Information Economics and Policy 26 (2014) 42–57

Contents lists available at ScienceDirect

Information Economics and Policy

journal homepage: www.elsevier.com/locate/iep

Exclusive quality – Why exclusive distribution may benefit the TV-viewers

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ARTICLE INFO

Article history:
Received 1 October 2012
Received in revised form 18 September 2013
Accepted 8 November 2013
Available online 7 December 2013

JEL classification:
C78
D43
K21
L42

Keywords:
Pay-TV
Exclusive contracts
Quality
Bargaining
Advertising
Investment
Two-sided market

ABSTRACT

Sports organizations, Hollywood studios and TV channels grant satellite and cable networks exclusive rights to televise their matches, movies and media contents. Exclusive distribution prevents viewers from watching attractive programs and reduces the TV-distributors incentives to compete in prices.

This paper demonstrates that exclusive distribution may also give providers of contents incentives to invest in higher quality and, as a result, force competitors to reduce their prices. Exclusive distribution may benefit all viewers, including those who are excluded.

1. Introduction

DirecTV is the leading distributor of satellite TV in the US. It has acquired the television rights to the NFL Sunday Ticket, the most popular sports program in the country. The rights are exclusive. The subscribers to the competing Dish Network can therefore not watch the games.

Not only sports organizations, but also Hollywood studios and even complete TV-channels routinely grant exclusive rights to their matches, movies and media contents. The common view is that exclusive distribution harms the viewers. It prevents some people from watching certain programs and those who can watch will have to pay higher prices since exclusivity reduces rival distributors' ability to compete.

This paper shows that there are also some social benefits to exclusive distribution. I will present a couple of examples that suggest that there is a positive association between programs of high quality and exclusive distribution in the TV-market. My theoretical analysis demonstrates two possible reasons for this relationship. One reason is that the distributors only demand exclusive rights for programs with a strong effect on demand, i.e. programs of high quality. The other reason is that exclusive

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[1] I am grateful for comments from Christiaan Hogendorn and an anonymous referee as well as from Claes Bengtsson, Henrik Horn, David Martimort, Chrysovalantou Milliou, P-J Norbäck, Mariano Selvaggi, Oz Shy, Thomas Tangerås, Arianna Vannini, Frank Verboven, Gregory Werden and seminar participants at the RIIE, WZB, IIOC (Northwestern University), IDEI (conference on two-sided markets), EARIE (University of Amsterdam), Umeå, University and the DG COMP. I thank Christina Lönnblad for correcting the language and Jan Wallander's Research Foundation and the Swedish Competition Authority for financial support.

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http://dx.doi.org/10.1016/j.infoecopol.2013.11.002

distribution spurs the producers of programs to invest in high quality.

Banning exclusive distribution therefore reduces investment incentives and leads to lower quality. As quality is reduced, the competing distributors are free to increase their prices. Regulatory intervention may thus harm all viewers, including those who are excluded.

1.1. Contribution

The main contribution of the paper is to demonstrate that exclusive rights may give *the party granting exclusivity* (here: a TV-channel or other producer of contents) incentives to invest more. Previous analysis (Segal and Whinston, 2000b) demonstrates that *the beneficiary of exclusivity* (here: the distributor) may invest more, while the granting party invests less. There are several reasons why exclusivity increases the producer's incentives to invest in quality:

- Higher quality increases the viewers' willingness to pay high subscription fees. The important point is that exclusive distribution allows the distributor(s) to increase subscription revenues more. If all the distributors carry the channel, each individual distributor will find it difficult to increase its subscription fee without losing customers to the competitors. A distributor with exclusive rights, on the other hand, can increase its fee when quality is increased without such a risk. This may be called the *product market effect.*
- But the distributor(s) will not be able to keep all the increased revenues; they have to share it with the producer through higher whole-sale prices. The important point is that exclusivity forces the distributors into a bidding competition for the contents. A larger share of the (increased) subscription revenues then goes to the producer. This may be called the *whole-sale market effect*. Taken together, the product and the whole-sale market effects imply that the whole surplus from increased quality ends up with the producer under exclusive distribution.
- Actually, the producer will sometimes over-invest in quality. The form of distribution (exclusive or non-exclusive) is determined by the producer and the distributors through a negotiation. Exclusive distribution increases the distributors' aggregate subscription revenues by reducing product market competition (first point above) but reduces the TV-channel's advertising revenues (which are presumed to be proportional to the number of viewers). The parties are more prone to agree on exclusive distribution if the gain in subscription revenues is large and the loss of advertising revenues is small. And since higher quality both increases the gain and reduces the loss, higher quality makes the parties more prone to agree on exclusive distribution. Thus, the producer has an incentive to invest in higher quality to induce exclusive distribution agreements (and intense bidding competition) in the subsequent bargaining with the distributors. This may be called an *over-investment effect.*

Table 1
(a) Satellite segment and (b) cable segment.

	(a)		(b)			
	Viasat	C.D.	ComHem	UPC	C.D.	Tele2
Movies			×	×		×
TV1000	×		×	×	×	×
Canal+		×	×	×	×	×
Hallmark	×	×	×	×	×	×
TCM	×	×	×	×	×	×
Sports						
via. Sport	×		×	×	×	×
Eurosport		×	×	×	×	×
General						
TV3	×		×	×	×	×
Kanal 5		×	×	×	×	×

A second contribution is to analyze how the form of distribution is determined by the producer and the distributors in a negotiation without arbitrary asymmetries between the parties. Previous analysis exogenously assigns more power to the seller. Armstrong (1999) presumes that the seller has the power to choose the form of distribution unilaterally before negotiating over prices. Bernheim and Whinston (1998) presume that the producer can commit to run a so-called menu auction.

1.2. Exclusive distribution, quality and competition

To obtain some information about why exclusive distribution occurs, and under what conditions, one may compare the frequency of exclusive relations in different markets. A first observation is that exclusive relations coexist with competition, and that they may even be more common in more competitive markets.

In Sweden, for instance, the satellites often carry channels with exclusive rights, while cable networks typically do not. Table 1a and b summarize this pattern in 2009. Distributors are indicated as columns, channels as rows and × indicates that the distributor carries the channel.[2]

What is the reason for this difference? It seems implausible that the cable households demand more variety than the satellite households, and the satellites do have the capacity to broadcast more channels than today. The explanation is more likely a difference in the competitive pressure. The satellites compete head-on since both cover the whole of Sweden and since most parabolic dishes can receive the signals from all satellites that cover them. Cable networks rely on economies of density; typically, only one network serves any local area.[3]

The Swedish experience is especially revealing since satellites and cable networks do not compete with each other. This segmentation is confirmed in antitrust market definitions,[4] although a common market for distribution may soon emerge, e.g. as a result of digitalization.[5]

[2] This information was collected from the companies' web sites in September 2005. None of the channels in the table are affected by must-carry obligations.
[3] Radio and TV Act Commission (2005).
[4] See *MSG Media Service* and *Nordic Satellite Distribution*.
[5] See *Telia/Telenor* and *Telenor/Canal+/Canal Digital*.