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HARD TIMES BUT HEARTENING NEWS FOR AUSTRALIAN PAPERS

Julian Lee
The Age
15 May 2009

The circulation declines of Australian newspapers appear to have slowed. Figures show the industry is weathering the downturn in consumer spending better than its counterparts in the United States or Britain.

Chief executive of the AFR's publisher, Fairfax Business Media, Michael Gill, said: **"Corporate cost-cutting, reduced investor activity and redundancies in key sectors have reduced our circulations. The trend is broadly in line with previous periods of weak business and investor activity."**

Sales of American and British newspapers fell by 7 per cent and 4 per cent respectively in the same period. In total, the circulation of the top-three Australian broadsheets — *The Australian*, *The Sydney Morning Herald* and *The Age* — rose by 0.2 per cent during the week and by 0.5 per cent at the weekend, according to Newspaper Works.

With the exception of Mr Gill, individual publishers have left commenting on the results to Newspaper Works. Its chief executive, Tony Hale, said: "This proves once again that newspapers play a vital role for Australians, and are not considered a discretionary purchase that can be given up in tough economic times."

Media buyer Steve Allen, of Fusion Strategy, said the results back the industry's view. The previous two quarters showed a 2 per cent decline in "headline numbers". "This quarter is a solid improvement," he said.

NEWSPAPERS HOLD UP DESPITE FINANCIAL CRISIS

Julian Lee
The Age
14 August 2009

The circulations of Australian newspapers have held firm during the economic downturn, in marked contrast to their British and American counterparts. Overall sales of metropolitan, national and regional papers fell by 0.7 per cent in the three months to June 30, compared with the same period last year; the latest figures from the Audit Bureau of Circulations show.

The industry managed to claw back another 800,000 weekly sales during

Off The Press: Without Fear or Favour

Michael Gill was appointed Chief Executive Officer, Fairfax Business Media in January 2007 and held the position of Publisher and Editor-in-Chief of Fairfax Business Media from July 1998. He is responsible for the business management and editorial direction of *The Australian Financial Review*, *AFR Magazine*, *BOSS*, *afr.com*, *BRW*, *The Australian Financial Review Smart Investor*, *CFO*, *MIS (Australia, NZ, Asia and UK)*, *AFR Education*, *Financial Essentials* and *Fairfax Business Research*. Prior to his current appointment, Michael was employed in business development for John Fairfax Holdings Ltd. From 1996 to 1998 his role was to examine opportunities related to digital media. From 1993 to 1996 he was deputy editor of *The Australian Financial Review*, having joined the AFR as a senior writer in 1990. He was a presenter on *Business Sunday* (TV) from 1988 to 1990. Michael is Chairman of AAP and of the National Institute of Economic and Industry Research. He is also the Chairman of UNICEF Australia. He captivated conference delegates with his informative plenary address, *The Global Recession: Wisdom versus Process*. An updated version is published below.

I noticed something written recently by George Soros in *The New York Review of Books* that I think serves as a good place to start in talking about the recession we are in.

George Soros: "There are two features that I think deserve to be pointed out. One is that the financial system as we know it actually collapsed. After the bankruptcy of Lehman Brothers on September 15, the financial system really ceased to function. It had to be put on artificial life support. At the same time, the financial shock had a tremendous effect on the real economy, and the real economy went into a free fall, and that was global.

The other feature is that the financial system collapsed of its own weight. That contradicted the prevailing view about financial markets, namely that they tend toward equilibrium, and that equilibrium is disturbed by extraneous forces, outside shocks. Those disturbances were supposed to occur in a random fashion. Markets were seen basically as self-correcting. That paradigm has proven to be false. So we are dealing not only with the collapse of a financial system, but also with the collapse of a worldview". (*The New York Review of Books* June 11 2009)

The thought I want to address is akin to the theme of a book by the late American historian, Barbara Tuchman.

In *The March of Folly* Tuchman reviews many extraordinary examples of foolish decision-making. More particularly, she points to cases where people chose to do things opposed to their own interests. In fact in every case their folly was compounded – or highlighted – by the fact that the decisions were opposed convincingly by competent, respected opinion.

Tuchman wrote of the fabled decision of the people of Troy to remove the mantle from their city gate so as to allow the wooden horse to be brought inside. And she went on, canvassing stark examples of a similar kind through the history of English colonisation to the mismanagement of the Vietnam War.

Tuchman did not address directly the Great Depression or any similar episodes of financial foolishness. (And I wonder sometimes whether finance is somehow exempt from

historical review ...)

When it comes to our recent debacle, the financial cognoscenti is inclined to cite academics, like Hyman Minsky, who found that financial markets are inclined to speculative euphoria.

Those experts are likely to extrapolate Minsky to the point of asserting, comfortably, that this is the natural cycle. They are unlikely to mention that his solution was central bank intervention and lending controls.

Minsky chose the benign "speculative euphoria" when he might have meant dangerous excess. And it is interesting how such phrases might be taken as code.

In December 1996 the then Chairman of the US Federal Reserve, Alan Greenspan, mentioned in an otherwise bland address the hazards of what he described as "irrational exuberance" in escalating asset values.

Greenspan's comments were decoded into a message that produced a global slide in share markets. Implicitly, the markets expected discipline. Explicitly, Greenspan suggested they needed some.

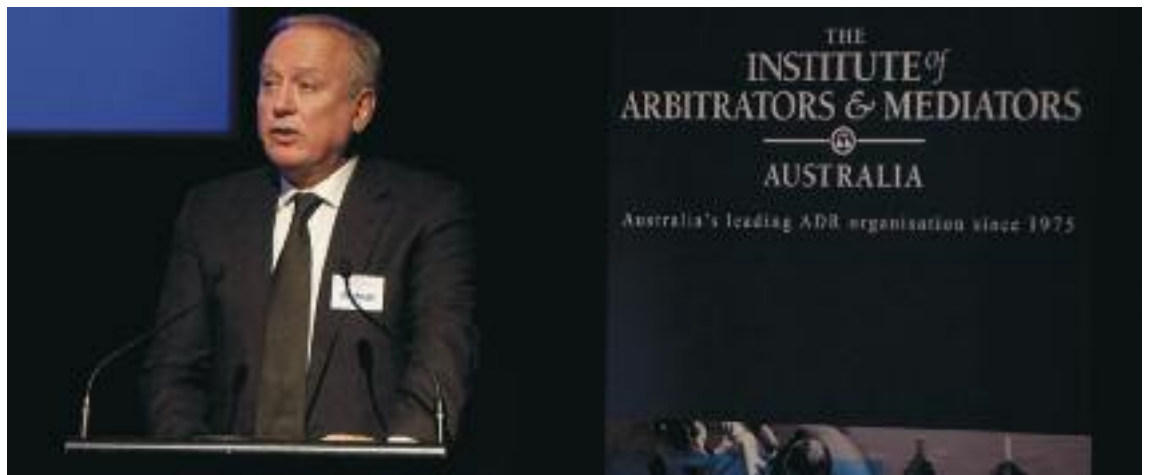
But they didn't get any.

Michael Lewis, author of *Liar's Poker*, goes back a decade before the Greenspan "Minsky moment" of 1996 to finger the origins of what he calls with typical understatement the biggest financial crisis in the history of the world.

Hyperbole aside, Lewis makes the valuable point that when Wall Street investment banks – like Salomon Brothers – turned from private partnerships to public corporations they made more than money.

Lewis points to Salomon's conversion in 1986 as the first of those and says the partners made a killing. But more importantly, they moved the risk of their business from the partners to the public shareholders. And so they created a black box.

Lewis says "the shareholders who financed the risks had no real understanding of what the risk takers were doing, and as the risk-taking grew ever more complex, their understanding diminished. The moment Salomon Brothers



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the period, bringing the average number of newspapers sold each week in Australia to almost 21 million. ...

Michael Gill, Financial Review Group chief executive, said despite the financial sector cutting costs and reducing its workforce, his publications had held up well compared with the preceding quarter.

The Newspaper Works said the overall figures demonstrated that Australian newspapers were continuing to defy the international trend, especially in the US and Britain where sales had fallen by 7 per cent and 4 per cent respectively.



OFFICIALS GRAPPLE WITH EVER-EVOLVING INTERNET

The Ottawa Citizen

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The forum, organized by the Organization for Economic Co-Operation and Development (OECD), had two goals: educate policymakers about the evolution of the Internet, and alert businesses to the major changes happening in the world around them.

With more than one billion people online, the Internet is already an economic, entertainment and political force. And the ongoing integration of processes that has been described as Web 2.0 will give people still more access to video, games and interactive services.

Michael Gill, chief executive with Fairfax Business Media, said consumers are choosing online services such as Craigslist.org over newspaper classified sections to sell goods.

"We have already seen the number of markets that have been challenged," he said.

Other topics in the wide-ranging discussion included the ethics of selling customer information to marketers, the degree of control Internet providers should have over the websites their customers can visit, and whether governments can place or should place the same regulations on the Internet that they place on traditional broadcasters and how much control should an Internet service provider have over what websites a customer can or cannot visit.

Reports on the Ottawa session will be considered at an international meeting on the future of the Internet economy in Seoul, South Korea, next June.

demonstrated the potential gains to be had by the investment bank as public corporation, the psychological foundations of Wall Street shifted from trust to blind faith."

To the point: would partners have leveraged their equity 35:1? Would they have taken punts that left the business with \$50 billion of mezzanine CDOs (collateralised debt obligation)? These are things that Salomon did: Its contribution to what we now call the global financial crisis.

As Lewis says, this should not have happened. In fact within a year or so of going public Salomon was in deep trouble. The crash of 1987 brought Salomon back to earth. But only temporarily, since by 1991 Salomon's leverage had created the second biggest balance sheet in the US.

In between, Michael Lewis' book *Liar's Poker* had appeared in 1989, with its sharp descriptions of the venality and recklessness of the new Wall Street – and especially of Salomon Brothers.

In 1991 Salomon struck a grave crisis when it was revealed that its money market dealing involved large scale false – illegal – bidding on US Treasury notes. As the facts unfolded, it turned out that Salomon's traders had on eight occasions used false bids to take more than a third of the total US Treasury bond tender. On four occasions Salomon used false bids to take more than three quarters of the tender.

According to Warren Buffett, in his authorised biography, the Treasury response was to exclude Salomon from bidding at US Treasury note auctions.

The effect, Buffett noted, would be a front page headline in the next day's *New York Times*: Treasury to Salomon: drop dead.

Buffett's personal rescue of Salomon in 1991 reveals the origins of the remarkable capacity of Wall Street investment banks to evolve so quickly from stable partnerships to massively dangerous breeders of toxic securities.

A notoriously cautious investor, Buffet had developed a trusting relationship with Salomon CEO John Geutfreund. His investment funds had become a \$700 million shareholder in the public Salomon Company.

To head off the Treasury action, Buffet agreed to become Chairman of Salomon. And in what is now a familiar argument, Buffet makes the point that Salomon owed billions in Japan and billions in Europe.

Buffet told the Treasury they might look silly backing off. "But they would look a whole lot sillier a few days later when financial carnage was spread from this act."

Buffet's intervention saved Salomon and after three years its position and his wealth were again framed by impressions of success.

But another clue to today's events was left behind, in public. In the course lending his own reputation to the repair of Salomon, Buffet had a *mea culpa* advertisement published in a full page of the *Wall Street Journal*. Buffet's quote read: "I said that we would have people to match our principles, rather than the reverse. But I found out that wasn't so easy."

And it was Buffett who, most publicly, sounded a very deliberate warning on the CDO and similar derivative

markets and the risks they were creating. Famously, in his shareholder letter of 2003, Buffett referred to these "financial weapons of mass destruction". He had already referred to them in 2002 as both "toxic" and "time bombs". And his sidekick, Charlie Munger, told shareholders at their 2002 annual meeting that "to say that derivative accounting in America is a sewer is an insult to sewage."

Barbara Tuchman opened *The March of Folly* with the following:

"A phenomenon noticeable throughout history regardless of place or period is the pursuit by government of policies contrary to their own interests ..."

In this sphere, wisdom – which may be defined as the exercise of judgment acting on experience, common sense and available information – is less operative and more frustrated than it should be.

Why do holders of high office so often act contrary to the way reason points and enlightened self interest suggests? Why does intelligent mental process seem so often not to function?

In our present remarkable instance there were ample warnings. Aside from Buffett and Munger, there were traders like Stephen Eisman – a hedge fund operator who made a fortune on the realisation that investment banks were effectively turning "garbage into gold." Eisman's realisation was triggered by a conversation with the rating agency Standard and Poors, in which he was told that the S+P rating model for housing had no ability to accept a negative number. The guys who rated the sub-prime mortgage paper as corporate paper had a model that assumed house prices would always go up.

Confirming his theory, Eisman met with Raymond McDaniel, the CEO of Moodys – which was 20% owned by Buffett and regarded as the benchmark for credit rating.

McDaniel asserted his confidence that its ratings would stand the test of time. Eisman said simply that he was "delusional".

The most damning part of Eisman's story is in a meeting he had at a conference of sub-prime investors. Having explained to a dinner companion – a professional manager with a \$15 billion portfolio – just how bad he thought the sub prime market would prove to be, Eisman was shocked into a new realisation.

The investor was pleased to meet someone who was short selling his market. Because without short sellers the market would have no liquidity.

Essentially, the income from the short sellers was helping make the market by funding notional mortgage repayments. Like a reverse ponzi scheme, the fees for short selling were income that funded new CDOs in a market where growth was so rapid there were insufficient sub prime mortgages being created to meet the demand to finance them!

After a few further iterations Eisman came to perhaps his sharpest conclusion: short Merrill Lynch. Why Merrill Lynch? Because there was going to be a calamity. And in his experience wherever there was a calamity, Merrill was in the front row.



"In between, Michael Lewis' book *Liar's Poker* had appeared in 1989, with its sharp descriptions of the venality and recklessness of the new Wall Street – and especially of Salomon Brothers." – Michael Gill.



“ICEBERG REPORT” STRIKES A NERVE, NEWSPAPER EXECUTIVES REACT

The Earl Blog
February 2009

A day after releasing “No Iceberg: Separating Truth from Fiction About Newspapers In This Recession,” the reactions are pouring in. Among the feedback from INMA members on the various internet forums:

Bernard Asselin of The Gazette in Montreal said now is the time to “focus on the core values of our products,” and that newspapers should “stop the non-value-added activities, make people accountable and responsible, start the client-supplier concept internally, implement the internet profit centre concept.”

Michael John Gill of Fairfax Australia said he worries that “we do not see much discussion of what the internet has done to the ‘news’ part of the equation. Fundamentally, primary sources are now – largely – available to all. So the distinguishing ‘news’ values have to be defined against today’s reality.”

Mike Donatello of USA Today said “the mess we find ourselves is largely of our own making” and “fueled by our myopic obsession with the quarterly care and feeding of fat margins.” He wishes there was a way to get publishers focused on brand- and share-building.

Mirek Kowalski of Media Regionalne in Poland said newspapers need visionary CEOs to stabilise their role as multi-media publishers, and he lamented that too much time is being spent on protecting print revenues rather than opening up revenues in other platforms.

The backstory to what is now being called the “Iceberg Report” is that I wrote this in response to the one-size-fits-all doom-and-gloom stories that are appearing everywhere in the world. I readily admit times are tough, but there are nuances and layers to the story. What the closure of a newspaper owned by a U.S. corporation that has amassed debt has to do with the future of newspapers in Germany or India or Argentina is beyond me. Hopefully, the Iceberg Report will get people thinking about that.

The report seems to have struck a nerve with newspaper executives who have been through economic downturns before or who see the P&Ls and realise that while this is tough, newspapers are going to survive – even if the corporations that own them may not.

Fascinating to see how this report got picked up so quickly on Twitter, Facebook, LinkedIn, and the blogosphere.

Which, unto itself, should tell you how the world is changing and how quickly information gets around in this world.

In my own experience I can recall – back in the early years of this decade – a friend who worked in mortgage securitisation in Australia telling me she had quit. She said simply it was unsustainable.

I put her view – that the disconnect between lending and the risk of default, which is what wholesale funding and derivative markets did, was horrendous – to the CEO of one of Australia’s biggest banks. He said there was no doubt that a problem might exist. But his bank and banks like it had too much at stake in their credit reputation to take the risk of passing on bad credits.

And what about the mortgage originators and wholesale financiers, I asked? He shrugged. “Who knows?”

Indeed.

We know that there were many, many ways that the regulators and politicians could have known that this disaster was going to happen. Why did they not?

Many people ask, reasonably, what were journalists doing?

Here I think there are two answers.

First, there is the credulity of editors. Bill Keller, editor of *The New York Times*, put it well when he said: “When we blunder in a bigger way – some of the credulous stories the *Times* published en route to the war in Iraq, for example – I ache for our precious credibility.”

Put simply, it’s hard to challenge the big lie.

Second, there is the simple idea of genius. Of superior capability producing extraordinary returns. The idea that we have a culture or process in business leadership that is actually removed from reality. Like fantasy footy. It creates fantasy finance. And if everyone accepts that, it’s a process that can’t really be challenged by commentators.

The creators of this financial doomsday machine were supremely confident of their models. They knew what they were doing. But the reasons for their doing these things were entirely self-centred. As Buffett said of Salomon: “the place was run for the employees, not the clients”.

But these people weren’t Doctor Strangelove types. Rather they were typically very well educated, if rather isolated, people with supreme confidence in their models.

These are the sort of people Henry Mintzberg, a business school academic at McGill University, has been railing against when he says of MBAs and business education generally: “You give completely the wrong impression and you send them out with an enormous amount of hubris which is ‘I can manage anything, even though I’ve never managed anything.’”

Tuchman, Minsky and many others who have studied the various iterations of these events have given us descriptions of these great social failures and some prescriptions for resolution. Which is why we see so much being said about regulation and so on.

I can’t avoid the feeling that there’s something more mechanical and persistent that we have to worry about.

A month or so ago I attended a private lunch with a senior adviser to former US President, George W Bush. In the course of that I asked what would future US governments do

to fix the problem they had created? That is, how would they restore confidence in the fundamentals of international finance?

I can’t name this bloke, but his reply struck me forcefully. It was critical, he said, that nothing was done to inhibit the activity of free markets.

To me there was a lot missing in that answer. But the message was plain: we are blind to any fault or failing and we determinedly will not accept any proposition for change.

Which is why, I think, there are prominent Republicans calling for fundamental change.

The full force of this experience is yet to be seen since among other things we do not yet know what will happen when \$US2 trillion of new government bonds runs into a global tsunami of splashed cash.

But here’s my point.

I think we have built powerful processes into our societies that are fostering unwise premises.

Think of this. If an insurance company like AIG is too big to fail, then are we really living in a market economy?

If financial institutions are not allowed to fail, then how do we constrain the risk they create? Because if the risk is not that they cannot remain solvent, then the new risk is that they operate solely for the benefit of the players rather than the supporters.

Fantasy finance we now know is horrendously dangerous. And fantasy finance is a construct of ideology and self interest. Just as foolishness in policy arises from weak premises in political life.

In the same way that the stranglers and leg breakers of factional politics have created a cookie cutter that spills out little Graham Richardsons and Michael Krogers and Kim Carrs at every preselection, we have allowed the conformist regime of business education to overcome the natural preference for experience and wisdom in leadership.

It is obvious that non-conformists like John Grill and Brian MacNamee and Wal King have been successful in business because they are different. And because they recognise and adopt their true role without any obvious obsession with their own wealth.

The default processes for government and managing in our communities appear to me to be conformist. They tend to conformity around timid notions that make life easier for powerful factions. They resist transparency. They encourage the power of insiders. They are ineffective in responding to real needs for leadership. And they discourage plain speaking and action.

A lot of what’s gone right in the world is because people were comfortable with wise, if unpopular, positions. A lot of what makes Australians feel relatively comfortable right now is due to their influence.

We need more wisdom and less process.

Michael Gill

CEO

Fairfax Business Media



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