LG Telenet / De Vijver Media

ACE 2019, Copenhagen

Dr Helen Weeds, CRA

CRA Charles River Associates

TOH 2: Customer foreclosure of Telenet's platform

TOH: Will the merged entity have an incentive to drop the Medialaan channels from the Telenet platform in order to divert advertising revenue to DVM's channels?

- **Full foreclosure** of Medialaan channels ('going dark').
- **Partial foreclosure** via positioning in the electronic programme guide (EPG) (or other user interface).

CRA provided detailed 'vertical arithmetic' analysis of customer foreclosure and further argumentation.

Outline:

1. Methodology for assessing customer foreclosure incentives.
2. Topic of debate: cost to Telenet of partial customer foreclosure via the EPG.

1. Analysis of customer foreclosure incentives

Vertical arithmetic (VA) methodology

Incentive to engage in full customer foreclosure (CF) depends on the balance between **benefits and costs** to the merged Telenet/DVM.

Merger-specific benefits:

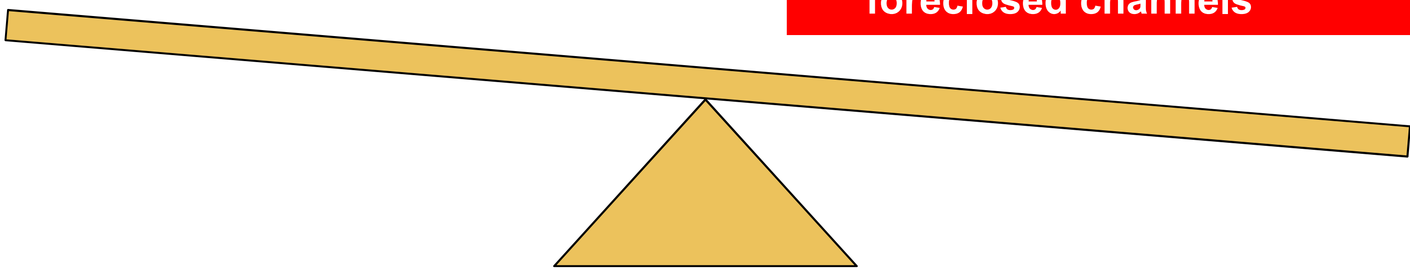
- **Ad revenue diverts to DVM channels**
- **SBS Sales Belgium agency fees on ad revenue diverted to other channels**

Non merger-specific:

- **Carriage fee saving**
- **Ad revenue diverted to Telenet channels**

Costs:

- **Lost profit on Telenet customers that switch to other platforms ('churn') due to absence of the foreclosed channels**



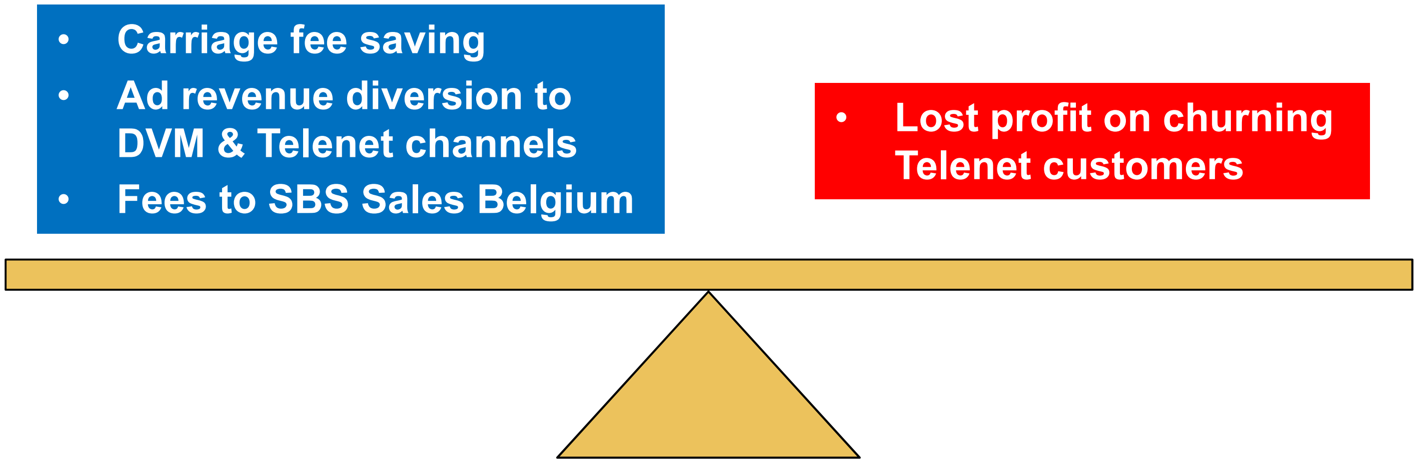
CRA Charles River Associates

Assessment of full foreclosure incentives

Calculate the **critical subscriber loss**:

number (or percentage) of Telenet subscriber losses at which

net benefit of foreclosure to the merged entity = zero



Calculating diversion of ad revenues

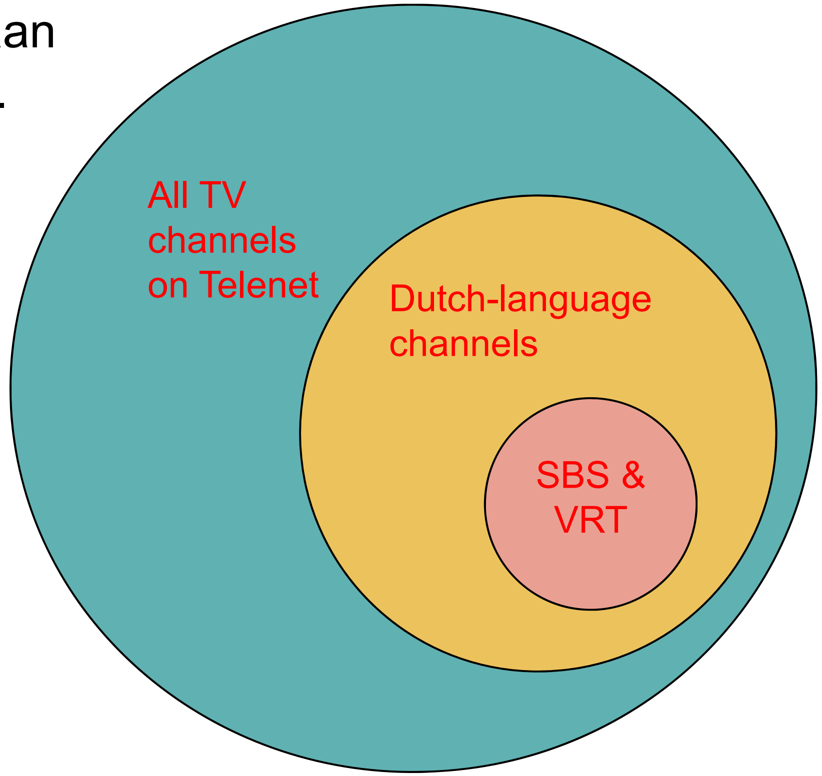
A crucial assumption is the **diversion pattern** of audiences/advertisers from the foreclosed channels (Medialaan) to other channels:

this determines the proportion of Medialaan ad revenues that accrue to Telenet/DVM.

Alternative assumptions:

- To **all TV channels** on Telenet
- To **Dutch-language channels** only
- To **SBS (i.e. DVM) and VRT** only.

The narrowest diversion pattern implies highest diversion to Telenet/DVM.



Benchmarking results

How can we assess whether the **critical switching rate** will be exceeded?

<u>Benchmarks</u>

1. Actual switching behaviour following channel loss – typically unavailable.

2. Customer survey

- Ask if they would switch TV provider following loss of Medialaan from Telenet.
- Ideally also ask about price sensitivity (combine with reductions in subs fees).

3. Viewing data: Telenet subscribers' shares of viewing devoted to Medialaan

- What is the Medialaan viewing share of the critical subscriber (assuming those with highest Medialaan viewing shares will churn first).
- E.g. if critical switching rate is 6% of Telenet's subscriber base, look at the 94th percentile in the distribution (6% have a higher Medialaan viewing share than this).
- If this is high, it is very plausible that these subs will churn, implying CF unprofitable.

CRA Charles River Associates

2. Partial customer foreclosure via the EPG

Partial customer foreclosure via the EPG

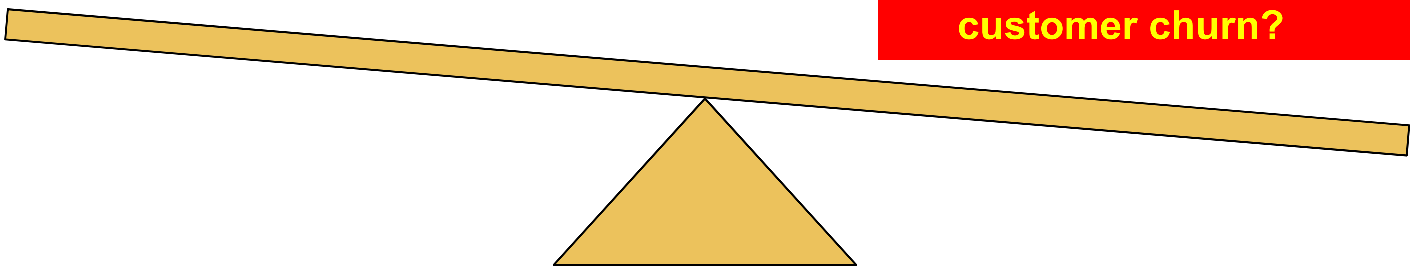
TOH: Merged entity might move Medialaan's channels to a **less prominent position (higher number) in Telenet's electronic programme guide (EPG)** – or other user interface – in order to divert part its audience and ad revenues to other channels, including Telenet/DVM's.

Benefits:

- **What is the impact of channel positioning on a channel's audience (and ad revenues)?**
- **Note that there is NO carriage fee saving as the channel continues to be carried**

Costs:

- **What is the impact of less prominent EPG positions for attractive channels on customer churn?**



Issue 1: Impact of channel’s EPG position on audience

There is some empirical evidence that loss of EPG prominence may reduce a channel’s audience share.

El-Husseini, 2013 (report commissioned by Ofcom): UK pay TV, 2010-12

- Concludes: ‘*if a major digital entertainment channel suffered a significant loss of EPG prominence, this would be associated with […] a* ***20-40% fall*** *in audience share’*.
- Reshuffles involving ‘page one’ EPG slots tend to have the biggest impacts.
- **Comment**: less clear how this extends to more minor channels that do not start from very prominent EPG positions.

European Commission: *LG/Corelio/W&W/DVM* decision, 2015

- Reports that less prominent EPG positioning of a children’s channel could **reduce its audience share by around 5%.**

CRA Charles River Associates

Issue 2: Impact on subscription of worsening EPG positions of attractive channels

EC 2015 decision and BCA 2019 make **2 inconsistent assumptions**:

- Partial foreclosure will cause **negligible subscriber losses for Telenet** because channels do not disappear and quality deterioration can be ‘subtle’.
- Yet partial foreclosure generates **significant audience diversion.**

If changing EPG positions creates significant audience diversion, it will also **reduce consumer utility** from subscribing to Telenet, which can be expected to generate churn.

2 steps in argument

- Partial foreclosure via the EPG results in a **loss of consumer utility.**
- Loss of utility implies that **some consumers will churn.**

Consider each step in turn.

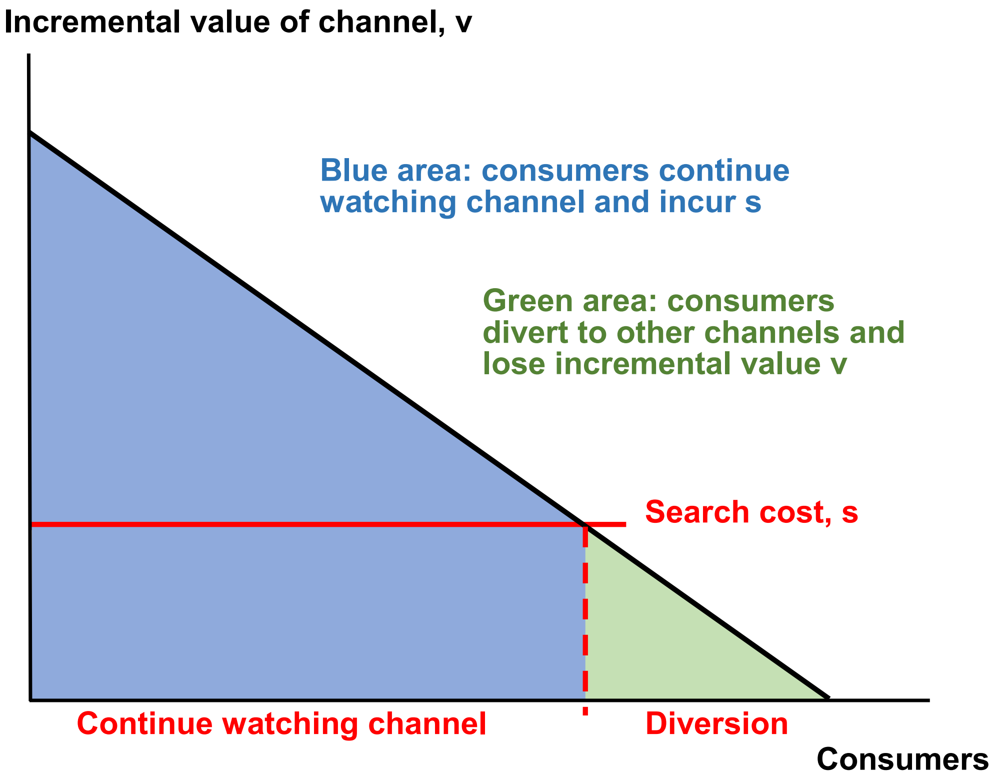
CRA Charles River Associates

Partial foreclosure via EPG reduces consumer utility

Reduces utility of all consumers that watch / would have watched the foreclosed channel.

2 groups:

- Consumers that still watch the channel [blue area]: **incur a 'search cost'** s of finding it.
- Consumers that divert to other channels [green area]: **lose the incremental value** of the foreclosed channel (relative to their next-best choice).
- High diversion implies **search cost is large** – which raises the utility loss for both groups.



Note there is no need for consumer awareness: if behaviour is affected (watch another channel because they do not find the foreclosed one) then their utility will be lower.

Charles River Associates

Loss of utility implies consumer churn

Consider **incremental value of being on Telenet**, relative to next-best platform

- Some consumers are **close to the margin** – i.e. incremental value is very low.
- **Utility loss from partial foreclosure then tips the balance**, generating churn.

Implausible that no marginal consumers exist

- This would imply that Telenet faces completely inelastic demand.
- I.e. Telenet could raise its retail price by the amount of the search cost with no loss of demand – but this would imply Telenet is **"leaving money on the table".**

Empirical evidence: **Demand for triple-play products (incl. TV) is elastic**
(Pereira, Ribeiro & Vareda, IJIO 2013, based on data for Portugal)

- Own-price elasticities between 3.2 and 1.3 for larger firms
- Market own-price elasticity of 1.4

Conclusion: Partial customer foreclosure via the EPG will incur costs, not only benefits, for the merged entity. Evidence needed on magnitudes.

CRA Charles River Associates

London
Tel +44 (0)20 7664 3700
8 Finsbury Circus
London EC2M 7EA
United Kingdom

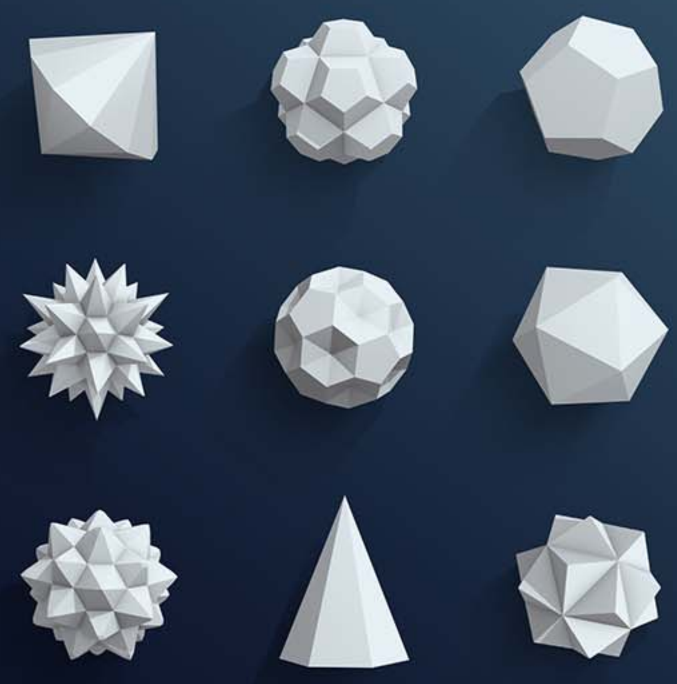
Brussels
Tel +32 (0)2 627 1400
143 Avenue Louise
B-1050 Brussels
Belgium

Munich
Tel +49 89 20 18 36 36 0
Palais Leopold,
Leopoldstraße 8-12
80802 München
Germany

Paris
Tel +33 (0)1 70 38 52 78
27 Avenue de l’Opéra
75001 Paris
France

Lyon
Tel +33 1 70 38 52 78
3 place Giovanni Da Verrazzano
69009 Lyon
France

Sydney
Tel +61 (0)406 820 214
Level 22, Tower 2
101 Grafton Street
Bondi Junction NSW 2022
Australia



www.crai.com/ecp

CRA Charles River Associates