

# Misleading Industry Market Analyses

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## Abstract

When the 3<sup>rd</sup> Circuit Court of Appeals reviewed the FCC's 2003 ownership rule changes in the *Prometheus* case, it recognized the legitimacy and need for a coherent approach to measuring media market concentration. The court however threw out the FCC's Diversity Index, the Commission's own bungled attempt at market structure analysis. The court also threw out the rule changes based on this flawed analytical approach -- an approach that produced results that were, in the court's words, "absurd".

But if the FCC is to live up to its obligation to promote the goal of "the widest dissemination of information from diverse and antagonistic sources", then it must approach market structure analysis in a manner that is not "arbitrary and capricious". The Commission must avoid its past mistakes and follow the map laid out by the *Prometheus* Court and other courts before it - the Commission must count audiences and apply the appropriate geographic boundaries when analyzing local media markets and market concentration.

In our previous comments we conduct methodologically rigorous market structure analyses, using the correct geographic market definitions, the appropriate weights, and factored in audience sizes. The results from this approach are clear -- local media markets in the U.S. remain highly concentrated, and elimination of FCC ownership restrictions would have the unambiguous result of drastically increasing this concentration to the detriment of the public interest.

However, in comments to the FCC, industry firms such as Hearst and NAB attempt to lead the Commission right back down the analytically treacherous path they took in 2003. Hearst constructs an "Audience Market Index" (AMI), which we demonstrate to be highly flawed due to a failure of product definition and a failure to analyze the entire media market. Hearst's argument against the top-4 exclusion ignores one of the central tenets of market structure analysis -- mergers between a large firm and a small firm will have a greater impact on market structure than mergers between two small firms. We demonstrate this in the local media sphere using Hearst's data, correcting for flaws in their market definition.

In a study that dramatically misrepresents the diversity of market voices, NAB offers a market analysis that is careless in the geographic market dimension. NAB also repeats the mistake of ignoring audience share. When we correct for these flaws we show that in contrast to the great diversity the NAB tries to claim exists in the radio market, that even this market is a very tight oligopoly. Instead of an average of 81 stations, we find four owners with a 90 percent market share.

If adopted, the market analysis approach offered by industry commenters would lead the Commission back to the finding that its rules are arbitrary and capricious.

Industry commenters present a number of analyses of media markets that are poorly executed. They reflect fundamentally flawed approaches to product and geographic definition and market structure issues. They make the same mistakes the Commission has made in the past, which have resulted in the overturning of prior Commission rulings. If the Commission follows their advice, it will run into the same problems.<sup>1</sup>

## **Hearst's Misleading Market Analysis**

### **TV Market Concentration**

Hearst's Audience Market Index (AMI) is ill considered and represents a failure of product definition and a failure to analyze the entire media market.<sup>2</sup> The essence of the flaw in the AMI is that it is not based on the actual television market, but on a hypothetical market for television. It includes in the estimate of television market shares households that do not watch television, but it fails to include the market shares of the media that they do use. If a household does not use any media, then they are not in the media market, but if they do, all media must be included. This is actually what several courts have told the FCC to do. This is what we did in our analysis contained within our initial comments.<sup>3</sup>

On the other hand, if the analysis is about the television market, as Hearst's examples suggest, then only people in the television market should be included. In either case, Hearst's AMI dramatically underestimates the level of concentration.

To appreciate the magnitude of the misrepresentation in which the Hearst AMI would result, we calculated two alternatives. Hearst had four TV outlets with a total market share of 42.25 percent, distributed as follows: 20.75, 14.75, 3.5, 3.25

We start from this point (see Exhibit 1). In one scenario we estimate the TV market only HHI. Thus, we calculate the market share of each outlet, as a percentage of the total TV market. In the alternative, we assume that the audience of other media is distributed among four other outlets in the same proportions as the four outlets that Hearst counted. If Hearst's outlets are TV stations and the missing outlets are newspapers, this is actually a conservative assumption since the newspaper market is generally much more concentrated than the TV markets, as we have shown in our initial comments. We find that in either approach the market is much more concentrated than Hearst claimed – the HHI is between three and six times as high. Moreover, the merger violates the merger guidelines in both cases.

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<sup>1</sup> Mark Cooper, Study Number 20, "The Critique of the FCC Methodology," attachment to *Initial Comments of the Consumer Federation of America, Free Press and Consumers Union*, In the Matter of 2006 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, 2002 Biennial Regulatory Review – Review of the Commission's Broadcast Ownership rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996, Cross Ownership of Broadcast Stations and Newspapers, Rules and Policies Concerning Multiple Ownership of Radio Broadcast Stations in Local Markets and Definition of Radio Markets, Docket Nos. MB 06-121, 02-277, 01-235, MM 01-317, 00-244 (hereafter, CFA, Free Press, CU Comments).

<sup>2</sup> Gannett, pp. 25-32.

<sup>3</sup> See CFA, Free Press, CU Comments, Studies Nos. 21-39.

**Exhibit 1:  
Correcting the AMI for Missing Market**

Market Shares	AMI	TV Market Only	All Media Outlets
Firm 1	20.75	49.11	20.75
Firm 2	14.75	34.91	14.75
Firm 3	3.5	8.28	3.5
Firm 4	3.25	7.69	3.25
Firm 5	N/A	N/A	28.36
Firm 6	N/A	N/A	20.16
Firm 7	N/A	N/A	4.78
Firm 8	N/A	N/A	4.44
HHI Pre Merger	664	3759	1924
HHI Post-Merger Firm 2+3	774	4572	2034
HHI Increase	110	813	110

**The Four Firm Exclusion**

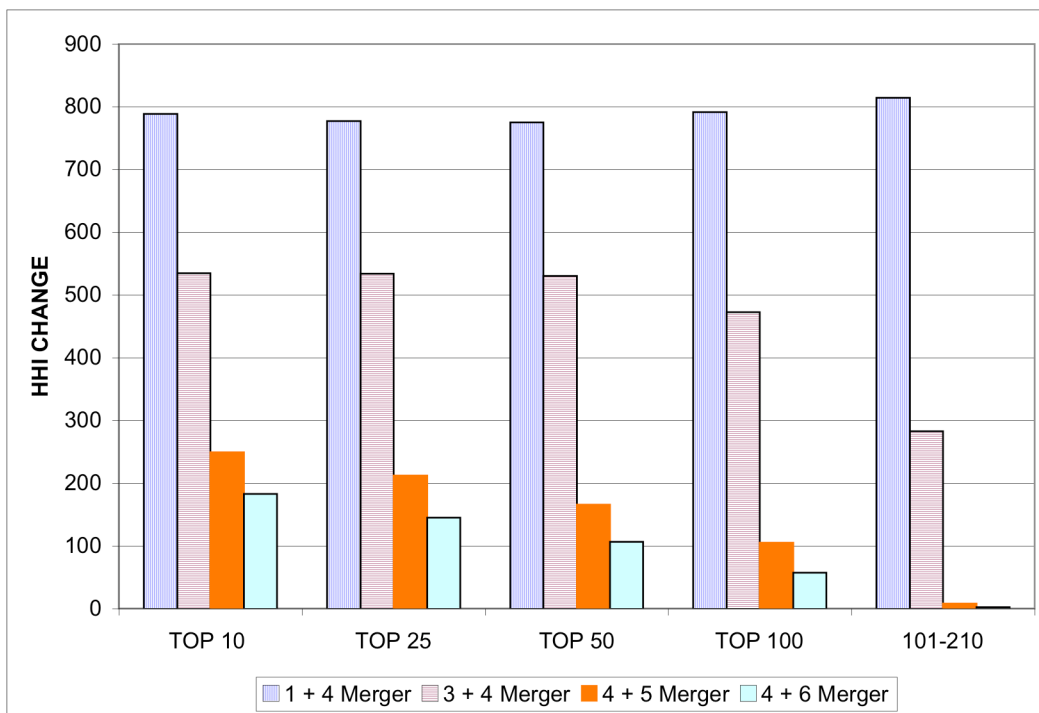
The failure of Hearst to properly understand market structure analysis is evident in its effort to show that the top four firm exclusion is inappropriate. Hearst argues that the four firm exclusion should be abandoned because the relative market shares have shifted.<sup>4</sup> It claims that the gaps between stations have narrowed, but it fundamentally misunderstands the nature of market structure analysis. The traditional measure of market concentration – the HHI – recognizes that relative differences in market share become more important as the absolute level of market share rises. Thus Hearst offers the observation that “the difference between the average fourth ranked station and the average fifth ranked station... is less than the difference between the average first and second ranked stations, the average second and third ranked stations and the average third and fourth ranked stations” to impugn the reasoning of the FCC.<sup>5</sup> Hearst fails to recognize one of the central tenets of market structure analysis – mergers between a large firm and a small firm has a greater impact on market structure than mergers between two small firms. A merger between a firm with ten percent and one with nine percent has a bigger impact than a merger between a firm with three percent and one with one percent, even though the difference between the two firms is smaller. Proper market structure analysis shows that Hearst’s approach is simply wrong.

<sup>4</sup> Gannett, pp. 33-47.

<sup>5</sup> Gannett, p. 41.

Exhibit 2 tests the dividing line drawn by the FCC by assessing the change in the market HHI. We use the Hearst data on audiences and convert the audience shares to market shares. We begin by correcting the failure to properly define the market as discussed in the previous section. This corrects the same mistake Hearst made in the AMI of including people who do not watch television in the television market. Here there is no doubt that this is a television market only analysis. We then calculate changes in the market HHI by squaring various combinations. There is no doubt that mergers within the top 4 have a much larger impact on market concentration than those that involve non-top four firms. The mergers involving the fourth ranked firm and higher ranked firms increase market concentration about twice as much as mergers involving the fourth ranked and lower ranked firms.

**Exhibit 2:  
HHI Changes Caused by Various Merger Scenarios based on Hearst Audience Share Data**

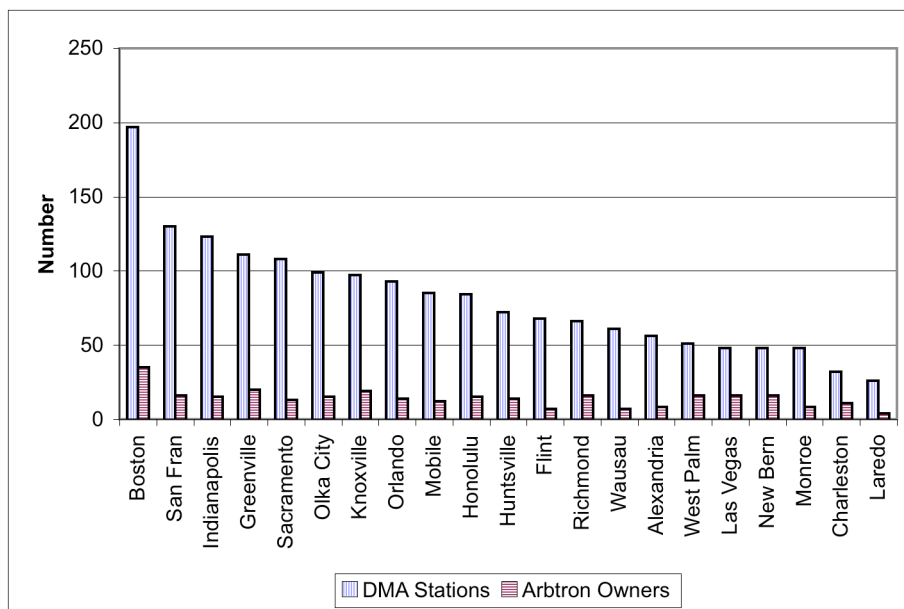


## **NAB'S Misleading Market Analysis**

Industry commenters are also careless in the geographic market dimension. The radio market is the Arbitron area, but the NAB, in its first Appendix, starts with a count of radio stations in the Designated Market Area (DMA), an area that is far too large for radio. That radio count is then mixed with television stations in the DMA. The NAB does count the number of owners of radio stations in the DMA, which is the policy relevant count applied to the wrong geographic market. It never notes the number of TV station owners, or owners of cable outlets and cable channels. It never provides a count of owners in the correct geographic market for radio – the Arbitron market.

Ironically, using NAB's Attachment B, one can extract the number of radio owners in the Arbitron area that would match the DMA. Exhibit 3 shows the dramatic difference in voice counts for radio. The count of independent voices – the number of owners in the Arbitron area – is less than one-fifth the number of stations in the DMA. There are an average of 14 owners per Arbitron area compared to 81 stations per DMA. The NAB analysis never actually provided the count of owners in the Arbitron area. Thus, the first study dramatically misrepresents the diversity of voices and the error is not corrected in their comments.

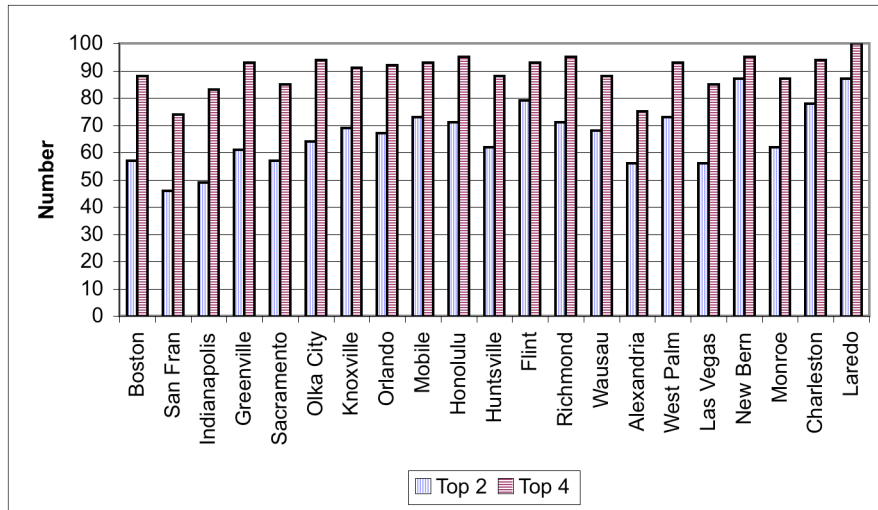
**Exhibit 3:  
Radio Market and Policy Relevant Count**



Sources: Designated Market Area Station Count, NAB, Attachment A: Media Outlet Availability; Arbitron Station Ownership Count, NAB, Attachment B: Independent Radio Voices in Radio Markets.

The NAB also never looks at market share data (see Exhibit 4). While there are 14 owners per Arbitron area, the top two owners have an average market share of approximately two-thirds of the market. The top 4 owners have about 90 percent of the market. San Francisco is the least concentrated market, but even there the top two owners have a market share of 46 percent and the top four have a market share of 75 percent.

**Exhibit 4:  
Market Shares of Top 2 and Top 4 Firms: 2003**



Source: Federal Communications Commission, Media Bureau, "Review of the Radio Industry: 2003", September 2003, Appendix F.

Thus, in contrast to the great diversity the NAB tries to claim in the radio market with its count of stations in its first study, when we define the market properly (Arbitron area), focus on the relevant policy variable (ownership), and take account of the key market structural characteristics (audience), we find that even the radio market is a very tight oligopoly. Instead of an average of 81 stations, we find four owners with a 90 percent market share.

**Legal Reasons that the Commission Must Reject the NAB and Hearst Analyses**

The above discussion shows why the industry analyses are empirically flawed and should not be relied upon by the FCC. There is a legal reason that the FCC must not take the approaches recommended by Industry comments. Underlying the NAB analysis is a fundamentally incorrect conception of what the FCC should do in assessing the market structure of the broadcast industry for purposes of its First Amendment policy. The industry commenters do not want the Commission to take the audience of the outlets into account when examining the market structure.

It is the availability of content from multiple outlets that matters – not that some ideas, viewpoint or content may be more or less popular than other content at any particular time.<sup>6</sup>

As the Commission itself explained in its 2002 *Biennial Review Order*, "viewpoint diversity refers to the *availability* of media content reflecting a variety of perspectives."<sup>7</sup>

<sup>6</sup> NAB, p. 54. See also NAA, 89-92.

<sup>7</sup> Gannett, p. 32.

In other words, it matters not if one voice speaks “louder” than another for purposes of assessing the diversity of viewpoints available in a local community – it matters only that different voices have the means through which to speak, and can be heard by any who choose to listen.<sup>8</sup>

While the industry commenters repeatedly cite the court’s ruling for support, they tell the Commission to ignore the most fundamental premise of the court order. The court told the FCC to not ignore the audiences of outlets. It was the failure to take audiences into account that led to the most damning criticism lodged by the court against the Commission’s rule.<sup>9</sup>

The industry commenters would have the Commission ignore the clear conclusion of the court that the audience matters and the Supreme Court’s understanding that “undue economic concentration” and “excessive impact on public opinion” are the core of the issue. The argument that all outlets are equal and that audience does not matter is antithetical to the fundamental Supreme Court jurisprudence.

The industry tells the Commission to abandon rigorous empirical analysis of media markets based on a legal theory that the Supreme Court has repeatedly rejected. They want the Commission to give up the effort to realistically measure the voices in the media markets on the grounds that the mere availability of outlets, regardless of their size or impact, is all that matters. They urge the Commission to reject congressionally mandated goals for media policy, like localism, even though the courts have repeatedly and consistently upheld these goals as legitimate governmental purposes. The Commission should reject the industry arguments on Constitutional, legal and evidentiary grounds.

The industry commenters repeatedly confuse counting with discounting. Outlets should be counted and their audience is a reasonable measure of the weight they should bear in a real world assessment of the media marketplace. Less popular sources occasionally play an important role and this is correctly reflected in counting their weight in influencing public opinion.

Indeed, it would be antithetical to our First Amendment values for a government agency to suggest that outlets offering less “mainstream” content should not count at all, or should be discounted substantially, in any media diversity analysis.<sup>10</sup>

“By analyzing diversity based on audience reach or market share instead of availability, the Commission would improperly discount the critical role that less popular media outlets often perform in local markets.”<sup>11</sup>

This would argue for a careful assessment of the importance, influence and reach of these voices, in order to avoid the pitfall of arbitrary and capricious outcomes in either direction. Yet the industry commenters urge the Commission to not engage in precisely this

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<sup>8</sup> Id., p. 33.

<sup>9</sup> See Note 1 above.

<sup>10</sup> NAB, p. 55

<sup>11</sup> Gannett, p. 33.

reasoned analysis. Rather they urge the Commission to ignore actual usage patterns and measures of reach and influence and just declare that there are sufficient voices available to meet its statutory and constitutional obligation to promote the “widest possible dissemination of information from diverse and antagonistic sources,” and to prevent “undue concentration of economic power” and “inordinate effect on public opinion.”

Nor is it the case that the industry commenters do not themselves look at audiences and market shares. They do, but they only consider them when it supports their case. Thus, they calculate the market share of the top five radio stations in the top 100 markets, but not the top owners in those markets. Ownership is what matters and the smaller markets are the at-risk markets.

They make repeated estimates of how much market share they have lost to alternative media and out of market broadcasters, but tell the Commission not to count market shares in evaluating market structure.

## **Conclusion**

The road laid out by the industry commenters is a dead end. As has happened three times, it would lead the Commission back to the finding that its rules are arbitrary and capricious and lack a rational that reflects the real world condition of media markets in America.