A case study by Lisa Givens

Radio One

Black-owned company eyes Hispanic market

Kellogg School of Management and Medill School of Journalism

Media Management Center
Northwestern University

Radio One

Media Management Center
Northwestern University
1007 Church Street, Suite 500
Evanston, IL 60201-5981

Telephone: 847.491.4900
Facsimile: 847.491.5619
E-mail: mediamanagement@docs.mmc.northwestern.edu
Internet address: www.mediamanagement.northwestern.edu

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Radio One
Written by Lisa Givens
Edited by Cynthia Linton
Designed by Gregory Swanson

This note was written by Lisa Givens, MBA student at the Kellogg School of Management under the supervision of Michael P. Smith, Managing Director of the Media Management Center at Northwestern University, as the basis for classroom discussion, rather than to illustrate either effective or ineffective handling of a management situation.

To make comments about this case study, please contact Cynthia Linton, Media Management Center, Northwestern University, 1007 Church Street, Suite 500, Evanston, IL 60201-5981.

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Introduction

When Radio One, Inc. completed its purchase of 12 stations from competitor Clear Channel Communications in 1999, the company became the seventh-largest radio broadcasting company in America — and by far the largest radio company targeting African-Americans. The company's CEO, Alfred Liggins III, had many decisions to oversee.

Radio One prides itself on its abilities as an Urban (mostly black music) format turnaround expert and has been successful in this strategy since it began its acquisition strategy in 1996. The company purchases an under-performing radio station or group of stations, then reformats them and gives them centralized infrastructure support to increase profitability.

But in the portfolio of stations purchased in the Clear Channel transaction, some were formats not generally considered compatible with the Urban audience, including one Spanish-speaking and one punk rock station.

One of the tasks at hand was to figure out what to do with these "non-conforming" formats.

Background

Founder's legacy

Radio One was founded by Catherine Hughes, a former broadcast lecturer and station manager at WHUR-FM at Howard University. In 1980, Hughes found an opportunity that would prove to be the beginning of the largest African-American-owned broadcasting company in America.

There was a District of Columbia radio station, WOL-AM, whose owners had violated FCC regulations regarding payola schemes. Under federal regulations, WOL-AM had to be sold at a discount to a minority buyer.[1] Hughes knew she wanted to take advantage of this opportunity but still faced the uphill battle of funding the transaction. Even at a large discount, gaining control of WOL-AM and covering operating expenses for the first year would cost more than $1.5 million.

In the early 1980s small radio stations had significant difficulty raising capital from investors and banks (see Note: The Radio Broadcasting Industry). Hughes eventually retained financing and several years later the station achieved profitability. Hughes then began to acquire additional radio stations. By 1998, Radio One owned and operated nine stations in four cities. At the same time growth at Radio One was helped by the relaxation of federal regulations that had restricted the number of radio stations a broadcasting company could own.

For many years, Hughes worked as both station manager and morning talk-show host. Her son, Alfred Liggins, also learned the business as Hughes often took him along while she worked. Liggins began working for Radio One full time when he was 21. Hughes describes her intent to groom her son to be a worthy successor: "Every day of the last 35 years of my life every motive, every goal, every mission was to enable Alfred to make his mark in the world of broadcasting."[2] Liggins became CEO of Radio One in 1993.

Though Radio One was defined by most as a family business, Liggins and Hughes understood how important sound fundamentals and strong systems would be to the future of the company.

Radio One's Chief Operations Officer Mary Catherine Sneed describes a sense of vision that has always been firmly in place. She says of Liggins: "He has always had this vision. He has always known exactly where the company was going ... and it's still moving in the direction that he wants it to." She attributes much of the company's recent success to the financial infrastructure and system controls put in place during Liggins' tenure as CEO.

Radio One was founded on the former FCC mantra that the purpose of radio

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1 "The Comeback Queen", Chandrani Ghosh, Forbes Magazine September 20, 1999.
2 "High Frequency Profits", Robyn D. Clarke, Black Enterprise.com

broadcasting was "to serve the public interest." Over the years this philosophy has contributed to a loyal listening audience and high ratings in all of the company's major markets. FCC regulations have been significantly relaxed since the early 1980s. Prior to 1980, radio broadcasters were required to document their efforts to address concerns in local communities. Relaxation of the rules meant that the company did not have to file as many reports on the subject, but service to the local community still remained a large part of Radio One's business strategy.

Community spirit

The entrepreneurial and community spirit that embodies Radio One Inc. started with Hughes, the company's chair and founder. The role of radio in the African-American community is significant because it is the main source of information about the local community. While mainstream America has more access to local television and newspapers that may serve in a similar capacity, radio is the primary source of local news and information for African-Americans.[3]

Since Radio One was founded in 1980, the shortage of other minority-owned daily, localized media contributed to radio's popularity in the African-American community.

In Hughes' words, "Black radio has in fact replaced, in the black community, what black newspapers had the responsibility of doing. They [most black newspapers] become historical journals, unfortunately, by the time they come out, Wednesday-to-Wednesday. Black radio was able to give you, with the flip of a dial, what is going on right now in your own back yard." Hughes also attributes the popularity of radio generally to the fact that it is "non-intrusive." One can conduct activities while listening to the radio, unlike other forms of media, which require undivided attention.

In addition, Radio One is directly involved in helping the local community and providing assistance when needed. For example, when a Baltimore neighborhood was virtually destroyed by area flooding, the radio station in Baltimore organized a 12-hour fund-raising drive on the air. The effort raised close to $60,000 to provide lodging for residents of the ravaged community and organized them to pursue aid from the government, which had previously been denied.

Strategy for the future

Hughes' aspirations for the company were for it to grow and compete with the largest radio broadcasters. When the Telecommunications Act of 1996 was passed, the only way for a radio company to remain independent was to grow to a large enough size to thwart takeovers. Because Hughes and Liggins wanted to remain an independent radio company, Liggins realized that at some point it would be necessary for them to turn to the public markets to fund an aggressive growth strategy. An integral part of that strategy was the addition of the CFO, Scott Royster, to Radio One's

[3] "Arbitron Fall 2000 MaxiMi$er Data", Radio Advertising Bureau Report based on Top 25 African American markets

management team in 1996. Royster had the requisite financial background and educational pedigree to be a significant asset to the company's 1999 IPO efforts (SEE EXHIBIT 1). Radio One now owns 63 radio stations, 34 of which are located in 14 of the 20 largest African-American markets in the United States: Washington, Los Angeles, Detroit, Atlanta, Philadelphia, Houston, Miami, Baltimore, Dallas, St. Louis, Cleveland, Boston, Richmond and Charlotte.[4] A timeline of Radio One's major acquisitions since the May 1999 IPO is shown below:

Radio One's acquisition schedule

Date	Markets	Number of Stations	Price
February 28, 2000	Philadelphia	1	$80 million
June 7, 2000	Augusta, Charlotte	6	$20.7 million 57,000 shares class A common stock 115,000 shares class D common stock
June 8, 2000	Indianapolis	3	$30 million 441, 000 shares class A common stock
August 25, 2000	Los Angeles, Houston, Miami, Dallas, Cleveland, Raleigh-Durham	12	$1.3 billion
September 25, 2000	Dallas	1	$16 million
November 15, 2000	Greenville, S.C.	1	$7.5 million
February 1, 2001	Dallas	1	$52.5 million
February 7, 2001	Cincinnati, Columbus, Dayton, Louisville, Minneapolis	16	$190 million

* Does not include divestitures of stations outside the company's core business during this time frame.

[4] “Investing Analysis”, Forbes.com, July 16, 2001, and Radio One Inc. SEC filing 10-K for fiscal year ended December 31, 2000.

Demographics in radio

Historically, African Americans listen to more hours of radio per day than other demographic group. African Americans spend an average of 20 percent more time listening to radio than non-blacks. African Americans represent 13 percent of the U.S. population, with buying power of approximately $600 billion.[5] The percentage is much higher in many cities and in the South. Statistics such as these have bolstered the growth of minority media and advertising companies over the past 15 years. Changes in the way Americans spend their time positively affected Radio One's ability to generate revenue in recent years. Radio is enjoying increased popularity because the average American's commute time to work is increasing while average leisure time is decreasing (SEE NOTE: RADIO BROADCAST INDUSTRY). In addition, 87 percent of commuters listen to the radio during their commute, and once at work 36 percent of Americans listen to the radio.[6] This provides a growing opportunity for companies like Radio One to serve captive listeners during daily commutes, and workers who listen to the radio during the day. This captive audience includes non-blacks as well as the traditional Urban radio audience.

[5] "The Source Book of Multicultural Experts 2001-2002," Howard Buford.

[6] "America at Work and Play", Michelle Skettino, Interep Research Division. http://site.interep.com/apps/Research/resweb.nsf/bf25ab0f47ba5dd785256499006b15a4/b3c6cee3db55e7018525688e0060a88a/$FILE/A21C003.pdf

The Urban format

Radio One currently targets African-American listeners with the Urban radio format. In the past several years, the Urban format has splintered into several variations. First, there is the Hip-Hop format, which caters to the youngest demo, with a strong listener base in the 12- to 24-year-old category, and includes rap music and other vocalists' current hit music. Artists in the genre include Jay-Z, Lauryn Hill, and P-Diddy. Second, there is Urban Adult Contemporary, also known as Rhythm and Blues (R&B), which serves more of the 25- to 54-year-old audience. Artists in this genre include Luther Vandross, Whitney Houston and Kenneth "Babyface" Edmonds. This group is separated into categories that focus on current hits or oldies. There also are other Oldies (Motown era), Gospel and Jazz stations competing for these same listeners.

The Urban format is generally associated with music that historically has been preferred by African-Americans and viewed rather monolithically. The differing age demographics generally have specific tastes in music, which is best addressed through a targeted approach. Surprisingly, the younger demographic is very flexible and enjoys a larger variation of music than ever before. This versatility in the younger demographic is good for Radio One, whose portfolio consists of many stations serving younger listeners.

In describing the relevance of the Urban format to other markets Sneed comments, "Urban radio stations across the country have been generally about 20 percent non-African American. ... We don't do anything to try to get that group to listen to the radio stations; they just come because they love the music, they love the culture, they love the vibe, especially the younger-end stations. Kids just like what they like. ... You've got a culture that I think is really being shared and probably will be even more than it is now. Just the lifestyle, it is a whole vibe and a lifestyle, with hip-hop especially."

Radio One is able to attract many different groups to its radio stations with formats that consist mostly of various types of African-American music. The market appeal of these formats transcends demographic lines and therefore Radio One can deliver more than just African-American listeners to their clients.

New ethnic market?

One of the stations acquired in Radio One's 1999 acquisition was WVCG-AM in Miami. WVCG is an international variety outlet that is Spanish-speaking and plays a variety of Calypso, Soca, Reggae, Caribbean Jazz, Zouk, Compas and Merengue, as well as having talk radio, news and information. Depending on one's perspective, this station could either be considered a candidate for format flipping or perhaps an avenue into another ethnic market with large future growth potential. WVCG was profitable serving its existing Spanish-speaking audience.

The Hispanic market

Spanish-language radio is a growing sector of broadcasting because of the growth of the Latino population and increases in the amount of time Americans listen to the radio (SEE NOTE: THE RADIO BROADCAST INDUSTRY). The Latino population is growing more than six times as fast as non-Hispanics and is estimated to become the largest minority population by 2005.[7] The Latino population is also relatively young, with a median age of 26.6, which is 9 years younger than the overall U.S. median age of 35.7 years. While median household income lags behind the national average, it has steadily increased since the mid-'90s.[8] Latino income rose 9 percent in 1996, 6.9 percent in 1997 and 6.4 percent in 1998. The youthful population tends to spend more than older demographics on consumer goods, which makes this population an attractive one for targeted advertising campaigns.

Latinos also listen to a significant amount of radio and are now the fastest growing minority population. The Latino population has grown 57 percent since 1990, making up 12.5 percent of the U.S. population. In major cities like Chicago, Latinos were the biggest contributor to population growth. If not for Latino growth, the city of Chicago's population would have declined in the past year. The Latino population in the United States totals approximately 42.5 million, with buying power estimated at $561 billion.[9]

Spanish-language radio is growing so quickly that it now ranks third among all radio formats in the United States.[10] In 1998 advertisers spent approximately $1.7 billion on Hispanic media; a 60 percent increase since 1995. Of those advertising dollars, more than 25 percent were placed on Hispanic Radio. Proctor & Gamble and AT&T

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[7] U.S. Census Data 2000.

[8] According to U.S. Census data Hispanic household income in the U.S. was $28,330 in 1998 compared to the U.S. Average of $38,885.

[9] "The Source Book of Multicultural Experts 2001-2002", Alex Lopez Negrete, President, Lopez Negrete Communications, Inc.

[10] "Arbitron Survey, Spring 1999", Michele Skettino, Interep Research. Shows Hispanic Radio receiving 8.1 percent share of total radio listening bolstering it to the 3rd rank position among all radio formats.

are leading advertisers to the Hispanic market, with estimated expenditures of $46 million and $35 million respectively.

General economic downturn

Recent financial performance was down an estimated 30 percent industry-wide during 2000, due to a general economic slowdown and a decrease in advertising revenue. Now would be a particularly risky time to allocate significant resources to branch out into a new format in a new market. Wall Street's reaction to such a move would be highly unpredictable. On the one hand, there may be a significant opportunity in that small Spanish-language stations are available at good prices. On the other, Wall Street might see the move into the Spanish-speaking market as a sign of unfocused management.

Advertising revenue

Despite the release of census data that shows significant Hispanic population growth, there are some risks to directing resources toward targeting this group in radio. The allocation by the nation's largest advertisers toward Latinos has been categorized by investment analysts as sub-optimal at best. In 1999, advertisers spent less than 1 percent of their budgets on Spanish-language media despite the fact that Latinos constituted roughly 12 percent of the population and accounted for about 7 percent of household income. While this gap is likely to close, in a time of general economic slowdown advertising expenditures would be strictly limited. Radio however, is less expensive than other advertising media, so it was difficult to predict whether economic performance during the year 2000 would be a boom or bust for Hispanic radio.

Current competition

There are several firms whose core strategy is targeting the Spanish-speaking community.

10 largest Spanish-language radio companies

Rank	Company	Pro Forma Estimated 1999 Gross Revenue (in millions)	Ticker
1	Hispanic Broadcasting	209.3	HSP
2	Spanish Broadcasting Systems	138.0	SBSA
3	Entravision Communications	67.1	PRIVATE
4	Arso Radio Corporation*	21.2	PRIVATE
5	Radio Unica	18.4	UNCA
6	El Mundo Broadcasting	15.9	PRIVATE
7	Mega Communications	15.4	PRIVATE
8	Liberman Broadcasting	11.6	PRIVATE
9	Lotus Corporation	9.9	PRIVATE
10	Big City Radio	9.2	YFM

* All stations are located in Puerto Rico
Source: BIA Research, company filings, and William Blair & Company, LLC estimates

The number of Hispanic radio stations has increased significantly over the past 20 years. In 1980, there were 67 Spanish-language stations. The number of Spanish-language radio stations increased to 376 in 1990, and 551 in 1999.

The decision

How does the marketing strategy for niche players such as Urban radio companies differ from mainstream radio broadcast companies? How does Radio One turn around a station that is already making its revenue goals? In this period of consolidation in the radio industry, is there an opportunity for Radio One to apply its management skill in another ethnic market and if so to what extent should it invest resources in targeting Spanish-speaking listeners? These are questions the senior management team at Radio One Inc. was pondering in the aftermath of the acquisitions from Clear Channel. Having gone public and quadrupled in size in the previous three years, for Radio One the challenges continued.

Radio Broadcast Industry

Introduction

Several factors contributed to the revenue performance and unprecedented merger activity in the radio broadcasting industry in recent years. Generally, the radio industry has been a steady performer over the last 10 years. A key reason for that is there are significant changes in the way Americans spend their time and utilize media. Those changes made radio a viable business despite competition from other burgeoning technologies.

This note will discuss how regulatory changes have affected the industry. It will provide snapshots of the past, present and likely future, as well as background of the radio company revenue model and discussion of the major players in mainstream radio.

Legacy of regulation

Radio, like other broadcast media, was and continues to be heavily regulated by the Federal Communications Commission. Historically, radio broadcasting was highly fragmented due to strict government regulations forbidding companies from owning more than one station in a given market. Prior to 1982, in the United States, one entity could not own more than seven AM, seven FM and seven television stations (known as the 7-7-7 ownership rule), and no company could own more than one AM and one FM radio station in a local market. There was also a federal regulation that no company could purchase a radio station if it already owned a television station in the same market. (The only exceptions were those that were "grandfathered" in before the setting of these rules). Radio companies also had to hold stations they owned for a minimum of three years (known as the anti-trafficking rule).

The FCC put these rules in place to prevent radio companies from routinely buying and selling ("flipping") stations with a large profit in the re-sale. At the time the FCC promulgated these rules, the commission believed that without these restrictions, broadcasting companies would seek to manipulate the prices of individual radio stations and their own company valuations to the detriment of the public interest. The commission also worried about a diminution of independent radio voices in the marketplace. The underlying mission of the anti-trafficking provisions in place before 1982 assumed that, on some level, continuity and diversity of ownership improved service to the public.

The financial effects

Prior to 1982, these federal regulations had the effect of constraining the supply of capital to fund radio companies. The combination of radio companies' small size and inability to buy and sell other radio stations made these companies less desirable to lenders and investors.

Despite a history of sound business fundamentals and significant cash flow, radio broadcasters had trouble raising the capital they needed to grow and improve existing operations. In an exception, the head of a top-10 radio broadcasting company got lucky when a banker extended a loan during the loan officer's first week on the job. The company had been turned down several times before. If the loan officer had not been new to the job, it is likely this company, that was a small start-up at the time, would have had an exceedingly difficult time raising its first round of financing.

The Telecom Act and other changes

Starting in the mid-1980s there was a sharp increase in the number of radio-station sales. The government relaxed restrictions regarding ownership of radio stations, and the anti-trafficking rule was repealed in 1982. Economic conditions improved, interest rates were lower and there was improvement in radio companies' ability to attract investments and loans. Government regulation was further relaxed in 1992, but the watershed event occurred later with passage of the Telecommunications Act of 1996.

The Telecommunications Act of 1996 (Telecom Act) had a profound effect on the radio broadcasting industry because it removed national ownership limits and relaxed local ownership limits for radio companies. The Telecom Act made the biggest changes to the preceding law governing telecommunications in 62 years. The purpose of the Telecom Act was to encourage competition within the industry and make entry into the market easier for start-up companies. After 1996, one company could own up to eight radio stations, in the largest local markets.

This drastically relaxed regulatory structure caught the attention of the United States Department of Justice (DOJ) Antitrust Division and raised concerns about uncontrolled merger activity. Therefore, the relaxed rules now in place via the Telecom Act are accompanied by additional scrutiny by the DOJ. The DOJ's approval authority regarding radio transactions is not dependent on maintaining multiple voices — freedom of expression. Rather it rests on the economic/business standards that affect all businesses. That is, DOJ looks at the concentration of advertising revenue before and after the transaction. A deal would be considered too concentrated and would be prevented without modifications if: 1) the acquiring group already has 50 percent or more of the local radio advertising revenues, or 2) the resulting group of stations after acquisition would have 70 percent or more of the local radio advertising revenues in the local market after the transaction.

The gradual deregulation of the radio broadcasting industry over the last 10 years has resulted in a large boom in radio station transactions and major industry-wide consolidation. Radio station transactions nearly doubled after passage of the Telecom Act, with total sales of publicly traded radio stations of 1,582 in 1996 compared with 834 stations sold in 1995.[1] This trend has continued albeit at a lower rate. More than 1,000 radio stations have been sold each year since passage of the Telecom Act. No single year prior to 1996 showed such high sales volume.[2] (SEE: EXHIBIT 1)

The effect of time pressure

In addition to relaxed government regulation, changes in the way Americans spend their time and demographic changes had a positive effect on the industry's ability to generate revenue. Radio is enjoying increased popularity because the average American's commute time to work is increasing while average leisure time is decreasing. Americans' average commuting time in 2000 was 24 minutes, compared with 22.4

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1 Results from Publicly Owned Radio Station Sales Data, BIAfn's State of the Industry: Radio Transactions 2000, Mark Fratrik Ph.D., Vice President.

2 *Ibid.*

minutes in 1990.[3] From 1975 to 1995 the average American workweek rose 7.5 hours from 43.1 hours per week in 1975 to 50.6 hours per week in 1995.[4] Americans leisure time has dropped by five hours in the same period. In addition, 90 percent of those people working longer hours commute to work by car and 87 percent of commuters listen to the radio during their commute. Thus, workers spend an average of nearly 50 minutes per day in their cars listening to the radio. At work, 36 percent of Americans listen to the radio.[5]

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[3] MSNBC staff and wire reports, How Newcomers are Changing U.S., http://www.msnbc.com/news/609901.asp?pne=msn.

[4] Harris Poll, November 1995

[5] Michelle Skettino, America at Work and Play, Interep Research Division. http://site.interep.com/apps/Research/resweb.nsf/bf25ab0f47ba5dd785256499006b15a4/b3c6cee3db55e7018525688e0060a88a/$FILE/A21C003.pdf

The industry today

The consolidation that began in 1996, had slowed significantly in 2000 because most large publicly traded radio companies shifted their focus from acquisition to achieving profitability and return on the assets acquired over the last five years.[6]

This is likely to be beneficial to investors in the long run. Radio broadcasting industry revenue is highly concentrated. There are more than 500 companies and individual owners operating radio broadcast facilities.[7] Of these firms, the top 50 earn 65.8 percent of revenue industry-wide.[8] (SEE: EXHIBIT 2) The largest radio firms are even more concentrated. The top 10 firms earn approximately 84 percent of operating revenue brought in by the top 50 firms. These 10 firms own 64 percent of radio stations held by the top 50.[9]

Financial performance in early 2001 was down an estimated 30 percent due to a general economic slowdown and a decrease in advertising revenue in 2000. An additional contributing factor was the collapse of the dot-com phenomenon, which had contributed greatly to a surge in advertising revenue during 1998-1999. To some degree the revenue that poured into the industry from dot-com companies during the late '90s raised unrealistic expectations of continued revenue growth. These unrealized predictions of increased revenue growth also may be affecting the lowered Wall Street valuations of radio companies in 2001. Surprisingly, some niche players, those in new growth or less popular formats, were less affected because they did not get any of the dot-com advertising revenue to begin with. During 2001, the market performance of niche players appeared to be more consistent and predictable.

Radio broadcasting business model — ratings, rate and revenue

Radio companies are engaged in heated competition with one another for ratings. A radio company's ratings in a given demographic determine how attractive they will be to advertisers. Virtually all radio company revenue comes from local, network and national advertising, all of which has increased since 1990. In 2000, radio advertising was approximately $19 billion, which was 8.3 percent of U.S. advertising revenue that year.[10]

Local advertising spots are those that are marketed to a local sales area and are placed by local or regional advertisers. Local spots make up the majority of radio advertising, with approximately 76 percent of total industry advertising. National radio advertising spots make up approximately 19.5 percent of advertising revenue for

6 RBR Source Guide Database
7 A Binocular Look at the Top 50 Owners, Radio Business Report 7/9/01. http://www.rbr.com
8 Broadcast Investment Analysts, Duncan's American Radio and see exhibit 2
9 See Exhibit 2(a)
10 BIAfn's State of the Radio Industry: Radio Industry Revenues — 2000 and Beyond and See: Exhibit 3

the industry and network advertising accounts for approximately 4.5 percent. While local advertisers are the "bread and butter" of radio broadcasting companies, one should not overlook the significant increases in advertising among national advertisers. National advertising increased the fastest, with an annual compounded growth rate of 8.9 percent from 1990-2000.[11] Industry consolidation plays a big part in this phenomenon. As consolidation increases the reach of radio broadcasters, the attractiveness of radio for national advertisers also increases.

Ratings in radio are determined by companies that use research data to determine the size of media audiences for each part of the listening day, called "day parts." One of the foremost companies that provides this service to the radio industry is Arbitron, Inc., an international media and marketing research firm serving radio, television, cable, advertisers, advertising agencies, magazines, newspapers and the online industry in the United States and Europe. Arbitron measures radio audiences in local markets across the United States, surveys the retail, media and product patterns of local market consumers and provides application software used for accessing and analyzing media audiences and marketing information data.[12]

The higher the demand is for a radio station day part in a given market, the more advertisers will be willing to pay for spots in that time slot. Demand for an audience that a particular radio station can deliver is a function of the rate, measured as the cost per ratings point per unit of time.[13] Advertisers do their own research to determine how they should target customers. The result of an advertiser's own research, combined with market data from a company like Arbitron about which radio stations have high ratings with a target group, usually form the basis for a decision to advertise on a particular radio station and the time of day the spot should run.

The number of commercials played on a particular radio station — or spot load — is constant within a given format. So, for instance, the number of commercials on a news or talk radio station may be more than the spot load on a music station. The disturbance caused by commercials is more noticeable on music radio stations and therefore consumers tolerate fewer interruptions. For example, Entercom Communications, the nation's fifth-largest radio broadcasting company, maintains 10-12 minutes of spot advertising per hour on music stations and 18-19 minutes per hour of advertising on non-music stations.[14]

Ratings and rate per point drive the revenue model in radio. Cost control is important because of the positive effect expense control may have on cash flow, and broadcast cash flow (BCF) is the primary metric for success of a radio broadcasting company. BCF is arguably the best measure of the financial success of a company that

11 BIAfn's State of the Radio Industry: Radio Industry Revenues — 2000 and Beyond
12 Company report: http://www.arbitron.com/home/home.htm
13 Alissa Graham, William Blair & Company Investment Report, Entercom Communication Corp, November 29, 2000.
14 William Blair & Company Investment Report, Entercom Communications.

invests heavily in fixed assets or has a lot of intangible assets on its balance sheet.

Many radio companies have large amounts of intangible assets, mostly goodwill, on their balance sheets and they incur a large amount of depreciation and amortization, which are non-cash charges. When a company's balance sheet is heavily laden with non-cash charges, the net income figure does not accurately reflect management's ability to generate revenue and control costs. Therefore, many analysts and financial specialists use cash flow as a metric for a radio company's financial performance.

Historically the expectations for a company's cash flow have been high compared with other industries because radio stations have few fixed expenses (salaries and rent), with most other expenses being variable with revenue (commissions), or discretionary (marketing and research). Therefore, in some cases good management teams are able to earn gross margins of 60 percent or more.[15] Even average performers can attain relatively high gross margins.

What is a radio format?

Format refers to the overall programming or the particular arrangement of programming elements heard on a radio station.[16] The list of formats used in the industry today has grown significantly since the inception of broadcast radio in the 1920s. Formats are defined based upon the need to attract many listeners to a single station and grow ratings. Listeners are drawn to a format because of commonalities among people, such as age, race, gender, education level, background financial status or musical interest. Radio formats used today vary in popularity and include the following:

News, talk, sports	Country music
Contemporary hit music	Adult contemporary music
Rock and alternative music	Urban music
Jazz and classical music	Oldies and nostalgic
Spanish and Latin music	World music
Religious	Public, government, community
College/school	Other (children's, ethnic, brokered)

While this list does not necessarily encapsulate every type of radio broadcast, it does show the types of radio that appeal to most consumers and the majority of content on stations held by the largest public broadcasting companies. Quality of content and focus within these formats greatly affects the ratings performance of a radio station in a given market.

15 Alissa Graham, Investment Analyst, William Blair & Company
16 http://tvradioworld.com/directory/Radio_Formats/

Major players

Radio broadcasters

Clear Channel Communications, Inc., headquartered in San Antonio, Texas, is a global leader with radio stations, television stations, outdoor displays, and entertainment venues in 63 countries around the world. Clear Channel operates approximately 1,180 radio and 18 television stations in the United States and has equity interests in approximately 240 radio stations internationally. Clear Channel also operates approximately 750,000 outdoor advertising displays, including billboards, street furniture and transit panels around the world. Clear Channel Entertainment is one of the world's leading diversified promoters, producers and presenters of live entertainment events and is a leading fully integrated sports marketing and management company.

Infinity Broadcasting, headquartered in New York City, owns approximately 180 radio stations located in 22 states in the nation's largest markets. Infinity's stations serve diverse target demographics through a broad range of programming formats, such as rock, oldies, news/talk, adult contemporary, sports/talk, and country.

ABC Radio Broadcasting has more than 4,500 affiliate radio stations and broadcasts five full-service news networks, as well as ABC News Radio, Paul Harvey News and Comment, Radio Disney, ESPN Radio, music, talk and information programming, 10 ABC Radio 24-Hour Formats and daily and weekly long- and short-form programming. The ABC Radio Network reaches 120 million people each week.[17]

Cox Radio, Inc. owns, operates, or provides sales and marketing services to 82 stations (68 FM, 14 AM) in 18 markets. In a time of industry consolidation, Cox Radio has increased revenue, cash flow and margins, and grown overall in size. Cox was founded in 1934 when WHIO-AM (Dayton, Ohio) went on the air. In 15 of their 17 markets, the company operates three or more stations. Cox operates top-ranked stations in Atlanta, Birmingham, San Antonio, Houston and four Florida cities: Miami, Orlando, Tampa and Jacksonville.

Entercom Communications Corporation[18] is a radio broadcasting company that currently operates 95 stations in 19 U.S. markets. The company has acquired 91 percent of its radio stations since 1996. Its largest acquisition to date was the purchase of 41 Sinclair Broadcast Group stations. The company has integrated more than 50 radio stations during 1999 and 2000, which more than doubled its portfolio. Entercom stations have a variety of formats and are programmed to suit local tastes with a concentration in news, talk and sports AM stations that dominate in their respective markets.

17 http://www.newmediamusic.com/ps/ecsnetwork_abcradio.html
18 Adapted from the Company Summary, Investment Analyst's report, William Blair & Company

Advertisers

Virtually all of radio broadcasters' revenue is generated from advertisers. In 2000, total U.S. advertising revenue was estimated at $236 billion.[19] Of that total $19 billion went to radio. The advertising revenue comes from corporate and brand companies in categories ranging from media and advertising to public transportation, hotels and resorts. Verizon Communications, AT&T Corp. and National Amusements, Inc. are the top three corporate advertisers, with total spending for national network and spot advertising of over $181 million.[20] The advertisers' power is significant, but in the future this power will be balanced by broadcasters' attempts to leverage their large networks to sell national spots. This also makes radio broadcasters susceptible to the state of the U.S. and international economy, though good management teams are usually able to weather economic hard times.

The competition

Radio broadcasters face competition for advertising dollars from several other forms of media. According to the revenue study by Universal McCann, radio broadcasters earned 8.3 percent of total advertising revenue in 2000.[21] Over the prior 30 years radio never captured more than 7 percent of total U.S. advertising revenue. The biggest competition for radio includes newspapers, television and direct mail. In 2000, newspapers, direct mail and television earned 20.8 percent, 18.9 percent and 18.8 percent of the U.S. advertising revenue, respectively.

Local newspapers are the largest advertising medium, but their share of advertising revenue has actually declined from over 25 percent 10 years ago to 20.8 percent in 2000.[22] Cable advertising has increased significantly, by double-digit growth rates, each year since 1990. However, even with double-digit increases in revenue per year, cable advertising revenue was in sixth place, at 5.2 percent of total advertising revenue in 2000. Non-cable television advertising revenue has experienced an average growth rate per year of approximately 6 percent from 1990-1999. (SEE: EXHIBIT 3)

19 BIAfn's State of the Radio Industry: Radio Industry Revenues — 2000 & Beyond

20 Figures obtained from Radio Advertising Bureau, Source: Competitive Media Reporting — LNA/Media Watch Service — 2001.

21 BIAfn's State of the Radio Industry: Radio Industry Revenues — 2000 & Beyond

22 Radio Industry Revenues 2000 and Beyond, p 7.

Industry outlook

Short-term predictions

Revenue performance during 2001 is not predicted to reach that of the previous year, due to the change in market conditions. Also, the presidential election and Olympics in 2000 had a large positive effect on radio sales growth for that year. Early in 2001, overall sales growth for the year was forecast to reach between 5 percent and 7 percent.[23] Consolidation is predicted to slow even more and firms will concentrate on increasing the profitability and cash flow of their current portfolios of radio stations.

Long-term perspective

Generally, the radio broadcasting industry has sound management and business fundamentals that are likely to carry it to higher sales growth beginning some time during 2002.[24] Prospects for growth however will continue to be heavily dependent upon general economic conditions and the impact of digital and Internet radio. The larger players will continue to try to increase the scale economies that can be achieved through pursuing national advertising, while continuing to serve their local spot advertising clientele. The ability to centralize functions such as personnel, finances and legal support will save large radio broadcasters money and significantly increase their return on asset compared with prior years. When the formats are consistent across a franchise there may be even more cost savings. For example a big player in urban radio, Radio One, Inc., has made a centralized management team a large part of its business strategy.

There are emerging technologies that may be significant to the long-term success of traditional radio. Web radio and satellite radio are predicted to have a minimal effect on the market share of traditional radio companies over the next five years. Web radio has been around for several years and still has not made any significant impact on the market for audio broadcasts because of lackluster sound quality and lack of standardization of software and necessary hardware. However broadband and wireless Web technologies are becoming more popular, which may increase the size of Web radio audiences.

Satellite radio is scheduled to be available to customers in late 2001, but most in the industry are skeptical about the impact it will have on traditional broadcasters. The two start-up companies that will provide satellite radio, Sirius Satellite Radio, Inc. and XM Satellite Radio, Inc., provide two different proprietary systems. Receivers that will accept both signals will not be available until 2004. XM and Sirius Satellite radio receivers will be available in select 2002 model cars. Receivers for existing cars

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23 Vincent Apicella, Stock Focus: Radio Broadcasting Companies, Forbes.com 3/14/01

24 See: Exhibit 4

are priced between $300 and $600.

Satellite radio will be a subscription service that will require specialized equipment not installed in vehicles already on the road. National Association of Broadcasters spokesman Dennis Wharton has downplayed the risk to traditional broadcasters, saying, "There will probably be a small niche audience for satellite radio."[25] Proponents of traditional radio argue that consumers will not be willing to pay subscription fees for satellite radio when similar services are readily available on traditional radio broadcasts for free. This argument holds particularly true for mainstream radio, but the effect of satellite radio on niche players such as Urban radio broadcasters remains to be seen.

In case satellite radio does end up capturing huge ratings, many of the traditional radio companies have developed strategic alliances with one or both of satellite radio's two start-up companies. For example both XM and Sirius have issued press releases saying they have deals to carry programming from ABC Radio Networks, and Radio One, Inc. has an agreement to feature its programming on XM. One other issue surrounding satellite radio is the promise of commercial-free radio. Sirius plans have up to 50 commercial-free radio stations available for the $9.95 per month subscription price. XM is planning 15 to 20 commercial-free stations with other stations limited to a spot load of seven minutes per hour.[26] This is a dramatic change from the average of 12- to 18-minute spot load per hour of many radio stations today. Traditional radio broadcasters can guarantee their position as a mainstream player by being conscientious about using available technology to improve sound quality and continuing to provide the content consumers demand.

25 Elizabeth A. Rathbun, Radio Flyer: Two Satellite Startups Bet Billions They Can Grab a Piece of the AM-FM Pie, Broadcasting and Cable Magazine June 5, 2000

26 *Ibid.*

Conclusion

Radio broadcasting is a viable media sector and the short-term and long-term prospects for the industry are good. Regulatory changes such as the Telecom Act contributed to merger activity, opportunities to raise capital and investment in new technologies. Changes in the American lifestyle and sound management teams have buoyed radio broadcasters' audiences and improved financial performance in the last decade. In 2001, public radio companies will continue to focus on operational efficiency and integration of newly acquired firms to achieve optimal shareholder value.

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Appendix

Exhibit 1: Radio industry transactions 1995-2000

Year	Number of stations sold	% change per year	Estimated sales volume in 000,000s
1995	1,259	n/a	5,371
1996	2,157	41.63%	14,336
1997	2,250	4.13%	18,046
1998	1,740	-29.31%	8,952
1999	1,705	-2.05%	28,539
2000	1,794	4.96%	24,930
Total	**10,905**	**n/a**	**100,174**

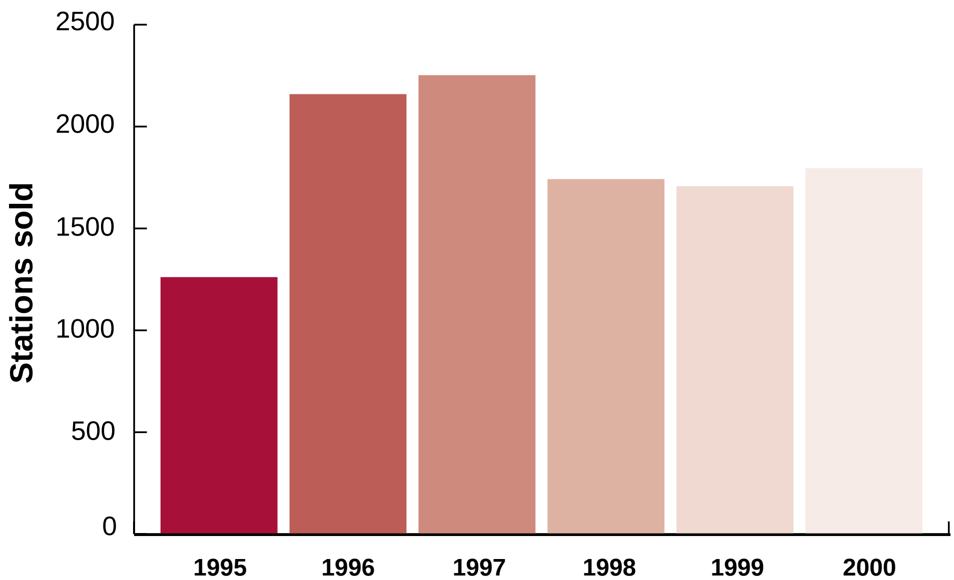
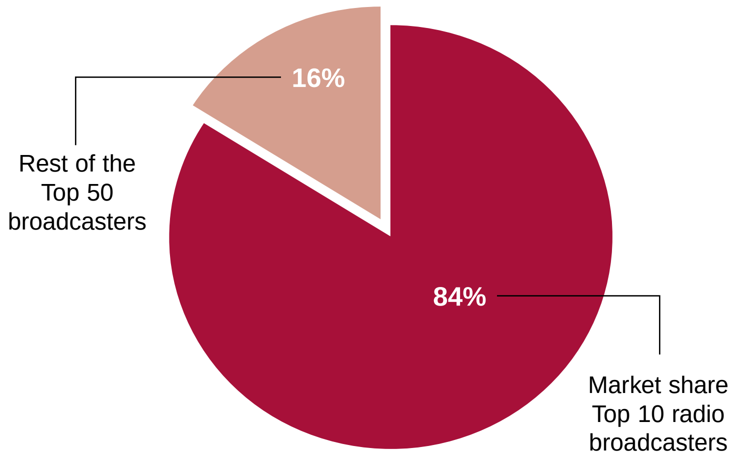


Exhibit 2: Top 50 radio groups

Rank	Owner	Estimated Total Revenue ($000s)	Number of Stations	Number of Markets
1	Clear Channel Communications	3,187,918	1157	190
2	Infinity Broadcasting	2,127,350	181	41
3	ABC Radio Broadcasting	4,111,625	55	27
4	Cox Radio, Inc.	380,855	81	18
5	Entercom	353,700	96	18
6	Citadel Communications Corp.	330,550	210	42
7	Emmis Communications	254,200	24	8
8	Radio One, Inc.	235,750	48	18
9	Susquehanna Radio Corp.	221,550	29	8
10	Hispanic Broadcasting Corp.	241,625	45	13
11	Cumulus Broadcasting, Inc.	209,625	226	44
12	Bonnecille International Corp.	177,300	20	6
13	Spanish Broadcasting System	139,400	26	8
14	Jefferson-Pilot Communcations	133,400	17	5
15	Greater Media	122,050	14	4
16	Beasley Broadcast Group	120,725	45	11
17	Saga Communications Inc.	95,340	55	12
18	Journal Broadcast Group, Inc.	70,400	36	8
19	Entravision Communications Co. LLC	66,600	67	25
20	Tribune Broadcasting Company	60,800	4	2
21	Inner City Broadcasting	57,350	17	8
22	Sandusky Radio	56,000	10	2
23	Regent Communications	52,865	45	10
24	Banstable Broadcasting Inc.	50,400	25	5
25	Salem Communications Corp.	49,575	77	35
26	NestMedia Group	45,850	55	11
27	Buckley Broadcasting Corp.	42,375	18	7
28	Lotus Communications Corp.	35,075	23	7
29	Aurora Communications	31,700	18	5
30	Renda Broadcasting Corp.	31,600	19	6
31	Fisher Broadcasting	30,950	5	2
32	Blue Chip Broadcasting Ltd.	28,200	18	5
33	Pamal Broadcasting Ltd.	27,750	25	5
34	South Central Communications Corp.	26,485	10	3
35	Big City Radio	26,050	16	9
36	Hearst-Argyle	25,700	2	1
37	Ackerley Group	24,100	4	1
38	WEAZ-FM Radio Inc.	24,000	1	1
39	Nassau Broadcasting Partners LP	23,625	12	4
40	Triad Broadcasting Partners LP	23,280	41	7
41	Simmons Media Group Inc	22,925	26	4
42	Midwest Communications Inc.	22,600	21	5
43	Midwest TV Inc.	21,900	2	1
44	Mega Communications Inc.	21,300	20	9
45	Brill Media Company	21,275	13	6
46	Arso Radio Corp.	21,200	11	1
47	Service Broadcasting Corp.	21,100	3	1
48	LBJS Broadcasting LP	20,900	5	1
49	Curtis Media Group	20,850	15	2
50	Hubbard Broadcasting Inc.	20,200	4	1
Total		**13,567,943**	**2997**	
Average revenue per station		**4,527**		

Exhibit 2a: Industry revenue concentration and publicly owned radio station sales

Concentration of revenue among Top 50 stations



Publicly owned radio station sales

	All sales in rated		Public sales in rated			
	Number of stations sold	Sales volume ($millions)	Number of stations sold	Sales volume ($millions)	Public % of stations sold	Public % of sales volume
Year						
1991	533	741	12	105	2.3%	14.2%
1992	685	1,340	51	463	7.4%	34.6%
1993	923	2,746	91	1,057	9.9%	38.5%
1994	792	2,548	57	616	7.2%	24.2%
1995	834	5,271	157	3,483	18.8%	66.1%
1996	1,582	14,109	587	11,139	37.1%	78.9%
1997	1,613	17,703	445	10,798	27.6%	61.0%
1998	1,119	8,640	364	6,645	32.5%	76.9%
1999	1,249	28,250	715	26,654	57.2%	94.4%
2000	1,224	24,050	1,092	23,778	89.2%	98.9%

Exhibit 3: Revenues by market share

TOTAL REVENUES

Markets	Number of stations	2000 estimated revenue (millions)	% of revenue	Revenue per station (millions)
Top 10	548	5420	0.307	9.9
11-20	481	2142	0.122	4.5
21-30	354	1233	0.07	3.5
31-40	323	869	0.049	2.7
41-50	329	801	0.045	2.4
Top 50	2035	10466	0.594	5.1
51-100	1333	1686	0.096	1.3
101-150	941	891	0.015	0.9
151-200	907	612	0.035	0.7
201-283	1127	600	0.034	0.5
Total Rated	**6343**	**14255**	**0.809**	**2.2**
Total Non-Rated	**4772**	**3371**	**0.191**	**0.07**
Grand Total	**11115**	**17627**	**1.000**	**1.6**

Source: BIAfn's MEDIA Access ProTM

The $236 billion advertising pie

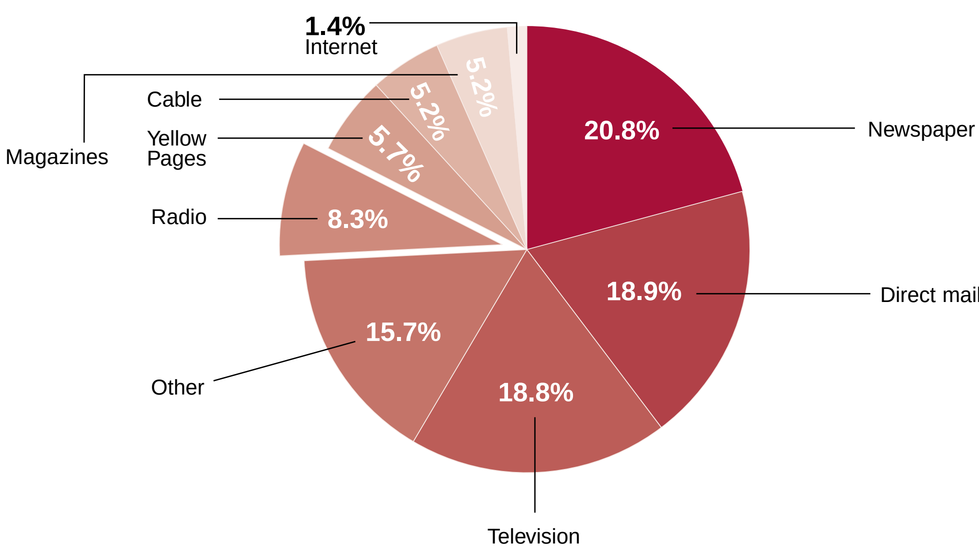


Exhibit 4: Historic and projected radio revenue growth in Arbitron markets

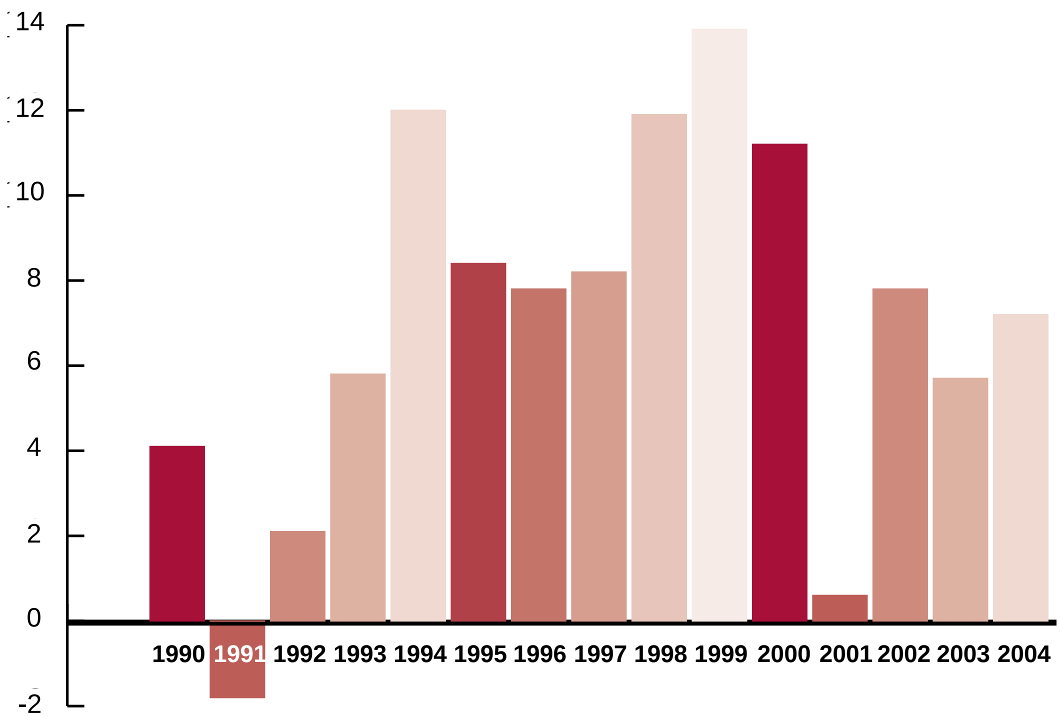


Exhibit 5: Top radio station buyers (Jan. 1, 1996-Dec. 31, 2000)

Owner	Estimated total spent ($000s)	Number of stations bought
Clear Channel Communications	30,219,756	1,283
Viacom International Inc.	15,500,865	190
Radio One, Inc.	1,678,350	43
Citadel Communcations Corp.	1,445,788	231
Entercom	1,332,155	108
Cox Radio, Inc.	1,259,045	90
Entravision Communications Co.	1,209,305	69
ABC Walt Disney Co.	1,000,000	21
Cumulus Broadcasting, Inc.	897,649	328
Spanish Broadcasting, Inc.	764,930	24

Exhibit 6: Radio broadcast financial statistics

	1990	1995	1997
ITEM			
Operating Revenue	6,954	8,518	10,193
Station Time Sales	6,397	7,779	9,287
Network Compensation	105	71	85
National Advertising	1,522	1,765	2,002
Local Advertising	4,770	5,943	7,200
Network Time Sales	305	464	553
Other	252	275	353
Operating Expenses	6,317	6,997	8,154
Annual Payroll	2,428	2,864	3,304
Social Security/Other Benefits	326	361	416
Broadcast Rights	264	304	303
Music License Fees	159	204	249
Depreciation	477	403	491
Lease and Rental	197	226	266
Purchased Repairs	79	76	81
Insurance	64	69	76
Telephone/Communication Services	115	123	140
Purchased Advertising	99	104	110
Taxes	368	409	454
Other	1,681	1,783	2,186

* In millions of dollars based on an average sample of taxable employer firms via the 1987 Standard Industrial Classification Code

Source: U.S. Census Bureau Annual Survey of Communication Services

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Radio One

A case study by
Lisa Givens

Media Management Center
Northwestern University

Kellogg School of Management and Medill School of Journalis