Cutting the Cord: Common Trends Across the Atlantic

Joint interview with

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C&S: How would you define cord-cutting, from a US or European perspective?

Gilles FONTAINE: Cord-cutting, in Europe, is seen mainly as a USA phenomenon, where consumers would trade-off their pay-TV subscription for over-the-top Internet services. The last years, in Europe, have rather seen the rise of powerful cable and IMPTV operators competing in the pay-TV market with legacy satellite packager.

Eli NOAM: Cord-cutting is the dropping, by consumers, of expensive cable TV subscriptions in favor of online access to TV programs and on-demand films. Drawbacks for consumers are less certain quality (bandwidth), less availability of live programming such as sports, and absence of some channels. Advantages are cost-saving, no need to pay for undesired channels, better search, less advertising, greater choice, more control. In a broader sense, cord-cutting is a transition of TV from a broadcast/cable push model to an individualized pull model. So this is not just about switching to yet another delivery platform. That's the easy part. It is much more fundamental. Looking ahead, one change will be that by going online, TV will move from a slow-moving, highly standardized technology controlled by

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broadcasters and consumer electronic firms to a system where multiple technical approaches compete with each other and propel video delivery into an internet-rate of change and innovation. And that's just the technology. Equally important changes will take place on the content level, and in the structure of the media industry, in the advertising and business models, and in the policy.

Do you see any evidence that cord-cutting is really happening?

Gilles FONTAINE: Cord-cutting, in Europe, is not happening, or is not happening yet. Several reasons account for this: on the one hand competition is intense in Europe between networks, and is driving Internet access and television prices down, therefore limiting the incentive to "cut the cord". On the other hand, Internet services are far from having the same level of offer as US ones, even if catch-up television is increasingly available throughout Europe. Also, the video-on-demand market is very fragmented, with still limited catalogues and interfaces that could be improved and subscription video on demand is nascent, and mostly pushed by US-bases players, even if some European players have launched first services. Finally, the penetration of connected TVs and connected set-top-boxes is probably also lower in Europe than in the USA.

Eli NOAM: In the short run, there is less cord-cutting than media reports and hype suggest. For a variety of reasons, almost all participants in the media industry have an interest in dramatizing the issue. Broadcasters are making investments in ‘second screen' distribution, partly to be prepared for change, and need to justify them. ISPs are expanding bandwidth to position themselves as providers of mass entertainment options. Telecom companies, similarly, need to upgrade their networks. New providers of bypass service to broadcast and cable, such as Aereo in the US, create buzz to their market-disruptive activities. Media cloud providers such as Amazon or Netflix present new options. And even cable TV operators, who are the ones negatively affected, have an interest in presenting the problem as a crisis, at least to policy makers, in order to gain regulatory relief.

The reality is more modest, at least in the short term, but not insignificant. According to a credible analyst, Craig Moffett, The "pay TV sector" – cable, DBS, and IPTV – lost 316,000 subscribers in a 12 month period mid-2012-mid-2013. Since IPTV has gained subscribers, cable losses must have been larger. That is a loss of about 0.3%. Another estimate for 2012 has the number at 1.08 million. In a 4-year period 2008-2011, anywhere between 3.65 and 4.75 million subscribers were lost. But that was in the midst of the Great Recession, and thus not all can be attributed to cord-cutting.

Do OTT services really challenge telcos and cablecos managed TV and video offers?

Gilles FONTAINE: Many studies seem to show that OTT services propose a better customer experience than the equivalent launched by the telcos or the cablecos. OTT services are Internet natives, customer friendly companies, with a rhythm of innovation that is difficult to compete with. Telcos and cablecos still concentrate on the "linear television model", even if they have developed their own on-demand offers, whereas OTT services specialize in on-demand services. But telcos and cablecos still benefit from a privileged access to the TV set through their TV set-top-box, a competitive advantage which is about to be undermined by low cost solutions to connect the TV set, such as Chromecast from Google.

Eli NOAM: Overall, the extent of video streaming has been quite large. In the evening hours, about two-thirds of internet traffic are video-bits. Netflix alone has added 630,000 streaming subscribers in the US in 3 months in 2013, to a total of 30 million. Thus, while the numbers of cord cutters is not huge yet, as mentioned, a steady loss of subscriptions is to be expected, and it is backed up by surveys in which cable subscribers grumble about staying with expensive subscriptions which they do not fully utilize. This is particularly true for the younger generation. 34% of the Millenials (cohorts born 1980-2000) say that they watch mainly online video and not broadcast TV. For Gen X and for Boomers the numbers drop to 20% and 10%.

With OTT available, the traditional business model of cable companies unravels. In the past, they were able to raise prices and to pass on the raises by channel providers. This becomes more difficult. Similarly, it becomes more difficult to offer only bundled channels ("prix fixe"). Similarly, the ability of channel providers to offer content to viewers directly reduces their bargaining strength considerably. If they want to keep up, they also need to develop expertise in online technology, social networking, and mobile communications.

UK cableco Virgin Media and Sweden cableco recently signed a distribution agreement with Netflix. Do you foresee any revision of the cablecos and telcos triple-play model?

Gilles FONTAINE: Building an IPTV service is not straightforward for a telco: network costs can be high to ensure a homogeneous quality of service. They also face high programming costs and the complexity of negotiating with the media world. On-demand services hardly prove to be profitable, because of the market power of Hollywood studios combined with the strong competition between telcos and cablecos, has for instance led to almost unrecoupable minimal fees to access programs. The situation can be similar for a cableco that would not have the resources to acquire exclusive, attractive content: the recent deal between Virgin Media or Com Hem and

Netflix heralds a change of strategy for the smaller telcos and clablecos, which could favor to comfort their Internet access business by offering the best OTT services rather than pushing their own television packages.

Eli NOAM: Overcoming all of these challenges is possible but requires an acceleration of internal processes, major investments, and a willingness to give up some control. There are signs of change in that direction. Comcast, which has just paid $ 39 billion for NBC Universal, thus gaining vertical control from the camera lense to the eyeball, has now announced a trial of a cord-cutting offer to subscribers: if they take a Comcast broadband service (of a quality that is today an upgrade for most customers) they get at basically no additional charge HBO Go (HBO's archive of self-produced shows plus current other shows, available anywhere in the US from most devices), plus the free broadcast channels. The regular monthly price $ 70/ month, compared to a price of $ 135 for a full complement of 200 channels including HBO Go. So the viewer willing to skip regular cable channels saves a lot of money. The data cap for such a service is 300 Gigabytes. This is about 120 hours of HD viewing per month, which is adequate for single viewer but tight for a multi-device, multi-viewer household.

So this shows that cable companies are considering to embrace cord-cutting as an inevitablity. Another development in that direction is the US cable industry's considering to integrate Netflix into its operations. They are holding talks with Netflix to make Netflix an option on their set-top boxes. In such a scenario, Netflix would, in effect, become cable companies' major VOD provider and revenues would be shared. This, together with the cable MSO's own cord-cutting option, would in effect accelerate cord-cutting. However, cable companies would not be entirely bypassed. They would mitigate cord-cutting into channel cutting. Ultimately, cable companies' main asset is their transmission network. Its exploitation will undergo transformation.

TV channels also face another form of cord-cutting, as viewers may directly choose their on-demand programs. How do you see their future role, if any?

Gilles FONTAINE: TV channels, as aggregators, may lose their specific role if on-demand consumption develops significantly. However, they will evolve proposing more and more live events to continue gathering strong audiences at the same time. Moreover, there is still a need of arranging the on-demand catalogues, pushing the right content to the right viewer at the right time and on the right device. TV channels should be able to leverage their linear programming to play their aggregator role in an on-demand market. But they will need to heavily invest in IT and review their trade-off between linear and on-demand distribution.

Eli NOAM: TV channels gain and lose. They gain in bargaining power over cable and other distributors. They can deal directly with users, though more likely they will go through new types of intermediaries such as Apple and Amazon.com. In a profusion of content offerings, strong brands are a valuable way for users to search for content. And if they can identify users or user characteristics they can fine-tune and individualize advertising. The danger for channel providers is that the loss of cable MSOs hold over viewers means that they cannot share in the MSOs pricing power. Furthermore, content providers can disintermediate them by going directly to viewers. Sports leagues, for example, could deliver their events directly and cut out the networks. Most of the channels do not have major operational IT expertise, and this provides an opening for an entire industry of new service providers and video clouds.