Exam 1 Media Economics

EC 150

The exam has 9 short answer questions, you must answer seven of these and you will have 75 minutes to answer. Give concise answers to each question. You may write on your exam. Good luck!

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Choose 3 of the first 4 questions (1-4, 15 points each)

1.) a.) How does monopoly power change when fixed costs are more important than marginal costs in producing and selling a product?

b.) What does the ability to deliver a product digitally do to help the scenario you described?

c.) Provide one example of an industry where digital distribution has become important and comment on how monopoly power changed from the industry before products could be delivered digitally.

2.) Give me four reasons in detail why Super Bowl ads are expensive and increasing in price. Give me economic intuition for each.

3.) We have talked about cable internet providers as well as traditional broadcast and cable television networks.

a.) Compare the market structure of a pro sports team in a local market in the United States (eg. Football) to ISPs in the US.

b.) Would increasing competition in the local markets improve the product? Why or why not for both?

4.) What is some of the increased competition movie theaters are facing? What are three ways in which theaters can take back revenue?

Choose 3 of the next 4 questions (5-8, 12 points each)

5.) Provide at least two reasons Netflix’s success in attracting subscribers and expanding worldwide have increased fixed costs of operation.

6.) a.) How can a social media company like Facebook create considerable market power.

b.) Why are there concerns about a company like FB’s market power? Discuss consumers directly and through competition.

c.) Why doesn’t the traditional regulatory concern about market power apply to a company like FB?

d.) What are some ways big tech can be tamed?

7.) Netflix is financing its own films and TV shows to try to avoid licensing films.

a.) Why would Netflix want to finance its own content? What kind of integration is this? Are they trying to take advantage of economies of scale or scope here?

b.) Why is unique about most of Netflix’s competitors (not true of Netflix) that may make them a risk to Netflix in the long run?

8.) What are four natural barriers to entry among the companies which would compete with Google, Netflix, and Amazon? Relate some of these ideas to economies of scale and scope.

You must answer this question (19 points)

9.) Media companies often integrate to take advantage of a larger size.

a.) If a company buys a company that produces a similar but separate product, what kind of integration is this? Explain the economic logic of a company doing this using terms we have explored in class. Provide an example of Disney using this form of integration and explain how it helped.

b.) If a company buys a company that works in production or distribution of the company’s products what kind of integration is this? Explain the economic logic of a company doing this using terms we have explored in class. Provide an example of Disney using this form of integration and explain how it helped.

Answers

1. Large fixed costs create a **barrier to entry** for potential entrants. This can create monopoly power for firms already in the industry.

Digital delivery of products makes **marginal cost**s very low, and fixed costs more important. In a world with digital delivery firms can deliver their products very cheaply, meaning fixed costs are most of the costs.

The specific scenario depends on how big fixed costs are. Movies or music are industries that could provide examples of both possibilities. First, marginal cost is near zero for these industries now. For music and movies, fixed costs can also be very low where a product can be produced on a small budget. Because of this, we would expect many more films and songs available, and they are. But at the same time, given this proliferation of products, it may be extremely expensive to create a very successful film or album. Large budgets (high fixed costs) may be even more necessary, causing the blockbusters to have even more monopoly power than before.

1. Super Bowl ads are sold in a market involving supply and demand just as any other product. **Supply has not increased** much over time, the supply is essentially fixed. At the same time, much has happened to demand. First, the game has become **more popular and** more people watch. Meaning the advertising reaches more people. Second, **substitutes like other commercials** are facing less real viewership as technology like DVRS and the internet are changing if commercials are watched. Finally, **the Super Bowl commercials have become an event.** Super Bowl advertising is watched for its own sake. Commercials are released on the internet, people view them because they are super bowl commercials, watch carefully for them, and talk about them with their friends. They are unlike other commercial offerings.

3.) a) Current state of major Hollywood studios:

* Consolidation: "Big Six" became "Big Five" after Disney-Fox merger.
* Fewer theatrical releases: Focus on big-budget franchises and tentpole films.
* Increased direct-to-streaming content production.

Key factors:

* Rise of streaming platforms
* Changing consumer behavior
* Economic pressures
* Vertical integration
* Global market considerations

b) Shift towards TV production in streaming era:

Reasons for favoring TV shows:

* Longer viewer engagement
* Better data collection
* Cost-effectiveness
* Flexibility in production
* Franchise potential

Impact on filmmaking and entertainment industry:

* Blurring lines between film and TV
* Emphasis on longer-form storytelling
* Talent migration to TV projects
* Evolving distribution models
* Opportunities for niche content
* Focus on global, local-language content
* Shift to subscription-based revenue models

Future outlook: More integrated entertainment industry with fluid boundaries between content types. Challenge lies in adapting while creating compelling content across platforms.

* 1. Movie studios are facing competition from **services like Netflix and Hulu, improved home theater environments, internet piracy, and increased alternative entertainment options like video games and the internet.**

Studios need to compete with these services in new ways. Studios could **change their release schedule** to compete with Netflix and Hulu and piracy. Studios are **differentiating from home theaters with 3D and IMAX.** Studios can **integrate horizontally with the alternative options** in order to take advantage of the revenue from them.

* 1. Netflix has become a victim of their own success in that they once were able to license films from large studios for relatively cheap because the number of subscribers they have did not challenge other revenue for those studios. Now that the number of subscribers have increased, **studios have raised prices, and may not even license to Netflix anymore.**

In response Netflix has started to **create its own content.** Spending on content has increased for Netflix, and all of its new competitors, so that the price of producing content has become nearly as expensive as licensing.

* 1. a.) Facebook **ties people** to their product so that they won't use other social media. These are **network effects.** This is like Amazon using Prime to get consumers to use their site first.

b.) Market power can **reduce consumer choice and consumer surplus**. Traditionally, we would expect higher prices and lower quality to accompany more market power. Facebook’s concerns are more about **quality and advertising. Also data concerns.**

**Quality** because Facebook may not have the incentive to innovate with their market power. The product may get worse.

**Advertising** because Facebook can become a monopoly for selling ads in social media. This means they will have considerable market power in that market, charging higher prices than would exist otherwise, hurting those that want to advertise.

c.) Facebook **doesn't charge a price**, so they have no price to raise.

d.) Facebook could be forced to **let users take their data with them.** This would make it easier to switch between services and increase competition.

Facebook could also be **held liable for user content.**

7.) This is **vertical integration.** Instead of licensing other movies in this case, **Netflix are making their own** to avoid the costs of licensing. Although it is expensive, Netflix can keep the show **forever.**

b.) Many of Netflix’s competitors **do not rely on their streaming revenues** to operate. Netflix does not have another business. Apple, Amazon, etc. all can rely on many other sources of revenue so that their streaming business does not have to be profitable. This is a huge advantage for those competitors.

1. These companies spend a lot of money. **Capital** is certainly a barrier to entry for them. Additionally, **network effects** are a major barrier to entry. This means that these companies already have a major base of consumers which make their products more valuable. It is difficult to enter into these markets and become successful facing those existing networks.

These companies increase and encourage barriers to entry by **spending a lot of money.** This ensures the capital requirements do not fall. Additionally, they **make it difficult to change networks through switching costs.** Starting a new product requires obtaining customers, these companies do a lot to try to prevent that. Finally, when new companies are successful, these major companies **horizontally integrate,** buying them to prevent competition.

9.) a.) This is known as **horizontal integration.** The company may be able to **lower costs, or share investments** across the different products they produce. This allows a company to gain **scale, different customers, and maximize profit.** Disney has done this many times. Any example will work.

b.) This is **vertical integration.** The company controls **more aspects of the production and/or distribution process.** This allows a company to take **more of the profit of sales and can lower cost if they achieve sufficient size.**