ANALYSIS OF THE CORPORATE DECISIONS TAKEN IN THE FRAMEWORK OF THE CASE "Paramount Communications, Inc. v. Time Incorporated" (1989) FROM A STRATEGIC PERSPECTIVE

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ABSTRACT

"*Paramount Communications, Inc. v. Time Incorporated*" is a paradigmatic case which falls within the field of study of Mergers and Acquisitions, and whose judicial decision marked a milestone in American jurisprudence. This paper analyzes, from a strategic approach, the corporate decisions that were made in the framework of the facts that are circumscribed in this case. Firstly, it offers both a review of the sector and the company from an economic perspective, and an abbreviated description of the most relevant facts that led to the case coming to Court. Secondly, an examination is made of the different strategic decisions taken by the companies concerned. In this regard, it analyzes Time's decision to enter the entertainment industry, Paramount's insistent offer to acquire all of the outstanding shares of Time, Time's continued refusal to be acquired by Paramount, and Time's strategic shift from a stock-for-stock merger with Warner into an all-cash and securities acquisitions of Warner.

Keywords: *Paramount v. Time, mergers, acquisitions, strategic decision, entertainment sector.*

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1. INTRODUCTION

Mergers and acquisitions are usually an essential part of the strategic decision-making of a company, even more, when dealing with big corporations. Through these mechanisms, managers can introduce the company into other sectors that may be strategically appealing for the company, increase market share in their current sector, or even integrate divisions that could reduce production costs.

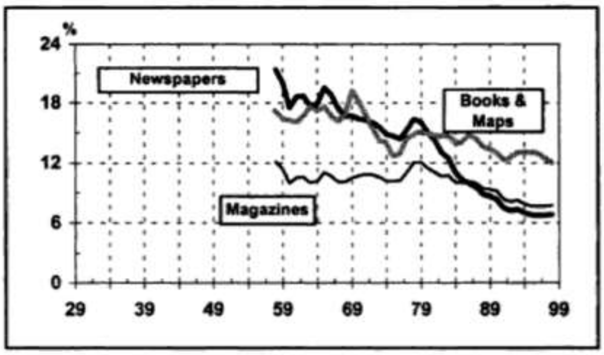
And, since we are students of the Double Degree in Law and Business Management and Administration, we sought to start from a legal case to carry out this project on that field. To do so, we have decided to analyze, from a strategic approach, the corporate decisions that were made concerning the attempts to undertake and prevent certain mergers and acquisitions in the framework of a paradigmatic case that reached the Delaware Supreme Court in 1989 and whose judicial decision marked a milestone in the commercial and corporate jurisdiction of the American jurisprudence: "Paramount Communications, Inc. v. Time Incorporated".

This was a noteworthy case regarding mergers and acquisitions as it highlights the importance of taking into account the long-term effects of a merger in terms of strategy. The analysis of this case will underline what aspects should be taken into account when deciding whether to accept an acquisition and what consequences may stem from such decision since managers have to consider the potential impact it may have on shareholders, but not only rely on it when deciding on the future of the company.

2. REVIEW OF THE ENTERTAINMENT SECTOR

The entertainment sector includes printing press, commercial theater, films, and television productions, broadcasting, and music recording among others. Time's core business was printing press (magazines) and cable TV, while Paramount's and Warner's were cable TV, filmed entertainment, and the recorded music.

Magazine readership flourished in the 1900s. Magazines used to provide general interest articles, but soon needs of specialized audiences raised. Therefore, magazines focused on more service-oriented journalism.[1] [2] The **magazine industry** was a very competitive industry due to the insignificant entry barriers existing in this sector during the first half of the 20th century. The number of magazines was doubled in the period from 1954 to 1980 and so did the market share of the top eight publishers. These firms publish many different magazines, taking advantage of its scale economies.[3]



The magazine industry was successful between the 1960s and 1970s. However, since the 1980s, the importance of this industry began to decline in favor of new forms of entertainment (*see Figure 1).*

Figure 1: Relative economic importance of printing press subsector (PCEs of selected entertainment categories as percentages of total PCE on recreation, 1929-1999).[4]

The **television and film industries** are two very important industries in the entertainment world. In the case of filmed entertainment, some Hollywood studio firms historically have dominated the production and distribution of films. These companies have been dominant over the film industry in the United States and the entire world. However, the success of the movie

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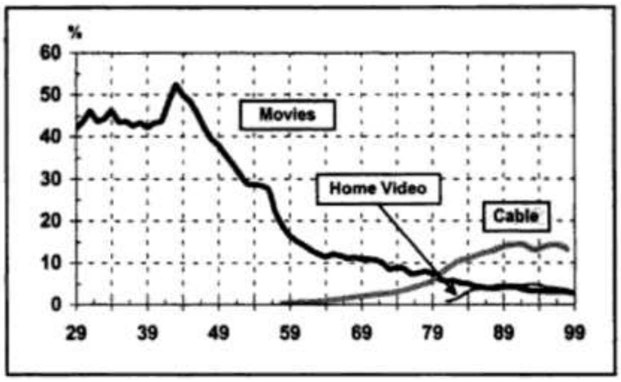
[1] Lauder, T. (updated 2020). *History of the magazine industry*. Available at: https://www.encyclopedia.com/media/encyclopedias-almanacs-transcripts-and-maps/magazine-industry-history

[2] University Christopher Newport. (updated 2020). *Primary sources: The 1920s: Magazines*. Available at: https://cnu.libguides.com/1920s/magazines

[3] Noam, E. (2006). *Who Owns the World's Media? Media Concentration and Ownership Around the World.* Oxford University Press. Available at: (DOI) 10.1093/acprof:oso/9780199987238.003.0018, p. 505.

[4] Vogel, H. (2001). *Entertainment Industry Economics: A guide for financial analysis.* Oxford University Press (5th edition). Available at: (DOI) 10.1017/CBO9781139871679, p. 25.



industry started to decrease after the 1940s due to the emergence of television. The Cable TV industry increased since the popularization of the TV as a household appliance (*see Figure 2*). Both industries were highly concentrated in a few big companies because there are important entry barriers related to scale economies.

Figure 2: Relative economic importance of television and film entertainment subsector (PCEs of selected entertainment categories as percentages of total PCE on recreation, 1929-1999).[5]

The **recorded music industry** creates and distributes music. It was not until the end of the 19th century when the recorded music industry was born due to the invention of phonograph and gramophone. These machines made recorded music reproducible and transmittable. Some years later, the creation of the radio played an important role in the development of the sector. After the 1950s, vinyl records started to be an essential part of the recorded music industry. The period between the 1960s and the 1990s was a golden era for the sector thanks to the multiple technological innovations that made recorded music more accessible and cheaper.[6]

3. REVIEW OF THE COMPANY: TIME INCORPORATED

Time was a mass media corporation based in New York and founded in 1922, which owned and published more than one hundred magazine brands.

In 1990, the company merged with Warner, until the spin-off in 2014. In 2018, Time was acquired by Meredith.

[5] Vogel, H. (2001), op. cit., note 4, p. 25.

[6] Bondy, D. (2016). *Same song, new dance: Analyzing Market Structure and Competition in the Digital Music Aggregation Industry.* Department of Journalism and Mass Communications College of Arts and Sciences at Kansas State University, p. 8-9.

4. CASE DESCRIPTION

1. Time (originally a news magazine company) began to contemplate expanding to other sectors and decided to enter the field of entertainment **(Time's first strategic decision).** To do so, it started contacts for possible mergers and acquisitions with many companies, including Warner and Paramount.

2. Time and Warner eventually agreed to merge at a stock-for-stock level.

3. But before the merger was approved, Paramount notified an all-cash acquisition of all outstanding shares of Time at $175/share (well above the market price, since Time shares were trading at $120/share) **(Paramount's first strategic decision).**

4. Time's managers met and decide to reject the offer since they believed it was actually a threat to Time's future business since the acquisition by Paramount could go against Time's corporate culture in the long run **(Time's second strategic decision)**. But at the same time, the Time board decided to change the stock-for-stock merger with Warner into an all-cash and securities acquisitions of Warner. For that end, Time made a cash offer for acquiring 51% of Warner's outstanding stock at $70/share and leave the remaining 49% of the outstanding stock to be purchased in the short run combining cash and securities equaling $70/share. That way, Time could continue existing **(Time's third strategic decision).**

5. Two weeks later, Paramount formally insisted on buying Time's outstanding stock, raising its offer from $175 up to $200/share **(Paramount confirms its first strategic decision).**

6. Time's directors met again to discuss their position on that new offer set out by Paramount but decided to reject it again, arguing that the Warner acquisition by Times offered better long-term value for Time's shareholders and that it would neither jeopardize Time's survival nor compromise Time's corporate culture in the future **(Time confirms its second strategic decision).**

7. Therefore, the case was brought to Court since Time's shareholders sued Time's board of directors, alleging a breach of their fiduciary duties, and concurrently, Paramount sued the Time board of directors for understanding that measures took by Time against Paramount's offer were excessive and not proportional.

5. ANALYSIS OF STRATEGIC DECISIONS

5.1. Time's first strategy decision: "Entering the entertainment industry"

Time's main strategic decision was to expand to the entertainment sector, so it contacted many companies for possible mergers (such as Warner Brothers, Paramount, Columbia, M.C.A., Fox, MGM, Disney, and Orion), ending up agreeing with Warner in July 1988.[7]

Before the agreement, Warner acquired Lorimar and its film studios, and therefore, Time could then make movies and television shows. Warner also had an international distribution system that Time could use do distribute all its products: films, videos, books and magazines. Therefore, his strategy was based on **diversification**, which is a good strategy for shareholders to have a diversified portfolio: expanding its business model to the music and recording field, since it was Warner's main business.

Furthermore, Time acquired Warner as an established firm within the industry, which was profitable since Time could identify Warner as undervalued by the stock market, a statement that can be confirmed by Time's rejection of Paramount, even after he raised its offer. Moreover, the present combination of somehow unrelated businesses may lead to making use of an internal capital market which is a good strategy for the firm, as the BCG strategy states: "*long term success requires it to develop a portfolio of businesses that assures an adequate and stable cash flow with which to finance its activities"*. Therefore, some units within the firm might generate surplus funds that can be channeled to other units that might need such funds.

Another advantage of Time's diversification, which we will extensively explain in section 5.5 is that diversification usually involves the enjoyment of running larger firms, which might conflict with shareholders' interests since they want such growth to increase their profits, but they cannot easily determine if Warner's acquisition will increase them or not. Moreover, and connected to the above-mentioned advantage of the internal capital market, there is a lower chance of high loss in any given quarter due to such heterogeneity within the company itself.

The present diversification is considered to be a **related** diversification since there are synergies between their services: magazines and filmed entertainment, being both parts of the communication sector.[8] Furthermore, for example, the publishing company or Warner sold

[7] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court 571 A.2d 1140 (Del. 1989).

[8] Daidj, N. (2019). *Strategy, Structure and Corporate Governance. Routledge*, p. 163.

softcover books and comics, meanwhile, Time used to sell hardcover books and magazines, being those clearly related businesses.[9]

Time's mass media is considered to have an **elastic** demand since the service is quite undifferentiated, bearing in mind the competition within this sector, as mentioned above. Furthermore, expenditure on the service is a large fraction of the total expenditure and search costs are low since it is easy to find a comparable item at a lower price within the magazine sector, even in the 1980s.

The **competitive advantage** of Time is well-known brands such as Golf, Sports Illustrated and Time, which makes the company different within the firms of their industry.[10] Therefore, their competitive advantage is the diversified portfolio of magazines that they offer to their customers.

Porter's Five Competitive Forces is a model that analyses the economic factors that shape an industry and affect its profitability. Under this model, the magazine sector was characterized by some **strong competitive forces** that could weaken the profitability of the industry. In the case of Time, like all other companies within the publishing industry, the bargaining power of suppliers was low since raw materials were brought from a wide variety of suppliers. Nevertheless, the bargaining power of consumers was high because of the elastic demand in the magazine industry. The threat of substitute products was also relevant, as the utility of a magazine can be compared to that of other entertainment products or services, such as books, newspapers or even radio. The rivalry among the existing competitors in this industry at the time of Time's offer was not very high because of the monopolistic competition of the market and the high differentiation between magazines. Finally, the threat of new entrants during the 1980s was not very high due to the relevant barriers to entry in the magazine sector. Despite these threats and competitive forces, Time's position in the magazine market was strong and the company had some significant strengths that helped maintain high profitability.

[9] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

[10] Rohn, U. (2010). *Cultural barriers to the success of foreign media content.* Peter Lang. Available at: https://books.google.es/books?id=xWl7coVHCncC&printsec=frontcover&hl=es#v=onepage&q& f=false

5.2. Paramount's first strategic decision: "The insistent offer to acquire Time"

Paramount Communications, Inc. v. Time case is *«the most significant takeover case to reach the Delaware Supreme Court in a number of years»*. At this point, we will discuss why Paramount is trying to hinder the merger operation between Warner and Time. What are the strategic reasons that guided this movement?

As we have seen in the facts, Time was a company that had traditionally been dedicated to editing books and magazines (as Time and Fortune) but also provides the pay television networks - Home Box Office (HBO) and Cinemax - and operates cable television companies.[11] It 1989, Time was looking for ways to expand his business and, after ruling out many potential partners (Paramount, M.C.A, Fox, MGM, Disney, and Orion), signed a consolidation agreement with Warner Communications.[12]

Against this agreement, Paramount decided to counter-attack with a hostile offer. For this reason, he launched an all-cash acquisition bid with the plan of generating a war inside the Time's organization, between managers (favored by Warner) and the company's shareholders (who saw Paramount pay them more money for their shares).[13] But is Paramount's strategy only seeking to harm its competitor or has any strategic reason that justifies it?

In 1989-1990 it began a «decade-long feeding frenzy in the media sector» where the main companies in the sector tried to grow by integrating other companies (*see Figure 3*) with the aim of increasing and combining the creation of content (producers) with distribution channels (televisions) thinking that this would maximize the productive efficiency of these firms.[14] The goal, independently if a television company bought a production company (backward integration, upstream) or the other way around (forward integration, downstream), was to coordinate the creation of content and the distribution of this content. As an example, we see how the most important studios of the moment merged during these years:

[11] Burns, P.E. (1991). *Timing is Paramount: The Impact of Paramount v. Time on the Law of Hostile Takeovers*. Fla. St. UL Rev., vol. 19, p. 762.

[12] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

[13] Ming, R. (1995). *Delaware's Duty to Auction After Paramount Communications, Inc. v. QVC Network, Inc.* Pepperdine Law Review, vol. 22, no 4, p. 1557.

[14] Kamar, E. (2009). *The story of Paramount Communications v. QVC Network: Everything is personal.*

Major Studio	Conglomerate (Acq. Year)
Warner Bros. Pictures	Time Warner (1989)
20th Century Fox	News Corporation (1985)
Paramount Pictures	Viacom (1994)
Columbia Pictures	Sony (1989)
Walt Disney Pictures	Disney (N/A)
Universal Studios	General Electric / Vivendi (2004)

Figure 3: The Six Major Movie Studios Market Share.[15]

Paramount did not want to fall behind this trend in the market, so he also tried to merge with some TV companies. This movement sought to make sure the distribution of its products as well as compete in the increasingly global media market.[16] Moreover, this vertical integration could cut coordination problems, transaction costs and enabled investment in specific assets or synergies between companies. The creation of content (series, films, TV programs, etc.) is a specific asset that, within the company, can be more efficient to realize. In addition, through these mergers and acquisitions, distributors guaranteed their own content and blocked their competitors from obtaining it. In other words, the fact that producers started working exclusively within a single television company – being vertically integrated – could hurt opponents by cutting off a source of content. Therefore, it is understandable that all the companies tried to merge during these years, trying to avoid the danger of running out of clients.

Undoubtedly, Paramount Communications wanted to take advantage of all these benefits that the integration could give. For that reason, after the failed merger attempt with Time, the company continued to talk with many media firms until in 1994 it accepted Viacom's offer. This allows us to prove that Paramount's corporate strategy was to integrate with a distribution company that will bring him all the advantages mentioned above.

But, in this particular case, we believe that Paramount's attitude was motivated by that the willingness to harm Warner (his competitor), and not to take strategically a positive action for the business. There must be some reason to understand why Time rejected Paramount's offer three times, against the will of certain administrators and shareholders of the company wanted to accept the offer because, in a financial aspect, Paramount's proposal was the most attractive bid. But, as we will discuss, Time continued with Warner because he considered it a more

[15] Pour-Moezzi, P. (2010). *Studio Wars. The Game Theory of Movie Release Dates.* Faculty Haas Berkeley. Available at: http://faculty.haas.berkeley.edu/rjmorgan/mba211/2010%20Final%20Projects/3MenandPejman-Game_Theory_of_Movies%20FINAL.pdf

[16] Burns, P E. (1991), op. cit., note 11, p. 762

beneficial long-term deal. In short, we must understand that the hypothetical agreement between Paramount and Time was not optimal for the two companies.

One of the main problems that explain why Time rejected Paramount was because coordination or integration problems could arise. In a merger, the companies involved disappear to create a new one. This conjunction between Time and Paramount would have been difficult for several reasons, such as (a) Paramount wanted to control the new company, imposing its will in detracting from Time's leadership; (b) the cable systems of the two companies were not compatible so the merger would require a large investment in changing infrastructures.[17]

So, if these problems made it difficult for the merger between the two firms, why did Paramount try to merge hostilely with Time? The only reason is that was trying to harm Warner removing it from the operation. During these years, there was a war between the producer firms (Studio wars) to see which one was able to merge before (*see Figure 3*). In 1989, Columbia and Warner signed a merger, leaving Paramount as one of the last to do so. Paramount's desperate offering - overpaying for the Time's stock - is for the unique purpose of not losing market importance compared to its competitors. This maelstrom of integrations, over time, has been seen not to be particularly optimal because most of the mergers that occurred in the 90s, during the 21st century have disappeared. This allows us to conclude that the main reason for which Paramount made its first strategic decision was to try not to lose the war with their competitors. The market of entertainment (studios) at the time was an oligopoly, so in the same way that if one puts a lower price the others follows their movements, when one company was vertically integrated with a distributor, the other firms tried to do the same in order to keep their clients (distributors), bypassing whether it was the rational and optimal decision for the long-term business.[18]

[17] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

[18] *Domestic Movie Theatrical Market Summary 1995 to 2020. The Numbers, where data and the movie business met.* (updated 2020). Available at: https://www.the-numbers.com/market/

5.3. Time's second strategic decision: "Refusing to be acquired by Paramount"

Time received notification of the purchase of all its outstanding shares from Paramount. In response, Time's directors met and finally decided to reject the offer. What were the reasons? They are set out below.

First of all, the fact that Time refused to be acquired by Paramount was certainly a strategic corporate decision. The main reason they gave, and which they maintained over time, even in court in the legal proceedings that followed, was that the Paramount takeover bid threatened Time's future because they considered it to be against their corporate culture, and therefore, could have serious detrimental effects on its long-term operability. As the BCG states: "*Long term success of a firm requires it to develop a portfolio of businesses that assures an adequate and stable cash flow with which to finance its activities*".[19] In this regard, it could be said that Time considered that the corporate culture it had at the time, which had been the result of a conscious evolution led by Time's management over time, was an asset that made it possible to secure the financing and development of the company's activities in the long term.

Following this line, it was proven in court, at the stage of hearing the parties involved, that "*the primary concern of Time's outside directors was the preservation of the Time Culture*".[20] What was this business culture that Time was determined to preserve, even rejecting Paramount's attractive offer? Time's management publicly stated before the Court, as the main reason it had taken into consideration in the deliberation that took place on Paramount's proposal, that "*Time had become recognized in this country as an institution built upon a foundation of journalistic integrity*".[21] According to Time's directors, a studious effort to refrain the managers from becoming involved in Time's editorial policy had been made through the years. This fact, publicly recognized by both clients and other media companies, had earned Time prestige and respect in the communications industry. As a result, several of Time's external directors feared that a merger with an entertainment company would divert Time's focus from news journalism and could threaten the culture of communicative integrity in the future, which would have led to a decline in Time's perceived value to its stakeholders in the long run.

[19] Boyes, W. (2003). *Managerial Economics: markets and the firm*. Second Edition, p.356.

[20] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court; note 4 - op. cit., note 7.

[21] Ibid.

Moreover, from a strategic perspective, it could be said that Time perceived a potential problem of multi-business firms. In that sense, Time could have thought the sum of the internal values of "stand-alone values" would be much lower than the value Time has at the moment: the reason why their market capitalization together would be lower in the future was meant to be the potential existence of a what is called a "corporate/conglomerate discount".

There is no doubt that at the financial and economic level, in the short term, the acquisition of Time by Paramount could have experienced certain improvements given the possibility of undertaking economies of scale and scope, so they could have been used to justify investment in growth, or using the growing initiative of the investment market to gain capitalization at the corporate level or even to allow a significant increase in shareholder profits, since Paramount's offer was well above market value: first, they offered $175 per share and then raised the offer to $200 per share, when Time shares were trading at approximately $120 per share. Thus, what the directors of Time valued at the time of rejecting Paramount's offer is reduced to the weighting of possible short-term corporate and shareholder benefit against long-term corporate and shareholder benefit, which would include not only financial or economic aspects, but also future operability in the market in which it had been acting. And it was this weighing task that deepened the divergence of interests between the shareholders, who in essence were the owners of Time, and its Board of Directors. The shareholders were looking to increase their profit, and the Paramount offer, as has been said, was enormously interesting in these terms. Meanwhile, the directors of Time, paradoxically, were seeking to fulfill their fiduciary duties to the company by rejecting Paramount's offer.

From a theoretical and analytical point of view, it can be said that the decision of Time's management is based on accepting or rejecting the implementation of a horizontal integration from a passive point of view; that is, Time being the object leading to such integration. Thus, when trying to acquire companies, what was being valued was to carry out transactions in the market with other companies, the object of which is the company itself, which places them in the "pure market" level. But the intention was none other than achieving integration, which would place it, if achieved, in the context of "pure hierarchy" between the integrated companies, according to Williamson.

Furthermore, Time's decision to reject Paramount's offer can even be analyzed from the perspective of rents and quasi-rents: the shareholders had with Time a relationship of specific assets which, through a particular activity in the industry in which they operated, produced rents, which should be understood as an economic profit of the investment *ex ante*; the asset return minus the opportunity costs; and quasi-rents, which should be considered as the economic profit of a relationship-specific investment *ex post*; its return minus the opportunity costs after a specific investment is made. Understanding as a “specific investment” the acquisition of Time by Paramount, Time could have made a valuation between the rents, or current benefits in all their forms, and the quasi-rents, or potential economic, operational and business advantages of being acquired by Paramount, and end up determining that potential quasi-rents were going to be lower than the rents that Time was actually obtaining if they had their company policy and corporate culture changed, as a compelling reason to understand the need to reject Paramount’s offer.

5.4. Time’s third strategic decision: “The offer to acquire 51% of Warner”

During the strategy formulation, it is necessary to consider the nature of competitive interaction in the markets in which the firm chooses to compete. The nature and intensity of competition are determined by the market structure among other key factors. This structure depends on the number of firms and their market share. The ***Herfindahl Hirshman Index*** (Concentration Index) is very useful to quantify the market structure and to determine whether an industry is very concentrated (monopoly or oligopoly) or fragmented (perfect competition). Following H. Vogel (2001), the entertainment sector has different market structures depending on the specific industry. In Table 1, it is shown the structural categories of the industries within the entertainment sector.

Monopoly	Oligopoly	Monopolistic Competition
Cable TV	Movies	Books
Newspapers	Recorded music	Magazines
Professional sports teams	Network TV	Radio stations
	Casinos	Toys and games
	Theme parks	Performing arts

Table 1: Structural categories of the different entertainment industries.[22]

In order to verify this information, we will calculate the *Herfindahl Hirshman Index* of magazine industry (Time’s core business at the time of the offer), cable TV, movie and recorded music industry (Warner’s core businesses) from the following data.

[22] Vogel, H. (2001), op. cit., note 4, p. 23-24.

a) Magazine industry: According to H. Vogel, this industry has a monopolistic competition.

COMPANY	1984	1988	1992	1996	2001	2004	2007	2009	2012
Time Warner[a]/Time Inc	9.0	9.3	9.8	11.1	14.0	14.3	11.1	13.0	8.6
Advance Publications[b]		3.9	4.3	4.7	5.7	7.0	11.9	12.8	9.2
Hearst	2.2	3.2	5.2	5.2	6.1	6.0	7.2	8.0	7.5
Source Interlink							1.6	2.2	3.0
Primedia[c]			0.9	2.5	4.5	3.4	Source Interlink		
Reader's Digest/Ripplewood[d]	1.3	3.1	3.4	3.3	2.2	2.6	2.5	2.6	1.1
Meredith Corporation[e]	2.3	2.6	2.6	2.3	2.1	2.6	2.9	2.3	2.1
Bertelsmann (Gruner & Jahr) (Germany)[f]			3.0	3.0	2.7	2.5	1.2	1.6	0.7
Thomson (Canada)	3.8	3.2	3.8	3.8	2.5	2.5	2.5	2.5	2.5
International Data Group	0.9	1.7	1.8	2.9	3.8	2.4	1.3	1.1	1.0
McGraw-Hill	2.1	2.2	2.2	1.9	2.7	2.1	2.8	2.2	2.0
Reed Elsevier (Netherlands)		1.0	3.6	5.2	3.2	1.9	1.8	1.2	0.0
Ziff-Davis[g]	0.5	1.2	1.5	2.0	1.6	0.9	0.2	0.2	0.2
Lagardère/Hachette Filipacchi (France)[h,i]			1.0	1.6	1.8	1.6	1.6	2.3	Hearst
Bonnier (Sweden)							1.0	1.0	1.0
Macrovision/Gemstar TV Guide[j]					2.0	1.9	0.4	0.2	0.1
News Corp			0.7	0.9	1.2	1.4	1.3	1.4	1.3
Triangle Publications	4.0	News Corp							
Others	73.8	68.4	56.1	49.5	43.9	46.9	49.6	46.4	60.6

Table 2: Magazine Publishers (Market Share by Revenue).[23]

$$\boldsymbol{HHI}\ (\mathbf{1984}) = 9^2 + 2{,}2^2 + 1{,}3^2 + 2{,}3^2 + 3{,}8^2 + 0{,}9^2 + 2{,}1^2 + 0{,}5^2 + 4^2 = 81 + 4{,}84 + 1{,}69 + 5{,}29 + 14{,}44 + 0{,}81 + 4{,}41 + 0{,}25 + 4 = 128{,}73 = 0{,}12873$$

$$\boldsymbol{HHI}\ (\mathbf{1988}) = 0{,}14872$$

$$\boldsymbol{HHI}\ (\mathbf{1992}) = 0{,}20892$$

In the previous years to Time's strategic decisions (1989), the concentration index confirms that the industry had a monopolistic competition structure, since the values were below 0,2 (*see Table 2*). The market was very segmented. The monopolistic competition is an imperfect competition where products are differentiated from one company to another, and consequently, the products are not perfect substitutes. In the case of magazines, monopolistic competition makes sense because magazines allow a lot of differentiation. There are magazines specialized in economics, sports, fashion, technology, etc. It is important to emphasize that Warner sold softcover books and comics, while Time sold magazines. For this reason, Warner's publishing company would integrate well with Time's established publishing company.[24]

[23] Noam, E. (2006), op. cit., note 3, p. 507.

[24] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

b) <u>Cable TV and movie industries:</u> The cable TV industry is defined by H. Vogel as a monopoly, while the Movie industry as an oligopoly.

Cable TV industry:

	1984	1988	1992	1996	2000	2001	2004/5	2007	2008	2009	2013
Time Warner			5.1	33.0	28.6	26.1	23.5	18.2	18.9	23.2	23.2
TBS	26.9	25.0	23.1	TW							
Viacom	13.8	15.1	13.8	10.9	16.6	16.1	15.8	15.9	14.2	13.6	13.6
CBS[a]							Viacom		1.3	2.3	
Disney	21.8	11.1	11.1	13.2	14.8	14.3	15.7	16.4	16.1	15.3	15.3
Discovery Networks		0.2	3.0	4.3	4.3	5.3	6.4	10.3	10.4	9.9	9.9
21st Century Fox											7.7
News Corp[b]				0.2	5.3	5.4	6.3	7.5	6.9	7.7	21st Century Fox
Comcast[c]					4.3	5.3	6.4	0.8	0.8	0.7	12.1
GE[d] (NBC Universal)		2.0	2.1	2.3	2.6	2.9	7.0	15.3	15.8	11.4	Comcast
RCA (NBC)	4.0	GE									
Liberty Media			2.1	1.5	3.1	3.2	4.8	1.6	1.5	1.5	1.5
Cablevision Systems				3.3	2.0	2.2	2.8	2.8	2.7	2.5	2.5
Rainbow Media Group		Cablevision									
Others	33.6	46.6	39.7	31.3	18.4	19.1	11.2	10.2	11.4	11.8	11.8

Table 3: Cable and DBS TV Programming Channels (Market Share by Revenues).[25]

$$HHI\ (1984) = 1{,}405$$

$$HHI\ (1988) = 0{,}980$$

$$HHI\ (1992) = 0{,}891$$

The concentration index demonstrates that the cable TV industry had a monopolistic market structure, as the values of the years from 1984 to 1992 were all above 0,6 (*see Table 3*). A monopoly occurs when a single firm dominates the market with little effective competition and little or no risk of new firms entering the market. Therefore, the market was highly concentrated. In this case, TBS, a cable channel owned by Warner, was the firm with a monopoly in that sector in the 1980s. However, there were other companies with lower market shares such as Time. Time and Warner's cable systems were compatible and could be easily integrated, while none of the other companies was considered as compatible cable partner. The integration of Time and Warner would allow controlling half of New York City's cable system, since Warner

[25] Noam, E. (2006), op. cit., note 3, p. 520-540.

had cable systems in Brooklyn and Queens; and Time controlled cable systems in Manhattan and Queens.[26]

Movie industry:

	1970	1978	1982	1984	1988	1990	1992	1994	1996
Time Warner (Warner Bros/Warner Comm.)	5.3	13.2	10.0	11.0	12.7	13.1	14.7	16.2	15.7
NewLine					2.7	4.4	5.4	6.4	5.3
Disney (incl. Miramax and Pixar)	9.1	4.8	7.0	9.8	14.5	15.5	17.5	19.5	21.0
Sony (Japan)						13.9	11.7	9.5	10.6
Columbia / Tristar	19.4	11.6	10.0	10.3	11.8	Sony			
Tristar					Columbia				
MGM / UA / Pathe	3.4	N/A	11.0	8.3	3.7	2.8	2.8	2.8	5.1
Orion / Metromedia					8.8	5.6	MGM		
21st Century Fox (ex-News Corp[a])						13.1	11.3	9.4	12.6
Fox	19.5	13.4	14.0	11.9	10.2	News Corp			
Viacom/Paramount								14.2	12.7
Paramount[b]	11.8	15.8	14.0	16.3	18.1	14.9	14.6	Viacom	
DreamWorks SKG									
Comcast[c]									
GE									
Vivendi Universal									
Seagrams									8.4
Matsushita							12.9	12.6	Seagrar
Universal / MCA	13.1	16.8	19.9	16.4	11.8	13.1	Matsushita		
Lionsgate									
Summit Entertainment									
Overture Films									
Weinstein Company									
Others	18.4	24.4	14.1	16.1	5.7	3.6	9.3	9.4	8.6

Table 4: Film Production /Distribution (Market Share by Box Office %).[27]

$$\boldsymbol{HHI}\ (\mathbf{1984}) = 1{,}067$$

$$\boldsymbol{HHI}\ (\mathbf{1988}) = 1{,}179$$

$$\boldsymbol{HHI}\ (\mathbf{1990}) = 1{,}229$$

[26] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

[27] Noam, E. (2006), op. cit., note 3, p. 520-540.

Contrary to H. Vogel's investigation, the concentration index shows that the film industry had a monopolistic market structure, like the TV Cables industry. Nevertheless, our result could be non-consistent. After analyzing the table with the data of the different companies in the movie industry and its market shares (*see Table 4*), we can say that H. Vogel was right in classifying this market structure as an oligopoly. The high value obtained by calculating the concentration index can be explained since there were several important companies with high market shares. An oligopoly is a market structure with a small number of firms, where none of which can avoid the others from having significant influence in the industry. Overall, the market for this industry was also highly concentrated. In this case, one of the oligopolistic firms was Warner with a market share of about 11,7% during the 1980s, after acquiring Lorimar and its film studios.

<u>c) Recorded Music industry</u>: According to H. Vogel, the market structure of the recorded music industry was an oligopoly. No data of the 1980s was available to calculate the concentration index at the time of the offer. However, other studies, such as D. Bondy's, corroborate this affirmation about the market.[28] The market was dominated by a few important firms which controlled content production, distribution channels and marketing. In the 1980s and 1990s, these companies were six (the "Big Six"): Warner, EMI, Sony Music, BMG Music, Universal Music Group and Polygram.[29] At the time of the offer, Warner was the most important firm in the music business and none of the other companies had its relevance nor influence.[30] Due to the oligopoly market structure the entry barriers in the recorded music industry were high.

In 1990, when this strategic decision took place, economies of scale in the media industry were huge, and a few big companies dominated the market.[31] Time's decision to acquire Warner would let the aforementioned enter a market that was close to having a blockaded entry, due to high structural barriers such as scale economies and learning curves. Therefore, incumbents did not have to raise strategic barriers to keep new firms from entering the market. Consequently, Time decided to make its way into the market through the acquisition of an incumbent, which would remove the potential hurdles to enter this sector.

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[28] Bondy, D. (2016), op. cit., note 6, p. 10-11.

[29] Daidj, N. (2015). *Developing Strategic Business Models and Competitive Advantage in the Digital Sector,* p. 308-309.

[30] Paramount Communications, Inc. v. Time Incorporated. Delaware Supreme Court, op. cit., note 7.

[31] Samuelson, P.A. (1958). *Aspect of public expenditure theories, Review of Economics and Statistics*, p. 332-338.

Time was essentially in the magazine business, and if it wanted to diversify into entertainment (particularly, film producing), a good strategy consisted of acquiring an experienced company in that sector, such as Warner. The main reason for this decision to be made relying on the fact that Warner could provide Time with experience in the sector, as the former knows, for instance, what the audience demands, which is a hurdle in the mass media industry, because it is difficult to predict if a film, TV show, etc, will be a blockbuster or a money-losing flop. Therefore, Time would benefit from the **learning curve**, which would allow it to achieve a cost advantage. Being able to be cost leaders in the mass media industry is key, as consumers demand is elastic and incumbent companies are old enough to be able to benefit from such learning curves. If a company produces a film, which is very costly, and it is not successful among the audience, it may lead to big losses, so having more information to predict such results is crucial. Furthermore, learning curves may deter the entry of potential rivals, as they do in this case. Consequently, Time would remove this entry barrier by acquiring Warner.

In addition to the latter, it is also key in the media market to profit from **economies of scale**, as the sector is dominated by a few companies that have very efficient cost structures. When producing media, one must incur in very high fixed costs, but marginal costs are usually very low, since the cost of producing a film is huge, but the cost of sharing it with one more person is very low.[32] Therefore, as demand is elastic, companies can become very profitable if they take advantage of economies of scale. If Time acquired Warner, it would control a company that already had scale economies, allowing the former to compete in the entertainment sector.

But why did Time **acquire 51% of Warner** instead of opting for a stock-for-stock merger? Essentially because Time still wanted to exist as a company. The decision stemmed from the threat of Time losing its corporate culture and image in the long run, due to Paramount's proposition of buying it out. Time realized the importance of maintaining its existence and culture over time.

A particular feature of the mass media industry is the importance of corporate image to promote a film, a TV show, etc. This is because the information is an experience good, i.e. a consumer must experience a good to value it. If that is the case, how does a consumer know if a product

[32] Bourreau, M., Gensollen, M. and Perani, J. (2002). *Economies of Scale in the Media Industry,* p. 2.

is good enough to buy it? This is solved by branding image.[33] In the entertainment sector, knowing that a film was produced by a particular company or directed by certain directors, gives the consumer a guarantee that he will be satisfied with the product. Consequently, maintaining both Time and Warner's names would contribute to that brand image.

Furthermore, this strategic decision can be seen as a way to avoid the hold-up problem. Although it seems unlikely, Time could enter the film entertainment sector and agree through a long-term contract that Warner would provide the movies, TV shows, music recordings, etc. In this sector, it is very unusual for one company to subcontract the production of films, since it would entail a high expense in the preparation of contracts and would not make sense, because these products are largely identified with the producer who made them. We could say that Time prefers to integrate Warner through the acquisition of its shares than to outsource its services in order to benefit from economies of scale and avoid double marginalization. On the one hand, the integration between Time and Warner allowed selling all the publications (magazines, comics and books) from both firms through Time's direct mailing network and Warner's international distribution system. On the other hand, films from Warner could be promoted and merchandised by using Time's network.

5.5. Decision

As said, Time's shareholders sued Time's board of directors for rejecting such a good offer from Paramount ($200/share), alleging a breach of the *Revlon rights* (set out by the same Court before which this case is presented, the Delaware Supreme Court, in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*, of 1985). In that sense, Time's shareholders claimed that the Time-Warner agreement undoubtedly put Time up for sale. So, according to the rule of the Court in the above-mentioned case, they alleged this fact triggered the requirement that the Time board had to seek to increase the corporation's short-term value for its shareholders. Thus, they claimed that the rejection of the Paramount offer, which included a purchase value well above the market price, was, in fact, a breach of this right that Time's shareholders have under the *Revlon* case.

Concurrently, Paramount sued the Time board of directors too. Their claim was based on the fact that the defense measures took by Time against Paramount's offer were excessive and not

[33] Creative Commons-licensed. (updated 2020). *Culture and Media - Chapter 13: Economics of Mass,* Available at: https://2012books.lardbucket.org/books/culture-and-media/s16-economics-of-mass-media.html

proportional. Paramount alleged that Time failed to fully investigate Paramount's offer, so their decision to reject it for being a clear thread to Time's future corporate culture could be considered as unreasonable, according to *Unocal Corporation v. Mesa Petroleum Co* (1985).

Throughout the entire lawsuit, Paramount defended the idea that the only possible answer to the rejection from Time Incorporated of their several offers, way bigger than the market price, was due to inadequate value. The Court, firstly stating that this contention "*represents a fundamental misconception of our standard of review under Unocal principally because it would involve the court in substituting its judgment as to what is a "better" deal for that of a corporation's board of directors*", and then evaluating different threats that also existed such as "*nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders, ... the risk of nonconsummation, and the quality of securities being offered in the exchange*", decided to reject the plaintiffs' contention that inadequate value was the unique threat posed by an all-cash, all-shares offer.

After a thorough analysis, the Court found that, indeed, the Time board were right in believing there were various more threats to be considered such as (1) the likelihood that shareholders might tender their shares in ignorance of the strategic benefits afforded by the Time-Warner merger; (2) the degree of uncertainty resulting from the conditions placed on the offer, and (3) the fact that the timing of the offer was designed to upset the originally scheduled shareholder vote on the Time-Warner merger to confuse the shareholders.

That is why, finally, the Court stated that "*given this record evidence, we cannot conclude that the Time Board's decision, considering that Paramount's offer posed a threat to corporate policy and effectiveness, was lacking in good faith or dominated by motives of either entrenchment or self-interest*". Thus, the Delaware Supreme Court ruled that Time (1) may reject Paramount offer based on the company's future image and (2) may reject it if it reasonably believes that the purchase of Time would be detrimental to its long-term corporate culture. It should be noted that the Court's conclusion could have been in part influenced since the majority of the board members were outside independent directors.

6. CONCLUSIONS

Time’s strategy to expand to the television and filmed entertainment sector was based on related diversification due to the existence of synergies between their services. Diversification is a good strategy for shareholders in order for them to have a diversified portfolio. Furthermore, Time identified Warner as undervalued by the stock market, a statement that can be confirmed by Time’s rejection of Paramount, even after he raised its offer. Time has an elastic demand since the service is quite undifferentiated and search costs are low ─it is easy to find a comparable item at a lower price within the magazine sector, even in the 1980s─. Despite the threats and competitive forces described, Time’s position in the magazine market was strong and the company had some significant strengths that helped itself maintain high profitability.

In the 1990s, the entertainment and television sector experienced a growth in mergers between suppliers (content creators) and distributors. For this reason, intending to maintain its position in the market and not lose the war with its competitors, Paramount makes a series of desperate offers to buy Time’s shares even though the strategy was not optimal. The TV cable, film and entertainment industry during the 1980s were highly concentrated and had an oligopolistic market structure. To enter this sector of the entertainment sector, there were high entry barriers such as scale economies and learning curves that could be avoided by acquiring Warner, which was already an incumbent firm. The Time’s decision of acquiring 51% of Warner instead of opting for a stock-for-stock merger is explained by the importance of maintaining the existence of the firm and its culture and corporate image over time.

On the other hand, and according to the ruling of the Court, it can be understood that any corporate strategic decision made by a company to prevent it from jeopardizing an intentionally established corporate culture is legitimate and also legal, if such a threat is likely to have serious adverse effects on the company’s long-term operability, and that these strategic decisions are in full compliance with the fiduciary duty that management owes to shareholders.

The idea that the unique reason for the rejection was inadequate value pushed Paramount to turn up to the Court, but finally the decision pointed out that there were many more reasons and studies made by the Time’s board in order to reject the different proposals. Time’s competitive advantage was their diversified portfolio of magazine brands, which they expanded by acquiring Warner entering in this case in the field of filmed entertainment and TV industry. Such related diversification led to a lower chance of high losses.

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