Media Economics

Economies of Scale

- When bigness is its own reward
- E.g.: hand-knit sweaters vs. auto manufacture
- Media generally have huge economies of scale, because they are based on cheap reproduction, and thus face huge pressures to be big

Mass media businesses, from the printed book to satellite TV, tend to have what economists call "economies of scale." When economies of scale exist, bigness can be its own reward. To understand the concept, it helps to start with a type of business that does not have economies of scale, for example, hand-knit sweaters. If you start a business making hand-knit sweaters, you can only make so many yourself; say, two sweaters a week. If you wanted to sell more, you would have to hire someone else to also make sweaters; another person would double your output of sweaters, but you'd also have to pay that person to do the work. So the more sweaters you make, the more costs go up at almost the same rate that income goes up. Because making four sweaters a week costs twice as much as making two sweaters a week, there's low economies of scale and thus no big advantage to being a big company in the hand-knit sweaters market.

In some businesses, however, the more you make, the lower the costs per unit made. Making one car by hand is so expensive that basically nobody does it. Making hundreds of cars per year in a small factory is much less expensive per car than making one by hand, but it is still very expensive and only very exotic and expensive cars get made that way. Making hundreds of thousands of cars per year in a giant global factory system, though, is much less expensive per car again, so that's how most cars get made. But that's also why cars are almost all made by giant multinational corporations; the economies of scale are such that you simply can't make money selling cars from a small business.

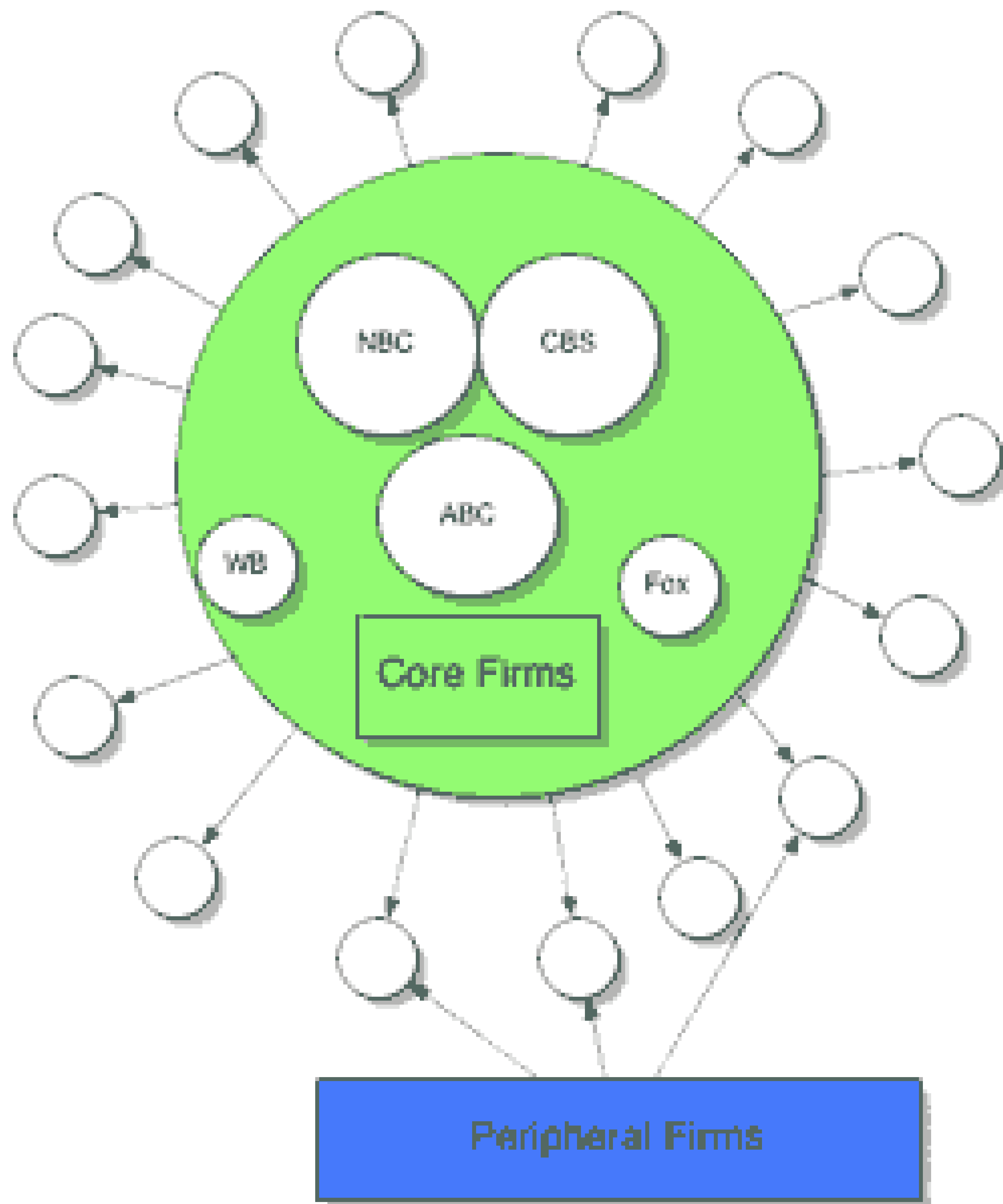
The economic peculiarity of mass media is that it is all based on cheap reproduction. Writing an original book may take you a year's work; making copies of that book will cost you only a couple of dollars. Making a Hollywood movie could cost more than $100,000,000; making a DVD copy of that movie can cost less than 50 cents. Mass media have enormous economies of scale. As a consequence, bigness in mass media is very much its own reward. The pressures to be giant in mass media are therefore immense.

Monopoly, Oligopoly, Limited Competition

- Monopoly = *one* overwhelmingly dominant firm
- More common: a few large firms, i.e., oligopoly
- Limited competition between these firms: the dance of the elephants

People throw around the term "monopoly" a lot in debates over commercial media; critics denounce media corporations as "media monopolies," whereas defenders sometimes act as though Disney and Time/Warner are no different from small businesses like the corner store. It helps in this debate to get a little more specific. There's no consensus definition of an economic monopoly, but generally monopoly means that there is one overwhelmingly dominant firm in a particular market. Microsoft comes pretty close to that with the Windows operating system, because roughly 95% of all desktop computers run it.

But situations like that are actually rare. In the media, a more typical situation is a handful of huge corporations sharing a single market. There are only five big broadcast television networks in the US, for example, and three of those (ABC, CBS, and NBC) are bigger than the others (Fox and WB). Situations like this are more properly called oligopolies, i.e., situations where only a handful of firms dominate. This situation is a little more complicated than simple monopolies: oligopoly firms have a lot of power, but they also do compete, with each other, and sometimes with smaller companies. The relations between oligopolies are sometimes characterized by kinds of limited competition, i.e., competition that falls short of the wide-open, completely free-market kind.


NBC
CBS
ABC
WB
Fox
Core Firms
Peripheral Firms

Vertical Integration and Synergy

- Uncertainty in media: for every hit, lots of disasters
- Hence: search for “market power” to reduce uncertainty
- One uncertainty-reducing strategy: “synergy” (e.g., coordinated movie/pop song/MTV video)
- E.g.: "Star Trek" franchise: recirculation, repackaging, reversioning, recycling, redeployment

Mass media have another peculiarity that acts at least a little bit as a countervailing pressure against the economic rewards of bigness. Mass media, remember, are forms of communication where people are physically and (often) temporally separated from their audience. As a result, mass media are faced with higher uncertainty than most industries about what will sell or not. If General Motors makes a minivan, they know that a good number of them will sell, though not exactly how many. Media, on the other hand, are faced with the entire range of possibility, from total, money-loosing flops to enormous blockbusters. For every smash hit like the first Star Wars, there are lots of disasters.

Because of this uncertainty, media executives spend a lot of time looking for ways to increase "market power" (which is kind of the same as decreasing competition). They want to reduce uncertainty by finding ways to ensure that the products they are the products that get bought. One of the strategies executives use for this is often called "synergy." Synergy is a buzzword (and therefore does not have a precise definition) but it generally means bringing different products together under one roof so that they reinforce each other. One of Walt Disney's major contributions to the media was the discovery of this process (though he didn't call it synergy): in the 1950s, Disney discovered that he could coordinate movies (e.g., Snow White), TV shows (The Wonderful World of Disney, the Mickey Mouse Show), a theme park (Disneyland), and consumer products for children (e.g., Mickey Mouse hats). Each element in the Disney system could be used to promote and reinforce the other; The Wonderful World of Disney regularly ran "making of" shorts about upcoming Disney movies, Disneyland would add rides based on movies, and so forth.

Since the 1950s, and with explosive intensity beginning in the 1980s, "synergy" strategies have become the norm in most of the media. Every major Hollywood movie now routinely pays for a pop group to make a song and a music video, so that when the video is played on MTV or the song on the radio it becomes an advertisement for the movie; pop groups do this because then the movie becomes an advertisement for their group. In children's media in particular, people no longer make a movie or a cartoon or a book; they develop an integrated merchandising scheme involving all of these and tied in to consumer products like Happy Meals or action figures ("tie-ins"). The results are sometimes good, sometimes not, but in any case they are done in the hope of reducing uncertainty and risk.

Vertical Integration

- Vertical integration = taking many parts of a process and putting it under one roof
  - E.g.: production houses + distribution chains + TV stations
  - E.g., Apple's iPhone/iTunes
- Horizontal integration = buying up all versions of one part of the process (e.g., buying all media outlets in one market)

A more precise way of understanding what's going on can be found in the economic concept of "vertical integration." Vertical integration is when a firm takes many different parts of a process of manufacturing and distribution and puts it all under one corporate roof. If buying up all the gas stations in one market is "horizontal integration," buying some gas stations, an oil distribution company, an oil refinery, and some oil wells is vertical integration. Media corporations generally like vertical integration because it reduces their uncertainty; this is why a company like Sony or Time/Warner will buy TV stations, production studios, theater chains, and consumer product manufacturers -- because they like to bring all different parts of the chain from producer to consumer under one roof, so as to better coordinate them.

- Problem: reducing uncertainty reduces competition, a fundamental principle of free markets
- 1948 Paramount Decision (antitrust law applied to movie studios)
- The battle over FCC Ownership restrictions

Reducing uncertainty is also a way to reduce competition, however, and limiting competition seems to fly in the face of the ideal of the competitive marketplace that capitalism is supposed to be all about. Antitrust law exists basically to keep the marketplace competitive. In the 1930s, the big Hollywood movie studios (e.g., Paramount and Columbia) bought up theater chains across the country so that they could ensure that the movies they made in Hollywood would be shown throughout the country (and so that movies not made in Hollywood would not be shown anywhere). This "studio system" produced a lot of popular movies like Gone with the Wind and The Wizard of Oz, but it also struck many people as unfair, so in 1948, the government won an antitrust suit against the movie studios in the "Paramount Movie Studio case." The studios were forced to sell off their local theater chains; this is why there are still a lot of old "Paramount" movie theaters in downtowns across the U.S. that are not owned by Paramount.

Since the Paramount decision, antitrust law has been applied irregularly to the media industries. In the 1980s, the media industries began to vertically integrate again, and the government has not done much about it, although there are occasionally calls that they should.