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Controversy on the Audiovisual Market – the Pay Television Model in Comparison with Open-Broadcast Television

This article analyses one of the current problems of the audiovisual market – the pay television model in comparison with open-broadcast television. It looks at various examples to study the consequences for the market should one of the models take up a dominant position. The scenario under study comprises a strong pay-TV platform, with market control, leaving open-broadcast TV void of content and preventing possible competitors from gaining access, giving rise to abusive behaviour by pay-TV companies in the audiovisual market.

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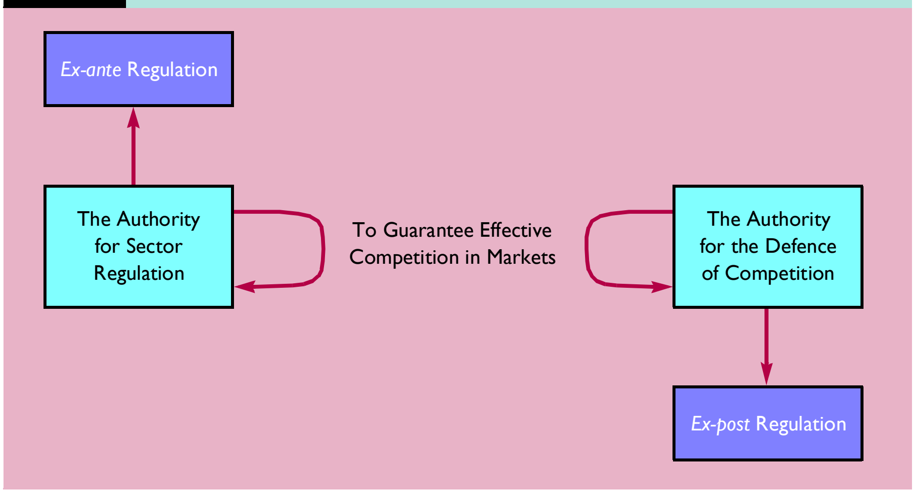
Introduction

The new regulatory framework for telecommunications of the European Union of March 2002 establishes the competencies of two regulation authorities – the authority for the defence of competition, and the authority for sector regulation. The authority for sector regulation (see Figure 1) acts when there is no evidence of abuse by the company but there is a need to discover whether or not there is dominance and it analyses the market to find out whether or not it is competitive once it has been defined. This body applies an *ex-ante* regulation if there is evidence to suggest that the market does not work and that there are dominant companies. In contrast, the authority for the defence of competition acts *ex-post* only, in other words, once a practice or behaviour considered abusive has taken place. Both seek to guarantee effective competition in markets, but the evidence available for the adoption of the decision and the instruments within their reach to correct the situation are different.

The consequent model is the result of political convergence[1]. The role played by European institutions is fundamental to the preparation of regulations governing the national media. This is contrary to other world markets where, as a result of religious beliefs or ideology, democratic values are unfortunately not in place.

The *ex-ante* regulation model we put forward in this article provides sector regulation authorities with a vision on which to base regulatory mechanisms for a sector where there are clear situations of dominance, where this dominance prevents

Figure 1 European Union regulatory framework for telecommunications



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the entry of new companies looking to compete in the market.

We need to create a field of action for the audiovisual market governed by the principles of perfect competition (Figure 2). Perfect competition is a situation that is entirely unreachable in most cases, where the following situations exist:

- the existence of many companies, none of them dominant, incapable of influencing prices;
- numerous consumers incapable of influencing prices;
- similar products;
- free entry to and exit from the market;
- an abundance of open, free information.

Each company looks to obtain the highest possible profit without taking into account, at least directly, social well-being. Each consumer maximises their own use without worrying about others. The result of these cases is maximum social well-being from the Pareto point of view†.

Unfortunately, the situations do not always arise naturally and there is a need for external intervention in markets to attain the social optimum. The case of the natural monopoly is the most typical in the market and arises when production costs are such that it is cheaper to satisfy the demand with one single company than with several. The situation contrasts with the first case of perfect competition, which states that there should be a number of firms incapable of influencing prices.

In these situations, regulation assumes importance as a way of guaranteeing social well-being when perfect competition is not a natural result. The regulator has to influence enterprise by inducing the production of the social optimum at a certain price. However, this situation does not normally arise in practice because the regulator does not have all the information required to determine the optimal quantities and prices. The regulator is rarely aware of a company's cost structure, which is the basis on which the socially optimal supply and price are determined.

However, there are two basic problems:

- there must be a characterisation of the optimal combination of price and quantity that maximises social well-being; in an ideal situation, basic concepts of micro-economy can be applied, such as that which states that price is equal to marginal cost in the optimal solution – however, it is not actually possible to establish this criterion since it would draw companies into a loss-making situation;
- a mechanism must be designed to induce the enterprise to attain the optimal solution – the regulator's objective is for the companies in the market to maximise profits when the socially optimal quantity is produced and sold at the socially optimal price.

The elements or forces intervening in this model (Figure 3) are as follows:

- consumer (who demands the content);
- company (who supplies the content);
- content (the product the company offers the consumer);
- content price (how much consumers value the supplied product, i.e. taking into account the value it is given by consumers and how much they would be willing to invest).

In addition, digital content must be defined: it is information that is digitalised, developed or acquired with the precise aim of being accessible and interchangeable to favour cultural dialogue and the economic development of those using this technology.

The idea is for it to be possible to distribute the content reaching users over various media and, depending on the type of content, for its use to be accessible through payment or otherwise.

Hypothesis

Deregulation brought about the revision of the universal concept of service. Consequently, in today's society, new regulations are necessary[2].

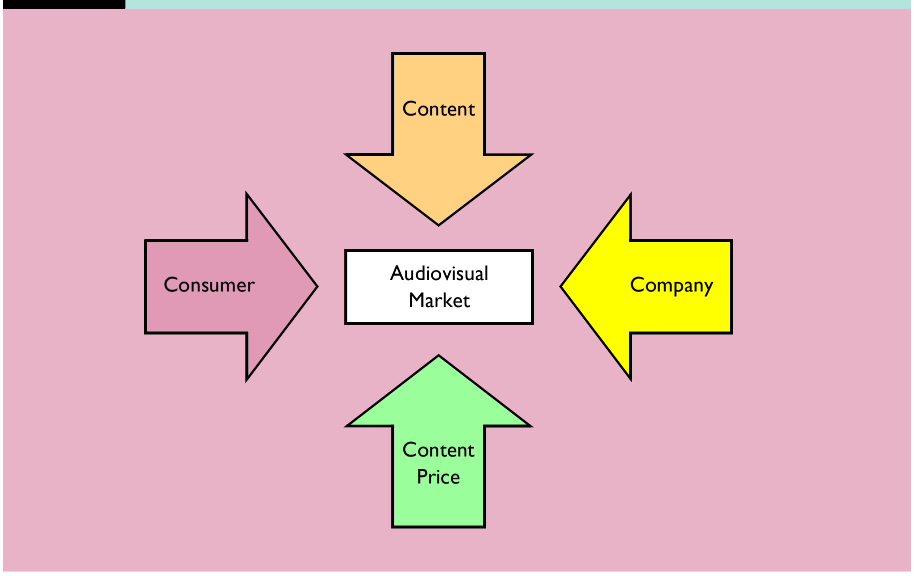
Our regulation model focuses on the consumer as the final beneficiary and also aims at making the market attractive for enterprise.

We must also consider that an appropriate design of a regulation is more important than its justification. Furthermore, before regulating content, it is necessary to regulate the structures that effectively improve access to the various levels and uses, especially with regard to provision and reception[3]. To date, it can be said that the part corresponding to the regulation of structures on a European scale is sufficiently developed, despite the occasional loose end. Therefore, and given the fact that access is regulated, the focus must be placed on regulating the content that is broadcast.

There is no straightforward formula that covers all these interests. For example, if we consult consumers regarding the type of television they prefer, most would choose free television – this is not, however, the

Figure 2 **Audiovisual market should be governed by the principles of perfect competition**

Figure 3 **The elements or forces intervening in the model**



† An allocation of resources *A* is Pareto optimal if there is not an allocation *B* in which at least one agent is better than in *A* and no agent is worse than in *A*.

best solution. Indeed, if all television channels were open, there would be no film premiere slots or certain thematic channels, for which there is demand from certain segments of the consumer base.

Consequently, open-broadcast television and pay television must coexist.

The aim of the model is for each consumer to find what they are looking for and the best tool for this is a varied supply. Indeed, competition between two different types of television is possible, since rather than compete for the same consumer, they complement each other to satisfy every kind of consumer. This is the pay television model in comparison with open-broadcast television.

So, our hypothesis is that the consumer and not the content will be the element that differentiates between open-broadcast television and pay television (Figure 4).

The aim must be for pay television to be limited in its function, that is:

- providing a service to a certain consumer with well-defined needs who is willing to pay;
- television without advertising;
- television with 'immediate' contents, e.g. film premieres;
- television with specific and particular themes, e.g. culture, sports.

Of course, open-broadcast television is unable to meet these objectives. Consequently, pay television is responsible for satisfying the needs of the part of the market that is beyond the possibilities of open-broadcast television.

To remain coherent with our initial hypotheses, we must establish the fact that a pay television channel should never compete with open-broadcast television channels, since its rivals in the market are the other pay television channels.

Scenarios in the Model

Scope

From the perspective of demand, all television consumers are consumers of open-broadcast content. However, this vast collective includes two different groups.

- Orthodox – majority group

  According to the latest study in Spain (EGM of February to November 2005), the number of viewers per day watching television is 88.9% (interestingly, this is the lowest level since 1997); in other words, they constitute a public that prefers open-broadcast (free) television only. They are capable of lowering their requirement criteria as long as the product is free – consequently they tolerate advertising.

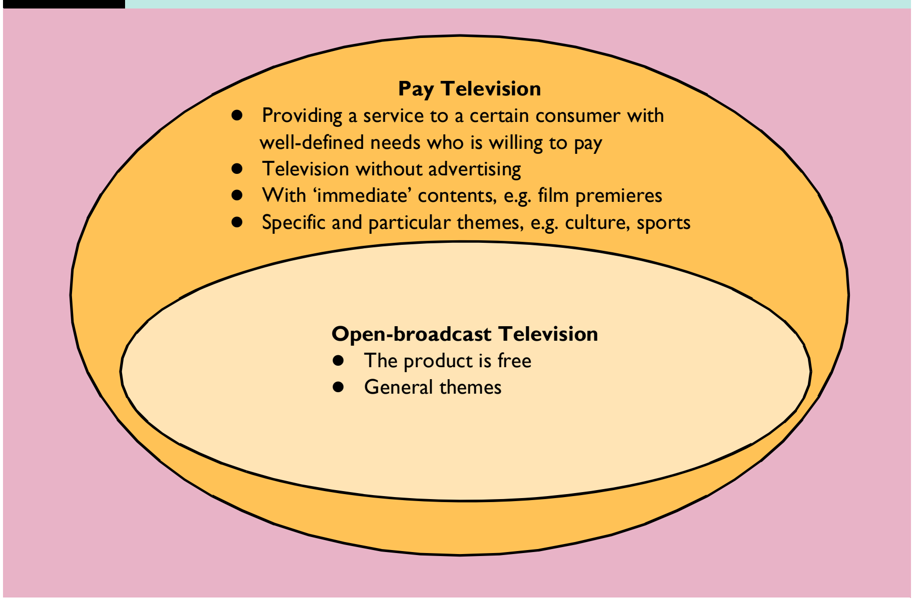
- Heterodox – currently a minority group

  These are also consumers of open-broadcast television. Unlike the previous group, this group is willing to pay for the satisfaction of certain needs that a free television is unable to provide, such as the absence of advertising, the broadcasting of specific content, the immediacy of content, etc.

Purpose

It is necessary to avoid the situation where a consumer in the orthodox group is forced to pay for content that should be available on

Figure 4 The consumer, and not the content, makes the difference



the structural diversity of broadcasting media is the best way of ensuring ideologically diverse programming which, in turn, is the best way of obtaining a healthy democracy

open-broadcast television due to the excessive activity of pay television. Consequently, a number of limits must be set. The simplest criterion would be to establish the market quotas for each kind of television. As we have already mentioned, the percentage of pay-television viewers is lower. Therefore, when it exceeds its quota, it would be penalised. However, 'easy' solutions such as this give rise to certain ethical questions: 'If a pay television channel obtains high viewing figures as a result of its work, would it be correct to penalise it in favour of other less effective open-broadcast TV channels?'

Scenarios

An initial question that must be considered is whether or not there is sufficient market quota for more than one pay-television channel. For example, in Spain, some pay-television channels have disappeared (QuieroTV, the first Spanish digital terrestrial television channel, closed on 30 June 2002) and the historical merger of the two most powerful platforms (Canal Satélite-PRISA and Vía Digital-Telefónica) as it was argued that there was insufficient business in the Spanish pay audiovisual market for two companies.

However, we must not overlook the fact that the structural diversity of broadcasting media is the best way of ensuring ideologically diverse programming which, in turn, is the best way of obtaining a healthy democracy[4]. The pluralism and diversity of the media is being reduced, while the concentration of the ownership of the media is on the increase[5].

Our model proposes the promotion of the development of various companies on the pay audiovisual market. We need to avoid the hidden monopoly we have today, since the only loser in this situation is the consumer. Therefore, our source of inspiration is once again the ideal of perfect competition, which benefits both consumer and enterprise alike.

However, if we examine the past and compare the structure of telecommunications networks before and after the market deregulation, the conclusion is that only slight changes have taken place during this period, making the network denser but not more open. A more successful deregulation would have led to a network more open to new players and one in which the power would have been less centralised, with a guarantee of competition[6].

If exclusivity (providing special or immediate thematic content) is one of the characteristics of pay television, when mishandled, it can become the largest obstacle for plurality in the supply. We shall therefore analyse the two extreme scenarios.

- Supremacy scenario

  A pay-television channel controls almost all interesting content.

  Business result: hidden monopoly – beneficial only for the dominant company, ruinous for the rest.

  Result for the consumer: poor supply, lack of competition in the market – it is never beneficial for the consumer. The dominant company can arbitrarily set its prices without concern. The only benefit for the consumer is that they only have to subscribe to one channel to receive all the pay-television content on the market. The situation of supremacy was studied by Noam[7], who quoted a teacher of Finance and Economy as saying that: '...the basic foundation of regulation has been the need to compensate the imbalance of power between huge providers of monopoly and small users who are technically ignorant'. In turn, Noam also pointed out that an atmosphere of convergence would solve the traditional problems of price, quality, security, privacy and content variety.

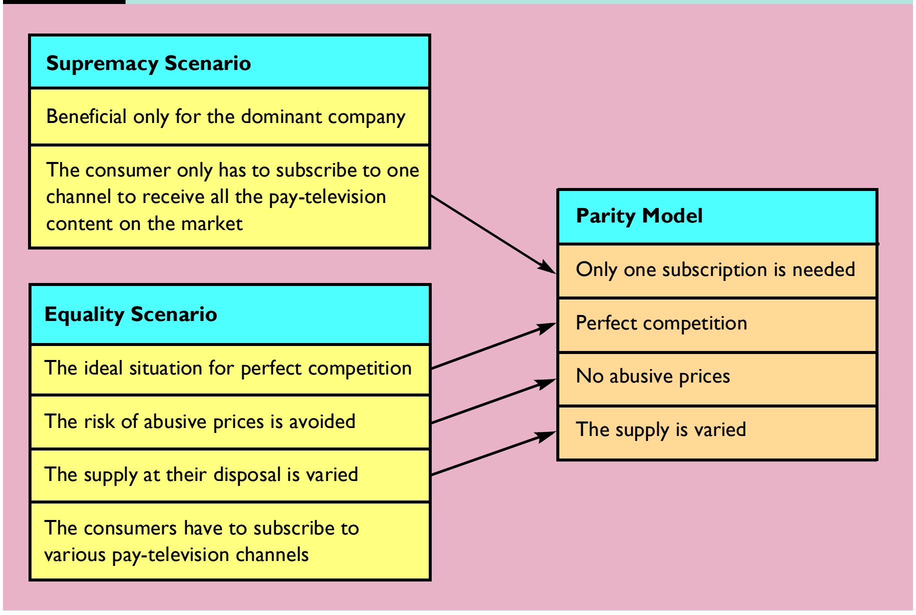
- Equality scenario

  Various audiovisual platforms operating under equal conditions share the content fairly.

  Business result: the ideal situation for perfect competition.

  Result for the consumer: owing to the competition, the supply at their disposal is varied and, as there is no dominant company, the risk of abusive prices is avoided. However, the disadvantage is that consumers wanting to access all the contents have to subscribe to various pay-television channels.

Figure 5 **Pay television – the new regulator model should take the best features from each scenario**



Model Proposal

Our regulator model takes the best features from each of these two scenarios (see Figure 5). From the business point of view, it is clear that plurality is the most profitable and the variety in the supply has advantages for the consumer. The great disadvantage is that, as we have already mentioned, consumers have to subscribe to various pay-television channels.

For example, let us suppose that one channel has acquired the exclusive rights for football, another for basketball and another for history documentaries. Consequently, a consumer or, for the sake of our argument, a family whose father is a football enthusiast, the son a basketball enthusiast and the mother a documentary enthusiast, will have no option but to subscribe to three different platforms. Different preferences in one family are not rare. For example, Van Rees and Van Eijck[8] identified eight clearly different programming repertoires in terms of status, gender, age, employment situation, religion and political leaning. It is therefore clear that there is also a segmentation of the supply in the media.

The solution involves avoiding the exclusive broadcast of content by one single channel. All pay-television market contents must be readily available for all platforms. This means that, for example, a product such as the History Channel could be broadcast by any or all the pay-television channels. The same would apply to football.

This would lower production costs because the content would not be 'auctioned', since there would be no sense in a pay-television channel spending excessive amounts on football matches, for example, when they are no longer exclusive. The interested channel would only have to pay the provider for the broadcast rights of content to include it in its programming. What would differentiate one pay-television channel from another, even though both channels offered the same content, would be the important subtleties of quality when presenting their products, the different presentation, etc. In other words, each company would use its own strategies, such as getting its programming right with regard to a new product, by taking into account the strength of the new product before programming it[9]. It would be similar to what happens with restaurants. On one single street, there are three different establishments offering the same product: a similar menu, the same prices and the same quality product. However, there will always be one that stands out as our favourite because we like its image or because its service quality is better. As with the restaurant example, the supply of various television channels tends to be similar – the higher the level of competition, the lower the level of diversity in programming[10].

The service (varied supply, absence of advertising, interactivity) would therefore be the element of competition and the reason behind the difference in price of the various audiovisual content distributors.

This would bring together the advantages of the two aforementioned scenarios and give rise to the following model.

- Parity model

  Various audiovisual platforms, operating under the same conditions, offer pay-television content without the restriction of exclusivity.

Business result: the ideal situation for perfect competition. Different companies offer the same product. They would be differentiated by their different forms of management and presentation. None of the providers has a dominant position, as is the case now with football clubs, which set excessive prices.

Result for the consumer: there are no abusive subscription fees as there is no one dominant company that takes over content of interest and, as a result of the competition, the supply at their disposal is varied, where each consumer can choose a television company that best suits their preferences (as in the restaurant example). This means that everybody is happy:

– the supply because their efforts do not have to focus on amortising the high cost of exclusive content, but rather on presenting them attractively;

– the demand because the consumer does not have to subscribe to various pay-television channels to access all the content.

Model of Coexistence with Open-broadcast TV

Open-broadcast television and pay television are necessary for consumer satisfaction. They can both coexist in peace and harmony since they are complementary to each other: the limitations of the one are the virtues of the other. We have to achieve this symbiosis, preventing it from becoming an aggressive relationship in which one of the parties tries to absorb the other. The risk will normally come from pay television. Consequently, certain measures are necessary to insure that it does not forget its identity or *raison d'être*, which is to provide a service for its market segment, which will generally comprise a number of smaller niche markets. Becoming the reference point for the audiovisual market must never be the goal of pay-television channels.

Figure 6 shows a model of coexistence between open-broadcast television and pay television. To obtain a better view of the situation, we again need to analyse the situation using the case of the extremes.

- Pay-TV supremacy scenario

  There is no kind of restriction to pay-TV platforms and they can broadcast any content. Together with the advantage of the parity model, this avoids the high cost of content of interest and places all the more attractive content in the sphere of pay-TV channels.

  Business result: monopoly of content held by the pay-TV platforms.

  Result for the consumer: many will be forced to subscribe to pay-TV channels to enjoy their content of interest.

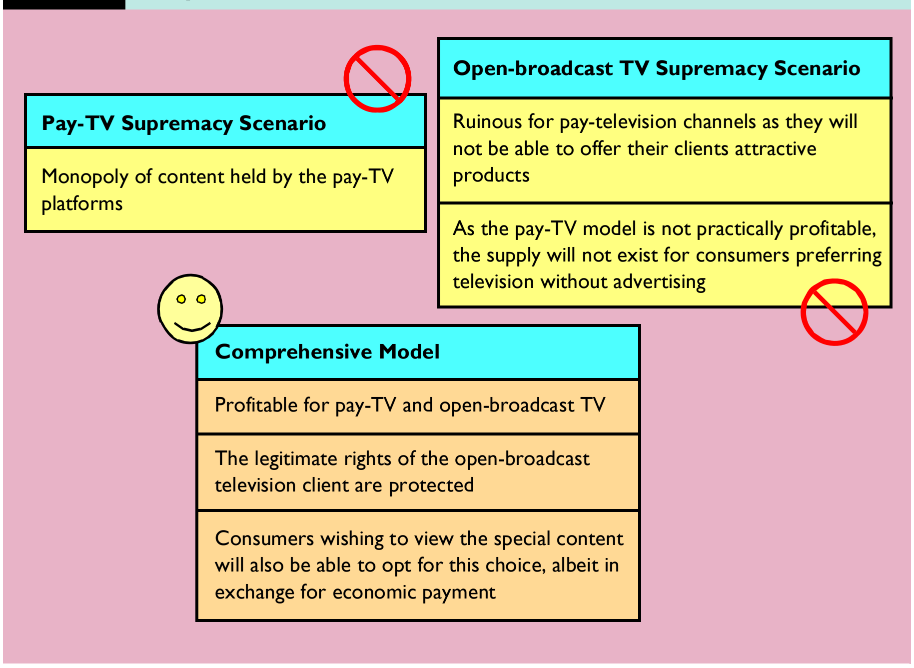
- Open-broadcast TV supremacy scenario

  Severe restrictions regarding the exclusivity of content on the pay-TV platforms. In practice, they will only be able to broadcast the leftover content rejected by open broadcast television.

  Business result: ruinous for pay-television channels as they will not be able to offer their clients attractive products – a company in the sector will not find it profitable to invest in a pay-TV model.

  Result for the consumer: completely satisfactory for the open-broadcast television client. However, as the pay-TV model is not practically profitable, the supply will not exist, and consumers preferring television without advertising, and with the immediate content open-broadcast television is unable to provide, will not be satisfied.

Figure 6 **Model of coexistence between open-broadcast television and pay television**



open-broadcast television and pay television are necessary for consumer satisfaction – they can both coexist in peace and harmony since they are complementary to each other

Consequently, in the same way that Burstein[11] proposes that the courts should distinguish between the regulation of the production of impact content or quality publishing companies and those which structure the distribution of information, a balance should be found in the case of television that benefits all parties – the business world and the end consumer. To achieve this, the best option is to establish limits for both.

The events of particular general interest would be determined by a certain screen quota (e.g. 20%). In this way, content exceeding this margin should be offered for broadcasting to both open-broadcast and pay-television channels.

Accordingly, the characteristics of both would be as follows:

- Open-broadcast television

  – open-broadcast programming;
  – with advertising;
  – will broadcast events of particular general interest.

- Pay television

  – closed-broadcast programming;
  – stricter regulation of advertising;
  – rights for the first broadcast of exclusive and immediate content that is not of particular general interest.

In the same way that we proposed that in the pay-television market model there should be no exclusivity of content for one single platform, we suggest the same between open-broadcast and pay television but with certain logical conditions.

- The events of particular general interest will be for common use

  The fact that their open broadcast is regulated does not mean that the content is not made available to a pay-TV channel. The pay-TV channel can also broadcast the content if it so desires to consumers who, for example, wish to follow a sports event that is of general interest without the advertising slots of the open broadcast.

- The pay-television channels will hold the rights for the first broadcast of certain content

  Once the character of immediacy and exclusivity has been lost, the content will be placed on the open-broadcast market. Examples include films and documentaries, which, by being broadcast first of all by a pay-TV channel, provide the channel in question with the immediacy and exclusivity a certain percentage of consumers are prepared to pay for. Subsequently, once the exclusivity and immediacy have been lost, the content is also placed on the open-broadcast television market for the enjoyment of other consumers.

Conclusion – the Comprehensive Model

In conclusion, we arrive at a balanced model we shall call the 'comprehensive model'.

- Comprehensive model.

  Harmonious coexistence permeates through both open-broadcast television and pay television. They complement each other and there is no rivalry (Figure 7).

  Business result: profitable for both. Each one competes for its potential clients with pay television clearly understanding that its market quota is lower.

  Result for the consumer: the party gaining the greatest benefit. The legitimate rights of the open-broadcast television client are protected and consumers wishing to view the special content (either due to its exclusive, immediate nature or to the fact that there is no advertising) will also be able to opt for this choice, albeit in exchange for economic payment.

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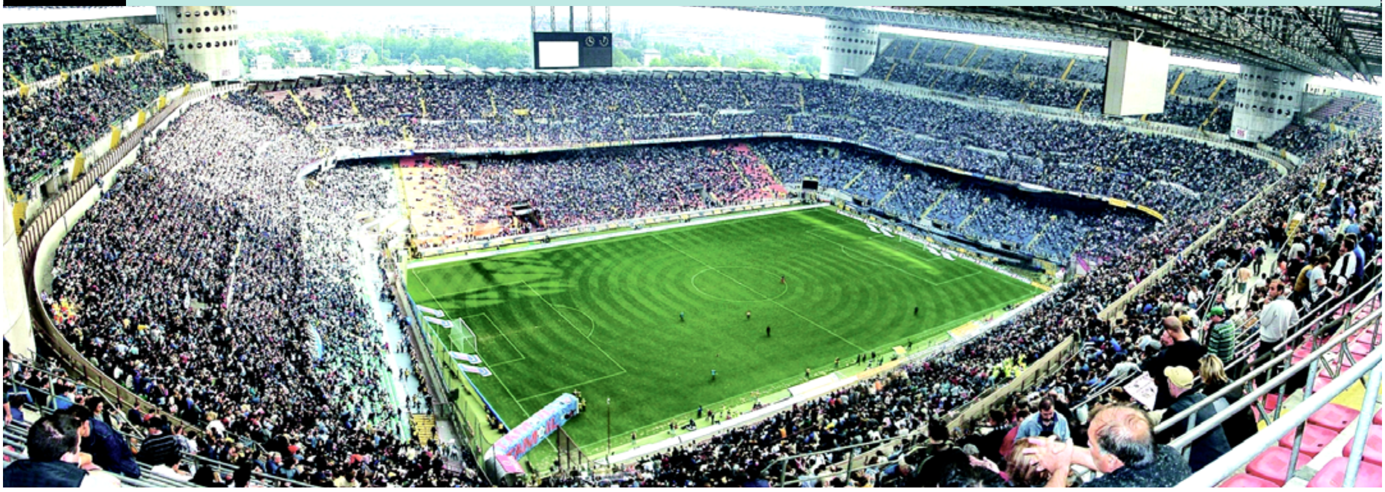
we propose that there should be no exclusivity of content between open-broadcast and pay television

Figure 7 **Events of particular interest will be available for viewing over both open-broadcast and pay-TV**



Biographies

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Beatriz Sainz is a telecommunications researcher and teacher in the University of Valladolid (Spain). She is finishing a PhD in Telecommunications Engineering. She has devoted all her professional life to the investigation of telecommunications regulation matters and to the teaching of novel telecommunications systems. Her future research interests are telecommunications policy and also digital content both from the user's standpoint and from the competitive market vision.

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