Comment: Multichannel Video Competition

Mark S. Nadel

Exactly where do video cassette recorders (VCRs) fit into the competitive video media picture? When Levy and Setzer (1982) examined media competition and measured the number of video channels available in each local television market they did not spend much time considering VCRs, and treated their presence as numerically equivalent to a single broadcast station. On careful examination, however, a VCR outlet is much more significant.

The video industry comprises four groups: video producers, video consumers, and the two groups of distributors in between: wholesale distribution networks and local retail outlets. Most discussions of media competition, like those in this volume, are concerned primarily with competition among retail distributors of video programming—those who sell directly to consumers. Where does a VCR fit in? It does not seem to be comparable to only a single channel retail outlet like a single screen movie theater or a single channel television or STV broadcaster, for a VCR gives a viewer several simultaneous viewing options. Nor is it comparable to multichannel retailers like multiple screen theaters, MMDS, or cable systems. Rather than being limited to the offerings that some retailer/editor selects, a VCR enables a consumer to bypass retailers completely.

The VCR enables a consumer to choose from among any of the programs recorded on video cassettes (VCs) and distributed over time via a variety of channels. While most consumers get access to VC software via local retail outlets—some are even located at movie theaters (Karp 1984)—viewers are not limited to any retailer's selection; they may deal directly with a wholesaler or even a producer.

Monroe Price (1984), observing the recent release of Fassbinder's 15-hour film *Berlin Alexanderplatz* as a $400 VC, noted that such minority interest material would ordinarily remain inaccessible to most consum-

ers; it is doubtful that it would be shown outside the few cities that have movie theaters catering to such very specialized audiences. VCRs, however, permit small groups to gain easy access to such programs no matter how small a minority they represent.

Rather than being comparable to any of the other retail video distribution technologies, VCRs and VCs suggest comparison to the *book* industry and—if Levy and Pitsch are correct in foreseeing the possibility that VCs may be used to disseminate news as well as entertainment—the entire, highly competitive print industry. VCRs increase diversity of content unlike any media except print and while cable television may or may not provide narrowcasting for live material or material of strictly local interest, VCRs permit the kind of national narrowcasting pursued by book and magazine publishers.

How will this whole industry affect the other video media? The present growth trend of VCRs is comparable to the path that color TVs took in their early days (Carey and Moss 1984); the continuing rapid decline of costs (VCR Sales to Dealers 1983) suggests that this trend will continue. Meanwhile, as the cost of machines declines and VCRs proliferate, additional software continues to be made available at a low price, due to the proliferation of cassette rentals and clubs for sharing cassettes (Harmetz 1984). If VCR penetration continues to rise swiftly, the substitution effect that Levy and Pitsch found between VCRs and pay cable could have dramatic effects. Consumers who desire access to movies at home may find it more attractive to see exactly what they want and when they want it on VCRs rather than settling for the time schedule and selections of pay TV movie services. Yet this also suggests how competing media owners might respond to competition from VCRs.

Although consumers may enjoy having the freedom to select exactly which video titles to watch, many may not have the time to carefully search for the most desirable combination of programs. They are probably willing to pay for an editing service to make expert selections for them. In fact, consumers pay print media editors precisely for that service rather than sorting through the reams of news stories produced daily (Nadel 1984). Cable and other new media owners may seek to follow this lead and shape channels to particular consumer groups the way that radio and independent television stations do now. Consumers can buy their own records, but often they prefer to take advantage of the services of a radio disk jockey/editor, who monitors both new and old

music and selects a combination to satisfy their tastes. Wholesale cable networks like Cable News Network (CNN) and Music Television (MTV) are already specializing to serve particular groups of viewers.

It would be desirable if VCR competition forces many retail media technologies to act this way—as value-added carriers of video programming—serving as video editors on individual channels or even groups of channels, rather than serving merely as electronic newsstands. Those operating the new media are certainly uniquely qualified to assess and serve their subscribers' needs and desires by vertically integrating into editing individuals or groups of video channels. Thus, in addition to providing the useful transmission service (similar to broadcast station network affiliates) for specially edited wholesale networks, they could also perform the valuable editorial service that independent broadcast stations do on their channels. Cable operators will probably continue to approach this "broadcast station" model as they get more involved in the type of advertising efforts that broadcast stations perform, efforts discussed by Wirth and Bloch.

Wirth and Bloch's results indicate that broadcast television advertising revenues have not suffered very much from the introduction of cable television. The authors dispute the widely shared belief that the decline in broadcast audiences translates into a similar decrease in advertising revenues. Wirth and Bloch find that the decline is substantially smaller.

On first blush their conclusions appear very surprising. They suggest that stations can make up for lost audience by exercising oligopoly power to increase the per capita amount that they charge advertisers (CPM). But if stations have such oligopoly power, why do they not exercise it when there is no cable? It is possible—though unlikely—that stations are simply apathetic, but why only those in cable markets?

Wirth and Bloch's results may be biased because they are based on data for the highest rated prime time program on CBS. Basic cable (advertising) networks would presumably have their smallest audiences when competing against the most popular (and expensive) network programs (although pay TV services are gaining growing audiences during this period). Cable networks probably have a considerably greater effect on station audiences and advertising revenues during daytime or late night viewing.

The results may also suffer from premature obsolescence, and there

are a number of reasons why their conclusions are probably not applicable today.

Not very long ago, neither cable networks nor their affiliate cable systems were very significant players in the advertising market. Networks faced a number of obstacles. They were handicapped by their inability to document the size of their audiences with the sacred Nielsen ratings that advertising agencies demand. Agencies were generally unwilling to spend much on cable unless cable could document the results of that spending in the only terms that agency clients found understandable (Kaatz 1982). The cable industry quickly discovered how "frightfully important" Nielsen numbers are (Hausman 1984a; I. Smith 1984).

A second problem was that the cable network audiences were simply too small overall to attract the interest of advertisers looking to reach large mass national audiences. All of the available cable networks combined did not even reach the audience of one of the three major television networks, and it was much easier to negotiate with one large network than with many smaller ones. Advertisers also desired more detailed information about the audiences that cable reached (Hausman 1984a; I.V. Smith 1984).

Finally, cable networks were as concerned with securing channels on cable systems as they were with attracting advertising, and maybe more so. They realized that it was necessary to reach a critical mass of audience before they could get Nielsen ratings and thereby become a reasonable purchase for national advertisers; thus their efforts focused on reaching such a critical mass. Access was the foundation that had to be laid before significant advertising revenues could be earned.

Meanwhile, cable systems operators faced their own roadblocks. First and foremost was the cost of equipment to insert ads into the programming feeds. High-quality equipment cost in the neighborhood of $200,000 and operators felt that its purchase was not justified unless they could realize $500,000 in annual gross billings (Rosenthal 1984). This made it impractical for smaller systems to sell advertising time. In addition, under the terms of the 1982 actors union contract, a talent compensation fee of $300 was set for each performer who appeared on camera in a commercial that was cablecast (New Union Pact 1984). Many advertisers in small markets found this amount to be prohibitively high.

Additionally operators felt that their first priority was to build their system and then market their services to consumers. Most early system managers were experts at local government relations, technical aspects of cable, and marketing. Advertising sales were treated as a secondary priority (Moozakis 1983).

Today things have changed dramatically. A number of cable networks are finally being measured by Nielsen and other rating services, partly because cable networks are serving larger audiences—on an aggregated basis they match the approximate 19 percent audience share of the television networks (Hausman 1984a; Ziegler 1984). By selling commercial time across all the cable networks they carry, cable operators can offer a cable "cross buy" on the same terms as television network time. Advertising agencies are therefore more willing to buy time on cable networks (Taub 1984).

Finally, cable networks had long stressed the advantages of using their specialized channels to reach targeted audiences in new ways, such as through five-minute commercials or "infomercials." Most advertising agencies wanted to see how well such tactics worked in practice before committing any significant portion of their budget on such new ventures. As the results of early experiments are being analyzed, the advertising community has begun to feel more comfortable with the medium. In one example, Warner Amex has released the results of a test use of the Columbus, Ohio interactive QUBE system for Ralph Lauren cosmetics (Dougherty 1984), in order to demonstrate the effectiveness of specialized advertising on cable.

Similarly, things continue to improve on the affiliate front. Multiple systems operators (MSOs) are seeking to trade local systems with each other to establish more economical regional clusters of systems. Such clusters increase the subscriber base over which systems can spread the cost of advertising sales equipment and staff (Marks 1983). And even where clusters are not possible, systems cooperate with each other to facilitate interconnections that permit ad sales to become economical (Rosenthal 1984). Finally, a new union pact has decreased the minimum on-camera fee for performers from $300 to $12.70 for systems of 10,000 or fewer basic subscribers (New Union Pact 1984).

MSOs are also beginning to treat advertising sales as a high priority. They are now hiring more advertising professionals on staff and soliciting reluctant buyers. For example, Group W Cable offered free time to

advertisers on its Detroit system (Moozakis 1983; Rosenthal 1984). Meanwhile, a Times Mirror system in Louisville, Kentucky is being sued for breach of contract by its advertising sales representative, who charges that "when the ultimate profitability of the advertising sales became apparent, the cable company wanted that business for itself." (Cable Ad Network 1984).

And as operators concentrate more on advertising they seem to be finding significant demand, permitting them to charge hefty ad rates, which may, at times, even surpass television broadcasters' rates (Hausman 1984b). In summary, despite Bloch and Wirth's results, cable systems appear likely to provide a competitive outlet for local advertising and force advertising rates to decline to competitive market levels.