Caught between the threat of a new owner and the demands of a skittish sharemarket, Fairfax needs to reconstitute itself to survive, writes Peter Browne.

FEARS about the future of newspapers, intensified by the advertising downturn during the global financial crisis, have depressed Fairfax’s share price with two results: the company’s board and management has been constrained in the ways they can respond to the company’s difficulties, and Gina Rinehart has been able to acquire a significant parcel of shares at a relatively low cost. Neither pressure – the demands of shareholders or the ambitions of Ms Rinehart – is likely to go away.

In Australia we’ve tended to worry most about media proprietors who want to use their outlets to gain political influence and shape public opinion. But developments at Fairfax over the past few weeks have highlighted how an open share registry can be just as corrosive of good quality journalism. At a time when Fairfax needs to develop a long-term strategy for survival, its owners – who are mainly large investors with no particular interest in the media’s role in a democratic system – treat the company like any other investment and make judgements every day about whether to shift their funds into higher yielding investments.

The shift away from sole proprietors to publicly listed newspaper companies began in the United States in the 1960s, well before the internet began to eat into audiences and revenue, and only became a feature of the Australian press after Warwick Fairfax’s disastrous attempt to take over the family company in 1987. In America, the underlying causes of the shift were the inheritance taxes faced by family-owned newspaper businesses and the need for extra funds to finance investment in emerging newspaper technologies. During that decade a series of privately owned newspapers went public, among them Dow Jones in 1963, Times Mirror in 1964, Gannett Co. in 1967, and Ridder Publications, Knight Newspapers and the New York Times Company in 1969. The Sulzberger family, long-term owners of the New York Times, made sure their company came out of this process in the best shape for preserving its values – a two-tiered ownership structure gave the family, which holds 19 per cent of shares, 70 per of voting power.

Over the following decade, financial deregulation fuelled a vast increase in share ownership and trading, accompanied by increasing demands for greater returns on investments. The newly exposed newspaper companies were under increasing pressure to deliver higher profits.

To gauge the impact of the ownership shift, three researchers, Gilbert Cranberg, Randall Bezanson and John Soloski, interviewed newspaper executives and editors and studied the financial reports of the major newspaper groups in the United States. In their book Taking Stock, published in 2001, they concluded that “the American newspaper is undergoing fundamental change, and that the change is compromising the newspaper’s continued role as a fiercely independent source of information and opinion judged relevant and necessary for public understanding in a free, democratic, capitalist society.” Publicly traded media companies “are a major, though not the only, force in producing this change,” they wrote, because the publicly traded newspaper:
adds something new, something very powerful, and something that is not economically or technologically predestined, to the equation. That something is (i) widely distributed ownership, (ii) in a highly competitive and liquid financial marketplace, by (iii) persons and institutions whose interests are strictly financial and whose expectations are by definition short term because of easy access to alternative investment at a moment’s notice…

Investors in the firms are concerned with revenues, margins, continuously improving profitability, and stock performance. They are indifferent to news or, more disturbingly, its quality… The most important short-term strategy for increasing margins is cutting costs, and this consists largely of cutting personnel.

The three researchers found that operating margins in the industry, once running at between 10 and 15 per cent, “now range between 20 and 30 per cent and higher in the newspapers owned by the public companies.” The cost-cutting yielded obvious benefits for shareholders but created instability in an industry that would be challenged in the decades ahead. Consolidation and rationalisation was also a feature of this period: the number of daily newspapers published in the United States fell by over 250 to 1489 between 1980 and 1998.

Cranberg, Bezanson and Soloski were contrasting the publicly owned companies with their predecessors, the family-owned newspaper. But they didn’t have any illusions about the virtues of private ownership: some family controlled companies have produced high-quality journalism and played a valuable role in a democratic society; others – as more recent revelations in Britain have underlined – haven’t. There seems little doubt that a Fairfax fully owned by Gina Rinehart would fall into the latter category.

The Australian debate about how to deal with the crisis in news organisations has focused narrowly on a choice between conventional market solutions and some form of government involvement. Elsewhere, though, newspapers have been run successfully as non-profit companies with high-quality journalism as the key objective. The best-known example is Britain’s Guardian newspaper, whose ultimate owner, the Scott Trust Limited, exists solely to protect the paper and its liberal journalistic values. The Guardian has not been immune to the pressures of the structural changes taking place in the media, but it has been able to experiment and innovate without facing the day-to-day judgements of the sharemarket or the vagaries of private ownership. Using its longstanding reputation as Britain’s leading left-of-centre outlet and its relatively large reporting staff, and underpinned by a constantly evolving, well-designed and comprehensive website, the paper has succeeded in attracting a huge online readership. Although it is nowhere near the biggest-selling paper in Britain, it has the third largest English-language newspaper audience in the world.

The Scott Trust was a creative response to a particular set of circumstances at the Guardian in 1936, including the death of its longstanding editor, and later owner, C.P Scott. Family owners created the trust to protect the paper’s values without having to deal with an array of restive shareholders. In Australia in 2012, the solution will undoubtedly be different, but it requires a recognition by the Fairfax board that its exposure to the sharemarket is an overwhelming constraint on its ability to preserve the quality and credibility of its major titles.

The board could draw inspiration, and useful financing ideas, from an innovative response to a recent crisis in another industry. In the wake of the collapse of the large-scale childcare operator ABC Learning in late 2008, a number of large charities, including Mission Australia and the Brotherhood of St Laurence, assisted by Social Ventures Australia and a group of business figures, formed a new company to bid for a large number of ABC’s centres. The consortium had developed a loan-based financial structure that delivered returns, via interest on bonds, to the charities concerned as well as to other classes of “investors,” including philanthropic trusts and venture capitalists. In other words, the new operator, Goodstart Australia, operates under charities law but is able to attract finance from conventional investors. If the federal government were to broaden the definition of charity to include a non-profit newspaper group, and a company like Fairfax could make the case that its dominant purpose is charitable (the current definition of a charity is broad enough for this to be possible), then this is one option for moving away from a very high level of exposure to market sentiment.

Other options might also become available if the federal government responds to this crisis creatively. In the
United States, a relatively new legal structure, the low-profit limited liability company, or L3C, is being adopted by at least one ailing newspaper company. L3C companies are primarily charitable but can distribute a modest overall level of profits to investors. The advantage of L3Cs is that they can also attract investment funds (as well as grants) from philanthropic foundations. As lawyer Brian Howe writes:

The flexibility of the limited liability structure allows ventures to structure differing levels (tranches) of investment opportunities. For instance, a L3C may offer three different tranches of capital with the first tranch to foundations (with lower rate of return, greater risk, high emphasis on social purpose), the second to socially conscious investors (medium rate of returns, lowered risk, emphasis on social return), and the third to regular investors (market rate of return, less emphasis on social purpose).

Regardless of which non-profit structure looked right for Fairfax, getting from here to there would be a complex and demanding process, especially with shareholders likely to be wary and Gina Rinehart certain to be opposed. But the present board would be creating a remarkable legacy by giving Fairfax a structure that more closely reflects the unique role of the news media and the challenges it faces.