Media Megamergers Aren't Big Hits
As Futuristic Synergies Prove Elusive

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One megamerger after another has roiled the media world, stirring fears
that a few powerful conglomerates will someday control all the world's
movies, music and television.

Time for a reality check: So far no media mogul has figured out how to
rule the world -- or even how to make a multibillion-dollar merger pay
off.

Two years ago, America Online Inc. and Vivendi SA each made huge
deals that promised to transform both companies and the entire media
landscape. Today AOL Time Warner Inc. and Vivendi Universal SA
have been transformed all right -- into floundering giants.

AOL Time Warner has been hammered by the advertising recession and
a slump in its America Online business, which was meant to be its
futuristic growth engine and the launching pad for a host of new services.
The company's shares are trading at a quarter of what they were before
the merger. And it has fallen well short of the aggressive profitability
targets it set when the deal was announced. For the first quarter of 2002,
it posted a $54 billion loss, as a new accounting rule forced it to take a
write-down reflecting a decline in the merger's value.

Since acquiring Seagram, Vivendi has seen its share price tumble 59%.
Last month, the Paris-based company, which has run up about $29 billion
in debt, posted a first-quarter loss of $15.34 billion. The loss reflects a
huge writedown related to both new accounting rules and a decline in the
value of Seagram's Universal movie and music businesses, along with
other Vivendi media assets.
Everywhere you look in the media world, big companies are grappling with their strategic shortcomings. Germany's Bertelsmann AG, for example, has spent hundreds of millions of dollars to build an e-commerce pipeline to expand its book- and music-sales operations, with little sign that the plan will be profitable. Though gains from asset sales have kept the company's overall profit high, it has reported "Internet start-up losses" totaling about $1 billion over the past 18 months.

Rather than buy cable systems and online services, Walt Disney Co. has mostly stuck to being a producer of entertainment -- only to suffer when the popularity of its entertainment waned. Viacom Inc. bought CBS to create a giant cross-media advertising platform, then ran headlong into the long ad slowdown. Rupert Murdoch's News Corp. has tried to build a global satellite-TV network, but it hasn't made a dent in the biggest market, the U.S.

These heavyweights have found it easier to build an entertainment empire than to make its various parts, each with its own priorities, pull together. The synergies they hoped to harness by owning all types of media outlets have largely eluded them. And forcing their executives to think about synergy may have distracted them from their main job: producing books, records, movies and TV shows.

Nor have media companies cracked the problem of how to wrest profit from every corner of the globe. Building efficient marketing organizations has been hard enough in the U.S., much less in countries around the world, where different languages and practices are a stumbling block, and consumers often prefer locally produced music and TV.

"No one has proven that consolidation works," says Joe Roth, a former studio chief at both Disney and Fox who now runs his own Revolution Studios.

**Turnaround Pressure**

For AOL Time Warner and Vivendi, the pressure to turn things around is particularly acute. Last month, AOL Time Warner dispatched Co-chief Operating Officer Robert Pittman to overhaul America Online. And it is considering selling a minority stake in its vast cable operation.
Vivendi has weighed whether to curtail Internet investments such as its Vizzavi joint venture with Vodafone Group PLC -- a broadband "wireless portal" that was supposed to be the high-speed platform for its vision of "anytime, anywhere" distribution of Vivendi Universal's music and movies.

Vivendi Chairman Jean-Marie Messier concedes that the market penetration of broadband services has been slower than anticipated but adds: "It doesn't mean that it's not happening." He also says Vivendi has spent a lot of its first 18 months cutting costs, which will increase future cash flow.

"The question is whether Wall Street will be patient enough" to let the various parts of these companies "get to know each other and figure out what will work and what won't work," says Bryan Lourd, a partner in Creative Artists Agency. "There is an impatience ... at every level," he says, from small investors right up to Hollywood executives who are frustrated that their stock options are in the tank.

When AOL Time Warner and Vivendi unveiled their cross-cultural megamergers -- one marrying old and new media, the other bringing together American and European media heft -- their rivals feared being left behind. Now, many of them are breathing easier, relieved that they didn't race to acquire Yahoo Inc. or any of the other hot properties of the Internet boom.

"As you may recall, we were severely criticized for standing on the sidelines when others were making what were then called dramatic and important strategic moves," says Robert Iger, president of Disney, which learned first-hand the difficulties of big acquisitions when it bought Capital Cities/ABC in the mid-1990s.

"Creating synergies and deriving value is not something you snap your fingers at to achieve."

Since acquiring ABC, Disney has resisted buying other distribution assets such as cable systems, opting instead to concentrate on producing entertainment. That focus helped fatten the company's profits in past years, when it could boast such hits as "The Lion King" and the first season of TV's "Who Wants to be a Millionaire." But lately, with the popularity of "Millionaire" ebbing and the launch of such box-office underachievers as "Atlantis: The Lost Empire," the same strategy has contributed to a severe earnings slump.

AOL Time Warner and Vivendi defend their buildups. "Admittedly we fell short on some issues," AOL Time Warner Chairman Steve Case said in a statement, in response to questions, but the merger "laid the significant groundwork necessary to lead this company into the future."

Barry Diller, who became chairman of Vivendi Universal Entertainment as part of Vivendi's recent acquisition of his USA Networks Inc.'s entertainment assets, says the current situation looks bleaker than it is because it comes in the midst of a global economic slowdown that has made investors feel that any bad news is catastrophic. The imperative to consolidate remains, he says.

"We won't know for five years whether or not AOL Time Warner works. And as far as Vivendi Universal is concerned, it's just happened," Mr. Diller says.

In January 2000, when AOL and Time Warner unveiled their proposed $156 billion merger, they said the idea was to combine Time Warner's array of "world-class media, entertainment and news brands" with America Online's extensive "Internet franchises, technology and infrastructure." The merger, they said, would speed up development of an array of high-quality content and interactive services.
Now, 17 months later, AOL Time Warner is playing down those promises, having concluded that the bulk of AOL's subscribers may not be ready for new interactive services, including high-speed Internet access.

AOL had hoped to make interactive TV a reality. Its AOL TV service, launched in October 2000, lets subscribers surf the Web and send instant messages while watching TV. AOL said its merger with Time Warner would help it develop interactive elements for TV shows, and it also planned to build AOL TV's software into Time Warner Cable set-top boxes to make the service more widely available. Some of the company's TV shows did develop interactive features, but Time Warner Cable has yet to add the service.

Insiders say that America Online has made development of the AOL TV a lower priority since Mr. Pittman, the AOL Time Warner co-chief operating officer, reassumed control of the unit last month. Mr. Pittman has said recently that the "consumer adoption curve" on new technology can't be rushed.

America Online was supposed to provide potent promotional fuel for the company's movie studio and music company. According to Securities and Exchange Commission filings, the former Time Warner divisions spent $222 million buying ads on the AOL service last year.

And, occasionally, the company has declared that such cross-promotions have contributed to a major success, such as the big opening-weekend receipts last year for Warner Bros.' "Harry Potter and the Sorcerer's Stone." But having AOL in the family hasn't helped in every case, as demonstrated by last year's disappointing "A.I.," which Warner Bros. promoted heavily on AOL. AOL played a video clip from Steven Spielberg, the film's director, on its welcome screen, and its subscribers in some markets got the opportunity to buy tickets for the first showing of the film.

Last spring, AOL Time Warner executives hoped to produce a synergistic windfall with a new girl band from Warner Music called Eden's Crush. The company's WB network aired a reality-TV show that documented the band's tryouts and rehearsals. The group's music was released by Warner's London-Sire Records label; it was promoted heavily on AOL.

But not everyone in the empire wanted to play ball. Time Inc.'s Teen People magazine refused to participate in the promotion, uncertain that the newly formed group had enough mainstream appeal. Despite good sales of the band's first single "Get Over Yourself," Eden's Crush's album, "Popstars," has sold a modest 376,000 copies since its release last year, according to SoundScan, seeming to justify the magazine's caution.

By contrast, a rival prefabricated teen group called O-Town sold more than 1.6 million copies of its debut album by playing the field: Disney's ABC aired the group's TV show, Bertelsmann's BMG released the record and Viacom Inc.'s MTV promoted it relentlessly.

Even so, an AOL Time Warner spokeswoman said that the fact that Eden's Crush debuted at No. 6 on the album charts "is a testament to the group's talent as well as the powerful promotion efforts" of Warner Music, WB and AOL.

That underscores a basic fact of life for the industry: in the marriage of content and distribution, the content still has to be compelling to be successful. So, even though Sony lacks the cable and broadcast networks that
are supposed to be essential promotional tools in today's media world, it shattered box-office records last weekend with a film the public was dying to see, "Spider-Man."

Yet the history thus far of Vivendi Universal shows that today's media monoliths can flounder even when studio chiefs and music moguls do well at picking hits. When Vivendi bought Seagram, it became owner of the Universal studios and theme parks. Vivendi's Mr. Messier has aggressively promoted the idea that consumers around the world would soon use mobile phones and personal digital assistants to plug into Universal music and movies anywhere at anytime. Recently, Vivendi bought cable's USA Networks to gain a home-distribution channel for its movies.

So far, Vivendi's creative executives in New York and Los Angeles have done their part. Over the past three years, Universal Pictures has cranked out a string of hits, including "The Mummy" and "The Fast and the Furious," as well as the "American Pie" comedies. And Universal Music Group has bucked a downturn in the music business, releasing best-selling albums by Eminem, Shaggy and Blink-182. But being part of the broader Vivendi Universal empire has done little to extend those successes beyond traditional channels such as home video and cable TV.

One possible reason: Universal's various parents have put its movie and music employees through a decade of nearly nonstop dealmaking. Since 1990, the company, once MCA Inc., has been bought and sold by Matsushita Electric Industrial Co. and bought by Seagram Co. It sold its TV assets to Mr. Diller's USA Networks, then bought them back again. Later, it absorbed the music and movie assets of Polygram NV, before being acquired by Vivendi.

That helps explain why the company's businesses often find themselves at cross purposes. Vivendi Universal Publishing, for example, distributes a music-software product called "MP3 Pro," which helps consumers transfer their audio CDs to their computers, then "burn" those musical tracks onto blank CDs. Meanwhile, Universal Music Group has become one of the industry's most aggressive pursuers of technology to prevent consumers from making digital copies of its CDs.

Last summer, Mr. Messier caught his Hollywood executives off guard when he adopted the mischievous cartoon monkey Curious George as the company's informal mascot. "When I look at this very famous character," he mused, "I think, 'Why don't we do a film?' " As it turned out, Universal Pictures already had a "Curious George" film project -- one it was thinking of ditching because of myriad development problems. But Mr. Messier's comments sent the studio scrambling to iron things out, and the computer-animated movie is now in the works.

A year later, Mr. Messier says the company is pursuing a coordinated campaign to make Curious George a "franchise" property, with books, the movie, merchandising and possibly a TV show.

Modest Success

Vivendi's businesses have enjoyed some modest joint successes. Its Vivendi Universal Publishing unit developed computer games based on Universal Pictures' popular "Mummy" films and "The Hulk," slated for release this year. Plans call for some of these games to incorporate music by Universal recording artists.
But Universal is now debating whether it should automatically deliver the bulk of its movies to USA Networks, now a corporate cousin. Mr. Diller says it will often be wiser to sell the films on the open market: "It does not serve the assets well to make a hard policy. ... I do not believe that synergies rule."

The media titans are also stumbling in their efforts to reach around the globe. Mr. Murdoch's News Corp., which has assembled an international collection of newspapers and satellite-TV systems as well as the U.S.-based Fox film studio and broadcast network, may be the closest thing to a global media company. But News Corp. has failed to link the world's biggest market, the U.S., into its vast network of satellite-TV systems and has been thwarted in repeated attempts to establish a foothold in Europe. European regulatory authorities, in particular, have rebuffed News Corp., in part because of concerns about the political agenda of Mr. Murdoch, a well-known conservative.

Disney has spent several years just trying to get the organization of its overseas businesses right, a painstaking process that so far has yielded few tangible results. Disney has done well overseas, as with its popular theme parks in Japan, when it finds savvy local partners who assume most of the risk in exchange for most of the reward.

Though the Disney name is on the new $2.8 billion Tokyo DisneySea theme park, Oriental Land Co., which also owns Tokyo Disneyland, paid for the project. The new park is off to a strong start, but Disney's prospects are modest: It collects a royalty that it hopes will eventually equal the $100 million annually it gets from Tokyo Disneyland. That's a pittance compared with Disney's overall annual revenue of about $25 billion.

The chief problem in building a global media empire isn't that entertainment doesn't travel well. Rather, it's a slow and arduous process to expand country-by-country around the world. Disney's ESPN has been working since 1989 to build its 25 foreign networks, but only recently made a deal to create its first channel in Europe.

When its merger was first completed, AOL Time Warner made international expansion one of its top priorities. The new company's first big deal was last year's $1.6 billion acquisition of British magazine publisher IPC Media. But more recently the company was forced, under terms of a contract, to spend $6.75 billion buying out its partner in AOL's European venture, which has been losing hundreds of millions of dollars a year. That expense has made it difficult for the company to fund further expansion anywhere in the near term, including overseas. Among international opportunities it recently passed on was NTL Inc., the debt-laden European cable operator.

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