Fact and Fiction: Market Definition and the Media

The ACCC and pay TV

Ross Jones

Australian media industries have been subject to substantial regulation for many years. The announcement in 1996 of a review of the cross-media ownership restrictions, the speculation surrounding the instability in the ownership of the Fairfax newspaper group, and the proposed mergers and alliances in the emerging pay TV industry have focused attention on the definition of the relevant market for regulatory purposes. The Australian Competition and Consumer Commission (ACCC), the principal regulatory agency, has been criticised for taking an inappropriate approach to market definition. A recent *Policy* article by Stephen King and Anthony Marshall (1996) described the approach as 'Russian Roulette' competition policy and one which had the potential to reduce rather than enhance competition. In particular, it has been claimed that the decision by the ACCC to reject a merger between two pay TV companies was based on an inaccurate definition of the relevant market.

However, there is a convincing case to be made that the ACCC's approach to market definition in the media is consistent and likely to lead to enhanced competition in media and related communications industries. The ACCC's decisions on pay TV alliances have likely prevented the immediate emergence of a dominant pay TV supplier in Foxtel and reduced the dominance of the local telephony supplier, Telstra.

A Pay TV Market?

Any sectoral approach to media market analysis has the problem of delineating the boundaries of the market. Nowhere is this more difficult than the pay TV market. In its decision to reject the Foxtel-Australis merger, the ACCC took the view that there existed a pay TV market, distinct and separate from wider market definitions.

As noted by King and Marshall (1996) the definition of the market is critical in the analysis of whether the merger would have the effect of substantially lessening competition under Section 50 of the Trade Practices Act. A range of market definitions might be possible. At the widest level, it may be possible to argue that there is a market for entertainment. A narrower definition might limit the market to television services. At the narrowest level the market might be defined as a market for pay TV services.

The ACCC defined the market at its narrowest level, that of pay TV services, and rejected the merger between Foxtel and Australis, two of Australia's three metropolitan pay TV services. King and Marshall state bluntly that in narrowly defining the market, the ACCC 'got it wrong'.

A wide market definition would likely include cinema, video, free to air television and pay TV. At issue is whether competition from cinema, video and free to air television would constrain the exercise of market power by a pay TV operator. That is, if a pay TV operator increased prices would a consumer be able to substitute other entertainment services?

Cinema and Video As Pay TV Competitors

King and Marshall argue that cinema and pay TV may be part of the same market. They make this claim based on a recent decrease in cinema prices in Melbourne. The inference is that the decrease in cinema prices is in response to the introduction of pay TV.

This claim is tenuous. In Melbourne there has been a substantial increase in the number of cinema screens in recent years, with recently announced further expansion by Hoyts and Village and the possibility of entry by a major US cinema group, Reading. The price cuts by Village and Hoyts in Melbourne are more likely related to excess capacity and attempts to make entry more difficult for new operators. The subsequent price increases by Hoyts and Village after Reading's entry was blocked by Victorian planning regulations suggests that the cinema price cuts were probably unrelated to pay TV expansion.

Market definition should take into account the product characteristics. Cinemas offer a unique, out of home

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experience which is not matched by video rental or television (both free to air and pay). It offers a product, first release movies, which are available only at the cinema. While the same movies may be on pay TV eighteen months to two years later, an increase in the price of pay TV would be unlikely to cause consumers to switch to cinemas.

With regard to video rental it might be possible to argue that such services compete with pay TV. One of the major subscription drivers of pay TV overseas has been premium movie channels. However there are significant differences in the services provided by pay TV and videos. The primary attribute of video cassette recorders (VCRs) is that they allow consumers to 'time shift' broadcast programs and view pre-recorded tapes at a time which suits the consumers. Pay TV does not provide the viewer with such options. Movies are available on video at least 12 months before being shown on pay TV so direct competition is blunted. Further, videos do not compete with most pay TV programming such as news, sport, music and various special interest channels.

The pricing of pay TV also limits the ability of video rental to be seen as a substitute. Pay TV movies are not sold separately (with the exception of the SBS World Movie Channel) but are bundled in with up to 20 other special interest channels, so the ability of video rental to act as a competitive constraint on pay TV pricing is limited by the bundling practices of the pay TV operators.

Free to Air TV As Competition

The most important issue is whether free to air television is a substitute for pay TV to an extent sufficient to constrain the exercise of market power by pay TV companies. At first sight it would seem that free to air and pay TV offer a similar service. The ease with which consumers can switch between pay and free to air television channels may suggest that they are close substitutes.

However such superficial analysis is misleading. A consumer can open a refrigerator and choose between beer, wine, milk, juice and soft drink. But the convenience factor alone does not make them close substitutes. A broad market definition may include these goods as part of a beverages market, but the critical issue for competition would be, for example, if Australia's two major brewers merged, would this lead to a substantial lessening of competition in the relevant market? It is unlikely that soft drink, wine, milk and juice companies would provide sufficient competition to prevent the merged brewers from exercising market power.

The fact that pay TV uses the same programming inputs as free to air television does not necessarily mean that their outputs should be considered as close competitors. The ability of pay TV to differentiate its programming from that of free to air via specialised channels devoted to particular programme genres such as sport, movies, video clips, etc. will be critical to its survival. As Pay TV develops more and more channels devoted to specialised programming interests, the substitutability of free to air TV will further diminish.

There is also limited evidence to suggest that households most likely to subscribe to pay TV watch more free to air television and rent more videos. It may be that such households see pay TV and free to air as complementary products rather than competing products. Under such circumstances a monopoly or dominant pay TV supplier may have considerable market power.

King and Marshall argue that market definition should involve the Mason-Brunt approach of 'standing in the shoes' of the firms and seeing how they assess their competition (see Brunt 1990). It would be expected then that if the free to air channels see pay TV as being a close competitor they will have adjusted their behaviour in response to the entry of pay TV. While pay TV has now been available for over one year, the free to air channel have given no indication of any change in behaviour since pay TV was introduced. After some initial reluctance, the commercial networks now accept advertising by pay TV companies. Their advertising rates continue to rise, indicating that their attractiveness to advertisers has not diminished (although it must be noted that advertising on pay TV is prohibited until July 1 1997). Their programming remains essentially the same as it was prior to pay TV's entry.

Statements made by pay TV executives indicate that they see their product as being separate from free to air television. Mark Booth, Foxtel's CEO, stated during the Super League case that it was essential for Foxtel, as a subscription television provider, to acquire program material which will be unique, while the Deputy Managing Director of BSkyB, Gary Davey, during the same hearing, stated that the nature of programming required for a successful subscription television service is quite different to that required in respect of free to air television, arguing that pay television needs to develop something unique and not readily available elsewhere.

Pay TV and free to air have substantially different attributes. The first is obvious from the name. Consumers have to pay for one service, while the other is advertiser supported. As a consequence, the relationship between the service provider and the consumer differs substantially. Pay TV requires that it respond directly to consumer demand. It is not necessarily after the largest audience. On

the other hand, free to air is a mass market product. Free to air firms maximise revenues by maximising audience size. Pay TV is able to respond to minority interests where those minority interests are prepared to pay.

Pay TV offers a wide range of program choices. For many consumers this range is a major reason for the purchase. It provides a diversity not catered for by the free to air operators. As pay TV develops even more channels, the substitution possibilities between pay and free to air will become even more limited. The primary subscription drivers according to the operators themselves are exclusive sport and movie channels, something which is not offered by free to air channels.

King and Marshall have argued that the loss leading activities of the pay TV companies are evidence that pay and free to air compete in the same market. They claim that subsidisation of new connections is implicit acknowledgment that pay is in direct and intense competition with free to air television.

THE ACCC'S ACTION IN BLOCKING THE FOXTEL-AUSTRALIS MERGER HAD THE EFFECT OF ENCOURAGING GREATER COMPETITION IN LOCAL TELEPHONY.

Two arguments can be made against this claim. Firstly, supplying installation below cost is not evidence of intense competition with free to air. In the pay TV market first mover advantages are likely to be substantial. That is, the first company which gains subscribers may have significant advantage over later entrants. Given the differing delivery technologies, switching costs for consumers may be high. Secondly, it is not uncommon for a firm to supply a good below cost to encourage the consumption of a related good. Shaving products companies such as Gillette may supply razors at below cost and charge higher prices for the blades which fit the razors. Similarly, the pay TV companies may subsidise the one-off installation to gain monthly subscription fees.

Contrary to the claim of King and Marshall, Australis did not suffer severe financial loss because of free to air competition. Competition for premium movies and other programming between Australis and its potential pay TV competitors in late 1994 made Australian programming fees to the major Hollywood studios among the world's highest. Consequently Australis (and its competitors) had relatively high programming costs from the start. Australis' later financial losses were largely the consequence of the intense competition from Optus Vision and Foxtel. Optus Vision entered the pay TV market and set a price below that anticipated by Australis. Australis was forced to cut its price to compete. Further, even in those markets where Australis had no direct immediate competition, the advantages of getting a large subscriber base before the entry of rival Optus via satellite, were sufficient to justify subsidisation of installation. Such activities in themselves are not evidence of competition from free to air TV.

Impact on Telephony

Activities in a related market had a major impact on Australis. The Foxtel partner, Telstra, saw pay TV as a means to protect its monopoly in local telephony. The Optus Vision shareholder, Optus Communications, saw pay TV as a means to compete in the local telephony market. The ACCC's action in blocking the Foxtel-Australis merger had the effect of encouraging greater competition in local telephony, not less competition as claimed by King and Marshall. A merged Foxtel-Australis would have had a major competitive advantage over Optus Vision in access to subscribers. While Optus Vision is restricted to delivering pay TV by cable only until July 1997, the merged Foxtel-Australis would have been able to access a much larger market via satellite, MDS (microwave) and cable. This would have given the merged company opportunities to buy more exclusive programming given its much greater audience reach, further jeopardising the viability of Optus Vision. The merged Foxtel-Australis would have been able to rapidly sign up subscribers to pay TV via the satellite and MDS delivery systems belonging to Australis 18 months before Optus Vision would have had access to these same potential subscribers. Had the merger been allowed in late 1995, it is possible that the strength of the Foxtel-Australis pay TV operations may have jeopardised the competitive position of the Optus Vision pay TV operations, and thus jeopardised the cable roll out of Optus Vision which was only just beginning, thereby reducing competition in both pay TV and telephony.

The fact that Australis and Foxtel had common programming but different distribution mechanisms would have further advantaged the merged company over Optus Vision. The ability of Australis to use satellite to access the entire market would have assisted its cable partner Foxtel in transferring satellite subscribers to cable once the cable

had been laid past subscribers' homes. Subscribers satisfied with the Australis programming content could have been more easily moved to the Foxtel cable which supplied the Australis programs plus additional channels. Once again, being first in the market would have given a major advantage to Foxtel-Australis.

It is possible that had the merger been proposed closer to the telecommunications deregulation in July 1997, many of the potential anticompetitive consequences would not have occurred. The Optus Vision cable roll out is now close to completion and Optus Vision has built a viable pay TV base. From July 1997 Optus Vision will be able to transmit pay TV via satellite so any first mover advantage which would have accrued to Foxtel-Australis would be slight. Indeed, it is probable that mergers will occur in the pay TV market post July 1997 without generating the same anticompetitive concerns as the 1995 Foxtel-Australis proposal.

King and Marshall's claim that the ACCC's rejection of the merger has the potential to distort local telephone competition is a misunderstanding of the facts of the matter. Their approach begins with the incorrect statement that Australis pays Foxtel a fee per subscriber for distributing its programs on the Foxtel cable. The facts are the opposite. Foxtel pays Australis a substantial premium over Australis' costs to distribute Australis' programs. Australis secured the Australian pay TV rights to the films of three of the seven major Hollywood studios while Optus Vision also secured three. The Foxtel venture had access only to the News Corporation owned Twentieth Century Fox. Without access to the Australis movie channels Foxtel would have been at considerable competitive disadvantage. The ACCC had previously approved a program sharing arrangement between Australis and Foxtel as a means to facilitate competition.

A major motivating factor for the merger from Foxtel's point of view was to remove the cost disadvantage of the high priced programming purchased from Australis and gain a huge first mover advantage over its major rival, Optus Vision. The Foxtel partner, Telstra, was prepared to use pay TV as a mechanism to protect its domestic telephony monopoly. Consequently Australis was caught in a battle between rival phone companies, Telstra and Optus, and the large losses of Australis were the outcome of a wider battle in the telephony market.

Overseas Approaches

Overseas regulatory agencies have also determined that there is a distinct pay TV market. The US Federal Communications Commission (FCC 1994) has determined that whatever constraining influence the availability of free to air TV may have had in the early days of the US pay TV industry, the expanding range of specialised programming choices on pay TV has reached a point where free to air television is insufficient to constrain pay TV market power. The FCC stated that even the availability of six or more free to air TV signals did not constrain cable rates (FCC 1994: 50).

The US approach has more recently emphasised that effective competition will most likely come via alternative distribution technologies. Satellite and microwave distribution of pay TV programming is now being seen as the mechanism to prevent cable pay TV market power in US markets. The approach of the ACCC is consistent with this view. In blocking the Foxtel-Australis merger, the ACCC prevented the merged company from having exclusive control over non-cable delivery mechanisms.

Incorrect data and a failure to correctly interpret market information led King and Marshall to describe the ACCC's approach to market definition as 'Russian Roulette' competition policy. A more reasoned analysis would conclude that the approach taken by the ACCC is consistent and justified by the available market information, and is consistent with overseas approaches. It may be that post July 1997 mergers in the pay TV industry reduce the number of competitors and that the outcome is something similar to that rejected by the ACCC in 1995. However, the decision by the ACCC to reject the merger was entirely consistent with the objectives of competition policy and market definition. The approach taken by the ACCC has led to increased competition in local telephony as Optus has rolled out its cable and prevented excessive concentration in the emerging pay TV market, outcomes which would have been jeopardised by defining the market as broadly as that suggested by King and Marshall and thereby approving the merger. *Policy*

References

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