Strategic Report for Viacom, Inc.
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Executive Summary

Viacom (NYSE: VIA:B) is a leader in entertainment media, operating primarily in the cable and other pay television services industry, as well as the motion picture and video tape production industry. It is comprised of many popular television networks such as MTV, Comedy Central, BET, Nickelodeon and Spike TV among many others, and of the film production studio Paramount Pictures.

The main problem facing the industry right now is the advent of digital media, which has allowed consumers to access entertainment in new ways and with greater speed. Not only does digital media act as a substitute for consumer leisure time but it allows for piracy of content. In the mature markets of film and media, competition for consumer attention is fierce and companies must be sure to stay on the cutting-edge to maintain interest, ratings, and therefore advertising revenues.

Viacom should position itself strategically to take advantage of the new ways in which consumers access entertainment. This means first and foremost that the company should establish a single advertising-supported website where viewers can watch popular television shows for free. Some movies should be available for free, while more recent or obscure films should be pay-per-view. However, the website should be the same for all forms of entertainment to encourage browsing, thereby increasing revenues and hopefully acquiring more viewers for other Viacom shows who will continue to watch in the future. Everything possible should be done to increase time spent on the website, including making recommendations to users for other content they are likely to be interested in.

Similarly, Viacom should focus on branching out into new digital media platforms. Mobile devices become more popular and allow for more content every year. Viacom should take advantage of this opportunity and create contracts with cell phone companies and producers of mobile devices, like Apple
with the iPad, to allow consumers to access content with their cell phones and other devices.

Viacom excels at targeting specific demographics. Generally, it targets youth, but has television networks geared towards certain ages and demographics such as race (Black Entertainment Television) and sexual orientation (Logo). This strategy should be continued, and Viacom should attempt to create more networks with specific demographics in mind, especially those which are underrepresented in traditional entertainment and media.

The company should continue to expand globally with networks targeted to local populations. This can be achieved by partnering with successful local networks, or by expanding preexisting networks in local markets.

**History**

VIACOM (Video and Audio Communications) initially started as Columbia Broadcasting System, Inc.’s (CBS) television syndication division. On June 4, 1971, Viacom, originally CBS Films, completed its spin-off from CBS and established itself as a publicly traded company. In 1976 Viacom established Showtime movie network to directly compete with Home Box Office (HBO). Seven years later Viacom formed a joint venture with Warner Communications and Warner Amex Cable Communications, which had owned half of Showtime. In 1985, Viacom acquired roughly 66 percent of MTV Networks. Viacom purchased the remaining portion of MTV in the subsequent year. In 1987 privately-owned National Amusements, one of the ten largest U.S.-based movie theater chains, acquired 83 percent of Viacom in a transaction valued at $3.4 billion but ultimately kept the Viacom name. That same year MTV initiated its international expansion with the introduction of MTV Europe. Viacom purchased the 50.01 percent of MTV Europe it did not already control for $65 million in 1991.
In 1994 Viacom acquired Paramount Communications for $9.9 billion, diversifying into the movie industry. Paramount was very successful during the ’90s. Most notably, Paramount (in conjunction with Fox) produced and distributed Titanic, the highest-grossing movie in history at the time. Paramount has failed to achieve the same level of success in the last decade, however. Viacom also purchased Blockbuster, the largest videotape retailer in the United States, in 1994 for $8 billion. The Blockbuster purchase provided Viacom access to notable television holdings controlled by Aaron Spelling’s company, Spelling Entertainment, as well his own productions (such hits as 90210 and The Love Boat).

The acquisition of Paramount and Blockbuster left Viacom with significant debt, however. In the late 1990s Viacom divested nearly $7 billion worth in assets, including cable systems, radio stations, Madison Square Garden, and the majority of publisher Simon & Schuster, to alleviate the company's burdensome debt. These lucrative divestitures, the overwhelming success of Titanic, and the adoption of an improved strategy by previously underperforming Blockbuster fueled Viacom’s recovery in 1998.

In 1999, nearly three decades after splitting from CBS, Viacom bought its former parent company in an all-stock merger valued at $39.8 billion, a move that allowed CBS to reach new markets (those of younger generations) and Viacom to utilize CBS's brand recognition. Sumner M. Redstone, Chairman, Chief Executive Officer and controlling shareholder of National Amusements, and the Executive Chairman of the Board and Founder of Viacom and CBS Corporation, gave up “effective operating control” of the post-merger Viacom to Mel Karmazin, the chief executive officer of CBS.

In 2001 Viacom acquired Black Entertainment Television, a network aimed at young African-American TV viewers, for $3 billion. BET was the first network of
its kind and prompted the emergence of similar networks hoping to imitate its success. In 2003 Viacom acquired the remaining 50 percent interest in Comedy Central for $1.2 billion.

Despite the synergistic promise of the Viacom-CBS merger, the corporation would not last. Redstone and Karmazin had a tenuous relationship, hardly ever speaking. In addition, the company failed to meet earnings targets from 2001 to 2003 under Karmazin’s direction. Redstone subsequently sought to regain some of the control he had relinquished to what was thought to be his successor as CEO. In 2004 Karmazin resigned from the conglomerate. Redstone named MTV’s Tom Freston and CBS’s Leslie Moonves co-presidents, setting up an intense rivalry to succeed Redstone. A year after the departure of Karmazin the stock traded around $34, compared to the $75 it was trading at shortly after the merger was finalized. The contention between top executives and the underperformance of the stock led the board of directors to agree to split the company into separate entities, Viacom and CBS Corporation, in December 2005. Freston headed Viacom, while Moonves assumed control of CBS. Analysts believed that CBS, which relied largely on assets in advertiser dependent mediums (broadcast television and radio), held back the growth potential of cable network MTV and the other young-audience cable stations held by Viacom. Unsatisfactory stock performance and increased skepticism regarding Viacom’s online strategy, prompted Redstone to force the resignation of Freston. Phillipe Dauman, who served as a longtime lawyer to Redstone at Viacom, became CEO in late 2006. Through National Amusement, Redstone maintains about 70 percent of the voting stock in Viacom and CBS. Redstone, who is currently 86 years of age, has been reluctant to retire completely. Shari Redstone, Sumner Redstone’s daughter, is the President of National Amusements and the Vice Chair of the Board of Viacom and CBS Corporation. She will mostly likely assume her father’s role in the National Amusements empire, including its subsidiaries
Viacom

Viacom and CBS, although a strained relationship between the two may lead Sumner Redstone to select another successor.

Since the unraveling of the merger, Viacom has acquired numerous companies. In 2006, Viacom purchased xfire, an online gaming communication service, and Harmonix, the video game developer known for producing the hit game Rock Band. Spokespeople have stated that the company would like to expand into the gaming sector. Viacom acquired DreamWorks later that year for $1.6 billion including assumption of debt. The acquisition included an ongoing partnership with renowned director Steven Spielberg in addition to the company's films in production and television operations. In 2008, Viacom announced epix, a joint venture between Viacom, Paramount, MGM, United Artists, and Lionsgate that hopes to provide premium cable television and video-on-demand services.

The emergence of video sharing websites, though, has presented a challenge to Viacom. In 2007 Viacom launched a $1 billion lawsuit against YouTube and its parent company Google, accusing YouTube of "massive intentional copyright infringement." Viacom argued that YouTube members uploaded Viacom's copyrighted material in such large quantities that Viacom suffered financially, while YouTube's revenue grew due to increased advertising sales. In January 2010, nearly three years after Viacom initiated its suit, both sides requested a summary judgment, in which a federal court would decide whether enough evidence exists for it to rule without sending the case to trial. As of April 2010 the filings are still in progress, with the battle turning uglier as YouTube alleges that Viacom, not only aware of infringing material and not asking it to be removed, actually uploaded infringing content itself to increase interest in its content. The filings may ultimately signal a resolution to the lawsuit within the year, although both companies will likely walk away with a slightly damaged reputation.
The recent economic downturn has posed difficulties for Viacom as well. With advertising making up a third of revenue, Viacom has been adversely affected by the recession as companies have sought to minimize costs and limit spending. In December of 2008 Viacom laid off 7 percent of its workforce, or about 890 people, due to the recession. At the time, the stock price dropped about 70 percent from roughly $45 to about $13 a share. The stock has recovered gradually over the last year, trading around $36 a share as of April 9.

### Competitive Analysis

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Viacom Inc. is a leader in entertainment media, operating primarily in the cable and other pay television services industry, as well as the motion picture and video tape production, radio broadcasting stations and television broadcasting stations industries (SIC codes 4841, 7812, 4832 and 4833, and NAISC codes 515210, 512110, 515112 and 515120). The company divides itself into two segments, the Filmed Entertainment segment, which consists primarily of Paramount Pictures and MTV Films and Nickelodeon Movies, and the Media Entertainment segment, made up primarily of Viacom's various networks. These include brands like MTV, VH1, CMT (Country Music Television), Logo, Nickelodeon, Nick Jr., Teen Nick, Comedy Central, Spike TV, TV Land, and BET (Black Entertainment Television). Video game developers include Harmonix, developer of Rock Band, and MTV Games, and Viacom also runs online games off of many of its network websites targeted to the corresponding demographics.

Revenues from the Filmed Entertainment division come from three main avenues, (1) the theatrical release and distribution of motion pictures, (2) home
entertainment, including DVD sales, and distribution of third-party content and (3) third-party license fees. These make up approximately 24%, 46%, and 25% of the total revenues of Filmed Entertainment, respectively, with ancillary revenues supplying the final 5%.8

Viacom’s Media Entertainment segment generates revenues from three main sources: (1) the sale of advertising time on its television and digital services and properties, (2) affiliate fees from cable television operators, direct-to-home satellite operators, mobile networks and other content distributors and (3) ancillary revenues, which include the creation and publishing of video games and other interactive products, home entertainment sales, and the licensing of content, brands and properties to third parties for content programming as well as for consumer products.9 Each of these sources of revenue is directly affected by the ratings, number of households subscribing to or watching content and the viewership demographics for the network’s shows, which are compiled by third-party research companies like The Nielsen Company. Higher-rated shows with more viewers in coveted demographics command more money per advertisement slot as well as higher licensing and affiliate fees, and higher ratings can signal that consumers would be willing to pay more for home viewing and licensed products.

**Internal Rivalry**
With many broad areas of service, the company faces competition from many different companies in various industries, although often the competition comes from other media conglomerates. For example, Paramount Pictures, the main division of Viacom’s Filmed Entertainment segment, faces competition from Warner Bros., Disney, Fox, Universal, and Sony Pictures, collectively known as the “Big Six”. However, the company’s cable programming faces competition both collectively from other media conglomerates like Disney and NBC Universal, as well as from individual networks. For instance The Disney Channel competes for the same demographic as Viacom’s Nickelodeon. Similarly, each show
competes with other shows in its time slot. While “America’s Best Dance Crew” (an MTV show) may not be related in content to National Geographic Channel’s “Dog Whisperer” the two compete for viewers in the same time slot, putting additional pressure on networks to time their shows so as to maximize viewership depending on other networks’ programming.

In terms of revenue, Viacom’s competitors have greater overall share. With $13.6 million in annual sales, Viacom hardly compares to media giants like Disney (with $36.1 million) and Time Warner ($25.8 million in annual sales). However, the media conglomerate outperforms its rivals in profitability, with a net profit margin of 11.8% compared to Disney’s 9.1% and Time Warner’s 9.6%.

Viacom’s Filmed Entertainment segment, comprised of Paramount, MTV Films and Nickelodeon Movies, competes with a handful of similar motion picture studios as well as a large number of much smaller independent film producers. The film producers compete to secure the best creative talent, including actors, directors, writers and scripts. Competition increases as public recognition increases, such that higher profile components command much higher prices, with studios often entering into bidding wars for potentially lucrative scripts and other factors. Once released, films compete with other films released around the same time for box-office revenues and then again for DVD sales, as well as for access to distribution channels. Film studios must successfully distribute and market films while consistently producing large numbers of highly rated films to remain competitive. Paramount, the main revenue source under Viacom’s Filmed Entertainment, markets and distributes its own theatrical and home entertainment releases. Feature films released in theaters on or after January 1, 2008 are available on epix, a joint venture that allows subscribers of certain cable providers to access new movies on their televisions and online, before the films have been released to DVD. Viacom’s Filmed Entertainment segment produces approximately 14-16 feature-length films per year.
Viacom’s Media Entertainment segment competes with several similarly large media conglomerates, primarily in the cable television industry. Each large company (e.g. Disney) owns several networks, which attempt to market toward specific demographics, grouping and targeting consumers by characteristics such as gender, age, race, or entertainment preferences. Viacom thus competes both with individual networks that target similar demographic groups as well as the aggregate media conglomerates that own these networks.

Competition in the Media Entertainment segment is characterized by attempts to secure many viewers and a positive response in specific demographic markets as well as the ability to distribute and market products. While revenues come from advertisers, ratings drive a network’s ability to charge more per 30-second spot, since advertisers will pay more to reach a greater number of target customers. Consumers can be fickle about entertainment, and their preferences are hard to predict. Switching costs are low since entertainment media is widely available and consumers have access to many platforms of entertainment, such as cable television, video games or online content, as well as many options within each platform. Advertising money follows the end-user, since an advertiser’s main goal is to reach as much of the target audience as possible. Rivalry among media conglomerates and smaller companies for consumer attention produces a need for fast-paced innovation in content and delivery.

Viacom also faces competition in the video game and online content industries. Revenues come from home entertainment sales (e.g. video games) and licensing to other distribution channels as well as the sale of advertising. Viacom’s main video game, by developer Harmonix, is Rock Band, but the company also receives royalties from similar game Guitar Hero. Viacom’s online content consists primarily of its network-affiliated websites. Consumer tastes for products determine success in these industries as well: advertisers will pay more for slots in popular games or websites, and consumers will purchase more copies of a video game. Advertisers pay per hit on a website, so more traffic increases revenues. Both the video game industry and the online media industries have
high levels of competition from several media companies. The online media industry in particular is characterized by competition because of the low barriers to entry.

A major factor changing the landscape of media-related industries is piracy. Viacom and other companies are finding that they must now compete with illegal websites and bootleg copies of DVDs and video games that are free to consumers. All media companies face the same challenges in this area and it is a significant threat to profits if consumers substitute away from purchasing products to acquiring them for free illegally. This has created a situation in which media companies face new rivals using their own content. Viacom’s $1 billion lawsuit against YouTube exemplifies the threat online content may pose to content providers.

**Barriers to Entry and Exit**

The entertainment industries (media, film, etc.) are mature and have reached the stage of significant vertical integration. Content creation, production, marketing and distribution of a product are often carried out by companies under the same umbrella, putting large financial constraints on anyone hoping to enter these industries. Consolidation of entertainment-oriented companies has closed off many potential avenues for new entertainment options, as distribution, marketing and advertising are often handled by the companies creating content, and when companies choose not to perform these functions in-house they occur through long-term and large-scale relationships. Without long-term relationships to negotiate good deals, new entrants will have significantly more difficulty promoting and distributing products. Distributor agreements are likely to be difficult for new entrants to secure because distributors may be unwilling to risk jeopardizing their current, lucrative relationships with existing firms to distribute lesser amounts of content they cannot be sure will be well-received.

Another barrier for new entrants is the lack of economies of scale that media conglomerates enjoy. Partnerships and relationships with other companies allow
conglomerates like Viacom to leverage the opportunity to distribute, advertise, or create large amounts of content (shows, video games, films) for lower costs per unit. Production of content is likewise lower-cost for those companies who already own necessary components, instead of being forced to rent a movie set, for instance, and for those have know-how in creation of content quickly and efficiently.

Entertainment industries are often characterized by large sunk costs, in that content-providers must first create content, investing large sums of money, before releasing it to the public for consumption. For motion pictures, this sunk cost may be up to hundreds of millions of dollars for big blockbusters. Consumer tastes can be difficult to predict, and with such high fixed costs new entrants may be put off by the high risk of creating content not well received by the public.

There is also a significant power of branding in the entertainment business. Scriptwriters, actors, and other inputs to television shows and motion pictures realize that major players, like Paramount or MTV, have money behind them to pay well and to distribute effectively, giving these companies an advantage over independents who have no reputation of good performance to promise those hoping to improve their careers. Consumers respond to brand-name, knowing that a film produced by one of the “Big Six” movie production studios, for instance, will have had a bigger budget and is therefore likely to be more entertaining than a film produced by an independent studio. Viacom and other media conglomerates are also able to capitalize on their good reputation to secure lucrative distribution deals.

Viacom and other media companies consist not only of heavily branded products but differentiated ones as well, which target very specific demographic groups. This provides another barrier to entry, as existing firms already fill the product space. For example, Logo, Viacom’s lesbian, gay, bisexual and transgender (LGBT)-targeted network, serves those looking for programming related to that community. While other companies could launch networks with similar

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programming, Viacom has already negotiated with several cable providers who are unlikely to approve two LGBT networks until after Logo has gained significant brand name power and proven the success of the content. By then, consumers are much less likely to switch.

Although Viacom mainly exists in traditional media industries, it may face more threats of entry in its newer online content ventures. Online, economies of scale are not as relevant and entry can often occur with low capital investment. Branding is less relevant in the online world as well, since innovation occurs much faster there. For example, many of the websites on which consumers spend much of their time, such as Facebook, Twitter or YouTube, were nonexistent or unheard of only a few years ago. Despite the popularity of MySpace only a few years ago, Facebook has since eclipsed it in numbers of users, such that Facebook is now twice the size of MySpace.12

**Buyer Power**

Those who purchase Viacom products are generally not the consumer. In this sense, Viacom and other media giants sell to two groups: distributors and other third-parties, and final consumers, the public. In general, third-parties have little power while the opposite is true of consumers, although they generally do not actually purchase Viacom’s products themselves.

In the film industry, distributors and theaters often have little power over negotiations with Viacom and other large media companies because of the profitable and iconic nature of many of Viacom’s products. Paramount films tend to have high budgets and much consumer interest, and refusing to agree to terms set by Paramount may prevent the company from conducting future business with Paramount and other Viacom subsidiaries. Since the majority of the film industry is comprised of only a half-dozen major firms, this decrease in revenues would be a significant blow to any distributor or theater chain. Buyers have more power when it comes to independent film producers due to a lack of brand power.
Consumers, on the other hand, play a large role in Viacom’s profitability and thus have high buyer power, mediated by the large number of separate transactions each makes. Consumer power is also limited, by the arrangement of purchase within the industry: since consumers often do not purchase directly from Viacom, their power is limited in this way. Entertainment options are plentiful and many different platforms compete for consumer attention. Switching costs are very low in all of Viacom’s entertainment industries, thus the company must attempt to differentiate its product from those of its rivals.

In the media entertainment industry of cable television, the biggest contributor to Viacom’s revenues, buyers are again removed from the product and end-users, as Viacom content gets to consumers through cable television, often dictated by negotiations with cable companies, and Viacom makes much of its money selling advertising slots to companies whose priority is to reach the biggest number of consumers within a target demographic. If Viacom has created a highly rated show then advertisers have limited bargaining power, as there will likely be many other companies hoping to advertise their product or service in a coveted time-slot. Viacom has further decreased buyer power by creating networks geared toward specific demographic groups, such as children or young African-Americans. A company hoping to interest children in its new product will have fewer options if there are a limited number of children’s networks and a plethora of potential advertisers. Advertising groups that purchase great quantities of advertising time in a package have more buyer power, however.

Advertisers have greater power within Viacom’s online media content industry. Again, switching costs for consumers are very low and brand names are less useful online, at least at this time. Advertisers may leverage their ability to take business to millions of other websites to negotiate a better deal, however since Viacom chooses to conduct most of its business outside of this industry, a blow to profit is unlikely.
Supplier Power

Suppliers to Viacom and other media conglomerates are generally individuals or small companies and as such are quite disjointed, which would seem to give Viacom the upper hand in negotiations. However, many of these individuals belong to guilds, which operate similarly to unions. Members are guaranteed a certain wage, but in exchange must promise not to work for companies that do not have relationships with the guild. This weakens Viacom’s ability to negotiate on its own terms, as it must come to terms with the entire guild rather than individuals, losing the ability to maintain competition in supply. Although Viacom’s switching costs between inputs, like writers, directors, actors and screenwriters, are very low, relationships with guilds force Viacom to compromise on contracts with guilds. In the recent recession, however, Viacom has had more leeway. In December of 2008, for example, Viacom laid off 850 workers with hardly a peep from the guilds due to the company’s struggle to maintain profitable.

Many of Viacom’s shows do not have as many suppliers, and therefore lower costs, as its competitors due to the nature of its content. MTV and VH1 tend to have reality shows in which participants are generally paid very little compared to actors, and Comedy Central airs many shows that have limited talent and production budgets, like South Park, an animated show written, produced, and voiced primarily by only a handful of people. Compare that to sitcom’s that must compensate many actors, constantly create new sets, and compensate the various staff members. Estimates suggest that a South Park style show costs about a third of the cost of a live-action series with actors to compensate.13

Substitutes and Complements

If consumers have limited hours of leisure time, they may substitute away from products created by Viacom, like television and movies, to newer or cheaper forms of entertainment. Substitution can occur both within an industry (a consumer may choose to watch another company’s film) or between industries (a consumer may switch from playing Rock Band to watching a rival’s television
network, reading blogs online, or playing online games). Rivals must constantly compete for consumer attention, especially since switching costs are effectively zero. Entertainment must always be cutting edge, and it is a rare television program indeed that continues on-air for a decade or more. Consumer preferences change, fans may become bored, and media companies must be sure to keep up, or risk losing advertising revenues to other companies with higher ratings. It is a constant rush to be the company with the new hit show or popular movie to compete with the myriad other forms of entertainment open to consumers.

Pirated content can also be a substitute—although the content is the same, the quality is likely lower and the price zero. This can lure some consumers to illegally entertain themselves with pirated television, films or video games, hurting Viacom’s overall revenues through lost advertising and lost sales.

Complements are not as relevant in the entertainment industry as elsewhere. Consumers and advertisers respond to economic conditions. In this sense, all advertised products can be thought of as complements to Viacom’s products: if the companies selling those products fail to make enough money to continue to advertise, Viacom will lose revenues.

**SWOT Analysis**

**Strengths**
Viacom creates products for specific audiences, and has a general target audience of children and young adults. This is a highly sought after demographic because of the group’s sensitivity to advertising, wealth of leisure time, and access to discretionary spending money from parents. Viacom's focus on this demographic allows it to perform well. For example, Nickelodeon targets elementary school aged children, TeenNick is targeted towards preteens, and Nick Jr.’s primary demographic is preschoolers, although the latter is mostly a tactic to hook kids on the Nickelodeon brand as it does not advertise non-Nickelodeon products or
content. BET, or Black Entertainment Television, targets young African-Americans and was the first network targeted specifically towards this group. As such, it has been remarkably successful. Dividing viewers into niche demographics helps to increase advertising revenue, as advertisers can be sure to reach their target demographic, while increasing the likelihood that a viewer in one of these demographics will turn to Viacom for entertainment (as there is a dedicated channel to what he or she is predicted to enjoy) as well as to keep them watching for long periods of time.

Viacom also excels at creating tie-ins between its products. The Nickelodeon channels run advertisements for shows on each other’s channels. Licensed products are plentiful. MTV pits contestants from two of its reality shows, Real World and Road Rules, against each other in a new contest, Real World vs. Road Rules Challenge. When everything connects internally products gain awareness, and Viacom is good at creating these tie-ins between similar products.

Viacom is well-positioned in the global market, which both diversifies risk and allows the company to increase revenues by establishing itself in growing markets. Entertainment is a mature industry in the United States, but elsewhere there are big gains to be had by companies at the forefront of bringing entertainment to huge populations in China, India, and Latin America, among others. Viacom reaches more than 640 million viewers in over 160 countries.¹⁴

Viacom has an advantage over many of its competitors in that many of its networks, for example MTV and VH1, are popular despite the low budget to produce them. This allows them a greater return on investment on these networks, a luxury that many networks do not have. Jersey Shore, for example, gained popularity despite paying at least one of its stars, Snooki, a small $2200 salary for the entire first season.⁵⁵

Paramount recently launched epix, an on-demand premium television channel, with MGM and Lionsgate. The channel offers films produced by Paramount since 2008 and films by MGM and Lionsgate produced in 2009 or later and plans...
on offering original programming in the future, all for $9.99 a month. Consumers can also access the on-demand movies online if they subscribe to their cable provider’s internet access. This provides Paramount with greater presence online, and brings in revenues from subscriptions. However, this particular approach may be misguided, as it severely limits the market. Currently the channel is only available on Verizon FiOS and several cable providers have already declined the channel. FiOS has only 1.9 million subscribers in the United States, and only 12.7 million have the ability to subscribe due to the layout of the fiber optic cables the service runs through. Although Verizon forecasts that this number will increase, it is still clearly not a large percentage of Americans.

Viacom is lucky to own the rights to a deep library of classic, popular movies, like *The Godfather* and *Breakfast at Tiffany’s*. Although DVD sales have been declining recently, many of these films will be popular for decades to come and offer the company the ability to creatively market these products.

**Weaknesses**

Innovation can be important in an industry that constantly competes for youth attention. Viacom has not been at the forefront of technology in the entertainment industry, which in the past has served them well but in the changing environment of entertainment, with many options online and many consumers watching pirated versions of television shows and movies, could seriously impact its ability to remain profitable. For example, many of its most popular television shows today follow old formats. *Jersey Shore*, while popular, follows the standard reality television format of many aggressive young adults living in a house together, with their most outrageous exploits broadcast to viewers. If Viacom continues to follow old formats in content creation and distribution, it may lose market share to the companies that are willing to take bigger risks and change with the times.

This could especially be a weakness in today’s environment as the entertainment industry changes. Piracy and the availability of online entertainment have
created new options for consumers seeking to be entertained, and the industry is currently trying to find a way to maintain profitability in this new landscape. Viacom may have a disadvantage compared to its rivals if it lacks the ability and drive to be innovative.

The majority shareholder, Sumner Redstone, behaves erratically and has had trouble with debt in the past, a pattern he seems to have no trouble passing on to his businesses: Viacom, CBS and National Amusements. Although he is getting on in age at 86, a successor has not yet been definitively established and family issues with his daughter, a candidate to take her father’s place, continue.

Viacom often struggles with public relations: both individual networks and the parent company. Viacom’s $1 billion lawsuit against YouTube has brought it into conflict with Google, and allegations have made Viacom look like a struggling company looking for someone to blame. Google claims that although Viacom accuses YouTube of purposefully using its content to make money, marketing firms were hired by Viacom to upload content to the website. There have been questions of Viacom’s motives since they tried to purchase YouTube on numerous occasions. Consumers, whose large numbers on YouTube indicate much interest in the website, may choose to watch short videos rather than support television shows produced by a company they do not support. Although the threat may not be terribly pressing, many YouTube users have already expressed a willingness to boycott Viacom. Taking content off of YouTube may hurt Viacom in the end as well, if consumers have fewer reminders of popular Viacom-brand television shows and therefore take less initiative to watch their full-length shows.

In a similar public relations mishap, Paramount recently announced its casting decisions for “Avatar: The Last Airbender,” a film based on a popular animated television show. Despite the fact that the main characters in the series are of Asian or Inuit descent, the studio chose Caucasian actors to play the main characters, while choosing darker-skinned actors to play the roles of villains.
Needless to say, those that believe these choices to be deliberate are incensed. Although the bottom line is always increased profits, which may be Viacom’s motives in these endeavors, the company risks losing customers or advertisers if their actions are perceived too negatively.

**Opportunities**
The entertainment industry must change to find a way to deal with piracy and consumers’ increased ability to find entertainment options online quickly, easily and at no cost. Viacom has a great opportunity to be at the forefront of these changes, positioning itself for the future and possibly gaining increased market share. This is especially true since the company’s television networks primarily target children and young adults, the demographic most likely to utilize new entertainment technology. The internet can be an incredibly positive tool for those who are able to utilize it correctly.

Advertising is increasingly national, which could create more transaction efficiencies as advertising is sold in larger blocks from fewer advertisers. Viacom may increase market share at the expense of more locally-oriented networks and content creators. Advertising overall is expected to increase by 5.5% in 2010 and Viacom has the opportunity to capitalize on this increase.20

The recent interest in 3D films is another opportunity for Viacom. While 3D in the home is unlikely to become a reality for several more years, due to high costs of 3D systems and the slow adoption rate of similar technologies, such as Blu-Ray, movie studios still have an opportunity to increase box-office revenues with increased output of 3D films. Paramount recently released “How to Train Your Dragon” in 3D based off of a 2003 children’s book of the same title. 3D films are expected to bring in 70% of their revenues through 3D viewings, although this is partly because 3D tickets cost more. Of course, movie studios split this money with theaters, but the increased revenues are still substantial. 3D theaters are expected to grow both within the U.S. and internationally within the next few years.21
MGM may go bankrupt within the year if companies are unwilling to purchase at the price of $2 billion. MGM seeks to pay down its debt, which seems unlikely at this point. This could mean less competition in the movie industry until the company sorts itself out, especially in DVD sales as MGM is especially reliant on them as a source of revenue. If the company is unable to sell, it may sell off movie titles piece-meal, in which case Viacom could benefit by purchasing relevant, in-demand titles. The sale of MGM or its bankruptcy could be problematic in the future, however, as Viacom is involved in a joint venture, epix, with the company.

**Threats**

Internet usage and piracy could significantly decrease the profitability of television and motion pictures. Illegal download and/or streaming websites offer consumers on-demand television and movie programming at zero cost, effectively forcing Viacom to compete with its own lower-cost programs and films. Viacom may be more affected by this trend because its target demographic of young adults and children are also the most likely to understand new technology and have grown up using computers and the internet. Some have never known an era when television shows were not available online for free.

The entertainment industry may be headed into problems similar to print newspapers, with fewer advertising dollars coming into due to cultural changes, and at this point, like newspapers, no company has discovered a way to make nontraditional revenue sources maintain profitability. This may mean that the industry will experience a shakeout in the future, with only the healthiest businesses surviving. Either way, Viacom must be sure that it as at the forefront of positive changes, and not clinging to an old system that consumers are unhappy with. Given Viacom’s recent history and lack of innovation, this may be a particularly hard time for the company. While other companies, like CBS, Time Warner, Sony and Disney have received advertising revenues from YouTube via its new ContentID feature, Viacom is involved in a $1 billion lawsuit against the
company. They have also recently pulled two shows from Hulu, The Colbert Report and The Daily Show.

This failure to integrate into popular online sites may reflect Viacom’s attitude toward change. The company seems focused on maintaining the status quo despite the market forces at work against them. This is a major problem because consumers have thousands of entertainment options presented to them, only one of which is turning the television to MTV, or any other Viacom network. If Viacom fails to make content available to viewers in a way they find acceptable then they may risk losing consumers to other entertainment options.

Another area that entertainment companies have yet to take advantage of is mobile devices, such as cell phones, music players and new technology like Apple’s iPad. This is an opportunity, but considering Viacom’s lack of interest in establishing itself in these markets, for the company it is likely to be a threat. The company first able to make sufficient profits in these areas is likely to have a first-mover advantage, with contracts in place with major cell carriers, for instance.

Viacom is heavily dependent on acceptance of their media products. Predicting tastes is difficult, but producing television shows and films is expensive. Risk is therefore inherent to the entertainment industry, as advertising, licensing and ancillary revenues depend on the commercial success of pre-created products.

The entertainment industry also suffers from difficulty in timing, in that film and entertainment products released at similar times compete directly with each other, especially if they exhibit the same type of content. This could be especially problematic for 3D movie releases, as many theaters have only one or two 3D theaters forcing films released around the same time to compete for limited space.
Financial Analysis

Most businesses were harmed by the economic recession, and Viacom is no exception. Media-based companies have struggled because of decreasing advertising budgets in most industries, bringing down media’s revenues, and the damage is likely to persist as long as other companies have reason to worry about their own future income. Since 40 percent of Viacom’s revenue comes from advertising, it could be a while before the company has restored its pre-recession income. ZenithOptimedia, a leading market research firm in the industry, suggests that advertising sales will drop in 2010, finally increasing again in 2011 but not by as much to offset this year’s drop. Viacom could therefore need to survive for a long time with lower revenue.

One reason this may be a problem is that Viacom has a higher debt to equity ratio than competitors. This could be especially problematic if advertising revenues do not pick up in the near future, increasing debt while holding equity the same.

However, Viacom’s stock price has recovered from its November ’08 low of around $14/share to around $34/share, still down from the December ’07 high of $44/share, which represents approximately the same gain as the S&P 500. Investors expect Viacom to come back and in a big way, ignoring the company’s current problems and expecting it to be poised to make big gains again when the economy turns around. Analysts at Barclays Capital suggest that Viacom is currently undervalued in the marketplace.
Viacom can be thought of as two major areas of operation, Media Networks (television networks such as MTV, BET and Comedy Central) and Filmed Entertainment (movie production companies like Paramount). The Media Networks segment accounts for approximately 60% of Viacom’s revenue and has for the past three years. Advertising sales, affiliate fees, and ancillary revenues generate most of the revenue from this division. The Filmed Entertainment segment accounts for about 40% of Viacom’s revenues, making money primarily through release, distribution and licensing of films, and selling those films as home products such as DVDs.

The economic downturn brought a decrease in revenue of $1.006 billion, or 7%, from 2008 to 2009, bringing worldwide revenues to $13.6 billion. $551 million of this decrease came from Filmed Entertainment, despite this segment’s smaller overall role in the company. This was primarily caused by a decline in revenues from theatrical and home entertainment, due to fewer released films and an unusual assortment of 2008 films released to DVD in this period. The Filmed Entertainment segment would have been more in the red if it were not for increased television and ancillary revenues in this period. Media Networks lost $468 in revenues in 2009, mostly due to decreases in advertising revenues as well as lower demand for Rock Band, although affiliate fees increased. Total expenses decreased over this time as well, down $1.4 billion (11%) to $10.7 billion.
Viacom’s debt has decreased by 15% from 2008 to 2009, from $8 billion to $6.8 billion, due to increased cash flow from operations.

The company, while far behind many of its competitors in terms of annual sales, outperforms its rivals in profitability. Gross profit margins, net profit margins, and return on invested capital all show that Viacom is more profitable than its competitors.

<table>
<thead>
<tr>
<th></th>
<th>Viacom</th>
<th>CBS Corp.</th>
<th>Time Warner</th>
<th>Disney</th>
<th>News Corp.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual Sales ($ mil.)</strong></td>
<td>13,619</td>
<td>13,015</td>
<td>25,785</td>
<td>36,149</td>
<td>30,423</td>
</tr>
<tr>
<td><strong>Gross Profit Margin</strong></td>
<td>44.30%</td>
<td>33.20%</td>
<td>44.00%</td>
<td>16.20%</td>
<td>35.80%</td>
</tr>
<tr>
<td><strong>Net Profit Margin</strong></td>
<td>11.80%</td>
<td>1.70%</td>
<td>9.60%</td>
<td>9.10%</td>
<td>10.80%</td>
</tr>
<tr>
<td><strong>Return on Invested Capital</strong></td>
<td>10.60%</td>
<td>1.40%</td>
<td>3.80%</td>
<td>6.70%</td>
<td>9.20%</td>
</tr>
</tbody>
</table>

Source: Hoovers

Viacom has managed to post profits over the last several years despite difficult economic times. Although gross margins and operating margins decreased in 2007 and 2008, the company still performed well and continued to be profitable.

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
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</thead>
<tbody>
<tr>
<td><strong>Gross Margin</strong></td>
<td>50.7%</td>
<td>47.2%</td>
<td>44.6%</td>
<td>39.9%</td>
<td>44.3%</td>
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<tr>
<td><strong>Operating Margin</strong></td>
<td>24.6%</td>
<td>24.2%</td>
<td>21.9%</td>
<td>17.3%</td>
<td>21.3%</td>
</tr>
<tr>
<td><strong>EBIT Margin</strong></td>
<td>24.1%</td>
<td>20.2%</td>
<td>19.2%</td>
<td>12.7%</td>
<td>16.7%</td>
</tr>
<tr>
<td><strong>Return on Assets</strong></td>
<td>6.69%</td>
<td>7.78%</td>
<td>8.22%</td>
<td>5.51%</td>
<td>7.26%</td>
</tr>
<tr>
<td><strong>Return on Equity</strong></td>
<td>11.83%</td>
<td>21.29%</td>
<td>25.75%</td>
<td>17.69%</td>
<td>20.47%</td>
</tr>
</tbody>
</table>

Source: Morningstar

Debt does not seem to be a major concern for Viacom. The company has decreased its debt-to-equity ratio since its increase in the financial crisis and
seems to be doing well with its levels of debt. This accomplishment is especially commendable given recent economic trends.

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<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Ratio</strong></td>
<td>1.07</td>
<td>0.91</td>
<td>0.92</td>
<td>0.93</td>
<td>1.18</td>
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<tr>
<td><strong>Quick Ratio</strong></td>
<td>0.72</td>
<td>0.64</td>
<td>0.67</td>
<td>0.63</td>
<td>0.85</td>
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<tr>
<td><strong>Financial Leverage</strong></td>
<td>2.45</td>
<td>3.04</td>
<td>3.22</td>
<td>3.20</td>
<td>2.52</td>
</tr>
<tr>
<td><strong>Debt-to-Equity</strong></td>
<td>0.73</td>
<td>1.06</td>
<td>1.13</td>
<td>1.12</td>
<td>0.76</td>
</tr>
</tbody>
</table>

Source: Morningstar

Strategic Issues and Recommendations

The most pressing matter at hand for Viacom is navigating the new, online forms of entertainment and finding ways to ensure profitability in a new age of entertainment options. Viacom must ensure that it can continue to bring in revenues despite increased piracy and more competition from the internet. Innovation is key, since current models are not working for Viacom or its competitors, and the company that is able to develop a profitable online model will have a first-mover advantage. In this respect, Viacom may already be behind with competition like Hulu, a website that legally allows consumers to view a wide variety of television shows and movies online with limited commercials. The service is free to consumers.

Until recently Viacom had two shows on Hulu, “The Daily Show” and “The Colbert Report.” Both were pulled as of March 9 2010, with Viacom citing a lack of financial incentive as the reason for removing the shows from the popular website. Now each show is available on its own website, where Viacom claims they bring in enough advertising revenue to make it worthwhile. While the media conglomerate may bring in more of the advertising revenue for itself, it is likely to decrease viewership as Hulu is well-known destination website.
Separating shows segments the market instead of creating tie-ins and promoting interest in shows that might not otherwise be viewed by the consumer.

Viacom needs to create an online space in which it is able to bring in substantial revenue while giving consumers the perks they have come to expect: on-demand television and movies at little to no cost. The industry has made moves towards this goal, with many television shows airing on their respective websites within 24 hours of airing on cable television. Consumers even seem perfectly willing to watch short ads between sections. However, companies have yet to apply a model that allows easy access to many shows, with a single web-address, that is profitable for all involved and that creates interest in other, related shows and movies.

To remedy this, Viacom and other media conglomerates should create a joint-venture website among the top six companies that provides content to users for free, supported by advertising. Without a third-party intermediary, like Hulu, each content provider stands to make much more from advertising. According to Viacom, money was the reason that it could not come to a deal with Hulu, which would be remedied by hosting it without a third-party. Consumers will know that content is most likely to be available from this website and will likely not turn to other sources for the same shows, allowing the companies to capture the full profit from their content.

Ideally, then, the website would be a joint-venture between media conglomerates looking for an online outlet for their programming. However, given Viacom’s recent reaction to Hulu and YouTube, it seems unlikely that the company will negotiate such a deal when the times are tough and profits are down. Negotiating a deal with Viacom’s rivals is likely to be an incredibly difficult task, made all the more difficult by the presence of Hulu, a joint enterprise by NBC Universal, Fox Entertainment Group and ABC Inc., a subsidiary of Disney, who are likely to prefer sticking with their website, especially since it already has significant name recognition. This further decreases Viacom’s incentive to be a part of Hulu, as
some of the advertising money its shows earn will eventually go to its rivals. If Viacom is unable or unwilling to create a website in which everyone’s content is hosted, they should create a single website to host all of their television shows and films, possibly as a joint venture with firms not involved with Hulu, such as Time Warner, which owns the CW, the WB, and Cartoon Network among other networks. They should ensure that as much content as possible is available on this website and that it maintains contact with the websites of the individual shows via website links.

The website should host an array of content, most of it available for free but supported by advertising. Like Hulu, it should all be available in one place, a “destination” website. This allows Viacom to hold consumers captive, and provides consumers with a place to go when boredom strikes: rather than first decide what to watch and then finding it online, viewers can go to the website and then decide what to watch. This should increase the foot traffic that the website sees. It also offers Viacom the potential to keep viewers watching, by making suggestions after an episode or movie is over for other options. By tracking each viewer’s preferences like Amazon, Viacom could make suggestions for new shows or movies.

Advertising could follow a model similar to Hulu, with viewers unable to fast-forward through the ads. Consumers could be given the choice before the show started of the length of advertising (one long ad at the beginning or multiple shorter ones interspersed throughout) as well as the content (choices between products, thus allowing consumers to see more relevant ads). If the website required a log-in or was tracked similarly to Amazon, the ads could be tailored to the viewer just like the recommended content.

Television content should include old seasons and even cancelled shows. Many current shows do not have all past episodes on the websites, which prevents viewers from getting hooked on a show and watching from the first episode all
the way through. Viacom should facilitate as much continued viewing as possible, as it increases advertising revenues.

For movies, Viacom could consider hosting a limited number for free viewing with advertising and offer the rest at a pay-per-view price or subscription. This is similar to epix, but that venture was short-sighted in that the total market of people with the correct cable channel is not large enough to create significant long-term profits. Instead, a website that offers films for viewing should be available to a much wider demographic.

Viacom also needs to establish a presence in mobile devices. Applications for the iPhone and other smartphones that allow viewers to stream videos from their phones should be available to consumers. Any device that can access the internet should be able to get television shows, or even movies, because that is where the future of entertainment lies. If Viacom is able to work out deals with the top phone providers, like AT&T and Verizon, they will be poised for the future. While Hulu says it will eventually develop iPhone and iPad applications, it has not yet made significant strides in this direction. Now is the time to fully take advantage of changes in consumer entertainment options, to position the company for the future.

Viacom’s Black Entertainment Television (BET) network was very successful when it first started (not under Viacom) and has since been copied by many other networks, such as TV One and Black Family Channel. Viacom’s Logo network, geared towards the LGBT community, has also seen success recently. Viacom should consider developing more networks and programming that target demographic groups like these, especially those underrepresented in traditional media. Viacom could create a network that represented the interests of many groups in the nation by creating a multicultural network with programming geared towards fast-growing population segments, like Chinese or Middle Eastern populations. While Spanish programming (usually soap operas, called telenovelas, or a translation of other programming) is abundant on cable
networks (for a fee), Viacom could create a network that targets the Hispanic population both in Spanish and English, with content specifically tailored to this group. BET has shown the success of this demographically oriented network model, with many networks attempting to reproduce its success.

Viacom should also increase its global presence. While the networks already reach 640 million viewers, the potential for both increased viewership and creating more global channels based on content made specifically for local regions is huge, especially in this age of rapidly growing technological progress in developing countries. These networks can be best established by utilizing relationships with those who have information concerning local tastes and customs. This can be achieved either through joint ventures with companies in local regions or by expanding networks in locations where Viacom already has a presence. Important markets include Asia, with its rapidly growing youth demographic (especially in India and China) as well as expansion in Latin America.

Since a major challenge in producing movies is the high risk involved, as firms must invest the full money into a movie, with only guesses as to the commercial success of the final product, and must hope that they have guessed correctly and will bring in more in revenue than the film cost to make. This riskiness of this business is problematic, and Viacom would do well to execute any plan that allowed it to decrease risk. Thus, the company should do everything in its power to improve the green-lighting process such that only the most profitable films are produced. There is a tendency in the film industry to focus on creating extremely high-budget films and to put as much money into a film as is needed. Once a film has been approved, there is not a routine process to approve major spending costs. A good strategy for Paramount would be to focus more on medium to low cost films, which often have the potential to have much higher return on investment. Improving the green-lighting process for all tiers of films will also help the company to reduce risk and maximize profits.
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