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ABSTRACT

This paper analyzes the state of competition in the pay cable industry. The analysis conceptualizes competition in pay cable and discusses the current structure of the pay cable industry and the competition for subscribers and programming. The competition for audiences that pay cable faces from both pay-per-view services and the video cassette recorder (VCR) is also reviewed. Future speculation on the competitive structure of the pay cable industry is included in a summary analysis. The paper concludes that the continued diffusion of the VCR, coupled with the expansion of the pay-per-view industry, adds to the competition for audiences between the communication industries. Three figures are included, and 42 references are appended. (MS)

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Competition in the Pay Cable Industry

by

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Competition in the Pay Cable Industry

The past few years American audiences have experienced a video "revolution" as new forms of television services have been introduced to consumers. Foremost among the new television industries is cable television, which currently serves approximately 53.8% of the TV households in the United States ("By the numbers" 1989). Cable greatly expands the types of television programming available to viewers. Specialized channels exist for news (CNN), sports (ESPN), children (Nickleodeon), rock music (MTV), home shopping (HSN), and other types of information and entertainment.

Coupled with the rise of cable television has been the steady growth of pay cable channels. Pay cable channels are premium program channels cable systems provide to their subscribers for an additional monthly fee. The primary types of programming on pay channels include movies, specials, and sporting events presented in an uncut, commercial-free environment.

The approach of this paper is to conceptualize competition in the pay cable industry. The current structure of the pay cable industry and the competition for subscribers and programming are discussed. The competition for audiences pay cable faces from both pay per view services (PPV) and the video cassette recorder (VCR) are also presented. Future speculation on the competitive structure of the pay cable industry is included in a summary analysis.

The Structure of The Pay Cable Industry

Pay cable is distributed to subscribers via satellite in one of two ways. The most common method is to send the signal to cable systems who then supply the channel to subscribers for an additional monthly fee (Singleton, 1986). Hence, pay channels are often referred to as "premium" channels. The second method is to deliver the signal to home dish owners who have arranged for the programming directly with the originating company. Home dish subscribers account for less than 2% of all pay cable subscribers (Marks, 1986).

In 1975 viewers were introduced to pay cable nationally with the debut of Home Box Office, a subsidiary of Time Incorporated. HBO's original programming follows today's pattern of commercial-free and unedited movies, specials, and sports programming. Cinemax, a sister service to HBO, debuted in 1980. That same year Showtime premiered as a joint venture of Warner-Amex and Viacom. A fourth pay channel, The Movie Channel, emerged late in 1980. The Movie Channel became part of Warner-Amex/Viacom in 1981. In 1986 Viacom acquired complete control of Showtime/The Movie Channel. The Disney Channel debuted in 1983 and quickly established appeal to children and families. Drawing on vast programming resources and the Disney name, the pay channel has reached over 3 million subscribers in just five years of operation. Figure 1 illustrates the changes in subscriber levels from 1981 to 1988 for HBO, Showtime, Cinemax, The Movie Channel and The Disney Channel.

Figure 1 about here

Today these five pay channels account for over 35 million subscribers (TV Cable Factbook, 1988). Industry analysts estimate smaller national services, regional pay channels, and home dish owners represent another 5-6 million pay subscribers (Booth, 1986; "Cable competes," 1986; Marks, 1986). The major pay channels and their currently reported subscriber levels are found in Figure 2.

Figure 2 about here

Major Firms Involved in Pay Cable

Pay cable in the United States is dominated by three multidivisional corporations: Time Incorporated, Viacom International, and The Walt Disney Company. A closer look at each firm provides a more complete picture of the role each company plays in the pay cable marketplace.

Time Incorporated

Time has interests in the areas of magazine publishing, books and information services, and video. The largest revenues come from the magazine group, followed closely by their video enterprises. In addition to HBO and Cinemax, Time's video division includes HBO Films (designed for home video), HBO Feature Films (aimed at American and European syndication market), American Television and Communications (ATC) Cable System, and 5% ownership of Turner Broadcasting System.

As the oldest pay channel, HBO considers their strongest competition for audience members is from the traditional tv networks and the home VCR rather than other pay channels ("At age 15," 1987). HBO's present plans include continuing development of original programming (movies and series), and the expansion of HBO feature films ("At age 15," 1987; Livingston, 1987; Ross, 1987).

Several studies have examined HBO's appeal to pay subscribers (see Childers & Krugman, 1987; Ducey, Krugman & Eckrich,1983; Krugman & Eckrich,1982; Webster, 1983). Cinemax receives little attention in either the trade or academic press. Cinemax has maintained steady but smaller subscriber levels and contributes to Time's profits, even though much of the program content is duplicated on both channels.

Viacom International

Viacom's media interests include radio and television stations, cable systems, and production and syndication of television programming. The company is also involved in pay-per-view, having established Viewer's Choice in late 1985. Viacom was recently acquired by National Amusements for $3.4 billion dollars (Tedesco & Stilson, 1987).

Showtime and The Movie Channel are now in their 12th year of operation. With a combined subscribership of 8.9 million viewers, Viacom holds a firm second place with pay cable subscribers but trails HBO/Cinemax by some12 million households. Viacom has initiated new strategies to garner more subscribers, including exclusivity in programming, new price structures, aggressive marketing campaigns, and continued development of original programming ("Showtime/TMC: 10 years old," 1986).

The next few months should indicate if new strategies implemented by Viacom will enable the company to close the large gap in pay cable subscribers that currently exists between the top two conglomerates.

Disney

The Walt Disney Corporation's evolution into pay cable has been extremely successful. The Disney Channel is the fastest growing pay channel in the United States, and is considered a leader in pay cable marketing and programming (Roel, 1987). The company finds itself in an excellent position to provide capital for future growth due to interests in theme parks and resorts, theatrical films, home video, residential and commercial property development, and consumer product merchandising (Disney Annual Report, 1986).

The Disney Channel's rapid escalation in pay subscribership is attributed to several factors. One strategy has been to position the channel to families rather than children. Disney's own research reveals more than 33% of their subscribers don't have children under 12, and 35% of their subscribers are age 40 or over (Roel, 1987). At least 35% of the channel's programming is original, higher than any other pay service. Successful marketing campaigns aimed at cable systems and at the consumer have also contributed to the rise in subscribers.

Disney executives believe subscriber levels will continue to rise. The Disney Channel is well positioned with a recognizable name in the entertainment industry, having establishing a niche in the marketplace where it has a competitive advantage, and delivering a quality product (Disney Annual Report, 1986).

Regional Services/Future Players

There are a number of smaller services delivering movies, sports events, and other feature programming to subscribers across the country. Other national channels are Bravo (cultural arts), Home Theatre (family programming), Galavision (Spanish), American Movie Classics, and Playboy (Broadcasting Yearbook, 1988).

Several regional services have emerged in the past decade. Among the more successful are Uptown (20,000 subscribers in New York City), Z Channel (93,500 subscribers in southern California) and PRISM (375,000 subscribers in Philadelphia) (Booth, 1986). Several other services are found in California including ON TV and Select TV. While many of the smaller, specialized services have found local success, they lack the capital and programming resources to challenge the major firms dominating the industry at this time.

Competition Within the Pay Cable Industry

As the preceding analysis has shown pay TV competition on the national level revolves around five channels (HBO, Showtime, TMC, Cinemax, Disney) owned by three different firms (Time, Viacom, Disney). This section of the paper examines the competition between these pay services for subscribers and programming.

Competition for Subscribers

The ability to attract and maintain subscribers determines the potential profit or loss of any pay channel. Because pay cable is commercial free, the only source of revenue is subscriber fees. Pay cable channels are but one of numerous choices viewers have for entertainment. As an industry, pay cable trails traditional television options in the amount of viewing hours per week as shown in Table 3:

Table 3 about here

Two studies describe the typical pay cable subscriber. Krugman & Eckrich (1982) determined subscribers were more affluent, younger, and of a higher economic status than cable only subscribers. Their study generalized pay cable users see television as a form of entertainment and look at the benefits of subscribing when choosing a pay channel. Rothe, Harvey & Michael (1983) found subscribers considered movies, program variety, and the absence of commercials important factors in selecting a channel.

Marketing is the primary strategy used by the pay channels to bring in new subscribers. All of the major channels offer "free" weekends through affiliated cable systems during the year coupled with local newspaper advertisements to lure cable-only viewers to sample their product. Direct mail is often used by the local cable company to bring in new subscribers, and usually carries brochures announcing special rates or upcoming features on the pay channels (Coaxial Communications, 1988). The major pay channels recognize price reductions are necessary to maintain and develop subscribers in light of expanding video competition, and many services responded with lower rates during 1988 ("Prescription for pay's ills," 1987).

Both Time and Viacom realize additional revenues available through dish owners or TVRO (Television Receive Only) households. By 1987 all major programmers had scrambled their signals, eliminating many channels dish owners could receive. Pay channels have been slow to tap into the home dish market. Viacom's Showtime/TMC joined a number of other basic cable channels to offer a convenient, cost efficient package to dish owners (Marks, 1986). HBO has been the only major pay service to release figures on dish subscribers. At the end of 1986 HBO claimed 90,000 dish subscribers which generated monthly income of over $900,000 ("Cable at the crossroads," 1987). New subscribers will continue to materialize from both dish owners and cable households. With pay cable ratings up 6% in 1987, the industry is considered stable by many analysts and limited subscriber growth is expected (Pierce, 1988).

Competition for Programming

While marketing efforts will make potential subscribers aware of pay cable, the programming available on each channel will lead to actual subscribers. Showtime considers program exclusivity the key to increased subscribership. Showtime intitiated a series of exclusive contractural agreements with Touchstone Films, Cannon Films, Atlantic Releasing, and the De Laurentis Entertainment Group (Block, 1986). This practice has met with controversy and criticism within the industry because it escalates program costs with no guarantee of increasing the size of the audience. HBO countered Showtime's moves with an exclusive five-year, $500 million agreement with Paramount to begin in 1989 ("HBO-Showtime struggle," 1987). The Disney Channel has avoided exclusive agreements, instead utilizing original programming and part of their own Disney library for programming.

Another area of competition is in the development of first-run programming. Showtime has offered several original series including *Faerie Tale Theatre, Brothers, The Paper Chase, Broadway on Showtime, Hard Knocks, and the Gary Shandling Show* ("Showtime/TMC-10 years old," 1986). HBO's recent series include *First and Ten, Vietnam Diary, The Hitchhiker, and Not Necessarily the News* ("At age 15," 1987). Disney's newest original programming includes *Kidscene, Wind in the Willows, Return to Treasure Island,* and several short films (Disney Annual Report, 1986). The only type of first-run programming on Cinemax has been musical specials. The Movie Channel has offered no original series to date. HBO, Showtime, and The Disney Channel will continue to place emphasis and money on the development of original programming as a means to attract and maintain subscribers.

Time, Viacom, and Disney currently have ample resources from their diversified holdings to provide for increased marketing and programming efforts. Viacom remains saddled with a large amount of debt from 1987's leveraged buyout, but the company has sold partial interests in its cable systems (20%) and Showtime/TMC (5%) to reduce their obligations (Mermigas, 1988; Stilson, 1988).

Competition Between Pay Cable and Other Communication Industries

Pay cable channels compete for the same audiences watching both regular television and basic cable. Webster (1983) found that cable and pay television channels increased viewer choices and fragmentation of the audience but also increased viewership of local channels and amount of time spent viewing. Because pay cable involves additional consumer spending, most pay cable services consider their primary competititors to be the home VCR and pay per view (PPV) programming. The home VCR and the expansion of video outlets have made renting extremely affordable. PPV enables the consumer to schedule movies at a pre-established time without a great deal of effort. The following section examines the competition between the pay cable and the VCR and PPV industries.

Pay Cable and the VCR

The home VCR adds a different level of competition to the pay cable industry. In addition to competing for audience viewing time, the home VCR has made the acquisition of movies and other entertainment content easy and affordable. Consumers can rent or purchase tapes from numerous locations. Videos can be borrowed from friends, relatives, and libraries. Low rental rates and the daily increase in available titles give the viewer numerous options and flexibility in selecting video entertainment.

The proliferation of home video has forced pay channels to reconsider their rate structures in order to remain a viable consumer option ("Prescription for pay's ills," 1986). Overall, the pay cable industry hopes the audience views the VCR as a complement to their services rather than a competitor. The Movie Channel became the first pay service to openly encourage taping of their channel with a nightly broadcast, *VCR Theatre* ("Movie channel pushes taping," 1986). Pay cable channels must continue to offer reasonable prices to consumers in order to maintain co-existance with the VCR.

The VCR has helped to differentiate and expand the types of programming available on pay channels. The VCR forced pay channels to develop more original programming. The pay channels found themselves in the same dilemma as the commercial networks of the 1970's in that many movies are made available for rental/purchase months before airing on the pay channels (Coe, 1988). Hence, the pay channels have had to offer some products consumers cannot rent or purchase at the local video store.

Pay Cable and Pay Per View (PPV)

Pay per view allows subscribers to select individual movies and special event programming from a predetermined schedule. PPV competes with pay cable through consumer dollars, competition for viewers, and programming. As an industry PPV is estimated to reach revenues of $1 billion by 1990 (Bauer, 1987).

PPV prices currently range from $4-40 for each program selected (Fanning, 1988). While PPV costs are usually higher than monthly pay cable subscriptions and daily movie rentals, they do offer convenience as its major appeal (Kurnit, 1987). PPV is marketed to the consumer who does not enjoy crowded video stores or waiting several days to obtain a popular title (Lucas, 1986). The PPV industry is becoming the first stop on a film's schedule following theatrical release.

In addition to getting an early jump on many Hollywood films, the PPV industry actively pursues sporting events as additional program features. To date the biggest sports program delivered on PPV was the Tyson-Spinks heavyweight boxing championship, which generated some $50 million in revenues (Fanning, 1988; Tedesco, 1988). NBC is also expected to feature some portions of the 1992 Olympic Games as part of a PPV package with their new cablevision venture, CNBC (Landro, 1989). Additionally, professional teams from Major League Baseball, the National Hockey League, and the National Basketball Association, along with numerous university and collegiate conferences, have negotiated PPV contracts on a regional basis throughout the United States (Breznick, 1986). As PPV revenues grow the industry will no doubt compete more effectively for other first-run and special event programming.

Viacom recognized the potential of PPV several years ago and is active in the new industry. Viacom's Viewer's Choice is one of the more established national PPV services (Kumit, 1987). HBO dropped their initial attempt at a PPV service in 1988 with the cancellation of the Festival network (Stilson, 1988).

A recent study by Childers and Krugman (1987) provides some insight as to the direct competition between pay cable and PPV. PPV was perceived as harder to operate by viewers but offering more control than pay cable. Both pay cable and PPV were found to be very similar services by the audience. Childers and Krugman conclude this perceived similarity could make pay cable vulnerable to PPV. As more cable systems and households become equipped with PPV capability it will no doubt have implications for the pay cable industry, although it is too early to offer specific predictions on how the nascent PPV industry will affect pay cable channels.

The Future Competitive Structure of the Pay Cable Industry

It is unlikely any new firms will venture into the pay cable industry on a national basis for several reasons. The enormous capital required for startup would limit potential players. Second, any new service would have to either generate new subscribers or draw from established pay channels. To be successful a new channel would have to develop its own niche in the marketplace similar to The

Disney Channel. Finally, the lack of programming would hinder any new national company. With the signing of exclusive contracts for movies becoming a standard practice, any new service would experience difficulty in generating a program schedule of new films. In short, significant barriers to entry exist for any new pay cable channel wanting to operate a national service.

With the likelihood that new pay cable services will not materialize, what does the future hold for the established pay channels? The following section discusses two possible scenarios for the future of pay cable.

Consolidation of Services

It is interesting that both Time and Viacom continue to operate a second pay channel in light of rising program costs and sluggish projections for future pay cable subscribership growth (Fanning, 1988; "Prescriptions for pay's ills," 1987). While neither company publicly plans to drop their smaller service, (Cinemax and The Movie Channel) the consolidation of HBO-Cinemax and Showtime-The Movie Channel into two pay channels seems logical and appropriate.

The combining of the services would lower program and operating costs for each firm, but would also result in the loss of some subscribers. In Viacom's case in particular the consolidation of Showtime/The Movie Channel may become necessary to lower debt if subscriber levels do not continue to rise in light of the large number of exclusive program contracts the firm has signed with major film companies.

Pay Cable Displaced by VCR and PPV

Another approach could find that consumer interest and subscribership in pay cable will soon peak and the audience will ultimately prefer the flexibility of the

VCR and PPV in satisfying their entertainment needs. Pay cable will eventually reach a limit on how far monthly rates can be reduced and still produce profits. If PPV can lower costs, viewers may find the flexibility and convenience of a PPV service superior to that of pay cable. If the costs are similar, consumers will likely choose services which gives them the most control--PPV and the VCR.

This shift from pay cable to PPV may cause some pay services to reposition themselves to specialized audiences, similar to the program strategies of The Disney Channel and The Playboy Channel. The subscriber strength of HBO would probably allow the service to maintain national status. Again, we could expect some consolidation of the smaller channels (Cinemax, Showtime, TMC) in some capacity.

The diffusion of PPV and the continued expansion of VCR usage will determine the future relationship between these industries. The ability to provide entertainment to the audience at the lowest economic level will no doubt be a major influence in shaping the competition between pay cable, the VCR and PPV.

Conclusion

This paper analyzes the state of competition in the pay cable industry. Competition within the pay television industry focuses on subscribers and programming. The continued diffusion of the VCR, coupled with the expansion of the pay-per-view industry, adds to the competition for audiences between these communication industries.

Future research is needed to measure and quantify competition among pay cable, pay-per-view, and VCR audiences. One approach would be to compare the mediums in terms of the individual uses and gratifications obtained by the audience. This data may be helpful in determining strategies on how to attract and maintain viewers.

Another area of research could investigate the possibility that pay cable is actually moving toward a two-tiered industry (reflecting a bi-modal distribution) with a set of major firms dominating the national mass market for movies and original programming, and a second set of smaller firms operating in regional or specialized markets. These firms could then be compared in terms of types of services offered to viewers and programming strategies.

As Noam (1985) and Rice (1984) suggest, it is difficult to offer predictions due to unknown changes in technology, regulatory policies, economics, and consumer choices. This analysis has attempted to conceptualize competiton in pay cable, rather than offer specific outcomes on future competiton among the various communication industries.

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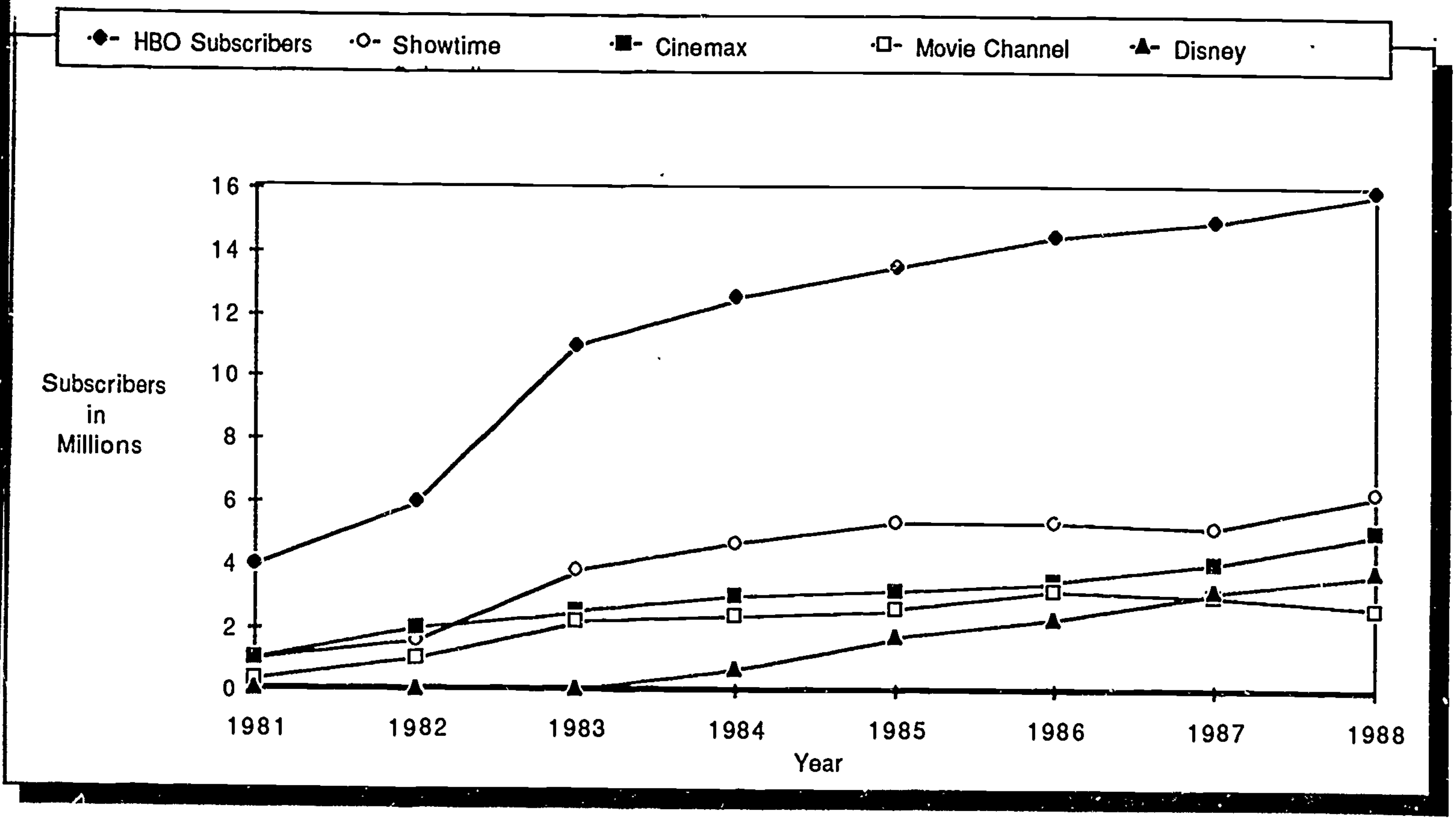
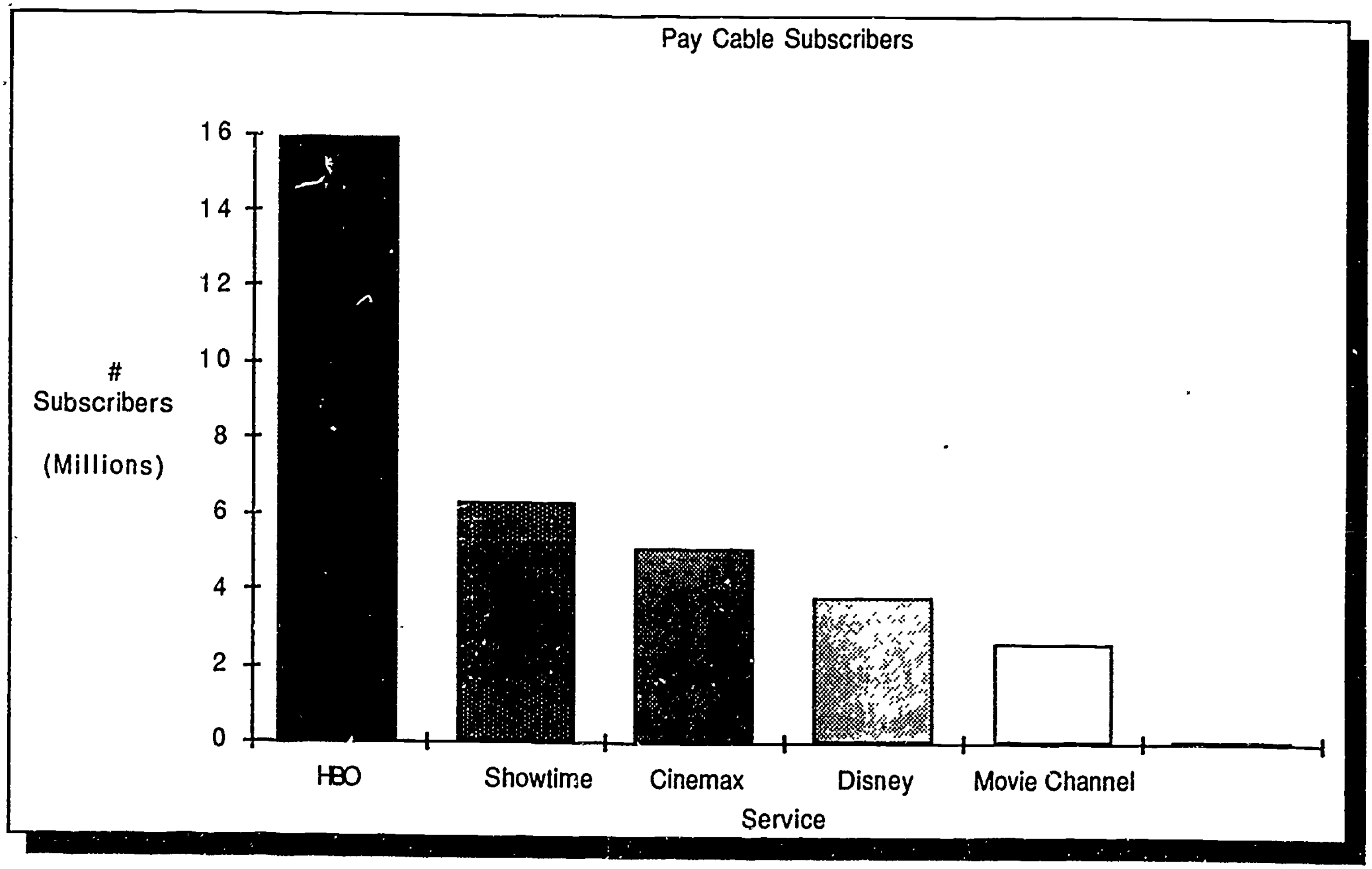
Pay TV Trends

FIGURE 1



Source: Television Factbook, 1981-88

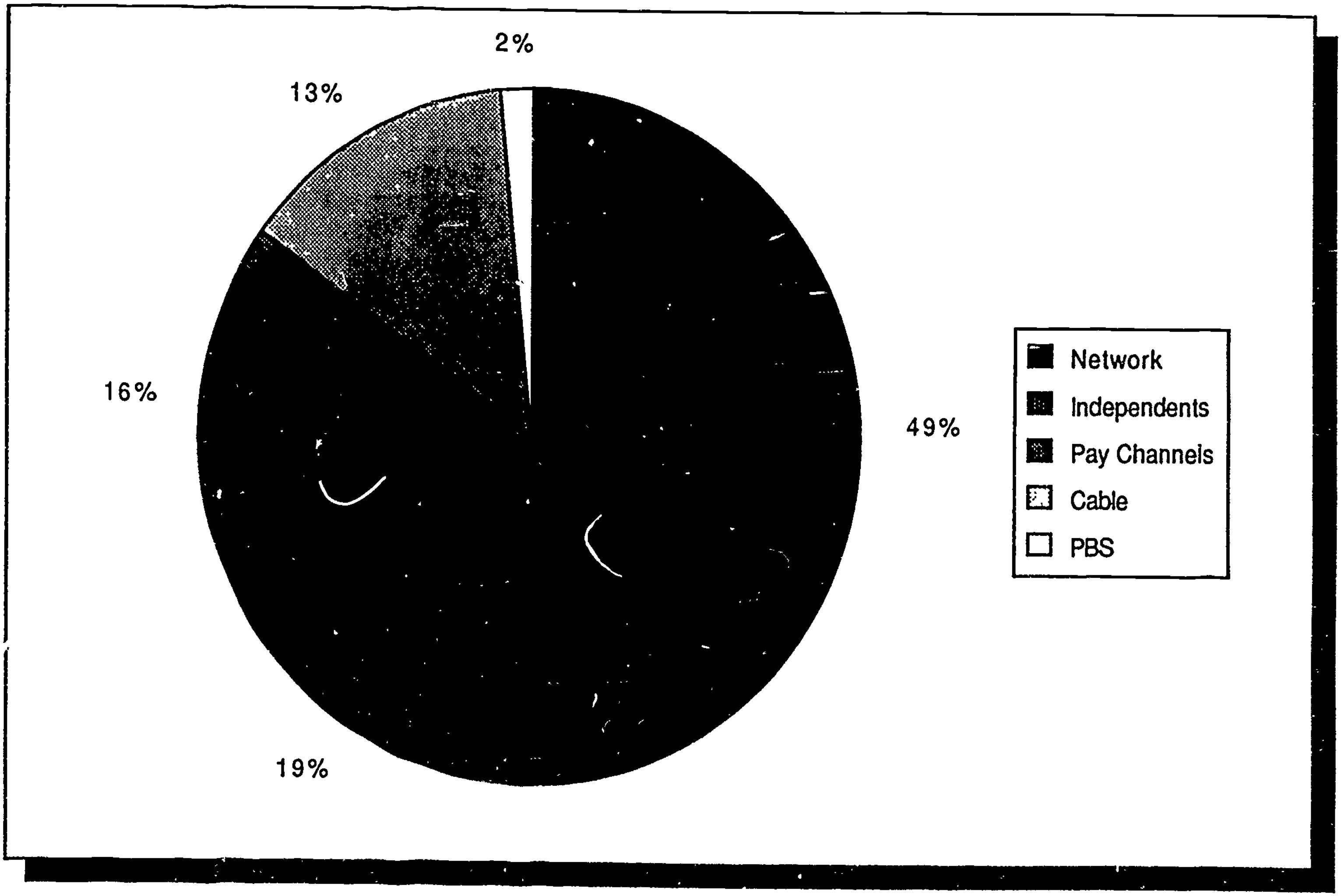
FIGURE 2



Source: Broadcasting Magazine, August 22, 1988

Amount of Weekly Viewing in Pay TV HH

FIGURE 3



Source: Economist, December 20, 1986