TV Wars: Content and competition in pay TV

Helen Weeds, University of Essex

IESE second audio-visual industry meeting
Barcelona, 27 November 2008
Today’s television landscape

- Multiple transmission platforms
  - Satellite
  - Cable
  - Digital terrestrial (DTT)
  - IPTV
  - Mobile TV

- “Premium” content drives choice of platform / retailer
  - Popular sports (especially football)
  - Hollywood movies
Control over premium content has given rise to antitrust concerns

- Monopolisation of premium content
  - Sports leagues sell televisation rights collectively, often to a single broadcaster
  - Hollywood movie rights often bought up by one broadcaster (staggered contracting)

- Role in retail competition
  - Refusal to supply premium content to rival broadcasters (i.e. exclusivity)
  - Or if supplied, wholesale terms may be unfavourable compared with holder’s own retail division
  - Concern over (full or partial) foreclosure
When do we observe exclusive supply of premium content?

- Competing satellite broadcasters
  - Scandinavia: Canal Digital & Viasat;
    France: CanalSat & TPS; Italy: Stream & Telepiù
  - Yet Telepiù supplied Stream’s *cable* customers
  - Wholesale offer required as merger undertaking
  - USA satellite radio: Sirius and XM

- Emerging platforms
  - USA: DirecTV’s NFL Sunday Ticket (satellite)
  - France: Orange Cinema Series (IPTV, mobile TV)
  - Belgium: Belgacom has Belgian football league (IPTV)
Ofcom’s Pay TV second consultation: “Access to premium content”

2 concerns from Sky’s control over premium content

- Limited distribution to rival broadcasters, resulting in distortion of retail competition and
  - Limited consumer choice: content not available on all platforms
  - Reduced innovation (platform & retailing)
  - Higher prices

- High wholesale prices
  - Resulting in high retail prices
  - Ofcom says it is hard to draw firm conclusions on this
Outline of talk

- Is exclusivity always bad for consumers?
- Static and dynamic incentives
- Ofcom’s proposed regulation
Is exclusivity bad for consumers?

Given that premium content is held by one broadcaster

- **Non-exclusivity: wholesale supply to rivals**
  - All broadcasters offer premium content to customers
  - Per-subscriber wholesale fee (or revenue share) is typical
  - Fee softens price competition, resulting in high retail prices
    - Buyer’s marginal cost of supplying a customer
    - Seller’s opportunity cost of winning a customer

- **Exclusivity: refuse to supply rivals**
  - Rival competes by cutting price
  - Retail prices are lower: consumers may be better off
  - Though not efficient (allocative inefficiency)
In a static setting, the holder has a strong incentive to supply rival broadcasters

- Seller faces trade off between
  - Forgone wholesale fees (& advertising revenues)
  - Attracting own subscribers

- In a static framework (current cashflows)
  - Seller’s profit is lower under exclusivity
  - No incentive for exclusive supply
  - (C.f. literature on licensing: efficient allocation is chosen)

- Puzzle
  - Why is exclusivity observed?
  - Seems too prevalent and prolonged to be bargaining failure
Dynamic effects can give incentive for exclusivity

- Higher market share today increases profit tomorrow

- Dynamics can provide incentive for exclusivity
  - Additional benefit to winning customers from rivals: higher profit in future
  - Including this, exclusivity may be more profitable

- Can explain observed exclusivity
  - Strong dynamic effect (war of attrition, emerging platforms)
  - Less differentiated competitors (head-to-head satellite)
  - High-valued (premium) content
Dynamic effect arises from scale economies

- Key: industry profit must be higher when market shares are asymmetric
  - Exclusive content generates asymmetry in market shares
  - In presence of significant scale economies, asymmetry raises industry profit (despite allocative inefficiency)
  - Seller chooses exclusivity

- Possible mechanisms
  - Switching costs: build larger base, higher profit in future
  - Platform investment: spread fixed costs across larger base
    - If raises quality, exclusivity may be good for consumers
Ofcom’s dynamic mechanisms

Exclusivity strengthens Sky’s retail position, which affects

- Content acquisition: weakens rival bidders for content
  - Lowers price of content rights (monopsony power)
    - If so, rights sellers should want to prevent this
  - Strengthens Sky’s dominant position in wholesale supply, as rivals unable to develop competing wholesale offers
    - But monopoly value is higher anyway (Gilbert & Newbery)

- Competition for basic subscribers
  - Economies of scope between basic & premium retailing: fixed costs in marketing/retailing; additional bundling
    - Are these really so large?
Relationship between downstream position and content acquisition

- Ofcom assumes that a retailer / platform with more subscribers automatically gains an advantage in competition for content (e.g. auction)
  - Earns greater revenues from the content
  - Bids more, hence wins the auction
  - May also reduce bids of rivals, which could reduce prices

- And that this provides an incentive for exclusivity
  - Distort or withhold supply of premium content to influence subsequent auctions
Fallacy 1: Content revenues depend on size of broadcaster’s own platform

- Revenues from premium content are earned from all platforms / retailers
  - Holder earns large revenues from other platforms
    - Indeed, rivals complain that Sky charges them too much!
  - Then little incentive to distort platform choice
  - NB: platform access may need to be regulated

- Possibility of inefficient / non-supply
  - E.g. breakdown in bargaining
  - Then own platform size may matter: broadcaster with larger platform has higher expected revenues from content, but…
Fallacy 2: Bids depend only on revenues earned from winning the content

- A bidder faces choice between
  - Winning the content for itself
  - Content going to a rival bidder
    - (May then be able to buy at wholesale level)

- Value of winning is the *difference* between these scenarios
  - E.g. Bid = revenue if win – revenue if lose

- Larger subscriber base raises profit in both scenarios
  - Not obvious how the difference is affected
Content acquisition and dynamic incentives

- Dynamic incentive requires scale economies
  - Equivalently, a *convex* relationship between today’s share and tomorrow’s profit

- Content acquisition does not generate this relationship
  - Even if larger broadcaster has higher value of winning (e.g. bargaining frictions), relationship is *linear* not convex
  - Does *not* provide an incentive for exclusivity

- Scale effects typically arise at *platform* level
Wholesale regulation of premium content

- Ofcom’s two concerns would call for different forms of regulation

- Distortion of downstream competition
  - Must-offer rule at wholesale level
  - Retail-minus price regulation to prevent margin squeeze (usual antitrust rules can achieve this)

- Excessive wholesale (& retail) prices
  - Per-subscriber fee effectively sets monopoly retail price
  - Regulation to reduce per-subscriber fee might seem attractive…
Regulation to reduce wholesale prices

Two major problems

- Circularity of cost-based wholesale regulation
  - Major cost of premium channels is the price of content rights, and this is determined endogenously by what broadcasters earn from them

- Effectively regulates the value of content rights
  - Ofcom appears not to want this:
    
    “any mechanism that caused an artificial depression of rights values would be extremely undesirable.” (para 9.75)
Retail-minus regulation

- **Competition law approach**
  - Based on integrated firm’s own retailing costs
  - *De facto* already applies to Sky (OFT 2002 investigation)

- **Entry-promotion approach**
  - Widen the minus to cover retailing costs of (less efficient) new entrant
  - Borrowed from telecoms regulation
  - Ofcom appears to be going down this route…
Widening the margin: is this appropriate?

- Ofcom is proposing to extend an approach familiar from telecoms regulation to pay TV

- This seems misplaced
  - Not a regulated industry with a legacy State-era incumbent
  - Competitors are hardly weak entrants
    - Telecoms incumbents (!)
    - Cable entered at same time as satellite
    - Competitors have other advantages (triple play)
    - Terrestrial has long-standing State support
  - Incentive effects of penalising successful firms
Widening the margin: unintended consequences

- Retail prices are unregulated (unlike ECPR): need to examine effects of widening the margin
  - If wholesale price does not fall (and it may not), retail prices will go up
  - If wholesale price falls, competitors’ retail prices fall, but incumbent’s retail price rises as margin is widened
  - Return to content rights seller is reduced
    - Winner (Sky) makes lower revenue
    - Losers make more revenue
    - Bids depend on difference: widening the margin (doubly) reduces rights values: very bad for rights sellers
  - If content quality is endogenous, this is likely to fall
To conclude…

- Dynamic incentives for exclusivity may exist, arising from economies of scale
- Content acquisition is unlikely to be the source of dynamic incentives
- Consumer welfare impact of exclusivity is mixed, and sensitive to the precise dynamic mechanism
- Ofcom’s proposed regulation – widening the margin – is likely to have harmful unintended consequences