

A closer look at how free-riding on originators' news stories in one market can drive the market for advertising revenue down in other geographic markets

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Tuesday, July 7, 2009

I. Free-riding on newspaper sites in one market can depress ad rates in other markets.

It is short-sighted to count a single newspaper's parasitic aggregators and conclude from today's total that there aren't enough free-riders for that newspaper to worry about.

The economic consequences of parasitic free-riding for any single daily metropolitan newspaper do not depend much on the extent to which free-riders pluck the fruits of that particular newspaper's website. They depend far more on the market choices – often defined by geography -- that the advertiser has.

Suppose that Freshfood supermarkets is a large firm with stores in suburban areas in southern California, the Bay area, and Las Vegas. Suppose that Freshfood wants to allocate its ad budget to reach at least two million people each week in its overall market at the most efficient cost. And suppose that Freshfood has success with advertising to the kinds of audiences that read daily newspapers, listen to news and information programming on radio, and watch TV news. In the context of Freshfood's online advertising goal, that means hitting similar online audiences for low cpm rates.

Assume that parasitic aggregators in Nevada do not persistently rewrite the

Las Vegas daily newspaper's local news stories. But also assume that rewriting California newspapers' statewide, local, and national reports is commonplace on sites that Californians visit.

As our original analysis explains, by free-riding on the California newspapers, parasitic aggregators that attract California readers compete with each other and with California newspapers to drive ad prices in California downward -- below rates at which the news originators can compete.

In that way parasitic aggregators depress ad rates in California. That, in turn, pressures the Las Vegas daily newspaper to do something to keep its share of Freshfood's advertising dollars. If Freshfood can advertise on California-based sites to more people for less money than the price-per-exposure that the Las Vegas newspaper offers, the Las Vegas newspaper will have to lower its rates or risk Freshfood shifting more of its ad dollars to the California sites.

That explains how free-riding on stories that originate in New York City and Washington, D.C. and Los Angeles can lead to depressed ad rates for online advertising in many other markets -- even if parasitic free-riding is less prevalent in those other markets.

II. What about purely local advertisers?

In our hypothetical, depressed ad rates on California news-and-information sites will not affect a local Las Vegas car dealer's advertising decisions. Since the

Las Vegas car dealer does not intend to advertise in the Bay area or in southern California, the lower ad rates in California will not attract the dealer's ad dollars to California sites.

But, as a much smaller business than Freshfood, the local car dealer may have far fewer ad dollars to spend. So the car dealer's impact on the economic health of the Las Vegas newspaper site will be less acute than Freshfood's impact.

Yet the car dealer may find that Las Vegas radio and television sites offer – in the aggregate – a cost-effective substitute for advertising on the newspaper's site. If the local broadcast sites attract local visitors in part by offering rewrites of local stories that first appeared as original reporting in the Las Vegas newspaper, the broadcasters will enjoy cost savings that arise from free-riding on the newspaper's journalistic labor.

That will allow the local broadcasters to compete with the local newspaper profitably at lower rates than the newspaper can match. And, in the aggregate, those broadcaster sites may offer a sufficiently large audience of the car dealer's target demographics to help the car dealer reach its advertising goals.

III. The inevitability of depressed ad rates under current law.

One of the most basic elements of economic theory is that, if market entry is inexpensive and profits are available, competitors will enter the market to reap the profits until the opportunity for additional profits is gone.

Especially since parasitic aggregating of originators' reports for profit has not fully matured, more aggregators will enter the field, competing with each other and with the originators of the news stories. Profits will fall for the aggregators and the originators until there is no additional profit available to potential new parasitic aggregators.

At that time, parasitic aggregators, which obtain news content at no cost to them, will receive modest profits, while the news originators, who bear the full cost of news-gathering, will post losses. The originator will have to reduce their news coverage or go out of business.

That will be the legacy of the copyright act. By apparently preempting the common-law of unfair competition and unjust enrichment for the news business, the copyright act will dramatically stunt the news business and threaten its very survival.

But if Congress pulled the copyright act away from common-law unfair competition, parasitic aggregators ultimately would contract with originators to carry the originators' reports during the reports' brief commercial life. Then aggregators would be paying an added cost – probably a fee to the originators.

Although ad rates would still fall as new aggregators entered the market and struck deals with originators of news reports, that would not endanger the originators' long-term survival. That's because the originators would be able to

offset the reduced volume of ad revenue with the fees negotiated from contracting aggregators.

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