Having It All

How Public Radio Stations Can Provide Great Service and Live Within Their Means

A report on the financial health of Public Radio, commissioned by the Corporation for Public Broadcasting

BWB SOLUTIONS

Table of Contents

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Executive Summary

Does public radio face serious financial threats that have been masked by audience growth? If financial problems are identified, are they universal or are they limited to particular organizations or station cohorts? And what steps should stations take to improve their financial health?

To answer these questions, the Corporation for Public Broadcasting (CPB) engaged the consulting firm of BWB Solutions to review the financial health of the public radio system. These were the objectives BWB Solutions had for this project:

1. To understand the current health of public radio overall
2. To understand if that health varies by strategic cohort
3. To identify trends, potential opportunities, and threats that would result in significant changes in the current health
4. To identify benchmarks for evaluating the financial health of public radio stations
5. To recommend actions that stations should take to improve their financial health

The findings in this report were derived from an analysis of the Annual Financial Reports (AFRs) submitted by 314 licensees, which represented 98% of the system listener-sensitive income for the five-year period from 1999 to 2003. In addition, interviews with nearly 30 public radio industry leaders, consultants, heads of national organizations, and station managers helped shape the conclusions and recommendations presented herein.

Findings

We found that public radio stations can achieve superior financial health and provide excellent service to their audience, at the same time. Stations are not forced to choose between one objective or the other. They can have both.

A careful review of loyalty[1] and net revenue numbers, for the period between 1999 and 2003, revealed that approximately 25% of all licensees had both acceptable financial health and above average audience service. And 10% had excellent financial health and outstanding audience service.

While the performance of these stations is laudable, the public radio system as a whole has experienced some troubling financial trends lately. Specifically, although total system revenue between FY1999 and FY2003 increased dramatically, systemwide net revenue actually decreased. The collective bottom line for the public radio system was $4.5 million lower in FY2003 than in FY1999.

More troubling was the finding that 45% of all licensees ran a deficit in 2003, and that the 20 licensees running the largest deficits lost a total of $21.7 million among them. This is clearly unsustainable over the long run.

Why the loss? The most important factor was the growth of programming costs, particularly those expended by stations on their own programming and production. The increase in programming costs accounted for $112 million, or 60%, of the total $184 million in increased operating expense over the period. But fundraising and underwriting, although smaller, grew rapidly as well.

Increases in programming costs generally were associated with *decreases* in net revenues. Increases in fundraising and underwriting costs were associated with *increases* in net revenues. This finding should not be surprising. Most managers we talked to confirmed that they have long known that a dollar expended on programming rarely brings back a dollar in revenue directly, while a dollar expended on underwriting and fundraising brings back much more than a dollar in revenue.

This means that one of the primary drivers of financial loss is increased spending by stations on programs that they produce - a driver that is under their direct control. Stations are going "into the red" in part because of choices that they have made, rather than choices that are forced on them.

Program investments result in audience service but program investments appear to detract from financial health. Is this stark choice inevitable? Must stations choose between investing in great programming to improve audience service, but suffering ill financial health as a result, or doling out program dollars in a miserly way, to achieve superior financial health at the expense of audience service?

We found that stations can achieve both superior audience service and excellent financial health. We call stations that truly combine the best of both worlds "soaring" stations. These stations represent not more than 10% of the public radio system.In contrast, 25% of all licensees have the worst of both worlds — poor financial health and below-average audience service. This is a difficult position and it is unsustainable in the long run. We call these “sinking” stations.

The public radio system must focus attention on how stations might move from sinking to soaring.

How does a public radio station move from sinking to soaring? The management styles of the “soaring” licensees can help us understand how to make this transition. Some of the strategies employed by “soaring” — high audience / high financial health — stations include hiring more experienced and skilled financial managers; focusing on controlling net revenue rather than just increasing gross revenues; being more pro-active and ready to cut costs quickly in response to financial pressures; and having realistic expectations for the cost and revenue models for program production.

Our analysis showed two additional factors that were strongly associated with net revenue.

The first factor was the decision to produce programming that is distributed nationally for a fee. The 22 licensees who produce national programming for a fee experienced more significant financial challenges than licensees who did not. In fact, these 22 stations as a group had a decline of $6.4 million in net revenue from 1999-2003. Our methodology did not allow us to tie the cause of these station losses directly to the cost of these stations' national productions. There is reason outside this study to believe that there is a causal connection, however. A study[2] by Public Radio International (PRI) and Accenture documented the challenges that station program producers face: almost no national program is self-sustaining. Nevertheless, all we can conclude from our study is that stations that produced national programming, as organizations, tended to have lower net revenue than those that did not.

Assume for a minute that the financial challenges experienced by station-based national producers are the result of their national production costs. Can this be addressed if producing stations simply priced their programs more realistically? Unfortunately, the answer is no. Our analysis showed that a substantial number of public radio stations are not generating sufficient revenues to cover their existing expenses. There are not enough surpluses in the non-producing station economy to be able to fill the deficits of the station-based national producers.

While we believe that the cost of national production may be one factor that concentrates system losses in this group of stations, we believe there are others. One that we were able to measure is underwriting. We observed underwriting was a much larger portion of top line revenue for these producing stations. With underwriting dollars harder to raise during the time period we reviewed, these nationally producing stations had poor financial results.

The second additional factor that affected net revenue was the size of the network that the licensee operated. We found clear evidence that increases in the size of the licensee's network produced significant cost savings. This suggests that collaboration, shared services and outsourcing can have a significant effect on station and system net revenue.

Recommendations

On the basis of our financial analysis and the interviews with public radio industry participants, BWB Solutions offers the following recommendations to the public radio system for improving financial performance on both an individual station and industry-wide level:

Improvements in station management:

1. Set ambitious goals for financial health together with audience service; gather and distribute information to ensure managers know where they stand against the goals.

We believe that the public radio system should set ambitious goals for improved financial health just as it did in the late ‘80s when the system decided to double the audience.

Our research in the nonprofit sector suggests that a minimum benchmark for acceptable financial health, in general, is net revenue at 2% of operating revenue.

We realize that there are many complexities of accounting, particularly among joint licensees and university licensees that may require that this benchmark be adjusted to fit specific circumstances.

Setting a goal that a specific percentage of licensees should achieve by a specific date would provide motivation and direction to the public radio system.

A benchmark for excellent financial health is net revenue at or above 5% of operating revenue. Again, setting a target for the percentage of licensees that will achieve this goal would be helpful.

CPB must also help ensure that the information needed to assess this goal is collected, interpreted, and distributed.

Right now, the AFR collects relatively little information on expenses, and there are wide discrepancies in the way that individual stations handle the reporting on those lines.

To really help stations address net revenue, the reporting needs to be expanded and improved, without being overly burdensome.

2. Modify operating model to achieve more robust financial health

A. Provide managers with tools and skills to improve their ability to manage station expenses

- Provide feedback, coaching and support for managers seeking to improve financial health
- Implement strategies for combining high levels of audience service and sound financial management practices.
- Develop better financial reporting and management systems
- Achieve stronger fund balances to weather financial storms

B. Develop new approaches to helping stations produce high-quality local and national programming that is financially sustainable

- Identify and emulate the practices of "soaring" stations.
- Document efficiencies and best practices for station-based national and local programming and associated expenses
- Develop vigorous business planning for station-based national programming
- Explore in more detail the economics for programming produced locally

C. Increase system productivity through collaborations, shared services and outsourcing:

- Develop models for attaining measurable efficiency while protecting the value of localism
- Encourage system-wide organizations to help stations across the system to implement these strategies

Improvements in CPB activities:

1. Support station initiatives through improved data.

A. Improve AFR questionnaire to provide stations and CPB with better benchmarking data

- Capture costs more usefully
- Encourage joint licensees to report radio portion of joint licensees' income and expense in ways that more closely reflect economic reality
- Develop analysis of "total picture" of joint licensees for television and radio together
- Capture university licensees' economic picture more accurately
- Capture national producers' economic picture more thoroughly

2. Evaluate the potential for using net revenue in the CSG criteria to increase system financial health.

A. Focusing on gross revenue alone doesn't align perfectly with strong station health. We should consider other possibilities, including net revenue, to correct this alignment.

Methodology

The primary objective of this financial analysis was to identify and evaluate the critical elements in determining the long-term viability of individual stations, and the industry as a whole. Our goal was to uncover the trends in the financial performance of the public radio system that have emerged over time, and decide whether these trends could help CPB and its constituents better predict the future financial challenges that public radio will face.

To accomplish these objectives, we developed a research methodology centered on three main components. First, we developed appropriate variables for analyzing the financial health and performance of the public radio stations and system. We assumed that a critical factor in the assessment process would be a focus on "Net Revenues" instead of "Gross" or "Total" Revenues. We defined "Net Revenues" as income from everyday operations that provides the fuel to sustain a public radio station. Specifically, a station's "Net Revenues" are equal to its "Total Operating Revenue"[3] (including in-kind, indirect support) ***minus*** "Total Operating Expenses"[4] (excluding capital, income from securities, and gains and losses on endowments).

The second component in the research methodology was identifying sources of financial data for both radio stations and the system as a whole. These sources included existing and recent public radio research, relevant radio-industry cost data, internal CPB documents and reports on station characteristics, audience and markets. Central among these sources was the Annual Financial Report (AFR) that public radio grantees file with CPB each year. We utilized the most complete set of financial data over a recent five-year period, which was 1999 to 2003. Our analysis focused on all licensees receiving a CPB Community Service Grant (CSG) of at least $65,000. For expedience, we combined data from licensees with multiple CSGs into a single licensee. As a result, this financial analysis covered 314 licensees, representing 98% of system listener-sensitive income.

We recognize that the use of AFRs for the primary source of financial data on public radio stations presented several limitations. First, AFR is designed primarily to capture and analyze data on station income alone. It is noteworthy that these reports contain nearly 100 lines of data on income, but only 10 lines on expenses. As a result, expense data is weak and can be inconsistent from station to station. Accordingly, we sought to "triangulate" results to verify that our findings were solid.

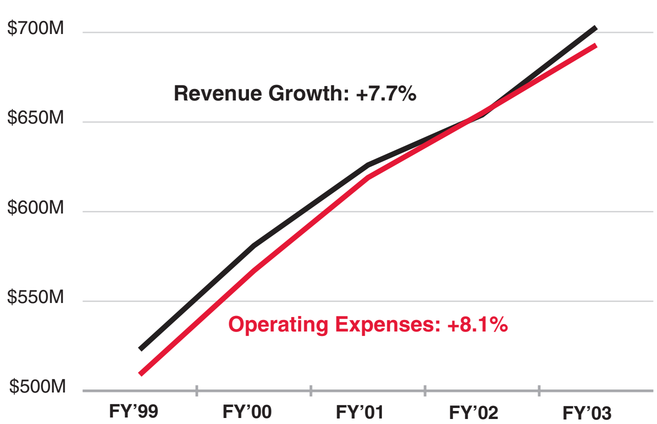
The final component of the research methodology was interviews with "system leaders", including station managers, heads of national organizations, independent researchers, and other analysts who monitor the industry. The goal of the interviews was to uncover explanations for current revenue trends, as well as issues that are not readily evident through the review of industry studies and cost data.

System-Wide Financial Health Trends

The public radio system's financial performance from 1999 to 2003 produced mixed results. During this period, important measures of financial performance were very positive. For the licensees analyzed, Total Operating Revenue grew from $523 million to $703 million, a growth rate of 7.7% per year, while their listener-hours grew from 878 million to 1.08 billion, a growth rate of 6.1% per year. Given this very positive growth, one might expect that the bottom line was doing well also. But this was not the case. Net Revenues declined during this period, falling from a system-wide total of $14 million in 1999 to $9 million at the end of fiscal year 2003.

Why the decline? The simple answer is that even though revenue was growing, expenses were growing faster. Over the period, Operating Expenses grew from $509 million to $694 million, a growth rate of 8.1% per year. In fact, Operating Expenses grew fast enough to exceed Operating Revenue in 2002, bringing the system as a whole "into the red". Operating Revenue growth picked up in 2003, helping to bring the system back "into the black", as indicated in the chart below:

Growth of Operating Revenue & Expenses



Source: CPB AFR Data

Faced with this statistic, some might say, "So what? The system as a whole is down a little over a five year period. That's not a particularly meaningful statistic". The reason that the drop in total Net Revenue is worth paying attention to is that it is an indicator of troubled financial health in individual stations. And that matters a great deal.

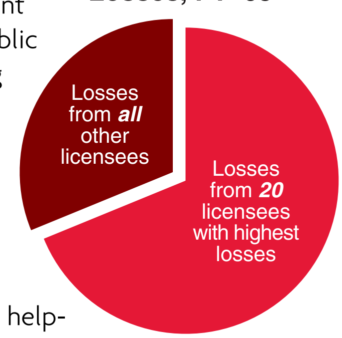
If we look deeper into the pattern of stations who had reported losses, we find that 142 licensees out of 314 were "in the red". In other words, 45% of all licensees are losing money. This is not sustainable in the long run.

Not only are 45% of stations losing money, some stations are losing a lot of money. A comparison of the number of licensees that reported net revenue deficits in 1999 and in 2003 shows an increase in both the number of stations and the scale of the losses. The chart below provides the data:

	FY 1999	FY2003
Number of stations reporting losses	133	142
Average loss	$168,000	$221,000
Number of losses › $1.0 million	4	7

Within the 142 licensees reporting losses, the problem for some licensees was much more significant than for others. We determined that 20 licensees, or just 6% of the total public radio system, accounted for nearly 70% of the loss in net revenues in 2003. This is likely to be unsustainable even in the short run. The chart below illustrates the concentration of losses in FY03:

Concentration of Losses, FY '03



Digging deeper into the causes of loss, it is evident that certain costs for public radio stations are driving this situation. Specifically, programming and fundraising costs, which jointly represent nearly 80% of a station's cost structure, were the major forces in helping expense growth outpace the change in revenues.

Throughout the remainder of this report, we will examine the causes behind the decline in Net Revenues in the public radio system. We will weigh the relative impact of those factors on this trend, and analyze the performance of specific subgroups within the system. Moreover, we will consider the performance of the system within the context of financial benchmarks used by institutional investors. Lastly, we present several recommendations for improving both individual station financial performance, and the reporting and monitoring practices for the entire public radio system.

Analysis of Financial and Audience Data

Financial Health Benchmarks

One of the key tasks of our analysis was to develop benchmarks for the financial health of public radio stations. We drew information to build our benchmarks from a variety of sources, including studies of public radio conducted by Public Radio Capital, Fitch, and Standard and Poors; interviews on station finances with station managers, CPB staff, and industry experts; and studies of nonprofit and government agency health conducted by Bridgespan and Moody's. See Appendix A for a review of these studies.

Based on this information, we developed the following qualitative and quantitative benchmarks for station financial health:

Net Revenue – Positive net revenue, which indicates that stations are generating enough revenue from operating sources to cover their regular operating expenses.

The AFR data provided us with the ability to analyze the financial health of the public radio system. Based on the AFR data, we see that roughly half of the licensees that we reviewed have "Acceptable" financial health, and roughly one-third of the licensees have "Excellent" financial health.

From the perspective of a lender or a rating agency, having "Excellent" financial health over a period of three to five years means that the station would be able to borrow from the banks or institutional investors for its capital needs without requiring additional guarantees or other types of credit enhancement. These stations would be considered "Investment Grade".

Stations with Net Revenue of greater than 5% of Operating Revenue per year are characterized as having "Excellent" financial health. Stations with Net Revenue of 2% to 5% of Operating Revenue per year are characterized as having "Acceptable" financial health.

Loyal and Growing Audience Base –Considerable research and analysis by public radio experts have demonstrated that the loyalty[5] of a station's audience base is the most important predictor of its ability to generate listener support. We have chosen 32%, the system's average loyalty, as the benchmark for adequate audience service. Growth in audience service is clearly desirable, as it is a key measure of mission fulfillment.

Diversification of Corporate Underwriting – The market for corporate underwriting is driven, in part, by the financial health of corporations and their spending on advertising and marketing. The collapse of the dot.com sector and the concomitant drop in underwriting, shows how this dynamic can play out. Financial health is best assured if there is diversification in corporate underwriting, so that a decline in corporate health, in a station's hometown or within any one particular business sector there, will not wipe out large portions of underwriting income for a particular station. Because the amount and type of corporate underwriting is so variable from station to station, we have not set a specific benchmark for the appropriate level of diversification.

Conservative Budgeting Techniques – A careful, organizational approach to budgeting that ideally involves conservative fiscal policies and multi-year modeling utilizes the following techniques –

- **Revenue Forecasting** – Strong management teams have a solid track record of meeting projections in most line items over several years. Over-optimistic revenue forecasting can lead to shortfalls within a fiscal year, which must then be filled, with last-minute fundraising pleas, expenditure cuts, or one shot draws from reserves. All of these measures can undermine future financial flexibility, which can create fiscal problems in subsequent years and pose a significant challenge to long-term financial viability.
- **Expenditure Controls** – Tight expenditure controls are a characteristic of strong management teams because such controls lessen the likelihood of financial distress, within a current fiscal year or beyond. Strong management teams have a keen awareness of the levels of flexibility within each expenditure category.
- **Budget Planning** – Multi-year financial budgets should perform two important functions: instill the use of "what if" scenarios into the planning process, and provide a clear road map for where the management team intends to go over the next several years.

Fund Balance Policies – Adoption of a fiscal plan which includes a fund balance target level and the instances in which reserves may be used. The specific fund balance target should be an amount equal to at least three months of operating expenses or approximately 25% of annual revenues.

Debt Planning – A formalized debt plan that includes target and minimum debt levels, targets for pay-as-you-go funding of capital work, targets for capital campaigns, and incorporation of these debt policies into a multi-year capital plan. The adoption of a debt plan demonstrates that management intends to maintain short and long-term debt obligations at manageable levels, while ensuring that capital needs will be met on an on-going basis.

Succession and Contingency Planning – A formalized succession / contingency plan, which typically include written documentation of organizational structures, succession plans should key personnel change, and specific scenarios to respond to likely changes that might affect credit.

Timely Disclosure – Timely audited financial documents that are attested to by an outside firm, and the direct disclosure of any material events as soon as possible.

Analyzing Factors Affecting Financial Health

What explains the difference in financial health? Why is it that some stations have excellent financial health, while others show very significant losses? To determine the answers to these questions, we pursued a two-stage process of analysis. We first sought to identify the factors that distinguished stations whose financial health was acceptable or better from those whose financial health was poor. Once we understood which factors were associated with better or worse financial health, we then looked in detail at those specific factors, to see if we could understand the dynamics that led those factors to be predictive of better or worse financial health.

This section of the report describes the first stage in the process: identifying the factors associated with better or worse financial health. We examined a wide range of potential factors in our attempt to understand what predicted better and worse financial health. We worked in close consultation with the CPB project team to identify the factors and to develop appropriate measures for them. The following is the final list of factors that we examined:

- Operating expenses
- Programming expenses
- Development expenses
- Licensee type
- Format
- Rural status
- Minority status
- Coverage area population
- Average Quarter Hour Audience ("AQH")

In order to gain a deeper understanding of the factors affecting the financial health of the entire public radio system and of specific subgroups ("cohorts") within it, we used a statistical technique called "Regression Analysis". Regression analysis helps determine the degree of correlation of the variable the researcher is seeking to understand (the dependent variable) with one or more additional explanatory variables (the independent variables). For the purposes of this study, we used regression analysis to determine whether there was a strong or weak statistical relationship between aspects of the financial performance (particularly changes in net revenue over time) and several specific factors.[6]

The regression analysis showed the following results:

Factors strongly associated with affecting the direction of Net Revenue:

The following factors were strongly associated with changes in Net Revenue from 1999-2003:

- Increase in Programming Expenses.[7]An increase in programming expense was strongly associated with a decrease in Net Revenue. In other words, most stations that increased their spending on programming did not experience a sufficient increase in revenue to cover the additional costs during the period examined.
- Increase in Development Expenses. An increase in development expenses (underwriting and membership) was strongly associated with an increase in Net Revenue. For most stations, this correlation means that an increase in their spending on underwriting and membership produced additional revenues significantly above the higher fundraising costs incurred during this period.

Our interpretation of these factors is that spending more money on programming does not produce an increase in listener-sensitive income commensurate to the additional programming costs, for most stations. This finding was not particularly surprising to most of the station managers we interviewed.

Similarly, the finding that spending more money on development was associated, across the system, with increases in net revenue was also not a surprise. As the Station Resource Group ("SRG") analysis[8] of CPB data shows, the return on investments in development expense is still quite positive.

Factors weakly associated with changes in Net Revenue:

- Licensee Type. Being a community licensee (as opposed to a university licensee) was somewhat associated with lower Net Revenue. Being a joint licensee (as opposed to a radio-only licensee) also was somewhat associated with a lower Net Revenue.
- Format. Having a music mix format (as opposed to any of the other formats) was somewhat associated with a lower Net Revenue.

It is worth noting that with regard to licensee type, our interviews suggest that there are complex accounting issues and institutional concerns that affect both the university licensees and the joint licensees. These accounting and institutional issues distort the Net Revenues in ways that are not reflective of the organization's true financial health. We were not able to investigate these issues within the scope of this study, but it is worth further analysis.

Factors not at all associated with changes in Net Revenue:

- Rural status (as defined by CPB)
- Minority status (as defined by CPB)
- Coverage area population
- Size of Average Quarter Hour audience

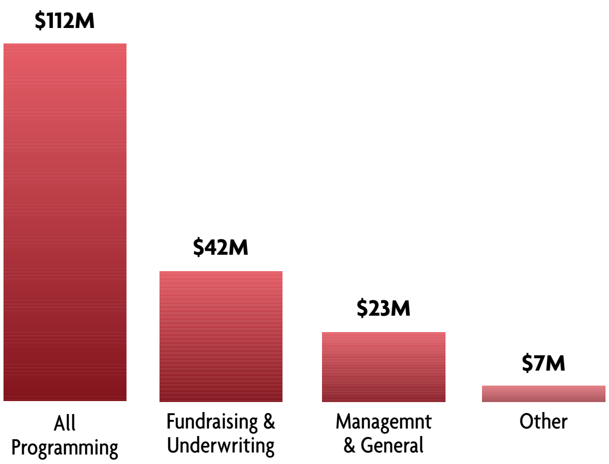
This last set of findings was somewhat surprising. The research team expected that there would be some relationship between these various factors and Net Revenue. But regression analysis indicated otherwise. There were rural stations that had excellent health, and those that did not. Similarly with the other three factors, the regression analysis indicated that whether a station was high or low on the factor did not have any statistical correlation with whether it had a high or low Net Revenue.

As noted above, our analysis showed that increases in programming expenses and development expenses have a significant relationship with changes in Net Revenue across the public radio system. In order to better understand the dynamics driving these changes, our second stage of regression analysis involved an in-depth look at programming expenses. Moreover, later in this report, we also present the findings from what we learned about the factors causing the half of the change that the regression could not explain. We chose not to examine development expenses closely because this has been the subject of extensive work by SRG, DEI, and others.

Programming Expenses

As our analysis above showed, Operating Expenses are rising faster than Operating Revenue – 8.0% compared to 7.7%, respectively. This is a key driver helping to push licensees "into the red". Within Operating Expenses, by far the largest growth between 1999 and 2003 occurred in total programming expenses.[9] The following chart shows the increases in all cost categories over the period:

Increases in Operating Expense Components 1999-2003



Source: CPB AFR data

AFR data shows that programming expenses grew by $112 million or an average of 8.1% annually, over the five-year period. Typically, programming expenses are the single largest cost for a public radio station, accounting for approximately 60% of the total operating budget.

The AFR breaks down total programming expenses into three major categories:[10]

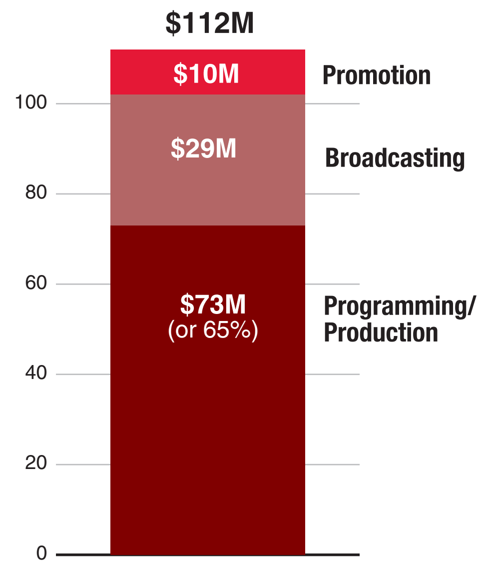
Programming/Production - the production and/or acquisition of programming, and the conducting of program operations. This category includes such functions as program development, program planning, equipment operation, and editing, as well as the salaries and benefits for personnel engaged in activities. It also includes national programming fees, such as those paid to NPR or PRI.

Broadcasting - all the costs of broadcasting and interconnection, as well as scheduling and engineering.

Promotion - the costs of informing the listening public of specific program services.

As the chart below shows, between 1999 and 2003, most of the increase in overall programming expenses was related to Programming/Production expenditures:

Components of Total Programming Expense Growth, FY99 – FY03

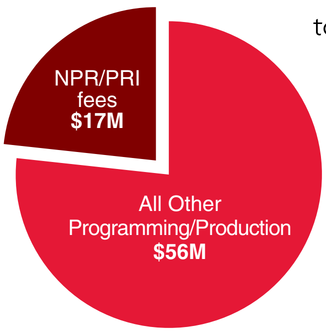


Source: CPB AFR data

Public radio stations have two options for their programming and production activities: acquire a program or to produce it themselves. Since the two largest program providers are National Public Radio (NPR) and Public Radio International (PRI), we wanted to determine how much of the increase in programming/production expenses were due to increases in the fees of NPR and PRI. To answer this question, we compared the growth in total program fees that NPR and PRI collected in 1999 and in 2003[11], with the growth in programming/ production expenses during the same period. We determined that the increases in the fees that stations paid to NPR and PRI was 23% of the increase in the total costs of programming/production. This means the remaining 77% of the increases in those costs came from increases in the cost of local production and programming.

Not only has the growth in NPR and PRI fees been a relatively small percentage of the total growth, it is also the case that NPR and PRI fees are growing less rapidly than station programming/production costs. From 1999-2003, NPR and PRI fees together grew at an annual rate of 7.6%, while other station programming/production costs grew at a rate of 8.1%.

Increases in Programming/Production Costs, by Source



This means that the primary growth over the past five year in programming / production costs have been costs that are directly controlled by the licensee itself. And programming/production cost increases are by far the largest increases in Operating Expenses, which in turn are the primary driver of losses. In other words, licensees with poor financial health have control over the choices that contribute to their condition, and the choices they made have driven them into the red.

But what if the licensees are facing a stark choice? Is it possible that you have to spend heavily on programming and production in order to produce great programs, and thereby achieve great audience service? Are great audience service and excellent financial health irreconcilable? Or is it possible that stations can invest in programming today in ways that lead to financial health in the future?

Financial Health Strategies

The first question to be addressed is whether it is possible to combine good audience service with sound financial health. Is there a conflict between serving your audience well, and achieving adequate (or even excellent) levels of net margin? To answer this question, we analyzed the relationship between audience service and financial health. We started this analysis by establishing a set of benchmarks to measure financial health and service to the public. We used Loyalty, as defined by Audience Research Analysis, to measure audience service. As of 2002, the system loyalty was 32%, so we used that as our benchmark for audience service. Our research into licensee financial health strongly suggested that 2% Net Revenue was the minimum level for long term stability, so we used that as our benchmark for financial health. This led to the following four categories:

Below Average Audience Service =
Less than 32% Station Loyalty
Above Average Audience Service =
32% Station Loyalty and above
Poor Financial Health =
Less than 2% Average Net Revenue
Acceptable Financial Health =
2% Average Net Revenue and above

We then used these benchmarks to divide the entire set of licensees into four cohorts. As the table below shows, we found that there were, in fact, a large number of licensees who have been able to achieve both "Acceptable Financial Health" and "Above Average Audience Service".

Above Average Audience Service	Serving 30	Soaring 23%
Below Average Audience Service	Sinking 27	Saving 21
	Poor Financial Health	Acceptable Financial Health

In the upper left hand quadrant, we see "Serving" - those stations that have been able to achieve above average audience service, but have poor financial health. Nearly one in three stations falls into this category. Directly below them, we see "Sinking" - those stations who have both poor financial health and below average audience service. This is clearly an unsustainable position, and it is a matter of significant concern that roughly a quarter of all licensees find themselves in this untenable position. In the bottom right hand quadrant, we see "Saving" - those stations that have achieved acceptable financial health, but have below average audience service. Finally, in the upper right hand quadrant, we see "Soaring". These are the stations who have both achieved above average audience service and acceptable financial health.

As the table shows, roughly a quarter of all licensees are "Soaring". They have been able to make investments in their programming and to manage their finances so as to achieve both above-average audience service, and acceptable financial health. This is clear evidence that stations do not have to choose between serving their audiences and achieving financial health. They can, in fact, have both.

With this analysis in hand, we then looked at an even tougher set of benchmarks. We wanted to see if it was possible to achieve excellence in both audience service and financial health. Maybe there is a choice. Perhaps stations cannot both have excellent financial health and excellent audience service.

We set the benchmarks for this analysis quite high. For audience service, we set the benchmark at a level of 35. Less than 40% of licensees achieve this level of audience service. For financial health, we set the benchmark at 5% Net Revenue. Our research into nonprofit and station financial health suggests that this offers excellent long-term stability and the ability to fund steady growth in programming. The table below shows the results of using this tougher set of benchmarks.

Excellent Audience Service	Serving 20	Soaring 10%
Less Than Excellent Audience Service	Sinking 46	Saving 21
	Less Than Excellent Financial Health	Excellent Audience Service

In the upper left hand quadrant, we again see "Serving". This time, it is stations who have achieved Superior Audience Service, but whose financial health is less than excellent. Directly below them, we see "Sinking" - those stations that have less than excellent financial health and less than excellent audience service. In the bottom right hand quadrant, we see "Saving" - those stations that have achieved excellent financial health, but have less than excellent audience service. Finally, in the upper right hand quadrant, we see “Soaring”. These are the stations who have both achieved above excellent audience service and excellent financial health. As the table shows, roughly a tenth of all licensees are “Soaring”. This is very good news for public radio. It is clear that stations can both have audience service that is well above average, as well as achieve a level of net revenue that enables both stability and long-term growth. Who says you cannot have it all?

But what is it that separates Sinking from Soaring? Why do some stations combine financial health with audience service, while others are unable to do so? To address these questions, we interviewed a sample of senior managers from more than 20 stations. We drew this sample from “Soaring” and “Sinking” stations, as defined by the first set of benchmarks. We also interviewed several senior managers from Soaring stations, as defined in the second set of benchmarks. We sought to clarify and understand what practices, activities and circumstances enabled stations to both “do well and do good”.

From these interviews, we found the following key points:

1) Experience and skilled financial management. Soaring stations tend to have more experienced and skilled financial managers than their Sinking station counterparts. Specifically, the best stations are the ones with strong Chief Financial Officers, who think about how to leverage resources to match strategies. These managers make effective use of business modeling or scenario planning in their financial decision-making.
2) Great focus on controlling Net Revenue. With stronger financial management in place, Soaring stations tend to have greater focus on controlling Net Revenue, rather than increasing revenues. As described above, the financial management of these stations tends to be more sophisticated than the Sinking stations. Some of the characteristics of Soaring stations include thinking strategically about cash flow management, and greater board oversight of the budgeting process.
3) More pro-active in responding to changes in Operating Revenue. Also, Soaring stations tend to be more pro-active than others, and tend to be ready to cut costs quickly in response to financial pressures. Conversely, Sinking stations are not adept at setting achievable budgets. These stations don’t closely examine the factors affecting their Net Revenues, and often rely upon a parent organization to cover the deficits.
4) Plan for ongoing subsidy requirement. Moreover, the Soaring stations usually have a clearer understanding that the programming they create will not break even; consequently, the stations plan for ongoing support. These stations are adept at calculating the ratio of their programming costs to financial return, as measured in audience growth, and in increases in membership and underwriting revenues. In making this calculation, the Soaring stations will often set benchmarks for the timeframe in which new productions should yield a specific return on investment.
5) No noticeable difference in programming strategies. Interestingly, there seems to be no noticeable difference in the programming strategies pursued by Soaring or Sinking stations. Both types of stations run a combination of local and national productions, and are experiencing sharp increases in programming expenses. As stated earlier, the Soaring ones tend to be more agile than the Sinking ones, in planning and managing programming strategies.
6) No difference in licensee type. The unique strengths and weaknesses that each licensee type possesses have no impact on whether a station is a high performer or not.

Impact of Producing Programs Distributed Nationally

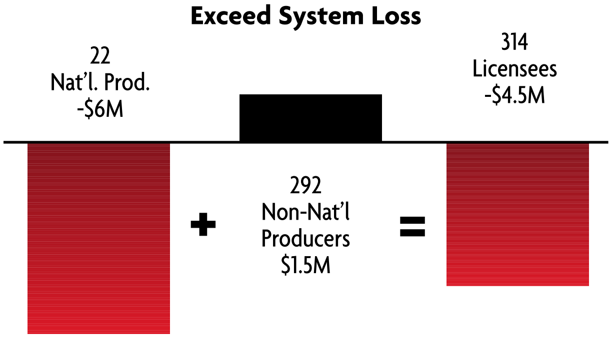
Examining the difference in strategies between Soaring and Sinking gave us some insights into what was driving financial performance. We also investigated why such a large proportion of the total loss was concentrated in a relatively small number of stations. This led us to examine the impact of producing programs that are distributed nationally.

Other studies have examined the financial challenges faced by stations that produce shows aired nationally. A recent study conducted by PRI and Accenture[12] looked in depth at this issue, and concluded that no programs outside of key drive-time slots have been able to achieve 100% sustainable revenue. For most nationally distributed programs, the study stated that the average sustainable revenue[13] after five years amounted to no more than 75% of total production expenses.

To understand this issue better, we looked at the financial performance of the 22 licensees in the public radio system that produce programs that are distributed nationally for a fee by NPR or PRI (see Appendix A for list). Because the AFR data does not permit us to break out the impact of a single program on a licensee's financial health, we focused our analysis on the financial performance of the entire licensee, not just the programming produced for national distribution.

When we looked at the financial health of these stations, which we will term "station national producers", we found several disturbing conclusions. The first is that total losses of the station national producers from 1999 and 2003, as a group, exceeded the losses for the system as a whole.

Station National Producers' Losses Exceed System Loss



Source: CPB AFR data

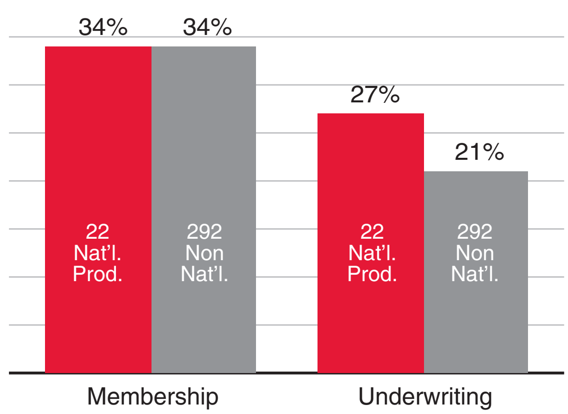
It is worth noting that this is not a problem that can be solved just by re-allocating existing surplus in the system. This analysis shows that there are not enough surpluses at the non-producing stations, taken as a group, to cover the deficits at the producing stations. This is a core system problem: The revenues of the system are not sufficient to fully cover the deficits incurred by the national producers. It is important to note that this lack of sufficient revenues does not pertain to the coverage of the deficit in the final year, but the changes in net revenues over the five years.

An additional fact that causes concern is that the majority of the decline from 1999 to 2003 is concentrated in one quarter of the national producers, even though more than half the producers showed declines.

The last key learning from our analysis of Station National Producers is the fact that these stations raise more of their operating revenue through underwriting (on a percentage basis), than through other sources. This fact is revealed in the chart below, which shows underwriting trends during FY'03:

Station National Producers Rely More on Underwriting

Percent of Total Operating Revenue



Source: CPB AFR data

We know that the underwriting market suffered a significant drop during 2000 - 2002. This suggests that the greater reliance on revenue from underwriting may be contributing to their financial difficulties.

While we have focused our analysis here on stations that produce programming for national distribution, we are not clear whether it is in fact the production of these programs alone that is causing the financial difficulties.[14] It is possible that the fact that these stations produce programming for national distribution may be a marker for an underlying driver - such as propensity to take risks, or to invest heavily in programming - that is leading the station both to produce programming for national distribution, and to also have losses in the period. In either case, it is particularly important for these stations to aggressively create and maintain high fund balances, in order to have the flexibility to take more risks with national programming.

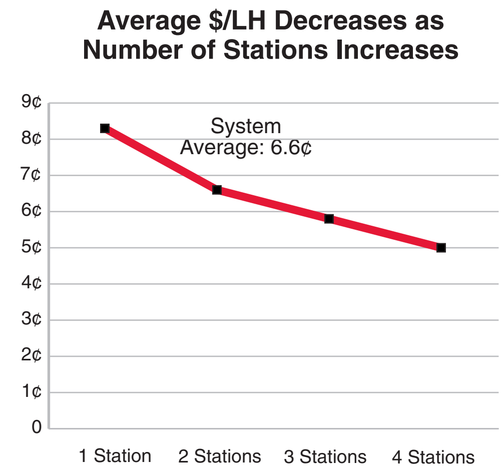
Economies of Scale

Both our analysis and interviews suggested that licensees with more stations in their network obtained some cost savings in their operations as compared to licensees with fewer stations. Initially, our analysis of net revenue did not bear this out. Licensees with many stations often had significant losses. But losses can be due just as much to too little revenue as to too much expense. In order to separate out the issue of the balance between revenue and expense from the issue of cost efficiency, we decided to focus in on a single cost measure, and see whether that changed based on the number of stations in the licensee's network.

We chose cost per listener hour as the basic metric to be used in analyzing operating efficiency. "Listener hours" are defined as a program's average quarter hours times its weekly hours on the air.[15] We defined the "cost per listener hour" to be the total operating expense in a year, less the expense of sending out the broadcast signal (AFR line E2), divided by the number of listening hours in that year. We omitted the broadcast signal cost because we felt that there was likely to be just a small economy of scale in broadcasting cost as the number of stations in a licensee's network was increased.

We found that the cost per listener hour varied widely across the system. The average cost per listener hour in 2003 was 6.6¢. The highest cost per listener hour was 59¢. The lowest was 1¢. Most importantly, regression analysis showed that there was a very clear relationship between the cost per listener hour and the number of stations in a licensee's network. The regression analysis showed that each doubling in the number of stations in one licensee's system was associated with a decline in the cost per listener hour of 1.7¢. This is a 25% reduction of the average cost per listener hour.

The chart below provides an illustration of how the cost per listener hour declines across the system as the number of stations managed by a licensee increases.



Source: CPB AFR data. Arbitron

The fact that the same reduction in cost is associated with a doubling in the number of stations may be confusing at first glance. How can it be that an increase from one station to two stations gives the same cost reduction as an increase from four to eight? The answer is that cost efficiencies come from spreading costs out across multiple stations. When you spread costs from one station to two stations, you're spreading the same cost over 100% more stations. This gives a certain reduction in the cost level. Yet, distributing the costs from two to three stations does not spread the cost over 100% more stations, just 50% more stations. As a result, the cost reduction is lower. To achieve a similar cost reduction, the costs per listener hour have to be spread over 100% more stations again.

The analysis here shows the importance of collaboration and shared services across the system. Increasing the number of stations in a network is one way, but just one way, of collaborating and sharing services. Sharing the cost of engineering or programming staff, outsourcing of underwriting staff, and sharing of fundraising costs are all ways that licensees have successfully lowered costs through consolidation and collaboration. Given the intense need to lower operating expenses, collaboration, cooperation, and shared services are critically important approaches to consider.

Recommendations for Action

Over its thirty-year history, the public radio system has achieved an outstanding record of success. Among the system's strengths has been the creation of outstanding programs that make a real difference in the quality of our listeners' lives, and that are generating continuing increases in audience and financial support. In order to sustain such success, the public radio system must overcome several industry-wide weaknesses, particularly the historically thin operating margins at many stations. To begin the process of addressing the financial management challenges faced by both individual radio stations and the entire public radio system, we offer the following recommendations:

Recommendations for improvements in station management

1. Set ambitious goals for financial health together with audience service; gather and distribute information to ensure managers know where they stand against the goals.

We believe that the public radio system should set ambitious goals for improved financial health just as it did in setting standards for audience service in 1998. Our research in the nonprofit sector suggests that a minimum benchmark for acceptable financial health, in general, is net revenue at 2% of operating revenue. This benchmark is consistent with the financial performance of comparable segments in the nonprofit sector. Moreover, we realize that there are many complexities of accounting, particularly among joint licensees and university licensees that may require that this benchmark be adjusted to fit specific circumstances. But setting a goal that a specific percentage of licensees[16] should achieve by a specific date would provide motivation and direction to the public radio system. Similarly, a benchmark for excellent financial health is net revenue at or above 5% of operating revenue. Again, setting a target for the percentage of licensees that will achieve this goal would be helpful.

CPB must also help ensure that the information needed to assess this goal is collected, interpreted, and distributed. Right now, the AFR collects relatively little information on expenses, and there are wide discrepancies in the way that individual stations handle the reporting on those lines. To really help stations address net revenue, the reporting needs to be expanded and improved.

2. Modify operating model to achieve more robust financial health

A. Provide managers with tools and skills to improve their ability to manage station expenses

Our analysis of public radio's financial performance revealed a clear distinction between high performing and low performing stations. This distinction is the quality of managerial leadership found in the stations we dubbed "Soaring". An essential step in building stronger stations would come in the form of providing feedback, coaching and support for managers seeking to improve financial health. Additionally, the high performing stations demonstrate that the pursuit of high levels of audience service and sound financial management practices is a deliberate choice; therefore, stations seeking to change their operating model should implement strategies for combining those two objectives. One component of sound financial management practices is strategy that achieves stronger fund balances, to help stations weather unexpected financial downturns. Lastly, to support a keener strategic focus, stations should also develop better financial reporting and management systems.

B. Develop new approaches to helping station-based local and national programming production to achieve both excellence and financial break-even

The financial assessment of the public radio system revealed that high performing stations make a deliberate choice to have both excellent audience service and sustainable operating margins. Stations must begin to push this strategic focus throughout their organizations. This means examining how a station delivers its programming to its audience. Improvements in this function can begin by documenting efficiencies and best practices for station-based national and local programming and associated expenses. This type of internal assessment should give way to the development of vigorous business planning and the exploration in more detail of the economics for station-based local or national programming.

C. Increase system productivity through collaborations, shared services and outsourcing

The strength and distinguishing characteristic of public radio system is its "localism". This characteristic, which is reflected in local ownership, local decision-making, local accountability, and locally derived approaches to meeting local community need, is a unique approach in today's media environment, and distinguishes public radio from almost all other forms of mass media. Preserving and enhancing this quality is challenging, especially for radio stations that struggle with financial performance, as well. Our study demonstrated that economies of scale play a significant role in the financial health of high performing stations. For small stations that are looking for strategies that will help enhance their financial condition, greater economies of scale can be achieved through collaboration, shared services or outsourcing. Consequently, developing models and broadly implementing strategies for attaining measurable efficiency, while protecting the value of localism, would be an effective means for increasing productivity in the public radio system.

Recommendations for improvements in CPB activities

Beyond changes at the level of individual stations, we would like to offer two recommendations for improving the public radio system through CPB's activities.

1. Support station initiatives through improved data

Improving the AFR questionnaire to provide stations and CPB with better benchmarking data, is one strategy that will help improve the financial performance of the public radio system. These questionnaires should be redesigned to capture costs more usefully. In addition, CPB should encourage joint licensees to report the income and expenses from the radio portion of their operations in ways that more closely reflect economic reality. Moreover, CPB should develop an analytical framework for the "total picture" of joint licensees, which examines television and radio operations together. Capturing a more accurate and thorough economic picture of radio operations should extend to university licensees and to station-based producers of national programming.

2. Evaluate the potential for using net revenue in the CSG criteria to increase system financial health.

At present, CSG criteria focus on gross revenue. To bring the criteria into better alignment with station health, CPB should consider other possibilities, including a tie between net revenue and grant awards.

Areas for Further Exploration

Over the course of this study, we have presented a framework for understanding the current financial health of the public radio system. As often is the case with such analyses, we have probably raised as many questions as we have answered. During the financial assessment process, we identified the following areas that should be subject to further analysis:

Net Assets and Endowments –The "Net Assets" are the retained earnings[17] of not-for-profit organizations. These resources are important measures of financial health. A positive change in Net Assets generally indicates that an organization is operating efficiently and, therefore, financially healthy. Moreover, a positive Net Asset balance, as well as endowment funds, provides a not-for-profit organization with a cushion against unexpected financial downturns, and a source of capital to fund growth. Data on the Net Assets of public radio stations is not captured in AFRs. As a result, it is difficult to ascertain the fullest picture of financial health in the public radio's system.

Joint Licensees and University Licensees – These licensees present a unique challenge, during the financial assessment process. Specifically, it was often difficult to isolate the radio station's performance, due to its affiliation with a television station or an educational institution. For this reason, further analysis should focus on separating the impact of radio operations from the impact of being a part of a larger institution. This inquiry will probably warrant an examination of accounting systems used by these types of licensees.

Capital Expenditures and Campaigns – In our assessment of the public radio system, we intentionally did not consider the impact that capital spending and its associated fundraising would have on a station's overall financial performance. In general, the decisions involved in these activities are strategic in nature, reflecting a long-term view of a station's objectives. Since our analysis focused on short-term operational decisions, we did not want to combine the two areas; however, further analysis of this area would be useful. Additionally, the impact of major gifts on improving a station's financial health should be explored, as well.

Appendix A: National Producers

CALL LETTERS	# OF PROGRAMS	NAME OF PROGRAMS
KSJV-FM	1	Linea Abierta
KQED-FM	1	Pacific Time
KVOD-FM	1	Classical Public Radio Network
WSHU-FM	1	Sunday Baroque
WAMU-FM	1	The Diane Rehm Show
KBSU-FM	1	JazzWorks
WBGO-FM	1	JazzSet
WXPN-FM	1	World Café
WDUQ-FM	1	JazzWork
KUT-FM	1	Latino USA
KPAC-FM	1	Riverwalk Jazz
WVPN-FM	1	Mountain Stage
KUSC-FM	2	Classical Public Radio Network, The Record Shelf
KCRW-FM	2	To The Point, Sounds Eclectic
KNBA-FM	3	Native America Calling, Earthsongs, National Native News
WBEZ-FM	3	This American Life, Wait Wait Don't Tell Me, Odyssey
WGBH-FM	3	Says You, Sound & Spirit, The World
WNYC-FM	3	The Next Big Thing, Studio 360, On The Media
WBUR-FM	4	The Connection, Here and Now, Only A Game, On Point
WHYY-FM	4	Fresh Air, Been There/Done That, Chefs Table, You Bet Your Garden
Wisconsin Public Radio	4	Whad'Ya Know, Calling All Pets, Zorba Paster, To the Best of our Knowledge
Minnesota Public Radio	9	Speaking of Faith, A Prairie Home Companion, Marketplace, American Radio Works, Classical 24, Pipedreams, Sound Money, Splendid Table, St Paul Sunday

Appendix B: Benchmark Studies

Prior to our effort, it does not appear that financial benchmarks were developed by either CPB or any other analyst of the public radio system. The closest attempt at creating standard measures of financial performance for public radio stations was the effort by the bond rating agencies, in their evaluation of the creditworthiness of stations that issued bonds.

For instance, **Fitch** offered insights on the characteristics of superior performance; however, it did not use any standard financial benchmarks unique to these types of enterprises. Moreover, all of the characteristics described by Fitch were qualitative and not quantitative. For example, here is how the rating agency described the "strengths" of one public radio network (Colorado Public Radio):

- Large, loyal, and growing statewide audience base
- Sophisticated news and music programming efforts, including locally produced programs
- Positive long-term track record of listener and business contributions
- Broad regional diversification of corporate underwriters
- Strong operating margins of recent years
- Healthy balance sheet
- Conservative budgeting and investment practices
- High barriers to market entry for potential competitors

Standard and Poor's provided a little more substance in its analysis of the public radio and television industry. It stated that "investment grade credits" should possess the following characteristics:

- A solid programming and listener niche
- Stable governmental support
- A history of stable financial performance
- Annual operating surpluses (at least 2% of operations)
- Growth in members over time
- A diverse revenue stream
- Unrestricted resources = at least 25%

Along with the quantitative financial benchmarks for public radio stations, our research identified a number of qualitative ones, as well. We considered the performance characteristics created by **Moody's** for evaluating the "critical components of strong management" in municipal government, since some believe that there are similarities between these entities and public radio stations. Below is a summary of those characteristics:

Conservative Budgeting Techniques – A careful, organizational approach to budgeting that ideally involves conservative fiscal policies and multi-year modeling. These techniques include –

- Revenue Forecasting – Strong management teams have a solid track record of meeting projections in most line items over several years. Rosy revenue forecasting can lead to shortfalls within a fiscal year, which must then be filled, with last-minute revenue enhancements, expenditure cuts, or one shot draws from reserves. All of these measures can undermine future financial flexibility, which can create fiscal problems in subsequent years and pose a significant challenge to long-term financial viability.
- Expenditure Controls – Tight expenditure controls are a characteristic of strong management teams because such controls lessen the likelihood of financial distress, within a current fiscal year or beyond. Strong management teams have a keen awareness of the levels of flexibility within each expenditure category.
- Budget Planning – Multi-year financial budgets should perform two important functions: instill the use of "what if" scenarios into the planning process, and provide a clear road map for where the management team intends to go over the next several years.

Fund Balance Policies – Adoption of a carefully delineated fiscal plan which includes a fund balance target level and the instances in which reserves may be used. The specific fund balance target should be an amount equal to at least three months of operating expenses or approximately 25% of annual revenues. Additionally, a target level of unrestricted cash balances is recommended, since cash on hand is a leading indicator of financial health.

Debt Planning – A formalized debt plan that includes target and minimum debt levels, targets for pay-as-you-go funding of capital work, and incorporation of these debt policies into a multi-year capital plan. The adoption of a debt plan demonstrates that management intends to maintain short and long-term debt obligations at manageable levels, while ensuring that capital needs will be met on an on-going basis.

Succession and Contingency Planning – A formalized succession / contingency plan, which typically includes written documentation of organizational structures, succession plans should key personnel change, and specific scenarios to respond to likely changes that might affect credit.

Timely Disclosure – Timely audited financial documents that are attested to by an outside firm, and the direct disclosure of any material events as soon as possible.

These characteristics represent useful qualitative financial benchmarks, from which we were able to develop benchmarks to evaluate the financial health of public radio stations.

Notes

1 Loyalty, as defined by Audience Research Analysis, is the total time that an individual listens to a particular station in a particular measurement period, as a percent of the total time that that individual listens to all radio during the same measurement period.

2 Public Radio International and Accenture, "National Programming Survey Results", Presentation to the Public Radio Development/Marketing Conference, July 2003.

3 Excluded AFR lines A16, A17, A18, included line A19.

4 Excluded AFR line E9.

5 Loyalty, as defined by Audience Research Analysis, is the total time that an individual listens to a particular station in a particular measurement period, as a percent of the total time that that individual listens to all radio during the same measurement period. For example, if a station has a loyalty score of 33%, then its listeners spend one-third of their total radio listening time tuned to that station.

6 The best regression analysis that we were able to develop explained about half of the changes we saw in Net Revenue. In other words, the factors we analyzed predicted approximately 50% of the variance in Net Revenue (total operating revenue minus total operating expense). This is considered to be a good level of explanation, but not a great one. Since unknown and unexamined variables explained the other half of the changes, these results indicate that we understand some of the significant factors associated with changes in Net Revenue, but are missing some of the predictors that could explain the remaining variance.

7 Programming Expenses include all expenses associated with producing, broadcasting, and promoting a program. These are lines E1, E2 and E3 on the AFR.

8 Station Resource Group, "2002 Revenue Update".

9 Lines E1, E2 and E3 in the AFR.

10 Definitions taken from the *Supplemental Guide to the Financial Reporting Guidelines – FY 2003 – 2004*

11 This data was gathered from NPR and PRI annual reports.

12 Public Radio International and Accenture, "National Programming Survey Results", Presentation to the Public Radio Development/Marketing Conference, July 2003.

13 The types of Sustainable Revenue are current station fees, listener-sensitive income and restricted grants and gifts.

14 We recognize that on average, increases in programming investments do not lead to increases in net revenue in the near term. Sometimes programming investments can yield net revenue, but usually the financial benefits are indirect and realized slowly. It is also important to note that the programming returns discussed in the report are defined in financial terms only. We acknowledge that programming yields many immeasurable returns, for the individual stations and the public radio system as a whole.

15 National Public Radio, "Station Manager's Handbook", May 2000.

16 Although we focused on radio stations, we acknowledge that a number of stations are joint licensees. We acknowledge that the television finances of joint licensees tend to outweigh the finances of the associated radio station. If the television half of the joint licensee is not financially solvent, the station will not be sustainable in the long run.

17 When a for-profit company generates a profit, management will often *retain* the *earnings*.