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Investment in Minority-Owned Media: A Social Investor's Perspective

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I. INTRODUCTION

The issue of capital access for minority media firms is a familiar problem. Minority representation is low in many media organizations, and minority representation among management and capital interests is virtually nonexistent. At this moment, there is only one publicly traded minority media organization, Granite Broadcasting, in which a large institutional investor would be able to invest.[1]

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1. Telephone Interview with Steven Lydenberg, Research Director, Kinder, Lydenberg, Domini & Co. (June 1998).

Recognizing that the current level of investment in minority media by pensions and mutual funds is small, this Article examines the situation by discussing, in turn, the nature of institutional investors, the structure of socially responsible investing, and the possible role that the largest media companies might play in a solution.

II. THE INSTITUTIONAL INVESTOR

The primary challenge facing minority executives seeking institutional capital is the nature of institutional investors themselves. Considerable research has been done in recent years on the preferences and behavior of this peculiar species (of which the Author is an example).

A. *Benchmark Driven*

Institutional investors usually measure performance relative to some benchmark. A portfolio return of 20 percent may appear acceptable, but most institutions would be disappointed if the passively managed alternative—an index fund—earned 25 percent during the same period. This introduces subtle but powerful biases into the institution's decision-making process, and these biases create significant obstacles for small firms making capital. As anyone who is measured against a benchmark knows, the first step in beating it is to buy a portfolio that closely resembles it, overweighting those names that offer superior return potential, and underweighting those with poorer prospects. This means that the vast majority of the portfolio will be invested in the largest names in the benchmark. If the capital-seeking firm is not in the benchmark, it may be entirely excluded from consideration.

B. *Loss Aversion*

Institutional investors are loss averse. Numerous studies have shown that, over the long term, investors consistently prefer to avoid losses at the expense of long-term gains.[2] This "myopic loss aversion"[3] may be attributed to the short time horizons over which managers are evaluated. In a typical firm, portfolio managers review performance with their clients at least annually, and often on a quarterly basis. These meetings require that the manager explain why this or that stock has performed poorly, even when the overall portfolio performance has been good. This fact of life

2. *See* Shlomo Benartzi & Richard H. Thaler, *Myopic Loss Aversion and the Equity Premium Puzzle*, 110 Q. J. ECON. 73 (1995).
3. *Id.*

deters managers from exploring stocks that appear to have significant short-term risk, no matter how promising their long-term prospects.

The fact that institutional investors often use a group decision-making process may also contribute to loss aversion. Although group decision making offers clear advantages—notably the ability to involve the best-informed people in the decision-making process—it also leads to more conservative decisions.

William O'Barr and John Conley report that the institutional investors they interviewed focused less than expected on cold, rational analysis of risk and return. Instead, their processes appeared to be designed to diffuse responsibility for decision making and enhance group cohesiveness.[4] They also found that analysts tend to be reluctant to recommend a stock unless they have a high degree of personal confidence in management.[5]

C. *Superficiality*

Even the most sophisticated institutional investors are, according to the late Phil Carret, professionally superficial. This does not result from a lack of competence, but from the constraints under which they operate. Most institutions deal with a very large number of securities; Harris Bretall Sullivan & Smith, a specialist in the large-cap growth style, has a universe of over 250 names. Even in the largest and most prosperous firms, no decision maker has sufficient resources to know every relevant fact of every investable company. Combine this with the mathematical complexities of portfolio management, and it is not hard to see why so few investors have a truly deep understanding of securities in which they invest.

All these factors tend to work against minority media organizations. These firms are usually small and not in any benchmark. Investment opportunities are usually at above-average levels of risk (although rewards are likely commensurate). They may require that managers expend greater than normal effort to understand them. And finally, precisely because of their minority status, these firms' managers are less likely, at least at first, than many others to be regarded as a "safe bet."

One may read the foregoing as a dismal assessment of the prospects for institutional investment in minority media, but these characteristics also imply opportunity. Institutional behavior is nothing if not predictable, and some companies become institutional favorites because they appeal to

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4. William M. O'Barr & John M. Conley, *Managing Relationships: The Culture of Institutional Investing*, FIN. ANALYSTS J., Sept.-Oct. 1992, at 21.

5. *Id.*

institutional preferences. As an analyst, it appears that popular growth stocks have some or all of the following features:

Easy-to-Understand: Peter Lynch has argued that if the story cannot be expressed in a single sentence, it probably is not much of a thesis.[6] The following sentence is a suggestion for minority media organizations: *Minority media organizations will generate superior returns for investors by reaching large, rapidly growing, and previously untapped markets.* The demographic changes in this country ensure that there is, in fact, a simple and powerful story to tell.

Great Track Record: Though all deny it, most investors tend to extrapolate past trends into the future. George Orwell called it a "major mental disease,"[7] but if so, it is virtually universal and probably incurable. This represents a major challenge for minority media organizations, which are, for the most part, unseasoned.

Good Economics: Warren Buffett defines good economics as having a strong competitive position and the ability to generate significant free cash flows relative to investment. Many media organizations are attractive by this standard. Warren Buffett himself has cited radio stations as an example of good economics, particularly in an inflationary environment. By definition, minority media organizations have strength in an important niche market, and this is an important barrier to entry.

Sell-Side Support: Investment banking firms employ large institutional sales forces that maintain contact with institutional investors. These sales forces can raise the visibility of an unknown company and articulate a complex strategy to time-constrained investors. In general, sell-side support is strongest for firms with which the banker does investment banking business. The strongest banking relationships are those in which the company makes many acquisitions. For this reason, a consolidator could play a positive role in attracting capital to minority media.

Socially Responsible Investing (SRI): Finally, there is the emerging field of SRI. One would expect social investors to be an ideal source of capital for minority media. Unfortunately, this does not appear to be the case, for reasons that will be discussed in the next Part.

D. *Socially Responsible Investing*

The field of socially responsible investing has enjoyed a renaissance in the 1990s, despite the loss of focus and assets caused by the end of the

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6. PETER LYNCH & JOHN ROTHCHILD, BEATING THE STREET 27 (1993) ("Never invest in any idea you can't illustrate with a crayon.").

7. GEORGE ORWELL, *Second Thoughts on James Burnham*, *in* THE ORWELL READER 347 (1956).

South Africa boycott. The Social Investment Forum reports that approximately $529 billion are now invested under some type of social screening.[8] Practitioners have been emboldened by strong recent performance: the Domini Social Index (DSI), an index of 400 stocks passing typical social screens, has outperformed the Standard and Poor's 500 since its inception in May 1990, and virtually erased memories of the underperformance of South Africa-free portfolios in the late 1980s.

Socially responsible investing has many definitions. There are as many approaches to SRI as there are value systems, and practitioners include not only political progressives and church groups (the DSI constituency), but also Catholic organizations, labor unions, and the not-for-profit sector. The value systems may be diverse, but the practice of social investment generally follows one of two patterns—portfolio screening or targeted investment. Unfortunately, neither is currently well suited to minority media.

Portfolio screening is by far the most prevalent approach, accounting for well over 90 percent of socially responsible assets in this country. Screening involves identifying companies whose behavior is at odds with the investor's values and excluding them from the portfolio. The process is fundamentally exclusionary, and, in spite of the efforts of industry leaders, little progress has been made in the implementation of "positive screens." One apparently ideal solution has not worked out: Two mutual funds focusing on diversity issues, the Women's Equity Fund and the Meyers Pride Value Fund, have had difficulty raising assets. Portfolio screeners are subject to all the constraints and shortcomings noted in the discussion of institutional investors. As a result, minority media organizations ought not to expect much of them.

The second SRI approach, targeted investing, may hold greater promise for minority media, particularly for small local firms. Also known as "community investing" or "high-impact investing," this method seeks out opportunities where relatively small capital investment can generate substantial social returns. Unlike portfolio screening, there is usually no demand that returns match or beat a specific benchmark.

Targeted investing generally commits small sums, usually via debt instruments, and is often combined with grants. Examples of recipients include affordable housing projects, day care centers, organic farms, and,

8. Social Investment Forum, *1997 Trends Report on Responsible Investing Trends in the United States, November 5, 1997* (visited Mar. 15, 1999) <http://www.socialinvest.org/Areas/Research/trends/1997-Trends.htm>.

most promisingly, small urban business. At least one new venture capital group has been formed with a view toward funding minority businesses.[9]

Minority media could clearly benefit from this growing pool of capital, but there are constraints. Minority ownership alone is unlikely to convince targeted investors to commit funds. The capital seeker must also demonstrate some social benefit. It should be recognized that targeted investors have little experience investing in media companies, which raises their perceived risk level.

	Portfolio Screening	*Targeted Investing*
Motivation	Avoid "Bads"	Positive Change
Usual Structure	Screened Equities	Micro-Loans
Typical Practitioner	Church/Individual	Foundation
Expected Returns	In-Line with Market	Below-Market
Assets Deployed	≈ $530 billion	≈ $4 billion

III. THE ENTERTAINMENT CONGLOMERATES

Although somewhat beyond the formal scope of this discussion, it is worthwhile to consider the possibility of seeking capital from large established media companies. These companies have traditionally been an important source of funding in the media industry and appear to have a good diversity record.

The idea that Time-Warner, Disney, or Viacom might be considered above average in their handling of diversity issues may seem counterintuitive to some. Leading social research organizations do tend to give them high marks, however, not just on diversity, but also on other issues. This is a good illustration of how social research is practiced today, and it illustrates both the strengths and weaknesses of current methods.

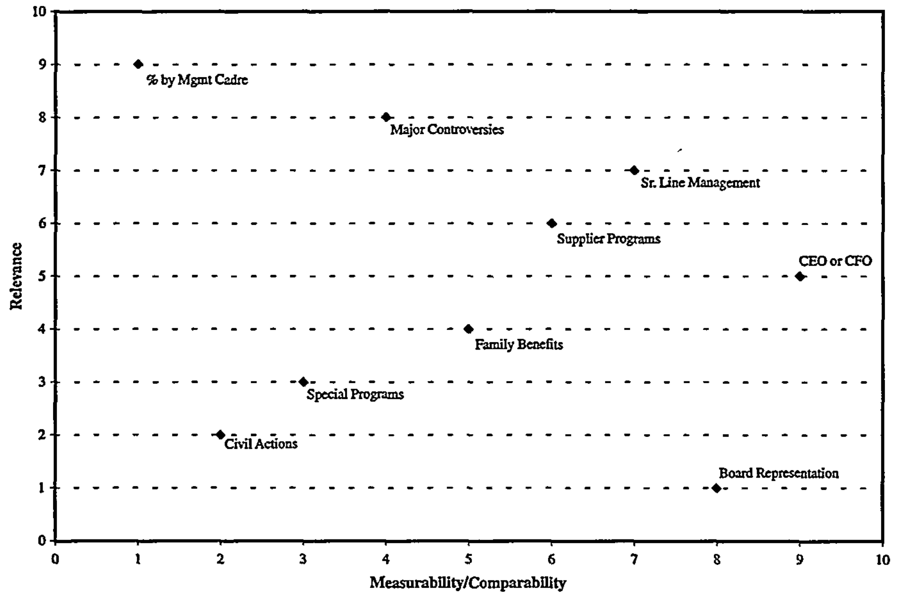
The 1990s saw a dramatic change in the practice of social research. Professional social researchers such as Steven Lydenberg of KLD, John Lickerman of Calvert Group, Ben Courson of Citizens Trust, and Steve Dyott of the Council on Economic Priorities began to perfect techniques that enabled them to analyze much larger groups of companies than had

9. *See* Exhibit 1.

been previously possible. Kinder, Lydenberg, Domini & Co., for example, now writes reports on over 700 U.S. corporations each year.

To do this, the researchers developed lists of bellwether issues on which large groups of companies could be compared.[10] For this type of system to work, the criteria must be both *relevant* and *measurable*. As the following figure illustrates, this can be a difficult combination to find.

Figure 1.



But given the limitations of this type of analysis, the large media companies rate very well compared with most other companies. One must conclude that they are motivated either by a genuine desire to improve the situation of minorities or the desire to give the impression that they are so motivated.

In either case, these firms should be viewed as potential capital sources for minority media. And, given their already considerable importance in the industry, as evidenced by their many joint ventures and affiliations with both content providers and distributors, they ought to also be attractive business partners.

10. *See* Exhibit 2.

IV. CONCLUSION

Although prospects for raising capital among institutional investors may appear bleak, the situation is certainly not hopeless. The most promising channels appear to be minority-oriented venture funds and social investors seeking targeted investments.

Minority media should also seek capital from nontraditional sources. Some socially motivated media organizations have chosen to solicit funds directly. For example, a group of American Catholics is raising funds for a Catholic radio network.[11] Their approach combines traditional funding sources with direct appeals to Catholics throughout the United States.[12]

Throughout this sometimes wearying process, minority media owners should bear in mind one great virtue of participants in American capital markets—the predictability of their behavior. They are motivated by fear and greed, and, as has been seen, their behavior may be viewed as a rational response to the constraints under which they operate.

One positive note for managers of minority media organizations is that this is one part of American society that is so constrained by other factors that racism is unlikely to be a major motivator. In the current environment, an organization that can meet the needs of institutional and social investors, as outlined above, ought to be able to raise capital regardless of the ethnicity of its owners.

Given the attractive economics of the media business, meeting those requirements should not be an insurmountable challenge. As is the case for all organizations seeking capital, strong performance will be the best predictor of success. Although the performance debate continues between advocates and critics of social investing, the ball is currently in the critics' court. At present, there is very little evidence that investing in minority-friendly companies hurts returns. In fact, the latest data, from *Fortune* magazine, suggests the opposite:

> Out of curiosity, we wondered if companies that do good also do well by shareholders. Indeed they do. The average return to investors for the publicly traded companies on our list [of best fifty companies for minorities] walloped the S&P 500 over the past three- and five-year periods: 125.4 percent to 112.2 percent and 200.8 percent to 171.2 percent, respectively. No one can say that companies striving for—and in most cases, investing heavily in—ethnic inclusion at every level are doing so at the expense of profits.[13]

11. John Mallon, *With $60 Million, Father Fessio to Launch Radio Network*, INSIDE THE VATICAN, June-July 1998, at 25.

12. *Id.*

13. Roy S. Johnson, *The 50 Best Companies for Asians, Blacks and Hispanics*, FORTUNE, Aug. 3, 1998, at 94, 96.

Although this should not be taken as proof that minority-friendly or minority-owned companies necessarily outperform the market, it is quite inconsistent with the idea that investors in those companies must bear a financial cost for doing so.

EXHIBIT 1

Black Enterprise Venture Fund[14]

The Black Enterprise/Greenwich Street Corporate Growth Partners, L.P., is the newly formed private equity fund that is backed by Earl G. Graves Ltd., the leading authority on African Americans in the business world, and Travelers Group Inc., one of the nation's leading financial services companies with over $159 billion in assets. The venture fund has been established to provide growth capital to existing companies with well-defined market niches. The targeted companies will also have a successful track record with solid financials.

14. Smith Barney (visited Mar. 15, 1999) <http://www.smithbarney.com>.

EXHIBIT 2

KLD Social Rating Criteria for Diversity Issues as of June 1998[15]

Strengths

- ***CEO.*** The company's chief executive officer is a member of a minority group.
- ***Promotion.*** The company has made notable progress in the promotion of women and minorities, particularly to line positions with profit-and-loss responsibilities in the corporation.
- ***Board of Directors.*** Women, minorities, and/or the disabled hold four seats or more (with no double-counting) on the board of directors, or one-third or more of the board seats if the board is less than twelve.
- ***Family Benefits.*** The company has outstanding employee benefits or other programs addressing work/family concerns, e.g., child care, elder care, or flex-time.
- ***Women/Minority Contracting.*** The company does at least 15 percent of its subcontracting, or otherwise has a demonstrably strong record on purchasing or contracting, with women and/or minority-owned businesses.
- ***Employment of the Disabled.*** The company has implemented innovative hiring programs or other innovative human resource programs for the disabled.
- ***Progressive Gay/Lesbian Policies.*** The company has implemented notably progressive policies toward its gay and lesbian employees.

Concerns

- ***Controversies.*** The company has either paid fines or civil penalties as a result of affirmative action controversies, or has otherwise been involved in major controversies related to affirmative action issues.
- ***Non-Representation.*** The company has no women or minorities on its board of directors or among its senior line managers.

15. KINDER, LYDENBERG, DOMINI & CO., SOCRATES USER'S GUIDE (June 1998).