Paying more for less…

the impact of cross-border access initiatives on consumers in Eastern European and Baltic countries

A regional focus based on our 2016 report ‘The impact of cross-border access to audiovisual content on EU consumers’

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Drivers

Converging prices are likely to disadvantage Eastern European and Baltic consumers

Move to pan-European model is likely to hurt local diversity

Consumers are likely to face quality issues such as enforced dubbing

Availability and diversity of content on OTT platforms are likely to decline

The impacts of these initiatives would be most pronounced in Eastern Europe

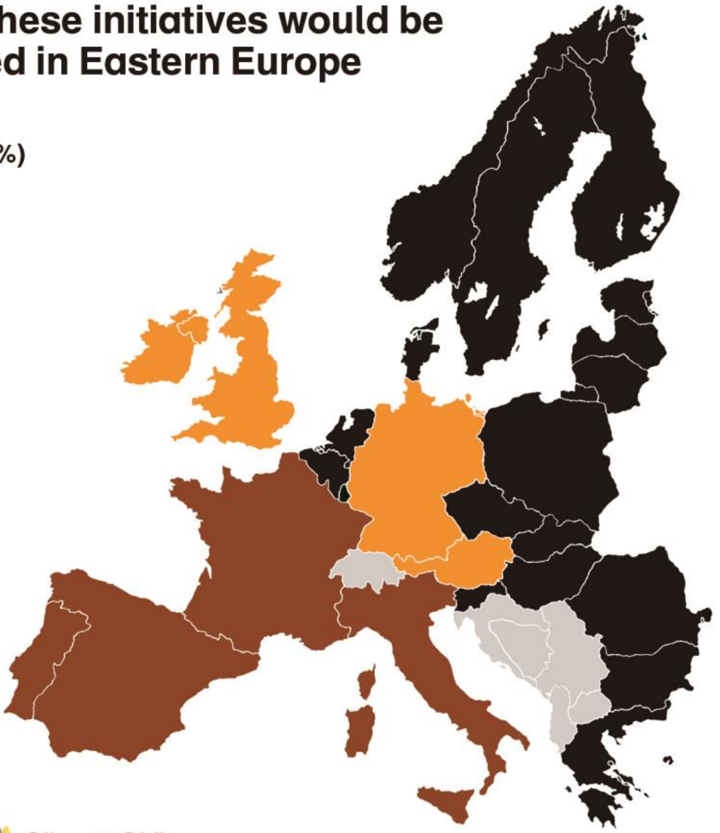
Long-term welfare loss(%)

10–15

15–20

20+

Not included in study



Local output reduction of up to 35%

Local platform revenue reduction of up to €1.1bn (39%)

Consumer welfare loss of up to €590m (25%)

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Oliver & Ohlbaum

To view the full report please visit www.oxera.com/crossborder

The full Oxera/O&O report and model captures orders of magnitude effects at a European-wide level. Impacts for individual countries and regions in the model are indicative of the potential distributional impacts across Europe. All figures based on long-run pan-European licensing scenario.

Summary

- Retail prices will rise in Eastern European and Baltic countries as cross-border access accelerates a move to exclusive, pan-European licencing
- The quality, quantity and diversity of locally produced, culturally tailored content will decline as investment by local platforms and distributors falls
- The quality and choice of local pay-TV and online distribution platforms will decline as a result of rights limitations and pan-European homogenisation

1 Introduction

In 2016, Oxera assessed the likely impact of the European Commission's emerging initiatives to facilitate cross-border access to audiovisual services.[1] Our modelling revealed a disproportionate impact in Eastern European and Baltic countries, with consumer welfare set to *decline* by 25% in these territories due to higher prices and a reduced availability of desirable content.[2]

We found that weakening the ability of rights-holders to licence content on a territory-by-territory basis (herein 'territorial licencing') would leave all European consumers worse off, as reduced content investments would result in fewer, lower-quality works being produced. At the same time, some consumers—particularly those in lower-income Member States—would have less access to high-quality content and/or have to pay higher prices than they do now. Finally, an accelerated convergence towards pan-European licensing would drive the homogenisation of both content and distribution services throughout the EU. These would be designed to appeal primarily to Western European markets, at the expense of tailored offerings for Eastern European and Baltic consumers.

Our empirical modelling provided an indicative scale of the impact this would have at both the aggregated EU and regional levels. Eastern European and Baltic countries are a significant segment, with total TV platform revenues of around €4.6 billion; generating an estimated content spend of €2.2bn each year.

Table 1.1 Eastern European audiovisual industry: indicative statistics

Total TV platform revenues	€4.6bn (€2.6bn pay-TV, €2.0bn FTA)
Content spend	€2.2bn (€1.1bn pay-TV, €1.1bn FTA)
Locally produced feature films and documentaries	172 per year
Total FTA content production	2,136 hours per year

Note: FTA = free-to-air.

Source: Statistics taken from Oliver & Ohlbaum analysis of 2013 Ovum World Television Information Service data and 2015 European Audiovisual Observatory data.

[1] Our full report, commissioned by a consortium of international audiovisual producers and distributors, is available in full at www.oxera.com/crossborder.
[2] The Eastern European and Baltic countries included in our study are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia.

Importantly, rather than focusing on any particular measures proposed by the Commission, our research took a broader view and considered the anticipated *market outcome* from the debate—that is, the erosion of exclusive territorial licensing within Europe. Since our first report, the Commission has taken concrete steps to realise this outcome in a number of domains, including:

- progressing its on-going competition investigation into cross-border access to pay-TV;[3]
- proposing a draft regulation on the prohibition of geo-blocking for online services (and while in its current form this excludes audio-visual services, it does include a review clause to explicitly revisit the inclusion of services providing access to copyrighted works after two years in force);[4]
- proposing a regulation that seeks to extend the 'country of origin' principle from the satellite and cable directive to encompass ancillary online transmissions (such as catch-up services) as well;[5] and
- having its proposed regulation on the portability of content services within the EU successfully adopted into European law by the Council.[6]

In this follow-on report, we focus in on Eastern Europe and the Baltics to consider the likely impact that measures such as these would have in that region.

2 Eastern European and Baltic consumers will pay more for less

Our analysis finds that consumers in Eastern Europe and the Baltics stand to lose the most from any measures, such as those proposed by the Commission, that serve to undermine territorial licencing. As the industry adapts, the anticipated changes would drive an increase in the prices consumers face for international works; a deterioration in the range and quality of the audiovisual services they receive; and a reduction in local content production.

Any weakening of the current territorial licencing system would have a negative impact on the value European pay-TV and SVOD platforms place upon distinctive, international content. Absent territorial restrictions, the ability of this content to differentiate platforms in the local market would be undermined by incursions from services in other countries.

In response to this, content producers might choose to sell exclusive licences to a single, pan-European pay-TV or SVOD platform so as to maintain the rights value. This would enable the platform to use the international content to attract subscribers, while preventing cross-border cannibalisation by setting a single price for subscribers throughout Europe—possibly differentiated by language.[7] In this

[3] European Commission, Case AT.40023 – Cross-border access to pay-TV.
[4] European Commission, COM(2016) 289 final, 'Proposal for a Regulation of the European Parliament and of the Council on addressing geo-blocking and other forms of establishment within the internal market and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC'.
[5] European Commission, COM(2016) 594 final, 'Proposal for a Regulation of the European Parliament and of the Council laying down rules on the exercise of copyright and related rights applicable to certain online transmissions of broadcasting organisations and retransmissions of television and radio programmes'.
[6] Regulation (EU) 2017/1128 of the European Parliament and of the Council of 14 June 2017 on cross-border portability of online content services in the Internal Market.
[7] Our analysis assumed that a pan-European platform operator would not undertake unilateral retail price differentiation by territory—but would instead set a uniform price throughout Europe (possibly differentiated by language or other content characteristics) within each relevant pay-TV window. This was considered most reflective of the overall *spirit* of the European Commission's Digital Single Market agenda at the time our original report was prepared. There are, of course, other short- and long-run scenarios that could evolve—such as content being withdrawn or delayed in low-cost territories—many of which we examine in our full report.

case, local platforms would be left with only a reduced range of lower-value, less distinctive content to offer subscribers.

2.1 Disproportionate effect in Eastern Europe and the Baltics

25%

decrease in consumer welfare

In our modelling we estimated the change in consumer welfare associated with different prices and qualities of audiovisual service offerings. In the above scenario, with the rise of a pan-European platform holding exclusive rights to international content, we found a reduction in consumer welfare of up to €1.5bn across the whole of the EU; of which around €360m is attributable to consumers in Eastern Europe and the Baltics.

Add to this the impact of reduced output—both local and international—and we find Eastern European consumers would suffer a welfare loss of up to €590m as a result of exclusive pan-European licensing. This represents a decrease of around 25%, as compared with the prevailing level of consumer welfare from film and TV content enjoyed in those territories today.

2.2 Retail prices will rise in Eastern Europe and the Baltics

Crucially, consumers in Eastern European and Baltic countries wishing to access first-run international film and pay-TV content would be worse off than they are today, as they would have to pay the higher price charged by the pan-European platform for the same content they can currently receive from local providers.

In our analysis scenario it is assumed that the pan-European platform would set a uniform price across the whole of the EU, to avoid cross-border cannibalisation while optimising returns. The optimal pan-European platform price would need to balance lost revenue in high-income countries with lost demand in lower-income countries. As such, it is likely to be closer to the prevailing retail prices found in high-income territories and would be unambiguously higher than the prices that consumers in Eastern Europe and the Baltics pay today.

12%

increase in prices

Our modelling suggests that the price set by the pan-European platform could be around 12% higher than current prices charged in Eastern Europe and the Baltics. Consumers in those territories would be forced to pay more for the content they currently enjoy, or would have to forgo the content on the pan-European service due to the higher prices being charged.

2.3 Fall in local platform & broadcaster revenues as consumers switch

As a result of significant switching to the pan-European platform by Eastern European and Baltic pay-TV subscribers in our analysis scenario, there would be a large reduction in local platform and broadcaster revenues, of around €1.01bn (39% of total). This includes both pay-TV and free-to-air services, with the former losing subscription revenues as consumer uptake falls; and both suffering from a decline in advertising income as viewer numbers decline.

€1bn

fall in local platform revenues

Across Europe, this loss of revenue would affect local distributors' and broadcasters' abilities to pay for high-quality local content. As a result, we estimate that local European producers would lose approximately €1.4bn of investment by pay-TV platforms.

2.4 Reduced local output as funding declines

35%
reduction in local content production

The effect of lost revenues would be particularly prominent in lower-income countries where consumers are less able to pay for audiovisual content. We estimate the cumulative impact on locally produced, culturally diverse film and TV content in Eastern European and Baltic countries would be a fall of as much as 35%.

Importantly, a pan-European platform (such as that in our modelling scenario) would be unlikely to replace this lost local content funding as it would be expected to focus on content with cross-border appeal. Furthermore, with a single pan-European price replacing territorial differentiation in our scenario, aggregate revenue at the retail level would decline by around €0.8bn–€2.4bn across Europe, further reducing the availability of local and international production funding.

2.5 Reduced quality and choice of retail offerings

With a move toward exclusive pan-European licencing, not only would consumers in Eastern Europe and the Baltics end up paying a higher price for access to the same international content they enjoy now; but the range and quality of platform services available to them would also be inferior to those they enjoy today.

First, while a pan-European platform may offer a superior breadth of international content and earlier timings of release compared to existing local offerings, it is unlikely to be well tailored to local cultures, tastes and preferences. Local platforms play an important role in contextualising content, curating appealing works and promoting them with relevant, targeted marketing activity.

Second, with both local and international producers losing revenue as a result of pan-European licensing, the quality and quantity of works available on all retail platforms is set to decline. This is particularly prominent in the case of local works, but will also apply to international content, which could see budgets cut as recoupment is put at risk.

Third, as consumers migrate to the pan-European platform to access its exclusive international content, local platforms would face a ‘vicious cycle’ of declining revenues and service offerings. In the extreme, it is conceivable that some local platforms may be forced out of the market entirely, leaving consumers with reduced choice and an increasingly homogenous viewing experience.

3 Further impact throughout Europe

The detrimental effects anticipated in the Eastern European and Baltic countries are just part of a wider impact that would be felt throughout Europe. Our analysis also examined a short-run scenario in which today’s wholesale prices and licensing arrangements would remain unchanged, but with newly increased cross-border access encouraging consumers to take advantage of foreign audiovisual services. In response to these changes in consumption, local distributors and broadcasters would reduce the price they are willing to pay when buying content, to account for the *de facto* loss of territorial exclusivity.

This has a knock-on effect on producers, whose established funding mechanisms (e.g. output deals, co-production agreements or pre-sale arrangements) are weakened by the resulting uncertainty around future revenues. We anticipate a fall of around €8.2bn in annual revenues throughout the EU, putting up to 48% of TV and up to 37% of film output at risk of having their budgets cut, or not being made. Given the value that consumers place on enjoying a variety of quality content, this loss would translate into a €9.3bn reduction in European consumer welfare per year.[8]

$9.3bn of consumer welfare lost each year

Given the magnitude and scope of the expected short-run impacts, we anticipate industry practices would be forced to adapt over the long-run to minimise the effect of a *de facto* loss of territorial exclusivity. In addition to an accelerated move towards a pan-European licensing model and short-run withdrawals or delays to supplying content in low-cost territories, we considered alternative responses that individual producers might consider to help them recoup their content investments, including:

- the sale of pay-TV film and TV content to closed platforms, removing open access to over the top (OTT) and catch-up services from the licences. The objective of amending licences in this way would be to make pay-TV packages in the lower-income countries less accessible to consumers in higher-income countries, so as to avoid cross-border cannibalisation. However, this would have an adverse effect on innovative online service development and overall consumer experience in lower income countries—meaning a consumer welfare loss of around €330m in Eastern Europe and the Baltics;

- the introduction of language-based licensing and enforcing dubbing (rather than subtitling). The intended effect would be to limit the appeal of content to a given language market, but with the side effect of reducing the quality of the output available to local consumers with a preference for programmes in the original language is common (e.g. Estonia, Romania and Slovenia). This could be expected to be particularly prolific among high-quality, English-language feature works with an international appeal, for which consumers would be forced to choose between: (i) watching dubbed content locally; (ii) watching in the original language abroad (and paying more to do so); or (iii) choosing not to watch content they currently have access to. Each of these would represent a net welfare loss relative to the present situation.

While these responses may serve to reduce content loss, they will also have a redistributive effect, as they will worsen the services on offer to certain European consumers. In each case, consumers in lower-income territories—such as Eastern European and Baltic countries—would be disproportionately worse off than they are now.

4 Conclusions

Our original report showed that eroding the established territorial licensing regime for audiovisual works would reduce the quality, quantity, and range of local distribution services and original content on offer, leading to reduced welfare for all consumers in Europe.

In this report, our focused modelling suggests that these effects would be particularly pronounced in Eastern European and Baltic countries. In a scenario where rights holders respond by issuing exclusive pan-EU licences our analysis

[8] In our report, consumer welfare is represented by 'consumer surplus'. Consumer surplus measures how much utility consumers receive from the good over and above the price of the good. If a consumer values a good at €5 but pays €2, the consumer surplus would be €3.

suggests that production of culturally diverse, local film and TV content could fall by 35% in Eastern European and Baltic countries, with a retail prices rise of 12%.

Given that pay-TV platforms in Eastern European and Baltic countries tend to be cheaper than equivalent packages elsewhere in the EU, right holders might decide to remove OTT and catch-up rights from licenses, or to enforce dubbing in these countries, both of which would lead to a degradation in the quality of services available to Eastern European consumers and reduce consumer welfare.

Overall, we anticipate consumers in Eastern Europe and the Baltics to be disproportionately affected by any measures that undermine the prevailing territorial licensing regime, with consumer welfare in the region set to fall by up to 25%.

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