

CARTOON¹

Role of General Manager of TXI: Japanese Buyer with U.S. Seller

You are the General Manager of TXI, an independent television station in Kanto area (including Toyko metropolitan, Kanagawa pref., Chiba pref., and Saitama pref.). The Kanto market has 20 million television households that are served by four major network television stations (2 government and 3 private stations) and four independent stations, of which you are the largest. Your station is a subsidiary of MULTIMED, INC. a highly successful media corporation. As an independent station, TXI relies mainly on the syndication market for its programming. Syndication refers to the right to replay a TV series a certain number of times over a specified period of years. After a TV series has been produced, shown on the air and developed a viewing audience, audience statistics can be compiled and the series can often be bought or "syndicated" to television stations. Your task as General Manager is to assess TXI's current ratings position in the Kanto area, evaluate the audience potential of its current library, analyze the programming available for syndication, and negotiate the best possible price for the programs that you wish to buy for TXI.

Until recently, TXI followed an aggressive buying strategy. During this time, series were bought not only to air, but also to prevent competitors from purchasing them. The result was the station found itself in financial difficulty. To remedy the situation, MULTIMED cancelled all buying for three years. Although the station is now out of financial trouble, its audience position has eroded because of the lack of new product; consequently, TXI has a relatively low household rating and weak demographics.

To improve this position, MULTIMED has recently permitted you to purchase new programs for the upcoming season. You are particularly interested in buying cartoons for the late afternoon time slot, which is when most children watch TV. You were just notified that Hollyfilm, an American production company that is one of the top producers of cartoons, is releasing the cartoon version of the *Ultra Rangers* series to syndication a year earlier than anticipated. This cartoon would be ideal for TXI's late afternoon programming slot. *Ultra Rangers* achieved a 10 rating and a 20 share in a competitive time slot.² This strong rating is reflective of *Ultra Rangers'* excellent writing and unique characters who appear to be normal high school students until the earth is threatened by fantastical forces of evil, when they transform themselves into *Ultra Rangers* with super-human powers, and the ability to coalesce into a collective force that can perform feats that no single *Ultra Ranger* can.

The cartoon appeals to children and young adults among whom it has a "cult-type" following. The *Ultra Rangers'* theme of transformation appeals to children whose literature in many cultures is filled with stories of transformation, as well as to adults whose science fiction and horror stories are frequently told by characters who are transformed by technology. These broad demographics make the program particularly appealing because of the higher rates that advertisers will pay to reach such a broad market.

¹ This exercise is based on *Working Women* by Ann Tenbrunsel and Max Bazerman

² A rating point is the percentage of all television households that are watching a particular cartoon (# households watching a program / # TV households). A share point is the percentage of all television households with a television **turned on** that are watching a particular program (# households watching a cartoon / # TV households with TV turned on).

These demographics are ideal for the late afternoon time slot that attracts a large audience of children in Japan surfing the cable channels for action, fantasy, and adventure.

An additional plus is that the *Ultra Rangers* characters have been effective in the U.S. with product tie-ins: action figures, books, posters - virtually anything with the figures sold out the first year the program aired on TV. Potential advertisers in the Kanto area, for example fast food outlets, might be interested in giving away *Ultra Rangers*' characters as promotions associated with sponsorship of the program.

To prepare for your meeting with the representative of Hollyfilm, you have researched your competitors' programming profiles and audience positionings. You are reasonably certain that the top two private network stations will not be interested in the program because of their close ties to Japanese production companies and their strong late afternoon line-up of programs. The number three network station, UTL, may be interested in purchasing *Ultra Rangers*. Although it currently has a strong late afternoon line-up of programs for children, the introduction of *Ultra Rangers* by a competitor would erode its market share. In light of this and its strong financial position, you expect that UTL will offer Hollyfilm a good price for the program. You know that the second independent in your market has had an excellent year with a 10% increase in overall market share. Its new profile, although fairly well balanced, is tending toward self-improvement and it is not likely to buy children's programming for the late afternoon time slot. Consequently, *Ultra Rangers* should not appeal to it.

Hollyfilm is one of the major film production companies in the U.S. It is a major supplier to television, but the production business taken alone results in a loss to the company. First-run television series typically incur a 20% loss. It is in the syndication market that this loss can be turned into a sizable profit, something in which Hollyfilm usually excels. However, this market is risky, as only about 15% of originally produced programs actually make it in syndication.

Over the past decade, the increase in programming outlets worldwide has increased the demand for syndicated programs and consequently has put producers in a more favorable bargaining position. Unfortunately, due to an unusually bad year, Hollyfilm has not realized the benefits from this increased negotiating strength. Two shows that Hollyfilm thought would certainly be attractive to the Japanese market never sold. Your job as TXI's General Manager is to get the best price and terms for *Ultra Rangers*. In calculating the worth of the cartoon to TXI, you realize that the value, determined by expected net advertising revenue, is really a function of the cartoon's performance. Although you expect that the program will draw 3-4 rating points, you know realistically that both the ratings and advertising revenue generated from the cartoon are uncertain. Your best estimate of the likelihood of various ratings and their corresponding valuations is as follows:

Ratings	Likelihood	Net Adv. Revenue
2-3	20%	\$7,000,000
3-4	50%	\$8,000,000
4-5	10%	\$9,000,000
5-6	10%	\$10,000,000
6-7	10%	\$11,000,000

Thus, your overall estimate of the net advertising revenue from the cartoon is equal to:

$$(0.20 \times \$7M) + (0.50 \times \$8M) + (0.10 \times \$9M) + (0.10 \times \$10M) + (0.10 \times \$11M) = \$8.4M.$$

This valuation assumes that each episode will be run 6 times. Up to 8 runs/episode, each additional run increases the advertising revenue of the cartoon by \$840,000 (i.e., 7 runs/episode would add \$840,000, 8 runs/episode would add \$1,680,000). An assessment of your current advertising needs reveals that any more than 8 runs/episode would not be beneficial to TXI. However, each decrease in the number of runs/episode results in an \$840,000 decrease in advertising revenue (i.e. 5 runs/episode would decrease the value by \$840,000, 4 runs/episode would decrease the value by \$1,680,000). The total cost of the program is determined by multiplying the agreed upon price/episode by the number of episodes. Hollyfilm will make 100 episodes of *Ultra Rangers* available. These 100 episodes are being offered as part of a 5-year contract; the length of this contract is non-negotiable. You know that management will not let you buy the series if the price exceeds \$60,000 per episode; however, you also realize that the cartoon would never sell for less than \$30,000 per episode. In evaluating the price you would be willing to pay for *Ultra Rangers*, you are aware that you can purchase a different program for the same time slot from another producer. You estimate that this cartoon would produce \$3,000,000 in net profit. Given Hollyfilm's financial position, you have heard that they would prefer 50% up front and 25% in years 1 and 2. You prefer zero payment up front and the payments spread evenly over five years. To assist you in the negotiation, your financial group has quantified the savings of delayed payment:

Money Paid	You Save
up front	0% of money paid in this year
1st year	10% of money paid in this year
2nd year	20% of money paid in this year
3rd year	30% of money paid in this year
4th year	40% of money paid in this year
5th year	50% of money paid in this year

Although you would like the best deal possible, you also know that your relationship with Hollyfilm will continue as new cartoons for future years become available. For example, you know that Hollyfilm is very interested in selling a new cartoon, *Strums*, for the 1997 season. Although the cartoon has done moderately well in its initial airing and the product tie-ins have also been successful, the cartoon appeals to young children (age 3-7) and advertising rates to this market segment are low relative to those for *Ultra Rangers'* broader market appeal. Due to your weak program profile, you may be interested in purchasing the cartoon. Based on 100 episodes of *Strums*, the maximum value that you would place on this cartoon is \$20,000 per episode. Thus, any price below \$20,000 per episode would result in a positive profit.

You are about to meet with the Syndicated Sales Representative from Hollyfilm to discuss *Ultra Rangers*. To assist you during the negotiation, "The Negotiation Agreement Worksheet" (found on page 5) can be used as a guide in calculating the final net worth of any agreement. In addition, an example of a net value calculation is provided on page 4. At a minimum, the agreement should specify the items listed below.

1. Expected Advertising Revenue from the Cartoon

The expected revenue from the cartoon can be determined by using the expected value of \$8.4 million as a base and then adjusting this value for any agreement that differs from 6 runs/episode.

2. Price of the Cartoon

To calculate the price of the cartoon, multiply the agreed on price per episode by 100 episodes.

3. Payment Savings

Any payments made in years 1-5 constitute a savings. For any agreement that specifies payments in these years, calculate the annual savings by multiplying the payment by the percent savings for each year. To determine the total savings from the payment terms, add up all savings from years 1-5.

4. Net Price of the Cartoon

To determine the net price of the cartoon, subtract the payment savings from the price of the cartoon.

5. Other Terms of the Agreement

If applicable, note any other terms of the deal and their corresponding value/cost.

6. Net Profit of the Cartoon

The net profit of *Ultra Rangers* can be determined by subtracting the net price of the cartoon from the net value of the cartoon and adding any other terms of the deal that have been agreed upon.

7. Value of the Alternative Deal

Your alternative to purchasing *Ultra Rangers* is to buy a different program from another producer. As described, the value of this program is \$3,000,000.

8. Net Value of the Bargaining Agreement

To determine the total net value of the bargaining agreement, subtract the value of the alternative deal from the net profit of the cartoon.

EXAMPLE: NET VALUE CALCULATION

Assume that you have reached a tentative agreement for the purchase of *Ultra Rangers* that involves the following terms:

purchase price: \$60,000 per episode
 runs/episode: 7
 financial terms: YR 0 80%
 YR 1 10%
 YR 2 10%

The calculation of the net value of this agreement is described below.

1. Expected Revenue from the Cartoon	\$ 8,400,000
Runs/Episode Adjustment	\$ 840,000
Net Value of the Cartoon	\$ 9,240,000
2. Price of the Cartoon	\$ 6,000,000
3. Payment Savings	\$ 180,000
YR Payment Savings(%) Savings(\$)	
0 0.80 * \$6M = \$4,800,000 0% \$0	
1 0.10 * \$6M = \$600,000 10% \$60,000	
2 0.10 * \$6M = \$600,000 20% \$120,000	
Total	\$180,000
4. Net Price of the Cartoon	\$ 5,820,000
Price of the Cartoon - Payment Savings	
\$6,000,000 - \$180,000 = \$5,820,000	
5. Other Terms of the Agreement	\$ 0
6. Net Profit of the Cartoon	\$ 3,420,000
Net Value - Net Price + Other Terms	
\$9,240,000 - \$5,820,000 + \$0 = \$3,420,000	
7. Value of the Alternative Deal	\$ 3,000,000
8. NET VALUE OF THE BARGAINING AGREEMENT	\$ 420,000
Net profit - Alt. Deal, \$3,420,000 - \$3,000,000 = \$420,000	

NEGOTIATION AGREEMENT WORKSHEET

1. Expected Revenue from the Cartoon	<u>\$ 8,400,000</u>
Runs/Episode Adjustment:	
If 4, subtract \$1,680,000 from value	
If 5, subtract \$840,000 from value	
If 6, make no adjustment	
If 7, add \$840,000 to value	
If 8, add \$1,680,000 to value	<u> </u>
2. Net Value of the Cartoon	<u>(1)-(2)</u>
3. Payment Savings	
Payments in Year 0 * 0.00	<u> </u>
Payments in Year 1 * 0.10	<u> </u>
Payments in Year 2 * 0.20	<u> </u>
Payments in Year 3 * 0.30	<u> </u>
Payments in Year 5 * 0.50	<u> </u>
Total Payment Savings	<u> </u>
4. Net Price of the Cartoon	<u>(2) - (3)</u>
5. Other Terms of the Agreement (specify):	<u> </u>
6. Net Profit of the Cartoon	<u>(1) – (4 + 5)</u>
7. Value of the Alternative Deal	<u>\$ 3M</u>
8. Net Value of the AGREEMENT	<u>(6) – (7)</u>