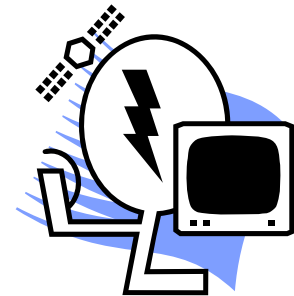


TV wars: content and competition in pay TV



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Overview

- Issues

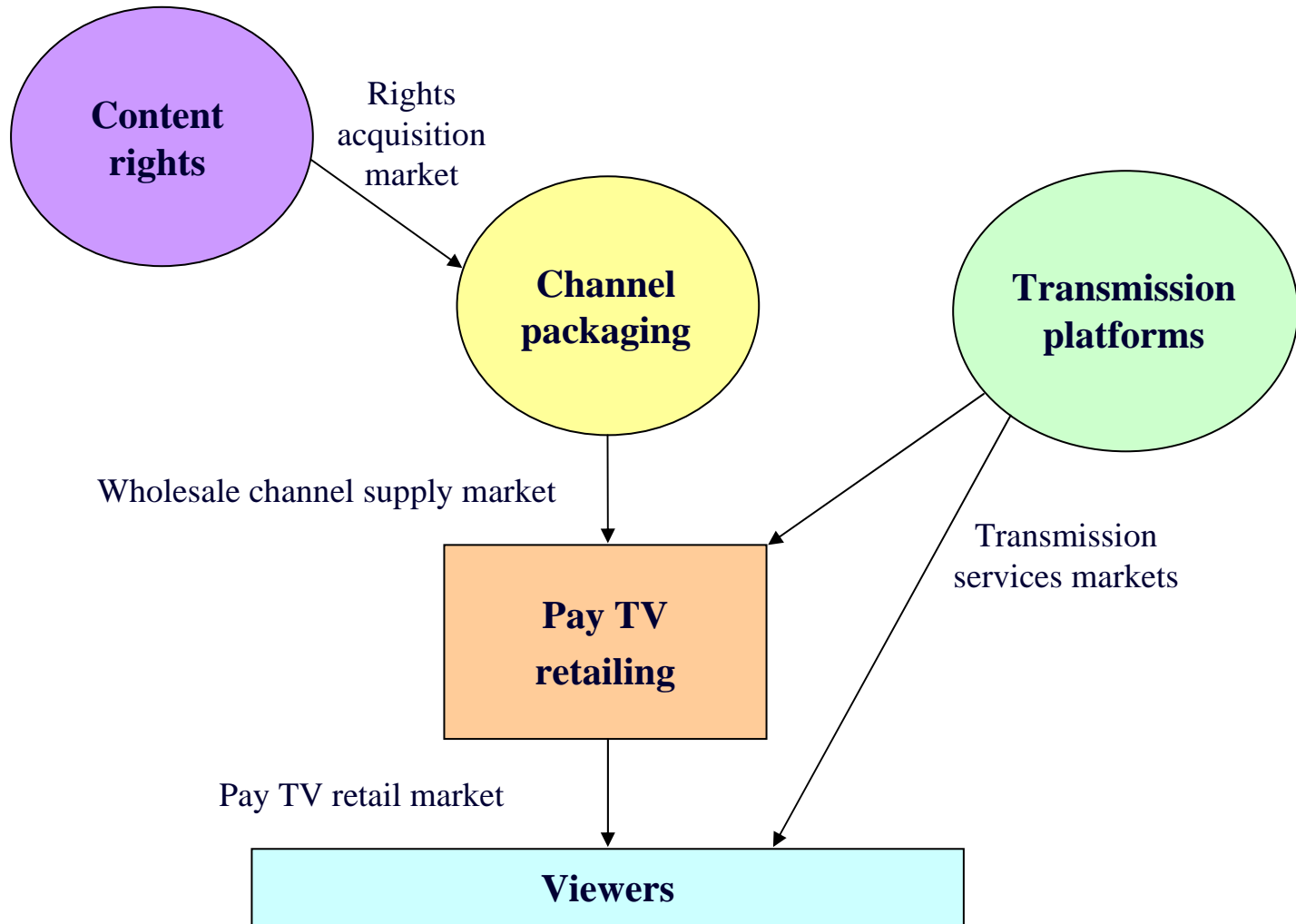
- Pay TV industry
 - Structure
 - Economic characteristics

- Supply of premium content
 - Static analysis
 - Dynamic competition

Shift in regulatory focus

- Transmission bottlenecks
 - Digitisation: relaxes capacity constraints
 - Platform proliferation: cable, satellite, DTT, IPTV
 - Access regulation
- Control over “premium” content
 - Popular sport; Hollywood movies
- 2 questions
 - (When) will a broadcaster supply its channels exclusively?
 - Is exclusivity anti-competitive?

Pay TV industry structure



Dutch TV industry

- Premium content: football, Hollywood movies
 - Eredivisie considering launching its own channel
- Channels
 - Premium: Chellomedia/Liberty (Sport 1, Film 1)
 - Commercial: RTL, SBS, TMF & others (international)
 - Public service broadcasting: NPO/NOS
- Transmission
 - Cable (87% of TV mkt): Ziggo, UPC & others
 - Satellite: CanalDigitaal
 - IPTV: KPN (Mine TV), Tele2, others?
 - Terrestrial (DTT): Digitenne/KPN

Premium content

- Highly attractive to viewers
 - High willingness to pay
 - “Pulling power”: drives retailer / platform choice
- Few substitutes
- Monopolisation
 - Collective selling by sports leagues
 - Large packages of exclusive rights
 - Staggered auctions for different rights

Channels

- Programme and channel costs
 - Large fixed cost
 - Additional viewers supplied at zero incremental cost

 - Need to reach many interested viewers
 - Multiple platforms
 - Not all subscribers will switch
- ⇒ Incentive to supply other platforms

Transmission platforms

- Economies of scale & density
 - Single operator on each platform
 - Access to bottlenecks may allow competition: IPTV

 - Dynamic competition
 - Single-homing and switching costs
 - Inter- and intra-platform competition
- ⇒ Incentive to build platform subscriber base

Supply of premium channels

- Retailer with premium channels (vertical integration)
- Does it choose
 - Exclusivity: supply to own subscribers only; or
 - Non-exclusivity: wholesale to other retailers / platforms?
- Is exclusivity anti-competitive?
 - Impact on platform competition
- Terms of wholesale supply
 - Impact on retail pricing
 - Margin squeeze

Cases

- UK
 - Wholesale supply of Sky's premium channels
 - Sky-Virgin dispute over *Sky One*
 - Ofcom: pay TV competition; Sky's DTT service
- Italy, France, Scandinavia
 - Exclusive contracts in satellite TV competition
 - Wholesale offer as merger undertaking
- USA
 - Cable overbuilding and channel access
 - DirecTV contracts with sports leagues (NFL, MLB)

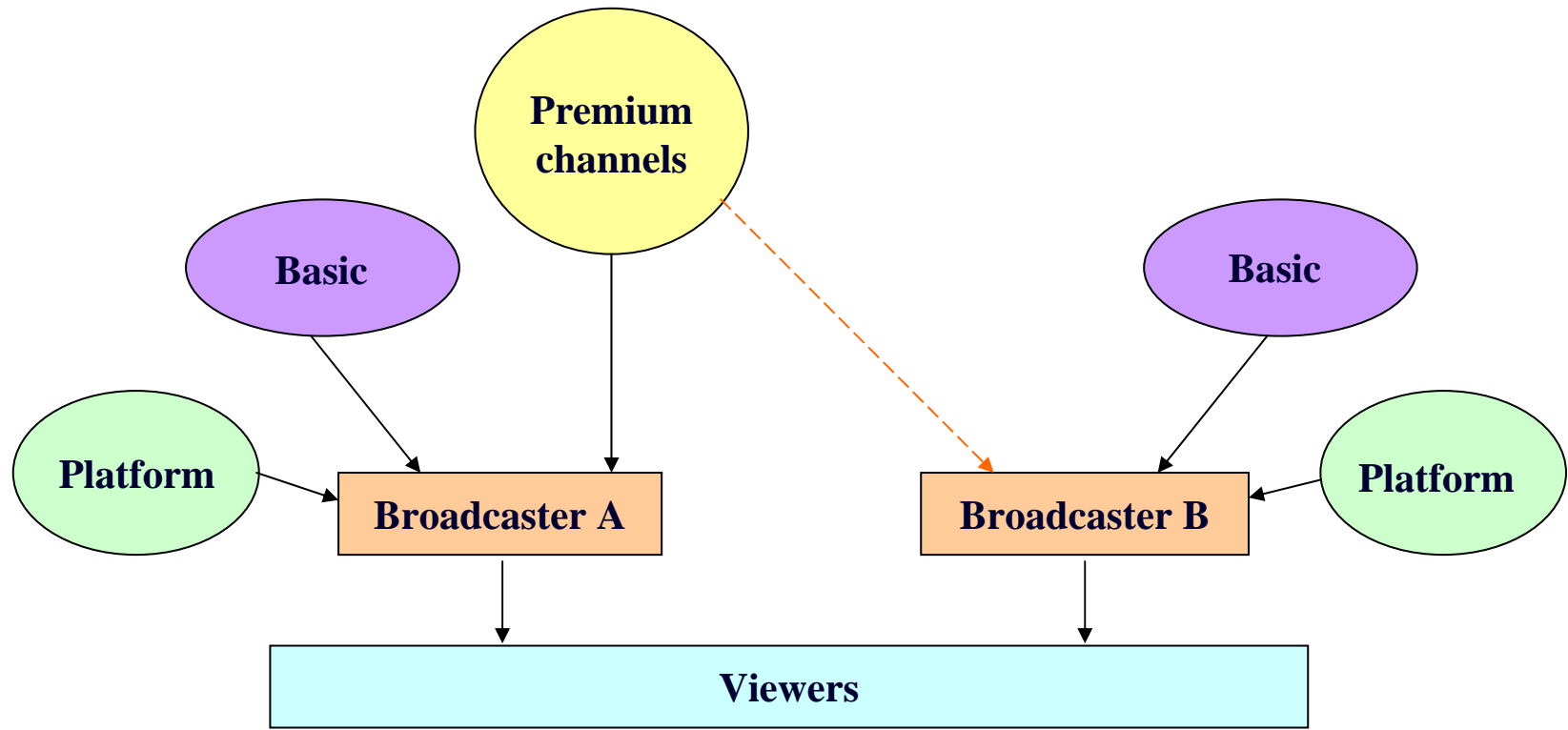
Model

- 2 competing broadcasters
 - Horizontal differentiation (e.g. platform, basic content)
 - Hotelling model with exogenous locations
 - Compete in prices (subscriptions)

- One broadcaster has premium content
 - Raises attractiveness to viewers by v
 - May supply to competing broadcaster
 - Wholesale contract: per-subscriber fee (or two-part tariff)

- Compare profit from exclusivity / non-exclusivity

Model structure



Static incentives for channel supply

- By supplying another retailer, channel supplier gains
 - Wholesale fees
 - Advertising revenues
- Fee structure is important
 - Typically per-subscriber fees or revenue share
- Static analysis: with per-subscriber fees, there is **no** incentive for exclusivity
 - Extracts willingness to pay of viewers on other platforms
 - Chooses **non-exclusive** supply

Role of per-subscriber fee

- Very important for wholesale supply
 - E.g. for channels to be carried on all platforms
- Softens retail competition between the same content when sold by different retailers
 - Marginal cost to buyer
 - Opportunity cost to seller
 - Raises retail price (compared with lump-sum fees)
- Without per-sub fees, channels may instead be withheld (i.e. exclusivity)

Competition effects

Non-exclusive supply has mixed effects

- Allocative efficiency
 - Both sets of subscribers view premium channels
- Retail price competition is weak
 - Per-sub fee determines retail prices of both operators
 - With exclusivity, price competition is stronger
- Unclear which dominates: consumers may be worse off under non-exclusivity

Regulation of wholesale fees?

Should there be regulation to reduce wholesale fees?

- Lowers retail prices
- Risks refusal to supply content (exclusivity)
- Effectively regulates returns to content
 - Difficult: cost-based pricing inappropriate
 - Incentives for content creation and investment in quality

Puzzle

- Exclusivity is sometimes observed
 - Scandinavia: Viasat and Canal Digital (satellite operators)
 - France, Italy: between satellite operators pre-merger
 - Most attractive content (e.g. HD) sometimes exclusive

- Possible (static) explanations
 - Breakdown in negotiations?
 - Inability to charge desired per-sub fee?

- Something more?
 - Dynamic competition

Dynamic competition

- Static analysis is not the end of the story
- Dynamic competition
 - Incentive to win subscribers
 - Exclusive content is an important draw
- Reasons
 - Lock-in: single-homing and switching costs
 - Economies of scale & density in platform operation
 - Investment in platform quality (e.g. digitisation, HD): largely fixed costs
 - Exclusion (not always plausible)

Dynamic incentives for channel supply

- Trade-off between
 - Wholesale fees & ad revenues (static incentive)
 - Dynamic benefits in platform competition

- **Exclusivity** may be chosen in some cases
 - Dynamic effect is strong
 - Relationship between current share and future profit
 - Operators are less differentiated
 - Intra- rather than inter-platform competition
 - For more attractive content
 - Premium not basic

Dynamic mechanism

- Exclusivity creates initial asymmetry in market share
- Future profit is convex in current market share
 - E.g. models of switching costs, network effects:
↑ current share \Rightarrow ↑ share **and** ↑ price in future
- With initial lead, marginal benefit from gaining share is higher \Rightarrow cut price to build share further
 - Initial asymmetry is enhanced
- Key principle: industry profit must be increasing in **asymmetry** of market shares

Effects depend on dynamic mechanism

Leverage from premium channels to retailing / platforms

- Exclusion
 - Reduces competition in the long run (like predation)
 - Less plausible when platform assets are sunk (though may prevent entry)

- Switching costs
 - “Sowing” period: lower prices under exclusivity
 - “Reaping” period: asymmetry weakens competition
 - Very attractive content: holder chooses exclusivity in sowing phase; consumers prefer non-exclusivity

Competition effects (2)

Exclusivity may benefit consumers in some cases

- Platform investment
 - Exclusivity raises average platform quality: good for consumers too
 - Economies of scale in platform investment
 - (Another way of creating asymmetry may be preferable)
- Market entry strategy
 - DirecTV: exclusive content rights used to enter market against entrenched cable incumbents
 - Why don't incumbents buy up content instead?

Margin squeeze

- Margin squeeze may have similar effect
 - Supply content, but raise wholesale fee (relative to own retail price)
 - Reduces rival's retail market share
 - Dynamic effects: lock-in subscribers; investment; etc.

- OFT's margin squeeze test (BSkyB 2002)
 - Prevents discrimination between own & competitor's retailing operations
 - Restricts distortion of market shares, & hence dynamic effects

Key messages

- Static analysis: strong incentive for non-exclusivity
- Dynamics may give incentive for exclusivity
 - Consumer effects depend on mechanism
 - Current developments: digital switchover, IPTV
 - Are we in a “sowing” phase?
- Underlying problem: monopolisation of content rights
 - Monopoly feeds down vertical chain
 - Regulators may try to limit discrimination (excl., margin sq.)
 - But can't prevent monopoly pricing
 - Preferable to avoid monopolisation