

The Double Bottom Line Media Industry: An Analysis of Investment Opportunity

The DBL Media Industry: An Introduction

The mass media market is a growing business sector that has a profound impact on all aspects of our lives. Mainstream media companies operate within both an intensely competitive industry and the unforgiving conventional financial markets. It is no surprise, therefore, that most media companies prioritize short-term profit maximization over concern for social impact. Many investors and interested observers, however, are examining the long-term effects that this market condition will have on our communities and global culture. In this context, both philanthropic and private market financial entities are increasingly paying attention to niche media that attend to the financial bottom line *as well as* social impact.

Some of these “double bottom line” (DBL) media companies have had notable success recently and have helped to generate attention to this fledgling market space. However, in most cases, DBL media companies are trapped in a cycle of under-capitalization. The traditional sources of philanthropic funding are vital but insufficient to compete with conventionally financed for-profit companies. Innovative equity and debt financial sources that are interested in social enterprises and DBL media companies are not yet organized as an efficient DBL media financial market.

Mindful of this present climate, in the Fall of 2004, the Investors’ Circle completed a report, “The Double Bottom Line (DBL) Media Industry: An Analysis of Investment Opportunities” (“Report”), with sponsorship from the Ford Foundation and in collaboration with Calvert Investment Foundation. The Report intends to provide preliminary insights into the DBL media companies as well as the DBL funders and investors. Surprisingly, we found a significant number of DBL media companies across every industry sub-segment that we surveyed. However, many such emergent companies face obstacles to growth because they do not have the necessary access to capital to grow or be self-sustaining and because investors perceive risk in this kind of social commitment. Our additional research with investors and funders underscored the hurdles intrinsic to the financial markets, but also helped us to identify the affirmative ways in which foundations and investors can meet the capital needs of DBL media companies.

The Report concludes three chief things: first, the DBL media represents substantial niche areas across the industry; second, in order to achieve long-term sustainability, DBL media companies must begin to look and prepare themselves for market-oriented financing, albeit from a narrow and unique segment; and, third, in order to improve its social impact and long term viability, the DBL media industry requires basic rationalization to improve its information and capital efficiencies. Proponents must, among other things, conduct further research on the industry’s structure and social and financial performance, provide enhanced trade forums for education and deal flow exchange, and develop diversified market-oriented investment vehicles for funders and investors. The Report ultimately advocates a substantial long-term initiative to sustain a viable DBL media market through the collaboration of interested investors, funders, trade groups, and entrepreneurs.

Identifying DBL Media Companies

The Report defines DBL media as comprising of three broad characteristics: minority-oriented, independent, and explicitly social mission-focused. Each category requires a different set of tools to measure social impact. **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 to the 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, focus of the editorial/creative staffs, as well as market share to determine whether a company falls into this category. Finally, **social mission media companies** focus primarily and 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 to have a positive social impact in ways that mainstream media do not. Of course, each individual investor determines for him or herself whether a particular company is socially valuable. The Report makes plain that while many of the companies that we observed have a progressive political perspective, we believe that it is the underlying value characteristics and not political orientation that is essential to the development of a vibrant DBL media market.

Mindful that the industry is transforming rapidly, the Report divides the media into the following segments (and sub-segments): television (broadcast, cable, and satellite), radio (broadcast and satellite), film (feature and documentary), entertainment (DVD, video, games), publishing (newspapers, magazines and books), the Internet, and advertising. Together, these segments represent \$405.27 billion out of \$648.3 billion in total 2003 industry revenues. The Report explains that there are DBL media companies in every segment of the industry. Among those segment and sub-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. The report briefly features **Urban TV Networks**, a media production company which produces and distributes African-American-focused content. The content currently reaches 22 million urban household 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 U.S. 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 features, among others, two notable companies: **Dragonfly Media (DFM)**, a new business that publishes five monthly "healthy living" newspapers in six major North American cities with a

circulation of 285,000 which generated about \$4 million in 2004; and **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.

- 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.

The lack of comprehensive capital investment research into the DBL media industry makes it difficult to draw firm conclusions about, let alone develop an accurate portrait of, the landscape of early-stage, privately held companies that might attract investors. Thus, we developed and distributed across the industry a survey designed to elicit preliminary demographic and financial information about such companies. As a voluntary response survey disseminated through 13 trade groups, this research effort was admittedly unscientific and non-representative. However, as a starting point, this survey generated over 641 responses nationally from trade groups (including, for example, The Association of Hispanic Advertising Associations, the Independent Publishers Association, the National Black Programming Consortium, and the New California Media) across every industry area. Preliminary analysis of the results improved our understanding of the industry. While more careful analyses are needed for a complete understanding of DBL media companies, the Report makes several preliminary conclusions, including the following:

- They are predominantly small companies, as measured by employees and revenues;
- They are highly motivated by their social missions;
- They are generally high risk and low financial returns;
- The majority were either breaking even or profitable;
- One-third are willing to consider selling their company;
- The majority are seeking some form of capital; and
- Most content producers are decisively committed to maintaining creative control.

Financing DBL Media Companies

DBL media companies traditionally have looked to the philanthropic sector for financing. As the entire media market continues to become more competitive and capital intensive, such sources of funding are simply not sufficient to sustain DBL media in particular. The Report explains that, in this climate, both private, for-profit sources as well as innovative debt and equity like philanthropic instruments of financing are critical to achieving long-term sustainability. These sources of financing, conversely, are increasingly interested in exploring more professionally the social and financial opportunity that DBL media represents.

Private Equity

Private equity firms and funds generally invest in high growth companies at all stages of development if they have stable underlying assets or intellectual property. Private equity finance

sources include strategic large media corporations, general buyout firms, specialty buyout 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 one percent 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 found that, in 2002, the capital invested in social and environmental deals represents about .6 percent of capital invested by venture capital funds; the total number of deals completed by DBL funds represented about 6.2 percent of venture capital (VC) deals. These 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 issues 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 two to six billion dollars available for investing in DBL companies, a small portion of which will be media.

Debt Markets

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 other sources of debt financing: revolving loan funds (RLFs) and program related investment (PRI) lenders.

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. These vehicles have emerged within the community investment debt sector. As measured by assets invested in community development financial institutions of all types, the market totaled \$14 billion in 2003 with a compound annual growth rate of 23% per year over the last six years. What is more, growth has been *accelerating* at 36% over the last two years. RLFs act as intermediaries for investors or donors wishing to reach enterprises' capital needs in a sustainable manner.

RLFs are historically non-profits with specific social missions. Originally, they were created to support low-income housing loans. RLFs perform substantial due diligence before making a loan, thereby decreasing risk of default on repayment. However, they do accept below-market rates of return. The overall landscape of such loan funds is \$3.6 billion as of the end of 2003, but almost no RLFs are specifically focused on DBL media companies (though many anecdotally lend to media enterprises). The only two DBL media debt funds are in fact RLF

models. These are the Independent Press Development Fund (IPDF) and the Media Development Loan Fund (MDLF). These funds have \$500,000 and \$30 million in assets respectively. These funds are examined in detail within the Report.

Although debt is often inappropriate for early stage ventures because of credit risk, intermediate stage companies may also have difficulties securing debt through traditional means – even if their risk profile is lower. We believe that debt financing may be a reasonable, moderate-risk method of investing in certain DBL media companies. Investors could see this potential enhanced when debt transactions are accompanied by lead equity investments. We discuss such a possibility in depth in the Report.

Program Related Investment Lenders

Foundations make program-related investments (PRIs) to support activities which jibe with their own grant-making priorities and from which they expect a return of capital within a certain period. PRIs include financing methods commonly associated with banks or other private investors, such as (below-market rate) loans and even equity investments in non-profit and for-profit organizations. According to the Foundation Center, in the U.S., foundations made over \$350 million in PRIs in 2000-2001, of which the most was spent on program areas such as community development (24.5 percent of total PRI dollars), the environment (18.3 percent), and education (16.8 percent). Foundations allocated 8.4 percent to “arts, media, and historic preservation” during the same period.

Foundations commonly make PRIs to supplement their existing grant programs, many of whom focus on the very social concerns addressed by DBL media. While PRI program activity has been on the rise, it has not increased significantly for media directly. Yet, many of the DBL media companies that we surveyed in this project meet the criteria for, and are in significant need of the type of risk capital that PRI programs are uniquely qualified to offer. Certain DBL media companies have the potential for generating income to repay the loan and have been unable to secure financing from traditional sources.

The central point here is that there is a critical intersection between the debt capital gap of DBL media enterprises – with their high risk, low financial return, and high social impact profile – and the explicit mission of the PRI programs foundations like Ford, Rockefeller, and MacArthur. Such concessionary debt from foundations (and the intermediaries that they fund) can be the lynchpin of a more efficient and effective capital market for DBL media.

Financial Service Markets for DBL Media Companies

Conventional media investors and companies alike make use of a broad range of investment services that are provided by a broad range of intermediaries, including strategic industry analysis, company due diligence, finance transaction structuring, and syndication of deals. The investment service sector of the mainstream market in 2003 included nearly 100 publicly traded companies (including the major giant corporations such as Morgan Stanley, Goldman Sachs, etc.) with a combined market capitalization of \$324.4 billion. This does not include the myriad of private and boutique investment service providers and media specialists.

In contrast, the DBL investment market in general and the DBL media market in particular are fragmented and have the capital and information inefficiencies of an under-developed market. A few DBL media industry niches show signs of substantial growth potential, such as the ethnic minority television broadcasting sub-segments of the DBL media industry.

However, DBL media companies generally are not established enough to attract conventional capital markets and their related services.

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. Independent DBL investors are also in the early stages of development and have limited resources. For example, Investors' Circle and the Calvert Social Investment Foundation have begun to support equity and debt investments in DBL companies but are financially limited; these organizations' annual budgets are, respectively, one million dollars and five million dollars. CleanTech and the Community Development Venture Capital Alliance are specialist intermediaries who focus on vertical industry areas (energy and community development, respectively) and provide legislative, trade, and investment services. However, all of such known intermediaries (including research and consulting firms active in this space), have less than \$20 million combined annual budget.

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 financial returns. The Report thus makes some of the following assumptions 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 the nascent ethnic minority broadcast television sub-segment;
- Pension funds, banks, and government funds have invested one to five million dollars in minority-focused media funds. These particular funds tend to invest in high return, larger media companies rather than smaller, high-risk DBL media companies.
- Most DBL media investors are individuals and foundation PRI programs set to invest between \$100,000 and two million dollars per deal directly through media funds;
- Most DBL media investors are particularly motivated by important social issues, 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, and, on occasion, lower to medium growth over time;
- Lack of collateral on the balance sheets makes equity investments, rather than debt vehicles, the appropriate instrument for growth and expansion finance for DBL companies in most cases;
- Debt instruments are a good investment instrument 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 creative product that is near completion and that has secured distribution.
- 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.

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 also 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. Business Fundamentals: Investors should choose DBL media companies that employ standard business fundamentals to drive their businesses.
3. Scaling: Investors should choose DBL companies with clear opportunities to scale revenues.
4. Aggregation: Invest in the aggregation of several companies into a larger platform.
5. Leverage of Dominant Players: Choose companies that have a proven track record in establishing deals for distribution or production with the larger players.
6. Acquisition: Choose DBL companies that are likely to be acquired by larger DBL companies or dominant Media Industry players.
7. Technical Assistance & 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 will also assist DBL media companies to secure capital. Creating a series of linked capital market intermediaries and syndicates of investors can facilitate the financing of a range of mission-based media projects.

On the basis of these guidelines, the Report recommends that proponents for this market, in collaboration with one another, consider developing 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.

This summary was created to support a presentation on “The Double Bottom Line (DBL) Media Industry: An Analysis of an Investment Opportunity” made in conjunction with the Council of Foundations 2005 Annual Conference. The original Report was created by Dominic Careri Kulik, Director of Investors’ Circle (IC), and edited for these purposes by Olivier Sylvain, a Sr. Associate of IC. For further information about this project and broader investment activities in this market, please visit www.investorscircle.net/IC/dblmediafinance. The full length version of “The Double Bottom Line (DBL) Media Industry: An Analysis of an Investment Opportunity” report will be posted on IC’s site by April 2005. You can also reach Dominic or Olivier by calling IC at (617) 566-2600 and asking for more information about the Report.