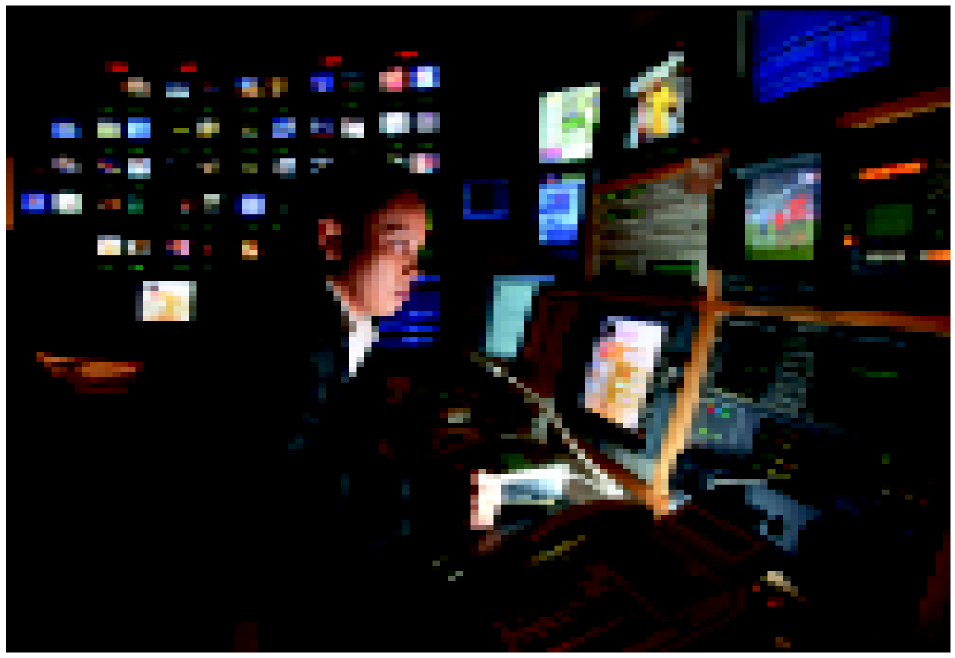
Supporting new channels in the

BY PAUL BROWN-KENYON

As early as the late 1980s, the development of new digital compression, two way communication technologies and higher bandwidth transmission systems, signalled the beginning of a new era in the global TV industry. While 20 years ago, viewers in countries like the UK were restricted to a handful of general-entertainment channels provided by national broadcasters, today the same viewers have the choice of multiple pay-TV offerings, each providing hundreds of cable channels supplemented by HDTV, VoD and interactive content.

At a macro level, the TV industry across Asia lags behind that of Europe and North America. While there are markets, such as Japan, South Korea and Malaysia, which support strong and well-established pay-TV operators, each providing a wide selection of channels, across other markets the choice is more limited. This lag in development compared to western media markets can be traced to lower levels of economic prosperity, less distribution infrastructure, and more restrictive media and communications regulations.

However, while the broadcast industry in Asia currently lags behind that of western markets, this is changing, and changing rapidly. With improvements in capacity, technology and regulation, existing pay-TV operators, such as Astro in Malaysia, are using an increase in available distribution capacity to broaden their channel offerings. In other markets, such as India, new direct-to-home (DTH) operators are entering the market with expanded offerings.



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From the channels' perspective, this expanding TV landscape provides a land of opportunity. Historically, pay-TV operators have held the key — restricted distribution capacity and a cautious attitude towards introducing new channels which have limited the opportunities for new content. But now, with access to wider distribution pipes and direct or indirect competition, pay-TV operators are actively searching for new content to improve their offering and expand their market.

To meet this demand, new channels are appearing. Some are being introduced by European and North American media companies importing channels from other markets (for example, the UK's BBC Prime), others by Asian broadcasters looking to take their channels regional (for example, the Philippine's GMA Pinoy TV), and yet others by new companies looking to introduce new and distinctive content.

While the opportunity appears there for the taking, new channels face significant challenges in realising the potential. Channels, in many ways, can be characterised as fixed-cost businesses. The cost of acquiring content, providing the playout facility and accessing distribution capacity are all largely fixed, being the same amount irrespective of whether the channel reaches 1,000 or 10,000,000 viewers.

With the roll-out of a new channel taking many years to achieve carriage on a critical number of pay-TV systems, channels can take many years to break even. Further, the profitability of the industry is heavily linked to the rating the channel is able to achieve with typically the No.1 and No.2 channels in any segment dominating both viewer ship and profitability.

While there are examples of successful models for channel operators carving out a position for themselves lower down in the viewer tables, smaller channels often struggle to generate the expected returns.

Given these factors, the launch of a new channel requires a significant financial commitment. Backers need to be prepared to cover loses for anything from a couple of years to as many as 10 before they can start seeing a return on their investment.

So what about satellite operators? Why is the COO of a satellite company writing about channel profitability? Because satellite operators play an important role in the pay-TV industry. Satellite operators provide capacity for contribution and distribution feeds for the channels themselves, and they provide DTH satellite capacity to pay-TV operators for the final delivery of the content to the viewer.

A vibrant pay-TV industry will support a strong and vibrant satellite industry. Because of this interdependence, anything the satellite industry can do to help the development of the Asian media landscape, from one of limited choice to one that mimics the breadth of choice found across the more developed media markets will help the satellite industry.

So what can satellite operators do to help?

With playout and satellite transmission costs making 30%-40% of the cost base of a new channel, "reduce pricing" is the natural response. However, pricing offered by satellite operators need to cover the significant capital expenditure (capex) of launching a satellite (in the order of US$150 million to $250 million) as well as the ongoing operational expenditure (opex) of running the business.

Further, with some overcapacity in the satellite transmission market over the past few years, pricing for satellite transmission capacity has already fallen significantly, in some cases to that below a level required getting a return on the true operating costs of the satellite.

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With a better balance between satellite capacity and demand now working its way through the market, the great deals that had previously been offered by some satellite operators are becoming scarcer. While the recovery of average pricing may not be welcomed by new channels looking to close their business models, it is important for the long-term development of the satellite industry.

So apart from reducing pricing, what else can satellite operators do? The key is to modify their approach to supporting new channels such that they are investing in helping them become successful. Three specific ideas come to mind:

- **Developing adaptive pricing structures:** As I mentioned above, for new channels, 30%-40% of the cost structure is related to playout and satellite costs. This cost item is only second to the cost of content. Given the high percentage of costs associated with satellite element, anything satellite operators are able to do to reduce this cost while the channel is still struggling to break even will be of significant advantage.

Innovative satellite operators are therefore adjusting their pricing approach for new channels. They are allowing slightly reduced pricing in the early years of the channel's operation, when they may not

changing media environment

have the critical mass of distribution, making up for it by slightly higher pricing in later years when the channel is more established and can afford the full transponder rates.

Actively supporting the roll-out of the channel: Satellite operators historically have held a strong relationship with the pay-TV operators. While this relationship is nowhere near that enjoyed by an established channel, the relationship may have some value for a new channel looking to get carriage.

In the roll-out phase of the channel, some of the more forward-thinking satellite and playout providers look to leverage these relationships to support their new customers. This can be done either in a coordinated manner, whereby the provider is contracted by the new channel to introduce the offer and achieve carriage across the footprint of the satellite, or in a more ad hoc manner.

Look at alternate payment approaches: Capacity on satellites has traditionally been based on five- or 10-year transponder leases, with payment in cash in advance. In the start-up phase of a new channel, cash is often at a premium. To address this issue, some satellite operators have considered offering lease payments in return for debt or in the form of an equity stake in the company.

While this, on the surface, may seem like a good idea, economists will rightly ask: "Why should satellite operators provide such financing, rather than other specialised financial institutions?" or "Are satellite operators in a better position than media investment funds or financing companies in spotting a winning concept?"

These are good questions and, to be perfectly frank, satellite companies are not better positioned. However, satellite operators have a vested interest in seeing the number of channels increasing. When one also takes into account that the satellite is, in fact, a 'sunk investment', there may be rationale for a satellite company (in selective cases) considering this approach.

The relationship between satellite operators and channels has traditionally been an arms' length relationship with the services. Each of the three approaches detailed above, and others that a number of the leading companies are testing, deepens the relationship between the channel and the satellite operator.

In this situation, the operator has more vested interests in the success of the channel. As a consequence, these approaches also increase the financial exposure and risk the satellite operator has in supporting the channel. As such, they are unlikely to be offered by all. Some companies will prefer the more arms' length approach.

Satellite operators provide capacity for contribution and distribution feeds for pay-TV channels.

Others will only be tempted to bind their business to that of the channel if they believe in the channel and believe that, over the long term, going the extra mile to support the channel will lead to a mutually beneficial long-term relationship.

The TV landscape in Asia is changing. Rising levels of prosperity means increase in distribution capacity and the relaxation of regulation is creating a rapidly changing media environment. Today the Asian TV industry is primed for rapid growth and the movement to a rich multi-system/multichannel model is expected to show up in Asia's more developed media markets.

However, to do this transition requires the development and introduction of new channels. While the traditional arms' length model that satellite operators adopted is workable for established and/or well-funded channels, it can be a difficult model for new channels to accept. To encourage these channels, satellite operators should re-assess their mode of operations and assess the viability of adopting alternate models that support the launch and success of new channels.

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