EXPECTED CONSUMER BENEFITS FROM WIRED VIDEO COMPETITION IN THE SAN FRANCISCO BAY AREA

by

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Summary

Advances in technology are permitting broadband service providers to enter the residential video market. This has enabled effective competition in the delivery of wired video services, bringing a wider variety of offerings and lower prices. Using current population and subscription rates and reasonable estimates of the effects of competition on subscription prices, we estimate the annual savings to consumers in the San Francisco Bay Area will range from approximately $160 million to over $235 million once this competition becomes a reality.

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 two-thirds of the households in the greater San Francisco metropolitan area 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.

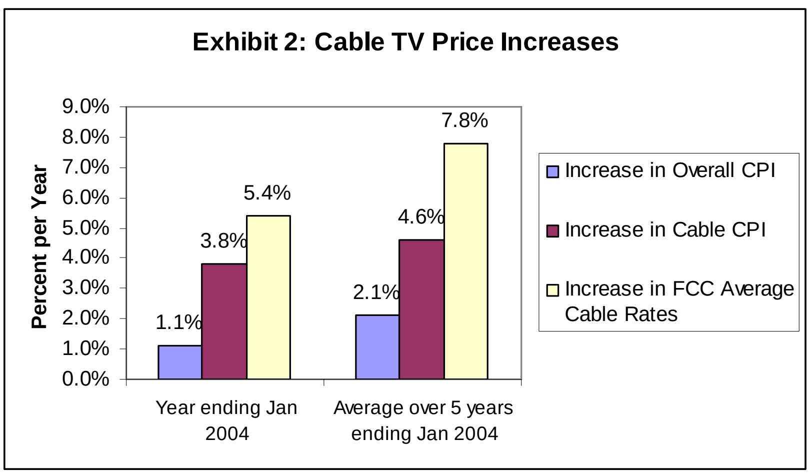
Exhibit 1	Penetration %
United States (a)	
Percentage of HH with Television	98.2%
Percentage of TV HH with Cable	69.4%
Percentage of HH with Cable	68.2%
California (b)	
Percentage of TV HH with Cable	
San Francisco DMA	66.3%
Weighted Average of four DMAs	59.3%

Notes:
(a) Data are for 2002. Source: Statistical Abstract of the United Sates, 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.)



This brief report provides an estimate of the savings cable television subscribers in the San Francisco area could expect if alternative wired distribution of video programming were to become widespread. (Throughout, we use the expanded metropolitan area definition that is based on the Nielsen Designated Market Area, which includes both the San Francisco and San Jose metropolitan areas. [5]) Using current population and subscription rates and reasonable estimates of the effects of

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[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.

[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.

competition on subscription prices, we estimate the annual savings to consumers will range from approximately $160 million to over $236 million. The remainder of this report explains the data, assumptions, and analysis on which these estimates are based. Both the longer report covering our findings for the State of California and a set of spreadsheets showing the calculations for this region and the statewide totals are 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 DMAs in California: Los Angeles, Sacramento/Stockton/Modesto, San Diego, and San Francisco. (The San Francisco region and statewide data are summarized in Exhibit 3. Data for the other DMAs are available in our statewide report.)

Exhibit 3 DMA Size and Cable Television Prices

	Households	Average Cable TV Monthly Price
San Francisco DMA (a)	2,355,740	$ 57.38
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. 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.
- 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 San Francisco DMA of over $1 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 the DMA. The average monthly cable bill dropped to $48.77 with the 15% savings, which we called Scenario A, and to $44.76 with the 22% savings, our Scenario B. These figures represent average monthly savings of $8.61 and $12.62 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.

Exhibit 4	Results		
San Francisco DMA	Current	Scenario A	Scenario B
Estimated percentage savings	--	15%	22%
Average monthly bill	$ 57.38	$ 48.77	$ 44.76
Average monthly savings	--	$ 8.61	$ 12.62
Annual savings ($ million)	--	$ 162	$ 237

At this point, it is important to realize that there are additional benefits from wired video competition. A few of these benefits and related topics are covered in the statewide report.

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

[7] *Ibid.*, p. 16.