The New Viacom

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CBS Broadcasting established Viacom as an independent company in 1970 to comply with regulations set forth by the U.S. Federal Communications Commission (FCC) barring television networks from owning cable TV systems or from syndicating their own programs in the United States. The increasing spread of cable television and the continuing possibility of conflicts of interest between television networks and cable television companies made the spinoff necessary, and Viacom separated formally from CBS in 1971 when CBS distributed Viacom's stock to its shareholders at the rate of one share for every seven shares of CBS stock.

Viacom quickly became one of the largest cable operators in the United States, with over 90,000 cable subscribers. It also owned the syndication rights to a large number of popular, previously run CBS television series that it made available for syndication to cable TV stations. Revenue from these rights accounted for a sizable percentage of Viacom's income. In 1976, to take advantage of Viacom's experience in syndicating programming to cable TV stations, its managers decided to establish the Showtime movie network to compete directly with HBO, the leading outlet for films on cable television. In 1977, Viacom earned $5.5 million on sales of $58.5 million. Most of its earnings represented revenues from the syndication of its television series, but they also reflected growth of its own cable TV systems, which at that time had about 350,000 subscribers. Recognizing that both producing and syndicating television programming could earn greater profits, Viacom's managers decided to produce their own television programs in the late 1970s and early 1980s. Their efforts produced only mixed results, however, no hit series resulted from their work, and the Big Three television networks of ABC, NBC, and CBS continued to dominate the airwaves.

During the early 1980s, the push to expand the cable television side of its business became Viacom managers' major priority. Cable television is a highly capital-intensive business, and Viacom made a large investment to build its cable infrastructure; for example, it spent $65 million on extending its customer base in 1981 alone. By 1982, Viacom had added 450,000 subscribers to the 90,000 it inherited from CBS, making it the ninth largest cable operator in the United States. Also, by 1982 Viacom sales had grown to $210 million, with about half its revenues coming from program syndication and about half from its cable operations.

Viacom's managers, however, continued to feel that its cable operations were not a strong enough engine for future growth. One reason was that cable TV prices were regulated at this time, and cable companies were limited in how much they could charge customers. Its managers continued to believe that real growth in earnings would come not from providing cable television service but providing the *content* of cable programming—television programs. Given their previous failure in making their own programs, Viacom's managers sought to make acquisitions in the content side of the business—in companies that made entertainment programs. In 1981,

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Viacom started in a small way by buying a minority stake in Cable Health Network, a new advertiser-supported television network. Then, in September 1985, in a stroke of fortune, it made the acquisition that would totally change the company's future. Viacom purchased the MTV Networks from Warner Bros., a company that desperately needed cash because Warner's own cable TV system needed a lot of capital to keep it viable.

The MTV Networks included MTV, a new popular music video channel geared toward the fourteen-to-twenty-four-age group; Nickelodeon, a channel geared toward children; and VH-1, a music video channel geared toward an older twenty-five-to-forty-four-age audience. MTV was the most popular property in the MTV Network. Its quick pace and flashy graphics were popular among young television viewers, and its young audience was a major target of large advertisers. The popularity of a station's programming determines how many advertisers it will attract and how much it can charge them. While MTV was performing well, Nickelodeon had been less successful and had not achieved any notable following among young viewers, which limited the revenues it could earn from advertisers. Viacom moved quickly to revamp Nickelodeon, giving it the slick, flashy look of MTV and developing unique programming that appealed to children, programming that was very different from that offered by competitors like the Disney Channel. In the next few years, Nickelodeon went from being the least popular channel on basic cable among children to being the most popular, and Viacom's managers were confident that they had in place the beginning of a new programming strategy to complement Viacom's cable TV interests and to guide the company to long-term profitability.

Enter Sumner Redstone

Viacom's hopes were shattered when its Showtime channel lost about 300,000 customers between March 1985 and March 1986 because of intense competition from HBO. HBO, under its then CEO Frank Biondi, was making itself the dominant pay movie channel by producing its own innovative programming and by forming exclusive agreements with major movie studios like Paramount to offer their movies to HBO first. As a result of the loss of customers, Viacom's cash flow dropped dramatically, and the company lost $9.9 million on sales of $919.2 million in 1986. Further weakened by the $2 billion debt load it had incurred to fund its cable expansion program and make its programming acquisitions, Viacom became a takeover target.

After a competitive six-month battle to acquire the company, Sumner M. Redstone bought Viacom for $3.4 billion in March 1986. Redstone was the owner of a closely held corporation, National Amusements Inc. (NAI), that owned and operated 675 movie screens in fourteen states in the United States and the United Kingdom. Redstone became chairman of Viacom's board and moved quickly to take control of the company. He had built NAI from fifty drive-in movie theaters to a modern theater chain. He is credited with pioneering the development of the multiplex movie theater concept, which offers moviegoers a choice of a dozen or more screens to choose from. However, running a chain of movie theaters was very different from running a debt-laden media conglomerate as complicated as Viacom.

Many analysts felt that Redstone had overpaid for Viacom, but he saw a great potential for growth. Besides its cable television systems and syndication rights, which now included the popular TV series *The Cosby Show,* Redstone recognized the potential of its MTV and Nickelodeon channels. Moreover, over the years Viacom had acquired five television and eight radio stations in major markets, which he saw as valuable investments. Redstone moved quickly to solve Viacom's problems, and with the "hands-on" directive management style for which he is well known, he fired Viacom's top managers and began the search for capable managers who would be loyal and obedient to him. To turn Showtime around, he immediately hired Frank Biondi, the chief executive who had made HBO the dominant movie channel, as CEO of Viacom.

Frank Biondi was just a few days away from moving to Hollywood to run Columbia Pictures when Redstone called and asked him to take over as CEO of Viacom. The forty-nine-year-old Biondi was known for his strong financial, deal-making, and strategic skills and a knack for managing a diverse group of young executives and building them into a cooperative unit. Unlike Redstone, who likes to be directly involved in the day-to-day operations of a business, however, Biondi felt that his job was to set challenging goals, find the resources—both capital and people—to achieve them, and then get out of the

way to let his managers achieve them. His approach was to decentralize control to his managers and to let them get the job done. Analysts felt the combination of Redstone's hands-on approach and Biondi's future thinking style made them a very effective team to head the growing entertainment conglomerate.

Viacom Speeds Up

Redstone's takeover of Viacom was fueled by his belief that cable television programming would become the dominant means of providing consumers with their entertainment content in the future. With the acquisition of Viacom, Redstone now owned 76% of MTV and Nickelodeon, which together gave Viacom access to millions of viewers aged two to twenty-four. Redstone believed Viacom's cable networks were its "crown jewels" because they provided half the company's revenues and profits, which came both from subscribers (the cable companies that bought the programming) and from advertisers (who advertised on these channels). To strengthen the cable channel franchise and build its brand name, Redstone restructured MTV and installed a more aggressive advertising and sales staff. Against the expectations of many industry analysts, MTV and Nickelodeon experienced continued growth and profitability. In 1989, for example, the MTV Networks won 15% of all dollars spent on cable advertising. MTV was expanding throughout the world, broadcasting to Western Europe, Japan, Australia, and large portions of Latin America.

Despite the success of the MTV channels, Redstone still faced the problem of paying off the debt that he had incurred to acquire Viacom—debt that amounted to $450 million in interest in the first two years following the takeover. Several fortuitous events aided him. First, shortly after the buyout, Viacom began to earn millions of dollars from television stations wanting to show reruns of the blockbuster *Cosby Show.* Second, in 1987 Congress deregulated cable television and allowed cable television companies to charge what they liked for their programming. The result was that the prices charged for cable television service soared, and so did the price of cable television franchises. Redstone took full advantage of this situation to sell off some of Viacom's cable assets to help reduce debt. In February 1989, Viacom's Long Island and suburban Cleveland cable systems were sold to Cablevision Systems Corp. for $545 million, or about twenty times their annual cash flow. Cablevision also bought a 5% stake in Showtime for $25 million, giving it an interest in promoting the channel to Cablevision's customers and helping Showtime get back in competition with HBO. These events enabled Redstone to significantly cut Viacom's debt and negotiate more favorable terms on its loans. However, it was rough going, and Viacom lost $154.4 million in 1987, even though its sales increased to almost $1 billion.

With Viacom's finances on a firmer footing and Showtime showing some renewed vigor, Redstone and Biondi began to plan how to make Viacom a leader in the production of creative entertainment. In a strategic alliance with the Hearst Corp. and Capital Cities/ABC Inc., Viacom introduced Lifetime, a channel geared toward women. Viacom Pictures was started in 1989 so that the company could make its own movies. Viacom Pictures produced ten feature films in its first year at a cost of about $4 million a film—a very low cost compared to the money the major studios like Paramount and Universal spent. Under Biondi, Viacom's television production operations, which had always achieved mixed results, started to achieve great success with programs like *Matlock* for NBC and *Jake and the Fatman* for CBS. To increase subscribers to the important Showtime channel, Redstone sold 50% of Showtime to TCI, a major cable systems operator, for $225 million in 1989. In November of 1989, Viacom bought five more radio stations for $121 million to add to [the] nine it already owned.

Together with the five television stations and fourteen cable systems it owned, Viacom's many dif[ferent] properties and assets earned revenues of $1.4 billion in 1989 and generated profits of $131 million. In 1990 and 1991, however, while Viacom's sales continued to increase, Viacom experienced losses of $89 million and $49 million on sales of $1.6 billion and $1.7 billion, respectively, because of increased costs associated with developing new programming and the lackluster performance of its Showtime network.

Viacom in the Early 1990s

The problem facing Redstone and Biondi was how to position Viacom for profitable growth in the 1990s. Both executives felt that developing and expanding Viacom's strengths in content programming—often referred to as entertainment software—were the key

to its future success, despite how costly such programming was. They believed that the message or content that is sent is what really matters, not the medium or distribution channels that carry it. As Biondi put it, "In the end, a pipe is just a pipe. The customer doesn't care how the information is obtained; all that matters is the message."

To build its content programming strengths, Biondi worked hard to build and expand on the success of Viacom's MTV channels. His goal was to promote the MTV networks as global brands that were perceived as having something unique to offer. Since MTV's viewers dominate the record-buying audience, Biondi sought to negotiate exclusive contracts that give MTV the first crack at playing most major record companies' music videos—thus making it unique. At the same time, under Redstone and Biondi's control MTV went from being a purely music video channel to a channel that championed new kinds of programming to appeal to a young audience. The result was innovative programming such as *Beavis and Butthead, Road Stories,* and other kinds of youth-oriented programming interspersed with music videos.

In developing its programming strategy, however, Viacom's interest was not in promoting certain specific programs or stars—all of which may have short-lived popularity of fame—but in building its networks as unique brands. For example, on the MTV channel, the goal was to attract viewers because of what the channel as a whole personifies—an appeal to youth. Its success is based not on any particular person but on what MTV stands for. Under its new management, MTV prospered and its franchise was extended into Europe, Asia, and Latin America. Soon, MTV reached 250 million households in seventy-four countries. Viacom began to perform much better: in 1992 it made profits of $48 million on sales of $1.86 billion, and in 1993 it made profits of $70 million on sales of $2 billion.

While the development of innovative new programming was one reason for Viacom's return to profitability, a second, very important reason was Redstone's emphasis on keeping costs under control. Redstone is well known for his frugal way of doing business. He runs Viacom in a cost-conscious manner, and this trend is evident throughout the organization, from the top executives to the lower levels of management. For example, Redstone has his office not in a prestigious Park Avenue, New York, location like the large networks, but in a small unimposing building a couple of blocks from New York's "red light" district. Despite his huge personal net worth, he was walking to work every morning.

Redstone tried to instill his cost-conscious attitude down through the organization and across its many properties into specific business projects. For example, in the last decade costs soared in many Hollywood studios and television networks because the producers were at the mercy of talent agencies that demanded high prices for their stars, writers, and production companies. Not so with Viacom. Redstone insisted that its own programming be produced by its own employees using low-cost, homegrown talent. An example of this is the production of its MTV shows. All of its hosts are virtually unknown and are paid little relative to well-known network hosts who are paid millions of dollars a year.

Changes in the Media and Entertainment Industry

In their efforts to build their companies' programming strengths, Redstone and Biondi realized that the environment around them was rapidly changing and that it was not at all clear how programming would be delivered to customers in the future. First, by the mid-1990s the U.S. cable television industry was in a state of flux. Emerging technologies such as wireless satellite TV and then Internet broadband threatened to bypass traditional cable systems, rendering Viacom's investment in wired cable much less valuable. Second, pressures were building to deregulate the telecommunications industry, and eventually companies in different industries, for example, cable companies, telephone companies, and Internet service providers (ISPs), were allowed to enter each other's markets. These changes reinforced Redstone and Biondi's belief that during the coming decade the most successful companies would not be those that offered customers a channel into the home by cable, telephone wire, or wireless transmission.

Instead, they believed that to prosper in this fast-changing environment an entertainment company should be the provider of the entertainment to all these channels. In other words, the most successful companies would be those that could offer the programming to go on the channels—*the software providers,* not the hardware providers who provided the infrastructure to bring the entertainment into peoples' homes. With its MTV, Nickelodeon, Showtime, and Cinemax channels,

as well as its syndicated programming, and its ability to make its own programming, Viacom was in a good position to form alliances with the companies that provided the channels into peoples' homes. It would provide the software (the programming) to the companies that provided the hardware (the wired and wireless cable companies and telephone companies). Viacom's revenues would come both from the fees it charged to the hardware providers for its entertainment channels and, most importantly, from the advertising revenues it would obtain from selling spots on its many channels—revenues that are determined by the extent of the viewing audience. However, Redstone and Biondi had discovered how expensive it is to develop innovative programming and how devastating the effects of a flop of several movies or programs can be for profitability. The question was how to obtain high-quality programming at the right price, especially in an entertainment and media industry in which the value of companies was rocketing as stock prices increased.

The Paramount and Blockbuster Mergers

Viacom now had a new mission: it should become a software-driven company with a goal of driving its entertainment software through every distribution system, to every multimedia application, and to every region on earth. To achieve Viacom's mission, Redstone began to search for a company that possessed the software strengths that could produce the programming content for worldwide distribution. In particular, he went looking for an entertainment company that had an already established film studio that would round out Viacom's programming portfolio by supplying feature films and TV shows to its television channels. Paramount Pictures provided Redstone with his opportunity.

Paramount's many businesses include both entertainment and publishing. Its entertainment businesses include the production, financing, and distribution of motion pictures, television programming, and prerecorded videocassettes; and the operation of motion picture theaters, independent television stations, regional theme parks, and Madison Square Garden. Paramount also owned a large library of movies. Its publishing interests included Simon & Schuster, which publishes and distributes hardcover and paperback books for the general public and textbooks for elementary schools, high schools, and colleges; it also provides information services for businesses and professions.

Redstone and Biondi began to picture the extensive synergies that a merger with Paramount would provide Viacom in the future. As Redstone told reporters, "This merger is not about two plus two equaling four, but six, or eight, or ten." Redstone believed that together Viacom and Paramount would be a much more efficient and profitable organization. He had a vision, for example, of Paramount making films that featured MTV characters like Beavis and Butthead and new cable TV channels supported by Paramount's library of 1,800 films and 6,100 television programs. Both Redstone and Biondi believed that Paramount was a priceless asset for an entertainment company hoping to provide a broad range of programming content for future distribution to global customers. With its strengths not just in visual programming but also in publishing books and magazines, Viacom would become a multimedia entertainment powerhouse that could redraw the competitive map in the entertainment industry.

On September 12, 1993, after behind-the-scene talks between Redstone and Paramount executives, Paramount announced an $8.2 billion merger with Viacom. Soon, however, a bidding war for Paramount started. Barry Diller, the CEO of QVC Network Inc., another large entertainment company and the owner of the home shopping network, recognized the logic behind Viacom's strategy and announced a hostile bid for Paramount. On September 20, 1993, QVC announced an $80 per share or $9.5 billion bid for Paramount, and the battle between Viacom and QVC for ownership of Paramount Communications Inc. was on.

This unwelcome bid from QVC presented a significant problem for Redstone: Viacom still had substantial debt because of his original 1987 acquisition of Viacom and the rapid development of its own television programming. Redstone could not afford to counter QVC's bid unless he obtained other sources of financing, and he had to search around for partners to support his bid. After a career of financing deals with his own pocketbook, including the 1987 Viacom takeover, the seventy-year-old tycoon was forced to turn to other companies to rescue the Paramount deal. Redstone found two potential partners in Nynex and Blockbuster.

Nynex, one of the Baby Bell companies, anticipated that deregulation would allow it to enter the cable television market and wanted an alliance with a

company that could supply it with programming content. Blockbuster, under its own energetic CEO Wayne Huizinga, had grown to become the largest chain of video stores in the nation. Blockbuster was cash rich as a result of its recent rapid growth. Huizinga, recognizing the threat that the growth in electronic movie mediums (such as video pay-per-view, wireless cable, and videos through fiber-optic phone lines) could pose to the sale and rental of videocassettes, was on the lookout for a way to reduce this risk. He agreed to support Redstone's bid for Paramount as a way to diversify Blockbuster's interests.

Redstone was not anxious to forge alliances with these companies, commenting that alliances are tricky: "No one who is not a hypocrite or a liar can guarantee how a relationship will look in the future." Moreover, Redstone also saw that Blockbuster's future was in doubt as a result of the growth in electronic means of providing home movie videos. However, his need for cash to outbid QVC for ownership of Paramount was stronger than his worries about forming the alliances. On October 21, 1993, after having aligned himself with these partners, Redstone obtained $600 million cash from Blockbuster and a $1.2 billion commitment from Nynex Corp. He then used this money to match QVC's offer of $80 per share for 51% of Paramount stock with the rest in Viacom stock. Furthermore, anticipating a higher offer by QVC, Viacom raised its bid to $85 a share for 51% of the stock. Many analysts argued that this bidding war had become a personal battle between Redstone and QVC chairman Barry Diller and that whoever was the winner was doomed to pay much too much for Paramount—so much for low-cost programming.

On December 20, QVC raised its offer to $92 a share in cash for 50.1%, topping Viacom, which asked for more time to raise cash. On December 22, Paramount signed a merger agreement with QVC, but the bidding could continue, with a deadline for final bids on February 1, 1994. Redstone, desperate for more cash, went to Blockbuster CEO Wayne Huizinga for more money. Huizinga, increasingly convinced that it was in Blockbuster's shareholders' best interests to merge with Viacom, suggested that Viacom should take over Blockbuster for a hefty stock price. Redstone, recognizing the value of Blockbuster's cash reserves and huge cash flow from current operations, agreed.

On January 7, 1994, Viacom announced an $8.4 billion merger with Blockbuster; it also announced a new bid for Paramount for $105 a share in cash. After the bruising battle with QVC, Viacom gained full ownership of Paramount on July 7, 1994. Redstone hailed the new Viacom as an "entertainment colossus" and "a massive global media company."

Explosive Growth

In a few short years, Redstone had gone from controlling several hundred movie theaters to controlling the properties and franchises of three *Fortune* 500 companies; Viacom, Blockbuster, and Paramount. By engineering the three-way merger of Viacom, Paramount, and Blockbuster Entertainment, Redstone created one of the three largest media empires in the United States (the others being the Disney/Capital Cities ABC, and AOL Time Warner), with annual revenues in excess of $10 billion. This was a large jump from the $2 billion revenue that Viacom had just before these mergers. However, Redstone and Biondi faced several major challenges in managing Viacom's new entertainment empire.

Engineering Synergies

To justify the expensive purchase of Paramount and Blockbuster, it became essential that Redstone and Biondi engineer synergies between Viacom's different entertainment properties, each of which was organized as a separate business division. Several efforts were immediately begun. Paramount executives were instructed to evaluate the potential of new shows developed by MTV for sale to television networks and TV stations. Viacom launched its new channel, the United Paramount Network (UPN), in January 1995 to take advantage of all the programming resources across its entertainment divisions. For example, MTV executives were instructed to quickly begin developing programming for the new network channel, which in 1996 was on the air only a few hours a day but today is on the air five days a week and through its TV broadcasting affiliates can reach almost all U.S. television households.

In another attempt to create synergies, Paramount executives were instructed to make their moviemaking skills available to the MTV Network and to help it make inexpensive movies that could be distributed through Paramount. One result of this was a Beavis and Butthead movie produced by Paramount and scheduled for late 1996. This was a first step in Redstone's strategy to boost the output of movies at the Paramount studio without having to finance a big increase in the

studio's own movie budget and to find ways of making low-budget movies. Redstone and Biondi also searched for synergies between Blockbuster and Viacom's other divisions. They hoped that Blockbuster could link its retail stores with Viacom's cable networks and Paramount's extensive film library. Perhaps Blockbuster could sell copies of Paramount's vast library of movies to encourage people to create their own video collections. Also, the release of a new Paramount movie on video could be timed to coincide with a major advertising campaign in Blockbuster stores to promote the launch. In addition, Viacom's publishing division, Simon & Schuster, would be able to release paperback books to coincide with the release, and perhaps even a multimedia CD-ROM product could be introduced to boost sales. Finally, the launch of new movies could be timed to coincide with a major advertising blitz on the MTV channel—something that happened when Paramount released *Mission Impossible*, in the summer of 1996. As Redstone said, "Viacom through its new combination of assets is poised to participate in, and in many ways define, the entertainment and information explosion about to engulf the globe." As things turned out, however, there was little potential for synergies to emerge between Viacom's various divisions.

Structure and Management Challenges

Sumner Redstone has always enjoyed hands-on control of the day-to-day running of the company and is constantly involved in managing the problems facing the various divisions. To jump-start the process of leveraging competencies across divisions and reducing costs, he moved quickly to develop a hand-picked team of executives across Viacom's new divisions to install his cost-conscious frugal values in divisional managers. Before being acquired, Paramount was run by an all-powerful boss, Martin S. Davis, and a group of executives who flew corporate jets and spent company funds lavishly. Redstone sold Paramount's two corporate jets and installed his own cost-conscious managers to change Paramount's free-spending habits. Also in 1994 Viacom dismissed Richard E. Snyder, the chairman of Simon & Schuster, who was known for his free-spending ways.

Media and Entertainment Industry Challenges

The fast-changing entertainment and media industry also created many new challenges for Redstone and Biondi. The major Hollywood players were changing rapidly. In the old Hollywood, seven major studios dominated film and the three Big Three networks— ABC, CBS, and NBC—delivered TV programming to mass audiences. Now, the number of distribution channels was exploding. Government regulations preventing broadcast networks from owning TV programming companies were phased out, and the competitive dynamics of the industry changed. Viacom's strategy to develop a full line of entertainment programming fitted well with the changes occurring in the industry. The media and entertainment industry was also experiencing rapid globalization as U.S. movies, news, and TV shows spread around the world. A major challenge facing Viacom was to obtain access to the global marketplace—with a potential market of 900 million viewers in India and a billion-plus in China. As an example of Viacom's global push, in March 1995 Viacom won a cable television license to launch its Nickelodeon and VH-1 channels in Germany, Europe's biggest and potentially most lucrative media market, to complement the MTV pop music network, which has operated in Europe since 1987.

Technology challenges also confronted the media industry. Advances in digital and information technology, including streaming audio and video, began to offer viable new ways to distribute software content to customers. Just as the dominance of the Big Three networks—ABC, NBC, and CBS—has been eroded by the growth of companies like Viacom with its assorted networks, so now many new avenues for distributing content to consumers were emerging with the growth of the Internet and advances in broadband technology. Digital piracy was also becoming evident, as websites were springing up to exchange digital files, and companies like Napster were just a few years away.

Finally, the growing strength of Viacom spurred the consolidation of the entertainment industry. In 1995, Time Warner announced that it would merge with Turner Broadcasting, and Disney announced that it would merge with Capital Cities/ABC. As a result, the industry was now composed of four major players: Disney, Viacom, AOL Time Warner, and News Corp., which owns the Fox channel.

Problems for Viacom

Soon after Redstone's expensive decision to buy Paramount, the Paramount movie *Forrest Gump* became a surprise hit, generating over $250 million for Viacom

and silencing those Redstone critics who had argued that he had spent too much to buy the movie company. Viacom's managers began to feel like Forrest Gump, with his philosophy that "life is like a box of chocolates: You never know what you're going to get." It seemed that Redstone and Viacom had been in the right place at the right time and had made a profitable acquisition. Just as Redstone had sensed the potential of MTV, so too had he sensed the potential of Paramount and Blockbuster.

By summer 1995, however, the selection of chocolates in Viacom's box did not seem as good as in 1994. Many of the hoped-for synergies had not been obtained. For example, before the merger Redstone claimed that Blockbuster would be valuable to Viacom as a distributor of its creative programming; however, few benefits of this kind had been achieved. Similarly, analysts argued that Paramount had to cooperate much more closely with Viacom's cable TV channels and with Blockbuster Video if synergies were to be forthcoming. Moreover, the performance of both the Paramount and Blockbuster divisions had been disappointing. The Gump smash hit had been followed by a string of expensive failures. Redstone and Biondi had begun to realize that making movies is a very risky business and that past successes are no indication of future success. Paramount's share of the box office dropped from 14% in 1994 to 10% in 1995. Moreover, Redstone was annoyed about the high marketing and production costs of the movies that Paramount was making, and after a string of failures, he wanted to know what the studio was doing. Hit movies are vital to a movie studio because they provide the cash flow that pays for the flops and bankrolls the future. Paramount's poor performance was hurting Viacom's cash flow and ability to service its debt. Moreover, box-office hits are crucial because they drive the rest of a movie studio's profits from international markets to home video and television.

To compound the Paramount problem, the Blockbuster division was also not doing well. Viacom had bought Blockbuster at the peak of its success—when its revenues were doubling every year and its free cash flow was a valuable asset. After the acquisition Blockbuster began to run into intense competition from two sources. First, a number of new rival video chains such as Hollywood Video had recently sprung up that were giving it intense competition and creating a price war in some markets. Second, pay-per-view on demand television was spreading rapidly in large urban markets. Blockbuster's revenues were flat, and the hoped-for growth in cash flow to help service Viacom's debts had not occurred.

To make matters worse, Redstone had a falling-out with the top management teams of Paramount and Blockbuster whom he thought were doing a poor job. He forced the resignations of many key executives and went in search of new leadership talent. Then, in January 1996 he stunned the entertainment world when he announced that he was firing his second-in-command Frank Biondi, who was well respected throughout Hollywood, because he believed Biondi did not have the "hands-on skills" needed to manage the kinds of problems that Viacom was facing. Redstone felt that Biondi's decentralized management style was out of place in a company actively searching for synergies and cost reductions. In place of Biondi he promoted his two lieutenants, Phillipe Dauman and Tom Dooley, to orchestrate Viacom's strategy, even though they had little direct experience with the entertainment business.

Viacom's New Moves

In March 1996, Redstone hired William Fields, a senior Wal-Mart manager who had extensive experience in running efficient retail operations through advanced IT, to be the CEO of Blockbuster. Redstone hoped he could find a way to transform the Blockbuster Video stores into broader based entertainment-software stores, given that it currently seemed likely that the video rental business would be swept away by the new wireless cable and direct broadcasting technologies.

Redstone himself became more involved in the day-to-day running of Paramount, spending more time with its marketing and production executives to understand the workings of the business. Many analysts wondered how good a job the seventy-year-old Redstone would do without the aid of a seasoned entertainment executive. Analysts also pointed to Viacom's lack of a strong global presence or any executives who had experience globally. They noted that Redstone did not have any personal international experience.

In the spring of 1996 Viacom's stock price plunged from a high of $54.50 to $35 as investors fled the stock because of problems at Blockbuster and Paramount. In the summer of 1996, after a string of

flops (with the exception of *Mission Impossible*), Redstone announced plans to cut back the number of movies Paramount would make and to reduce its production costs as he searched for a new strategy. Chief among Viacom's problems was its huge debt, which had to be pruned by more asset sales. In addition, Redstone and his managers had to find ways to reduce rising operating costs and overheads as well as to find new ways of leveraging resources and competences across divisions to increase revenues and build cash flow.

On the cost side, flat revenues and soon-to-be losses at Blockbuster and Paramount were pulling down the performance of the whole corporation. Blockbuster was now a growing liability, and Field's efforts were not bearing quick results. In fact, Blockbuster's revenues were falling. In 1997, Fields left and Redstone brought in a new CEO, John Antioco. In 1998 they streamlined Blockbuster's operations and sold off its new music store business for $115 million in cash. (Case 13 on Blockbuster provides detailed information on Blockbuster's new strategy.) They also introduced the radical idea of video-rental revenue sharing with the movie studios, and within a few years Blockbuster's revenues were increasing again. Also, in 1998 Redstone sold off all the rest of Paramount Studios' publishing interests, except for its lucrative consumer publishing group, to Pearson for $4.6 billion and used this money to reduce debt.

On the revenue side, there were signs that some potential synergies were emerging. For example, an alliance between MTV and Simon & Schuster resulted in a successful line of "Beavis and Butthead" titles, and Paramount did produce a successful Beavis and Butthead movie. Also, Viacom's global presence was widening as Redstone formed alliances overseas and as its television studios were developing new channels, including a second MTV channel to be called MTV2, which would focus exclusively on music videos, since the regular MTV channel had become more involved in regular programming. In 1997, growing demand for its entertainment content led Viacom to offer to buy the rest of Spelling entertainment with its Star Trek franchise and Big Ticket Television Unit. Its content was perfect for Viacom's growing UPN network, although that network had yet to make a profit. Redstone integrated Spelling into Paramount's television operations to obtain economies of scale and scope in the production of new television programming. He was clearly focused on reaping the long-term benefits from his entertainment empire, although the poor performance of Viacom's stock was a big personal embarrassment to him as his acquisitions were continually being criticized.

By 1999, Blockbuster's recovering revenues and cash flow allowed Redstone to announce an initial offering of Blockbuster stock so that the performance of that division could be separated from the rest of the company. Redstone believed it was impossible to assess Viacom's true value until a real market value was put on this unit. About 18% of Blockbuster's stock was sold at $16 to $18 a share, and the over $250 million raised was used to pay off its debt.

Also in 1999, Redstone hired the experienced media and entertainment manager and former head of CBS, Mel Karmazin, as Viacom's chief operating officer to help solve its ongoing problems. Karmazin was well known for his ability to select and manage hit programming and for his hands-on ability to find ways to leverage resources to improve operational effectiveness. He set to work restructuring Viacom's businesses to engineer cross-divisional synergies, create new programming content, and enhance its revenue and earnings stream.

Both Redstone and Karmazin also understood that one of the most important reasons to build an entertainment empire was to achieve economies of scale that arise from being able to offer potential advertisers the opportunity to advertise their products across multiple channels that attract different kinds of viewers. In other words, a potential advertiser could produce one or more themed commercials to run across all of Viacom's different TV networks as well as with its movies or in its books, theme parks, and so on. Redstone had also watched Disney merge with the ABC networks to provide it with a major new distribution channel for its Disney franchise, a move that also had made DisneyABC the biggest entertainment and media company in the world.

Since the majority of Viacom's future revenue stream would come from advertising, Redstone established a new unit, Viacom Plus, to provide a centralized advertising service that deals directly with large advertisers and handles advertising for *all* of Viacom's divisions. For example, in 2001 Procter & Gamble and Viacom Plus negotiated a groundbreaking cross-platform deal whereby P&G would pay $300 million for advertising spread across nine of Viacom's major divisions; the success of this deal led it to pay $350 million in 2002 for advertising spread

across fourteen of Viacom's divisions. P&G obtained a better deal than if it had negotiated with each Viacom property individually, and Viacom Plus reduced the costs associated with managing the vital advertising process. In 2002, Monster.com, the online job site, signed a $15 million deal with Viacom Plus to put all its "scatter money"—the money a company has to scatter across different channels and demographic groups—into the Viacom platform.

The CBS Acquisition

A new opportunity arose in 1999. CBS networks were in trouble because CBS ratings were dropping, and the company was interested in a merger in the consolidating entertainment industry. Redstone realized that with CBS's assets Viacom would reach the greatest number of viewers and listeners (CBS-owned Infinity Radio Broadcasting) of any media enterprise, spanning all ages and demographics from "cradle to cane." As such, it would become a premier outlet for advertisers around the world because it could now offer them the opportunity to achieve huge economies of scale and scope in their advertising efforts. Advertising content could be driven and promoted across virtually all media segments, including broadcast and cable television, radio, and outdoor advertising and new digital media. Also, channels such as MTV, MTV2, VH-1, and CMT could now be broadcast over Trinity's radio stations and over the Internet, and CBS's high-quality content, such as its news and sports programming, could be broadcast over all Viacom's properties. The huge scale would also give the combined company bargaining power with programming suppliers and allow it to maximize the effectiveness of its sales force across all its divisions—a major source of potential extra revenue and cost savings. Perhaps a part of Viacom's problems was that it was simply not big enough?

In September 1999, Viacom and CBS Corp. announced that they would merge the two companies in the largest media transaction to that date. All operations of the company would report to Mel Karmazin. The range of Viacom's properties was now staggering in its scope, especially because at the time of the merger CBS was in the process of taking control of radio station owner Infinity Broadcasting and King World productions, which syndicated such shows as *Jeopardy* and the *Oprah Winfrey Show*. Moreover, the merger was achieved through a stock swap so that no debt needed to be incurred to fund it, something Viacom could not afford because its revenues and performance were still slowly increasing.

Karmazin now gave his full attention to structuring and managing Viacom's assets to realize the gains from sharing and leveraging the competencies of its division across all its operations. It began to seem that with the CBS acquisition Viacom had achieved the critical mass that made such gains realizable. In May 2000, Karmazin announced the integration of the company's theme parks, Paramount Parks, into the Viacom Entertainment Group. This move would grow the parks faster by linking them to Viacom's other properties, such as its Nickelodeon and MTV cast of characters. In 2000, Karmazin integrated Paramount's and CBS's television groups, and the new division consisted of thirty-five television stations reaching eighteen of the top twenty television markets in the United States. The hope was that this would lead to major operational and sales efficiencies, especially because all advertising and promotion could be linked to the company's Infinity radio stations and outdoor advertising operations, creating the "advertising bundle" mentioned above. CBS would now function as a local as well as a national broadcaster and it could leverage its news, sports, and other programming across many more markets. In 2000, Viacom's television studios also formed a unit called MTV Films to produce movies for Paramount. Some of its low-budget movies, which generally cost around $30 million to make, half the normal Hollywood budget, made a profit, including the Rugrats and *Beavis and Butthead Do America*.

In 2001, in yet another move to make it the number 1 advertising platform in the world for advertisers with programming that appealed to every demographic category, Viacom acquired Black Entertainment Television (BET) for $3 billion. The BET network reaches 63.4 million U.S. households, and its other channels, like BET on Jazz and BET International, reach thirty countries in Europe and thirty-six in Africa. The BET acquisition was just one part of Viacom's push to become the dominant global media company. Continuing its strategy of leveraging value from its properties, BET is seeking more ways to integrate its activities with other Viacom properties, both by customizing various Viacom TV programming for BET's channels and vice versa, not only popular shows but also news and sports.

All of Viacom's networks were also instructed to follow MTV's lead and develop a global strategy to

produce content locally in each country in which they were broadcast to increase the company's global viewing audience. MTV, for example, has a presence in most of the world's major markets; it reaches 125 million households and is a major revenue generator for Viacom. And, while it broadcasts its U.S. programming in countries abroad, it had also produced successful shows in countries abroad that are customized to local tastes; these have proved so popular that they have been transferred successfully to the United States and other countries. In 2001, Redstone met China's president Jaing in Beijing to affirm Viacom's commitment to China, and in May 2001 channels such as MTV and Nickelodeon started to be broadcast in China, also with extensive programming customized to the Chinese market.

Viacom's stock climbed in the spring of 2002, despite the huge fall in advertising revenues caused by the recession in 2000 and the following September 11 tragedy—a fall that caused the earnings of its broadcast networks to drop by 20%. The over 10% fall in advertising revenues affected all entertainment and media companies and caused a plunge in the stock price of companies like Yahoo and AOL Time Warner. Indeed, the latter's stock price fell so far that Viacom became the number 2 global media company in 2002. Analysts felt that Viacom was the best-positioned media company to benefit from the upswing in advertising that was expected in the latter half of 2002 because of its combination of large-scale operations, leading brands, and diverse revenue streams. While the broadcast groups' earnings fell by 20%, for example, the earnings of the cable network division rose by 12%, largely because of greater broadcasting in the United States and abroad. Redstone claimed in the summer of 2002 that the worst was over.

Still reeling from the downturn in advertising, Redstone and Karmazin continued to seek ways to counter future threats to the Viacom empire, particularly because now the threat from digital and broadband technology was hurting its Blockbuster unit and might in the future threaten Viacom's distribution channels as TVs and computers merged as broadband connections to the Internet increased. Indeed, there have been many reports since the hiring of Mel Karmazin that he and Redstone have locked heads on many occasions about major strategic issues. Karmazin was especially critical of Redstone's expensive acquisitions, which increased debt but had no clear future benefits, and he also made strong suggestions that Viacom should increase its online presence. However, in June 2002 with the positive results from the CBS merger and BET acquisition suggesting the value of Redstone's growth-by-acquisition strategy, Karmazin was joking that their management styles were complementary and that he was in no rush to assume leadership of Viacom, especially since the seventy-nine-year-old Redstone was "good for another thirty to forty years—at least!" Redstone, however, joked that when Karmazin's contract expired in 2003, Karmazin "might want to retire." Karmazin's response? "Never, never, never."

New Problems for Viacom: The Growing Use of the Internet

Viacom made no significant acquisitions in 2002 or 2003. Redstone felt his company has all the right pieces of entertainment property in place and that the main issue for Karmazin was to manage them to realize the stream of advertising revenues and profits locked up in its entertainment assets. Operating revenues from its entertainment division, which included Paramount Pictures and theme parks, rose by 46% during 2003 and its operating income was up 15% to $66 million as a result of higher movie ticket sales and—paradoxically—much stronger sales of DVDs. Its Viacom Plus unit continued to aggressively market its "one-stop-shopping approach across all marketing channels," and, as the economy picked up in 2003, advertising revenues at the national level rebounded. In the spring of 2004, Viacom was happy to announce that the company's overall revenues were up 11% and that 46% of its 2003 revenues came from advertising.

While national advertising revenues on Viacom's many cable channels rebounded, however, local advertising revenues from its TV stations, including the CBS network, and from its radio stations were now lagging behind and hurting the company's performance—Viacom only just met analysts' earnings expectations. The reason local advertising revenues were not keeping pace with national advertising was that fewer and fewer people were watching or listening to local channels, preferring to watch their favorite cable channels or to surf the Web. Slowly but steadily the growing use of the Internet and new online digital media properties were cutting into available advertising revenues. Redstone and Karmazin were slow to pick up on the dangers the Internet posed, not just as

a competitor for advertising revenues but also as an important emerging media asset that could complement its existing businesses. And major online companies such as Yahoo were now expensive, and these too were suffering from new competition from upstart websites that began to offer specialist services, such as www.rottentomatoes, the movie review website, and soon Flickr and YouTube, which offered photograph and video content now made possible by the rapidly expanding use of broadband Internet connections. Karmazin and Redstone preferred to regard falling revenues as a temporary phenomenon and announced that they expected revenue increases in 2004 of 5 to 7% and operating profits to increase by 12 to 14%.

At the same time, however, Viacom has always been alert to the threat downloading movies through the Internet or by pay-per-view cable posed for its Blockbuster unit, so Redstone and Karmazin also announced that despite Blockbuster's considerable contributions to its revenues and free cash flow, they believed the business models of both companies had drifted so far apart that the lack of fit between them would hurt Viacom's future profitability. Viacom's business model is based on growing the value of its properties and the advertising revenues they generate. Blockbuster's business model is to increase its presence in the movie DVD rental and retail sales market. The was especially true by 2004 when the prospect of increasing competition from movie downloads through broadband channels started to increase, and so in the future falling revenues from DVD rentals might offset any increase in advertising revenues that Viacom might enjoy. However, divesting Blockbuster and losing its revenues would make Viacom even more dependent on advertising revenues.

Another problem by 2004 was that Viacom's acquisition of CBS was now causing major problems because the anticipated synergies were not forthcoming—buying more media properties also results in a company facing more sets of competitive threats. Investors were becoming increasingly wary of Viacom's stock because they found it more and more difficult to evaluate the real value of each of its many media properties and its cash flow. Spinning off Blockbuster would help eliminate the uncertainty this unit's future performance was having on its stock price. So in January 2004, when Blockbusters stock was trading at a high of $20, Viacom announced that it would divest its remaining shareholding in Blockbuster by allowing holders of Viacom shares to swap them for shares in Blockbuster. New Blockbuster shareholders would also receive a substantial once-and-for all dividend for swapping their Viacom stock for Blockbuster's. This made the deal attractive, and enough Viacom shareholders took advantage of the offer for Redstone to finally spin off the unit into a fully independent company controlled by its current CEO, John Antioco.

The Big Split

At the same time Viacom was failing to build strong Internet and online media assets, it was now also encountering many other problems with its empire of media assets. First, even after the Blockbuster spinoff, the company's erratic performance failed to reassure investors about the value of Viacom's remaining assets. Five years after Redstone bought the CBS television network in 2000, adding its television stations and Infinity Broadcasting radio stations to his movie studio, theme parks, and Blockbuster video stores, it was clear that bigger is not always better. Redstone had learnt the hard way that the different units of a company grow at different rates, and the performance of the weakest unit pulled down the performance of the whole company—and Viacom's growth was slowing fast. Its theme parks, radio stations, and CBS assets had not met Viacom's aggressive growth goals, and Redstone was frustrated that Viacom's slowest growing units were dragging down its stock price, which by 2004 was almost half its 2000 high of nearly $70 per share. Karmazin had warned Redstone about this, and the personal relationship between Redstone and Karmazin continued to deteriorate. Although in 2003 it was announced that Karmazin's contract would be renewed for two more years, Redstone now had other plans for his company, and in 2004 Karmazin was fired (he is now the CEO of Sirius Satellite Radio).

In March 2005 Redstone announced that Viacom would split the steadier, slow-growth units, the CBS side, from the faster-growth side, MTV and the film studio. The $60 billion conglomerate would be split into two smaller, separately traded companies, one running CBS and the stations and the other the movie studio and cable channels, such as MTV and Comedy Central. He also announced the company was looking to sell its slow-growth, expensive Paramount theme parks and buy growing Internet and

videogame companies, and that it might also divest its 858 movie screens in Canada—the original Redstone media property.

The split was approved by Viacom's board June 14, 2005, took effect December 31, 2005, and effectively undid the Viacom/CBS merger. The existing Viacom was renamed CBS Corp. and was headed by Les Moonves, its long-time CEO. It now includes Viacom's "slow-growth businesses," namely CBS, the CW network (formerly UPN), CBS Radio, Simon & Schuster, CBS Outdoor (formerly Viacom Outdoor), Showtime, and most television production assets. In addition, CBS Corp. was given Paramount Parks, which it later sold to amusement park operator Cedar Fair, L.P., on June 30, 2006.

Then, a new spin-off company was created called Viacom, which was headed by Tom Freston, the long-time head of MTV networks. It comprises MTV Networks, BET Networks, Paramount's movie studio, and Paramount Pictures' home entertainment operations. Redstone still controls 71% of the voting stock of both companies and is the chairman of both companies—he still earns $27 million a year as its chairman, and he and his family members are a major drain on its cash flow.

Do Media Empires Create Value and Profit?

After a decade of growth by acquisition, media conglomerates such as Viacom, Sony, and Time Warner all began to reconfigure their business models, pushed by new Internet technologies and changing customer viewing habits that had altered the mix of advertising revenues on which media content companies depend. The 1990s cookie-cutter model of a media giant where one could just add different media properties, such as a television network, to others, such as a movie studio, theme parks, music company, or pro sports team, had been shown to be a failure—at least in terms of generating consistent increases in a company's stock price. Nevertheless, in December 2005, Viacom's Paramount Pictures sealed a deal to buy movie studio DreamWorks for $1.6 billion, thwarting rival NBC-Universal's five-month-long attempt to acquire the independent movie studio. "The acquisition of DreamWorks is an enormous step forward in our ongoing work to unlock the full potential of Viacom's brands and businesses," said Redstone. But how the acquisition would actually do this was left unsaid.

Redstone's focus on fixing the ongoing problems with his media empire also made him very late to recognize the growing importance of the Internet and the World Wide Web and the threat of competition from digital video downloading and streaming media. In 2005, Viacom moved to acquire some small Internet media properties; for example, in June 2005 it acquired Neopets, a virtual pet website, and in 2006 it acquired Xfire, iFilm, Quizilla.com and Harmonix Music Systems, and Atom Entertainment. These companies serve niche markets, such as virtual pets, or make music gaming titles. However, these acquisitions had nothing like the reach of a MySpace or YouTube, and despite this progress Viacom was much slower to react to the changes in Internet technology taking place than its rivals, and its stock price suffered.

New threats were also emerging; Disney, which had always had a strong interest in developing media websites, was rebuilding a strong Disney Internet property and announced it was pioneering movie downloading through the Internet. In 2005 it claimed it had a proprietary new technology for delivering movies over the Internet, and in 2006 it formed a close alliance with Apple to download its movies and TV programs over the Internet to iPods. Similarly, after its disastrous start with AOL, Time Warner was also developing a new business model, based on free user access, to build its AOL channel into a major Internet property and so share in the billions of dollars of advertising revenues that were up for grabs. But the company that showed the best developed strategy was News Corp., whose CEO, Rupert Murdock, had pushed early for a strong Internet strategy, and the result was early important strategic Internet acquisitions. The most important of these acquisitions was MySpace.com in 2004, one of the fastest-growing social networking websites ever. It also bought several other specialist websites such as RottenTomatoes.com, a movie review website, and it developed these into major websites to increase advertising revenues and also to advertise its other media assets, such as the movies it made through its Fox Studios.

More Changes at the Top

As the names of its Internet acquisitions suggest, Viacom was failing in its attempt to develop a strong, coherent Internet strategy. In particular, it had lost the battle with News Corp. to acquire MySpace.com,

and now this strategic failure too began to hurt its stock price. Its stock, which had been around $45 after the 2005 split, plunged to $35 by the summer of 2006, and Redstone, as usual, responded by firing Viacom's CEO, Freston, blaming him for the company's poor performance. Redstone named Philippe Dauman as the new head of Viacom. Dauman has been a Viacom board member since 1987 and, as mentioned earlier, had been a top Viacom executive from 1994 to 2000.

In his first public announcement, Dauman claimed he had free reign to run things and develop a new business model, and that he wasn't simply a pawn for Redstone to use. Redstone himself had been getting negative attention from analysts who believed he had undermined Freston's authority and was grooming his own children to take over the company when he decides to retire (he turns eighty-four in May 2007). If Redstone attempts to micromanage or meddle in operational issues, Dauman said, "I can push back," but he also indicated he would work to continue Freston's legacy, "creative excellence," while focusing on strategic Internet acquisitions—an area that led to Freston's downfall. However, given the frugal Redstone, he optimistically said that he does not anticipate any acquisition as big as News Corp.'s $580 million MySpace purchase. He will look for companies under $100 million that have the potential to become the next MySpace—companies that will not be easy to find in today's competitive digital environment.

At the same time, Dauman said the company has untapped organic growth, meaning that it could achieve more innovation and product development internally so that the company could make better use of its media resources. He cited BET and Comedy Central as lynchpins with huge future potential and said that even with established brands, such as MTV and Nickelodeon, Viacom could bring in more advertising revenues by offering advertisers opportunities to reach both targeted and mass audiences. Once again, a corporate group focused on selling the aggregated reach of Viacom's cable network assets is being formed, something similar to Viacom's former centralized marketing unit that was disbanded after the split. If advertising revenues don't increase in the next few years, it seems that more divestitures may be likely.

In November 2006, the first financial reporting period under Dauman's leadership, Viacom reported a 16% fall in third-quarter profit, as weakness at the box office from unprofitable movies offset strength in cable and higher advertising revenues. Viacom's share price, which had been recovering, closed down 3.3% at $38.37. As usual, Redstone fired someone, this time Viacom's chief financial officer, and Redstone once again announced that his company would "move rapidly to the forefront of emerging digital markets, keeping us on the path to outstanding long-term financial performance and free cash flow generation" and backed its full-year target to deliver double-digit growth in revenue and operating income. Clearly, even managing a smaller, more focused media company to achieve profitable growth is a difficult task—especially when its units each face complex problems and agile competitors. Only time will tell if the new Viacom will succeed or if, once again, the company may be split apart to realize the value in its assets. Clearly its top executives face difficult choices in figuring out the best corporate and business strategies to pursue to create a highly profitable business model. Having an eighty-three-year-old owner in charge may not be the best thing for its shareholders, apart from Redstone himself, of course.

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