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BLOG

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How I Knew AOL Time Warner Was Doomed (No, Really!)

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In 2000, a couple of days after the AOL/Time Warner merger, I was scheduled to guest-lecture in a Rotman School class on the "New Economy." In the class, I blasted the newly-announced merger as idiotic for Time Warner and doomed to failure. But I struggled to explain why to the MBA students, even though I was absolutely positive that I was right. The fact that I turned out to be right is not the point, though it is more fun to be right than wrong. The intriguing question is *why* I was so sure. I couldn't figure it out for ten years — and only just did.

My intuition at the time was simply that the rationale for the merger was too good to be true. What I worked out finally — with a little help from my writing buddy Jennifer Riel — was that the rationale was fundamentally illogical. It was an example of what I now call a logical mash-up, and I suspect that logical mash-ups form the foundation of many other failed strategies.

Let's look at what happened at AOL/Time Warner.

Time Warner had a problem. The online world — exemplified by AOL at the time — was coming at it like a freight train. It had no idea how to get customers to pay for its content online, and worried that in an all-digital future, a paid subscription model would fall apart. AOL had a vast audience of paying customers, all presumably thirsty for information.

So, Time Warner posited the following: together, they can provide AOL's customers with proprietary access to the Time Warner's valuable content, providing a point of differentiation among competitive Internet service providers (ISP), creating more AOL customers and simultaneously providing a revenue stream for the digital content. Plus, the deal would also give AOL access to Time Warner's broadband cables, increasing its capacity to deliver the rich content.

It seems like a lovely, tidy solution, but let's examine the thinking more closely.

Underlying the new business model was the assumption that AOL customers care about proprietary content.

Now if that turned out to be true, then customers would flock to the merged company in droves. This starts to look attractive until we dig a bit deeper. AOL did have about 30% market share at the time, but the ISP market was turbulent and competition in that market was intense. Was it likely that competitors would merely sit by and watch AOL steal their lunch thanks to its Time Warner content?

No, they would refuse to distribute anything that Time Warner produced, online or not, and instead launch their own proprietary content. Time Warner, in order to have preferential access to AOL's subscribers, would have cut themselves off from distribution to some 70 percent of the market. Given the high fixed costs inherent in Time Warner's business model, this would be a devastating hit to profitability.

The only way that this retaliation would not take place would be if have been if AOL customers didn't care all that much about the proprietary content. But in this case, offering proprietary content is a bad idea: your subscribers don't care and Time Warner has given half of its shares away for something that turns out to have no strategic value.

So much so obvious. But now let me put the arguments down more formally. What we have are two clear IF-THEN-BUT conditional constructs:

1. IF customers don't care about proprietary content, THEN competitors won't aggressively retaliate when we wall off our content BUT we won't make any money from greater AOL success.
2. IF customers care very much about proprietary content, THEN we will be able to build share of AOL and charge a high premium for our content BUT this will lead to a competitive retaliation and a bloodbath in our content business.

Looking at these two statements, it became clear to me that what happened at Time Warner was that the folks in charge of the merger took one predicate (an 'IF'), mashed it together with both consequents (the 'THENs') of the two conflicting conditional statements and imagined-away the negative consequences (the 'BUTs'). In doing so, they created a nonsensical structure that was unsupported by the facts at hand:

IF customers care very much about proprietary content, THEN we will be able to build share of AOL and charge a high premium for our content AND competitors won't aggressively retaliate when we wall off our content.

I now realize that this is a repeated form of logical failure in strategy. Two independent logical strands, each of which is internally logical, get mashed together to produce something quite illogical.

To come: More examples of the logical glitch, the way to guard against it, and how to use opposing models to produce great (rather than hopelessly flawed) strategy.

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