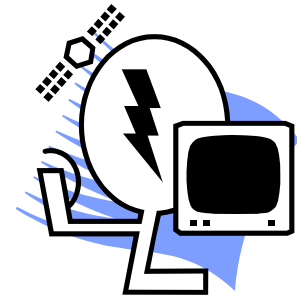


TV Wars: Content and competition in pay TV



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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 television 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. $\text{Bid} = \text{revenue if win} - \text{revenue if lose}$
- 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