Addressing the Capitalization Gap for Independent News Media

Mobilizing funding for Independent News Media

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Abstract

The capitalization gap for independent news media businesses in developing markets is a stark reality. There are persuasive social impact arguments to extend support to independent news media businesses. There are also convincing arguments that providing finance capital has a significant impact on independent media sustainability, as proven by recent successful public-private initiatives that have mobilized funding to independent news media businesses around the world.

This paper assesses the capitalization gap, identifies entry points for philanthropic capital and prepares a compelling case for developing existing initiatives and exploring new ones that can bridge the gap and channel necessary funding to the sector.

April 2011

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Executive Brief

Independent news businesses across the developing world face a shortage of investment capital to develop their outlets into sustainable democratic institutions. This shortfall is known as the capitalization gap. In most developing markets, it is a stark reality.

The demand for capital with no editorial conditions attached far outstrips its supply. Many news outlets that are committed to delivering free and independent news are unable to access the necessary financing they need to develop into sustainable businesses. Without capital, they are forced to survive on limited personal, family or grant finance or forced to compromise their editorial independence in order to gain access to the investment they need to compete with subsidized state media.

Effective democratic societies cannot flourish without viable self-sustaining independent news businesses. There are persuasive social, political and economic arguments for extending support to independent news media, yet most donor communities and philanthropic investors lack the necessary focus and detailed knowledge of the sector to provide systematic assistance.

There are also powerful financial arguments supporting investing in news media, both in terms of the impact such financing has on investees as well as the likely returns for investors, provided that financing is structured to mitigate and price risks accordingly and borrowers' independence can be ensured. Unfortunately, such blended investment deal structures are few and far between.

Although it is widely accepted that a free press is an essential condition of open societies, in developing countries in which an independent media is most crucial, the lack of funding is most acute. The philanthropic and donor communities have not kept pace with the need for creative scalable financing.

In sum, this paper is a wake up call for donors and philanthropic and impact investors to collaborate and mobilize efforts to develop financial solutions that can address the critical capitalization gap for independent news media.

The paper assesses the arguments in favor of investment support and the specific demands placed on independent media. It examines the nature of the capitalization gap at all stages of news business development, from seed capital to the expansion of established medium-sized businesses and the forms such financing can take, including loans, guarantees and equity.

This paper also explores the underlying reasons behind the gap: banks remain risk averse to politically charged independent media, while private investors tend to focus on quick returns in high-growth businesses, and impact investors focus their attention on high-visibility "impact" sectors. From a borrower's point of view, many sources of capital are unsuitable as they risk interfering with the outlet's editorial independence. To date, media loan funds are the only significant suppliers of capital.

The report builds the case for increased public-private partnerships — partnerships that can blend capital and finance independent media in a scaled and sustainable fashion — and points to specific entry points for donors and investors.

Among the key lessons are:

For donors: The only way to ensure the long-term delivery of independent quality content is by supporting the transition of leading news outlets into sustainable news businesses.

For investors: Tailored financial instruments adjusted to the specific needs of small and medium sized media enterprises are key to building a vibrant and strong media industry.

By partnering with media loan funds and supporting innovative financial vehicles, development agencies, foundations, social investors and others can help scale the delivery of finance and dramatically reduce the capitalization gap. In particular:

Development Agencies and Foundations can:

- Provide grant and loan financing to existing global, regional and local media loan funds;
- Provide guarantees for investment vehicles such as structured capital market products;
- Make zero-interest and below market-rate investments in blended investment vehicles and in so doing mobilize private investors demanding higher returns;
- Provide grants to build the capital base of new affiliate loan funds and finance technical assistance.

Social Investors can:

- Invest directly in existing loan funds;
- Make near market-rate and market-rate investments in "regular" structured capital market products and "blended" vehicles, including those supporting regional loan funds.

We hope the solutions outlined will serve as a catalyst for action by donors and investors so they can begin mobilizing the finance that is required by independent news media.


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Introduction: Independent News Media – Free Marketplace of Ideas

"Democracy is about multiple voices. These may be contradictory; some may be more informed than others, while others may be personal opinion, gossip or speculation. That is a marketplace of ideas. As in all marketplaces, not everything is of equal value. So long as our institutions enable people to understand how to assess ideas in this marketplace, selecting the rigorous and rejecting the shoddy, democracy is not only sustained, it thrives".

-Professor Amartya Sen, the winner of the 1998 Nobel Prize for Economics

It has been said many times that the media play an indispensable role in the proper functioning of democracy. Discussion of the media's functions usually focuses on their "watchdog" role: a free press should inform the public of how effectively its representatives have performed and also help to hold them to account. However, this is only one of many roles played by the press in an open society.

According to the widely accepted Social Responsibility Theory, the news media serves as a key pillar of civil society and democratic political systems by providing information that enlightens the public and helps it make informed decisions, by protecting individual rights by serving as a watchdog over the government, and by promoting the economy by bringing together buyers and sellers through advertising. (Siebert et al., 1956.) A free press underpins all other development by increasing transparency and accountability both in government and in the private sector.

Democratic governance depends on the ability of citizens to make informed decisions. Informed decisions require the consistent and sustainable dissemination of accurate information through a free press, as well as exposure to a variety of opinions. The basic building blocks of a free press are thousands of businesses around the world operating as commercial entities, often struggling to maintain editorial freedom in markets influenced by vested corporate, government and political interests. Without such businesses[1] producing and delivering independent news on a daily basis, the public would be denied the breadth and depth of independent information they

1 Independent news media is defined as that which is free of influence of government, political or corporate interests.

"I have discussed elsewhere the remarkable fact that, in the terrible history of famines in the world, no substantial famine has ever occurred in any independent and democratic country with a relatively free press".

- Professor Amartya Sen, the winner of the 1998 Nobel Prize for Economics

require to function and to which they have a fundamental right, as recognized by Article 19 of the Universal Declaration of Human Rights: "Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless frontiers."

Unfortunately, the unique needs and challenges of independent news media businesses are not widely understood. Given difficult market and political environments, many news businesses struggle to maintain financial viability — an essential precondition for sustained editorial independence — to grow their businesses and transition to core news-producing institutions. For many, balancing commercial success with integrity of content remains an enormous challenge. Often, success depends on building rigorous business models based on diverse sources of income that can withstand not only market but also political pressures.

Access to capital plays a critical role in the success of those business models, with affordable financing the key to overcoming short-term cash shortages and longer-term investment in assets essential for growth. Without capital, businesses cannot broaden the scope and range of their news products nor can they achieve the type of scale needed to compete with state-subsidized media whose editorial is often used as a tool of government. International capital is not easily accessible or widely available. Financing is rarely available locally and, when it is, it is often tainted by lenders and investors seeking to influence content.

As a sector of development, independent news media is largely overlooked and underinvested in, with access to capital being, by far, one of the biggest obstacles to growth. "When media enterprises are self-sustaining — financially liberated from corruptive practices, government influence, or dependence on foreign nongovernmental organizations — they are more likely to assert and maintain editorial freedom and independence."[2]

2 CIMA report "Towards Economic Sustainability of the Media in Developing Countries", Working Group Report, June 22, 2007.

Media loan funds: Primary source of financing

Media loan funds are the main source of finance for independent news media businesses in developing markets. The New York–based Media Development Loan Fund is the only global fund of this type and has provided more than US$100 million in affordable financing to 26 countries since it was founded in 1995. Two regional media loan funds also exist: Southern Africa Media Development Fund (SAMDEF) and West Africa Media Development Fund (WAMDEF). In its 13 years of existence, SAMDEF has provided about US$18 million in financing, while WAMDEF, which was helped into existence by Dutch media donor Free Voice, began operations only late last year. Together, media loan funds have provided financing to well over 100 news businesses.

Media loan funds provide "soft" loans and pre- and post-investment advisory services to borrowers and may also provide equity financing. They already deploy the full palette of financing mechanisms used in SME financing, including debt, equity, quasi-equity, finance leasing, factoring, mortgage financing, and guarantees.

Media loan funds enter into long-term relationships with clients. Their business model is based on "incubation" services prior to investment, significant pre-investment technical and managerial advisory support, patient capital, below market-rate loans, flexible loan structures, a strong "compassionate" relationship management, and intensive monitoring.

"Local" media loan funds are a good source of small-scale capital. Two such loan funds are noteworthy. In Indonesia a loan fund operated by radio news agency KBR68H provides small loans — typically up to $10,000 — to radio stations that are part of its network. Loans are secured against future revenues from shared advertising across the network. In Russia, the Association of Independent Regional Publishers (ANRI) provides loans to members of the trade association. Together, these funds have provided approximately US$500,000 in financing to their members.

In Nepal, the Media Development Fund, which is supported by the Royal Danish Government and Nepal's government, is a rare example of a guarantee fund in the media sector. Guarantee funds address the capitalization gap by extending partial guarantees to banks that lend to SMEs, lowering the risk borne by the banks in case of default.

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I. The impact of providing capital to independent news media

"A free press is not a luxury. A free press is at the absolute core of equitable development, because if you cannot enfranchise poor people, if they do not have a right to expression, if there is no searchlight on corruption and inequitable practices, you cannot build the public consensus needed to bring about change."

- James Wolfensohn (Former World Bank President)[1]

Impact on socio-economic development

What is the social-development impact of investing in independent news media? Why should it be considered a priority development challenge that warrants the urgent attention of both donors and impact-first investors?

The short answer is that independent news media lie at the heart of maintaining and building democratic and equitable societies. Principally:

- **Empowering decision-making:** Free and independent news media are necessary for the effective functioning of democratic societies. Democratic governance depends on the ability of citizens to make informed decisions, and this requires the dissemination of accurate information and a diversity of opinions, possible only through a free and independent press.

"People with more information are empowered to make better choices... To reduce poverty, we must liberate access to information and improve the quality of information. People with more information are empowered to make better choices".

-Former World Bank President, James Wolfensohn.

1 "Voices for the Poor," The Washington Post, November 10, 1999.

- **Promoting economic growth:** A World Bank study[1] demonstrated that reliable, current and independent information is important in making good economic decisions. Furthermore, the media are responsible for disseminating market information and aiding communication between buyers and sellers – essential ingredients for economic growth.

- **Encouraging transparency, accountability and exposing corruption:** Media exposes corruption and holds public officials accountable, serving as a "watchdogs" for the public and a "window" on the inner workings of the government. The World Bank study above establishes that there is a significant positive correlation between high media transparency and good governance (8th UN Millennium Development Goal).

- **Building critical awareness for issues in key sectors such as health, environment and business:** Media provide reliable information and a focus of attention on issues of particular local importance that are otherwise ignored, building awareness, exposing malpractice and this builds awareness, and provides a platform for debate.

- **Empowering local communities, minorities and the disenfranchised:** Independent news media provide a voice for those who otherwise have no voice in society, particularly women, children, and religious and ethnic minorities. A 2000 World Bank survey[2] of the poor—the largest ever done—found that what people wanted most was not money, but a voice in decisions affecting their lives.

- **Facilitating disaster relief:** The media play a crucial role when disasters strike. For example, independent media were critical in providing information to the survivors and families affected by the tsunamis in Japan and Banda Aceh, providing the public with up-to-date information and helping to connect those who had been separated.

1 Kaufmann, Daniel, Kraay, Aart and Mastruzzi, Massimo: «Governance Matters IV: Governance Indicators for 1996 –2004» (May 2005), World Bank Policy Research Working Paper Series No. 3630.

2 Narayan, Deepa with Raj Patel, Kai Schafft, Anne Rademacher and Sarah Koch-Schulte. 2000. Voices of the Poor: Can Anyone Hear Us? New York, N.Y.: Published for the World Bank, Oxford University Press. Accessed at http://siteresources.worldbank.org/INTPOVERTY/Resources/335642-1124115102975/1555199-1124115187705/vol1.pdf

Impact on news business sustainability

Is providing financing the most impactful form of assistance? Is now an opportune moment for investors and donors to provide assistance to independent news outlets in developing countries?

Despite the economic crisis facing many news media businesses in Europe and North America, growth continues in many emerging markets and there is significant potential for continued expansion of the sector, with possibilities arising from both economic and technological developments. Access to financing would enable many independent news outlets to take advantage of economic and technological changes and so build their financial sustainability.

- **Market growth -** Many funders and investors from the North are familiar with the economic crisis facing North American and European media, in particular newspapers operating in saturated, mature markets. However, both new and traditional media markets in many developing and emerging economies continue to grow. For example, the single most dynamic region in terms of the printed press is the Arab world, where recent data indicates that there has been sharp growth in paid-for circulations in countries including Jordan, Syria, and Saudi Arabia – and this was before the recent upheavals and the "freeing" of several countries in the region. Elsewhere, according to WAN-IFRA's World Press Trends 2010, the paid-for circulation of Chinese newspapers grew by 10 percent over the previous year and India's by 40 percent. Other notable performers included Mexico's 15 percent growth, Brazil's 20 percent rise, and Costa Rica's 77 percent increase. Community newspapers, especially in Africa, also are becoming increasingly popular. For example, South African community newspapers now have a circulation of 5.5-million[1]. Although the economic challenges facing the media in developing countries should not be underestimated, such data does demonstrate that in many countries, print media have a real potential for growth.

> "We do live in a global economy. But it is characterized not only by the free movement of goods and services but, above all, by the free movement of ideas and of capital."
> **- George Soros**

As for broadcast, the number of television households continues to grow in all developing nations, with growth strongest in the commercial regional television sector, where the performance of state television is almost static. Radio remains the most accessible and the most popular medium of information and entertainment for rural populations in most developing countries. It remains the principal source of news and

1 About South Africa – The Press (2010)

"Development of free and plural media is a precondition of democratic progress in every society"
- Open Society Foundations

information for illiterate segments of the population, complementing printed media especially in countries where few people use the Internet, or where local online content and content in local languages is limited.[1] In the developing world, more than 75 per cent of households have a radio.[2]

- **Technology changes** – Technological advancements continue to transform our global economy, revolutionizing the news media landscape and creating new opportunities for investment. The internet and associated technologies are revolutionizing media production, distribution and consumption. Traditional, digital and social media are all playing a part in feeding the rising demand for timely and reliable information. Increasing liberalization of media regulation in many developing countries is opening up still more opportunities in the sector. While these developments show that there is enormous potential, risks remain: digital media and new forms of interaction may offer extraordinary investment possibilities in certain markets, but proven success stories and effective business models remain limited.

- **Growing youth population** – With more than 60 per cent of Africa's 1 billion people under the age of 25, demand for media in many developing countries will continue to rise for the foreseeable future. As literacy rates increase and more people enter the workforce and begin to take a "stake" in their societies[3], the demand for information will continue to increase creating new opportunities for independent news media. "Images, ideas, news, and points of view are travelling along countless new routes to an ever-growing number of new places where they can be seen and absorbed"[4].

- **Ongoing innovations** – The media landscape continues to be reshaped by the "bottom up" innovations of amateur-engaged citizens. From blogging to citizen journalism, from twitter to mash-ups, a new breed of media producer is driving creativity across the whole sector and bringing new entrepreneurial opportunities.

- **Opportunities to consolidate** - There is significant potential for companies that are able to consolidate smaller community-based media initiatives and generate economies of scale, production and distribution, especially in highly fragmented markets. However, national limits on concentration of media ownership often exist.

1 International Telecommunications Union – ICT Development Report 2010 (Target 8)
2 International Telecommunications Union – ICT Development Report 2010 (Target 8)
3 "Not all bad news", The Economist 07/24/2008
4 The Future of Independent news media, A GBN News Publication 09/2004

Financing success stories

"Governments deny access to newsmakers. Threaten advertisers. Delay licenses so that the legal status appears shaky and unstable… Send, systematically, different kinds of inspections, from financial to tax auditors. Many MDLF clients face exactly the same pressure today — in Russia, in Montenegro, in Zimbabwe… I remember thinking how unjust it was that a hostile government has so many sophisticated tools at its disposal to make an independent media company appear unsuccessful in the market. How they can strangle you in silence. I will never forget that incredibly powerful feeling of solitude (or is it loneliness) you get in this fight. The only thing we needed - I thought - was a level playing field. A fair chance to try. Nothing else."

- Sasa Vucinic, Former Managing Director of Media Development Loan Fund (CIMA: Media Visionaries: Conversations with Key Players, Don Podesta)

A Serbian radio and TV broadcaster, an online news website in Malaysia and a multiplatform media company in Mozambique are among the independent outlets that have defied challenging financial and political climates and established enduring news businesses.

Each was born out of the commitment to publish independent news and bring truth to their readers, listeners and viewers, but to survive and grow, however, they needed more: they required affordable and timely financial investment.

B92, Serbia:

A banned local radio station grows into the country's largest broadcaster with the help of a unique type of investor

During the Yugoslav wars of 1991-1999, radio station B92 was one of the very few sources of reliable information and balanced reporting. By fighting against hate speech and intolerance, and by campaigning against nationalistic propaganda, B92 made a crucial contribution to the moderation of Serbian politics. The station only managed to withstand the political, legal and physical assaults by the Milosevic regime thanks only to grants from Western donors and human rights organizations.

Although it survived the wars, B92 was far from being a sustainable enterprise. As donor funding began to dry up, B92 needed to start operating on a commercial basis and to expand into TV if it was to survive. The climate of intimidatory politics, continued violence and organized crime, combined with B92 being "socially owned" and so subject to privatization by auction, deterred commercial investors.

B92 succeeded in securing its future only thanks only to its intensive work with Media Development Loan Fund (MDLF). Firstly, MDLF participated in the privatization of B92 and purchased the full ownership stake, thereby preventing a takeover by an oligarch or other political interests. This was followed by large injections of capital to finance operating deficits while it was developing its TV station in a fledgling local advertising market. MDLF also provided intensive training and monitoring in strategic planning, financial management and organizational structure.

After B92 had consolidated and obtained a national broadcasting license, MDLF worked with its management to find private investors that would provide additional capital without impinging on the B92's editorial integrity. With a Swedish investment fund on board, MDLF sold part of its stake, recovering its investment and realizing a sizable capital gain.

Malaysiakini.com, Malaysia

Capital investment and strategic advice enable online news website to become market leader

News website Malaysiakini.com (Malaysia Now) was launched in 1999 as an alternative to the pro-establishment media that dominated the market. With independent newspapers and broadcasters effectively outlawed, Malaysiakini took advantage of a loophole in online media regulation to begin providing objective news, in particular coverage of politics.

Throughout its existence, Malaysiakini has had to continually reappraise its business and technology strategies to maximize revenues and sustain its market presence. Key to its development has been an equity investment by MDLF coupled with ongoing business advice. In 2003, after the dot-com bubble burst, for example, it switched from an advertising-based to a subscription-based model that kept a selection of the most important articles freely accessible but hid others behind a pay wall. While readership initially dropped, there was an increase in revenue that has grown strongly over time. Readership too has since flourished.

Malaysiakini played a key role in providing independent information to voters in the 2008 elections, which broke the ruling party's 40-year hold on power. On election day, it was the country's most-visited website and was the only source of real-time coverage of the election results. Malaysiakini has built on its success since then and is now the leading online new site in the country. In February 2011 it served 33 million pages to 2.2 million unique visitors – more than the *New York Times* on a per capita basis – and during a contentious regional election in April 2011 served 120,000 computers per minute in Malaysia alone.

SOICO, Mozambique

In 2004, the media company SOICO in Maputo, Mozambique, obtained its first loan from Southern Africa Media Development Fund (SAMDEF), enabling the country's only media group to expand beyond TV coverage. After the first loan was repaid, SAMDEF provided further financing for the company to purchase a printing press and turn its flagship publication *O Pais* into a daily newspaper printed in color and with nationwide distribution. The investment reduced printing costs by 50 percent and helped establish its financial sustainability.

TV SOICO continues to provide news, information and entertainment to the people of Mozambique. It has played a major role in educating the people about HIV-AIDS and has also launched a pioneering children's TV channel, forming close collaboration with other media companies in other countries, including Brazil. Support has also been provided by Dutch NGO Free Voice and Sida.

CEO Daniel David has a clear vision for the company: "We need to invest in accountability. If no one holds the government accountable for how it uses taxpayers' money and national resources, we will soon be in the same situation as Zimbabwe."

The above cases illustrate some of the market and non-market obstacles that independent news businesses face in developing economies. They also demonstrate that capital financing can provide these businesses with the support they need to overcome sector-specific obstacles by development that optimize returns without sacrificing content.

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Image © www.sxc.hu/profile/PocketAces

II. Demand and supply of finance for independent news media businesses worldwide

"A free press is not a privilege but an organic necessity in a great society"

- Walter Lippmann: American journalist (1889-1974).

Independent news media: focus on SMEs

Entities active in the independent news media sector vary in size from micro-level community entities to large-scale media companies that secure national coverage. However, most independent news outlets with aspirations of financial sustainability are of moderate size and struggle to find "no-strings" financing, forming what may be called the "missing middle": they are unable to access the type of financing that larger media rely on and have needs that are far greater than those of micro-outlets.

While there is no universally recognized definition of small and medium sized businesses (SMEs), the World Bank's definition is perhaps the most pertinent when analyzing independent news media in emerging democracies:

Small enterprise:		Medium-sized enterprise
up to 50	employees	up to 300
up to $3 million	total assets	up to $15 million
up to $3 million	total annual sales	up to $15 million

Image © www.flickr.com/photos/afgmatters/

Understanding the unique financing challenges of independent news SMEs

"In many countries, a lack of capital is a greater obstacle to the freedom of the press than official censorship. The media are often co-funded by influential figures in politics and business. This has a negative impact on journalistic independence. Access to independent sources of finance and management know-how is crucial to build successful and stable media without having to make journalistic compromises. Only on this basis can media organizations perform their sociopolitical function in the long term".
- responsAbility Social Investments AG

Independent news SMEs face far more difficulty in accessing finance than do regular SMEs. This arises from the unique political, economic, legal, technological and managerial challenges facing the sector.

- **The economic model** - The media industry is characterized by a variety of barriers to entry, including high fixed costs, economies of scale and high costs of differentiating products. For most media businesses financial sustainability may only be obtainable only when critical scale and scope is achieved. For example, the cost of producing and selling additional copies of a newspaper is low, and for broadcasters to reach additional viewers and listeners may bearno cost at all. Businesses that achieve scale also have competitive advantages when negotiating with suppliers and advertisers. Moreover, it is an industry that rewards product differentiation, though investing in talent that sets a news outlet apart is expensive. Without substantial financing, independent news SMEs typically do not have the resources (R&D, marketing, advertising, etc.) required to overcome these barriers.

- **Commitment to social results and lack of business skills** - Most independent media businesses grow organically from the passionate commitment of one or several founding journalists to providing objective news to their audiences. Profitability is not the driving force behind the businesses and is often considered a means to an end, consequently investors who might seek to influence editorial to maximize returns are unsuitable. Such unconventional business models also need more time to develop into stable, profitable operations and can present too big a challenge for conventional investors and lenders. Closely related to this is that many news businesses are run by journalists who lack the business skills and financial experience required to run a profitable company. They often favor content over marketing, advertising and financial management.

- **Exposure to political and economic pressures** - Providers of independent news, businesses often face severe pressure from the political and economic elite of the countries within which they operate. Such pressure can be in the form of withholding licenses, intimidatory tax inspections, regulatory restrictions, unfair competition from heavily subsidized competitors, pressure on advertisers, and pressure on providers of finance. These pressures often dissuade financial institutions and investors from lending to the sector.

- **Ongoing developments in technology require continuous investment** - The pace of technological change remains a constant challenge for all media businesses as they are forced to rethink and adapt their business models and promotion, marketing, and distribution strategies. While technological developments may provide significant financial opportunities in the future, in the short-term there is an imperative to invest in technology for positioning reasons that rarely offer short-term financial returns.

- **Legal environments** - Many countries restrict foreign investment and concentration of media ownership, both of which may have an impact on the availability of financing. Other legislation and regulations may also restrict media investment, such as licensing requirements.

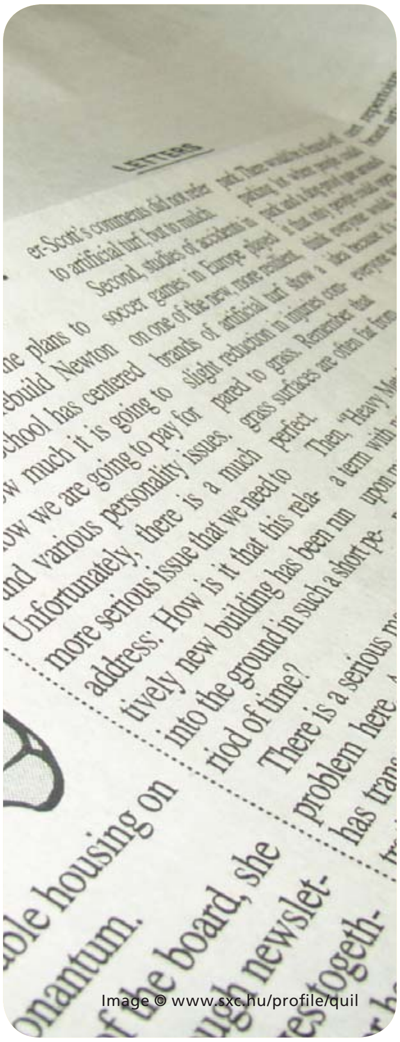
"More efforts should also be directed toward making development of the independent media sector abroad a priority at international gatherings, such as the World Economic Forum, the Asia-Pacific Economic Cooperation Summit, and other events attended by world leaders".

- Center for International Media Assistance

Varying capital needs of independent news SMEs

As we have seen, the financing requirements of independent news SMEs are aggravated by the specific conditions under which they operate. For example, sustained political pressure on advertisers not to buy space in an independent newspaper will lead to a shortage of working capital in the short term and a lack of investment capital in the longer term.

Whether a news outlet is a small or medium-sized company, it needs financing for the same basic purposes; the only major difference is the size, scale and financing structures that are available. In addition, as news businesses grow from smaller into medium-sized entities, they reach a critical point at which a significant injection of capital is necessary to achieve the scale required to maintain or further develop their position in the market.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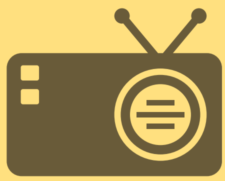
Differing needs of print, radio and television

A vast majority of independent news SMEs in emerging democracies are traditional media. Although there are digital-only media, they largely fall outside this SME analysis as many are micro-enterprises or have a track record too insufficient to attract philanthropic or impact investment capital.

If we look more closely at the unique needs of print, radio and television, it becomes clear that the delivery of news content by different means requires different types and levels of finance – see illustration bellow. Note also that finance alone is rarely sufficient. As discussed above, technical assistance in areas such as business planning, financial planning, advertising and marketing can have a significant impact, particularly when when such assistance accompanies injections of capital.

- Medium term to long term asset finance for printing presses, pre- and post-print equipment, editorial systems, and distribution vehicles.
- Mortgage and construction/renovation finance for printing house premises, newsroom and office space, and distribution kiosks.
- Credit lines for bulk newsprint purchases.
- Working capital financing to manage seasonality, long receivables cycles and new product development.



- Medium term to long term asset finance for recording equipment, broadcast equipment, transmission equipment, digital archiving systems, and IT equipment.
- Mortgage and construction/renovation finance for recording studios, office space, and transmission towers.
- Working capital financing to manage seasonality, for new program development, and for network expansion.

- Medium term to long term asset finance for production equipment, broadcast equipment, transmission equipment, program inventory management systems, IT equipment.
- Mortgage and construction/renovation finance for production studios, office space and transmission towers.
- Small term to medium term finance for content production and content acquisition.
- Working capital financing to manage seasonality, and for new program and new channel development

Financing needs and sources dependent on stage of business development

Analyzing the gap between the demand and supply of finance requires a closer look at the specific capital needs at various stages of a news business's development and the sources of capital available throughout the process. Let's examine the demand and supply of finance available at each of the below stages of a business's development (Figure 2).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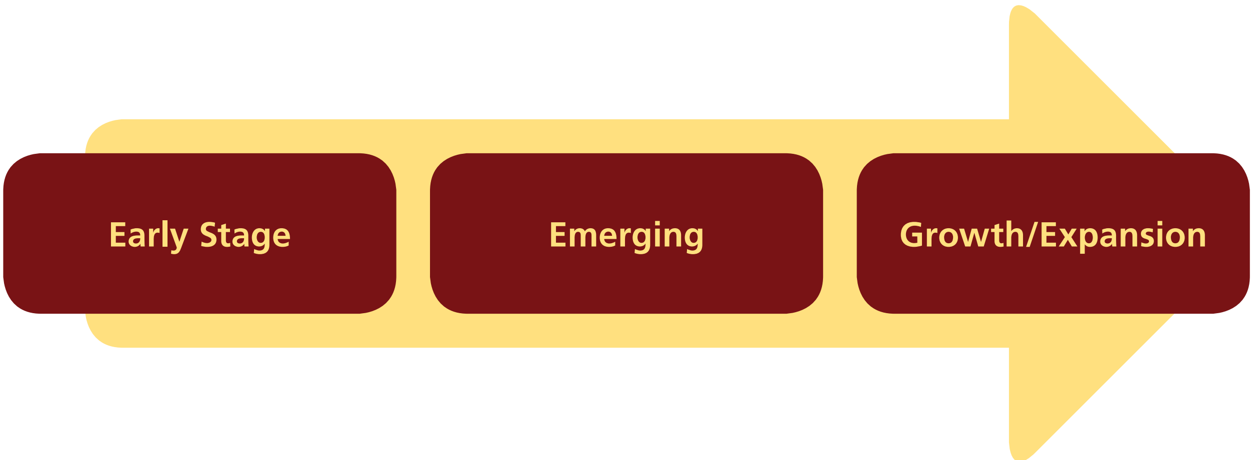

Early stage

What are the financial needs? At the outset, like other businesses, independent news media normally require some form of seed capital to develop a project and cover research, development and initial business planning. Support needed at this stage is typically limited to finance, technical assistance and incubation services. With initial research and development carried out and a business plan prepared, start-up capital is needed to cover initial expenses until the businesses can generate revenues to cover operating expenses. Equity investments are particularly suitable for early stage companies with unpredictable cash flows, while debt financing is not.

What is the capitalization gap? In early stage development, most independent news SMEs are self-financed. Seed capital is typically provided by family and friends, which means that supply is normally limited. Other seed capital is scarce or, when available, largely grant-funded on an individual and selective basis. Linked to this is a danger that grant funding from the outset might distort the enterprise and lead to a culture of grant reliance. Media loan funds and banks are unlikely to support start-up businesses because of the risks inherent in untested businesses and the lack of short-term revenues to cover repayments; they typically request a minimum track record (one to two years) prior to investing. Privately run seed funds and early stage equity investors typically focus on high-growth scalable businesses in sectors such as ICT. Also, from the point of view of the news business, they are usually unsuitable investors as they may seek to influence content to maximize returns. Venture philanthropists tend to invest in highly visible impact sectors, such as health, renewable energy and housing. Though the social returns might be high, investors of all kinds are deterred by the challenges facing independent news media start-ups, which may be political, technological or due simply to intense competition.

Emerging stage

What are the financial needs? The first years of a news media business can be difficult as it struggles to capture a niche in a competitive industry in which the playing field is rarely level, especially when there are publicly funded outlets. Most do not survive. Those businesses that do succeed often have established business models based on differentiated products, quality content, cost-efficient distribution systems or a steady source of non-subscription-based ad revenues.

Once established, SMEs usually require loans on an ongoing basis to finance working capital, asset investments and bulk purchases. Ongoing working capital coupled with minimal level asset finance is essential to fuel and grow these businesses. Typically, debt-based finance is preferred to risk capital as it is less costly and allows the owner to maintain greater control, something especially important for independent news media. Still, it is not uncommon to provide mixed debt, equity and quasi-equity products to satisfy the unique needs of these businesses.

What is the capitalization gap? Media loan funds remain the main source of finance for independent news media businesses. Media loan funds such as MDLF – which is the only global fund of this type – Southern African Media Development Loan Fund (SAMDEF) and Western Africa Media Development Loan Fund (WAMDEF) are still the most attractive (and often the only) source of funding available for media outlets. They provide soft loans, equity and pre- and post-investment advisory services to borrowers and often enter into long-term relationships. Their business model is based on "incubation" services prior to investment, significant pre-investment technical and managerial advisory support, patient capital, below market-rate loans, flexible loan structures, a strong "compassionate" relationship management, and intensive monitoring. However, resources are limited and they are unable to offer the range of working capital finance products provided by banks (e.g. flexible overdraft facilities, savings, transfers, etc.).

"Local" media loan funds are a good source of small-scale capital. Two such loan funds are noteworthy. In Indonesia a loan fund operated by radio news agency KBR68H provides small loans – typically up to $10,000 – to radio stations that are part of its network. Loans are secured against future revenues from shared advertising across the network. In Russia, the Association of Independent Regional Publishers (ANRI) provides loans to members of the trade association.

Working capital finance and asset finance from banks are difficult to obtain as they consider independent news media high risk and un-bankable (low levels of collateral, volatile cash flow, undercapitalization, insufficient turnover, lack of tangible guarantees). General SME loan program may be adaptable to independent news media, but so far they do not target independent news media businesses specifically, and they may have the same risk concerns as banks. Again, from the point of view of the news business, such investors might also threaten editorial independence. Debt financing from DFIs and venture philanthropists is theoretically possible, but in practice so far unavailable

Expansion stage

What are the financial needs? At some point in a business's development, managers will focus on rationalization, building efficiency and scaling operations. A small newspaper, for example, might seek to scale its operations and enhance its business model by acquiring its own printing press. A printing press can free a newspaper from depending on state-controlled printers while also cutting printing costs. It will improve the quality of the newspaper, and this in turn may attract new advertisement spend. Purchasing such equipment also allows the business to secure secondary sources of income by selling its services to other publishers. It is often this type of growth capital that is critical to facilitate transitioning from being small "fringe" players with limited audiences to becoming credible, enduring news-making institutions. Such investments require access to substantial amounts of asset finance.

What is the capitalization gap? There is a clear gap in adequate long-term, cash flow-based expansion financing for news SMEs, largely due to their risk profile and insufficient collateral. Expansion capital tends to be sourced by niche impact investors investing directly or indirectly through media loan funds. To date, media loan funds still offer the best solution for growth capital for these businesses, but lending resources remain limited with only one global and a handful of regional and local loan funds operating worldwide.

Other sources of financing are rare, with traditional private equity investors looking for higher returns than independent news media can offer (and the news business's reservations over suitability as above), and impact investors and venture philanthropists focusing on other sectors.

The merits of actual and potential sources of capital for news SMEs are summarized in Appendix I.

III. The role of the public and private sector in bridging the "capitalization gap"

In 2006, the European Foundation Center identified 65 foundations and corporate funders in 17 European countries that employed a form of social investment as part of their program's portfolio of capital investments.

Can donors and the public sector bridge the capitalization gap?

The majority of "traditional" donors providing funds for international media support are the national development agencies from the European Union and North America. However, funding can occasionally be obtained from bilateral and international and development financial institutions. The World Bank, for example, runs the Communications for Governance and Accountability Program (CommGAP) promoting the use of communication in governance reform programs.

Despite the clear existence and scale of the capitalization gap, the reality is that donors are not making the type of long-term commitments required to build sustainable independent news

Philanthropy often serves to fill the funding gap between the private and public sectors, but it is often insufficient. Philanthropists can still do a lot to advance independent media by supporting experimentation, funding issue-focused content, investing in trusteeship models and targeting areas such as distribution that can shift the system.
Many foundations dedicate much more funding to civic engagement and leadership programs than independent media. A big question is "How can they integrate these funding areas more strategically?"
- The Media Consortium, "Will Philanthropy adjust its role" 12/2009

media businesses. Although many governments identify press freedom as crucial to building democratic, prosperous societies, it is rarely seen as a priority sector warranting separate budgets. Instead, media assistance is often placed within broader categories of international development, such as governance, civil society democracy and human rights. Media assistance often takes the form of journalism training, media law reform, and support for professional journalism and broadcast associations, rather than economic sustainability and/or access to finance.

Overall, the media sector remains desperately under-supported and under-funded by the donor communities. While the public sector might in theory be able to bridge the capitalization gap, it would take a reprioritization of resources and a radical reorganization of development agencies and international financial institutions. If advances are to be made in this direction, education and advocacy is critical to informing donors of the social and development impact independent media have on maintaining and building democratic societies around the world.

Can the private sector bridge the gap?

Private sector funding for independent news media offers distinct advantages over public sector/donor funding, in that it provides flexible, creative and innovative solutions that are not tied to country funding restrictions. However, much of the currently available private sector funding for independent news media remains concentrated in only a handful of impact-driven investors including retail, high net worth individuals and foundations. For these pioneering investors, the social and development returns combine with below market rate financial returns to provide an effective impact investment.

The large traditional foundations (Knight, Ford, MacArthur) and smaller family-owned foundations and political foundations (Friedrich Ebert Stiftung, Friedrich Naumann Stiftung, and Konrad Adenauer Stiftung) are increasingly supporting media development initiatives. There is also a new breed of philanthropists including Skoll, Omidyar, and Google that invest in triple-bottom-line strategies and media infrastructure investment. The biggest player in the independent news media landscape and one of the strongest advocates for independent news media, however, remains the Open Society Foundation (OSF).

Private foundations are increasingly using commercial finance-type vehicles such as Program Related Investments (PRIs), which optimize their mission focus with the discipline and leverage of a financial investment. Given the high-risk, low financial return, and high social impact profile of independent news media, these PRI programs offer effective vehicles to provide concessionary debt and equity to these businesses. To date, European foundations are only just starting to experiment with PRI programs - typically referred to as Mission Related Investing. Where PRIs have been used by European foundations, they tended to be in the form of interest-free loans, which were seen as problematic, or loans provided to support specialist providers of finance in particular sectors .

The increasing trend amongst foundations especially those in the United States to move away from charitable philanthropic funding towards PRI investments is a positive one. Yet foundations in general could do more to leverage their capital and attract other sources of capital necessary to fund independent news media in a scalable way.

For the most part, investors remain unaware of investment opportunities in independent news and many are unfamiliar with the industry as a whole. Many potential impact investors overlook the less tangible but vitally important impact of a free press, focusing their attention on more visible social sectors. Similarly, on the business side, commercial investors simply do not have the necessary access to business models, rigorous market research, success cases, rating agencies and databases that would stimulate increased investment in the sector.

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IV. Scaling the delivery of finance through media loan funds

Exploring new mechanisms leveraging public and private resources that provide win-win-win solutions for donors, investors and recipients.

> If the press is not free, if speech is not independent and untrammeled, it makes no difference under what form of government you live, you are a subject and not a citizen.
>
> **– U.S. Senator William E. Borah**

Revolving loan funds focused specifically on independent news media - such as the highly successful MDLF - offer the most effective vehicle for channeling funds through loans, leases, and/or equity, in addition to advisory services. These funds act as intermediaries for investors or donors wishing to bridge the capitalization gap in a sustainable, cyclical manner.

The challenge for most media loan funds is accessing capital in order to scale operations. Media loan funds are doing their part to fill the finance gap, raising financing from individual investors, institutions and foundations interested in supporting independent media Such investors and donors have provided grants and/or concessionary loans to build the capital base of existing loan funds - some also extend grants to cover operating costs and technical assistance.

While such financing provides a strong base on which to build scalability, it is only the first step towards closing the capitalization gap; media loan funds have so far been unable to attract the critical volumes of investment needed for the sector. Moving forward, there is a real need to build on the financial creativity and innovative solutions that have been used to leverage both private and public resources in all areas of SME growth.

This section looks at how scaled delivery of financial services through media loan funds could be developed.

Structured capital market products

One successful solution already implemented was the "Voncert responsAbility Media Development Basket", launched in 2006 by MDLF, Swiss Bank Vontobel and responsAbility Social Investments AG, as a structured product that combined a bond-like investment (80 percent of the investment) with a loan (20percent) to MDLF. This product successfully provided a yearly annual return of 2.8 percent over four years and provided MDLF with $ 4 million Swiss Francs with which to provide additional loans to the sector. The Swiss Agency for Development and Cooperation's contribution as a guarantor was critical in bringing the product to market, as was the contribution of responsAbility, facilitating the deal and providing the necessary due diligence.

New blended investment deals to raise capital

Fund managers, donors and intermediaries need to explore new structured finance instruments that can align investors' interests and, in doing so, broaden participation in their funds. Instead of offering identical shares to all investors, different types of investors with different tolerance for risk could invest in media loan funds and receive varying levels of returns. For example, foundations and governments might invest in these funds at below-market returns in exchange for strong social outcomes and so doing enable the fund to leverage private capital seeking higher returns.

"Structured funds can be highly effective when each investor assumes a different level of risk using a distinct investment instrument, and receiving a return that corresponds to the risk undertaken. SEAF has used this concept, categorizing investors in multiple equity classes according to their objectives. As a result, SEAF funds have attracted a variety of investors, including the Belgian Investment Office, Belgium's development finance institution; AFP Integra, Peru's largest pension fund; and New York Life International Inc., a mutual insurance company."

—Tom Gibson, of the SME Institute (Milken Institute Conference 2009 – Stimulating Investment in Emerging Market SMEs)

Further develop regional and local media loan funds

MDLF should be encouraged to continue supporting the development of regional loan funds such as SAMDEF and WAMDEF. MDLF has provided technical assistance, process documentation and management training to help smaller funds become established. It has also set up an Affiliates Fund from which it provides capitalization for their loan pools. Successful examples of "affiliate" loan funds include those established in Indonesia by KBR68H and by ANRI in Russia (as discussed above). This "localization" strategy can be highly effective as the loans provided by local funds are smaller than those that larger loan funds are able to manage directly.

However, the demands for such funds are high and MDLF's "affiliate" capital is limited. Moreover, loan capital must be complemented with grants from donors to create a capital base for these funds and/or to cover ramp-up costs.

The donor community in collaboration with venture philanthropists, impact investors and key foundations should explore establishing a seed capital fund to provide the necessary capital to media loan funds that follow the successful and proven business models used by established media loan funds.

Developing new investment vehicles utilizing blended forms of capital

As media loan funds develop and grow, their need for patient equity capital (equity and/or quasi-equity) will increase. An "investment vehicle fund for independent news media" would allow investment to flow to the emerging regional media loan funds. MDLF might be well positioned to initiate such a vehicle with outside investors including multi- and bi-lateral government agencies as well as private investors from Europe and the United States. Development Finance Institutions (DFIs) could participate as anchor investors.

DFIs typically focus on SMEs in all sectors and do not highlight independent news media as a priority sector but a number of the regional development finance institutions (EBRD, African Development Bank, etc.) might be viable partners in setting up such investment vehicles.

Parallel to the vehicle, a technical assistance facility could provide the necessary technical support to media loan funds.

Partnerships to develop new guarantee funds

Banks clearly face fewer capital constraints and provide a breadth and depth of financial services that media loan funds cannot. However, without credit risk enhancements and the sector expertise that media loan funds offer, banks will not be able to lend successfully. Increasing initiatives that stimulate collaboration is critical. This type of collaboration has worked in the field of microfinance. By using first-loss guarantees and enhancing the role of media loan funds as agents responsible for the supervision and collection of loans, such arrangements could leverage the balance sheets of banks, thereby increasing lending volumes to the sector.

Alternatively, media support organizations and media loan funds could play a role as operational fund administrators within newly created guarantee funds. The administrator's responsibilities would include initial screening of borrowers prior to approaching banks. Media loan fund officers could also add value in guarantee schemes by providing the necessary technical assistance to build capacity within the banks.

In Nepal, the Media Development Fund, which is supported by the Royal Danish Government and Nepal's government, is a rare example of this type of fund in the media sector. There are, however, numerous guarantee funds focused on "cultural industries" in developing markets. While cultural funds do not focus specifically on independent news media, "cultural industries" do share some traits and risks similar to independent news media (e.g., insufficient business skills, evaluation of intangibles, lack of collateral, insufficient sector information, cash flow volatility, etc.) and can provide workable examples of what might be achieved in the independent news sector.

However, it must be noted that the viability of both these forms of guarantee fund models is questionable in most circumstances. The loan rates that would need to be charged to cover the costs of the media loan funds as well as the return required by commercial banks would be out of reach for most independent news outlets.

It will also require a sufficient critical mass of independent news outlets in one geographic area to justify a local bank taking on such an effort, a situation that remains uncommon in most of the developing world.

Finally, it would require a banking institution that is free from any political influences and willing to be associated with independent news outlets offering critical coverage of the government and other local actors. Adequate means would need to be implemented to assure that financing is directed towards deserving independent news media, as opposed to non-independent, "yellow," or entertainment-oriented news media.

Utilizing existing guarantee facilities for independent news media

There are numerous existing guarantee schemes that, in theory, could provide funding to independent news media businesses, but they generally tend to target sectors such as agriculture, health and/or energy. USAID uses the Development Credit Authority (DCA) that allows USAID missions to stimulate lending through the use of partial credit guarantees. These risk-sharing guarantees cover up to 50 percent of loss on loans made by financial institutions and investors and have been used in a variety of ways including municipal lending, access to clean water and clean energy, enabling health clinics to invest in medical equipment, and enabling businesses and families to recover from natural or man-made disasters. Although existing loan facilities such as the DCA facilities might not be directly suitable for independent news media businesses due to scale-ability issues and existing sector focus, we should not rule out expanding media loan fund capital through such partnerships between DCA and media loan funds.

A ten-year, $22 million guarantee with Root Capital, a social enterprise fund, will increase access to finance in seven target countries for small and medium-sized rural agribusiness enterprises and cooperatives. Credit under this guarantee will be lent against World Food Program contracts, helping many producers without the necessary collateral to access credit for the first time. Even social enterprise funds such as Root Capital are hesitant to increase their risk exposure. The partnership with USAID has been instrumental in expanding Root Capital's portfolio through new lending practices.

V. Recommendations for funders and investors

By partnering with media loan funds and supporting innovative financial vehicles, development agencies, foundations, social investors and others can help scale the delivery of finance and dramatically reduce the capitalization gap.

Development Agencies and Foundations can:

- Provide grant and loan financing to existing global, regional and local media loan funds;
- Provide guarantees for investment vehicles such as structured capital market products that raise financing for media loan funds, reducing the risks to acceptable levels for private investors;
- Make zero-interest and below market-rate investments in blended investment vehicles that raise financing for media loan funds, and thus mobilize private investors who demand higher returns;
- Provide grants to build the capital base of new affiliate loan funds and expand the capital of existing funds;
- Finance technical assistance funds for existing and newly established local loan funds;
- Provide first-loss guarantees to mobilize banking capital.

Social Investors can:

- Invest directly in existing media loan funds;
- Make near market-rate and market-rate investments in "regular" structured capital market products and "blended" vehicles, including those that support regional loan funds.

Development Finance Institutions, Development Banks and Development Credit Authorities can:

- Provide investment guarantees and anchor investment vehicles to mobilize social capital.

VI. Conclusion

At the heart of a free and independent press lie businesses - businesses that are strongly committed to providing society with the objective information and news that people need to play an active role in their governance.

"The theory of the free press is not that the truth will be presented completely or perfectly in any one instance, but that the truth will emerge from free discussion"

Walter Lippman (American editor and writer, 1889-1974)

These businesses also recognize that long-term success depends on financial sustainability and workable business models. Given the regulatory, political and economic constraints that are specific to independent news media, assistance is justified. Given the opportunities for growth in a dynamic and technologically-driven industry, investment makes sense. Given the impact on societies, investment is essential.

It is clear that access to finance remains one of the critical challenges for SMEs active in the independent news media sector in emerging democracies. Without access to both working and investment capital at all stages of the business's development, these businesses will never achieve the type of scale required to overcome the obstacles that impact their sector.

The public and private sector alone will not be able to address the capitalization gap. Instead, it will take a concerted effort to forge public-private alliances with development finance institutions, bilateral and multilateral donors, foundations, impact investors, and intermediaries that can push for creative and innovative solutions to bridge the gap. To date, several initiatives have successfully mobilized critical funding for the sector, but much more is needed to make a lasting impact.

It is our sincere hope that this report will inspire investors, financial intermediaries, the philanthropy and donor communities, and enterprise development organizations to increase capital flows and improve capital deployment to sustainable independent news media SMEs in developing markets.

Appendix I: Assessment of actual and potential sources of capital

Provider of Capital	Types of Capital	Pros	Cons	Potential
Self-Finance	All	Independence and flexibility	Limited volumes of available finance	Access to self-finance remains limited.
Grants	Grant seed capital, growth capital + free money	Access to capital when business is not yet bankable	Not always sustainable Encourages dependency Upfront cost of obtaining grants, high administrative costs Does not encourage financial discipline	Access to grants remains limited and the process of obtaining them is cumbersome
Private Equity	Equity, Quasi-Equity	Shareholders participate in management, transfer of know-how and expertise Direct involvement in business decisions Rewards of accessing patient capital	Borrowers relinquish control Poor exiting strategies for VC funds investing in developing markets Third-party exits at the SME level are rare in developing markets Limited acceptable deals available	Access to private equity is limited and reserved for specific high-growth businesses in visible “impact sectors” with assured exit strategies
Venture Philanthropists	Debt, Equity, Quasi-Equity	High engagement partnership approach Focuses on building organizational capacity Strong links to private equity Tailored financing Multi year support	Limited availability of capital for independent media Significant reporting requirements	Venture philanthropy is relatively young; access to capital remains limited and focused primarily on non-profits active in high social impact sectors

Provider of Capital	Types of Capital	Pros	Cons	Potential
Banks (without credit enhancement)	Debt Capital	Range of products Scale Encourages financial discipline Limited availability of debt for borrowers	High rates Inflexible loan structures Bank's depositor base is relatively narrow and short-term, providing a technical obstacle, or at least a disincentive, to making long-term loans Conservative lending practices. Unfamiliarity with media business Potential bias against or fear of association with independent news media	Limited potential
Banks (using credit enhancement)	Debt Capital	Range of products Scale Encourages financial discipline amongst borrowers. Risk-sharing encourages increased lending	High rates Potentially long loan processing times. Unfamiliarity with media business Potential bias against or fear of association with independent news media Limited potential	Limited potential
Leasing Companies	Debt	Satisfy the need for asset finance Use financed asset as collateral	Fixed and inflexible payment schedules Highly customized assets	Leasing companies not familiar with media assets

Provider of Capital	Types of Capital	Pros	Cons	Potential
MFIs	Debt/ mostly short term, and small amounts	Less risk averse than banks Familiarity with labor intensive loan processes	Inflexible loan structures High rates Small amounts	Potential for MFI to finance community independent media is a possibility, not suitable for SMEs
DFIs	Low cost credit Lines (sub-loans) through Banks, or directly. Typically managed by regional development banks	Partner banks that would manage these loans typically commit to establishing a "unit" or at least a loan officer dedicated to the sector. Increased understanding and awareness for the independent news media sector by loan officers is the first step towards increased involvement by banks to the sector. Technical assistance is usually included	Usually reserved for other sectors (health, agriculture, energy) Limited volume of borrowers per individual country	In the future, increased portions of these credit lines could be "reserved" to support the sector
Media Loan Funds	Equity, Debt, Lease, Quasi-Equity	Offers a workable model to successfully provide capital to independent news media businesses. Offers critical non-financial support	Limited availability of working capital Difficulties in scaling	Offer promising solutions
SME Loan Funds (non-profit)	Equity, Debt, Quasi-Equity	Patient capital Access to know-how	Limited availability of such funds focused on independent media	SME funds tend to focus on other higher growth sectors

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