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Proximity to consumer affects value creation

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Software companies create the most value in the chain from content to end user, while media companies would seem to destroy it most.

Radio destroys the most value, while online social networks generate the most for shareholders. It seems that the channels that bring consumers closer and put them in control are those with the biggest business rewards.

These are some of the findings of IESE Lecturer, Javier Aguirreamalloa, after analyzing the performance of 349 American and European businesses grouped into 41 segments from the Technology, Media and Telecommunications (TMT) sector between 2002 and 2007.

During the period studied, the market experienced an upward trend, as did consumption among families. The period was also marked by the growing presence of the Internet, which has brought down the cost of content-production tools, making them more accessible and orienting demand more toward an individualized offer.

According to the author, the criterion for measuring value creation is the excess yield on the required return for shares resulting from the companies' increased capitalization, the dividends paid and the buyback of shares, less the payments for capital increases and conversion of convertible debt compared with the market capitalization at the start of each period.

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The most and least profitable

Of the 41 sectors analyzed, nine destroyed value during the period analyzed, two paid their shareholders the required cost of capital and 30 created value.

The five sectors that destroyed the most value (and their annual rate of value destruction) were: radio broadcasters (-37 percent), record labels (-15 percent), television stations (-14 percent), press (-12 percent) and television channels (-6 percent).

The five sectors that created the most value for their shareholders (and their annual rate of value creation) were: social networks (+42 percent), businesses providing services to telecommunications companies (+28 percent), online content retailers (+24 percent), multimedia application software (+21 percent) and consumer electronics (+19 percent).

If we order the sectors analyzed according to their proximity to the end consumer - for example, telecoms, user software and online retailers - we see that the greater the distance between the sector and the user, the further removed these companies are, and the more difficulty they have creating value. End consumers benefit from increasingly greater freedom to enjoy entertainment according to their interests, and not those of the manufacturers and packagers of content.

The study shows that the creation or destruction of value during the period analyzed has little correlation with profitability ratios (ROA, ROCE, ROE, ROCE-WACC). At the same time, shareholder return is not isolated from the fundamentals of business. Sales growth accounts for 44 percent of shareholder return, whereas the combination of sales growth, improvement or deterioration of EBITDA margin and increased or decreased leverage account for 49 percent.

According to Aguirreamalloa, the sectors destroying the most value - primarily the media - have seen their share prices plummet far more than their results, in a period still considered as good. In anticipation of further structural changes to the sector, with audiences growing increasingly fragmented, the author predicts that content packagers will have even greater difficulty capitalizing on the time and money that consumers spend on information.

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