

EXPECTED CONSUMER BENEFITS FROM WIRED VIDEO COMPETITION IN CALIFORNIA

by

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Introduction

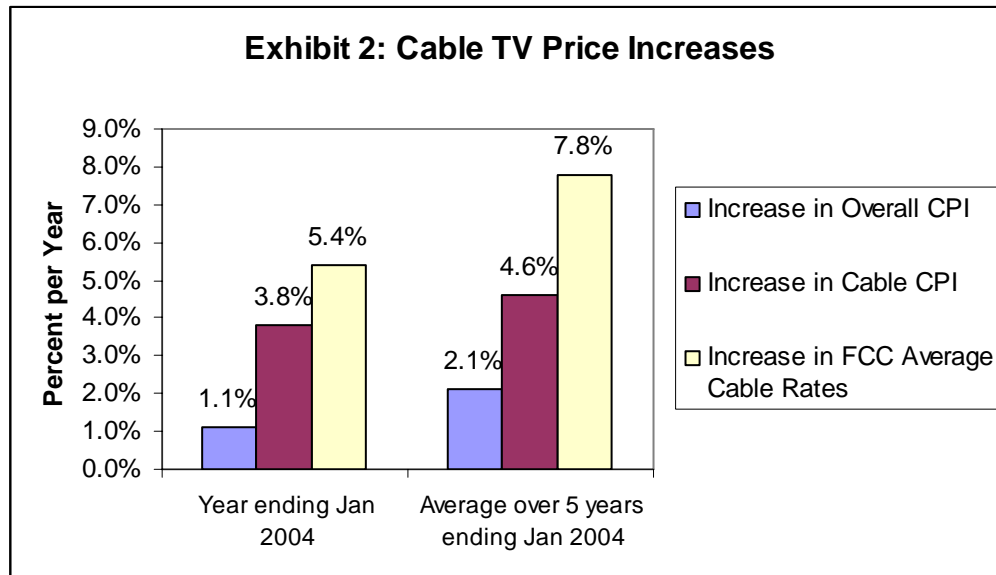
Cable television is the dominant means by which households, both nationwide and in California, receive video programming. Using the most recent data available, over 68% of U.S. households and approximately 60% of the households in the four largest California metropolitan areas have cable television. (See Exhibit 1.) Almost all of the remainder of the over 98% of U.S. households with televisions currently either receive television signals over-the-air or via satellite. The vast majority of the cable systems operate with exclusive local franchises, and their subscribers have no competitive alternative for wired video delivery. In recent years the emergence of broadband service providers that offer both video and broadband data services has led to the situation where what happens in one area affects the other.

Exhibit 1	Penetration
	%
United States (a)	
Percentage of HH with Television	98.2%
Percentage of TV HH with Cable	69.4%
Percentage of HH with Cable	68.2%
California (b)	
<i>Percentage of TV HH with Cable</i>	
Los Angeles DMA	55.1%
Sacramento/Stockton/Modesto DMA	53.9%
San Diego DMA	72.9%
San Francisco DMA	66.3%
Weighted Average of four DMAs	59.3%
Notes:	
(a) Data are for 2002. Source: Statistical Abstract of the United States, 2004-2005, Table 1120.	
(b) Data are for 2005. Source: Calculated by the author.	

¹ Dr. Braunstein's past research on the economics of cable television has been funded by the National Science Foundation and the Network Inquiry Special Staff of the FCC. He has consulted for and published research on a wide variety of media and telecommunications industries. Christoph Rothballer and Nadine Schmidt provided research assistance for this study. This study was commissioned by AT&T, which sought an independent assessment of expected consumer savings in a competitive broadband subscription television services marketplace.

The widespread diffusion of new technologies has enabled carriers in what were previously viewed as separate industries to start to compete head-to-head, or at least bundle-for-bundle, in many geographic areas. In other words, the convergence that was a subject of much speculation and discussion over the past decade is now here, at least in part. But convergence is not complete, either geographically or across all service offerings. In its 2005 “Report on Cable Industry Prices,” which uses 2004 data, the Federal Communications Commission (FCC) found that cable television service was provided in 32,510 “non-competitive” communities while there were only approximately 400 communities with competitive wireline overbuilds.² Based on a stratified random sample, the monthly subscription rates for basic and expanded basic services were on average 15.7% lower in the competitive group than in the non-competitive group and 27.2% lower on a per-channel basis.³ There is very little direct competition in the cable industry, but where there is, consumers generally see both lower prices and additional service offerings.

Cable television system operators are subject to local franchise agreements and partial regulation by the FCC. In addition eleven states had public-utilities-like regulation of cable systems in the 1970s, but this state regulation was generally viewed as ineffective and was pre-empted by the federal government in 1984.⁴ The remaining federal and local regulation is also viewed as being ineffective in controlling prices, and cable television subscription prices regularly increase at a rate faster than overall prices in the economy, as measured by the Consumer Price Index (CPI). (See Exhibit 2.)



² FCC, “Report on Cable Industry Prices” (February 4, 2005), at par 14.

³ *Ibid.*, at par. 7.

⁴ See Yale M. Braunstein, “Economic Effects of State Regulation of Cable Television,” in H. S. Dordick, ed., *Proceedings of the Sixth Annual Telecommunications Policy Research Conference* (Lexington, 1979). The 1984 Cable Act, 47 U.S.C. § 543(a), pre-empted state regulation of cable television rates.

This report provides an estimate of the savings cable television subscribers in California could expect if alternative wired distribution of video programming were to become widespread. Using current population and subscription rates and reasonable estimates of the effects of competition on subscription prices, we estimate the annual savings to consumers will range from approximately \$690 million to just over \$1 billion. The remainder of this report explains the data, assumptions, and analysis on which these estimates are based. A set of spreadsheets showing the details is available on the web at: www.sims.berkeley.edu/~bigyale/cable/.

Analysis

We obtained data from a major cable television market research firm on the number of cable television subscribers and the monthly prices they pay for the major cable television systems in the four major Designated Market Areas (DMAs) in California: Los Angeles, Sacramento/Stockton/Modesto, San Diego, and San Francisco.⁵ Together, these four DMAs contain approximately 90% of the households in California. (See Exhibit 3.)

Exhibit 3	DMA Size and Cable Television Prices	
	Households	Average Cable TV Monthly Price
Los Angeles DMA	5,536,430	\$ 58.29
Sacramento/Stockton/Modesto DMA	1,345,820	\$ 53.41
San Diego DMA	1,026,160	\$ 49.54
San Francisco DMA	2,355,740	\$ 57.38
Four DMAs overall (a)	10,264,150	\$ 56.40
California state total (b)	11,502,870	

Notes:
 (a) Data are from 2005. Source: Nielsen Media Research Local Universe Estimates
 (b) Data are from 2000. Source: California Quick Facts from the US Census Bureau

Since each cable system typically offers several packages of channels at different prices, the next step was to calculate weighted average monthly prices paid by the subscribers—first for each cable system, then for each DMA, and finally for the state. These average prices are also shown in Exhibit 3. In performing these calculations we needed to make a few assumptions:

- The average price paid to the cable system operator for non-digital cable television service without a premium package was the simple average of the prices for non-digital “basic cable” and “expanded basic.” This assumes that basic and expanded basic each account for 50% of the subscriptions to non-digital packages without premium service.

⁵ “Designated Market Area” is a term developed by Nielsen Media Research to indicate a group of counties that are covered by a specific group of television stations. It is a standard definition of metropolitan area used in media businesses.

- The average price paid for non-digital service with a premium package was on average \$10 per month over the price charged for non-digital expanded basic.
- The market shares of the different cable television operators in each DMA are assumed to hold across all packages.

These assumptions represent approximations, but the overall results are not sensitive to small changes in the assumptions. Similarly, although the different sources provided data from different years, any errors introduced by this are likely to be small.

Combining the weighted average prices paid with the number of cable subscribers in each DMA gives us the total monthly spending on cable television in the DMA. We then multiplied this sum by twelve to get annual spending on cable television service in the four DMAs of over \$4 billion. This number became the starting point from which we calculated the expected savings after the introduction of wired competition.

Our next step was to estimate the likely reduced cable subscription prices when there would be direct competition. One estimate was the 15.7% from the FCC's 2005 Cable Industry Prices report described above. Using a different methodology, the General Accounting Office (GAO) compared the monthly cable television rates in six markets with broadband service providers who offered a full range of services including subscription television with six comparable markets without such competition.⁶ The monthly cable TV subscription prices for expanded basic service in five of the six matched markets ranged from 15% to 41% lower with competition than without.⁷ In the sixth market the subscription price was 3% higher. Averaging the results from all six markets, the average price was 22.2% lower when competition was present. (Prices for voice telephone service and high-speed Internet service were either less or the same in the competitive markets when compared to their matched non-competitive pairs.)

Using these two estimates, we then calculated the likely prices for each cable package in each market and the resulting savings from competition. (We actually used 15% and 22% for the estimated savings percentages, figuring that it was more conservative to truncate the numbers rather than risk rounding up.) At this point we introduced another assumption; specifically, that savings occurred equally in percentage terms across all cable packages in a given DMA. The average monthly cable bill dropped to \$47.94 with the 15% savings, which we called Scenario A, and to \$43.99 with the 22% savings, our Scenario B. These figures represent average monthly savings of \$8.46 and \$12.41 for each cable subscriber with the two competition scenarios. The dollar estimates of the expected savings are likely to be low as they ignore cable subscriber spending on non-English language channels and programming that is not included in the packages.

Although the four DMAs account for the overwhelming majority of the households in California, there are still another 1.24 million households (just under 11% of the total)

⁶ U. S. General Accounting Office, "Wire-Based Competition Benefited Consumers in Selected Markets" (GAO 04-241, February 2004).

⁷ *Ibid.*, p. 16.

outside the DMAs. Therefore, we scaled up the total savings to include these non-DMA households. This scaling may lead to an over-estimate of the savings if the non-DMA areas do not see wired video competition, or it may lead to an under-estimate if the cable penetration outside the DMAs is greater than in the metropolitan areas and competition does emerge. In any event, completely ignoring any savings outside the DMAs would only lower our savings estimate by 11%. The resulting annual savings statewide under the two scenarios amount to \$692 million and \$1.015 billion. These results are summarized in Exhibit 4.

Exhibit 4	Results		
	Current	Scenario A	Scenario B
Estimated percentage savings	--	15%	22%
Average monthly bill	\$ 56.40	\$ 47.94	\$ 43.99
Average monthly savings	--	\$ 8.46	\$ 12.41
Annual savings (\$ million)	--	\$ 692	\$ 1,015

Discussion

It is important to realize that there are additional benefits from wired video competition. The FCC Pricing Study found that the average price per-channel was, on a percentage basis, even lower than the average overall price for wired video service in competitive markets than in markets without competition. This finding can be explained by the fact that the operators in the competitive markets, on average, offer more channels as well as lower prices than those in the non-competitive markets.

Another advantage relates to competitive operators offering a wider variety of packages and options as they seek to serve additional market segments. One example of this can be seen in the packages and programming services available from SureWest, which serves parts of Roseville-Sacramento area. SureWest offers nine different digital video packages and a wide range of video programming services over a fiber-to-the-home network. These packages range from 27 to 244 channels, enabling SureWest to provide direct competition to the dominant cable operators.

Finally, we should point out that some of these gains from direct competition in the delivery of video services occur instantaneously while the full benefits will be achieved over time. The competitive pairs in the GAO study included broadband service providers who had offered video services for at least one year.⁸ Our estimates assume competitive services are rolled-out sufficiently to provide competition throughout California. As a result it may take several years for the full value of these benefits to be achieved, and as the competition becomes more entrenched the magnitude of the benefits can increase substantially.

⁸ *Ibid.*, p. 2

The likely timing and nature of the roll-out of the infrastructure to provide competitive wired video services is difficult to predict. There are both franchise and regulatory hurdles that take time, and this delay can often be longer than the time necessary to install or upgrade the required network. In addition, some have charged that any roll-out by competitors will likely target high-income neighborhoods, leaving other demographic groups without the benefits of competition. It is difficult to understand how this would come about as the demand for video services does not appear to be positively correlated with family income or other related demographic and socio-economic factors.⁹

⁹ See, for example, General Accounting Office, “Issues in Providing Cable and Satellite Television Services” (GAO 03-130, October 2002; Table 3 on page 47) where the regression coefficient for the median household income variable in the reduced form cable subscribers equation is negative and significantly different from zero.