



## On The Cover/Top Stories

### Broadcast Bullies

Scott Woolley, 09.06.04

**In a fair fight, XM Satellite Radio would capture a good share of the U.S. audience. Unfortunately, competition in the broadcast industry is anything but fair.**

Hovering 22,000 miles above the Earth, two satellites for XM satellite Radio blanket every corner of the continental U.S. with 130 digital channels--everything from heavy metal to the BBC News to children's songs to seven different flavors of country music. XM's chief executive, Hugh Panero, proudly ticks off the new technology's advantages over traditional radio, which dates back 90 years: greater variety, clearer sound, better coverage, lower cost. And no advertising to interrupt the music--none of the blaring and banal spots that fill almost 20 minutes of every hour on radio; freedom from homogenized formats or cookie-cutter playlists.

#### Radio Rules

AXM Satellite radio has many advantages over AM and FM. Unregulated, it would have far more.

**Analog Radio.** AM and FM signals cover limited areas, so 91.1 FM is different in L.A. than D.C.

**Digital today.** XM Satellite's 130 channels blanket the U.S.; towers boost those channels in cities. But only AM's and FM's towers may legally originate local programs, so even XM's local traffic channels are sent nationwide.

**Digital as it might be.** Instead of filling the entire nation's airwaves with channels only one city wants, XM could use a slice of its airwaves to beam short-range signals from its towers, creating a dozen or so new local channels in each city.

Yet XM's geriatric competitors dominate the market in listeners, revenue and profits, nine years after the federal government first cleared satellite radio to compete. In fact, in that same period the old guard--Clear Channel, Viacom's Infinity Broadcasting and other AM/FM giants--has enjoyed a boom. Combined AM and FM revenues this year likely will break the \$20 billion mark for the first time. Ad rates have doubled in nine years amid deregulation and a resulting merger binge. Despite all that has been done by broadcast TV, cable and now the Internet to make it obsolete, terrestrial radio commands an average of 21 hours a week of adult Americans' time. By contrast, XM has only 2 million subscribers, accounting for only one in 300 radios in the U.S. The company is set to take in \$260 million in revenue this year--and still post a loss of \$470 million. Its sole rival, Sirius Satellite Radio, is in worse shape, with just a quarter of XM's subscriber base and even shakier finances. Other promising digital technologies--Internet radio, new cell phones--also offer huge advantages over traditional radio (*see box, p.140*), but they too remain bit players.

Digital revolutions have transformed television, recorded music, medicine and more. But radio remains frozen in time, an analog anachronism in a digital world. It drives Hugh Panero crazy. "It's 2004. In what other environment does a consumer listen to music in an analog format? Name me one," demands Panero, a former Time Warner executive who fought TV broadcasters trying to block new cable systems in the 1980s. "You have incumbents who are afraid," he says. "I've watched the hand-wringing and whining and protectionism that goes on."

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For decades the radio industry has crushed incipient competitors by wielding raw political muscle and arguments that are at once apocalyptic and apocryphal. Radio station owners, who formed the National Association of Broadcasters in 1923, have won laws and regulations that have banned, crippled or massively delayed every major new competitive technology since the first threat emerged in 1934: FM radio.

In 1945 many AM incumbents, ostensibly concerned that interference related to sunspots might endanger their rivals in FM, encouraged the feds to uproot the FM dial and move it to a higher frequency band. This rendered half a million FM radios useless and forced the nation's FM stations to start over. A congressional investigation in 1948 found that the interference fears were bogus and that a Federal Communications Commission report had been conveniently altered to disguise that fact. Too late--the shift helped inferior AM technology remain dominant for the next 25 years. The coda: In 1954 the inventor of FM radio, Edwin Armstrong, frustrated by repeated setbacks and all but bankrupt, penned a suicide note to his wife and leapt out the window of his 13th-floor apartment.

Fifty years later radio's old guard has been as effective at thwarting the digital threat. Existing stations thrive on an array of perks won by radio operators, including free use of the airwaves (XM and Sirius, by contrast, had to pay almost \$200 million combined for their spectrum) and an exclusive exemption from paying royalties to performers. But the NAB's real

forte has been in the modes of attack and delay, persuading regulators and Congress to impose daunting restraints on the satellite rivals and stalling their debut for the better part of a decade.

Meanwhile, earthbound radio is pushing its own digital service, a long-gestating and tepid alternative aimed at neutralizing the satellite threat: "high-definition" radio, first proposed 14 years ago. It does nothing to expand reach or reduce operating costs, but it will add CD-quality sound to the same playlists and station lineups now on the air, for those listeners who buy the new HD radios that debuted in January. A hundred of the nation's 11,000 commercial AM and FM stations now simulcast their programming digitally.

"Over-the-air radio is facing a challenge in the area of technology. HD radio will answer that call," says NAB president Edward Fritts. A former radio station owner himself, Fritts has run the powerful broadcast lobby since 1982. Shouldn't satellite radio be allowed to compete freely for listeners? "I'm not here to protect consumers from the big bad satellite companies," he says innocently. "I'm willing to let consumers make their own choice."

Yet for 15 years his NAB has taken the opposite tack. Digital satellite radio's origins date to 1990, when Satellite CD Radio, forerunner of Sirius and the first of five nascent players, proposed a new 30-channel service and began the poky and convoluted approval process at the FCC. The NAB's initial response was uncharacteristically subdued: It said approving a new service would be "premature."

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But in 1992 the FCC startled broadcasters by setting aside a 50-megahertz swath of radio spectrum for new satellite services--two and a half times the size of the FM and AM bands combined. Four other newcomers applied, including American Mobile Satellite (which would change its name to XM Satellite in 1998 and go public a year later).

The FCC ruling was seen as a dire threat inside the imposing seven-story headquarters of the NAB in downtown Washington. The group already was fretting over new satellite TV service that was bypassing over-the-air stations to reach large backyard dishes in rural areas. DirecTV was plotting a debut, as well. "The NAB viewed satellite TV like it was the Death Star. Clearly they didn't want satellite radio to repeat the same pattern," says a former NAB lobbyist.

In waging a crusade to stop satellite radio, the Fritts forces exhorted the nation's radio station managers to contact their congressmen and tell the "truth about satellite radio."

"They got broadcasters across the country to hammer like hell on the Congress and the FCC," says the ex-NABer. The NAB literature's central talking point was straightforward: "There is no need for 'more' radio service, no need for national radio service and no need for more competition in radio service."

Digital radio promised lower costs, higher quality and more variety. To portray this as a bad thing, the NAB turned the free-market logic of 18th-century economist Adam Smith on its head, stressing the harm satellite radio could do to the listening public.

Satellite's "purported benefits are, in the main, nonexistent, unrealistic or of minimal value," the group assured the FCC in 1995. Left free to compete, the NAB added, satellite radio would offer inferior programming and shove better-quality AM and FM service off the air. Thus competition would leave consumers worse off, the NAB said in an Orwellian conclusion: "Adding a new service would likely decrease the overall service to the public."

"Economists just don't take a lot of those arguments seriously," says Stuart Benjamin, a Duke University professor who studies broadcast regulation. "To be blunt, the NAB has power that is not commensurate with the persuasiveness of its arguments." The power comes in part from connections. Ed Fritts went to the University of Mississippi with former Senate Majority Leader Trent Lott, and they remain close; the NAB's general counsel, deputy counsel and regulatory director who led the antisatellite effort are FCC veterans. Far more power, however, comes from the fact that the NAB represents owners of just about every large and small broadcast outlet in the country--and you can't get elected if you can't get on the air.

"There are no threats," says Senator John McCain (R-Ariz.). "There's no coercion. It's just the people who represent the best way of getting your image and message across to the people in your state." This reality, he says, is why NAB is "one of the most powerful lobbying groups in Washington--and one of the most arrogant."

In 1995 lawmakers slapped down digital newcomers by passing a law backed by the NAB and the Recording Industry Association of America. Traditional radio has never had to pay royalties to performers, on the rationale that the airplay helps those same performers sell records. The Digital Performance Right in Sound Recordings Act of 1995 maintained that exemption but barred almost every form of digital radio from getting the same break. The sole type of digital broadcast that Congress kept royalty free: the NAB's baby, HD radio.

The law helped put some fledgling Internet radio stations out of business. For XM Satellite, it meant having to pay almost \$20 million in royalties in two years--17% of its total revenue during that time.

By the time the FCC approved the entry of XM and Sirius in 1995, victory was illusory. Regulators burdened them with an array of restraints that strengthened old radio's grip on advertisers and viewers. The FCC's license forbade free, advertising-supported satellite stations, instead requiring firms to sign up paying subscribers. It reduced the number of players from four to two and cut the number of channels the satellite industry could carry in half by shrinking its airspace from 50 to 25 megahertz.

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Worst of all the FCC rules made it illegal for the new satellite services to broadcast locally--sports reports on the Lakers in Los Angeles; traffic updates on the Massachusetts Turnpike in Boston. The terrestrial radio operators argued that local programming was the purview of local stations that would be hurt by competition from a national satellite company ignorant of local tastes. Never mind that the radio titans were knitting together nationwide networks to let hundreds of their own stations carry identical programming. The satellite rivals again gave in and assured the FCC they had no local ambitions--a claim that would prove to be dubious.

The FCC restrictions might otherwise have sunk the young industry, but XM and Sirius raised cash in the bubbly late-1990s. Panero joined XM in 1998 and quickly set about raising money to buy satellites and launch the service. In 1999 he borrowed \$250 million and raised \$114 million more in a public offering. XM launched first, going live with 100 channels in September 2001 and charging \$10 a month. Sirius launched its \$13-a-month, 100-channel service ten months later. A dozen years had passed since its first filing with the FCC.

Panero knew joining the fledgling industry would be a big gamble, but the cable veteran had a natural faith in the idea. "People were saying no one would pay for radio," he says. "But I had grown up in cable, and had heard the exact same things about television."

XM and Sirius had to finance programming lineups for 100 channels, pay for their satellites and fund the royalties--all before they had any subscribers to speak of. As the stock market crashed, capital dried up. Just months after its service launched, Sirius warned shareholders that bankruptcy was certain without an injection of cash. Eventually private equity funds agreed to put up \$1.2 billion, but only after forcing bondholders to take a 20% haircut and virtually wiping out the common stockholders, who were left with 8% of the recapitalized company. The cash situation also grew critical at XM, which was forced to lay off 80 of its 480 employees and raise \$210 million, most of it debt convertible into shares at \$3, 75% below the price at its initial public offering. A group of AM and FM radio stations began broadcasting attack ads gleefully warning consumers that if the satellite companies go bankrupt, "there are gonna be a lot of folks out there sitting on some expensive equipment they bought."

Today Panero points to rapidly growing subscriber rolls and vows the cash drain will be staunch by next year, with profits soon to follow. Both XM and Sirius have doubled their subscriber counts in the past year, albeit from very low bases (of 1 million and 250,000, respectively). General Motors, one of XM's early backers, now offers XM in its new cars, which has proven a key distribution channel. Satellite has also picked up notable talent. XM just landed NPR veteran Bob Edwards. Sirius has an exclusive deal for NFL football games. XM's stock has rebounded to \$26 from a low of \$1.75 in 2002 (though it still is 48% below its peak price four years ago). Sirius shares hit a low of 41 cents last March but are back to \$2.

In January Panero riled radio yet again, this time by offering local radio content in an effort to accelerate his growth even further. Despite assuring the FCC in 1995 that it would be a national radio service, XM began offering local traffic and weather channels tailored to 20 different markets. It did so by exploiting a loophole. XM and Sirius systems require a network of ground-based antennas in cities with tall buildings to boost satellite signals that otherwise would have trouble seeping in. At the NAB's behest the FCC forbade XM to use those transmitters to originate and broadcast local content.

It never occurred to the NAB lobbyists that XM engineers would figure out a way to squeeze local traffic and weather channels into supersmall streams and simply send 20 new localized feeds via satellite to the entire country. Panero readily admits that flooding the entire nation with a traffic channel that's of interest only to drivers in a single city is a grossly inefficient use of XM's capacity. The FCC rules leave him no choice, he says. Sirius Satellite has launched a similar service.

Even this little bit of cleverness could get tossed out by the NAB's friends in Washington. The FCC is now considering an NAB petition that could result in a ban on the local programming. In Congress, meanwhile, the NAB is plying another argument for halting XM's local push: The traffic and weather channels put national security at risk. The NAB says that by undermining the viability of local radio stations, listeners could lose access to regular radio's emergency broadcasts in a

disaster. It worked for the NAB's many fans in Congress. In March a bipartisan group, led by Republican Charles Pickering of Mississippi and Democrat Gene Green of Texas, introduced the Local Emergency Radio Service Preservation Act. It would ban all "locally differentiated" satellite programming outright. The bill, with 43 eager cosponsors, is pending before the House Committee on Energy & Commerce.

If you can't compete, get a bill to outlaw the competition. The NAB may yet win this battle.

### **Radio Revolution**

AM and FM radio face a plethora of digital threats.

**DMP2** Pull into your garage and this gadget links up to your wireless home Wi-Fi network. It then downloads the latest additions from your MP3 music collection into your car.

**Super Cell Phones** Two of radio's classic selling points are local traffic reports and sports. New cell phones download just the traffic info you need, conveniently overlaid onto GPS-linked maps. They can also tune in baseball games.

**Prismiq** Sitting on top of your home stereo, new "media adapters" can wirelessly tap your PC's MP3 library--or open entirely new musical horizons by tapping thousands of Internet radio stations.

**Apple Airport Express with Airtunes** Like the Prismiq, Apple's latest gadget is aimed at bringing Internet radio (and MP3 collections) to your home stereo. This gadget takes up less space and makes installation a snap.

**Radioshark** "TiVo for radio." This gadget records AM/FM radio and converts it to an MP3 file. Download Howard Stern onto your iPod and listen at your whim--and you can fast-forward past all those ads.

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