The Cable and Satellite TV Industry
Why Cable and Satellite TV?

- Information good
- Industry operates almost exclusively on a domestic basis
- Highly concentrated
- Myriad of pricing strategies
Why Cable and Satellite TV?

- 2011 industry revenue was $63.5 billion
  - 96% from the residential market

- Nielson estimates that 90% of Americans have some form of cable subscription

- Price elasticity of demand is -1.95
INDUSTRY STRUCTURE
Services Provided

**Cable**
- Distribution of video services by optical fiber or coaxial cable
- Provides internet access over optical fiber or coaxial cable
- Provides third-party distribution systems for public broadcast programming

**Satellite**
- Broadcasting TV via direct-to-home satellite connections
- Satellite operation
Cable Subscribers

Cable Subscribers

Cable Subscribers (in millions)

Year

07' 08' 09' 10' 11' 12' 13' 14' 15' 16' 17'
Industry Organization

- Natural Monopoly
  - Over 90% of towns in the U.S. only have one cable provider

- Satellite TV is a duopoly

- The industry is service based
  - Deliver content produced by third parties

- Main revenue source is monthly subscription fees
  - Secondary payments for rented equipment
Industry Organization

Television Networks
- ESPN
- Nickelodeon
- AMC
- FOX News
- Disney Channel

Cable & Satellite Operators
- comcast
- DIRECTV
- dish Network

Subscribing Consumers
Television Content

- Content producers receive advertising revenue
- Networks with high viewership typically also charge cable/satellite operators a monthly per-subscriber fee
- Fees can range from over $4.00 (ESPN) to $0.01 (Nick Too)
Cable TV Industry

- Industry concentration is medium
  - Top four companies generate 60% of industry revenue

- HHI = 1344

- High barriers to entry and exit
  - Must be licensed by the FCC
  - Capital intensive
  - Buyer switching costs
  - Major companies are vertically integrated with cable networks
Cable TV Industry Market Share

- Comcast: 32%
- Time Warner: 14%
- Cox Enterprises: 11%
- Charter Communications: 5%
- Verizon: 3%
- Cablevision: 3%
- Other: 33%

Cablevision 3%
Verizon 3%
Charter Communications 5%
Cox Enterprises 11%
Other 33%
Comcast 32%
Time Warner 14%
Comcast Corporation

- Market Share = 31.5%

- 39 states – 22.3 Million Video Customers

- Joint Venture – NBC & Comcast
  - Combined strength between broadcast & cable

- Revenue growth annualized rate of 2%
  - Acquisitions, premium packages, pay-per-view
Time Warner Cable Inc.

- Market Share = 13.7%
- Located in 6 states
  - 15 Million subscribers
- Time Warner spun off of Time Warner Cable
- TWC revenue growth of 2.7% in the last 5 years
  - Due to aggressive marketing and regional expansion
- Profit is below industry average
Satellite TV Industry

- Industry concentration is high
  - Top 2 companies account for 94% of total market share

- HHI=4548

- Similar barriers to entry as the cable market
  - Substantial initial capital investment
  - Extensive regulation
  - High cost of new technology
  - Major companies have large market penetration
Satellite TV Industry Market Share

- DirecTV: 57%
- DISH: 37%
- Home2US Communications: 1%
- Other: 6%
DirecTV

- Market Share = 56.5%
  - 18.5 million subscribers

- US revenue accounts for 93.9% of total company revenue

- Owns four TV networks

- Focused on:
  - Premium content, extra services, strong reputation for reliability
  - Value-Added Services

- Annual revenue growth of 8.5%
  - Profit margin = 17%
DISH Network Corporation

- **Market Share = 36.8%**
  - 14.1 million subscribers
    - High churn rate due to heightened competition and poor customer service

- **Two Separate Entities (No cross ownership interest)**
  - Dish Network
    - Pay-TV Operator
  - Echostar
    - Digital set top boxes, satellites, real estate, etc.

- **Annual revenue growth of 6.6%**
  - Low customer service costs leads to higher profit margin
  - Profit margin of 23%
Competitive Environment

- Compete on the diversity, quality, and consistency of programming
  - Most bundles and channel offerings are homogeneous

- Cable provides a more reliable connection

- Satellite providers compete using prices and perks

- Both compete using access to the newest technology to provide superior service and quality
Key Success Factors

- Building an extensive distribution network
  - Access to required utility infrastructure

- Possessing a license
  - Negotiating successfully with regulators

- Ability to franchise operations

- Access to niche markets

- Ability to quickly adopt new technology
Regulatory Environment

- Level of regulation is High
- Subject to Federal, State, and local regulation
- Primary regulator is the Federal Communications Commission (FCC)
- Varying state laws
  - Local Franchising Authority
- Industry does not receive any direct or special governmental assistance
PRICING STRATEGIES
Pricing Strategies

- Second Degree Price Discrimination
  - Mixed Bundling

- Third Degree Price Discrimination
  - Geography

- Locking-in
  - Increasing buyer switching costs
Mixed Bundling

- Raw Data Analysis
  - Collected bundle prices by hand for Cablevision, Time Warner, and Verizon FIOS
  - Compared:
    - Triple Play
    - TV and Internet
    - TV and Phone
    - TV
  - Prices are all for New York City to eliminate geographic price discrimination
**Bundle Price Comparisons**

*Only bundles Triple Play--Other services are purchased a la carte*
Third Degree Price Discrimination

- Raw Data Analysis
  - Collected the price of Comcast Xfinity’s basic cable in 11 cities
    - Chose Comcast because it has the largest market share
  - Plotted prices relative to geography
  - Ran regressions against the number of competitors in the market
Price vs. Number of Competitors in the Marketplace

\[ y = -1.5295x + 27.735 \]
\[ R^2 = 0.6439 \]

\[ y = -1.5295x + 27.735 \]
\[ R^2 = 0.5554 \]

- Price
- Log. (Price)
- Linear (Price)
Comparison Between DISH and DirecTV

• Raw Data Analysis
  ◦ Collected the prices and discounts for entry-level Dish and DirecTV bundles

• DirecTV = Premium
• Dish = Cost Leadership

• Things to look for:
  ◦ Lock-in
  ◦ Buyer switching costs
  ◦ Price per channel
Price for 24 month contract (with savings)

Price (Dollars)

<table>
<thead>
<tr>
<th>Company and Number of Channels</th>
<th>Price for 24 month contract (with savings)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dish 120+ DirectTv 140+</td>
<td>$1,000</td>
</tr>
<tr>
<td>Dish 220+ DirecTV 205+</td>
<td>$1,500</td>
</tr>
<tr>
<td>Dish 315+ DirecTV 285+</td>
<td>$2,000</td>
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</tbody>
</table>
Savings for 24 month contract

<table>
<thead>
<tr>
<th>Company and Number of Channels</th>
<th>Savings (Dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dish 120+ Direct TV 140+</td>
<td>~$200</td>
</tr>
<tr>
<td>Dish 220+ DirecTV 205+</td>
<td>~$400</td>
</tr>
<tr>
<td>Dish 315+ DirecTV 285+</td>
<td>~$600</td>
</tr>
</tbody>
</table>

Legend:
- Dish
- DirectTV
Price per Month after 24 months

Company and Number of Channels

Price per Month (Dollars)

- Dish
- DirectTV

Dish 120+ Direct TV 140+
Dish 220+ DirecTV 205+
Dish 315+ DirecTV 285+
Analysis of Carrying Costs

- Raw Data Analysis
  - Collected the costs to satellite and cable providers for carrying specific channels

- Calculated the cost of individual packages based on the channels provided

- Things to look for:
  - Incentives to bundle
  - Confusion Pricing
  - Varying Willingness to Pay
Carrying Cost Versus Subscription Price Breakdown

- **DISH America (60)**
  - Cost to Carry/Mo.: $10.64
  - Price/Mo.: $34.99
  - % Markup: 69.6%

- **DISH Top 120**
  - Cost to Carry/Mo.: $10.48
  - Price/Mo.: $44.99
  - % Markup: 76.7%

- **DirecTV 140 Carrier**
  - Cost to Carry/Mo.: $16.25
  - Price/Mo.: $54.99
  - % Markup: 70.4%

- **DISH Top 200**
  - Cost to Carry/Mo.: $15.41
  - Price/Mo.: $59.99
  - % Markup: 74.3%

- **Comcast Digital Premier (200)**
  - Cost to Carry/Mo.: $22.4
  - Price/Mo.: $84.99
  - % Markup: 73.6%
Lerner Index

\[ \frac{P - MC}{P} = \frac{1}{E} \]

- Markup on most popular bundle: 76.7%
- 0.767 = \frac{1}{E}
- Elasticity is 1.30
The Cost of Sports

Cost to Carry per Month

<table>
<thead>
<tr>
<th>Price per Month (Dollars)</th>
<th>Sports</th>
<th>Non-Sports</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>11.28</td>
<td>18.83</td>
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<tr>
<td>$2</td>
<td></td>
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</tr>
<tr>
<td>$4</td>
<td></td>
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<td>$6</td>
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<tr>
<td>$20</td>
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</table>

Number of Channels

<table>
<thead>
<tr>
<th>Number of Channels</th>
<th>Sports</th>
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</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>21</td>
<td>148</td>
</tr>
</tbody>
</table>
The Cost of Sports: ESPN

Cost to Carry/Mo.

Number of Channels

ESPN | All Other Channels Combined
---|---
5.28 | 30.11

ESPN | All Other Channels Combined
---|---
6 | 169
Complementary Pricing Strategies

- Temporal Price Discrimination
- Confusion Pricing
- Technological Tying
ANALYSIS AND RECOMMENDATIONS
Analysis and Recommendations

- Investor Recommendations
  - Cable vs. Satellite TV

- Pricing Strategies
  - Cable providers should place more emphasis on basic cable
    - 48.8% of total industry revenue in 2011
    - Own-price elasticity of demand is -1.5
Analysis and Recommendations

- **Pricing Strategies**
  - Satellite TV should expand into more basic offerings
    - Own-price elasticity for Direct Broadcast Satellites is -2.4
    - Elasticity of premium cable is -3.2
  - Undercut cable companies
    - Lower prices due to fewer infrastructure costs
Analysis and Recommendations

- Invest in innovative technology

- Do not change to a la carte
  - Mitigates threat of online substitutes
  - Decreases consumer heterogeneity
  - Increases firm profits by 6%
Analysis and Recommendations

- Focus on increasing advertising revenue
  - Currently only 5.5% of total industry revenue

- Many advertisers cut budgets after development of DVR
  - Recent studies show DVR does not significantly lower consumer retention rate

- DVRs accumulate data on what consumers skip
  - Cable companies can sell that data to advertisers
QUESTIONS?