LICENSES TO STEAL ARE EXPENSIVE - Speculation in Commercial Radio Broadcast Privileges in the United States,By Charles Metalitz, Chicago, IL

(editor's note: The following talk was presented at the Council of Georgist Organizations conference Sept. 1, 2001, at the Holiday Inn-Pittsburgh Airport. It's based on Henry George School Research Note #4, which is posted at www.hgchicago.org (Select "our publications"). The posted version includes data tables which are omitted here due to space limitations. Chuck Metalitz is the Executive Director of the Henry George School of Social Science, Chicago)

This paper was written because I resented being sold for $17

This paper stems from an event shortly before the Des Moines conference last year. Chicago's only remaining privately-owned classical music station, WNIB, was sold for $165 million. Bonneville International Corporation bought the station not because they wanted to continue or improve its operation; what they really bought was a license to broadcast to a market of nearly 10 million people. In fact, they bought the market, at a cost of about $17 per person.

Well, I used to listen to WNIB, and I resented being sold for $17. I wanted to look into the business of broadcast radio, and try to analyze it in Georgist terms. Henry George pointed out that those who monopolize natural opportunities could exact a toll on users, and that speculation could lead to excessive costs of access which eventually make productive use impossible.

What I found is, first, that the major asset of broadcasters is privilege. Actually, I could have figured that out just by reading the Chicago Tribune, who quoted the publisher of a radio trade magazine: "These radio stations are a license to steal. They're gushing oil wells."

And, second, I found that speculation in broadcast licenses does indeed appear to have reached a point where productive activity is quite difficult, though not yet impossible. One can make money in radio, but it's mainly done by holding licenses rather than producing programming.

Limited financial data about the radio broadcast industry is available.

The 4,685 AM and 8,032 FM commercial stations licensed in the United States have literally hundreds of owners. Many are privately-held corporations with just a few stations, or companies in other businesses - notably newspapers - with a station or two among their holdings. But the really valuable licenses, those serving large metropolitan areas, are largely controlled by a few huge corporations. One report claims that four companies control the stations receiving 90% of radio advertising revenue.

The biggest radio broadcaster, Clear Channel Communications, owns 1,140 stations, including five or more in each of the seven largest market areas. Infinity Broadcasting, a subsidiary of multimedia conglomerate Viacom, has 184 stations in 41 market areas, accounting for 13% of total U. S. radio advertising expenditures. Data on licenses, assets, and revenues for these and thirteen other large radio broadcast companies are shown in Table 1 (not included here, but available at www.hgchicago.org).

Of course, some major broadcasters are missing from that table. Disney, through its ABC Radio, owns 25 stations, one in Pittsburgh and the rest in larger markets. Bonneville has 16 stations. This reminds us that, even if the airwaves belong to the people and licensees must report on their operations, they aren't required to release much data and in fact the only financial data most release is what's needed by investors. Disney doesn't report on its radio operations because they're only a tiny part of a huge conglomerate. Bonneville doesn't report because it has only one shareholder, the Mormon Church.

In Chicago, of the 14 full-power commercial (class B) FM stations, Clear Channel and Infinity each have 4, Bonneville has 3, and Disney has one. Emmis Communications, a smaller chain who also own newspapers, has one, leaving one controlled by a local not-for-profit.

In Pittsburgh, a smaller market, the concentration is somewhat less. Of ten full-power commercial FM stations, Clear Channel has 4 and Infinity 3, with the others owned by smaller companies.

The value of privilege is visible - but it isn't going to the shareholders.

A large number of radio broadcast licenses have changed hands during the past couple of years. Whenever a station is sold, it is normal practice to report separately the value of the license and the value of the physical facilities. This data can give us a pretty good idea of how much these privileges are worth in the market. The cost of the license is amortized over a period of 10 to 40 years.

For most broadcasters, licenses constitute over 80% of assets. And paying for these licenses will not be easy, because for most broadcasters the cost of the licenses is four to eight times their annual net revenues.

Data on operating income provides another view of how little income is made using these expensive licenses (See Table 2 at www.hgchicago.org). (continued on page 8)

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Operating income is what's left of revenues after all the salaries, maintenance, depreciation, and other costs necessary to produce the broadcasts are paid. Of the 15 companies, only 3 were able to squeeze out an operating profit in excess of 5% of assets, less than Treasury bills paid that year. The same number, three companies, actually had operating losses.

But the operating "costs" include amortization of assets which, in fact, are for the most part gaining in value. And another source of income can be a gain on sales of assets, the assets being of course primarily broadcast licenses. Each of these is an imperfect measure of speculative gain—depreciation because it doesn't measure increases in value and it includes actual physical wearing out of wealth which will need to be replaced, and gain on sales because it recognizes only assets sold during the particular year, and may include their growth in value during previous years. If we simply take the larger of these two measures, added to operating earnings, things look a little better. Nine of the 15 companies have earnings in excess of 5% of their invested assets; two still show deficits.

But even where there is profit from operation or speculation, this can be diverted before it gets to the common stockholders. Some of it goes to pay interest on debt. Some is skimmed off by insiders holding various special securities. Some pays for taxes. In the end, only five of the fifteen companies were able to generate any income for benefit of common stockholders.

While the data in the tables is based on the most recent completed fiscal year (calendar 2000 for most companies), more recent earnings reports aren't much better. Of the 14 companies still extant as public entities, only four reported positive earnings for common stockholders thus far in the current year. (see, at www.hgchicago.org, Table 3 - Operating Profit and Income Available to Common Stockholders.)

The Radio Broadcast Spectrum is Being Auctioned

For many years, the way one got a broadcast license was to apply for it. Whoever applied first, and fulfilled all the requirements, was granted a construction permit and license, which was routinely renewed as long as regulations were approximately observed. Today, of course, commercial licenses are virtually unavailable in or near large cities, but quite a few channels are open in less-populated areas.

However, it's no longer standard practice to simply apply for a license. If more than one applicant is interested in a channel, an auction process will be followed. The FCC has designated 359 FM construction permits for auction, with minimum opening bids ranging from $2,500 to $400,000. These are not in major metropolitan areas, but include some well-populated places such as Normal, IL (McLean County, population 150,433, minimum opening bid $250,000). The auction will begin December 5, 2001, and those wishing to use the proper name for their activity might choose to bid on Speculator, NY (opening bid $5,000, village population 348). An auction for up to 39 AM licenses is also being held.

As far as I can tell, the fiction that the spectrum belongs to the people and the licensee does not own it will be maintained with the results of these auctions.

Large operators have the advantage in getting financing, but FCC pretends otherwise.

It is, I think, well-known that large corporations can borrow cheaper than small ones. Therefore, as expensive licenses increase the amount of upfront money needed to get into the radio broadcasting business, it becomes relatively more difficult for small operators, and relatively easier for large ones, to own and operate stations.

As one station broker put it, "First time buyers are not going to get bank financing. In the present business climate some experienced buyers are not going to get loans unless they have 'outside' assets to pledge. Most bankers do not understand the broadcasting business. If it does not have a car title attached they are without a clue."

The FCC does not seem to recognize this problem. In their paper which "explains why auctions are superior to comparative hearings for selecting among mutually exclusive applications for spectrum licenses," FCC staff address the concern that small businesses may be unable to compete, using phrases reminiscent of economist jokes: "Given efficient capital markets, the bidder with the best business plan, producing the highest expected profits, will get the best financial backing and will be able to place winning bids." The paper, of course, does not consider any other method of spectrum allocation.

Not only the radio broadcast spectrum is being auctioned

It isn't merely, or even principally, the radio broadcast spectrum that's being auctioned. Spectrum auctions for all services through February, 2001 raised $31 billion in actual or anticipated revenues, and quite a few additional billions are included in the "balanced" Federal budgets of the future. As a percentage of the total budget, these figures are minuscule, but they seem to represent an outright sale of a privilege in order to balance an operating budget.

How much of the planned revenue will actually appear remains questionable. A prominent example is NextWave TeleCom. After submitting winning bids totalling $4.87 billion in 1996, NextWave declared bankruptcy and was unable to pay. Although the FCC (continued on page 9)

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re-auctioned the licenses - for $15.9 billion -in 2001, the appeals court ruled that the re-auction was improper and the licenses still belonged to NextWave's creditors.

The outlook for radio broadcast license values

While investors appear to be banking on an increase in license value, there are reasons to question whether this will occur. The simple dynamics of a speculative privilege market provide one reason. Eventually license prices could become so high that nobody can make any money using them, and there will be no "greater fools" to sell to. But for now, since some operators are able to generate a decent return on investment, prices may continue to rise. In fact, as the overall market (population and spending) continues to grow in most areas, it is possible that growth will eventually bail out the speculators.

Other worries for license-holders come from new competitors, Internet radio and satellite radio.

Many broadcast stations nowadays copy their programs to the Internet, where they are available to anyone properly equipped. How to profit from these broadcasts may be more of a question, as most advertisers are not willing to pay to reach listeners outside of their own respective market areas. It might be possible to arrange subscription charges to support the service, but this hasn't been done on a large scale.

Satellite radio will be introduced late this year by two companies, XM Satellite Radio and Sirius Satellite Radio. These mutually incompatible systems are designed mainly for in-car listening. For the cost of equipment ($300-$500, although it will be included in some new cars) plus $12.95/month, customers will get their choice of 50 commercial-free (Sirius) or 100 limited-commercial (XM, six minutes per hour) stations.

Not that the success of satellite radio would remove privilege from the equation. These operations also use part of the radio spectrum and, if they're successful, their licenses will become more valuable.

Henry George's solution might cause some dislocation

As Henry George would have expected, the cost of privilege is making production difficult. I think most of us understand George's remedy - since spectrum is a limited natural resource and exclusive rights are necessary to use it efficiently, the community should collect the rent. As a practical matter, this means that a heavy tax on valuable broadcast licenses should replace some taxes on productive activity. Speculation would then be unprofitable, the cost of licenses would fall to nearly zero, and independent entrepreneurs would be able to compete. George proposed that such a change be made immediately.

But George's remedy might cause some difficulty. Most broadcast companies haven't sufficient assets to cover their debts unless the value of licenses is considered. Table 4 (at www.hgchicago.org) subtracts the estimated license value from the total assets for each of the fifteen companies, and compares it to long-term debt. Only two of the companies may have tangible assets greater than their long-term debt.

While negative book value does not invariably result in bankruptcy, there does seem to be problem here. If license values are abolished, somebody is going to find that they don't have the assets they thought they had. A similar problem exists when any type of privilege is abolished.

Conclusion

I don't think many people here are surprised to see that, in the broadcast spectrum as elsewhere privilege has made production more difficult. For us as consumers, it means just plain lousy radio. Henry George's solution, regular payment of rent by license-holders to the community, would solve the problem but cause some dislocations.

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