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Position Statement on Challenges Faced by Online Video Distributors

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The last ten years have witnessed a dramatic increase in broadband Internet provision and adoption, making it both technologically and economically feasible for an unprecedentedly wide range of entities to supply video content to end consumers. This dramatic change in the video provision landscape brings the promise of enhanced competition and innovation in what has traditionally been a rather concentrated industry. Indeed, we have already seen a wave of new video distributors enter the market utilizing the ever-improving Internet infrastructure, generally termed online video distributors (OVDs), and consisting of firms such as: Hulu, Netflix, Sky Go, YouTube, and several others. What's more, OVDs collectively have already achieved noteworthy shares of household leisure time as evidenced by recent Nielsen data. In particular, as of year-end 2014, people were watching approximately 14.5 hours of video on their phones, computers, and/or multimedia devices (e.g., smart TVs) per month – a figure on the rise, and in stark contrast to falling viewership of traditional TV.

Generally speaking, OVDs are differentiated along three broad dimensions: content offerings, content delivery method, and revenue generation model. OVDs vary in content offerings according to vertical relationships (e.g., Hulu and NBC, Fox, ABC), licensing and rebroadcast agreements (e.g., Sky Go and Comedy Central), and original content offerings (e.g., Netflix and House of Cards). The method of content delivery varies in terms of on-demand vs. linear (i.e., delivery at a scheduled time). Lastly, revenue generation models include: ad-based, subscription, and transactional.

OVDs use varying combinations of the above modes of differentiation to compete with multichannel video programming distributors (MVPDs), largely consisting of cable, satellite, and telcos. The business models of current MVPDs generally encompass those of the OVDs,

¹ The opinions expressed in this document are mine alone, and do not necessarily reflect those of my co-authors or Indiana University.

spanning virtually all types of content offerings, content delivery methods, and revenue generation models. In addition, many MVPDs have substantial content assets and/or contracting relationships with content providers containing most favored nation (MFN) and/or alternative distribution method (ADM) clauses. Lastly, and in contrast to OVDs, MVPDs as currently defined control the means of video transmission.

Despite the substantial entry of OVDs into the video provision marketplace, current and potential OVDs – and possibly by extension the FCC – face substantial challenges. The recent bankruptcy of Sky Angel, along with the fact that traditional TV still dominates alternative forms of video watching (nearly 10-to-1 in time spent according to Nielsen), are consistent with this claim. Several of these challenges stem from asymmetries between OVDs and MVPDs, and various facets of the challenges can be seen in recent research on the demand side of the video market that I and others have conducted. In particular, research reveals challenges rooted in OVDs being “downstream disintegrated,” “content limited,” and “new.” I will clarify the nature of each of these challenges in the context of recent research.

The first challenge I see OVDs facing comes from being downstream disintegrated, which stems from the fact that, unlike MVPDs as currently defined, they generally do not control the means of video transmission. This can create a disadvantage vis a vis current MVPDs, who have the capability of bundling multiple services. In particular, MVPDs typically offer broadband Internet – and often home telephone – in addition to video programming. An offering of these three services for one bundled price is commonly known as Triple Play. In theory, Triple Play bundles can be effective in attracting and retaining video customers, since they lower the incremental cost of purchasing video for anyone already planning on purchasing the other two services. Such bundles may make for a challenging competitive environment for OVDs, who cannot make similar offerings.

Recent empirical research suggests that Triple Play bundles have been effective in retaining customers for MVPDs. Specifically, Shane Greenstein and I examined multiple years of household data containing information on households’ telephone, television, and broadband Internet purchase decisions, along with demographic and locational indicators, and importantly, whether they purchased a Triple Play bundle from a cable company. By matching up similar households over time, we were able to ascertain whether the purchase of a Triple Play bundle in one year lowered the likelihood of dropping any one of the three services the following year. Particularly relevant to OVDs was our finding of a strong retention effect for television service. This finding implies an added challenge to new competitors, e.g., OVDs, trying to gain market share from television providers offering Triple Play. At the time of our study (2007-2009), the primary set of firms offering Triple Play consisted of cable companies; however, such offerings have only increased since. Currently, Triple Play is widely offered by cable and satellite firms, as well as telcos.

Before discussing the next challenge for OVDs, it is important to note that offering Triple Play may generate an advantage for MVPDs for various reasons. Triple Play bundles could be a vehicle for extending market power from one market (e.g., broadband Internet) into another (e.g., television). They also could be a means of capitalizing on economies of scope, if MVPDs find cost advantages from offering all three services together. Further, Triple Play bundles may simply be a way of simplifying the choice set for households. While our research suggests they do create switching costs, it does not go so far as to examine or comment on whether there is reason for competition policy concerns.

A second challenge I see OVDs facing comes from being content limited. Specifically, OVDs can be limited in the content they offer (if refused, or hindered in, access) and when they offer it (typically through ADM clauses). Of particular concern is the potential unwillingness of vertically integrated MVPDs to license content to competing OVDs, and MFN and ADM clauses by MVPDs with programmers that may hinder opportunities for OVDs to work with those same programmers. In addition, ADM clauses by MVPDs can generate limits on the timing of video content distribution by OVDs (known as windowing). In theory, both types of limitation may render OVDs unable to effectively compete with MVPDs.

Again, recent empirical research can shed light on the extent of challenges resulting from content limits. Shane Greenstein and I again examined multiple years of household data to determine whether households notably responded to content offerings of OVDs, with a specific focus on Netflix and Hulu, who were early players in this space. In addition to demographic and TV subscription information, our data also contain valuable information on content preferences. Our analysis finds no evidence that relative content offerings were a notable driver of households' decisions to "cut the cord." For example, if a household exhibited a preference for a particular type of programming (e.g., Comedy Central), there was no measured difference in likelihood to drop traditional TV service (relative to a household that did not prefer Comedy Central) when Comedy Central content became available via OVDs. While we are unable to investigate further why we find this indifference, one possible explanation is the general windowing (i.e., time delay) of the content provided by the OVDs we examine during the time period we observe. That is, delayed content may be considered sufficiently inferior to "live" (or first-run) content for it to be a significant means of competition between OVDs and MVPDs.

The third challenge I see OVDs facing comes from being new to the video provision market. Television watching and even Internet surfing behavior had been well established for many households before OVDs began offering services. If these behaviors are at all resistant to change, then OVDs may struggle for market share simply because they require households to make varying alterations to either or both types of behavior.

Ongoing empirical research also provides some guidance on this challenge, although substantially more limited than the prior examples. Andre Boik, Shane Greenstein, and I are currently examining online attention patterns, and have made a striking discovery. We measure online attention patterns in terms of breadth (i.e., how spread out is time online across domains)

and depth (i.e., how much time is spent at each domain). We find that breadth and depth of online attention remained remarkably stable between 2008 and 2013, despite many new domain options (particularly video) and points of contact (e.g., smartphones). This stability exists despite notable movement in which domains households visit; we see notable increases in social media and video consumption and declines in chat and news. These findings suggest that, at least for computers at home, OVDs have a limited number of attention slots available, as their content requires deep (i.e., relatively long) visits and households appear reluctant to trade several shallow (i.e., relatively short) visits for one deep visit. In addition, if we are willing to extrapolate further, these findings indicate some strong persistence in behavior on a device that uses content provided by OVDs. If there is also persistence in traditional TV consumption patterns, this could pose an additional challenge to OVDs attempting to acquire share. Indeed, empirical analyses (by myself and Shane Greenstein, and many others) indicate that cord cutters (“nevers” and “shavers”) tend to be younger, a group who may have a weaker degree of persistence in behavior for video consumption.

In this statement, I have presented several challenges faced by OVDs and corresponding empirical work that informs them. Some of the empirics are only suggestive, and they are best used in combination with deep industry knowledge and additional analyses to build a more robust understanding of the evolving video distribution landscape and the full extent of OVD challenges. The challenges I’ve highlighted in this statement do not necessarily per se imply regulatory changes, but hopefully prove useful in evaluating regulatory options for the FCC.

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