

Channel Bundles Persist—for Now—Despite Digital Disruption

By Amanda D. Lotz

16-20 minutes

There may be no more irksome issue for contemporary media consumers than the persistence of the “cable bundle” — the requirement to buy access to cable channels in large, provider-determined packages. This article explains why the bundle persists as well as some reasons to think its days as the dominant form of programming transaction may be numbered.

The practice of bundling or “tying” goods together for purchase is not particular to media industries, but media is a sector that uses the practice more than most. Most basically, a bundle is a group of commodities—in this case, cable channels—packaged together. Notably, even the channel is a bundle, a group of programs packaged together, the arbitrariness of which has become more obvious as viewers increasingly move away from linear viewing and seek out specific shows rather than watch “what’s on.” Other examples of media bundles include the film industry’s practice of block booking (selling blocks of films to theaters and requiring all to be shown), and the output deals studios use in selling films and television shows to exhibitors in

international markets. Likewise, we can think of albums as bundles of songs and magazines as bundles of articles, all with varying advantages and disadvantages for consumers, producers, and distributors. Several of the advantages of bundles were linked to an era of physical and analog media delivery, so digital distribution is a significant force in recalculating the necessity and relative desirability of bundles.

The US television industry features bundles of bundles: individual shows are bundled into channels; channels are bundled by owners such as Viacom, Disney, Time Warner, and Discovery and effectively sold in bundles to multichannel video programming distributors (MVPDs) such as Comcast or DirecTV; MVPDs bundle channels into tiers and sell access to viewers; and MVPDs bundle these video channels with Internet access, home phone, and mobile phone service. A [Needham analysis](#) estimated that bundling adds 100% to annual television ecosystem revenues.

Are bundles always bad? No. And even in the case of cable, the bundle once worked well for consumers as well as the industry because of “heterogeneous demand”—or difference in priority or desires among consumers. In the early days of cable, the bundle was a good way to get enough subscribers to support a system even though some might have been motivated to subscribe by MTV, others by ESPN, and others yet by CNN or HBO. But a lot has changed since then. The efficiency of the bundle requires reconsideration because of newer opportunities for digital distribution, the tremendous expansion in content produced by both linear and on-demand video providers, and

various non-competitive forces at work in the bundle. The bundle made sense when distributing person-specific programming was technologically infeasible and when it subsidized the fairly meager programming costs of a handful of channels; now, armloads of channels spend extensively on original programming and technology has arrived to provide alternative distribution models. Simply put, it's unsustainable for content providers and distributors to expect viewers will continue to absorb the rising costs of an expanded media ecosystem.

[“Studies”](#) and reports, often funded by the cable industry, touting the value of cable bundles or warning of the loss of content diversity and the rise in costs that will purportedly result from an end to bundling are released weekly, if not daily. Many of these studies tell partial stories, rely on data available only to those funding the studies, and generally ignore the reality of the macro scale transitions taking place. Many are full of estimates of how much viewers would have to pay for each channel outside the bundle, but these costs assume the channel continues to make the same level of profits, which seems unlikely in this marketplace correction. Such a paradigm ignores the fact that there is now real substitution available and it seems unlikely that a consumer would re-create the array of offerings the bundle currently provides. Prime time television consumption has begun a path of radical change.

There is now far more programming available than most can watch, and programs too expensive or difficult to access due to exclusivity will be casualties of the plentitude. Reports that try to assert the [“value” of the bundle](#) don't take into account that

audiences now have alternatives to weekly scheduled program viewing: Viewers may subscribe to a service such as Netflix for a month, view desired programming, and then cancel until a new season comes along -- all while creating new models of customized programming experiences.

Here are five things to know about channel bundles.

- 1. Bundles mostly benefit owners of cable channels.**
- 2. An uncompetitive media ecosystem obscures alternatives to bundles.**
- 3. The bundle has become unsustainable for small cable providers.**
- 4. A groundswell of discontent over MVPD pricing and service issues has become pervasive.**
- 5. Over-the-top services are a concern—if not a particularly threatening reality.**

- 1. Bundles mostly benefit owners of cable channels.**



Even though we might have hundreds of channels, industry analyst [Todd Junger](#) identified that “nine companies (Disney, Fox, Time Warner, Comcast/NBCUniversal, CBS, Viacom, Discovery, Scripps, and AMC) control about 90% of professionally produced TV content in the U.S.” Each of these

nine companies owns at least one channel (ESPN, Nickelodeon, TNT, USA, FoxNews) that would be a catastrophic loss for an MVPD if it were unable to include the channel in its offerings (at least to date—some [smaller systems have dropped all Viacom](#) offerings in the last year because of high rate increases and the requirement of carrying so many channels to get Nickelodeon and MTV). These content companies demand basic tier carriage and rates for other channels on the back of that most desired channel. This is how Viacom's Palladia ends up in the basic cable package. If Comcast wants MTV, then Viacom says Comcast must take Palladia too, and that it must be available to just as many homes as MTV. It is likely that channel subscription fees also are caught up in this power dynamic, but accurate data about the fees MVPDs pay to channels are not public, and the channels have been willing to go to court to keep that data secret during the Comcast/Time Warner merger assessment. The pending [Cablevision/Viacom](#) lawsuit is also about these practices, and perhaps will make some of this data public.

2. An uncompetitive media ecosystem obscures alternatives to bundles.

The content oligopoly is also largely why new innovators continue to strike out in efforts to revolutionize the living room screen. Channels simply refuse to sell the content a service must have to compete, or are prohibited from doing so in contracts with incumbent MVPDs. Ask Apple, or Intel. And this is why [Sony's coming service](#) looks a lot like—and is priced as—the cable service you already have. It remains to be seen whether Verizon (who purchased Intel's technology) will be able

to negotiate for something different.

The second way these markets are uncompetitive results from the fact that MVPDs operate as oligopolies, and in many places, increasingly as monopolies. Competition from telcos such as AT&T U-verse, Verizon FiOS, or Google exists in some markets, but the inability of satellite providers such as DirecTV and Dish to offer Internet has reasserted the monopoly status of cable MVPDs in much of the country. The entrance of satellite in the 1990s created some competition for monopoly cable providers and helped contain consumers' cable fees, but the evolution from cable to broadband has reasserted the competitive power of MVPDs that can also provide broadband service. For consumers, this leads to frustratingly few options.

3. The bundle has become unsustainable for small cable providers.

The situation of all MVPDs is not the same, and this is one of a growing range of forces that might actually bring an end to channel bundling. Large MVPDs, such as Comcast and DirecTV, have the scale to negotiate deals assuring they pay the lowest carriage fees to the oligopoly of channel providers. Most MVPDs are much smaller or newer and consequently pay much more for their channels. Recent cable industry [coverage](#) has attended to the fact that smaller MVPDs are either eliminating or considering eliminating their video services and reinventing themselves as purely broadband providers that help their subscribers access over-the-top video. Such providers are typically in more rural areas and have less than a million subscribers. Those cutting video service do so because they

can't make the economics work. Because they don't have the competitive position of giant providers like Comcast or DirecTV, they pay much more in carriage fees, lack the scale to hold out against fee increase demands, and lose subscribers when the increased cost of channels inflates cable bills.

Customers that drop video but maintain broadband connections don't hurt the MVPDs tremendously. Profit margins on broadband are very high, more than enough to compensate for a downturn in video. Yet, lost video subscribers do hurt cable channels, and hurt in two ways. First, lost video subscribers lower a channel's penetration rate, which adversely affects ad revenue. Second, lost video subscribers mean lost carriage fees because MVPDs pay the channels per subscriber. (A service/content conglomerate such as Comcast would consequently feel these losses more than other service providers). For instance, [Suddenlink dropped its Viacom](#) offerings in October 2014 for its 1.1 million subscribers (following Cable One, which did the same for its 900,000 subscribers in April 2014). Both companies claim this is a long-term plan rather than negotiating ploy. Though [Cable One](#) did lose subscribers, the decreased operating expense incurred by no longer paying Viacom actually resulted in an increase in profits in the one quarter since the channels went dark.

4. A groundswell of discontent over MVPD pricing and service issues has become pervasive.

Viewers are more aware of the business of television than in the past. While most consumer ire is directed toward those to whom they pay monthly bills and from which they generally receive

abysmal service, the prevalence of [retransmission and carriage fee battles](#) and even the [net neutrality debate](#), draw attention to the consistent, acrimonious, and public disagreements taking pace around the country between content providers and distributors. These battles also call attention to subscribers' frustrations with the cable and broadband market and their relative inability to do anything about it. The fact that Congressional leaders would become involved in these negotiations speaks to the vehemence with which their constituents are reaching out for help. We learned of the intensity of citizen concern about telecomm issues in the 1990s when the US Congress was forced to become involved in rate regulation for cable. We may be reaching a similar juncture. These issues have uncommon regulatory attention at the moment with net neutrality and the Comcast/Time Warner and AT&T and DirecTV mergers pending. Though removed from the pending STELAR/STAVRA legislation, a provision called "[Local Choice](#)" would have allowed consumers to choose which local stations they would pay for, thus enabling consumers some way out of the price hikes that result from increasing broadcast retransmission fees.

The existence of the Cablevision lawsuit is also noteworthy. The suit, filed in February 2013, alleges Viacom engaged in anticompetitive behavior by threatening a "[10-figure penalty](#)" if Cablevision didn't license networks such as Palladia, MTV Hits, and VH1 Classic. It may be settled before trial, but drawing public attention to these anti-competitive practices at the same time the public is uncommonly incensed about MVPD mega-

mergers and net neutrality shines more light on practices that both channels and MVPDs would prefer to keep in the dark.

5. Over-the-top services are a concern—if not a particularly threatening reality.



The volume of contradictory reports about the reality of over-the-top services makes it difficult to have a firm grasp of the present and future threat of these services or their ramifications for different segments of the television business. Again, the channel business has more at stake than the MVPDs that can move lapsed video subscribers into more expensive broadband packages, especially if MVPDs achieve a transition to usage-based billing. At a minimum, there seems to be evidence of cord shaving—which does not necessarily mean viewers are spending less, as they add subscription fees from broadband video distributors and a variety of OTT services. Nevertheless, the amount of content interesting to any one viewer continues to expand beyond the logical limits of what he or she can consume, and yet control technologies such as DVRs and streaming services have made it easier for viewers to watch content free from the linear dictates of traditional television. The persistence of network-era economic models continues to stymie the full potential of new distribution technologies, though change will come here too as

announcements of a way to pay directly for access to current and back catalog content from [HBO](#) and [CBS](#) suggest.

The alternative to bundled cable is often discussed as “a la carte” and imagined as a list of individual cable channels to which viewers can selectively subscribe for particular fees, similar to the way premium cable channel subscriptions operate today. It is a reasonable concern that this model might threaten the sustainability of some channels—content for which not enough people are willing to pay—but forecasts that predict a certain number of channels will attempt to use the industry structure of the past to predict the future. Such logic is the equivalent to the recording industry issuing reports in the 1990s that argued the retail price for a single song download would need to be \$9 to make recording it a feasible investment or that estimated labels would purge 20 percent of their artists once the album was no longer the primary unit of sale.

Few channels, networks, or studios for that matter have rethought their identities in a post-network world. Unsurprisingly, HBO has been at the forefront. As a subscription service, it has moved more quickly into new technology and distribution because they don’t need to wait for advertisers to move with them or for alternative mechanisms for counting audiences to emerge. HBO also has the advantage of owning the rights to most of its original programming. Just as premium cable embraced VOD a decade before broadcast and cable channels, platforms like HBO Go or Netflix in the US, or BBC’s iPlayer in Britain, illustrate the necessary rethinking of video aggregation that was once bound to linear schedules and related norms.

There is clearly an ongoing role for program aggregation—and at their core, this is what channels, networks, and even Netflix and Hulu do. Yet, how much cost does the proliferation of aggregators and their respective subscription fees add to the act of watching television? Do we still need to pay an entity to aggregate a “program day” in which we no longer have interest? In the analog era of linear viewing, the channel provided a crucial curatorial service that deserved a level of remuneration but digital distribution disrupts the channel’s primacy and enables new viewing practices and economic models. An appetite for video content remains, so too does the need for a distributor to deliver content to our devices. But a growing desire for more control over the content we consume makes bundling look increasingly anachronistic.



The most radical version of unbundling connects the studios that make content with the audiences who watch it. MVPDs are just the dumb pipes in between. Though not described in this way, HBO’s uncommon ownership of most of its original content, and the back catalog of CBS Studios will make available through CBS All Access, allow us to consider these first experiments as studios connecting their content directly to consumers just as easily as we can view them as traditional channels being offered

over broadband. In this nascent ecosystem, MVPDs provide the broadband link, while cable bills transform into app subscriptions. Sure, even this is still a bundle, so maybe an even more radical vision is the show-based app. Not an app to watch a show “live” or to watch the five most recent episodes, but to access any episode at any time by paying the studio directly and cutting out payment to a whole lot of middlemen. Still sounds like pie in the sky in 2014. But so did iTunes twelve months before it changed the recording industry forever.