Working Moms

Confidential Information for Terry Schiller

You are Terry Schiller, Syndicated Sales Representative for Hollyville, Inc., an international producer of television shows and motion pictures, located in Los Angeles. It is February 19, 1995, and you and Kim Taylor are involved in a negotiation over the sale of one of Hollyville's syndicated programs, *Working Moms*. Taylor is the Programming Manager of WCHI, one of four independent television stations in Chicago. WCHI is one of the potential buyers of *Working Moms*. Though she now resides in Chicago, Taylor spent her childhood and early adult years in Alabama.

Background

Hollyville is a major producer of television shows, supplying the three major U.S. television networks with first-run programs. Taken alone, the production and sale of first-run network television programs typically result in a 20% loss for Hollyville. After a program's initial run, Hollyville makes its money through syndication (i.e., selling the shows for rebroadcast on a number of local television stations).

Hollyville is interested in syndicating its network hit, *Working Moms*. The story focuses on three women who are trying to balance their lives as advertising account executives and mothers of pre-school children. The show's popularity reflects the program's excellent writing and talented cast. The primary viewing audience, 45% of the total audience, consists of 18-49 year old women. Such demographics make it ideal for the 6:00 p.m. time slot which attracts a large viewership, especially for local television stations such as WCHI.

The value of *Working Moms* to a local station is largely determined by the advertising revenue generated by the show. Advertisers pay higher rates for programs that attract a larger viewership, especially for audiences with attractive demographics. A network's success in attracting a large audience is reflected in its Nielsen ratings. These ratings, expressed as a percentage of all households with televisions, measure how many televisions are tuned into a particular program. For example, in Chicago's market of 3 million viewing households, a "2 rating" means that 60,000 households were tuned into that program. For syndicated programs, a rating of 10 is considered excellent. *Working Moms'* ratings are expected to be somewhere in the range of 7 to 10 points.

One of the local television markets Hollyville has targeted for the syndication of *Working Moms* is Chicago, Illinois. The Chicago market is mainly served by three networks and four independent television stations. Because of Federal Communications Commission regulations, only independent stations are legally able to purchase *Working Moms*. The four independent television

Professor George Wu of the University of Chicago derived this case from a simulation originally written by Ann Tensbrunsel and Max H. Bazerman of the Dispute Resolution Research Center of the Kellogg Graduate School of Management and Newspaper Management Center of Northwestern University.

stations in Chicago are, in order of market share, WWIN, WCHI, WILL, and WXYZ. *Working Moms* is too expensive for WXYZ, the smallest station. WILL is also not interested in *Working Moms*, because its current programming is oriented toward 18-49 year old men. WWIN, Chicago's highest rated independent, already has a successful program in the 6:00 time slot. However, the station is aware that the purchase of *Working Moms* by a competitor could seriously affect its market leadership. Consequently, WWIN is very interested in purchasing the program. WCHI is also attracted to *Working Moms*. For the last three years, WCHI has been in a poor financial position, and management has imposed severe buying restrictions on the station. These restrictions have finally stabilized WCHI's financial position, but in the process its ratings have fallen far behind those of WWIN. WCHI is looking for new programs for the 1995-96 season.

You and Taylor have met once before, three years ago, for less than ten minutes at a trade show. On January 4, 1995, you called Taylor to inquire as to whether WCHI would be interested in purchasing the rights to broadcast *Working Moms* in Chicago. Since then, you and Taylor have carried out your preliminary discussions either by telephone or fax. The two of you have arranged to meet at Taylor's downtown Chicago office tomorrow morning. You are flying in from Los Angeles and will be in town for 4 hours before flying on to New York City.

The Issues

Your job is to get the highest possible net profit from the syndication of *Working Moms*. In the past few years, Hollyville has had difficulty syndicating its programs. In just this past year, you were unable to sell two shows, both of which Hollyville's management had expected to syndicate. Consequently, the company's financial position has deteriorated significantly from its yearly financial plan. Therefore, it is important to you and to Hollyville that you negotiate successfully for the syndication of *Working Moms*. There are at least three issues to be negotiated: fee per title, runs per title, and the payment terms.

<u>(1) Fee Per Title.</u> The revenue you receive from the show is determined by multiplying the agreed upon fee per title by the number of available titles. A "title" is an individual show produced for an overall series (such as *Working Moms*). *Working Moms* will end its network run with 100 titles available. These 100 titles are being offered as part of a 5 year contract; as a matter of industry practice and Hollyville policy, the length of this contract and the number of titles are non-negotiable. Optimistically, you would like to receive $70,000 per title.

<u>(2) Runs Per Title.</u> It is important to you that *Working Moms* maintain its potential value beyond the five years of the contract. Your preliminary discussions with Taylor have focused on 6 runs per title, which means that WCHI could broadcast the same title 6 times during the life of the contract. Today, *Working Moms* has substantial value because of its network popularity. The value of the show beyond the five year contract largely depends on local audience interest for *Working Moms* five years from now. You believe that 6 runs/title over the next five years are probably too few to sustain such audience interest in *Working Moms*. WCHI could easily exhaust all of its rights to broadcast *Working Moms* in the first three years. In this case, it is hard to imagine Hollyville getting much for the show in the next round of syndication.

You believe that a contract which increased the number of runs per title to 7 would enhance the value of later contracts made after the expiration of the original five year agreement. You estimate that a contract with 7 runs/title is worth $500,000 more in net present value than an otherwise identical agreement with 6 runs/title. If the agreement involved 8 runs/title, then you estimate that the net present value of the show would increase by $1,000,000 over 6 runs per title. However, at 9 runs/title, there is some risk of overplaying the show and diluting future interest, so that the net effect to Hollyville of 9 runs per title (a $400,000 adjustment) would actually be less valuable to Hollyville than would be 7 runs per title. Finally, broadcasting 10 runs/title would so dilute interest in the show that you estimate a $200,000 *reduction* in the NPV of the show, compared to 6 runs per title. Hollyville policy specifically states that any agreement with more than ten runs per title over a 5-year contract is not acceptable. This is summarized in the following table.

Runs/title	Adjustment to NPV
6	$0
7	$500,000
8	$1,000,000
9	$400,000
10	-$200,000

(3) Payment Terms. Your typical payment terms consist of three installments: 50% of the total price up front; and additional payments of 25% of the total price in each of years 1 and 2. Of course, buyers generally prefer payments spread evenly over the entire 5 year period. Your financial analyst has informed you that your annual discount factor (which reflects Hollyville's cost of capital and other financial considerations) is 20%. In other words, you are indifferent between receiving $1.00 up front and $1.20 in year 1. Similarly, you are indifferent between receiving $1.00 up front and $1.44 in year 2. You should use this discount factor to quantify the cost of delayed payment.

In sum, the expected value of the deal with WCHI is the expected NPV of revenue, adjusted for financing costs, plus any adjustment in NPV involving runs/title. Besides your preliminary discussions with Taylor, you have talked extensively with the program manager from WWIN. These conversations have led you to believe WWIN is likely to make an offer for *Working Moms*. Though the numbers have varied from conversation to conversation, your best guess, based on your last conversation, is that WWIN's offer will come in with a net present value of $4.75 million.

You find it difficult to estimate how much WCHI might pay for *Working Moms*. Of course, the amount any station is willing to pay for a syndicated program depends largely on the expected ratings for the show. To help determine the value of the program to WCHI, your analysts have estimated the chances that *Working Moms*' ratings will fall within certain point ranges if WCHI broadcasts the program. The information is provided in the chart below:

Ratings	Probability
7	0.1
8	0.2
9	0.3
10	0.4

Although *Working Moms* will be sold for broadcast starting in 1995, you hope that your relationship with the buyer of *Working Moms* will continue when future shows become available. You have other shows that you believe the independent stations will be interested in purchasing.

The Meeting

You are currently planning your meeting tomorrow in Chicago with Kim Taylor. In your only previous meeting with Taylor, you found her to be rather slow of speech. It could have just been Taylor's Southern drawl, but you found yourself wanting to finish her sentences for her. On the other hand, her promotion a couple years ago, at a fairly young age, to Programming Manager at WCHI, indicates that she is competent and highly regarded. You are hopeful that the outcome of the negotiation will be the profitable sale of *Working Moms* to WCHI. Hollyville's fiscal year closes at the end of this month, and it would be great for you and your company if you could close a deal on *Working Moms* by then.

Your financial analyst has provided an evaluation of a sample deal for you. You are not limited to the structure suggested by your analyst; rather this calculation is intended to be helpful for organizing the various pieces of a negotiated agreement and to provide a reasonable basis for evaluating any proposed deal.

Example: Net Present Value Calculation

Assume that you have reached an agreement with Kim Taylor on the sale of *Working Moms* with the following terms:

- purchase price: $50,000 per title
- runs/title: 7
- payment terms: 50% of price paid in Year 0

  30% of price paid in Year 1

  20% of price paid in Year 2

The net present value of this agreement is now calculated as follows:

1.	**Program Revenue** ($50,000 × 100 titles)			$5,000,000
2.	**Present Value of Program Revenue**			
	Present Value of Year 0 Payments: (50% of $5M)	=	$2,500,000	
	Present Value of Year 1 Payments: (30% of $5M) / (1.20)	=	$1,250,000	
	Present Value of Year 2 Payments: (20% of $5M) / (1.44)	=	$694,444	
	Present Value of All Payments			$4,444,444
3.	**Expected Runs/Title Adjustment**			$500,000
4.	**Expected Net Present Value** (line 2 *plus* line 3)			**$4,944,444**
5.	**Surplus or Net Present Value less Reservation Price of $4,750,000**			**$194,444**

REPORT FORM

Your Name(s): ____

Kim Taylor Players' Name(s): _____________________________________

Did you reach an agreement? Yes: _______ No: ________

If you reached an agreement, describe the *structure* of the deal on each of the issues. Then approximate the total profit from the deal. Feel free to make (and note) reasonable assumptions that affect the worth of your agreement and provide an approximate value for each issue.

Purchase price (thousand $ per title): $_______

Runs/title (6, 7, 8, 9, or 10): _______

Payment terms: _____% in Year 0

_____% in Year 1

_____% in Year 2 **should add to 100!**

_____% in Year 3

_____% in Year 4

_____% in Year 5

Other conditions ____

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Net profit of the show (in millions $) __________