Networks and Contents: Is Convergence possible?

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Yes! Convergence is possible!

In the early 1880s:
The Théâtrophone of Clément Ader

Nowadays:
- triple play (ADSL TV)
-user generated content platforms
-podcasting
-video blogs
-illegal file-sharing
-IPTV…

But, is convergence viable in the long run?

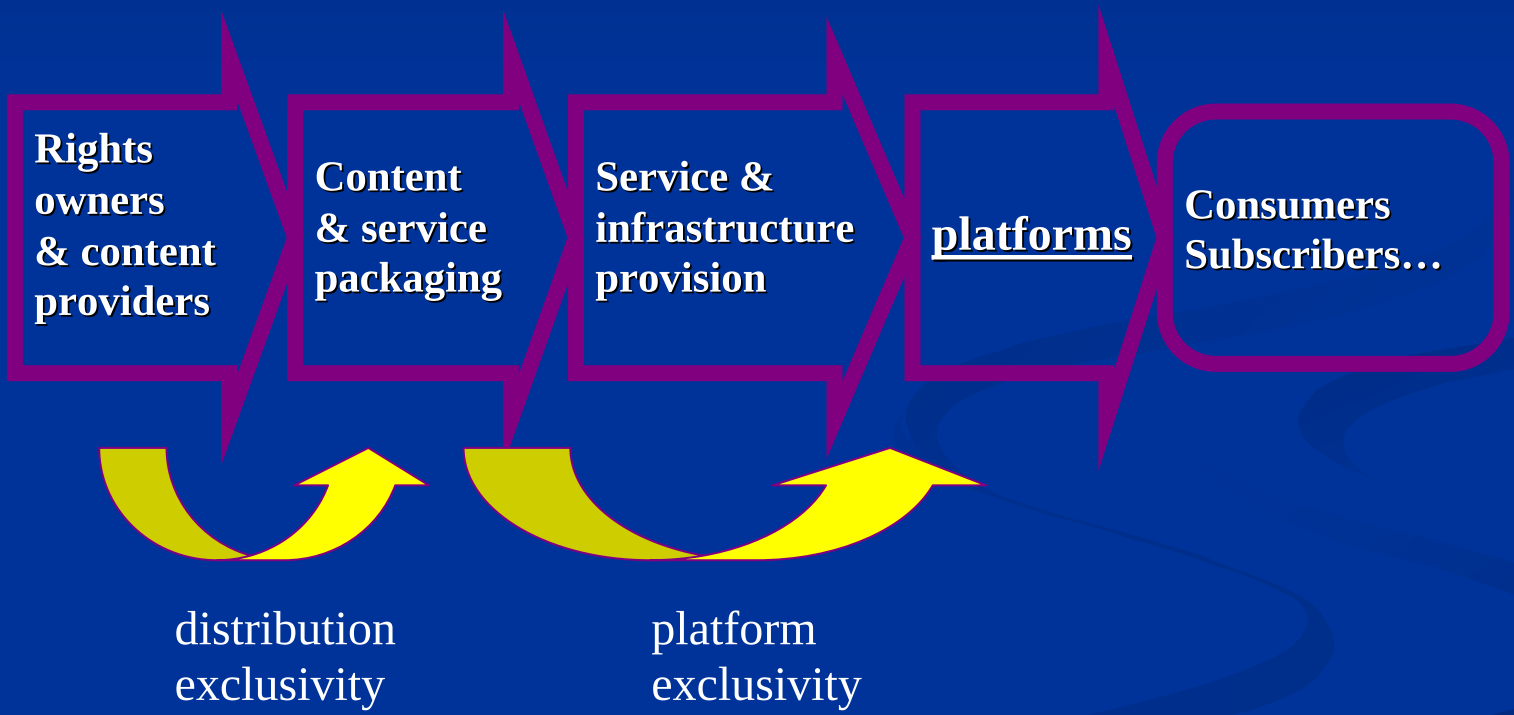
Not sure…

- Digital convergence?
  - Green Paper on Convergence (European Commission 1997)
  - telecommunications, media and computing increasingly **using the same technologies**
  - blurring of borders between these 3 industries
    - not just the same digital technologies
    - also new services and ways of doing business and interacting with society

- 4 dimensions of convergence:
  - technology and network platforms (dematerialization)
  - industry alliances and mergers (emergence of new industries)
  - services and markets (convergence towards a unified market)
  - policy and regulation (media and telecoms regulations)

- Many definitions in economics:
  - *"the ability of different network platforms to carry essentially similar kinds of services or the coming together of consumer devices such as the telephone, television and personal computer" (Pajai, 2001)*
  - *a process challenging the "pre-existing boundaries between all of the industries whose performance has historically or may have the potential to become intimately linked to communication" (Steinmueller, 2000)*
  - the ability to influence not only the ICT industries, but also all industries in which information is a key component of what is sold as a product or service

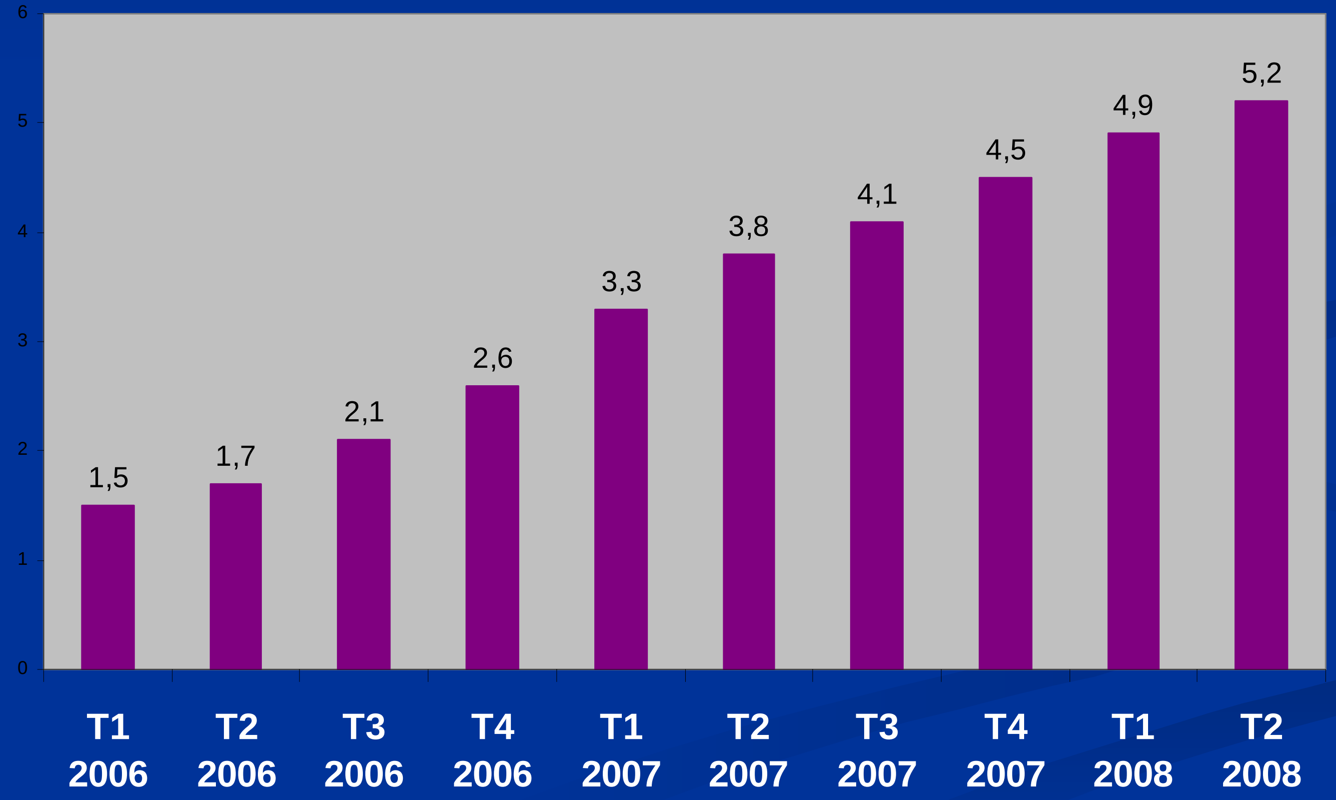
Value-chain of convergence



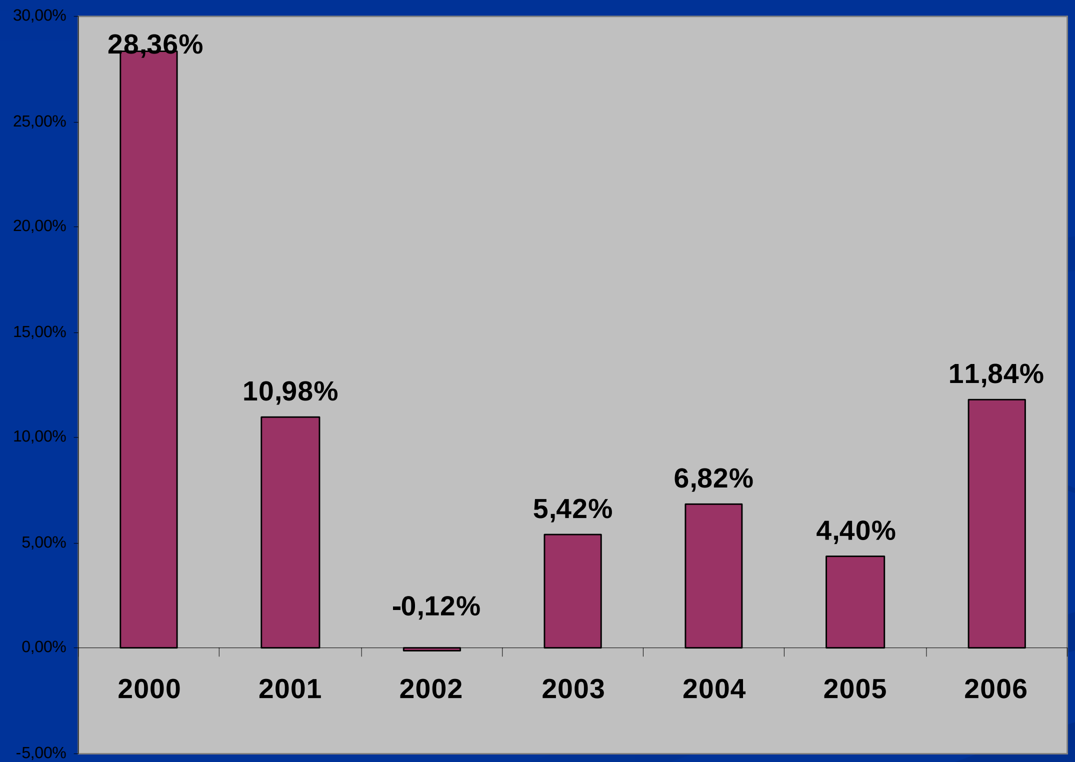
- **Digital convergence and movie industry**
  - Two universes, even three… and different strategies
    - Media: exclusivity (as a key factor for creating value)
    - Telecoms: interoperability
    - Computing: compatibility
- **French market:**
  - A large success of ADSL TV + illegal sharing of movies
  - Two dominant firms on multimedia platforms:
    - Canal+ France
    - Orange

- A large diffusion of broadband Internet (France, sources: CSA, Arcep))
  - Pay TV:
    - subscribers (2006) = 6.5 M HHs (26% equipped HHs)
    - turn-over = 1.1 M€ =14% TV market
  - Broadband Internet
    - 15.8 millions HHs (2008)
    - ADSL TV = 5.2 millions HHs
    - Internet subscriptions = 4.5 M€ (2007)
      - =4 x > TV markets (TV channels + channel package)
      - Electronic communications services = 42.5 billions € (Internet, mobile and fixed telephony, x2 since 1998)

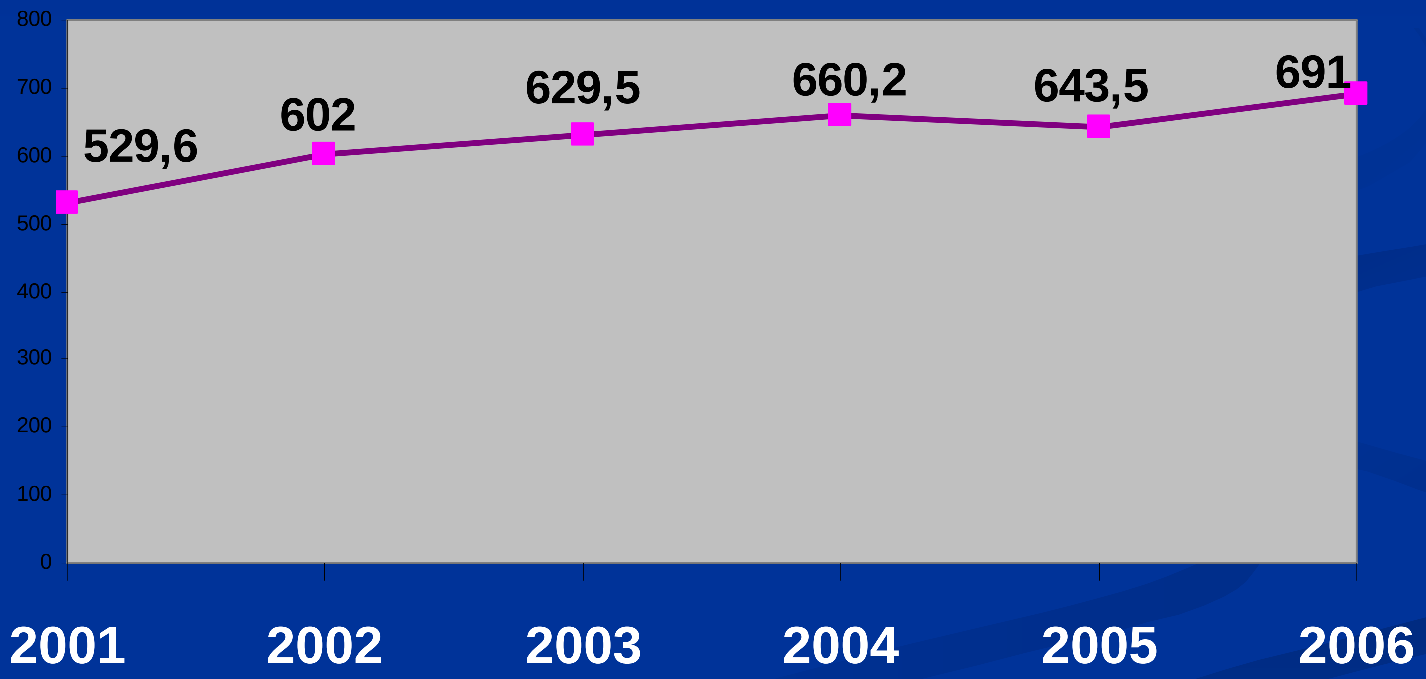
- Evolution of ADSL TV subscriptions (growth rate, France, 2006-2008, source: Arcep)



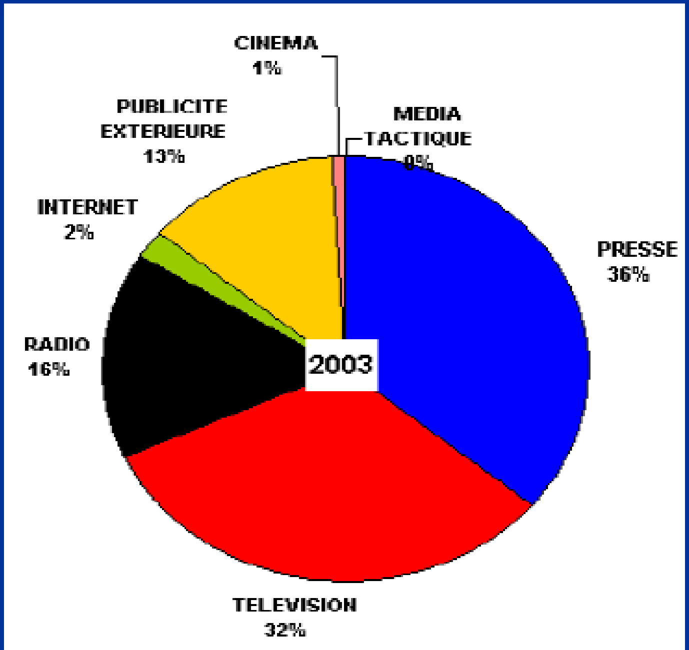
- Evolution of pay TV market
(growth rate, France, 2000-2006, source: CSA)

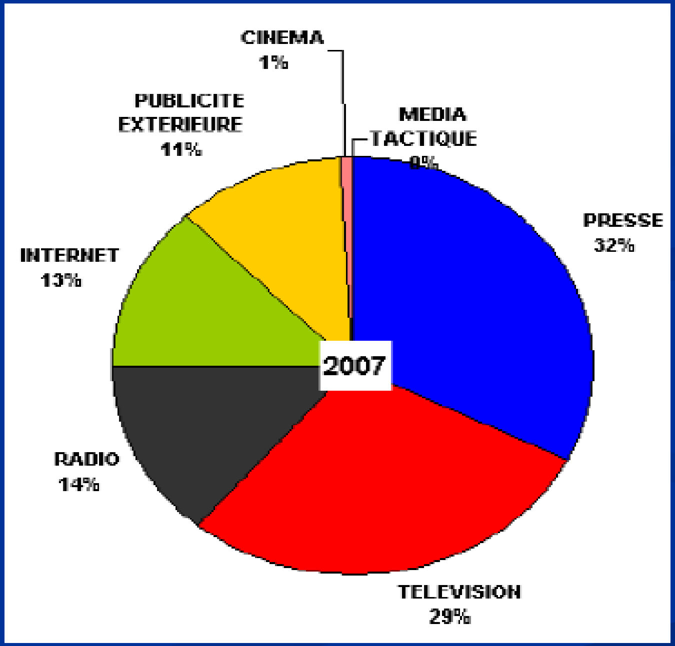


- **Evolution of pay TV subscription sales**
  (millions €, France, 2006-2008, source: Arcep)



- Distribution of advertisement revenue per media (France, source: CSA)





- TV advertisement = 6.7 billions € in 2007

- A large potential for the 'service and market' convergence
- But also some important limits:
  - Stagnation of purchasing power of households:
    - How to lead people to pay more for online pay TV and services?
  - The recent slackening of advertisement market
  - Allocation of time + audience fragmentation:
    - more time spent on Internet (blogging, online interactions...)
      - zero-cost activities (except for subscription fees)
    - less time devoted to traditional media
  - Illegal file-sharing and posting (P2P, UGC…)

- In this context:
  - How to transform convergence potential into value?
  - In particular:
    - Financing upstream activities with high costs of production (in particular, movies and TV programs)
    - Improving the quality of online services and infrastructure
    - Capturing without decreasing the WTP of consumers
  - What are the key factors for the viability of digital business models?

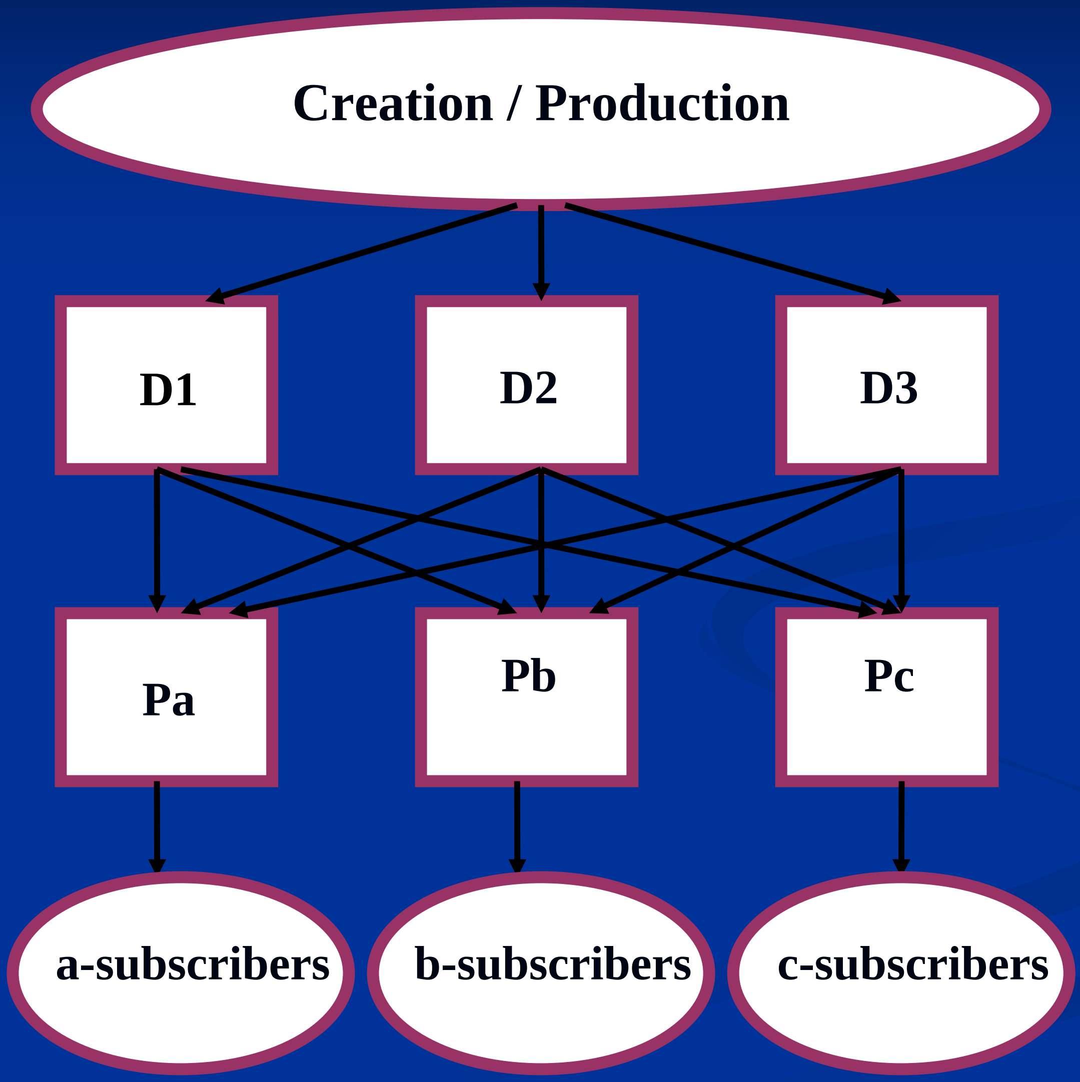
- Defining viable TV business model
  - Industrial feasibility:
    - sharing of revenues must be balanced enough to:
      - (1) finance sufficient volume of production
      - (2) ensure high quality of service and infrastructure
  - Acceptability of TV consumers:
    - WTP depends on:
      - quality of contents
      - actual access to diversified contents
      - usability and supply of new functions (portability, interactions…)
    - An empirical analysis (Rochelandet, Le Guel, 2006)
      - contingent valuation survey on music and video contents

- Many issues to solve…
  - Designing innovative services
    - How to capture the value of social interaction between users?
  - Avoiding destructive cannibalization between medias
    - Designing an optimal media chronology
  - Fighting against piracy and leading people to legal supply
    - And respecting individual rights (privacy, freedom…)
  - …
- One key issue: **exclusivity**
  - A big concern for business and regulators
  - Orange/France TV, Bouquet Canal+, Football…

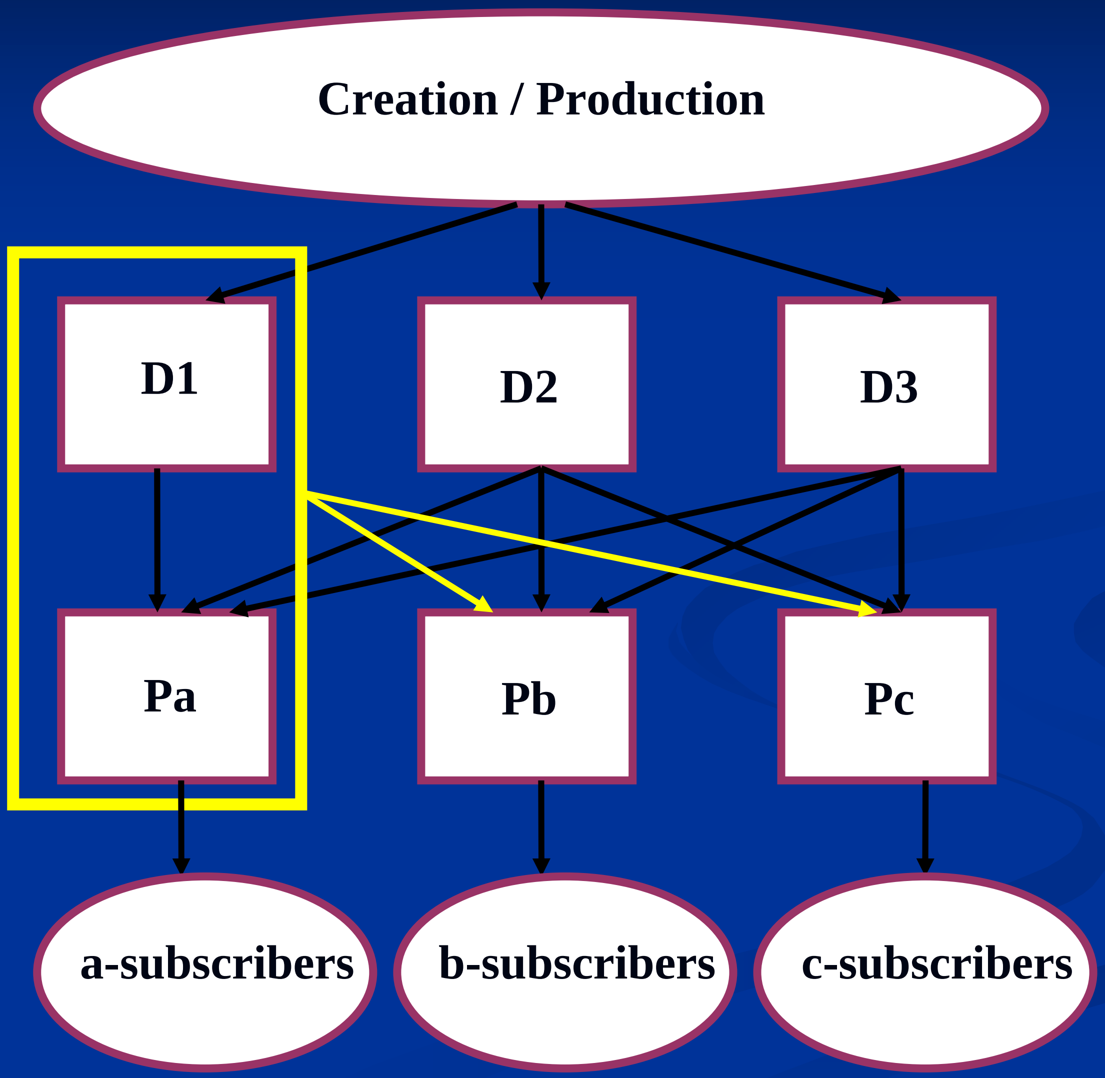
- Exclusivity is fitted to the traditional media world
  - Source of higher income/licenses fees (the case of Canal +)
  - True when considering only the traditional world of media
  - Consumer welfare? Media chronology and cultural diversity
    - high-value consumers accept to pay more now than low-value ones
    - but in the long run, all consumers have access to the media contents
  - Quite large access to popular events such as football matches
    - Obligation to diffuse large events (world championship final)

- But what would happen if exclusivity prevails in a world based on digital convergence?
- At best, no significant change:
  - replication of old business models
  - a simple cannibalization between new and old distribution platforms (without new added value)
- Different scenarios can be envisaged

- **Case 1: « Common carriage »**
  - exclusivity only on the upstream segment of the value-chain (production-distribution)
  - No exclusivity downstream
    - hence whatever the platform she subscribes, any consumer have access to all kind of contents.
    - perfect substitutability between platforms (P)
  - Competition between platforms is based:
    - either on **prices** (consumers choose the cheaper platform)
    - or on **innovation** (consumers select the most innovative one or the best fitted according to their needs)
    - In all cases, consumer surplus + content exposition maximized


Creation / Production
D1
D2
D3
Pa
Pb
Pc
a-subscribers
b-subscribers
c-subscribers

- **Case 2: « Imperfect substitutability »** between platforms
  - Vertical integration:
    - Distributor D1 buys out existing Pa or sets up its own platform Pa or
    - Platform Pa buys out a distributor D1 or sets up D1 (Orange channels)
  - Discrimination:
    - new entity **D1-Pa** can impose discriminative conditions to Pb and Pc:
      - higher prices
      - restrictive conditions of exploitation (e.g., no prime time)
  - b-type and c-type subscribers do not enjoy the same conditions of access to the contents distributed through entity D1Pa.
    - Reduction in their satisfaction and less content exposition
    - They can be incited to switch from Pb or Pc to D1Pa


Creation / Production
D1
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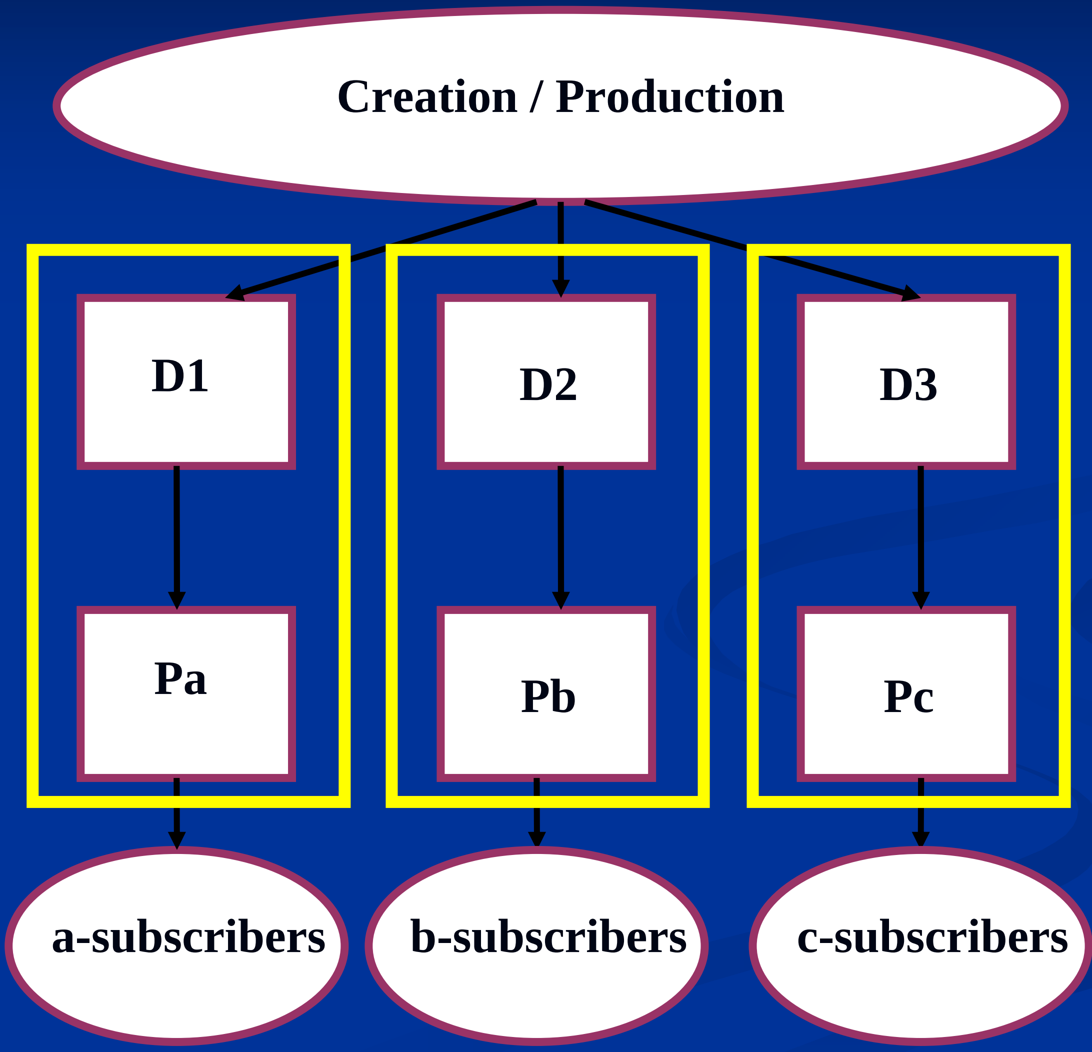
- **Case 3: « Convergence to 2 or +» (one industry, few platforms)**
  - **Generalized exclusivity war:**
    - Exclusivity upstream + downstream
    - Contractual relationship, vertical integration
  - Orange **AND** Vivendi-Canal+ would survive in France
  - k-type subscribers have only access to k-type contents (according to their distributor, k={a,b,c}) but no access to j-type contents delivered by j-type distributor (j≠k)



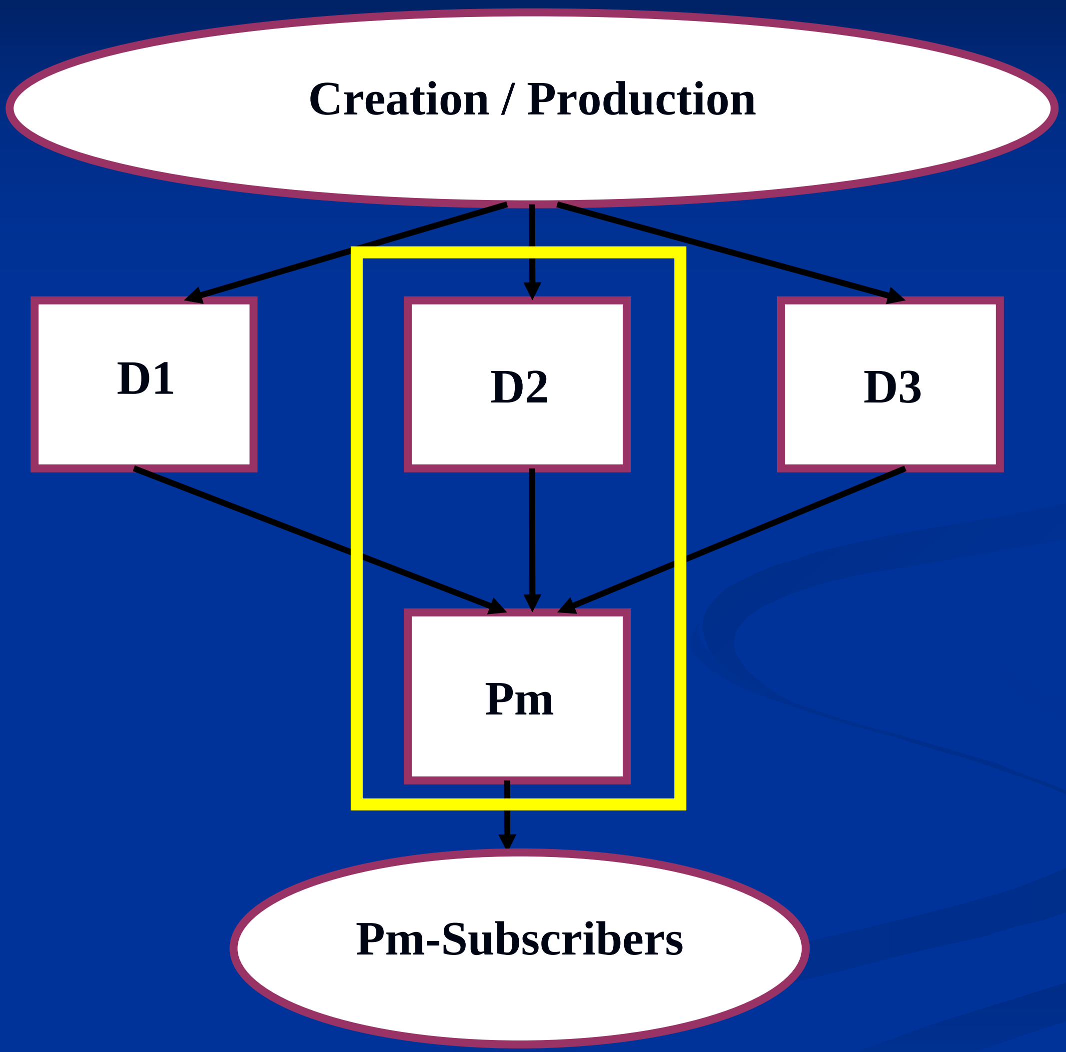
Creation / Production
D1
D2
D3
Pa
Pb
Pc
a-subscribers
b-subscribers
c-subscribers

- Strong differentiation between platforms:
  - Exclusive distribution of premium contents (blockbusters, sport events)
  - Competition for acquisition of exclusive rights
  - hence, potential increase in price of premium content + revenues of premium content providers
- **But social welfare?**
  - depending also on the size of the market, i.e. utility of services
  - impact on subscribers' welfare, hence on their WTP??
  - in fact, potentially less revenue for the content industry

- **Negative impact on innovation:**
  - Risk of reduced competition ("leveraging effect")
    - monopoly rent derived from resources produced and valorized independently of actual effort of platform providers
  - Risk of concentration of investment on premium contents to the detriment of:
    - other kinds of contents (independent movies…)
    - investment in building innovative services
      - key and valuable input for differentiation between platforms

- **Negative effects on market:**
  - oligopoly: prices determined by:
    - reaction of competitor(s) / potential for collusion
    - actual base of subscribers and utility of services
  - Exclusivity: less exposition, diversity and value
    - Sub-optimal exposition of contents
    - Reduction in subscribers' satisfaction , hence smaller WTP
    - potentially less revenue for the content industry
  - Cultural diversity requires consumers to be rich!

- **Case 4: ‘Convergence to one’** (one industry, one platform)
  - Only Orange **OR** Vivendi would survive in France
    - A similar case: CanalSat vs. TPS in the satellite market
  - The worst case: both monopsony and monopoly
    - Monopsony: *de facto* exclusivity in acquisition of rights
      - reduction in license fees and revenues for content producers
    - Monopoly: prices determined only by actual base of subscribers and the utility of services
      - reduction in consumer welfare
      - risk of large migration towards digital terrestrial free TV and illegal sharing of movies and TV series


Creation / Production
D1
D2
D3
Pm
Pm-Subscribers

- **Final remarks**
  - **Non-exclusivity** = a condition for higher income for copyright holders and welfare for consumer in the digital economy
    - Exclusive rights higher than income from ads and public subsidies?
    - Rather, combination contents + new online services
      - Targeted ads lead advertisers to accept paying more
      - Mobility and interactions increase the WTP of consumers
    - Differentiation between platform should be based on **innovative service** (creation of value) derived from social interactions (the very nature of Internet) and not on premium contents (replication of old business models)
  - **Need of empirical studies!**

Muito obrigado!

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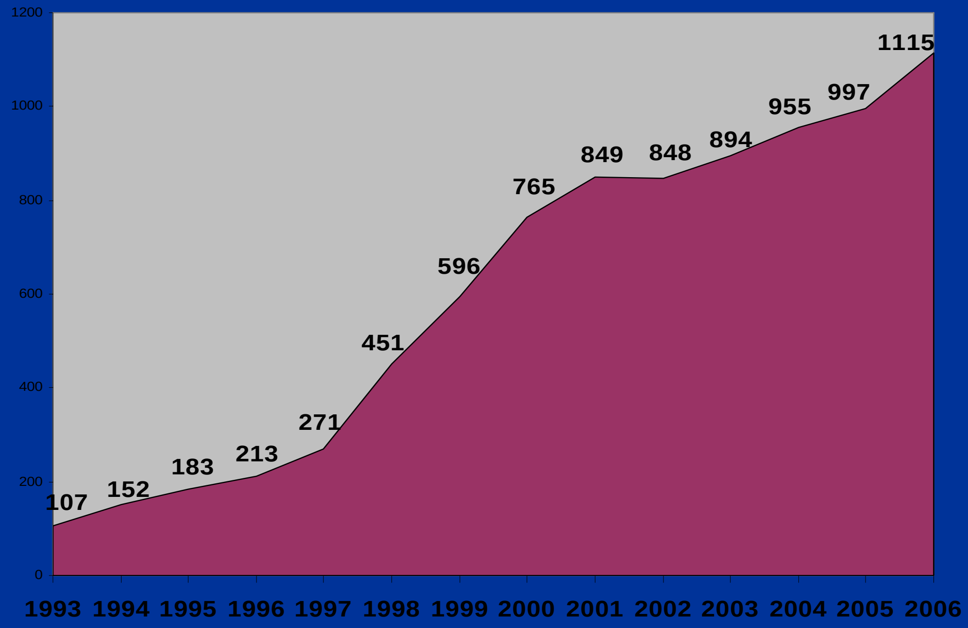
Appendix

- The classical trade-off in telecommunications
  - interconnection benefits / universal access
  - incentives to invest in the improvement of the quality of infrastructure and services

Broadband Internet (millions HHs, 2008)	**15.8**
ADSL TV (millions HHs, 2008)	**5.2**
Pay TV subscribers (2006)	**6.5** **=26% equipped HHs**
Pay TV turn-over	**1,115 M€** **=14% TV market**
TF1 turn-over	**1,7 billions €** **(+M6 = 2,3)**
Internet subscriptions (millions €, 2007)	**4.5**
Electronic communications services (Internet, mobile and fixed telephony)	**42.5 billions € in 2007 (x 2 since 1998)**
TV markets (TV channels + channel package)	**4 x < than ECS market**
	Sources: CSA, Arcep

- Evolution of Pay TV turn-over (France, 2006-2008, source: CSA)



2006 :

- subscription sales: 62% (= 691 M€)

- advertisement: 15%

- programs sales, diversification: 23%