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Clash of TV platforms: How broadcasters and distributors build platform leadership

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Clash of TV platforms: how broadcasters and distributors build platform leadership

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DRAFT PAPER TO BE PRESENTED AT THE 2014 EUROPEAN REGIONAL ITS CONFERENCE

Abstract

The TV industry has evolved into a multi-sided market in recent years, with distribution platforms increasingly occupying a central position in the market. Whereas until recently their business models resembled that of utility providers, distributors start playing a multi-sided role, liaising with third-party content providers, advertisers and viewers. As a result, we might expect a struggle for platform leadership between TV broadcasters and distributors. This struggle is further intensified by the rise of over-the-top (OTT) TV platforms, which challenge existing power relationships in the TV industry and give rise to conflicts of interests in the media value chain. This paper attempts to provide a deeper understanding of the platformisation in the TV industry, and explore the levers both TV broadcasters and distributors employ in building power to pursue platform leadership.

Keywords

TV industry; platformisation; business models; power

Introduction

In recent years, the TV industry has evolved into a multi-sided market, with distribution platforms increasingly occupying a gatekeeping position in the market. Whereas until recently their business models resembled those of utility providers (e.g. cable/satellite access like water or electricity), distributors start playing a multi-sided role, liaising with third-party content providers, advertisers and viewers. Especially when they expand into the production of content themselves (e.g. establishing their own TV channels), distribution platforms may

exert considerable power over TV broadcasters. Likewise, TV broadcasters are enveloping into a subscription platform (e.g. Hulu) that seek to control the customer relationship. As a result, we might expect a struggle for platform leadership between TV broadcasters and distributors. This struggle is further intensified by the rise of over-the-top (OTT) TV platforms, which challenge existing power relationships in the TV industry and give rise to conflicts of interests in the media ecosystem.

Indeed, the TV ecosystem has been marked by a series of power conflicts between TV broadcasters and distributors. Notable conflicts are those between CBS and Time Warner Cable (USA), and between BBC and Sky (UK). Since technology shocks disrupt the established power relationships, distributors pressure broadcasters to demand lower wholesale (input) prices. In contrast, broadcasters demand a fair compensation for heavy investments in original programming. Although these conflicts have been well-covered in popular press, the dynamics of these conflicts remain underexplored in literature. Distribution is becoming ever more crucial in contemporary media industries, but little research has centered on the power strategies of both TV broadcasters and distributors. This paper aims to fill this void, and discusses the strategies undertaken by all the platform ‘wannabes’ in order to become a platform leader in the TV ecosystem. More specific, the paper zooms in on the platformisation of the TV industry and identifies, in a qualitative way, the bottleneck functionalities that are leveraged by each platform.

The main goal of the paper is to analyze how power relationships in the TV industry are structured, and to identify the levers to establish, maintain and grow as a platform leader. Since most of the debates largely occur in a vacuum, however, empirical evidence is needed to ground the arguments made and justify policy intervention in the market to monitor developments in the market, identify possible problems and define adequate answers based on the availability of reliable and valid research data. Empirical findings drawn from in-depth interviews with thirty-six policymakers and industry representatives from several European TV markets (Belgium, Denmark, Germany, the Netherlands, the United Kingdom) and document analysis (with a focus on telecommunications/media policy) will allow us to build an analytical framework that accurately describes the individual nature of power relationships between TV broadcasters and distributors, and that allows for the assessment of economic power in the TV ecosystem. Such instrument will provide insight into the economic mechanisms underlying the production and distribution of media content, and will help

policymakers in really understanding the platformisation of the TV ecosystem, with a substantial influence on the quality and approach of broadcasting policy.

The paper is structured as follows. The first section comprises a literature review of industrial organization theory with regard to power conflicts between TV broadcasters and distributors, and describes the platformisation of the TV ecosystem. In a similar vein, the competitive strategies used by each of the platform wannabes is explored. In the second section, the paper discusses the levers through which both TV broadcasters and distributors build power to pursue platform leadership. The final section of the paper discusses the role of policymakers and regulators, and assesses the need for public intervention when this struggle for platform leadership escalates.

Platformisation of the TV industry

A multi-player TV environment

The digitisation of television has reshuffled the configurations of power and control in the audiovisual industry. More in particular, digitisation has created a window of opportunities for innovative video services and has enabled firms to play a much more active role in the financing, production, aggregation and distribution of programming (Given et al., 2012). Telecommunications and cable operators have moved beyond their traditional roles of transmitting channels, but are increasingly involved in (commissioning) content creation as well as in directly monetising TV consumption (e.g. through video-on-demand) and even in advertising. Cable operators have not only launched their own TV channels, often targeting a niche, special-interest audience, but are more and more investing in original content, buying sports rights or liaising with independent producers of TV shows and series. Due to long-term contracts with Hollywood studios, most distributors have access to the exclusive first-run pay-TV window and control video-on-demand platforms that sell previews to first-run programming (D'Arma, 2011; Evens, 2013a). Consequently, one can ask to what extent distributors, formerly acting as a utility providers, now function as a mediating platform and play a powerful role in the TV industry. However, the emergence of global OTT platforms like Netflix and iTunes, and streaming players including Roku and Google's Chromecast begs the question how long traditional distributors, usually operating on a local scale, will retain this leading position in the audiovisual industry.

Due to the rapidly growing popularity of Internet-based video delivery, the TV industry has evolved in a complex ecosystem, characterised by the emergence of (potentially) disruptive business models and hyper-competition from OTT services (e.g. Netflix, Apple, etc.). One key feature of this complex, multi-player environment is the possibility (or risk) of disintermediation. The value creation process no longer follows a linear value chain, but digital technology allows plenty of opportunities to lessen reliance on their traditional suppliers/buyers (Evens, 2010). Indeed, content producers and TV broadcasters can bypass traditional distributors like cable/satellite operators, and build a direct relationship with the customer. Whereas in the past producers and broadcasters highly depended on the business terms imposed by traditional distributors, they can now use technology and offer their content directly to the audience. In the United States, broadcast networks ABC, NBC and Fox have launched the Hulu platform, which allows consumers to watch their favourite shows directly over the Internet across multiple screens. The opportunity of OTT platforms, which entail a process of remediation and renew gatekeeping positions, requires content producers and broadcasters to build straight-forward relationships with numerous distribution platforms in the TV ecosystem in order to benefit from a multiplatform strategy. Hence, partnerships with as many distribution platforms as possible form one of the major strategies for creating competitive advantage in the future TV industry (Doyle, 2010).

From two-sided to multi-sided

These developments towards a multi-player environment reflect the evolution of the TV industry from a two-sided into a multi-sided market. Although both broadcasters and distributors operate on a two-sided market, they increasingly depend on the interaction between multiple sides of the market. TV broadcasters need to coordinate the supply of attractive programming with the demand of advertisers, and instead manage distribution. In a similar vein, distributors need to have access to a content delivery network (cable, satellite etc.) and need popular programming to entice subscribers (Evens and Donders, 2013). However, since broadcasters and distributors both operate as a multi-sided platform, leveraging common components and shared user relationships, they are moving into each other's market, resulting in a multi-platform bundle, a phenomenon called platform envelopment (Eisenmann et al., 2011). As platform envelopment occurs, previously separate products and markets evolve, and integrate into ever-larger platforms. Figure 1 shows that distributors are looking to partner with content producers (e.g. sports rights owners) and advertisers whereas broadcasters are directly connecting with viewers (e.g. Hulu) and network

carriers (e.g. mobile services). In light of the enduring convergence of media and telecommunication services, TV broadcasters as well as distributors (including OTT platforms) are now directly competing in the online video marketplace, and therefore deploying competitive rather than cooperative strategies to become a platform leader.

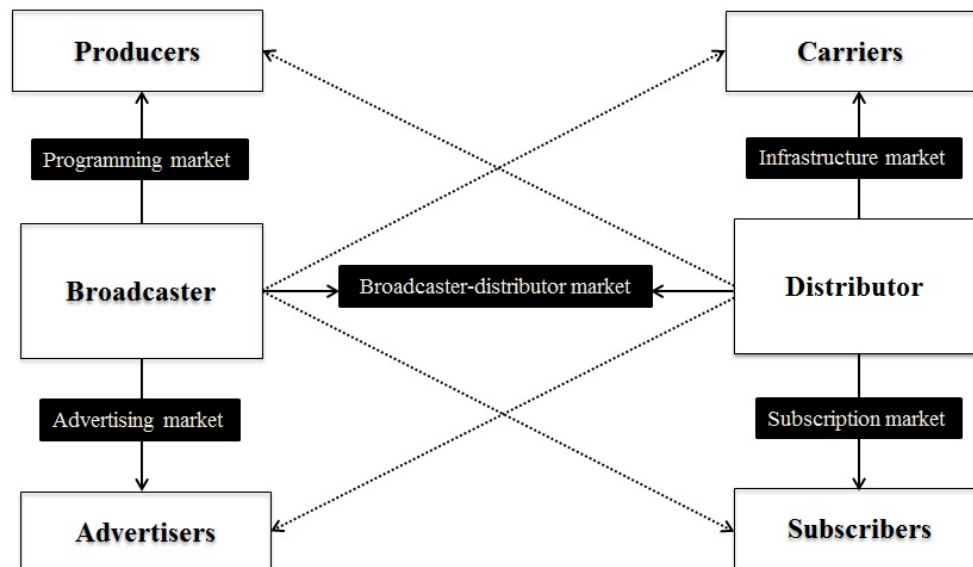


Figure 1: Platform envelopment in TV industry (Evens, 2013b)

This strategic by-passing behaviour, driven by the struggle for platform leadership, might eventually end up in a battle for power and control in the TV industry. The evolution towards platform envelopment, whereby both TV broadcasters and distributors expand into a multi-sided platform to play the first fiddle in the TV industry, often leads to a clash of platforms. Although one might suggest that both platforms heavily rely on each other and benefit from their complementary interests (e.g. content producers benefit from distribution whereas distributors need compelling programming), both platforms are able to deploy strategies to internalise market externalities and simultaneously harm the other platform's interests. Since distributors have pricing power and decide upon the carriage of TV channels (including positioning and numbering on the EPG), they can reduce the availability of these channels and therefore negatively influence a channel's advertising and/or subscription revenues (Kind et al., 2010). In a similar vein, retransmission disputes between TV broadcasters and cable/satellite operators have increasingly risen over the last couple of years. Whereas TV broadcasters claim a higher payment for retransmission of their programming, distributors are keen on squeezing the margins of TV broadcasters. Platform envelopment has been identified as the most successful business strategy undertaken by platform wannabes, but Hidding et al. (2011) show that successful platforms stimulate third parties by creating incentives to bring

them on-board. It can be questioned to what extent the current platform clash between TV broadcasters and distributors helps in building a sustainable TV ecosystem.

Clash of TV platforms

In order to assess the multi-sided character of the TV industry, we need to consider the gatekeeping position of TV broadcasters and distributors with regard to third parties in the ecosystem, more in particular advertisers and independent producers. It is of vital importance for the performance of a platform's business model to bring all these parties on board and coordinate the factors of supply and demand around the platform. The interplay of the various markets (advertising, programming, etc.) and the subsequent indirect network effects constitute an important element of the underlying dynamics of platform competition. Hence, management must focus on the strategies to turn the platform into a winner-takes-all market in order to become a platform leader finally.

With regard to the *advertisers*, a broadcaster's ability to attract and maintain mass audiences puts broadcasters in a powerful position with regard to advertisers. As audience fragmentation continues, popular TV channels that successfully capture and aggregate consumer attention may benefit from scarcity and gain gatekeeping power. However, distributors, most notably operators of digital platforms (cable/satellite/IPTV) own the customer and have a billing relationship with their customers. Hence, they have insight about real-life viewer behaviour and audience figures through the use of set-top boxes or common interface (CI) modules. Distribution could move beyond their role as data broker (e.g. for audience measurement purposes) and create opportunities that allows the advertising industry to better target and personalise marketing messages.

With regard to *independent producers*, broadcasters used to find themselves in a relatively comfortable gatekeeping position. Although the Internet has certainly opened up opportunities to go over-the-top (e.g. by developing their own platform), broadcasters are still the primary commissioner of original programming. Since broadcasters leverage their brand to build mass audiences, independent producers choose to liaise with broadcaster (but they can also consider to start their own channel to reap the fruits of their reputed brand name as some sports leagues have done). In recent years, distributors started developing a multitenant platform that integrate many competing leisure activities, including watching movies, gaming, browsing the Internet and updating social media accounts. By means of interactive services and social

media overlays, distributors have the opportunity to shape, control and monetise the customer experience. Furthermore, many distributors are increasingly eager to close deals with independent producers, even before the programming has been broadcast on traditional networks. Nowadays, many distributors also invest in regular programming such as fiction series in order to gain competitive advantage.

Since broadcasters and distributors are both transforming into multi-tenant platforms integrating advertisers and independent producers, the clash between the two platforms is likely to intensify in the coming years. Up until today, broadcasters are still the main commissioner of programmes, and claim the lion share of the advertising expenditure. As distributors are feeling competitive pressure from OTT platforms, they will move into advertising and especially content more and more. Hence, the key strategic issue for multi-sided platforms at play is to seduce as many stakeholders as possible in order to create a vibrant ecosystem of third-party content providers, advertisers and (paying, if possible) viewers. Moreover, platform leaders draw on a variety of tactics and strategies to construct a compelling customer experience built on cross-subsidisation and service bundling, thereby creating customer lock-in. In a market characterised by network effects, this impact of customer lock-in is of vital importance to claim platform leadership.

Levers of power in platform fights

Crucial in the outcome of platform fights are the levers through which both TV broadcasters and distributors build power to pursue platform leadership. Based on a literature review and in-depth interviews with thirty-six experts in TV production and distribution, five important clusters of power variables were defined (Figure 2).

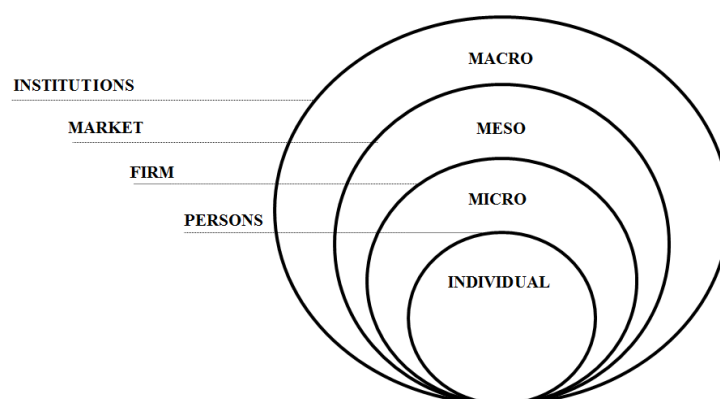


Figure 2: Sources of power to pursue platform leadership

Macro-level: institutions

ANTITRUST LAW. Competition law concerns intervention in the marketplace when there is what economists refer to as ‘market failure’, and is usually designed to promote a competitive marketplace characterized by a high number of buyers/suppliers, and absence of market power. The antithesis of a competitive market is a monopoly, a market controlled by a single party that has the power to provide its goods on a ‘take-it-or-leave-it’ basis. Hence, a monopolist reduces supply and forces prices up so as to maximize profits. Antitrust law aims at creating a level-playing field between TV broadcasters and distributors.

MEDIA-SPECIFIC LAW. Sector-specific regulation comprises additional rules for the media industries (such as ownership and pluralism), and takes into account the economic and cultural specificities of TV broadcasting and distribution. An important strand of media-specific law addresses the imbalance of bargaining power in particular TV markets, and imposes measures to put TV broadcasters on par with distributors. One of the measures is to introduce mandatory arbitration during carriage disputes, and eventually fine parties that fail to negotiate ‘in good faith’. However, the trend is that sector-specific regulation is gradually replaced by antitrust law.

TELECOMMUNICATIONS POLICY. The telecommunications policy framework seeks to strengthen competition by lowering entry barriers and stimulating investments in transmission networks and services for electronic communication. The rules prescribe measurements to ensure a non-discriminatory treatment that are related to bottleneck functionalities such as network infrastructure ownership. Recent discussions have centered on whether infrastructure-based (inter-platform) competition in telecommunications is sustainable and whether service-based (intra-platform) competition discourages investments in infrastructure. Hence, telecommunications policy seeks to find a balance between promoting competition and stimulating investments in services and network infrastructure.

COPYRIGHT LAW. Copyright is of utmost importance in understanding the dynamics of the relationship between TV broadcasters and distributors. The WIPO Copyright Treaty gives authors of creative works the right to authorize (cable and satellite) retransmission of broadcasts. Broadcast programming is thus protected by copyright and is accompanied by an obligation on distribution platforms to require a channel’s consent and to pay a copyright fee. Limited copyright protection denies broadcast networks to charge distributors for retransmission and clearly advantages cable and satellite operators.

Meso-level: market structure

INDUSTRY CONCENTRATION. The degree of market concentration, and, hence, the level of competition is usually considered an important indicator for power in media industries. Due to the presence of scale economies in broadcasting and distribution markets, there is a tendency towards oligopolistic control. Since scale economies tend to increase efficiency in networks the most, consolidation patterns are more prominent in distribution. Mergers and acquisitions may help in building relative bargaining power and improving a firm's competitive position. Industry consolidation could lead to pivotal power and result in power asymmetries.

NUMBER OF BUYERS/SUPPLIERS. Density of competition is determined by the number of business partners in the market. Reference is made to the hourglass structure of TV markets, characterized by a small number of large distributors and a large number of broadcasters. The strength of a firm's competitive position ultimately depends on the presence of substitutes, and the ability of suppliers (or buyers) to bypass powerful parties to bargain better commercial terms. Collective action (pooled bargaining) might help smaller parties in equalizing bargaining power, but has been subject to antitrust scrutiny.

ENTRY BARRIERS. Bargaining power in TV markets is reinforced by barriers to entry, which protect incumbents from competitive entry. Distribution value is created through market demand for scarce resources. Entry barriers may have been lowered by digitization, illustrated by the spectacular increase in competition both for broadcasters and distributors. Increased rivalry in distribution has allowed broadcasters to bargain better distribution deals. However, entry barriers are likely to persist, even in times of digital abundance. Due to economies of scale, entry barriers remain higher in distribution compared to broadcasting.

TECHNOLOGICAL CHANGE. Technology is a factor often overlooked in competitive industry analysis. Competition is shaped by new technology, and especially its potential to disrupt established industry structures and monopolies. New technology erodes entry barriers and challenges oligopoly control over bottlenecks that give rise to gatekeeping power. Digital technology not only increases efficiency in the supply chain, but also tends to shift bargaining power to those parties that adapt quickly in order to reap the fruits from the new digital opportunities.

Micro-level: firm-structure

FIRM SIZE. Economies of scale create greater efficiency and give rise to further industry consolidation. Firm size enhances a firm's bargaining position vis-à-vis its buyers/suppliers. Large distributors, relative to smaller ones, bargain lower fees with broadcasters. Similar, popular broadcasters bargain better deals with smaller distributors. Market share (or the amount of viewers reached or served) is an important indicator for firm size both in broadcasting and distribution. Additionally, nationwide coverage may bestow both broadcasters and distributors a competitive advantage over (vertical) rivals that serve smaller parts of the market.

VERTICAL INTEGRATION. Vertical integration remains a popular and effective strategy to extend control of the content supply and increase bargaining power regarding broadcasters. Increasingly, distributors have been combining multiple roles in the supply chain and started to control access to premium programming, most notably sports and movie rights (backward integration). Affiliated programming allows distributors to bargain lower input fees with TV broadcasters. In contrast, forward integration into distribution is not widely applied by broadcasters. However, the Internet provides an effective means for TV broadcasters to lessen dependence on distributors and directly target the viewers.

CONGLOMERATENESS. The fact that independent broadcast networks are not affiliated to a cable/satellite operator does not automatically mean they are overpowered by vertically integrated distributors. By being part of big media conglomerates, broadcasters can leverage the collective strength of the entire company and bargain better deals for less popular networks. Rather than vertical integration, capital resources derived from the accumulation of power common to international corporations is one the most significant advantages of successful suppliers. Diversification through cross-media ownership allows firms to reduce risks and benefit from economies of scope.

FINANCIAL RESILIENCE. The respective financial position of the bargaining firms are another indicator for power asymmetry. Financial ratios can be used to benchmark the economic performance of broadcasters and distributors respectively. Furthermore, the financial losses when a deal remains unclosed might be completely different for both negotiating parties. For a broadcaster, no carriage means a decline in viewership and advertising income. For distributors, not carrying a popular channel might put the platform at

a competitive disadvantage and induce its subscribers to switch to a rivaling distribution platform.

Micro-level: product characteristics

PRODUCT DIFFERENTIATION. Distinguishing a product/service from its competitors to make it more attractive to a particular buyer lowers competitive pressure from substitutes and reduces the impact of rivalry. Uniqueness enhances a broadcaster's ability to charge distributors a higher price. Therefore, broadcasters providing must-have programming may have better cards during negotiations with distributors. Especially (expensive) live sports rights help broadcasters in building viewership and create leverage to bargain higher payments. Similarly, distribution is said to become a commodity with little room for differentiation. Nevertheless, they have launched affiliated channels to differentiate from rivaling platforms.

EXCLUSIVITY. One popular way for distributors to enhance differentiation in competitive markets is acquiring exclusive access to popular programming. This may put broadcasters in a position to reduce supply and charge higher payments. Exclusive programming primarily serves differentiation purposes, rather than the wish to exploit monopoly power. Exclusive dealing, however, is typified by a bilateral monopoly (single supplier and single buyer) and may give rise to double marginalization. Exclusive dealing produces inflated upstream and downstream prices, as both the broadcaster and distributor have pricing power.

BUNDLING. Distributors remain in a gatekeeping position and aggregate channels in different packages. Increasingly, distributors are offering channels à la carte so that subscribers only pay for the channels they want. Cherry-picking affects the less popular channels that lose guaranteed reach and will find difficulties being selected. Furthermore, distributors bundle pay-TV access with other telecommunication services (telephony, Internet, etc.). Bundling allows distributors to diversify activities and cross-subsidize between multiple product categories. Distributors are therefore less vulnerable to financial demands of broadcasters and have more bargaining leverage.

SWITCHING COSTS. Bundling also creates lock-in effects and imposes switching costs for subscribers that want to switch to another distribution platform. In contrast, the costs incurred by a consumer in zapping from one TV channel to another is practically zero. However, broadcasters create viewer loyalty by investing in their brands and programming.

Here, the question is how many subscribers would switch to another platform if a particular channel was to stop being carried (churn), and how viewing rates would drop as a result of failed negotiations (viewer impairment). Consumer behavior thus influences for which party the at-risk income is the greatest.

Individual level: interpersonal relationships

NEGOTIATION STRATEGY. It is important to stress that neither firms nor industries negotiate, but that firms are represented by human beings. Apart from negotiation techniques (brinkmanship), the applied negotiation strategy is an influential variable in the bargaining process. Information asymmetry therefore forms an essential part of negotiation strategies and their subsequent outcome. Parties that have more or better information have an advantage during negotiations. As a result of their gatekeeping position, distributors might benefit more from information asymmetry than a broadcaster during carriage negotiations.

RELATIVE FAMILIARITY. Relative familiarity may exclude opportunistic behavior and enhance constructive negotiations. High levels of trust between negotiators indicate a close, collaborative relationship that leave room for pie expansion. In contrast, lack of trust implies that negotiators begrudge and try to maximize their interests at the expense of the other party. Parties do not always negotiate with the intention to reach compromise. In such case, the party is said to be negotiating in bad faith and act in an unfair manner. This possibly favors parties that have higher bargaining power.

REPUTATION FOR FAIRNESS. Fairness is crucial in negotiating productively and maintaining a positive, respectful relationship. In that respect, honesty and empathy strongly increase one party's ability to influence the other. Fairness implies that all negotiating parties have a feeling of fair play, and induces concessions from both parties. In fact, broadcasters and distributors both accuse each other from unfair economic practices, which illustrates the divergence in standpoints and makes a compromise difficult.

HISTORY OF CONFLICT. The state of present negotiations is often influenced by the outcome of previous deals, or is scarred by serious conflicts in the past. Negotiating parties with a history of conflict will lack a reasonable level of trust and could take though draw during the negotiations. When broadcasters and distributors operate in multiple geographical markets, it is likely that conflicts appearing in one market may affect the relation in other

markets. Besides conflicts in regional markets, tensions in different product markets (like in online TV) might trouble a relationship between a broadcaster and distributor.

Conclusion and discussion

In this paper, the focus has been on the enduring platformisation of the TV industry and the clash of the platforms that follows from this evolution. We have put emphasis on the rise of distribution platforms as a powerful gatekeeper and the possible conflicts of interests with TV broadcasters. Following an evolution towards platform envelopment, it has become clear that the TV industry is marked by an intense competition between TV broadcasters and distributors, which have both the ambition to become the leading platform and to control the TV industry. This implies that the platforms aim at shaping the rules that facilitate interactions among a network of industry stakeholders: content producers, advertisers and the audience. It has been suggested that the party who controls this network of partners has the best cards for becoming a platform leader in the future TV industry.

Although it may have been suggested in this paper, platform leaders benefit from a cooperative approach, one that incentivizes third parties to contribute to the leading platform. Instead of competitors, broadcasters and distributors should be regarded as complementors that share similar interests. Said that, it can therefore be regretted that broadcasters and distributors are attacking each other in such an aggressive way. One can question whether or not broadcasters and distributors' envelopment strategies are self-destructive. Some of these strategies may generate considerable profits in the short term, but may prove counterproductive in the longer term. Indeed, the ability to convey a long-term commitment to cooperative relationships seems of utmost importance to act effectively as platform leader. Broadcasters will always need distribution, whereas distributors benefit from strong content parties.

Despite the substantial stakes at play, policymakers both in Europe and the US have undertaken few specific attempts in regulating power conflicts between TV broadcasters and distributors and preserving a fair balance between broadcasters and distributors. In certain countries, national regulators have imposed ownership rules, but such regulations have not prevented large media companies, either broadcasters or distributors, from developing into powerhouses that settle platform struggles in their favour. Apart from preserving fair competition in the market by eliminating artificial entry barriers and fighting the excessive concentration of economic power leveraged by particular players, it seems, however, that

policymakers are rather limited in their options to deal with conflicts between two or more contracting parties. For policymakers, analysing economic structures of broadcast markets may identify important issues for cultural policies, such as the effects of corporate concentration on media diversity and pluralism in society. The results indicate that regulatory intervention aimed at creating a level-playing field between broadcasters and distributors could have far-reaching implications for the financial health of the broadcast market, which suffers from shrinking advertising expenditures and increasing competition from online video platforms.

Lowering entry barriers in network access (*e.g.*, open access rules) or imposing limits in market concentration (*e.g.*, through cross-ownership regulation) could increase competition in the distribution market and improve relationships with broadcasters. Ultimately, regulators can impose a separation between content production and distribution activities when ownership restrictions fail to eliminate anti-competitive conduct and abolish dominant positions. The remedies show that competition regulation forms an appropriate framework to regulate abuse of power. Competition policy should therefore continue to play the first fiddle, but needs to be complemented with media-specific regulation that is tailored to the specificities of media and ICT markets. In that context, a more coordinated cooperation between the different regulators proves necessary for a more effective regulation of converging markets.

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