Mandating Programmers To Offer Operators Programming On An A La Carte Basis: Solution Or Quagmire?

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Just imagine if you went into the grocery store to buy a quart of milk and were told that you could purchase milk, but only if you also paid for horseradish, diapers, disposable contact lenses, and fifteen other pre-selected products. If this were to happen, the offending grocery store would be bombarded by outraged customers and investigated by government agencies. But a similar experience happens to most Private Cable Operator (PCO) customers when they pay their monthly service bills—their rates includes dozens of programming services they don't want to pay for and don't watch. Raising the stakes, some PCOs and cable companies have rightfully accursed programmers' increasing rates for much of the rate increases that they have passed on to their customers. Now, some lawmakers are wondering if greater consumer choice when selecting their programming would reduce their constituents' monthly PCO, cable, and satellite bills. Legislation that increased consumers' programming choices would not be without precedent, since re-regulation of the cable industry in 1992 required operators to offer a tier of broadcast services to those consumers that were only interested in receiving improved broadcaster reception. What would happen if Congress legislated programming be available on an a la carte basis? While this would create an increased "freedom of choice," it would create significant and unintended consequences.

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There is increasing demand by consumers to have more control over their programming packaging and selection. Most subscribers watch only a fraction of the total channels of programming that they purchase, and studies have confirmed that PCO and cable subscribers spend as much as 80% of their time viewing only eight channels. Then, why don't operators offer customers more programming selection choices and why do programmers charge significant penalties for or prohibit a la carte distribution?

Increased choice allows consumers to make more efficient purchasing decisions, but advances in technology can create a plethora of new options that may not always be beneficial to the customer. Today, technology is available that could permit some customers to choose their video programming on an "a la carte" channel basis, by subscribing to selected shows or episodes within individual channels, or via an on-demand basis (pay only for what you watch). So, if a la carte were for the public good, would legislating service on a by-program or on-demand basis be better—or—"where does Congress draw the line?" Increased choices would also create new responsibilities for consumers—and while investigating what motivates customers to want more choice, researchers found a surprising result.

During a study conducted in 1998, participants that had expressed an interest in digital video service were asked how they would prefer to choose and package their digital video programming. Almost half of the respondents indicated that they would prefer to choose their programming on an a la carte basis. They stated that they wouldn't mind paying more on a per channel basis if they were able to choose the specific programming they wanted. But when presented with a hypothetical a la carte service and asked to choose their programming lineup from over 100 programming services, respondents had difficulty making choices with unfamiliar services and when trying to make decisions for their other family members. Eventually, more than half of the subset that had a preference for a la carte packaging reconsidered their original decision—which was an unexpected result. The survey also helped identify a key motivator for consumers desiring to exert increased control over their programming selections—they viewed increased "choice" as a way to reduce their monthly fees. The survey suggested that customers would reduce the number of programming channels they receive by approximately one-third to two-thirds, but would expect a corresponding rate reduction of 25% to 50%. Consequently, consumers' interest in exercising more control over their programming appears to be a desire to improve the price-value proposition offered by PCO, cable and satellite providers.

Would legislating a la carte programming change the price-value proposition by saving consumers a significant amount of money? While the cost of programming is often a PCOs single most significant expense, it accounts for less than 50% of operators' total expenses. Hypothetically, if the programming expenses comprised 50% of operators' total expenses and the operator realized a 50% reduction in its programming expense and passed along the entire savings to the consumer, the consumers' monthly bill would only be decreased by 25% (assuming all else remained constant). This is a significant amount, but most of the more popular services (such as ESPN and Nickelodeon) that are more likely to be retained account for a disproportionate amount of an operator's programming expenses. The less popular services that might be more likely to be discarded will have a much more moderate affect on any savings an operator could attempt to pass through. Therefore, customers eliminating a significant number of less popular (and relatively inexpensive) programming services might be surprised how modestly their programming costs would be affected. Further, a la carte pricing would require most programmers to increase the rates that they charged operators so that this new form of packaging does not penalize them financially.

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Basic programmers have substantial fixed costs and subscriber reductions would not allow them to absorb a prorated reduction in revenue without adversely impacting their bottom line. Most basic programmers generate revenue via a combination of subscription and advertising revenues. The ratio varies among programmers, but larger programmers generally attempt to balance both revenue streams. Hypothetically, if a larger programmer realized a 50% reduction in its customer base, it would be required to double the monthly subscriber fee charged to operators to cover the subscription revenue shortfall. The reduction in advertising revenue could be more than 50% due to the loss of critical mass for the advertisers—and programmers would be required to double or even triple their subscription charge to operators to offset the advertising revenue reduction. In fact, legislated a la carte programming could produce the unintended effect of increasing programming costs by 300% for some services! Smaller programming services whose customer base fell below ten to twenty million subscribers might be unable to generate significant amounts of advertising and might find their viability affected. A reduction in the number of eyeballs would most seriously affect independent programmers and could force some of them to shut down or sell out to larger programming conglomerates. Ultimately, the cornucopia of programming diversity could be adversely affected and new programming services might experience more difficulty obtaining funding.

Consequently, legislating a la carte packaging could result in an unsatisfactory experience with PCO customers. Programming diversity and the viability of independent programmers could also be adversely affected. Since there would not be an aggregate programming rate reduction for operators to pass along to consumers, most subscribers would not realize any savings and many would receive less programming for about the same or a higher rate. Further, research suggests that a primary motivation for consumer interest in a la carte packaging is to realize a reduction in their monthly rates, and legislating a la carte packaging would create expectations that will likely not be met. While regulations that "improve" the way America chooses its video services has inherent and populist appeal, it is unfortunate that the economics do not support such flexibility. In fact, the results could well have unintended consequences by not resulting in the expected savings to consumers, increasing customer frustration with their providers, and adversely impacting the programming industry.

So what's the right solution? Congress should pass legislation that allows PCO, cable, and satellite operators the right to be able to offer their customers programming services on an a la carte basis. Operators will adjust their programming packages that appeal to their consumers while gaining the flexibility to prevent rouge programmers from raising their rates without regard to how it will affect operators and end users. A few programmers will suffer the consequences of using their well-penetrated programming services to consistently increase their rates 20% each year to fuel their cash flow machines. Their service will be removed out of basic and offered a la carte to those customers that really want to pay for it. And it will send a message to selective programmers—just as PCOs and DBS operators have sent a message to franchised cable providers. In a world of level playing fields and fair and healthy competition, the operators, programmers, and consumers all will win. ■

About the Author

Don Kent has spent over 25 years working with Private Cable Operators, wireless broadband providers, and early stage companies specializing in the delivery of broadband and digital content services. Please address questions or topics that you'd like to see discussed in subsequent columns to Dkent@HTINC.com.