, indicating trend factors, DBL opportunities and examples of DBL companies. Together, these sections offer a comprehensive introductory report unto themselves. This section may be enough for those readers who are more interested in the cursory concepts and bottom-line recommendations. However, for those who wish to explore more of the finance-oriented discussion and case study, they may want to proceed to Part Two.

Part Two of the report explores **financing options** with greater industry detail and through four sections. The first section documents the media industry’s historic reliance on debt and equity funding. The second section describes the use of different kinds of debt and equity in different subsets of the industry. Third, Part Two analyzes specialized fund vehicles that have been used to invest in DBL media, including foundation PRIs, as well as three detailed case studies on existing funds in the space: the Independent Press Development Fund, the Media Development Fund and the Lowell, Blake and Associates’ Film Partnership.

Part Three of the report is a forward-looking set of **concrete recommendations** for investors interested in supporting the future development of DBL media. It outlines guidelines for investors and includes an overall strategy of specific, forward-looking actions.

In addition, there is an appendix to the report that includes more detail on our national survey (summarized in Part One), as well as case studies of organizations discussed in the report.

The executive summary of this report may be downloaded free of charge from Investors' Circle's Web site at the following link: www.investorcircle.net. Access to the rest of the report requires registration with Investors' Circle.