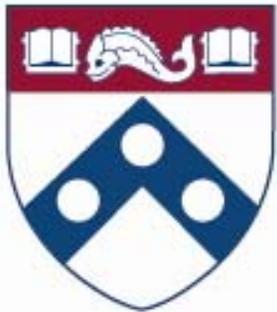

The Impact of Advertising: Lessons from Broadcasting



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December 12, 2013

The FCC's Longstanding Preference for Free Television and Radio

■ Television

- Opposition to subscription TV (overturned by D.C. Cir.)
- Cable: superstations, bundling, antisiphoning, network nonduplication, syndication exclusivity, must carry
- Satellite distant signal importation, carry one, carry all
- Digital television transition via broadcasting

■ Radio (conventional and satellite)

■ Confounded with commitment to local

Impact on Total Revenue

- Theoretically ambiguous
 - Pay models reflect audiences' preferences for programs
 - Advertising models reflect responsiveness to advertising
- Empirically clear
 - Noll, Peck & McGowan (1973): $\text{pay} = 7x \text{ advertising}$
 - Effect confirmed by Levin (1971); Besen & Mitchell (1974); Spence & Owen (1977); Ellickson (1979); Park (1980); Holden (1993); Hansen & Kyl (2001)

Pricing vs. Voting Models

- Pricing: two ways to signal intensity of preferences
 - Viewing vs. nonviewing
 - Price (revenue not just a function of audience size)
 - Voting: only one way to signal preferences (viewing)
 - Revenue (primarily) a function of audience size
 - CBS derives 1/8 the revenue per viewer as HBO
 - Implications
 - Program quality falls (HBO's dominance of the Emmys)
 - Programs with small audiences cannot survive (diversity)
-

The Advertiser as Intermediary

- Biased towards demographics most responsive to advertising
- Instills consumerist mentality (avoid controversy)
- Subjects content to advertisers' political preferences and vulnerabilities
 - NBC's *Roe v. Wade* vs. HBO's *Roe v. Wade*
 - HBO: "We're not any braver than the other networks. It's just that our economic basis is different."
 - Viacom's shift of *The Reagans* from CBS to Showtime

Importance of Two-Sided Markets

- Network consists of two types of actors
- Value is determined by number of other type
- Advertising is a classic two-sided market
 - Two types of actors: subscribers and advertisers
 - Value to advertisers determined by no. of subscribers
- Natural flow: advertisers → last-mile providers
 - History of broadcast network economics
 - Logic of paid peering

Implications for the Internet

- Advertisers introduce considerations unrelated to end users' preference for content
- Ads are the product of choice, not regulation
- Do online ads understate end user preferences?
- Do online ads reflect intensity of preferences?
- Are content → last-mile payments beneficial? (Netflix, ESPN, etc.)
- Wireless may mitigate problems (lesser reliance on ads, greater willingness pay for apps)

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