Peer Review
of:

Vertical Integration and the Market for Broadcast and Cable Television Programming, by Austan Goolsbee (Federal Communications Commission Study No. 9, April, 2007; MB Docket No. 06-121).

by
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The first part of this study presents descriptive data to measure the extent of vertical integration between broadcast television networks and their prime-time program suppliers, and in the second part, between cable television and other multi-channel system operators and cable television networks. In the broadcasting segment, statistical regression methods are applied to determine or infer whether vertical integration limits market opportunities of independent programming suppliers. In the cable segment, regression analysis is used to determine whether vertical integration affects the economic performance of cable networks, and whether cable system operators carry their vertically affiliated networks more frequently than do unaffiliated system operators. Possible reasons for integration and its effects are discussed in both the broadcast and cable study segments.

The report acknowledges that some of the results of the study, especially those involving vertical integration in cable television, are intended to be suggestive due to limitations in the evidence.

The broadcast study

Using program information for the 2000-01 through 2004-05 seasons (and also a more detailed February-March, 2007 dataset) the report shows that a majority of prime time programming on the six largest broadcast networks is supplied by vertically affiliated producers, while less than 20% of shows are produced by "fully independent" suppliers. This descriptive analysis is straightforwardly presented and makes use of publicly available, respected sources of information. In concluding from these data that "the life of an independent producer of programming is likely to be rather difficult" (p. 11), however, the report may understate in one respect the access that independent suppliers have to the prime time market. Perusal of program ownership information from the period of study indicates that the great majority of vertically affiliated programs are co-produced with independent suppliers, although as the author implies, such co-ownership does not necessarily preclude discrimination in acquiring those co-production rights.

The report then employs a regression analysis using the same data to show that advertising revenues earned by vertically integrated programs are not statistically different from those earned by independently produced programs. That finding leads Professor Goolsbee to the conclusion that there is no evidence of "bias" by the networks in favor of carrying their own worse programs just because they are vertically affiliated. As a means to address this question, regression analysis is a valid methodology in general. In my opinion, however, the results of this regression must be regarded as suggestive rather than conclusive, at least in the absence of a more detailed vetting of the results' robustness to alternative model specifications. As the report acknowledges, program profits are the desired measure and meaningful cost measures are not available. Although dummy variables are used to control for expected cost differences by network and by time slot, and "[the] regressions purposely exclude various types of programs such as news…," (p. 14). In general, however, there are large differences in prime time program costs by program format (eg, sitcom, variety, drama) as well as by network, that may not be captured by the model, and could thus bias or invalidate the results. As Prof. Goolsbee notes, syndication revenue data, which may affect the findings, are also absent.

The cable study

This part of the report first documents that the extent of vertical integration between Multiple Cable System Operators (MSOs) or DBS operators and cable television networks has substantially declined over the 1996 to 2005 period. (Although using slightly different year cutoffs, these data also form the basis of other analysis in this section of the report). The sources for these data have been widely used by other researchers and are regarded to be reasonably accurate. The author's general conclusion from these data that whatever advantages vertical integration apparently has had to cable networks or to multi-channel operators in earlier years must have diminished, is reasonable. As the report also notes, the overwhelming majority of "independent" cable networks successfully launched in the period of study are owned by affiliates of large media conglomerates who do not have cable system interests, such as NBC-Universal and Viacom. That observation implies that the financial resources or bargaining leverage in common to the large corporations which also own numerous other established networks, rather than vertical integration itself, may be the most significant advantage that successful cable network suppliers now have.

The report then makes use of regression techniques that show vertical integration to have little or no positive effect on cable network performance. In my opinion, this regression analysis, while interesting and suggestive, employs a methodology that makes interpretation of the results questionable. The primary measure of vertical integration used in the report's regression models in order to predict network performance (as measured by the number of subscribers, the change in subscribers over time, license fee revenues, advertising revenues, and related variables) is labeled as "the vertical integration ratio." That ratio is defined as the total national subscriber base of the MSO (or DBS operator) that owns the network, divided by the network's national total of subscribers. (If the network is unintegrated, the ratio equals zero.) This variable has some desirable characteristics. The larger is the downstream operator that owns the network, the greater the predicted impact of vertical integration; and the greater is the network's

own subscriber base (ie, the closer to ubiquity of carriage that it achieves), the less is the predicted impact of its vertical ownership ties. The main difficulty of interpretation is that the measure essentially combines in one particular functional form three separate aspects of vertical integration's potential effects: the fact of integration itself, the influence of MSO size, and the variations of influence that integration may have over a network's life cycle. While aggregated variables of this kind can facilitate econometric estimation from a technical perspective, it is difficult to understand the effects of integration per se. A more detailed defense of how the sample is subdivided, and more attention to an inherent selection problem caused by absence from the sample of networks that go out of business, would in my opinion also be needed to reach the author's conclusions with confidence.

Finally, the report applies regression analysis separately to 11 vertically integrated basic cable networks having between 5% and 95% national market penetration. These models show that in 9 of the 11 cases, carriage rates are significantly higher on affiliated cable systems than on unaffiliated systems. The report also shows that in most of these cases, the effects of vertical integration on carriage are significantly mitigated in geographic areas that have higher DBS penetration. The report concludes that cable systems do tend to favor their affiliated networks by means of more frequent carriage (a finding generally consistent with prior studies), but also that greater competition from DBS reduces that tendency. In my opinion, these models and the estimation methods are consistent with those used by previous researchers and are generally valid, and the author's conclusions are reasonable. It is notable, however, that while favoritism toward a vertically affiliated network presumably reduces a cable operator's tendency to carry a "rival" network that is a close substitute (eg, the Outdoor Channel, which is not integrated, vs. the Outdoor Life Network, which is), the effects of vertical integration on the carriage of independently owned networks are not studied in this report. Also, as the author acknowledges, the study does not consider whether the various integrated networks (or their non-integrated rivals) are carried on basic tiers or on generally less accessible digital tiers.