Comment: Analyzing the Critical, Unknown Factor

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The cable television industry, in recent years, has been broadening its view to encompass a full range of spectrum-based media. At an earlier stage, the focus was on the potential pay programming competition from subscription television (STV) and multipoint distribution service (MDS). In retrospect, the predictions of fierce competition by them has proven to be way off the mark. STV and MDS will be recorded in the annals of electronic media development as transitional technologies that only attracted and retained subscribers until a cable service was franchised and constructed in the same geographic area. Once direct competition with cable arose, these single-channel pay programming systems lost their subscribers because cable could offer more programming services at a comparable or lower price.

The advent of multichannel technologies, however, will present the cable industry with what many industry observers deem a much tougher competitive challenge. Already, the industry has fought a number of battles in the video marketplace with entrepreneurs operating satellite master antenna television (SMATV) systems and SMATV has proven to be a feisty competitor. Well after cable service becomes available, SMATV operators have managed to retain subscribers—displaying staying power that STV and MDS have failed to establish. SMATV has succeeded—albeit on a modest scale—largely because of its ability to offer a minimum of four to six channels of programming, typically a mix of pay movies, sports, news, and superstations.

And SMATV represents merely the beginning; the cable industry increasingly will be forced by the realities of competition to formulate and implement aggressive strategies to maintain its leadership position in an expanding pay media universe. Emerging in the near distance will be two new competitive threats—direct broadcast satellites (DBS) and multichannel multipoint distribution service (MMDS).

Like SMATV, these technologies offer attractive costs, in comparison with urban cable, for both construction and maintenance. Moreover, the financial, management and marketing resources behind them are significantly more formidable. The SMATV industry has developed as a series of largely independent local or regional businesses backed by modest financing of individual investors or newly organized limited partnerships. In contrast, industry giants such as CBS, Comsat, The New York Times Company, Prudential Insurance, ABC, and dozens of other major companies are casting their lot with DBS, MMDS, or both. Even the big names of cable, among them American Television & Communications (ATC), Cox Cable and Daniels & Associates, are jumping on the multichannel bandwagon to ensure that their investments will be sufficiently diversified to capture viewers who turn away from cable to more available or attractive competitors.

The rush to become involved with the DBS industry or to apply for an MMDS license to date has been predicated on little more than a defensive instinct by cable to deal with new competitors at an early stage, and by others who envision large financial rewards from newer exotic technologies.

There is also some sketchy evidence that viewers will freely substitute cable for another technology if a core of comparable programming is available on each, but it lacks the level of precision necessary to justify anything more than an educated guess. In November 1983, for example, Television Audience Assessment, Inc. (TAA) released a report entitled *The Multichannel Environment: A Study of Television Viewing in Two Cable Markets*. The research it reported involved 3,000 randomly selected individuals living in cable franchise areas in New Britain, Connecticut and Kansas City, Missouri, and encompassed both subscribers and nonsubscribers. One of the study's primary objectives was to gain insights into the effect that cable is having on viewers' reactions to television programs and on the way viewers use the medium.

A clear message that emerged was that cable subscribers, although having a more positive attitude toward television than nonsubscribers, did not find specific programming to be more enjoyable or compelling. "It's not the method of delivery that makes the difference," explained the study's director, "but the program itself." In other words, data indicated that enjoyment of television programming was not necessarily a function of how many channels were available.

Viewers are becoming increasingly comfortable with, and therefore oblivious to, new communication technologies. The medium, contrary to the teachings of Marshall McLuhan, is *not* the message. Rather, all that seems to matter for viewers is the message itself—namely, what programming can the viewer receive and enjoy on a television screen? DBS, MMDS and all the other acronyms are to the average viewer just letters in an alphabet soup. As Gertrude Stein might say if she were alive today, "Television is television is television."

The TAA report is an interesting, though unintended, complement to a 1982 contract research study released by the National Cable Television Association (NCTA), entitled *The Impact of Competitive Distribution Technologies on Cable Television* (Pottle and Bortz 1982). No empirical data were available which could have provided reliable subscriber penetration estimates or pricing structures. A number of indicators were presented, however, to suggest that relatively few premium and non-premium channels could satisfy most expressed demand for nonbroadcast services by any individual viewer. These indicators included data from *The Pay TV Census* (Paul Kagan Associates 1983c) which showed the decrease in demand for each additional premium TV services after the first in both typical and new build cable systems, and Nielsen data which showed that although viewing of premium cable channels was comparatively high, viewership of other cable program services was relatively low.

"Taken together," the NCTA study summarized, "these data imply that a large portion of consumer demand for nonbroadcast program services can probably be met by a four- or five-channel service, suggesting multichannel [technologies such as DBS or MMDS] can capture a significant market share" (Pottle and Bortz 1982).

Random experience in the field seems to underscore further the implications suggested by these studies. Both cable industry insiders and outsiders have begun to realize that the initial honeymoon with viewers has ended. The technological razzle-dazzle of interactivity and enhanced services is giving way to a revived emphasis on marketing, product differentiation, and customer service. The cable industry is now confronting the real bottom line: maximizing subscriber units.

These activities, however, may be implemented too late to prevent the cable industry from losing a substantial number of viewers to DBS or MMDS, both of which will be able to offer multichannel packages on a

national basis comparable with the four or five most popular nonbroadcast channels on cable television.

DBS has the ability to aggregate substantially more subscribers than any multiple group of cable systems, and MMDS can underprice its service because of lower capital costs. Both represent potential barriers to increased cable revenues and higher profit margins.

Moreover, DBS and MMDS will not be hampered by the layers of local and state regulations that govern the cable industry, regulations that frequently have generated substantial financial commitments to secure franchises rather than to promote profitable operation of the system. Backed by substantial corporate resources, DBS and MMDS may have a superior ability to focus on the most profitable services and thus lower their cost vis-à-vis cable to acquire and retain subscribers.

Historically, those who conjure up projections of market growth in a competitive media environment have often been proven wrong because of an inability to project one or more critical, unknown factors that have the power to skew underlying assumptions. What at first seemed like a potential rivalry frequently evolved into parallel searches for separate positions in the marketplace. For example, an ongoing debate for many years dealt with how cable television systems would siphon viewers from conventional television stations. The critical, unknown factor that demonstrated the fallacy of this assumption was the development of satellite pay services, which provided the financial basis for cable's growth. Advertiser-supported television and pay-supported television were transformed rather rapidly into bushels of apples and oranges that defied the simple comparisons of old.

Similarly, the developers of the videodisc staked much of their business on an ability to underprice the same movies available for purchase by videocassette owners. But again, the marketplace was unexpectedly turned upside down: the videocassette industry's sales-only strategy was abandoned in favor of low-cost rentals from local retail stores. Those remaining in the videodisc business now search for new market possibilities in instructional and arcade game programming, having conceded feature films largely to the videocassette market.

The list could continue. Long-playing records vs. audio cassettes. Radio vs. television. Television vs. motion pictures. Each time, a critical, unknown factor has demonstrated that something that seemed like a direct competitor turned out not to be one at all. In these cases, the

critical, unknown factors were respectively, the rising popularity of automobile and personal stereo units; the development of rock and other music formats; and increased budgets for theatrical films. Given this brief litany, any projections for DBS or MMDS growth should at least be tempered with a reminder that, again, the unexpected may emerge.

Although it is possible to speculate on a virtually infinite number of situations that could generate the unexpected, my discussion here will be limited briefly to several key questions whose answers are likely to produce dramatically changed perceptions of the multichannel video marketplace.

First, to what extent will DBS or MMDS pursue business opportunities in heavily cabled areas? At least for DBS, the original business plans of the initial two entrants—Satellite Television Corporation and United Satellite Communications Incorporated—indicated a strategy favoring homes in areas without access to cable. If such a strategy is in fact implemented, there may be little direct competition between cable and the other multichannel technologies, since they will be pursuing separate market niches. But given the increased costs of urban wiring, and the growing trend of cable operators to scale down the elaborate construction plans promised in franchise agreements, the opportunity to pursue lucrative cable markets seems too good for DBS and MMDS to maintain a separatist business plan.

Second, will DBS and MMDS emphasize pay programming, or will they move to a hybrid system of pay and advertiser-supported channels, thus resembling a conventional cable system on a much smaller scale? The original thinking among DBS and MMDS planners was to "cream skim" the pay cable audience by offering a comparable package of pay services at a lower price. Yet with Microband Corporation of America's plan to launch a twelve-channel MMDS hybrid system in cities such as New Orleans, Philadelphia, and San Francisco, it appears that one original premise for multichannel competition—pay channels—may become rapidly diluted. With basic cable rates in newly constructed urban markets such as Boston and Denver in the two to four dollar range for 35 to 54 channels, it is difficult to imagine how DBS and MMDS will be able to underprice cable if all that is offered is a combination of basic and pay services.

Price sensitivity, as suggested above, looms as a critical, unknown factor. The 1982 NCTA study was premised on the notion that a DBS or

MMDS service could attract price-sensitive viewers away from cable by charging half of what cable subscribers were billed. Although that may have been a valid assumption upon which to establish an initial level of price sensitivity, it is unlikely that in the marketplace DBS or MMDS will be able to reach those benchmarks. How attractive will DBS or MMDS be if they are able to reduce the price of their service only slightly below that of cable; further along the continuum, how competitive will they be if they offer a more limited quantity of service (namely, fewer channels) at the same price as cable, or even in excess of it?

Most of the upbeat talk about DBS and MMDS has unfortunately focused on the hardware and its capital costs, while ironically justifying their future growth on research indicating that software, not hardware, is the real point of differentiation to attract viewers. When DBS and MMDS are actually in the market, if they cannot underprice cable yet still choose to compete directly against it, they will have to offer programming or services that are somehow unique. Will it be something on the order of pay-per-view or high-definition television? So far, demand for these types of enhanced services is barely existent, and thus does not seem likely to represent the primary financial basis for other multichannel video entrants. Unless a new type of programming service emerges, a budding one develops a substantial market, or current program sources utilize DBS and MMDS as distribution windows before selling to cable, there seems to be little on the horizon to make cable television appear as yesterday's news.

Even if DBS and MMDS can erode cable penetration to some significant extent—on the order of five to twenty percent—it remains to be seen how long such erosion can be sustained, and how successful the cable industry will be in launching a counterattack. On the first point, there has been no real experience with disconnects for DBS or MMDS, hence no data to compare it with disconnects for cable service. This is a critical, unknown factor that will have a direct bearing on the depth and length of cable audience erosion.

Finally, like all vigorous competitors, the cable industry can be expected to move forcefully to stem market-share erosion, and to expand its overall share as well. With a newly organized Council for Cable Information, the industry will be committing substantial resources to build viewer loyalty to the cable medium itself, thereby sharpening the distinction between cable and other multichannel technologies in the

minds of consumers. If this marketing campaign is successful—and that is a big "if" indeed—the premise that DBS and MMDS would be able to capitalize on viewers' not distinguishing among delivery modes could be all but destroyed.

The foregoing analysis underscores my central theme: be prepared for a major turn of events to change current perceptions about multichannel video market entry and long-term success. History and the rapid flow of events in the field of electronic media suggest that today's seers have skipped too lightly over areas that lead to the unknown, perhaps fearful of discovering that beyond the beyond may be just a slightly altered version of the status quo.