

INTRODUCTION TO MEDIA ECONOMICS

The study of media and communications has traditionally been dominated by non-economic disciplines. Analysis of media content, for example, can provide a means of understanding the societies we live in and our value systems. But economics is also a valuable subject area for media scholars. Most of the decisions taken by those who run media organizations are, to a greater or lesser extent, influenced by resource and financial issues. So economics, as a discipline, is highly relevant to understanding how media firms and industries operate.

This book provides an introduction to some of the main economic concepts and issues affecting the media. It is designed for readers who are not specialists in economics but who want to acquire the tools needed to unravel some of the more interesting economic features and pressing industrial questions surrounding media firms and markets. No prior knowledge of economics is assumed.

The first two chapters explain a number of broad and fundamental concepts relevant to the study of economics as it affects the media. This opening chapter introduces you to firms and markets and it examines the distinctive economic characteristics of media. Chapter 2 focuses on the relationship between these special characteristics and the corporate strategies that are commonly deployed by media firms.

These initial chapters are followed by six others, each of which concentrates on a particular sector of media activity, e.g. television broadcasting, print media publishing or 'new' media. Sector-specific chapters are not intended to offer stand-alone accounts of the economics of each media activity. Instead, they provide a framework within which two or three of the main economic concepts or questions that are commonly

associated with or best exemplified by that industry sector may be examined more closely. So, the structure of the book enables a series of economic themes and questions relevant to the media to be gradually and progressively opened up and explored. The final chapter examines what role media economics can play in informing public policy questions.

After studying this opening chapter, you should be able to:

- Identify the kinds of questions that media economics seeks to address
- Explain what a firm is, and its motivations
- Describe the different types of competitive market structures that exist
- Understand what is special about the economics of the media
- Identify and explain some of the key economic characteristics of the media

WHAT IS MEDIA ECONOMICS ABOUT?

Media economics combines the study of economics with the study of media. It is concerned with the changing economic forces that direct and constrain the choices of managers, practitioners and other decision-makers across the media. The economic concepts and issues introduced in the course of this book provide a basis for developing your understanding of the way in which media businesses operate and are managed.

Some attempts have been made to formalize a definition of media economics. Economics has been described as ‘the study of how people make choices to cope with scarcity’ (Parkin et al., 1997: 8). Scarcity is a familiar concept for most, and we are all economists to the extent that we have to decide how to make the best of our limited incomes or resources. According to Robert Picard, media economics ‘is concerned with how media operators meet the informational and entertainment wants and needs of audiences, advertisers and society with available resources’ (1989: 7). Likewise, Albarran’s definition of media economics focuses on ‘how media industries use scarce resources to produce content . . . to satisfy various wants and needs’ (1996: 5). For Alexander et al., media economics refers to ‘the business operations and financial activities of firms producing and selling output into the various media industries’ (1998: 2).

Media economics, then, is concerned with a range of issues including international trade, business strategy, pricing policies, competition and industrial concentration as they affect media firms and industries. These themes are explored below, as each of the main sub-sectors of the media is examined in turn. The predominant focus throughout the book is

‘microeconomic’ (i.e. to do with specific individual markets or firms), but some of the questions addressed also have a macroeconomic dimension.

MACROECONOMICS AND MICROECONOMICS

The distinction between macro and microeconomics is about whether that which is being studied involves large groups and broad economic aggregates or small well-defined groups and individual firms and sectors. Macroeconomics is concerned with very broad economic aggregates and averages, such as total output, total employment, national income, the general price level, and the rate of growth of the economy as a whole. These sorts of aggregates are arrived at by summing up the activities carried out in all individual markets and by summarizing the collective behaviour of all individuals.

One of the most commonly used measures of a nation’s overall level of economic activity is its Gross Domestic Product (GDP). A country’s GDP represents the sum of the value of all goods and services produced within the economy over a particular period, usually a year. Media goods and services represent a small but growing proportion of total economic activity in developed countries and, in the United Kingdom (UK) for example, they account for some 3–5 per cent of GDP.

In the UK, the long-term trend in GDP since the Second World War has generally been upwards and this, in turn, has facilitated a substantial increase in living standards. Within this overall growth trend, a second feature of movements in GDP has been short-term fluctuations around the trend. Rather than growing at a steady and consistent pace, economies tend to move in a series of up and down ‘business cycles’ which are characterized by four phases: trough, recovery, peak and recession (Lipsey and Chrystal, 1995: 500–5).

The overall performance of the economy has important implications for the business performance and prospects of firms in all sectors, including media. Indeed, the fortunes of most media firms are highly sensitive to the ups and downs of the economy as a whole. Many media firms rely on advertising as a primary source of income. Analysis of long-term trends in advertising shows that there is a strong association between the performance of the economy as a whole and levels of advertising activity. Revenues for media firms from direct expenditure by consumers are also clearly dependent on broader economic aggregates such as levels of disposable income and consumer confidence.

In theory, public policies on the economy (monetary, fiscal, etc.), and policies to promote or restrain growth or social welfare may have an effect

on the economic environment in which media firms and industries operate (Alexander et al., 1998: 9). For example, government control over the supply of money and over interest rates provides a means of influencing levels of investment and economic activity in general. However, it may be argued that the power of state authorities to exert such influence is waning. ‘Globalization’ means that it is increasingly difficult for open economies to predicate monetary and other economic policies on domestic considerations alone.

Whereas macroeconomics is about forces that affect the economy as a whole, microeconomics is concerned with the analysis of individual markets, products and firms. An economy is ‘a mechanism that determines what is produced, how, when and where it is produced, and for whom it is produced’ (Parkin et al., 1997: 21). These decisions are taken by three types of economic actors – consumers, firms and governments – and are co-ordinated in what are called ‘markets’. Economics relies on certain assumptions about how these actors make their choices.

Each consumer, for example, is seen as having unlimited wants and limited resources. It is assumed that all consumers seek to maximize their total ‘utility’ or satisfaction. ‘Marginal’ utility represents the change in satisfaction resulting from consuming a little more or a little less of a given product. The law of diminishing marginal utility suggests that the more of a given product that an individual consumes, the less satisfaction he or she will derive from successive units of the product. The example used by Lipsey and Chrystal to illustrate this principle shows that, everything else being equal, the more films a consumer attends each month, the more satisfaction he or she gets. However, the marginal utility of each additional film per month is less than that of the previous one – i.e. marginal utility declines as quantity consumed rises (1995: 128–9).

THE FIRM IN ECONOMIC THEORY

In economics, production is defined as the conversion of resources – labour, land and capital – into goods and services. ‘Firms’ are establishments where production is carried out and industries consist of a number of firms producing a commodity for the same market. The concept of a media firm spans a variety of different types of business organization, from the online ‘fanzine’ publisher to the vast television corporation and from single proprietorship to major transnational Stock Exchange listed companies. What all media firms have in common is that they are involved somehow in producing, packaging or distributing media content.

All media firms are *not*, however, commercial organizations. Most countries have a state-owned broadcasting entity which takes the form of a public corporation and which is dedicated to ‘public service’ television and radio broadcasting. Many public service broadcasters (PSBs) rely on public funding (e.g. grants) but some depend, in part or in whole, on revenues derived from commercial activities such as sale of airtime to advertisers. Even when they compete for revenues from commercial sources, PSBs are usually distinguished from commercial firms by the fact that their primary goal is to provide a universally available public broadcasting service rather than to make a profit.

By contrast, it is assumed that a commercial firm’s every decision is taken in order to maximize its profits. The assumption that all firms seek to maximize profits is central to the theory of the firm. It allows economists to predict the behaviour of firms by studying the effect that each of the choices available to it would have on its profits.

However, there are two commonly cited criticisms of the traditional theory of the firm and both are relevant to media. The first suggests that it is too crude and simplistic to assume that businesses are motivated purely by pursuit of profits. The case for profit maximization on the part of business owners is thought to be ‘self-evident’ but, in fact, some are undoubtedly motivated by alternative goals. These range from straightforward philanthropy to the desire for specific benefits associated with owning certain types of businesses. An alternative motivation – especially in the case of media firms – might well be the pursuit of public and political influence.

A second criticism is that the theory assumes that all firms will behave in the same way, irrespective of their size and organizational structure. In reality, a firm’s institutional structure may have an important bearing on its priorities. Rupert Murdoch’s involvement in the running of News Corporation shows how some media firms are closely managed by their owners. But the dominant form of industrial organization these days is the public limited company (or plc) under which, more typically, the day-to-day running of the firm is carried out not by the owners (or shareholders) but by managers.

When ownership and control of an organization are separate, its managers may decide to pursue goals other than maximizing profits and returns to shareholders. This conflict of interest is referred to as a type of ‘principal–agent’ problem. The managers appointed to run a media firm (agents) may not always act in the manner desired by shareholders (principals) but might, instead, have their own agendas to pursue. When the agent’s goal is allowed to predominate then pursuit of profits may be superseded by, for example, a desire to maximize sales revenue or the firm’s growth.

There are good grounds for questioning how well the broad assumptions of conventional economic theory apply in practice to the behaviour of media organizations. Nonetheless, to the extent that media firms and consumers make their decisions in a 'rational' manner and in pursuit of what are assumed to be their own individual goals (of, respectively, profit and utility maximization), there will be a role for government to play in creating a regulatory environment within which these individual goals are not achieved at the expense of societal welfare (Alexander et al., 1998: 14). The issue of supplying violent media content provides an example of an economic activity that realizes the goals of one set of economic actors (i.e. it contributes to the success and profitability of film and television programme-makers) but, arguably, may detract from overall well-being of society (*ibid.*).

A firm's profits are the difference between its revenues and costs. Costs in economic theory refer to all 'opportunity costs' – i.e. 'the cost of using something in a particular use is the benefit forgone by (or opportunity cost of) not using it in its best alternative use' (Lipsey and Chrystal, 1995: 185). So, as well as assigning costs to purchased or hired inputs, an 'imputed' cost must also be calculated for and assigned to any factors of production owned by the firm, especially the firm's own capital.

The concept of opportunity cost is important in economics. Our resources can be used in many different ways to produce different outcomes but, essentially, they are finite. All of the land, labour and capital available to us will be relatively more efficient in some activities rather than others. Opportunity cost is inevitable and requires firms to make trade-offs. The most productive outcome will be achieved when every worker, piece of land and item of capital equipment is allocated to the task that suits it best (i.e. the one that results in the most productive outcome).

For example, if we want more educational CD-Roms and fewer computer games, we might switch some of the creative, marketing and administrative personnel, the computers and production equipment involved in producing computer games into CD-Rom publishing instead. However, because game inventors will be less good at creating CD-Roms than original educational CD-Rom publishing personnel, the quantity of CD-Roms produced will increase by a relatively small amount while the quantity of computer games produced falls considerably. Similarly, CD-Rom creators can be reassigned to the task of producing interactive computer games but, because they are not as good at this activity as the people who currently make computer games, there will be an opportunity cost in terms of lost output. The opportunity cost of switching resources from computer games to CD-Rom production (or from CD-Roms to games) can be calculated as the number of games that must be given up in order to produce more CD-Roms (or vice versa).

In order to maximize profits, firms need to decide which overall rate of output would be most profitable (e.g. whether to produce 100,000 or 200,000 copies of a magazine). To do so, they need to know exactly what costs and revenues might be associated with different levels of output. The so-called ‘production function’ describes the relationship between input costs and different levels of output. Changes in relative factor prices (of labour, capital equipment, etc.) will result in a replacement of factors that have become relatively more expensive by cheaper ones. For example, the introduction of new print and desk-top publishing technologies in the magazine publishing industry in the 1980s and 1990s reduced capital equipment costs and allowed a reduction in labour inputs.

‘Marginal product’ is the change in total product (or the total amount produced by the firm) that results from adding a little bit more or a little less of a variable input to a fixed input. The ‘law of diminishing returns’ suggests that if extra quantities of a variable factor (e.g. freelance technicians) are applied to a given quantity of a fixed factor (e.g. plant and equipment), the marginal and average product of the variable factor will eventually decrease. Picard offers the example of a television news director who is deciding how many news crews (whose labour represents the ‘input’) are needed to produce a newscast (the ‘output’). The size of the marginal product increases at first, demonstrating increasing returns to scale, and then it begins to decline. According to Picard’s example, the onset of diminishing returns occurs because, as more production crews are added and the use of production equipment has to be shared, the efficiency and productivity of each crew begins to reduce (1989: 53–4).

But contrary to what is implied by the law of diminishing returns, many media firms tend to enjoy *increasing* rather than diminishing marginal returns as their output (or, rather, consumption of it) increases. The explanation for increasing returns to scale in the media industry lies in the nature of the product and how it is consumed. The value of media content lies not in the paper that it is printed on or the ink or videotape that conveys its text or images but in the meanings, messages or stories that it has to offer – its intellectual property. This is an intangible and costs virtually no more to reproduce in large than in small quantities. The cost of producing a television programme or a film is not affected by the number of people who watch it. So, for media firms, the relationship between input costs and different levels of output tends to be skewed by the availability of increasing returns to scale.

COMPETITIVE MARKET STRUCTURES

As discussed above, the production function describes how costs vary at different levels of output. Firms that wish to maximize profits are not only concerned with costs but also need to know what revenues are associated with different levels of output. To a large extent this depends on what sort of 'competitive market structure' a firm finds itself operating in.

Economic theory offers us a model for analysing the different sorts of structures a market can have and the degree of competition between firms in that market. The competitive market structures within which media operate will have an important bearing on how efficiently media firms organize their resources and business affairs. The main theoretical market structures are perfect and imperfect competition (i.e. monopolistic competition and oligopoly) and monopoly. The distinction between these structures is largely dictated by the number of rival producers or sellers in a given market. This provides a significant indication of the 'market power' that individual firms possess and their ability to control and influence the economic operations in that market (e.g. to set prices). The less market power individual firms have, the more competitive the market structure they are operating in.

The structure of a market depends not only on the number of rival sellers that exist but on a variety of other factors, including differences in their product, the number of buyers that are present, and barriers to the entry of new competitors. Perfect competition and monopoly are at opposite extremes. In perfect competition, markets are highly competitive and open and each firm has zero market power. In monopoly, a single firm has absolute control over the market. Most firms tend to operate in some intermediate market structure rather than at the extremes.

Perfect competition exists when there are many sellers of a good or service that is homogeneous (i.e. exactly the same or not differentiated) and no firm(s) dominate(s) the market. In such a situation economic forces operate freely. Each firm is assumed to be a price-taker and the industry is characterized by freedom of entry and exit. So, under perfect competition, no barriers to entry exist – there are no obstacles (e.g. lack of available spectrum, or high initial capital costs) to prevent new rivals from entering the market if they wish. Monopoly, at the other extreme, involves just one seller, no competition whatsoever and (usually) high entry barriers.

It is very rare to find an example of perfect competition in the real world. Most industries, including the media, sell 'differentiated' products, i.e. products that are similar enough to constitute a single group (such as books) but are sufficiently different for consumers to distinguish one from another. In other words, they may be close substitutes but are not

exact substitutes as would be the case in perfect competition. Monopolistic competition exists when there are a number of sellers of similar goods or services, but the products are differentiated and each product is available only from the firm that produces it. Firms thus have some control over their prices.

If there are only a few sellers in a market but some competition exists for their products, either homogeneous or differentiated, the market structure is described as an oligopoly. How few is 'a few'? The most usual method of measuring the degree of oligopoly in a market is by applying a 'concentration ratio'. These measures show the proportion of, say, output or employment or revenue accounted for by the top four or five firms in the sector. In the media sector, concentration levels can be calculated on the basis of audience shares (as defined by ratings or readership figures). According to Lipsey and Chrystal, in an oligopoly 'each firm has enough market power to prevent it from being a price-taker, but each firm is subject to enough inter-firm rivalry to prevent it from considering the market demand curve as its own' (1995: 262). So, in an oligopoly firms have a greater degree of control over the market than in a monopolistic competition.

Oligopoly is the most common type of market structure that media firms operate in. The next chapter addresses the question of why it is that so many sectors of the media are dominated by a few large firms. In many cases, the answer is to be found in falling costs due to the economies of large-scale production. Economies of scale are prevalent in the media because the industry is characterized by high initial production costs and low marginal reproduction and distribution costs. Economies of scope – economies achieved through multi-product production – are also commonly characteristic of media enterprises. So there are major advantages in large size for firms that operate in the media industry.

The theory of imperfect competition says that cost advantages associated with size will dictate that an industry should be an oligopoly unless some form of market intervention or Government regulation prevents the firms from growing to their most efficient size. If no such intervention takes place, existing firms in the industry may create barriers to entry where natural ones do not exist so that the industry will be dominated by a handful of large firms only because they are successful in preventing the entry of new firms. But substantial economies of scale in any industry will, in themselves, act as a natural barrier to entry in that any new firms will usually be smaller than established firms and so they will be at a cost disadvantage.

MARKET STRUCTURE AND BEHAVIOUR

The expectation that the behaviour or conduct of firms may be determined by the market structures within which they operate is formalized in what is called the Structure–Conduct–Performance (SCP) paradigm. The SCP paradigm suggests that market structure (the number of firms, barriers to entry, etc.) will determine how the firms in an industry behave (e.g. their policies on pricing and advertising) and this conduct will, in turn, determine the performance of the industry in question – i.e. its productive efficiency (Moschandreas, 1994: 11). This model implies that the fewer firms in a market, the greater the likelihood of collusion, anti-competitive strategies and other inefficiencies.

More recently, some doubt has been cast on the causal links of the SCP paradigm by the theory of market contestability, as developed by US economists Baumol, Panzar and Willig. A market is ‘contestable’ if entry to it is possible. The theory of contestability suggests that the very fact that a market is potentially open to a new entrant will serve to contain the behaviour of monopolists – i.e. market contestability prevents the exploitation of market power to restrict output and to raise prices (Lipsey and Chrystal, 1995: 271). Contestable markets are therefore said to be susceptible to ‘hit and run’ entry (George et al., 1992: 276).

How media firms behave, in practice, under different market structures has been a concern for many media economists (Picard, 1989: 79–83; Wirth and Bloch, 1995; Albarran, 1996) and will be a subject of interest throughout this book.

WHAT IS SO SPECIAL ABOUT THE ECONOMICS OF THE MEDIA?

Because media and other ‘cultural’ output have special qualities not shared by other products and services, the application of economic theory and economic perspectives in the context of media presents a variety of challenges. Media output seems to defy the very premise on which the laws of economics are based – scarcity. However much a film, a song or a news story is consumed, it does not get used up.

Economics seeks to promote ‘efficiency’ in the allocation of resources. The notion of economic efficiency is inextricably tied up with objectives. But the objectives of media organizations tend to vary widely. Very many media organizations comply with the classical theory of the firm and, like commercial entities in any other industry, are primarily geared towards maximizing profits and satisfying shareholders. A good number, however, appear to be driven by alternative motives. For those who

operate in the public service sector, quality of output and other ‘public service’ type objectives form an end in themselves. Some broadcasting firms find themselves in between the market and the non-market sector – appearing to fulfil one set of objectives for an industry regulator, and another set for shareholders. Because objectives are hazy, the application of any all-embracing model based in conventional economic theory is difficult.

In free market economies, most decisions concerning resource allocation are made through the price system. But the relationship between price and resource allocation in the media is somewhat unusual, particularly in broadcasting where (notwithstanding the growth of subscription-based channels) many of the services consumers receive still do not involve a direct payment from the viewer. Without price as a direct link between consumers and producers, there is a failure in the usual means of registering consumer preferences with suppliers.

In terms of economics, production methods are said to be inefficient if it would be possible to produce more of at least one commodity – without simultaneously producing less of another – merely by reallocating resources. However, when it comes to the production of media output, this approach begins to look inadequate. For example, it might well be possible for a television company to redistribute its resources so as to produce more hours of programming output or bigger audiences for the same cost as before. But if this were to narrow the diversity of media output, could it be said to be a more efficient use of resources?

These questions about the efficiency of production and allocation belong to the branch of economic theory called welfare economics. Much of the work that has been carried out in the UK in relation to broadcasting economics and associated public policy issues – most notably by Alan Peacock and, more recently, by Gavyn Davies and others – belongs to this area. Implicit in this approach is the assumption that a ‘welfare function’ (i.e. a functional relation showing the maximum welfare that can be generated by alternative resource decisions) can be defined for society as a whole. Within such a conceptual framework, media economics can play a role in showing how to minimize the welfare loss associated with any policy choices surrounding media provision.

KEY ECONOMIC CHARACTERISTICS OF THE MEDIA

A good way of getting to grips with what is special about media economics is to consider the characteristics of the media as a whole that distinguish it from other areas of economic activity. One such feature is that media

firms often sell their wares simultaneously in two separate and distinct sorts of markets. Media industries are unusual in that they generally operate in what has been referred to by Picard as a 'dual product' market (1989: 17–19). The two commodities that media firms generate are, first, content (television programmes, newspaper copy, magazine articles, etc.) and, second, audiences. The entertainment or news content that listeners, viewers or readers 'consume' constitutes one form of output which media firms can sell. The audiences that have been attracted by this content constitute a second valuable output, insofar as access to audiences can be packaged, priced and sold to advertisers.

Audiences are the main currency for many media companies, as these provide advertising revenue which, as later chapters will discuss, is a primary source of income for commercial television and radio broadcasters as well as for newspapers and many magazines. Even non-profit-seeking media are concerned with audiences. Public service broadcasters, for example, must pay close attention to their ratings and the demographic profile of their audience because the audience utility or satisfaction they can demonstrate is normally central to negotiations surrounding what level of funding, whether public or otherwise, is made available to them.

The other type of media output – i.e. content – exhibits a number of interesting and unusual features, as have been noted by, for example, Blumler and Nossiter (1991) and Collins et al. (1988: 7–10). Media content is generally classified as a 'cultural' good. Feature films, television broadcasts, books and music are not merely commercial products but may also be appreciated for the ways they enrich our cultural environment. Many cultural goods share the quality that their value for consumers is tied up with the information or messages they convey, rather than with the material carrier of that information (the radio spectrum, CD, etc.). Messages and meanings are, of course, intangible. So media content is not 'consumable' in the purest sense of this term (Albarran, 1996: 28).

It is sometimes difficult to define what constitutes a unit of media content. This could describe, for example, a story, an article, a television programme, an entire newspaper or a radio channel. One way or another, the essential quality that audiences get value from is meanings, which are not, in themselves, material objects. Because the value of media content is generally to do with attributes that are immaterial, it does not get used up or destroyed in the act of consumption. If one person watches a television broadcast, it doesn't diminish someone else's opportunity of viewing it. Because it is not used up as it is consumed, the same content can be supplied over and over again to additional consumers.

So television and radio broadcasts exhibit one of the key features of being a 'public good'. Other cultural goods such as works of art also qualify as public goods because the act of consumption by one individual

does not reduce their supply to others. Public goods contrast with normal or private goods in that private goods (such as a loaf of bread, jar of honey or pint of Guinness) *will* get used up as they are consumed. As soon as one person consumes a loaf of bread it is no longer available to anyone else. A loaf of bread can only be sold once. But when an idea or a story is sold, the seller still possesses it and can sell it over and over again.

The consumption of private goods uses up scarce resources and therefore needs to be rationed (usually by the market and by prices). But public goods do not comply with this logic. The initial cost involved in establishing a public good may be high but then the marginal costs associated with supplying an extra unit of it are next to zero. The marginal cost involved in conveying a television or radio programme to an extra viewer or listener within one's transmission reach is typically zero, at least for terrestrial broadcasters. Likewise, the marginal cost of providing an online publication to one additional Internet user is negligible.

Hoskins et al. (1997: 31–2) note the widespread use of a Research and Development (R&D) analogy to exemplify the very high initial production costs and low replication costs which are characteristic of broadcasting and other media. Generally speaking, once the first copy of a media product has been created (in the expensive R&D phase), it then costs little or nothing to reproduce and supply to extra customers. Increasing marginal returns will be enjoyed as the audience for any given media product expands.

Conversely, there are relatively few savings available for media firms when audiences contract. In most other industries, producers can vary some of their costs up and down in response to how much of their product is being sold (they can cut back on purchases of raw materials if demand slows down). For broadcasters, however, the cost of putting together and transmitting a given programme service is fixed, irrespective of how many viewers tune in or fail to tune in. Similarly, few savings can be made by newspaper and other print media publishers when circulation fails to live up to expectations (although, unlike in broadcasting, marginal print and distribution costs are present).

ECONOMIES OF SCALE

Economies of scale, then, are a highly prevalent feature of the media industry. They will be mentioned and discussed frequently throughout this book so it is worth clarifying what is meant by the term. Economies of scale are said to exist in any industry where marginal costs are lower than average costs. When the cost of providing an extra unit of a good falls as the scale of output expands, then economies of scale are present.

Many industries experience economies of scale, especially those engaged in manufacturing (e.g. of cars) where larger production runs and automated assembly line techniques lead to ever lower average production costs. A variety of reasons may explain why economies of scale are present. Sometimes it is because large firms can achieve better (bulk) discounts on required inputs than smaller firms can. Often, scale economies are to do with the benefits of specialization and division of labour that are possible within large firms.

Economies of scale exist in the media because of the public-good attributes of the industry's product. For media firms, marginal costs (MC) refer to the cost of supplying a product or service to one extra consumer. Average costs (AC) are the total costs involved in providing the product or service, divided by its audience – the total number of users who watch, read, listen to or otherwise consume it. In most sectors of the media, marginal costs tend to be low, and in some cases they are zero. Marginal costs are virtually always lower than average costs. Consequently, as more viewers tune in or more readers purchase a copy of the magazine, the average costs to the firm of supplying that product will be lowered. If average production costs go down as the scale of consumption of the firm's output increases, then economies of scale and higher profits will be enjoyed.

ECONOMIES OF SCOPE

Economies of scope are also to do with making savings and gaining efficiencies as more of a firm's output is consumed. In this case, however, savings are created by offering variations in the character or scope of the firm's output. Economies of scope – economies achieved through multi-product production – are commonly characteristic of media enterprises and, again, this is to do with the public-good nature of media output.

Economies of scope are generally defined as the economies available to firms 'large enough to engage efficiently in multi-product production and associated large scale distribution, advertising and purchasing' (Lipsey and Chrystal, 1995: 880). They arise when there are some shared overheads or other efficiency gains available that make it more cost-effective for two or more related products to be produced and sold jointly, rather than separately. Savings may arise if specialist inputs gathered for one product can be re-used in another.

Economies of scope are common in the media because the nature of media output is such that it is possible for a product created for one market to be reformatted and sold through another. For example, an interview

with a politician which is recorded for broadcast in a documentary might also be edited for inclusion in other news programmes, either on television or, indeed, on radio: the same television content can be repackaged into more than one product. And the reformatting of a product intended for one audience into another 'new' product suitable for a different audience creates economies of scope.

Whenever economies of scope are present diversification will be an economically efficient strategy because 'the total cost of the diversified firm is low compared with a group of single-product firms producing the same output' (Moschandreas, 1994: 155). Strategies of diversification are increasingly common amongst media firms and this reflects the widespread availability of economies of scope. Economies of scope and economies of scale are important characteristics of the economics of media and these concepts will be developed and exemplified in later chapters.

