Insight

Comcast-Time Warner Cable: An Overview of the Relevant Markets

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As with any modern tech acquisition, the Comcast-Time Warner Cable (TWC) deal could have ramifications in a number of markets, but at its core, the deal asks an important question in technology policy yet again: should we regulate beforehand and deter all potential positive benefits, or should we regulate after a deal when there is a consumer harm? A dislike of cable providers should not deter from a sound analysis of the current competitive environment and the one that a larger Comcast would find itself in. Below is an outline of the issues at stake for such a merger.

Pay TV

Horizontal mergers can reduce the number of competitors in the market. However, TWC and Comcast do not generally compete in the various Designated Market Areas (DMA), so should a merger go through, consumers will not see a reduction in the number of choices. Even though the 1992 Cable Act prohibits exclusive cable franchises, local regulations called "cable franchising rules" usually result in just one cable provider for a market. Consequently, this deal will not change an important feature of TV: 98 percent of Americans can choose from three or more multichannel video programming distributors (MVPDs). In addition to two satellite providers, the entry of Verizon FiOS and AT&T's U-Verse into countless market allows 32.8 percent of Americans the choice of four or more MVPD options, up from a mere 4.7 percent in 2006.

Even still, the combined company would sit below the 30 percent market share threshold that had long been a cap by the Federal Communication Commission (FCC). The FCC established this cap as a limit for pay TV ownership, but it was struck down by the courts in 2009, because the agency "failed to demonstrate that allowing a cable operator to serve more than 30 percent of all cable subscribers would threaten to reduce either competition or diversity in programming."

Programming is really the primary concern in the pay TV market. About half of a cable bill goes to programming companies such as Viacom and Disney, and costs are on an incline. From 2006 to 2011, total spending by cable companies on programming increased 29 percent in real, inflation adjusted dollars. And while there have been increases in the prices consumers pay, programming expenditures have increased substantially more than the average cable price. Time Warner spun off its cable operations partly due to this squeeze. Even more, TWC just saw itself on the losing side of a programming debate with CBS when they negotiated their programming fees.

Will this deal stifle the production of content? Cable only owns about 14 percent of all programming channels, according to the FCC. It is hard to see how this would substantially change the production of programming given that it is a little more than an 1/8 of the market. Moreover, Comcast will still be subject to its conditions from its acquisition of NBCU. In allowing the deal to move forward, the cable company agreed to a length set of restrictions, which included network neutrality rules, a provision requiring the company to provide online distributors with TV content, and an agreement to not "exercise corporate control over or unreasonably withhold

programming from Hulu."

What will change is the calculus between Comcast and huge content players like ESPN, CBS, and NBC. Merging the two operators would give them bargaining power. Consumers have the potential to win in this deal because the combined company would be able to slow down these programming costs. Moreover, there is the real possibility that Comcast could force networks and video providers onto one online package. As one commentator noted,

> "A cable company with true nationwide reach could cut the kind of deal that would change that, providing enough subscribers to make a next-generation TV product viable and create enough market pressure to bring its competitors to the table and sign on to similar arrangements. It's the kind of deal that could turn a new Apple TV into a set-top box that would let you watch live television — and one that Cupertino has reportedly been working on with Time Warner Cable already."

The future of cable is the Internet, and that is where proper concerns of this acquisition lie.

Broadband Internet

While many proclaim the broadband market to be noncompetitive, speeds for wired broadband increased 31 percent last year, and investment is not slowing. Of the world's investment in broadband, the US has nearly a fourth of it, even though we only have 4 percent of the world's population. Interestingly, the average profit margin for publicly traded telecom and cable broadband companies is still among the lowest in the world. Even among high tech companies, cable is not a particular standout. As I wrote in The Daily Caller on this subject,

> "Return on invested capital" (ROIC) paints a much more accurate picture of how the cable industry is performing. Unlike the gross profit numbers, ROIC actually attempts to incorporate long-term investment in infrastructure, giving a better sense of how a company is using its money to generate returns.
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> Using ROIC, we find that until very recently cable companies were earning small returns, still trying to recover their colossal initial investments. It often takes years of positive profits for these companies to make up for that initial investment and start seeing a return. So, what may appear to be a massive annual profit using GPM is really just recoupment of a tiny piece of past costs. Returns for cable companies range from negative to quite small.
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> Comcast, supposedly the greatest cable monopolist, has averaged just a 4.5 percent ROIC over the last five years. Time Warner Cable's 5-year average is -1.3 percent. Compare those with Apple (32 percent) or Google (16.1 percent).

Building out cable infrastructure is expensive. Since 1996, the cable industry has invested nearly $210 billion in building networks and it continues to invest more than $13 billion more each year in maintenance and upgrades. As consumers demand faster broadband, cable companies will need to ramp up their speeds and bring the next generation of technologies online. One of the primary benefits of a larger company lies in the economies of scale, which would give Comcast a cheaper upgrade path and allow consumers to see faster speeds at lower prices.

Again, local franchising deals typically allow only one cable company to exist in a market, which means that the number of broadband competitors is unlikely to change substantially with this deal. Given these realities, U.S.

communication competition policy has generally been one of intermodal competition, that is, competition exists among technologies. So, there has been an effort by regulators to ensure that cable competes against fiber, DSL, satellite. and increasingly wireless for broadband market share. Because of the sheer cost in laying wire and the rules set up by the Telecom Act, it is unlikely that two companies will utilize the same last mile technology in serving wired customers, as is the case right now.

Moreover, the very nature of competition is changing. In response to the National Broadband Plan, the Department of Justice (DoJ) noted,

> "We do not find it especially helpful to define some abstract notion of whether or not broadband markets are "competitive." Such a dichotomy makes little sense in the presence of large economies of scale, which preclude having many small suppliers and thus often lead to oligopolistic market structures. The operative question in competition policy is whether there are policy levers that can be used to produce superior outcomes, not whether the market resembles the textbook model of perfect competition. In highly concentrated markets, the policy levers often include: (a) merger control policies; (b) limits on business practices that thwart innovation (e.g., by blocking interconnection); and (c) public policies that affirmatively lower entry barriers facing new entrants and new technologies."

In all, even the DoJ should be willing to accept this deal. And why not? Comcast will still be under the constraints of the conditions from their acquisition of NBC Universal. In addition to certain guidelines with regards to programming companies, Comcast also agreed to network neutrality rules. Of all the concerns about the deal, network neutrality is probably the strongest, along with issues in interconnection.

A larger Comcast might be able to bully content providers on the Internet for more money or stop their consumers from gaining access to content. Again, they are restrained by their previous deal to abide by network neutrality rules till at least 2018, and this deal will probably extend that out further. So this concern should be allayed.

Another issue here is in interconnection. Not long ago, most networks sent each other similar amounts of traffic. When the data being sent over the Internet was simple web pages and email, networks were symmetrical in their traffic. But now, the rise in video has meant that networks tend to see asymmetric traffic. Netflix and YouTube, for example, send other networks, like Comcast, far more traffic than it receives. This changes the economics, and the deals between these networks. Should a deal between Comcast and TWC be struck down just because of the relative bargaining power that a bigger Comcast would have? This arguments lacks merit. For one, the FCC probably has regulatory oversight to determine the structure of the peering deals, especially with the powers just granted to it by the recent network neutrality decision. Even still, the Internet's unregulated interconnection market works substantially better than the FCC's managed interconnection regime in telephone. The current market-based system has been vital in "matching supply with demand, supporting Internet build-out, and yielding incentives for the creation of larger, faster networks."

Never the less, the FCC will be the agency that this deal has to placate, not the DoJ. The FCC's public interest mandate is far more subjective and unpredictable. For its own part, the FCC should be much more concerned about barriers to entry in this industry. It even recognized the problems, and is moving towards solving some of the key deterrents to investment (See the pole attachment order). But still, as many as 30,000 jurisdictions issue video franchises, with just as much variance as you'd expect. As Milo Medin, Google's vice president for access services and a lead on the Google Fiber project, testified before the Senate, "regulations – at the federal, state, and local levels – can be central factors in company decisions on investment and innovation." Franchising rules are often the worst offenders and "result in unreasonable fees, anti-investment terms and conditions, and long

and unpredictable build-out timeframes.” These are the real problems to broadband deployment that need to be dealt with.

Other Markets

An expanded Comcast could have an impact on the bargaining positions in the equipment market. As the number one and two in the cable space, their ability to negotiate as buyers of equipment might change, but this is a relatively small portion of their business, and shouldn't deter a deal. On the plus side, the deal will also bolster Comcast’s efforts to build the nation’s largest WiFi hotspot network, which would mean increased competition in the wireless space.

Conclusion

This deal presents policymakers with one of the most important questions in tech policy: should businesses be allowed to merge or contract to do business and then be regulated when there is a consumer harm, or should we rather regulate beforehand and deter all potential positive benefits? As with network neutrality, only real harms should be punished, not potential harms. Cable companies have few friends, but it is far from clear that competition will automatically be deterred if the acquisition goes through, and the benefits to consumers could be substantial.