Special Report

What is the cost of NOT investing in capital projects?

ROI: Betterment *vs.* Bottom Line

IMAGINE that you're an enterprising fellow named Noah, anxiously eyeing the rising waters as you calmly put your case to your community council. The goal: enough capital to get your ark afloat.

"Hmm...what exactly will the return on our investment be?" a councilmember asks.

"Well, our continued existence," you explain. "And those of all the animals. It doesn't really make us any money, exactly."

"Then we can't very well give you the money, can we? Perhaps if you took just one of every animal...."

Absurd, certainly. But some in the newspaper industry say that's just the position a growing number of media companies are finding themselves in today.

To beat back the rising tide of competitive forces, newspapers must invest in online, color and other technological capabilities to keep themselves afloat. This requires wrangling funds from business executives who not only demand to know when the return on investment, or ROI, will come about, but also how many dollars the project will generate or the degree to which it will slash current expenses.

by A.S. Berman

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FOUR Tips for Making Your Case >>

A place to learn how best to tackle ROI and the art of making a case for capital expenditures is the Equipment Acquisition Workshop, at the Dallas Convention Center March 18-22 during Newspapers '05.

Here are four tips from Owen Smith, president and managing director of workshop sponsor NAA-Ifra Technical Solutions LLC in Vienna, Va., that will help you build the strongest case for a capital investment.

1 **HAVE PERFORMANCE MEASURES IN PLACE.** The only way to determine what aspects of your operation need beefing up is to truly understand what the data you have actually are measuring, Smith says. "If my [pre-press] costs go up," for example, "is it that I'm being less efficient, or did I just happen to spend more in vacation pay this month?"

OWEN SMITH, NAA-IFRA TECHNICAL SOLUTIONS PRESIDENT & MANAGING DIRECTOR

SPECIAL REPORT

Occasionally, some companies choose to ignore less attractive ROIs on individual purchases in favor of realizing greater revenue for the paper as a whole later on. Others rationalize investments by using new technology to branch out into ancillary markets.

Most companies, however, are facing challenges entirely unique to the publishing industry: how to wring larger and larger returns from every big-ticket purchase, while struggling to place a dollar value on the hardware and software necessary to compete in today's multimedia marketplace.

THE COST OF NOT INVESTING

Keen to expand its classified-advertising sales online, the Eagle-Tribune Publishing Co. in North Andover, Mass., had hoped to install by year's end a classified-ad solution with Web-order-entry capabilities.

However, the return on investment did not meet the requirements of the company, which publishes several weeklies and dailies, including The Eagle-Tribune (evening, circulation 50,094). Internal policy requires that software must pay for itself in three years, and hardware in nine years, says Vice President of Operations Dennis Turmel.

"Where we're hung up is, are we going to make people more efficient?" Turmel says. "Are we going to sell more ads? That's where it gets a little more challenging."

In an industry competing against ever-evolving technology giants like Monster.com and AutoTrader.com, which continue to siphon a significant portion of newspapers' classified advertising dollars, taking too much time to figure out the answers can be fatal. "You'll never get that business back," says Edward Baer, chief information officer at The Atlanta Journal-Constitution.

"Newspapers are in a much more competitive environment than they used to be," Baer adds. "Ten years ago, they had a dominant position in their markets because the barrier to entry for someone else was extremely high.

"The capital investment history of newspapers has always been about hard ROI"—actual, demonstrable earnings or savings that a given investment is likely to generate—"but not necessarily with a view to competition," Baer says.

To build the technical infrastructure it takes to accept ads online, it is nearly impossible to project concrete savings or revenue. However, such infusions of capital, he says, simply have to be chalked up to "an imperative of competition....There is a cost to *not* doing it."

It's an argument that was made at The Eagle-Tribune, Turmel says. But in the end, "we can't afford it."

Instead, funds will be allocated this year to pave the way for the classified system, which won't be installed until 2006, he says. In the meantime, "like every newspaper these days, we're going to look for what generates revenue."

CREEPING ROIs

Complicating matters further, industry insiders say, is that newspaper companies are demanding greater and greater returns before they'll underwrite capital projects.

Finance departments are saying, " 'Don't submit a request unless your ROI is greater than 15 percent,' " says Mike Ide, director of aftermarket business development at Goss International Americas in Dover, N.H. "I think some of those numbers are climbing as high as 17 when they used to be at 10 and 12.

"Projects that extend the life of the equipment or are required to stay in business are generally forgiven such a high expectation."

A former vice president of production at The Boston Globe, Ide attributes these creeping ROI targets to growing unsteadiness in the industry. "As a result, there's more diligence paid to analysis of the ROI," he says. "And the higher return reflects a need to offset possible higher risks associated with investing too much money at any given time in any given project."

Part of this concern derives from industry consolidation. With several—and sometimes dozens—of newspapers owned by one company, those papers have to compete for a limited number of capital dollars, Ide explains. If Property A has a $1 million project with an ROI of 15 percent, and Property B has a $1 million project with a 12 percent ROI, the money will almost always go to Property A.

Add to that the boardroom pressures publicly traded media companies face.

"There's no question that being a public company keeps us focused on value building and keeps our capital expenditure decisions focused on the best mix of asset spending to achieve the growth," says Marshall Morton, vice chairman and chief financial officer of Media General Inc. in Richmond, Va. But, he adds, "I think most shareholders recognize that investments in certain...projects are necessary to maintain a competitive advantage and that returns come in many forms."

Says Ide, "In times past, especially under private ownership, one would simply have lunch with a publisher and explain the need [for equipment] in general terms. If you had the right relationship, you would get the nod and go forward. Today, there's a whole other layer of due diligence required to justify capital expenditures."

That includes a greater reliance on "return on invested capital," or ROIC, a measure of how well a capital investment achieved the goals laid out in the project's initial ROI report.

"Finance departments today increasingly verify project ROIs with audits to be sure you are achieving what you proposed you were going to achieve," Ide says. "You can't loosely justify reasons to go forward and spend the money and expect immunity if the project does not deliver the savings or revenue. There is a higher level of scrutiny today."

Morris Communications Co. in Augusta, Ga., decides which projects to subject to an ROIC audit based not on the dollar amount of the investment, but on which projects are likely to have the biggest impact on the company, says Steve Strout, vice president and chief information officer.

"For me, [ROIC] also identifies whether or not the process of evaluating the technology or project was valid," he says.

OUT WITH THE OLD

Chuck Blevins, president of Chuck Blevins & Associates in Naples, Fla., says department heads often have an easier time getting purchase approval for relatively state-of-the-art equipment, provided it is to replace equipment that is terribly out of date or has proven itself to be unreliable.

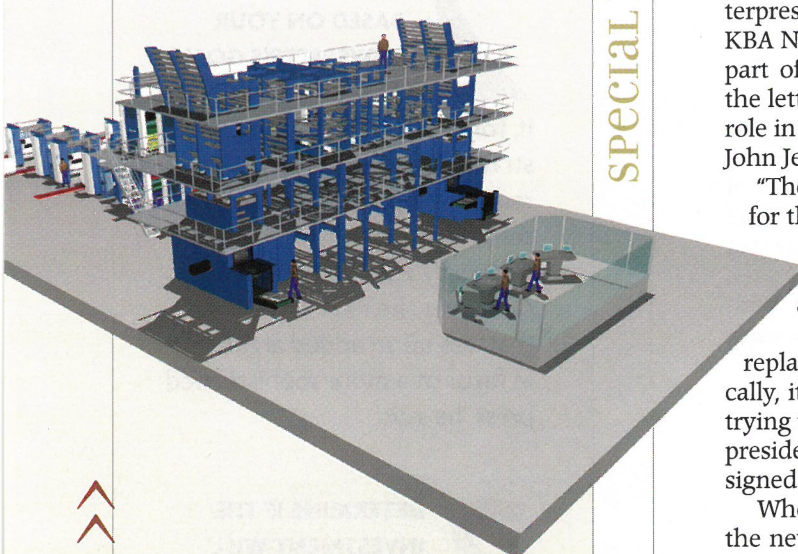
2 APPROACH INVESTMENTS BASED ON YOUR NEWSPAPER'S GOALS AND STRATEGIC PLAN. If, for example, your company's strategic plan calls for you to reduce the annual number of subscriber complaints for late papers by 2 percent per thousand over the next three years, that can be an added argument in favor of a more sophisticated press, he says.

3 DETERMINE IF THE INVESTMENT WILL DIFFERENTIATE YOUR PAPER IN A CROWDED MARKETPLACE. If your paper carries information similar to that published in another paper in your market, Smith says, "there is a dollar value" to investing in technology that differentiates your product from the competition.

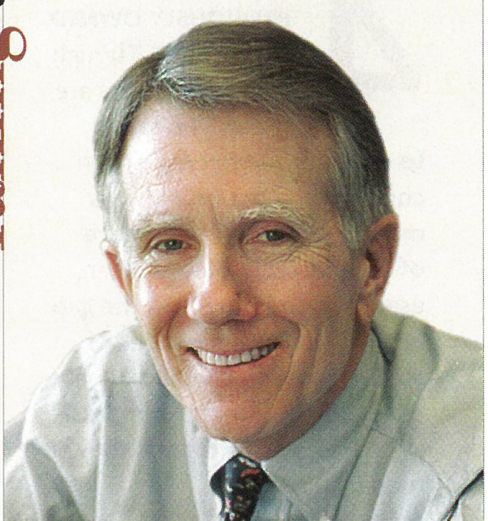
4 DON'T RULE OUT PREVIOUSLY OWNED EQUIPMENT. Though "the best buyers are those who strive to exceed their needs," Smith concludes, there isn't always money available to buy state-of-the-art technology. Often, used equipment can fill the gap nicely. "I can think of tons of small papers that would benefit from a 15- or 20-year-old press vs. the 30-year-old press they're running now."

Special Report

Taking a Longer View >>



When Media General invested $16 million in a new Bristol, Tenn., facility—including a KBA Comet press, above—it paid less attention to short-term ROIs and more to the project's long-term revenue potential, Morton says.



MARSHALL MORTON, MEDIA GENERAL VICE CHAIRMAN AND CFO

In 1999, Fayetteville Publishing Co., parent of The Fayetteville (N.C.) Observer (morning, 66,245), replaced the paper's 1956 letterpress with a new Colora high-speed, shaftless offset press from KBA North America Inc. in York, Pa. Although the installation was part of an overall master plan some eight years in the making, the letterpress' age and potential for breaking down played a large role in the decision to upgrade, says Observer Production Director John Jenkins.

"There's interest in ROI, but there's also the availability of parts for the technology you currently have," he says. Accessibility to the replacement materials and know-how to keep aging equipment running has to be figured into any discussion about ROI, he adds.

If a department head cannot get a request approved to replace equipment that is severely behind the curve technologically, it often is because the department in question is essentially trying to replace a Ford Taurus with a Maserati, says Dario DiMare, president of Dario Designs in Framingham, Mass., which has designed dozens of newspaper facilities over the years.

When the purchase proposal is for the latest version of a press the newspaper already owns, rather than a top-of-the-line model, he says, the ROI often is more favorable. And, he adds, the new version of a paper's current press still will bring greater reliability, quality and a longer lifespan than the one it is to replace. Automatic controls also may allow staffing costs to be trimmed.

NOT-SO-OBVIOUS RETURNS

Newspaper executives usually have no trouble identifying the obvious returns, such as staff reductions and newsprint savings from shorter cutoffs. However, there are other areas where a strong case can be made for upgrades, and to which Dario Designs has assigned dollar values.

QUALITY. Focus groups conducted by Gannett Co. in McLean, Va., indicate that advertisers are more likely to devote more of their ad dollars to newspapers if production is of a high quality. Advertisers "know the paper has a much better market penetration" than most other media, DiMare says. Quality improvements include better registration and truer colors. Increased ad revenue: Add 2 to 5 percent.

INCREASED COLOR USAGE. The more color positions a newspaper can offer, the more ad revenue it stands to make. Increased ad revenue: Add 100 percent to current color ad earnings.

INCREMENTAL SAVINGS. Moving from a press that handles a 40-inch diameter newsprint roll to the 50-inch variety, for example, will reduce the number of rolls handled by about 57 percent. Fewer web breaks also can be expected due to the use of fewer pasters, with 57 percent fewer roll cores to store in a facility's waste area. This also means that if three people normally run the reel room part of the press, only two are now required.

FEWER MAKE-GOODS. A new press can significantly reduce the number of faulty ads and, consequently, the number of make-goods a newspaper must provide. Rather than a specific percentage, the savings involved may best be demonstrated by the following ex-

When it comes to calculating ROIs on equipment such as presses, newspapers tend to "see the obvious [returns] real quick, but there are a hundred things beyond" those, DiMare says. In addition to newsprint savings from shorter cutoffs and potential staff reductions, a new press can boost the bottom line by providing:

Increased Color Capability. This can add 100 percent to current color ad revenue.

Better Quality. This can increase ad revenue by 2 to 5 percent.

DARIO DIMARE, DARIO DESIGNS PRESIDENT

ample. After the Milwaukee Journal Sentinel installed a Commander pressline from KBA North America in 2003, the amount it had to set aside for make-goods dropped from $27,470 in 2003 to about $2,500 during the first six months of 2004, according to DiMare, whose company did the forecasting for the Journal Sentinel.

TAKING A 'LONGER VIEW'

The perception that newspaper decision makers are loathe to pony up the funds for any capital project for which cold, hard ROI numbers are unavailable is not far from the truth, says consultant Blevins. However, some large companies have been convinced to forsake a project's initially favorable ROIs to realize greater potential profits later on.

Some years back, when Media General first approached Dario Designs about expanding the Bristol (Va.) Herald Courier's print facilities and headquarters, it wanted to do so by building an addition onto the existing structure, DiMare says. "We started to show them some of the ROI in different ways. All of the sudden, it wasn't as smart" a solution.

Instead, Media General decided to build a new $16 million facility in Bristol, Tenn., a few miles across the border from the paper's Virginia headquarters. By doing so, the company "invested more in long-term potential and not the short-term ROI, because they looked at the bigger, broader picture," DiMare says. The paper went from a projected half-million dollar revenue gain to $5 million over time, he adds.

The 50,000-square-foot plant, which is expected to open in spring 2006, will feature substantially more color and semi-commercial printing capabilities, thanks in part to a new Comet press from KBA North America. The 75,000-copies-per-hour press will be the first 3-x-2 Comet to be installed in the United States.

"We would not have required a rate of return before agreeing to build that facility," says Media General's Morton. "In order to protect or enhance the franchise, we know it's necessary to modernize a facility. It will give us the ability to do things we can't currently do, so there we would [take] a longer view."

That's not to say Media General isn't looking for some manner of return on its investment, he hastens to add. "Rather than it being a project-specific ROI, we expect revenue growth and profit growth from the division overall."

COMMERCIAL PRINTING

Another way some newspapers have cost-justified major investments in technology is by using the new equipment to dip into previously untapped revenue streams. Nowhere has this been more apparent than the proliferation of newspaper companies offering commercial printing services.

"The pressroom problem that most papers have is that their presses have excess production capacity," leaving them idle for large chunks of the workday, says Owen Smith, president and managing director of NAA-Ifra Technical Solutions in Vienna, Va.

When The Fayetteville Observer installed its KBA Colora press in 1999, it was with the intention of attracting a large number of third-party commercial print jobs. Today, it regularly produces its own biweekly Spanish-language tabloid, TV books for other newspapers, a weekly trader and publications for the military. It also

What About Commercial Printing? >>

special report

In addition to its own paper, The Fayetteville (N.C.) Observer produces TV books, a weekly trader, third-party tabloids and publications for the military. "There's realization of a need to diversify" in the industry, Jenkins says.

JOHN JENKINS, THE FAYETTEVILLE OBSERVER PRODUCTION DIRECTOR

prints its own comics and TV book for less than it would cost to have them done offsite, says Production Director Jenkins.

While declining to name a dollar amount, he says the company's commercial printing revenue has increased over the last few years.

"There's realization of a need to diversify," Jenkins says. "In nearly every project, there is a piece in place or a determined ROI to bring in commercial printing."

Equipment makers, too, understand this and have responded accordingly.

According to Jenkins, almost every new North American newspaper expansion project he has seen in recent years has included presses with built-in commercial capabilities. That includes such features as wide formers on doublewide presses, which allow for the running of multiple widths of paper.

Adds Smith, "Perhaps a newspaper can justify an investment in a press by calculating the incremental revenue gain from using it a few more hours a week." That said, Smith admits that he tends to discount non-core product revenue projections when calculating ROI.

"Commercial printing is so fickle," he says. "It's a very cutthroat business."

MOVING FORWARD

The Atlantic Journal-Constitution's Baer echoes the sentiments of many when he says that sticking to hard ROI cost justifications will eventually have to change because "it's not going to be based on cost savings. It will be based on protecting market share."

And to do that, art must be combined with science.

"What you're trying to do is use the best information available to make a decision," says Jim Berry, vice president of financial planning and analysis at The Dallas Morning News.

For purchases light on hard ROI numbers, a newspaper's finance department should be involved in discussions early in the process, Berry says. To that end, the Morning News has financial analysts assigned to circulation, marketing, production and other departments to work shoulder-to-shoulder with those making capital requests. "We don't want to just be gatekeepers," Berry says. "We want to understand why [a project is] a good idea."

Ultimately, most agree that ROI can't be the sole criterion when it comes to investing in a newspaper's infrastructure.

"Sometimes intuition comes into play," says Morris Communications' Strout. "It's like being a soccer goalie. Sometimes you have to go where you think the ball's *going* to be." ■

sources

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