

THE VALUE OF CONTENT



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FOREWORD



This report is intended to stimulate discussion and debate about the fast-changing dynamics in the video industry. Our focus in the pages that follow is on “television”. In 2016, of course, that term needs defining, as content is increasingly consumed on computers, tablets, and mobile phones (along with television sets) thanks to the advancement of online and mobile content delivery. A more accurate definition is *“professionally produced long-form video content* that is delivered across a variety of traditional and digital or mobile pathways and consumed on devices from television sets to smartphones, tablets, and PCs, both inside and outside the home”*.

This is an industry made up of three key segments: content owners, and rights holders; FTA and Subscription TV channels; and distributors and aggregators. Our report is focused on the nature of change in the industry and primarily focused on the potential implications of these changes for the channels, distributors, and aggregators.

We are publishing this report as the industry is facing a higher degree of uncertainty about its future than at any other point in history. Our goal is to stimulate discussion among industry decision-makers, influencers, and academics. We hope this work challenges conventional wisdom and provides a valuable contribution to the ongoing industry discourse.

* For example, television programming versus either user-generated video or two- to three-minute professionally produced video segments.



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key messages

KEY MESSAGES

The emergence of a new online-content value chain is threatening the history of incremental change, and is changing roles, relationships, and value capture. Over time, this might be as disruptive as the changes experienced by the music, newspaper, and magazine industries.

➔ Until recently, the nature of change in the video industry (FTA and Subscription TV value chains) has been evolutionary as opposed to discontinuous; with every new development, most players were able to gradually modify their strategies and business models in order to continue to be successful.

➔ The emergence of a new online-content value chain is threatening that history of incremental change, and is changing roles, relationships, and value capture.

➔ These changes might, over time, be as disruptive as those experienced by the music, newspaper, and magazine industries.

➔ \$530 billion (U.S. dollars) are at stake for the incumbent actors across the content, broadcast networks, and distribution and aggregation segments of the value chain.

➔ Content – its ownership, aggregation, and monetization – is at the center of these changes, and \$530 billion will be redistributed in large part on the basis of which players are able to retain content as a key control point.

➔ Three key forces have enabled the emergence of the new online-content value chain that is driving this threat of industry disruption:

» The development of technology infrastructure (streaming network topology, connected devices, and software) capable of delivering a high-quality video experience directly to the TV; by 2017, 74 percent of the European Union and 96 percent of the U.S. will have access to “video ready” fixed broadband

» Increased availability of high-quality online content, including professionally produced television entertainment

» New and cheaper models of online content creation that are driving large audiences assisted by a new breed of industry player, the multichannel network; the most successful YouTube series, for example, have a given “episode” reach several million viewers for a cost well under \$50,000

➔ These forces have led to significant change in consumers' viewing behaviors, in particular the following:

» Whilst overall viewing time still grows, consumers' content viewing habits are shifting to the online value chain increasingly at the expense of FTA and Subscription TV viewership (by 2020, the average global viewer is expected to watch 24 hours of online content per week)

» Driven by serialized entertainment, consumers are increasingly viewing time-shifted, non-linear content (by 2020, half of all entertainment viewing in the U.S. is expected to be non-linear, with the Europe Union trailing closely behind)

➔ These forces are also showing early impacts on the traditional FTA and Subscription TV value chains:

- » An increasing share of TV ad money and consumer spending is moving into the online value chain
- » Content value is shifting away from commoditized, second-run content to compelling mass entertainment and sports and high-engagement niche programming entertainment and sports and high engagement niche programming
- » Content creators are capturing a slightly larger percentage of industry value with enhanced bargaining power

» Players across the value chain are diversifying their portfolios to position themselves around key content assets to drive future value, manage content cost, or both

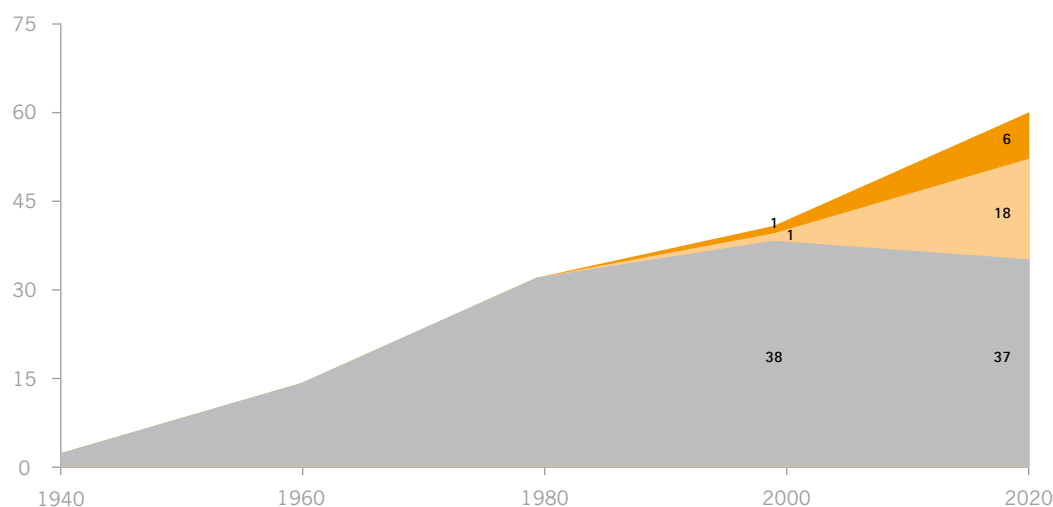
➔ Disaggregation of value from the traditional ecosystem driven by the emergence of the online value chain has created a specific set of risks for incumbent actors:

» **Distributors and aggregators**, to prevent a decrease in the value of their physical video infrastructure and protect video content revenues, are being forced to adjust and diversify their video offerings and make up for revenue losses over multiple platforms

ONLINE/MOBILE DRIVING VIDEO CONSUMPTION GROWTH GLOBALLY

■ Mobile video ■ Online video ■ TV

Nr. of hours per week spent per media type



Source: Carat insight media survey; European Technographics Benchmark Survey; emarketer; Gallup TV meter; SKO; MMS; BARB AdvantEdge; Mediametrie; CIM TV; Eurodata TV, The Nielsen Company; BCG Analysis

Exhibit 1.0
Nr. of hours
per week spent
per media type

KEY MESSAGES

» **Broadcast networks** will face more pressure in passing along their increasing content costs to distributors and will see TV advertising revenues erode as monies move online and non-linear; potential unbundling, as consumers buy content from a variety of available à la carte offerings, will necessitate a greater emphasis on direct consumer relationships and content that appeals strongly to a mass or very niche audience

» **Content creators and rights holders**, which have relied on strong TV buyers to grow revenues and promote their content assets, will gain new buyers and new business models to monetize their content over an increasing number of platforms and forms of content usage

➔ There are **a number of future industry scenarios**, centered on content ownership and aggregation, that together bound the range of outcomes from gradual, evolutionary change to one of the following potential disruptive changes:

» **Multiplatform navigation** with cross-platform content-navigation capability as the entry point to all video and the key asset to acquire customers

» **Exclusive content**, where platform-exclusive high-profile content (for example, sports or original entertainment content) are the key content assets acquired exclusively by distributors to differentiate in a multiplatform world and drive customer acquisition

» **Direct-to-consumer service**, which bypasses infrastructure-based distributors, content, and broadcast networks with high-quality content and strong channel brands

» **Linear streaming aggregation**, which is online content aggregators' ability to obtain streaming content licenses from key FTA and Subscription TV channels, is the key asset-disrupting facilities-based aggregation and distribution

➔ The implications of each scenario lead to distinct actions across incumbent and new players:

» **Content creators** continue to be advantaged across all scenarios, particularly those that own must-have content that drives significant audiences or small, loyal fan bases

» **FTA channels** with mass content will also be well positioned if they can manage the shift from traditional, live TV viewing to multiplatform, time-shifted viewing

» **Subscription TV channels** will face erosion of market share depending on the degree to which they are able to access differentiated and engaging content

» **TV distributors and aggregators** with scale and well-developed video and broadband infrastructure are well positioned to compete; smaller players or those without well-developed video and broadband capabilities will need to quickly expand capabilities, either through partnerships or M&A activity

» **Online video distributors and aggregators** will face a unique set of issues that determine the size of their value capture, particularly whether to migrate their platforms from non-linear to live content, whether and how to expand internationally, and how to balance their business models between consumer pay services and ad-supported revenue streams

➔ The scenarios above are not mutually exclusive. Many markets are expected to develop into hybrids. Which scenarios play out in which markets will be influenced by market maturity, key player moves, and the regulatory environment.



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executive summary

EXECUTIVE SUMMARY

The television industry has a long history of change – from the way content is captured (first on film, then videotape, and later, digital media) to the way it is delivered (via live broadcasts, then cable, satellite, and online platforms) to the way it is consumed (via television sets, computers, tablets, and mobile phones). These changes have brought new players with new business models to the landscape. But through all of these changes, the fundamental structure of the industry has remained relatively constant.

Until recently, the most fundamental change in the history of the television industry was the evolution from one value chain, free to air (FTA), to two value chains, FTA and Subscription TV. But despite these changes, the fundamental structure of the industry remained relatively constant. Content rights and content creation has remained core to value creation, as have the relative roles of creators (such as studios), broadcast networks, and distributors. Content creators and rights holders provide programming to broadcast networks; the broadcast networks, in turn, program and package content into channels for linear consumer viewing; and distributors then deliver it to television sets and other viewing devices. Each of these roles within the value chain has, for the most part, retained its key relationship to others and has thrived in the face of all of this change.

But now, there are a number of new changes affecting the industry – changes introduced by the development of an online television value chain. The question is whether this and a number of related changes – discussed in more detail below – will continue to be evolutionary. Will industry players continue to adapt to them successfully, or will they, for the first time in the industry's history, create significant disruption, changing the nature of these

roles, shifting control points, and effecting enterprise value?

As there is and will continue to be a lot of uncertainty, another key question becomes crucial: What actions should current players contemplate taking to chart a successful path into the future?

These questions lie at the heart of this report.

To address them, we look back at the evolution of the industry to date, identify and evaluate the key trends that are affecting the industry today, suggest several alternative scenarios for how the industry might evolve, and finally, discuss high-level implications for different types of players as they look forward across these potential scenarios. Understanding this is crucial for every player at every stage along the value chain, for it is a prerequisite to knowing how best to act and how to move forward as the industry moves forward in new and perhaps disruptive ways.

PART 1: THE ROLE OF CONTENT IN THE CURRENT TELEVISION INDUSTRY

Two traditional ecosystems

The television industry began with just a single business model: free to air, or FTA. Content was broadcast over the airwaves in unencrypted form and revenue was derived from either advertising (in the U.S.) or public tax levies (in many European markets). However, by the 1980s (in the U.S.) and the 1990s (in the European Union), another ecosystem, Subscription TV, emerged. The Subscription TV value chain – including cable, direct-to-home satellite, terrestrial, and the IPTV networks

of telecom companies – enabled the delivery of dozens to hundreds of channels through a single infrastructure. Under the Subscription TV model, new commercial broadcast networks developed that generated revenue not only from advertising and public tax levies but also from consumer subscriptions.

Both the FTA and the Subscription TV models relied on the same overall structure for creating, aggregating, and delivering content, with players at each stage along the chain assuming a well-defined and well-understood role. Significantly, the emergence of the Subscription TV ecosystem did not harm the FTA model. Competition did increase, but with more viewing pathways available, viewing time – and revenues – increased, too, and every element of both ecosystems thrived and grew.

Content was at the center of these ecosystems. In 2014, 36 percent of total industry value went to content creators and rights holders, and 34 percent went to broadcast networks. Content creation and curation drives two-thirds of the industry's revenue.

The strategic role of content

While all content has been, and will continue to be, critical to the evolution of the television industry, different types of content play different roles. Each of the three main genres of content – sports, news, and entertainment – triggers a unique set of roles, relationships, and economics.

Sports, particularly must-see events, in many markets is a significant differentiator among broadcast networks and distributors, and vis-à-vis the new online value chain. Not surprisingly, those that control the rights to top sports events can typically sell them at premium prices. Although sports accounts for only 15 percent of all viewing, it

accounts for some 65 percent of the direct revenues earned by content creators.

News has more strategic than economic value for broadcast networks and content creators. In fact, it accounts for only about 2 percent of direct payments to creators (and rarely creates sustainable profits for networks). But it can help channels offer a full range of programming and, while it can take varying forms, some more premium (for example, investigative journalism) than others, it is generally not as expensive as sports and entertainment.

Entertainment programming drives the lion's share of network profitability; broadcast networks rely heavily on it (in the UK, for example, entertainment content accounts for 74 percent of all broadcast hours). And within the Subscription TV ecosystem, entertainment content accounts for the bulk of overall carriage fees distributors pay networks. But entertainment content also has a unique risk component: from idea to development to production, more shows fail than succeed, and even those that get on a network's schedule have just a 41 percent chance of making it to a second season. However, hits – the shows that run for multiple seasons – can be highly lucrative for a network and studio. The risk profile of entertainment content is also reflected in the level of the licensing fees of that content.

Changes, not disruptions – until now?

Clearly, the video content industry has seen great changes over the past half century. Yet the nature of these changes – in most markets, at least – has been evolutionary as opposed to disruptive. Players have adapted. With every new development, most players were able to gradually modify their strategies and business models in order to continue to be successful.

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However, the last few years have seen the emergence of several new trends that may lead to a greater degree of disruption. One of the most critical of these is the emergence of a third value chain: the online content ecosystem. Its appearance – and increasing embrace by consumers – has started to raise questions about whether the industry’s history of incremental change is likely to continue, or whether this time, the changes will be as disruptive as those experienced by the music, newspaper, and magazine industries.

There are key reasons to believe that this new value chain might create disruptive change. The online and mobile ecosystem supports new viewership patterns – particularly non-linear viewing, where content is watched “on demand,” and not according to a schedule fixed by a broadcast network. Moreover, online video does not require channels or other content aggregators (such as the emerging wave of online video aggregators, including YouTube and Netflix) to own or operate physical infrastructure – the cable networks, broadcast towers, or satellite fleets that have traditionally delivered content to consumers. Instead, video can travel over any broadband Internet connection.

Finally, the online landscape has led to significant changes in the advertising market. In the U.S. and the European Union, TV advertising spending is beginning to come under pressure as ad spending is following the shift of viewers into the online value chain. Historically, it has been the unique ability of FTA and big-event Subscription TV programming to deliver large audiences, which remain in high demand among marketers seeking to reach dedicated audiences at a specific point in time.

The question is: Will this scale advantage remain in place as mechanisms are developed by online video players to replicate that impact in the online video value chain?

PART 2: THE ELEMENTS OF CHANGE WITHIN THE TELEVISION INDUSTRY

Through all the changes the industry has experienced, the relationships among the different types of players were well defined.

Today, significant new trends – triggered by the emergence of the online ecosystem – raise the prospect that perhaps the industry’s history of incremental change will, in fact, be history. The music, newspaper, and magazine industries have already been disrupted by online pathways. Is television next?

Three key forces – all emerging and acting in unison – are driving the changes now being seen in the television industry:

1. Advances in technology.

Widely available high-speed networks – both fixed and mobile – have enabled consumers, en masse, to access video content independent of traditional infrastructure-based pathways. Programming now comes directly over the Internet to PCs, mobile devices, and most critically, televisions. The Internet now has the technical capability to deliver video content reliably, with high-quality results, on an enormous scale. By 2017, 74 percent of households in the European Union will have access to such “video ready” fixed broadband.

2. The increased availability of high-quality online content, including professionally produced television entertainment.

While user-created videos may have once been the mainstay of Internet-delivered content, today's lineup is largely professionally produced and includes new-release television shows as well as catalogs of past seasons. Even live TV is being made available over the Internet via services such as Sling TV and PlayStation Vue in the U.S. and Sky Go in the UK.

3. New models of original content creation

Emerging, too, are new low-cost production models for creating professional – and in the most successful cases, profitable – content for online channels. Assisted by a new breed of industry player, the Multichannel Network (MCN), content creators are challenging the long-held assumption that quality content is expensive to produce. While an episode of a top broadcast network series might attract 14 million or more viewers and cost up to \$5 million to produce, a top YouTube series might see an episode reach several million viewers yet cost well under \$50,000. And with the MCNs (whose ranks include the likes of Collective Digital Studios and Vevo) providing production and promotion support, the path to content creation has been simplified as well.

At the same time, the lines are blurring between content creators and aggregators. Companies such as Netflix and Amazon, both of which initially licensed the rights to distribute content, are commissioning their own high-quality, mass-market programming: TV series that in every way resemble the programming found on traditional broadcast networks.

These forces, in turn, are spurring the trends that are reshaping the industry today. Specifically, they have led to six key developments that, together, are leading to significant change in the structure and relationships that have long defined the video content business:

Online viewership is becoming significant – increasingly at the expense of FTA and Subscription TV viewership in several markets. While overall viewership is increasing, the growth in several markets is coming from online viewing – a pattern that is more pronounced among younger viewers. By 2020, the average global viewer is expected to watch 37 hours of “traditional” TV each week, essentially the same as the 38 hours watched in the early 2000s. But online viewing will have increased from a couple of hours a week to approximately 24 hours.

Viewing is undergoing a major shift to non-linear consumption. On-demand viewing – where viewers choose when to watch programming instead of being locked into a schedule set by a broadcast network – isn't a new concept. But the new online aggregators and VOD providers are making this a particularly compelling experience. By 2018, nearly half of all entertainment viewing in the U.S. is expected to be non-linear, and many European countries are quickly following.

Online value capture is beginning to follow viewers. Three primary business models have emerged within the online ecosystem: advertising-supported video on demand (viewers watch for free), transaction-based video on demand (viewers pay for individual units of content), and subscription-based video on demand (viewers pay a monthly fee

EXECUTIVE SUMMARY

to access a content library). While value capture is still in its early stages, all three of these models are expected to experience significant growth.

The profile of valuable content is changing.

With online pathways, there are now more ways than ever to access content. With nonlinear viewing, there is now more flexibility in when that content is viewed. Together, these factors are having an impact on what content is considered valuable. Top-tier entertainment – for example, live events and original scripted and unscripted programs – and compelling niche content have gained an audience; second-tier “filler” content – for example, entertainment reruns that fill time slots in a linear world – is seeing its audience erode.

The distribution of value across the supply chain is relatively stable, but it is slowly shifting to content creators.

While the industry’s value – the sum of the subscription fees, advertising revenues, and so on – continues to grow, we are starting to see a shift in how it is being divided. Content creators and rights holders are the beneficiaries here at the expense of broadcast networks and distributors. This is not surprising, perhaps, given the many new players on the scene competing with traditional players for the most in-demand content.

Key industry players are diversifying their business portfolios as they seek to get ahead of shifting control points.

Already, there are signs that in the emerging content landscape, some players may be able to structure profitable businesses without relying on their traditional partners. As a result, we are seeing the beginning of a battle for key content assets along the value chain – a battle reflecting a “make or buy” dilemma in view of spiraling content-licensing costs. Online aggre-

gators and infrastructure-based distributors are expanding into content creation, whether by commissioning original programming or acquiring their own production capabilities. Meanwhile, content creators, FTA and Subscription TV channels, and distributors are expanding into online via internal development or external acquisitions. For many of these players, the rationale for these moves is simple: to improve the access to content (and improve the terms of its acquisition) and to stay relevant in an increasingly online-centric world.

These trends are already having some initial implications. But this is just the beginning. The current trends are not static and they will continue to develop. And if the changes they spark do prove increasingly disruptive to the structure and business models of the industry, what will that mean?

PART 3: SCENARIOS FOR INDUSTRY EVOLUTION

With so many significant and simultaneous changes taking place, it is impossible to predict their ultimate impact, but we believe that no single industry structure will emerge across markets. Instead, in looking at the current trends and the spectrum of outcomes, we believe that five scenarios in particular are possible and that most markets will in fact be a blend of two or three of them (depending on factors specific to each market). Each of these scenarios will have its own implications for players along the content value chain – and for the strategic value of content itself.

Scenario 1: gradual evolution within the current industry structure.

This scenario represents the base case: the industry continues to evolve in a natural and gradual process. Nonlinear viewing continues to grow, but cord cutting is limited; most consumers will use online services in addition to – not in place of – their existing TV service. For this to happen, incumbents will need to home in on ways they can take advantage of the new distribution pathways. But in gradual evolutions of the past, this is exactly what incumbents did: make adjustments in order to remain healthy and maintain their relevance within the value chain.

Under this scenario, the growing array of viewing opportunities will increase the downstream value of desirable content (such as the serialized dramas that work so well in a non-linear world). This will boost the importance – and the bargaining power – of those that create or hold the rights to that content. Infrastructure-based distributors, on the other hand, will be impacted by the cord cutting that does occur. And because of multiplatform competition, their infrastructure may not be quite the crucial content asset it once was. But initiatives such as TV Everywhere, which lets consumers access subscription content across multiple platforms and devices, will help them remain attractive partners for content creators, broadcast networks, and aggregators, who – now more than ever – will want to make their content seamlessly and broadly accessible.

Scenario 2: disruption driven by the rise of multiplatform navigation.

Historically, the key mechanism for content discovery has been the electronic program guide. These guides, however, have been and remain

platform-dependent. A Subscription TV guide, for example, generally does not direct users to online content. More recently, social recommendations and referrals have also played a role in the discovery of content, but this is an incremental evolution rather than a wholesale change in the way consumers find content.

The opportunity is clear – consumers watch content from far more sources than ever before, but there hasn't been a single platform to offer full navigation and curation of that content. As some traditional infrastructure-based distributors invest in extending their navigation into the online ecosystem – covering content they provide through the traditional set-top box as well as content they don't – they are attempting to deliver a single interface through which to access all of the programming that interests them (and access all of their subscriptions as well). The traditional distributors would remain consumers' "front door" to video content.

Distributors who can make this transition will be well positioned to preserve their standing as the primary gateway to content. They will likely gain a strong position, too, in their negotiations with networks on carriage fees. Content creators and rights holders also stand to benefit, since their content will now be easier to find and access. But online content aggregators may see their power diminish. Traditional distributors will now have the primary relationships with viewers as well as visibility into their cross-platform viewing behavior. This could give them a significant competitive advantage over online-only rivals.

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Scenario 3: disruption driven by exclusive entertainment content.

In this scenario, both traditional distributors and online aggregators invest in exclusive sports and entertainment content. Under this strategy, they utilize high-profile content available only via their service to differentiate themselves and drive customer acquisition. Already, infrastructure-based distributors, such as British Telecom and DirecTV, have made high-profile deals with sports leagues to carry exclusive content. And online aggregators, such as Amazon and Netflix, are increasingly creating their own original programming.

Clearly, this scenario will have a positive impact on the owners of sports and entertainment content. With distributors and online aggregators battling for exclusive content – and competing, too, with other players who want it – the prices for top content will rise. For smaller distributors and aggregators, this doesn't bode well: if they can't afford enough exclusive content, they risk losing market share. But for larger players, the benefits – if they invest in content wisely – can greatly outweigh the costs, increasing their subscribers, and with them, their importance in the value chain and their bargaining power with networks.

Scenario 4: disruption driven by direct-to-consumer strategies of content creators and broadcast networks.

One of the key characteristics of the online ecosystem is that traditional delivery pathways – terrestrial, cable, and satellite – are no longer necessary to get content to viewers. In this fourth scenario, content creators and broadcast networks take advantage of that fact and deliver their programming directly to consumers via the Internet, bypassing infrastructure-based distributors. Doing so, however, isn't without risks. Among other things,

these players will no longer have certainty about revenues, and viewer acquisition efforts will add to their costs. Then there is the matter of investing in Internet connectivity for reliably delivering video content – critical since that content will no longer be delivered by traditional distributors. Yet for those who do take this route, there may be an opportunity to capture more value from their viewers, as content-related revenues will not need to be shared with distributors.

If this scenario succeeds and enough content creators and broadcast networks can deliver their own content, the impact could be severe for traditional distributors. They would likely see cord cutting accelerate and their importance in the value chain diminish. Online aggregators will likely lose subscribers, as well, since users may be able to cherry-pick enough direct-to-consumer offerings to make their services unnecessary. Yet even for content creators and networks, the impact of this scenario will vary. Those that have enough strong content and a strong brand – the HBOs – will have the best chance for success. Those that don't will struggle with this model, having to invest too much to attract viewers or having insufficient content with which to woo and retain them.

Scenario 5: disruption driven by online content aggregators moving into linear streaming of broadcast networks.

Even as online viewing has gained traction, traditional distributors have enjoyed one key advantage: live television. Many viewers who would otherwise cut the cord don't, because despite all of the original series and past TV seasons they can stream online, consumers' desire to watch live programming (whether the premiere of a new TV episode, a newscast, or a sporting event) remains robust. In this final scenario, leading online aggregators flip

that advantage by licensing network content from key FTA and Subscription TV channels and combining it with their own nonlinear offerings to offer the best of both worlds.

If online aggregators succeed in this endeavor, they could potentially replace traditional distributors in the content value chain (hence, this is the worst case scenario for infrastructure-based players, especially those without strong broadband or nonvideo businesses). Smaller online aggregators, however, will be less likely to play this game, and they run the risk of disintermediation, too.

Market-specific factors will play a key role in the likelihood of these scenarios. The more mature video markets, such as Germany and the UK, where broadband is readily available and non-linear viewing already has become popular, are much more likely to see direct-to-consumer offerings and disruption from online aggregators. Yet markets where online video capabilities are less developed and consumers are still largely watching linear TV are a quite different story. They provide traditional players with an opportunity to proactively shape the market, and solidify their own standing, by pursuing a navigation or exclusive content advantage.

PART 4: IMPLICATIONS FOR KEY INDUSTRY PARTICIPANTS

For industry participants, the crucial task is to consider what these potential scenarios mean for their path forward. What steps can they take to help spur the most favorable scenarios? What actions should they be taking to prepare for possible future outcomes? While the answers will vary, we see a specific set of implications – and responses – relevant for each type of content player.

Sports rights holders that own “must have” content of high strategic importance across all scenarios will continue to be in an advantaged position. The value of their rights will almost certainly increase, even dramatically. That same content, moreover, may enable them to create their own compelling direct-to-consumer offerings. They should continue to put their increased bargaining position to work, mining incremental value from their rights negotiations and splitting these rights across formats and pathways.

Entertainment content creators and rights holders will also be in a strong position, and those with a critical mass of in-demand content – and strong brands – have the potential for generating added value through direct-to-consumer offerings. Even without taking that path, however, the growing array of distribution pathways will increase “windowing” opportunities, where rights are split across platforms, geographies, and time periods, maximizing the value generated by a single unit of content.

EXECUTIVE SUMMARY

FTA broadcast networks are already competing on the basis of hit content – a dynamic that will serve them well in all scenarios. Yet in a nonlinear world, a key advantage that these players have – the ability to use a highly rated series or sports event to generate awareness and viewership of other programming – will decrease. This makes it important to embrace that nonlinear world and develop online products and services that maximize the reach of their content (as many FTA networks have already done, for example, by making content available on iTunes, Hulu, and TV Everywhere apps).

Subscription TV broadcast networks tend to be much more content- and genre-focused than FTA networks, and among them, brand and content strength vary widely. Those with strong content and brands are well positioned for pursuing direct-to-consumer offerings. A savvy approach is to develop these in parallel with more traditional partnerships with infrastructure-based distributors and online-only aggregators. All of the scenarios, however, present a less promising outlook for channels that provide “second tier” content – the programming that either does not have mass appeal yet or does not draw a dedicated niche audience. Unless these players can tweak their programming mix, they almost certainly face declines in viewership, advertising revenues, and carriage fees.

Infrastructure-based distributors that have well-developed video and broadband infrastructure will be well positioned going forward. They have the customer relationships and navigation experience that can help them develop – and differentiate – via multipathway content curating (creating the entire video experience through their “front door”). Larger players – with their larger budgets – will also be in the best position to differentiate via exclusive content. Smaller providers that lack the scale to build integrated navigation layers and the budgets to buy sufficient exclusive content will need to expand their capabilities. That won’t be easy, but smartly crafted partnerships, mergers, and investments can help.

Online content aggregators, some of whom are already thriving, face a strategic choice: protect their position in nonlinear viewing or directly attack traditional distributors by licensing linear content. The optimal path will depend on several factors: their competitive position and financial strength, the status of the infrastructure-based providers in their market (household penetration, network quality, level of customer satisfaction, and market power), and regulatory frameworks. Online aggregators face tactical choices, as well: Do they pursue subscription-based or advertising-based models – or a combination of the two? There is still much debate – and much to be resolved – about which is the best approach. In the meantime, aggregators should keep a close eye on how the various models perform. They should think, too, about whether – and how – to expand internationally.

Up until now, the history of the television industry has been one of steady evolution. But its future – to some degree, at least – is more likely to be revolutionary. Along the value content chain, roles and relationships will change. And to stay relevant – and continue to thrive – industry participants will need to change, too, often in fundamental and unfamiliar ways. Tweaks and adjustments aren't going to cut it anymore. But one thing is certain: content will be at the center of where the industry goes from here. And those who own and control the content will help steer the direction.





part 1

THE ROLE OF CONTENT IN THE CURRENT TELEVISION INDUSTRY

THE ROLE OF CONTENT

THE ROLE OF CONTENT IN THE CURRENT TELEVISION INDUSTRY

Almost since its inception, the television industry has seen continuous technology-driven change. Content that was primarily distributed live and over the airwaves would, in a steady stream of developments, be captured on film, videotape, and digital media and be delivered via a growing number of platforms: cable, satellite, the IPTV services of telecom operators, and more recently, online. Content came to look differently, too. Initially, shows were in black and white, then in color, then in high definition and even 3-D, and now, with the emergence of new standards such as 4K, in ultra high definition.

Along the way, new players came on the scene, as did new content value chains – ecosystems for getting programming to viewers. The original public and commercial free to air (FTA) model was joined by Subscription TV and now is being joined by online video. The new pathways brought more content to more viewers. They spurred innovation. And they brought increased competition to every stage of the business.

Yet even with all of these changes, the core structure and nature of the industry hasn't changed all that much. Content creators and rights holders provide content to broadcast networks that, in turn, get it to consumers through distributors (traditionally, infrastructure-based providers such as cable and satellite providers). Although the relationships among content producers, rights holders, and broadcast networks are changing, the general dynamic has held constant even as the number

and types of value chains have grown. So, too, has another key characteristic of the industry: content rights and related production have been at the core of value creation – and the center of a complex series of relationships among the different elements of the value chains.

Each of those elements – content creators and rights holders, broadcast networks, and the aggregators and distributors that deliver content to consumers – has remained more or less focused on its key role in the chain. Indeed, outside of publicly funded broadcasters, examples of integration across roles have traditionally been rare. And each type of player has, in general, thrived as the industry has evolved, driving growth in revenue, earnings, and value.

The question is this: Will this still be the case in the future?

It is a question many in the industry are – or should be – asking. The emergence of the online value chain, of nonlinear (or “on demand”) viewing patterns across large segments of consumers, and of new approaches to content creation with new players and business models holds the potential for triggering significant changes. This time, the scale of the changes may be such that they do prove disruptive to the historical evolution of the industry.

Already, some broadcast networks are starting to break free of downstream distribution partners and deliver their programming directly to consumers. Some content creators and rights holders, meanwhile, are starting to bypass their network partners and also go direct to consumers – or even create their own channels. Aggregators and distributors – companies that traditionally relied on other elements of the chain for their content offerings – are increasingly investing in content creation. And then there are the big-footed players from outside the television ecosystem: companies such as Apple, Amazon, and Google are starting to enter this business with objectives that may not be aligned with the traditional flow of value.

These trends and their potential implications will be explored in detail in this report. In this first part, our objective is to establish the context for examining the current trends and what their future (and indeed, in some cases, very near future) impact may be. We do this by describing the industry as it evolved into its current state, how it has been defined by roles and relationships that have taken form over the past half century, and how the role of content in shaping industry structure and value has developed along the way.

Two traditional ecosystems

At its start, the television industry had a single “free TV” value chain. Under the FTA model, content was broadcast over the airwaves in unencrypted (or “in the clear”) form and revenue was derived either from advertising (in the U.S.) or from public tax levies (in many European markets).

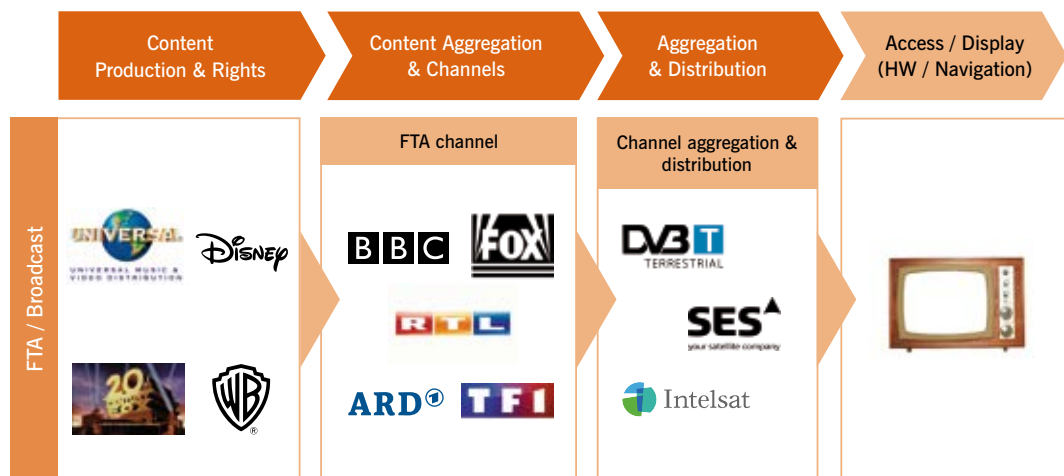
The FTA model operated under a structure that is still in place in today’s television industry – a structure defined by the roles the different players at the different stages of the value chain played. In the U.S., content was created primarily by independent studios – postfinancial interest and syndication rules – that licensed their content to broadcast networks that, in turn, distributed their analog video stream through local TV stations. All three key elements of this value chain ran as independent businesses, with successful value capture at each stage.

In the European Union, the model was similar, but it had a few differences driven by the regulatory environment and the role of governments. In these markets, funding for much content stemmed from government tax levies, which supported quasi-public content production entities that were integrated into broadcast networks – such as the BBC and ITV in the UK, ARD and ZDF in Germany, and TF1 in France. Unlike their U.S.-based counterparts, FTA channels in the European Union were distributed by third-party infrastructure providers, whose broadcast repeaters operated on a pure services basis, with revenue coming from fees paid by the FTA channels.

The FTA model had the television landscape to itself until the 1980s (in the U.S.) and 1990s (in the European Union), when the Subscription TV value chain emerged as an alternative. A new distribution infrastructure – beginning with cable and evolving to include telecom IPTV and direct-to-consumer satellite – now enabled the delivery of multiple channels through a single service: initially dozens of channels and eventually hundreds.

THE ROLE OF CONTENT

Exhibit 1.1 FTA VALUE CHAIN



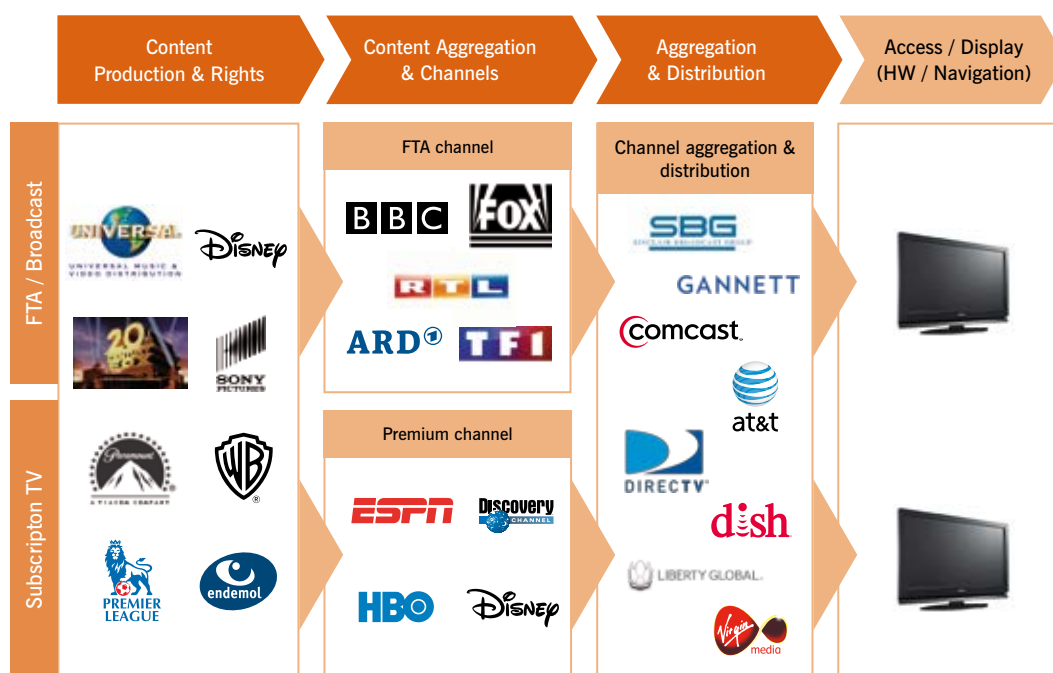
Within the Subscription TV ecosystem, the roles of the players largely mirrored the FTA model. Creators and rights holders licensed their content to broadcast networks that, in turn, programmed and delivered the content to cable-, satellite-, or IPTV-based distributors such as Comcast and DirecTV in the U.S.; CLTUFA in multiple European countries; Kabel Deutschland, Unitymedia, KabelBW, and other regional cable providers in Germany; and Ziggo in the Netherlands. As in the FTA model, revenue for content creators came from either tax levies (when the content was carried by public broadcasters) or commercial broadcast networks. The broadcast networks, in turn, derived revenue from advertising and from carriage fees they received from distributors. To generate their own

revenue, the distributors sold subscriptions to consumers, earning monthly fees in return for access to the channels they bundled and delivered.

Yet even if the basic structures of the value chains were similar, changes were afoot. The development of a richer multichannel environment spurred both competition and innovation. New content creators emerged to serve the larger number of channels that could be distributed over these new platforms. New broadcast networks emerged with new business models. In the European Union, Subscription TV accelerated the development of commercial, advertising-supported channels – independent entities that weren't owned or funded by the government. New premium subscription

THE FULL VIEW OF THE TWO VALUE CHAINS: FTA AND SUBSCRIPTION TV

Exhibit 1.2



channels, such as HBO in the U.S., Premiere in Germany, Canal+ in France, and BSkyB in the UK, emerged as direct consumer-pay services on top of government-funded and commercial broadcast networks.

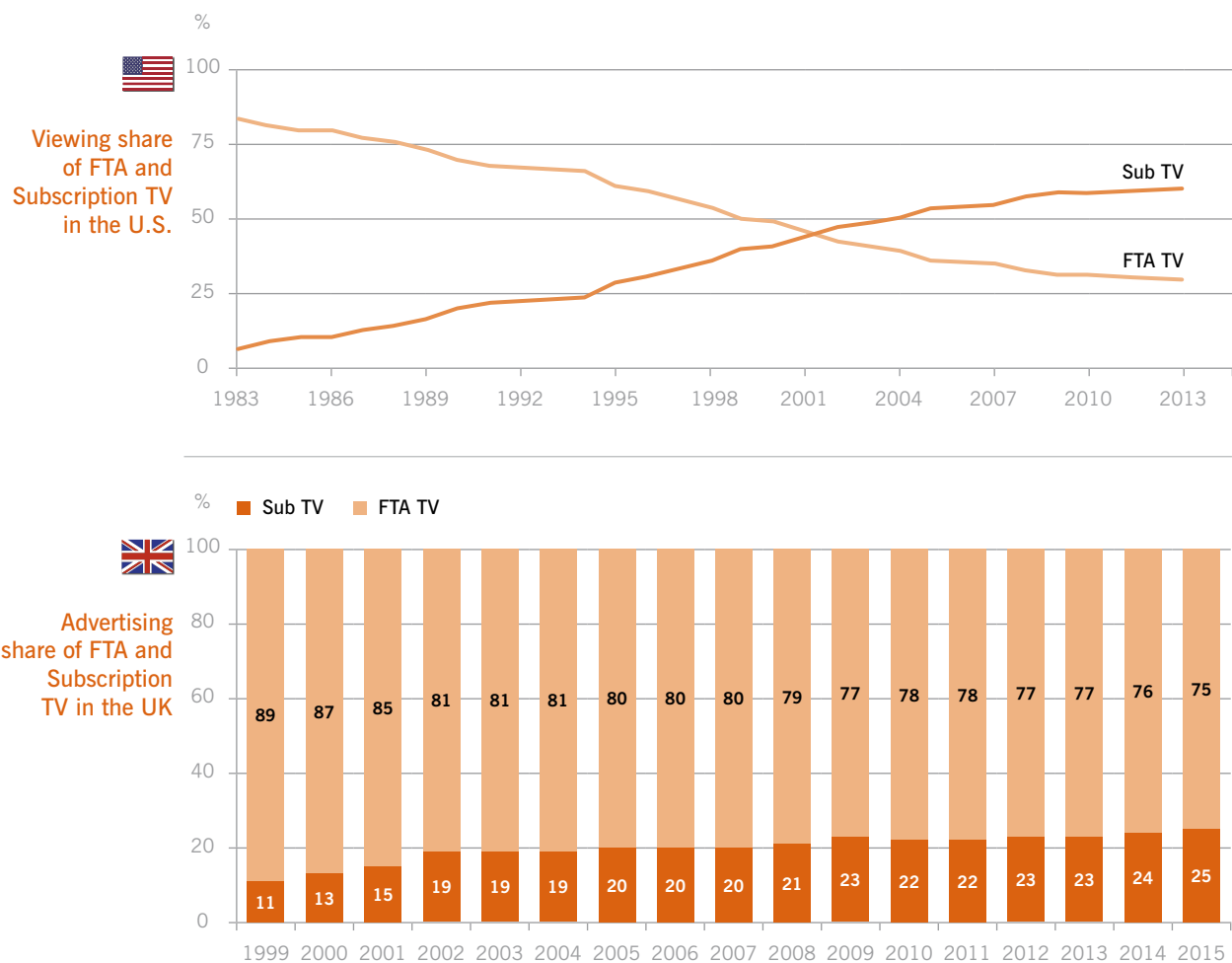
As the Subscription TV ecosystem innovated and grew, one might think its rise would mean a fall for the FTA value chain. But as competition increased and new business models gained traction, every element of both value chains – FTA

and Subscription TV alike – thrived and grew. To be sure, new Subscription TV services did capture a large share of viewing and advertising revenue. Whereas once – when FTA was the only player in town – 100 percent of households with televisions watched FTA channels, over time, most markets saw Subscription TV take between a 20 and 70 percent share of viewing and advertising revenue.

THE ROLE OF CONTENT

Exhibit 1.3

SUBSCRIPTION TV WAS FORMERLY A NEW ECOSYSTEM, THAT EVOLVED TO CREATE INCREMENTAL VALUE AND STEAL SHARE FROM INCUMBENTS



Source: SNL Kagan; Magna Global

However, with so many channels now available, presenting so many more “viewing opportunities,” the time individuals spent watching TV increased. Combined with a growing consumer economy in the U.S. and European Union, this spurred rising

revenue in both value chains – with subscription dollars burgeoning – translating to expanding revenue, profit, and enterprise value for players at each stage of each chain.

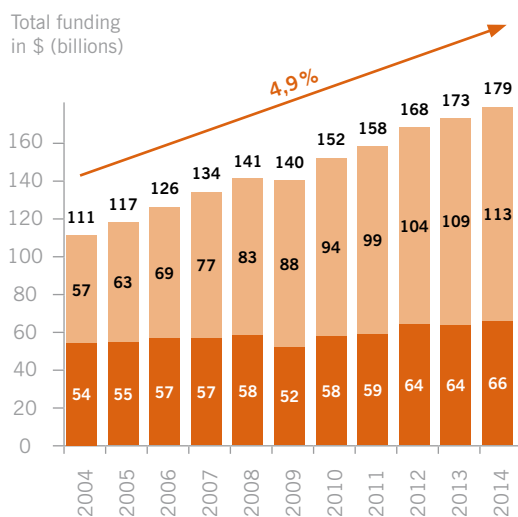
MATURITY OF AD AND SUBSCRIPTION REVENUES OVER TIME IN THE U.S. AND EUROPE

Exhibit 1.4



U.S. growing at 4,9% p.a.

Subscriptions Advertisment

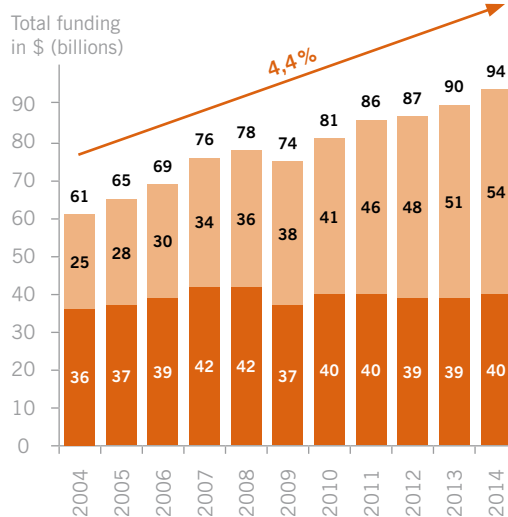


CAGR '04-'14 7% 2,1%



Europe growing at 4,4% p.a.

Subscriptions Advertisment



CAGR '04-'14 7,8% 1,3%

Source: SNL Kagan 2015, MAGNA Global 2015, iDate

THE ROLE OF CONTENT

Different markets, different rates of evolution

Within these overall trends, the television industry developed differently in different markets and is still at various stages of development today.

Subscription TV penetration – the percentage of households that have any kind of TV subscription, from basic cable with hundreds of FTA channels to

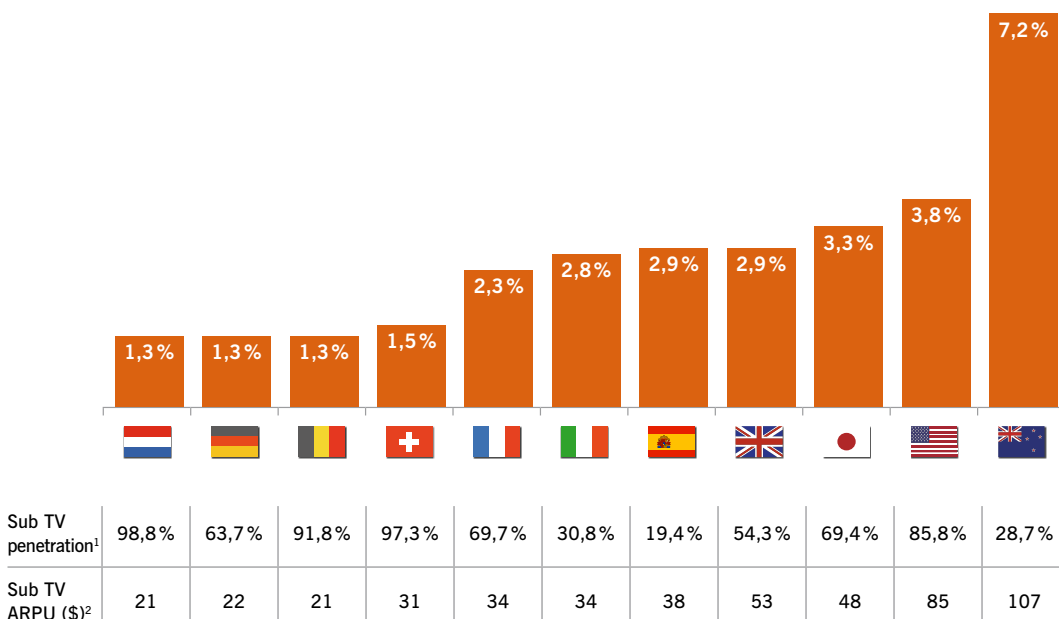
fee-based premium channels – varies widely across the world. In Switzerland, for example, more than 97 percent of households with televisions held TV subscriptions in 2014. Yet in Spain, just over 19 percent did. Subscription TV spending can differ greatly from region to region as well. While it accounted for 7.2 percent of median household disposable income in Australia in 2014, the figure was just 1.3 percent in the Netherlands.

Exhibit 1.5

SUBSCRIPTION TV SPEND VARIES IN A LARGE SPECTRUM ACROSS THE WORLD



Share of Subscription TV spend of median household disposable income across geographies



Note: 2014 figures; Household income adjusted for purchasing power parity; PayTV refers to basic access and premium payTV subscriptions
 1. Penetration of PayTV HH in total TV HH per country; 2. Among payTV subscribers in the country; nominal USD
 Source: iDate, 2014, OECD, Luxembourg Income Study

Viewing habits also vary – significantly – across geographies. In Switzerland, the average viewer spent 152 minutes per day watching television in 2012; in Italy, viewers averaged 257 minutes; and viewers in the U.S. watched even more: an average of 283 minutes a day.

A look across geographies further highlights how around the world, the television industry is at different stages of evolution. Emerging regions such as Latin America and the Middle East are growing the fastest, while in the European Union, the pace is decidedly slower. Meanwhile, North America remains the largest television market – and with nearly 40 percent of total global funding, it should hold onto that title for yet some time.

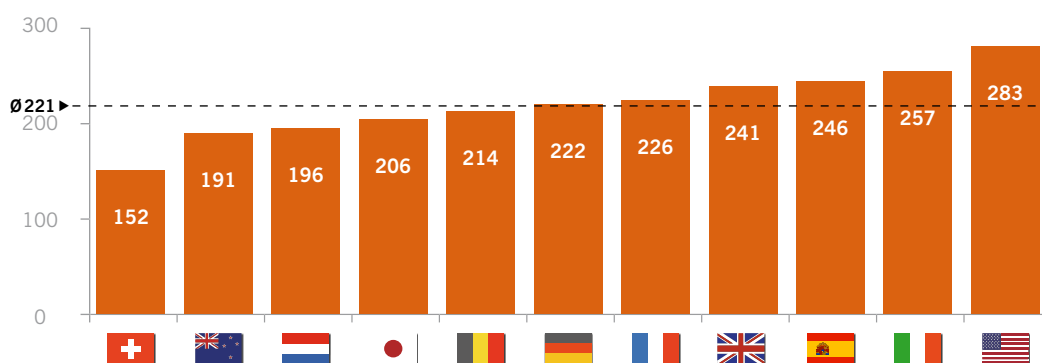
LINEAR TV VIEWING VARIES ACROSS THE GLOBE

Exhibit 1.6



Linear TV viewing across geographies, excluding online/mobile

Minutes/person
per day



Note: Figures on actual viewing in 2012
Source: iDate, 2014

THE ROLE OF CONTENT

The value of content: Two-thirds of the \$500 billion global TV market – and growing

Content creation and aggregation have played key roles in both the FTA and Subscription TV value chains – and in their economics. Globally, subscription fees, advertising revenue, and public funding amounted to \$530 billion in 2014 – more than the gross domestic product of Norway, Austria, or Taiwan. More fundamentally, approximately two-thirds of that total was directly tied to content:

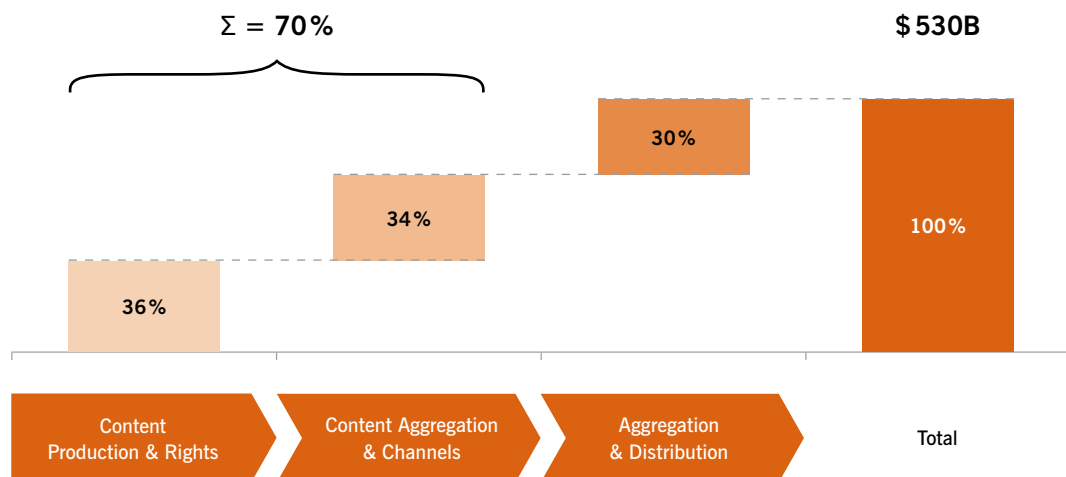
36 percent went to content creators and rights holders and 34 percent to FTA and Subscription TV networks (the remaining 30 percent was paid directly to distributors for content access and navigation).

While regional differences can be significant, the overall balance is clear. In most markets around the world, content creation and curation – taking individual units of entertainment, news, and sports content and aggregating them in TV channels – drive the bulk of the industry's revenue.

Exhibit 1.7 **70% OF INDUSTRY VALUE FALLS IN CONTENT**



Share of overall industry value add in %



Source: BCG analysis

The strategic role of content in the value chain

In all markets, content has played a crucial role in defining industry structure and creating value. Over time, this has led to a complex set of interdependent and complementary approaches to monetizing content across the value chain. To understand this fully, however, we need to go a level deeper and look at the different genres of content, as each triggers a unique set of roles within the industry and different underlying economics.

This might seem like a formidable task; after all, video programming comes in many forms, from the police procedural to the reality TV show to the championship tennis match. But in fact, all of these forms fit broadly into one of three content archetypes: sports, news, and entertainment. The characteristics of these genres – and more important, their strategic impact – differ in quite significant ways.

WITHIN ECOSYSTEM, WIDE VARIETY OF CONTENT FITS THREE MAIN GENRES

Exhibit 1.8

Wide variety of content types...

Sport

- Live events
- Studio programming
- Documentaries
- ...

News

- Breaking news
- Magazine style
-

Scripted entertainment

- Film
- Serialized drama
- Procedurals
- Comedy
- ...

Reality

- Shows
- Events
- ...

...which can be grouped in three main archetypes with distinct characteristics



News

- Captive produced time filler
- Limited cost burden, but also limited profit potential

Share of cost¹

3 %

Share of viewing¹

10 %



Sports

- Huge differentiator for networks/aggregators; explains imbalance between cost/viewership
- Leverage/control with rights holders

60 %

16 %



Entertainment

- Largest share of viewing and value
- Emergence of new buyers and time-shifted viewing moving power upstream to content producers

37 %

74 %

■ % of viewing
■ % of cost

1. Representative of the UK
Source: Ofcom, SNL Kagan, BCG Analysis

THE ROLE OF CONTENT

SPORTS

» *Key Characteristics.* Sports accounts for just 15 percent of all viewing but a far larger share of broadcast network programming cost. The most popular sports events are “must-see” marquee content that can reliably be depended on to draw an outsize audience (even viewers who don’t follow the sport watch because everyone else will be watching and talking about it afterwards). Not surprisingly, sports content has been used strategically by both broadcast networks and distributors – in both the FTA and Subscription TV value chains – as a key mechanism for driving market share and building the brand. Moreover, because sports – unlike sitcoms and dramatic programming – is almost always viewed live, the top events are extremely attractive to advertisers, since there are few other ways to reach such a broad audience in one fell swoop.

» *Role Within the Value Chain.* Rights holders sell FTA and Subscription TV channels – and increasingly, distributors and pure-play digital services – the right to air games. Typically these are sold at premium prices, often exceeding the direct revenue – from advertising, carriage fees, and consumer payments – associated with sports programming. Those that acquire the rights produce their own broadcasts of the games, usually through in-house production units.

» *Impact on the Balance of Power.* Sports represents “killer content.” Broadcast networks and distributors will often use it as a “loss leader” because its unique ability to garner live viewership – and its halo effect on subscriber acquisition and retention – can drive audience exposure to additional programming. Indeed, over the years, sports content has been used strategically, and successfully, to build or renew franchises. Examples include Fox Network’s acquisition of NFL rights to help establish Fox in the U.S. and DirecTV’s acquisition of NFL out-of-market game rights to drive consumer subscriptions. The multisided benefits sports can deliver have led to its premium pricing. But it is a price programmers are willing to pay.

NEWS

» *Key Characteristics.* News content has rarely created substantial profits for broadcast networks and represents only about 2 percent of direct payments to content creators. News does take varying forms, of course, with some more premium iterations – for example, investigative journalism – than others. But on a relative basis, it is far more inexpensive than sports and entertainment. It also serves both regulatory and strategic purposes; for example, by helping the broadcast networks offer a full range of content offerings.

» *Role Within the Value Chain.* Generally, broadcast networks that provide news services to consumers produce their programming in-house. So there are few third-party content costs associated with news. As a result, it is not a meaningful genre to independent studios and the content creation industry; it also represents the smallest portion of content creation costs. For instance, in the UK, news accounts for 10 percent of broadcast hours but only 3 percent of content spending.

» *Impact on the Balance of Power.* While news provides limited direct economic value to the broadcast networks that create it, it plays several important strategic roles. In many markets, networks have a public service obligation, which they can meet by providing news. And by rounding out their range of content services, news helps some channels become a one-stop destination for viewers, driving engagement and loyalty. Yet with the advent of 24-hour news-only channels, and the increasing ubiquity of digitally distributed video-news sources, both the regulatory and consumer drivers for news content are beginning to decline in many markets.

ENTERTAINMENT

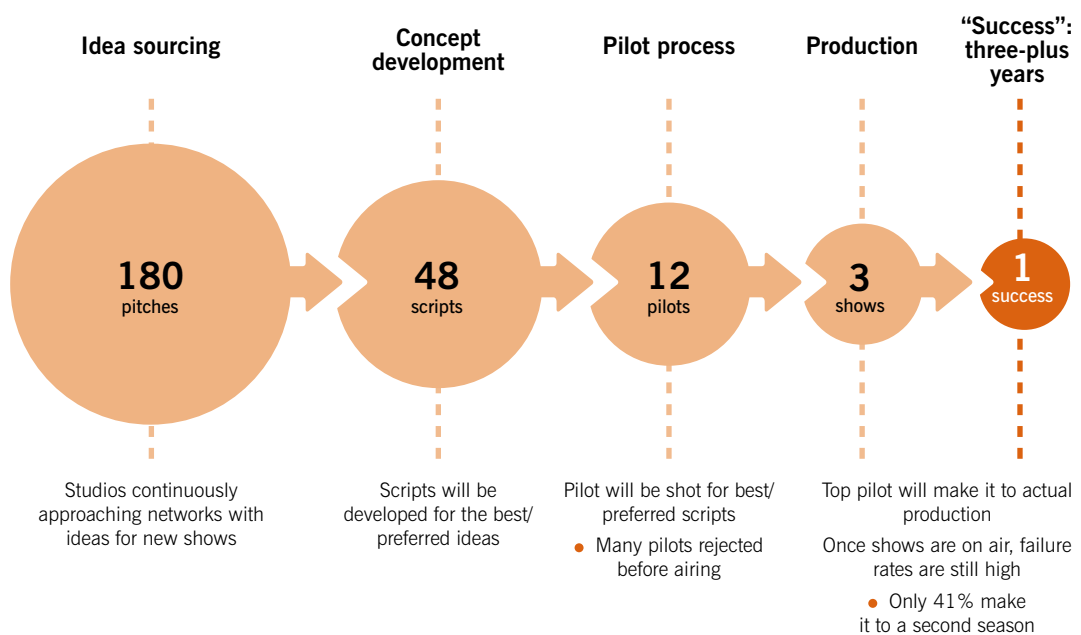
» *Key Characteristics.* Entertainment programming – most of which has traditionally been created by independent content creators or the internal production arms of public broadcasters (such as the BBC) – has three key characteristics: it is responsible for differences in viewership (which help broadcast networks differentiate themselves); it drives the lion's share of broadcast network profitability; and it drives the bulk of carriage fee increases paid by distributors to broadcast networks in the Subscription TV value chain (while the fees paid to individual sports channels may be greater than those paid to individual entertainment channels, the sheer number of the latter makes this genre a larger contributor to overall carriage costs).

Entertainment also has a unique risk component – one that sports and news do not share. From idea sourcing to concept development to on-air pilots to production, there is more failure than success. And even the shows that make it into production have a high failure rate. Just 41 percent of series make it to a second season, and fewer still will run for three seasons – the point at which a show is generally considered a hit. Indeed, the “hit rates” of major U.S. content creators (such as ABC Studios, Fox Studios, and Sony) are less than 10 percent post pilot.

THE ROLE OF CONTENT

Exhibit 1.9

ENTERTAINMENT PRODUCTION: A LONG AND COSTLY JOURNEY LEADS TO A SUCCESSFUL SHOW



Source:BCG Analysis

» *Role Within the Value Chain.* Entertainment is the key driver of profitability for broadcast networks, typically accounting for the lion's share of earnings. Not surprisingly, networks have come to rely heavily on the genre. In the UK, for example, entertainment programming accounts for 74 percent of all broadcast hours. As a result, it is the key source of negotiations along the value chain. Successful studios, actors, and producers command

significant premiums – particularly once a show is successful – from broadcast networks that need top-rated programming to attract large audiences. In the Subscription TV model, the networks then pass these costs on to distributors in the form of increased carriage fees. This is a key reason why in most markets around the world, the content creation industry is both independent and highly fragmented, with intermediaries – such as Creative Artists Agency, ICM Partners, and William Morris Endeavor – auctioning access to key content-creation talent and organizations.

» *Impact on the Balance of Power.* With entertainment, the power dynamics are complicated. Given the high uncertainty surrounding a show or idea in its early stages of development, content creators are often at the mercy of the broadcast networks that fund that development. Once a show is successful, however, the balance of power shifts, frequently to the individual actors, writers, and producers who can hold the show up for ransom to the broadcast networks. The broadcast networks, in turn, exploit the strong viewership position a mix of successful shows gives them – larger audiences and market share – to win richer fees from both advertisers and the distributors that carry their shows and to cross promote other programming on their channels. And the studios, of course, turn a significant profit licensing the show in the downstream syndication market to buyers across all three value chains.

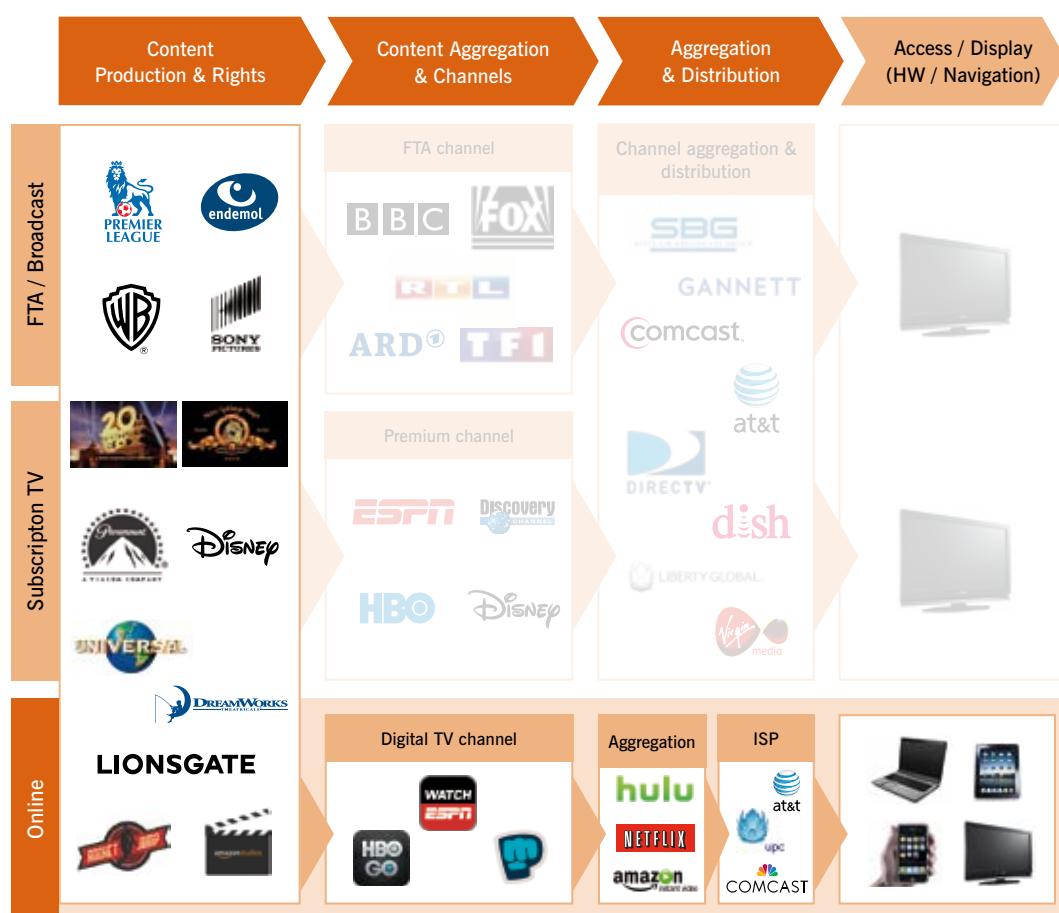
Changes, not disruptions – until now?

Clearly, the video content industry has seen great changes over the past half century. Yet the nature of these changes – in most markets, at least – has been evolutionary as opposed to disruptive. Players have adapted. With every new development, most incumbents were able to gradually modify their strategies and business models in order to continue to be successful.

However, the past few years have seen the emergence of several new trends that may lead to a greater degree of disruption. One of the most critical of these is the development of an emergent third value chain: the online video-content ecosystem. Its appearance – and increasing embrace by consumers – has started to raise questions about whether the industry's history of incremental change is likely to continue or whether this time the changes will be as disruptive as those experienced by the music, newspaper, and magazine industries.

Exhibit 1.10

THERE ARE NOW THREE INDUSTRY VALUE CHAINS: FTA, SUBSCRIPTION AND THE EMERGING ONLINE VALUE CHAIN



On the surface, the online value chain has much in common with key aspects of the traditional FTA and Subscription TV value chains. It is comprised of the same major elements: content creators and rights holders, broadcast networks, and distributors. And it is supported by both advertising revenue and consumer subscriptions.

Yet there are key reasons to believe that this new value chain might create disruptive change. The online ecosystem supports new viewership patterns – particularly nonlinear viewing, where content is watched on demand, and not according to a schedule fixed by a broadcast network or distributor. Moreover, online video does not require networks or distributors to own or

operate the physical infrastructure – cable lines, broadcast towers, or satellite fleets – that has traditionally delivered content to consumers. Instead, video can travel over any broadband Internet connection.

The trends that online video are sparking are the focus of Part 2 of this report. Understanding them is essential, because in doing so, we can better understand where the video content business is headed and what the future may hold both for consumers and for the industry's players. But already these trends have shined a spotlight on one thing: the role of content as a key strategic variable in the ways the industry may change.



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part 2

THE ELEMENTS OF
CHANGE WITHIN
THE TELEVISION
INDUSTRY

WITHIN THE TELEVISION INDUSTRY

THE ELEMENTS OF CHANGE

THE ELEMENTS OF CHANGE WITHIN THE TELEVISION INDUSTRY

Several key forces are beginning to change the nature of the television industry. These include the emergence of new high-speed digital pathways and related video-enabled devices, the increasing availability of traditional television programming through these pathways, and the development of new lower-cost models for the creation of professionally produced content – content that in the most successful cases is drawing mass audiences.

In turn, these changes have led to several significant trends that are changing industry dynamics and beginning to have an impact on traditional players and roles – as well as leading to new “attacker models.”

In this part, we discuss these three key forces, the trends they are spurring and the impact they are having on traditional players, and the initial responses we are seeing.

The major forces at work

Like a perfect storm, three key forces are simultaneously driving change in the TV industry.

Advances in technology. The emergence of broadly available high-speed fixed and mobile broadband is enabling large numbers of consumers to access video independent of traditional infrastructure-based pathways – on mobile devices, PCs, and potentially most important, TV sets.

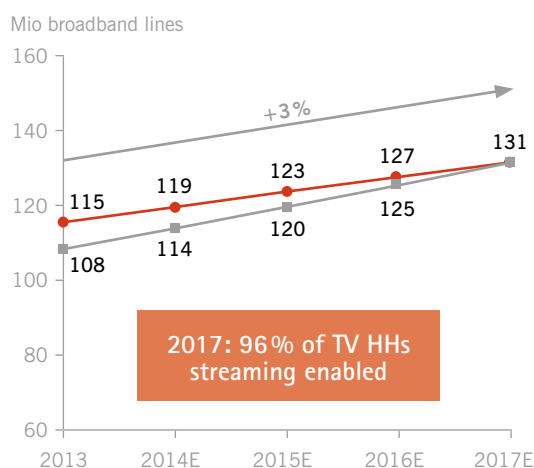
IP networks – the backbone of the Internet – have long had the *technical* capability to deliver video content to consumers. What they lacked was the ability to do so *well*, without the delays and fuzzy images that frustrated viewers. The emergence of a streaming-ready IP infrastructure along with advancements in video compression technology – capable of reliably delivering high-quality video – has changed that. By 2017, 74 percent of TV households in the European Union will have access to high-enough-quality fixed broadband (in the U.S., almost all households – some 96 percent – will). At the same time, Wi-Fi hotspots and high-speed LTE mobile networks are proliferating, with deployments increasing at a rapid rate.

STREAMING-READY FIXED BROADBAND INFRASTRUCTURE IS IN PLACE TO SUPPORT ONLINE VIDEO DEMAND

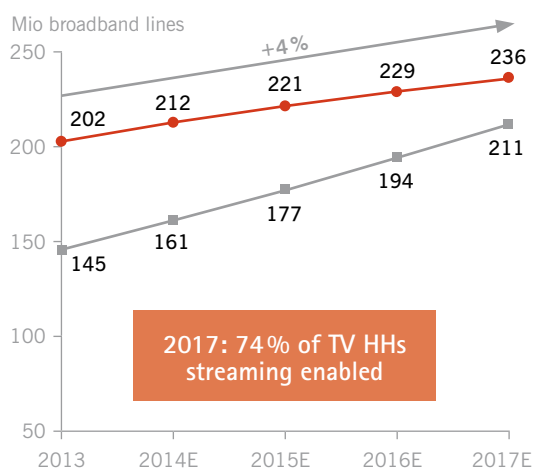
Exhibit 2.1



North America is almost fully OTT enabled ...



... and the European Union is following quickly



—●— Total broadband —■— Broadband lines > 2Mbit

Note: Absolute minimum bandwidth requirement for OTT TV of 2Mbit is assumed
Source: OECD 2014, Bernstein Research 2013, iData 2013, FCC

Meanwhile, devices are doing a better job of rendering video content – even in high definition – thanks to advances in microprocessors and displays. And a growing array of hardware – gaming consoles such as Sony's PS4 and Microsoft's Xbox One, along with a new generation of set-top devices from the likes of Amazon, Apple, Nvidia, and Roku – are able to stream online content

directly to televisions (so-called Smart TVs, which have the necessary software built in and therefore can stream without any additional hardware). These aren't niche products, either. By 2017, an estimated 160 million streaming devices and 250 million connected consoles will be installed across the globe – on top of the 900 million tablets and 850 million Smart TVs that are expected.

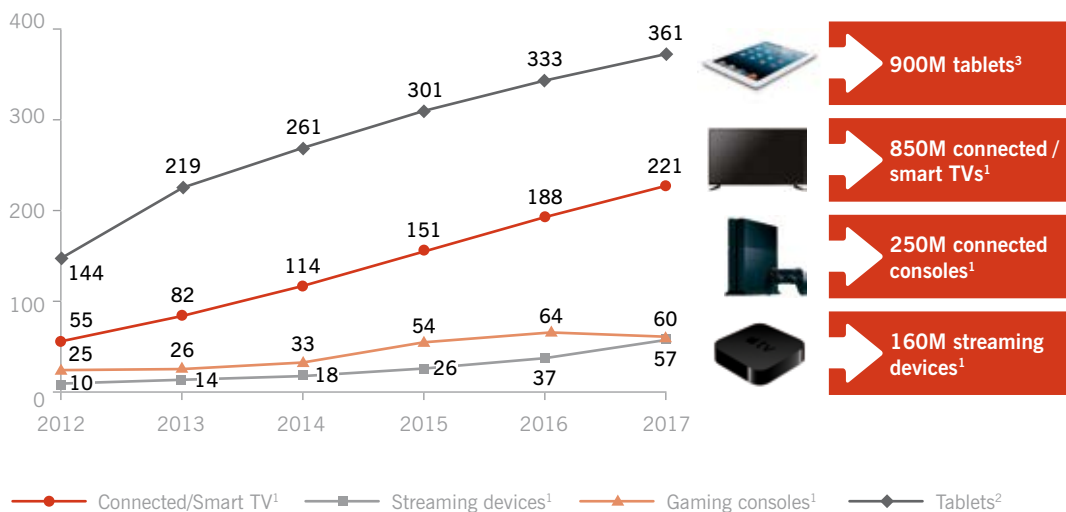
THE ELEMENTS OF CHANGE

Exhibit 2.2

GLOBAL NUMBER OF TABLETS AND CONNECTED/SMART TV'S IS EXPECTED TO APPROACH ONE BILLION DEVICES IN 2017

More devices used to watch video content

Devices shipped yearly (Mio)



Note: Forecasts do not take into account the launch of \$35 streaming sticks such as Chromecast
Sources: 1. Informa 2012, 2. IDC 2013, 3. Forrester Research 2012

The emergence of these connected devices, combined with wireless distribution of data in the home, is enabling online content delivery to the existing installed base of flat panel and HDTV sets to compete directly with traditional infrastructure-based TV delivery. And growth has exploded over the past few years. In the U.S., for example, the aggregate number of households with a TV connected to the Internet is now more than 50 percent of total homes. In the UK, the figure is north of 25 percent.

Online pathways have achieved critical mass. They have the technical ability to effectively deliver video content, and they are widespread enough to do so for a vast audience.

The increased availability of high-quality, professionally produced television entertainment. The development of these new pathways would have no impact without the availability of content that consumers want to watch. Over the past several years, the quantity and quality of professionally produced new-release television shows, along with catalogues of past season high-value content, have increased tremendously. This

change has created the opportunity for seamless, on-demand time shifting of recent TV shows, as well as the ability to go back and pick up prior-season episodes of favorite shows.

Regional and global online aggregators, such as Hulu and Netflix, offer thousands of hours of original content. Hulu has carved out a niche in offering content between one and seven days after a program's "live" television airing; Netflix has exploded in part due to its unique "content stacking" of multiple seasons of high-value content from FTA and Subscription TV channels, often offering every season of a given series.

Increasingly, live linear content is also being made available over the Internet. The recent launches of Sling TV and PlayStation Vue in the U.S. have joined existing players such as Sky NowTV in the UK. And third-party players have emerged to lower the barriers to entry for traditional players. Zattoo, a Swiss company whose technology can transmit live TV programming over the Internet, is one such vendor, offering mobile telecom companies, smaller cable operators, and other providers a white-label solution for delivering TV channels over their broadband networks – without having to build a platform from scratch. Such products reduce the complexities, costs, and

time to market for launching online products and services. The numbers are reflective of the trend: according to recent estimates, as many as 460 unique OTT services were available globally by mid-2015.

New models of original content creation.

Finally, these new pathways are leading to new approaches to creating professionally produced television content – content created specifically for online distribution. Particularly significant is the development of lower-cost models for producing content that is, in the most successful cases, both profitable and attracting mass audiences.

New digital studios are challenging the industry's long-held belief that producing quality content must be expensive. An episode of a top series on a broadcast network might attract 14 million or more viewers but cost up to \$5 million to produce. Yet a top series on YouTube can reach several million viewers at a per-episode cost often well under \$50,000. Content from PewDiePie, the Swedish producer and host of YouTube's "Let's Play" videos, is estimated to have gained some 9 billion total views by June 2015 – and to have generated for his company, PewDiePie Productions, \$7.4 million in revenue in 2014, according to the Swedish newspaper *Expressen*.

THE ELEMENTS OF CHANGE

Exhibit 2.3

NEW AND CHEAPER CONTENT PRODUCTION MODELS ARE EMERGING AND WINNING AUDIENCES

Broadcast model



FTA channels have huge reach and subsidize costly top-tier series with high advertising dollars

14M¹

~\$5M²

Cable model



Subscription TV channels have dedicated audiences and subsidize costly content via subscription fees

2M¹

~\$3M³

New digital model (MCN)



Online content is driving meaningful viewership at a fraction of the production cost

3,1M⁴

~\$30-50K

■ Viewers in M ■ Cost/Episode in \$M

Digital studios are challenging a long-held belief that quality content must be expensive

1. Blended average over all seasons; 2. Estimated cost in the first season; 3. First season: approx. 3M per episode, last season: approx. 3.5M per episode; 4. Average number of viewers of the last 10 episodes – on January 13, 2015, the 10 episodes in question were published between January 6 and January 13 2015; MCN = Multichannel Network
Source: Press search, BCG Analysis

This “YouTube model” has spurred the emergence of yet another type of content player: the Multichannel Network, or MCN. These firms – which include Vevo, Machinima, and Collective Digital Studios – provide production and promotion support to content creators. Often this includes funding, digital rights management, music clearances, studio and editing facilities, and most important, support for content monetization (via advertising, merchandising, and other revenue streams).

In return for this assistance, some measure of revenue – and sometimes even intellectual property rights in the content – go to the MCNs. The contract terms will vary. The creator and MCN might jointly own the content, the MCN might own it 100 percent, or the MCN might offer only a licensing agreement, keeping 100 percent of the ad revenue. There are many permutations.

What sometimes gets lost in the discussion of these new production models is that they create opportunities for established players as well as new entrants. Many of the key investors in MCNs, for example, come from the ranks of traditional content companies, including Comcast, DreamWorks, ProSieben, FreeMantle Media, and RTL Group.

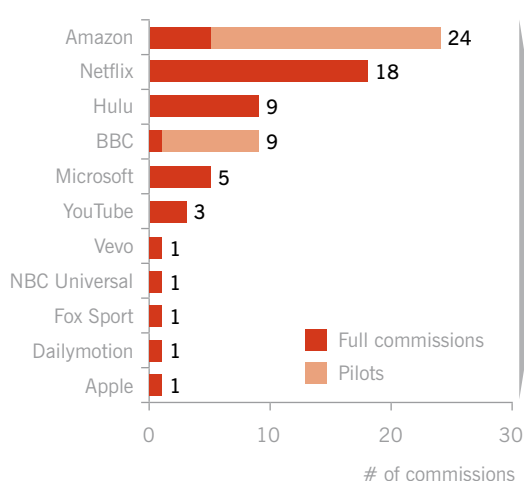
New approaches to producing content are now being applied to traditional TV formats, too. A very visible example of this is the way online content aggregators – companies such as Netflix and Amazon – are increasingly commissioning and producing high-impact, mass-market programming comparable to what consumers would view on a FTA or Subscription TV channel.

They are able to do this because they value the investment in the context of its impact on customer acquisition and retention – not unlike the approach pioneered by HBO in the 1990s. Netflix, for example, spent more than \$100 million to produce the first two seasons of *House of Cards*. But it only needed to increase its subscriber base in the U.S. by some 1.5 percent to break even on that investment. In the process, *House of Cards* became the first original online series to be nominated for a Primetime Emmy Award in a major category (its first season received a total of nine nominations in 2013, and it ultimately won three awards). The series' critical and commercial success not only propelled Netflix's subscriber numbers but also helped establish it as a key player in the video content industry.

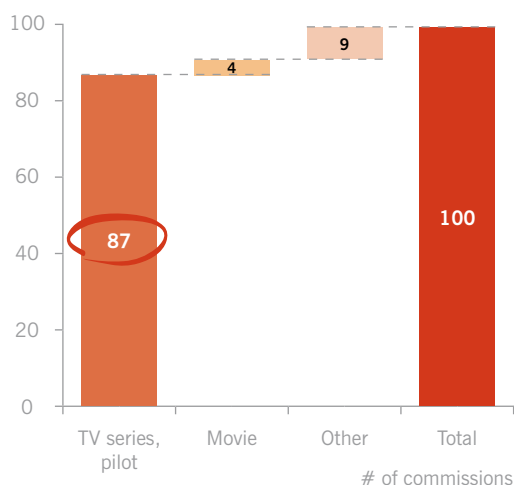
ONLINE/MOBILE PLAYERS INCREASINGLY INVOLVED IN ORIGINAL CONTENT PRODUCTION

Exhibit 2.4

Original commissions by OTT players from the start of 2012 to Feb 2014



SVoD players specifically focused on Entertainment TV



Source: Informa 2014

THE ELEMENTS OF CHANGE

House of Cards also highlights how tech-savvy players are leveraging another asset – tools and expertise in big data – in order to focus their content acquisition and production efforts on programming that can generate the most value. Netflix, for example, uses analytics to, in effect, learn what its subscribers want to watch. It crunches the numbers it is continually collecting – on what its users are downloading, on which stars and directors are most popular, and so on – to determine the kind of content, down to the talent, that is most likely to resonate with viewers.

Meanwhile, new ways in which viewers interact with content are emerging. Traditionally, interaction – such as viewing itself – followed a linear, well-defined path. We watched content and if it was particularly noteworthy, discussed it after the fact at the proverbial water cooler. But connected devices enable immediate interaction.

Significant industry changes

Already, these forces are having an impact on both consumer preferences and the relationships among the various players along the content value chains. Several key trends are emerging:

- » Online viewership is becoming significant, increasingly at the expense of viewership within the FTA and Subscription TV value chains.
- » A major shift in viewing patterns to nonlinear consumption is occurring.
- » Value capture is beginning to follow viewers online.
- » The profile of valuable content is changing.
- » The distribution of value across the supply chain is relatively stable but slowly shifting to content creators and rights holders.
- » Key industry players are changing their business portfolio as they seek to get ahead of shifting control points.

In aggregate, these trends may, for the first time in the history of the television business, reshape industry structure in a revolutionary as opposed to evolutionary manner. If this is true, the television business, which has to date been able to “defy gravity” relative to the digital transition, may join the ranks of other traditional media businesses that also felt they were immune, such as the music, newspaper, magazine, and radio industries.

Online viewership is becoming significant at the expense of viewership within the FTA and Subscription TV value chains in several markets.

Video traffic on IP networks is growing at a sharp rate. By 2018, video will account for nearly 80 percent of global data traffic on fixed networks and close to 70 percent on mobile networks (up from 61 percent and 53 percent, respectively, in 2013).

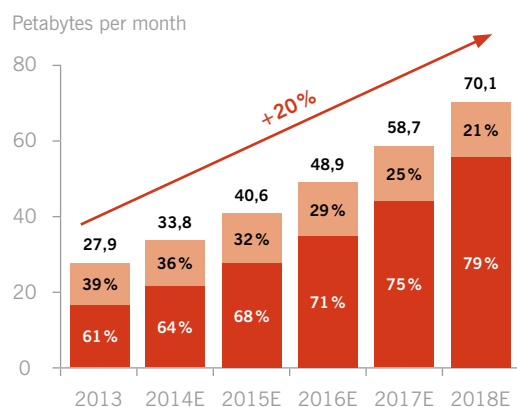
ONLINE VIDEO TRAFFIC IS INCREASING – BOTH ON FIXED AND MOBILE NETWORKS

Exhibit 2.5



Global fixed data traffic

Other Video



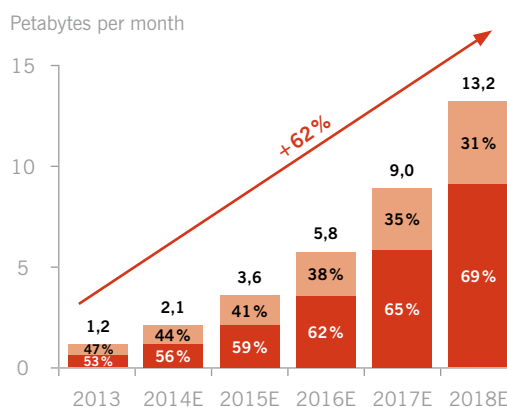
CAGR '13-'18

+6%

+27%

Global mobile data traffic

Other Video



CAGR '13-'18

+49%

+70%

Source: Informa 2014, BCG analysis

Viewers are embracing the new video-distribution pathways at the expense of the traditional value chains. Overall video viewing has grown on a global basis for decades. And while there are specific differences across geographies, in general, this growth is continuing. But its composition is shifting. Almost all of the increased viewing is in online and mobile with

flat to declining viewing levels for traditional FTA and Subscription TV pathways. Indeed, by 2020, online viewing will account for nearly 40 percent of all video consumption – some 24 hours per week for the average viewer, up from just a couple of hours per week in the early 2000s.

THE ELEMENTS OF CHANGE

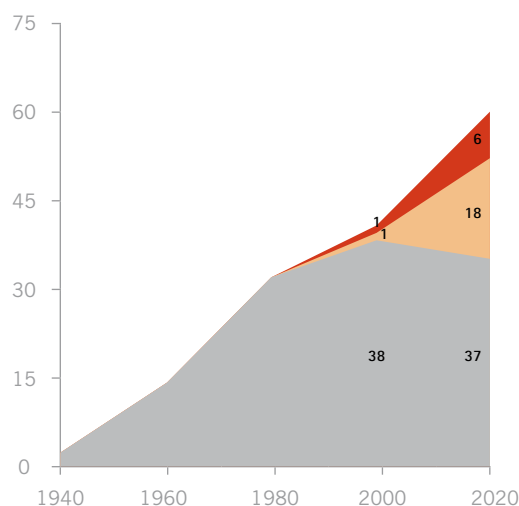
Exhibit 2.6 VIDEO CONSUMPTION IS SHIFTING, WITH ALL GROWTH ATTRIBUTABLE TO ONLINE AND MOBILE



Video consumption growth globally

■ Mobile video ■ Online video ■ TV

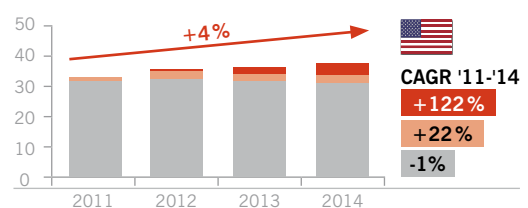
Nr. of hours per week spent per media type



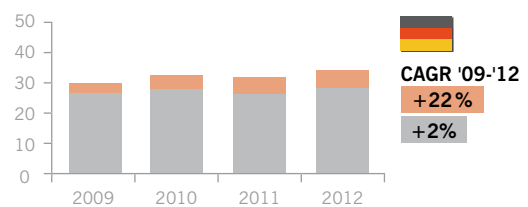
U.S. /DE online video-growth examples

■ Mobile video ■ Online video ■ TV

Avg. time per week with video in hours



Avg. time per week with video in hours



Source: ICarat insight media survey; European Technographics Benchmark Survey; emarketer; Gallup TV meter; SKO; MMS; BARB AdvantEdge; Mediametrie; CIM TV; Eurodata TV, The Nielsen Company; BCG Analysis

This shift in viewership highlights the beginning of economic stress in the traditional Subscription TV business. “Cord cutting,” “cord thinning,” and “nevers” – where consumers decide either to eliminate, reduce, or never subscribe in the first place to traditional cable-, satellite-, or telecom-based TV – is becoming a reality in mature markets and will likely follow suit in currently emerging markets once they mature. For many consumers, there is no “master plan” to do this; instead, as they get exposed to new online services, and as the prices of traditional TV bundles continue to increase, they begin to shift their time and spend-

ing, frequently opting for less breadth of video offerings for less cost.

In a 2014 survey of German-speaking online-video users, only 3 percent said they had signed up for an online video service expressly so they could cut the cord on their existing TV provider. But 58 percent said they could imagine doing so now that they’ve started to use the service. Indeed, looking out to 2018, we expect TV subscriptions to decline in some markets, such as the U.S. market, and experience slower growth in others, particularly in Western Europe.

GROWTH IN TV SUBSCRIPTIONS EXPECTED TO SLOW OR DECLINE IN MATURE VIDEO MARKETS AROUND THE WORLD

Exhibit 2.7

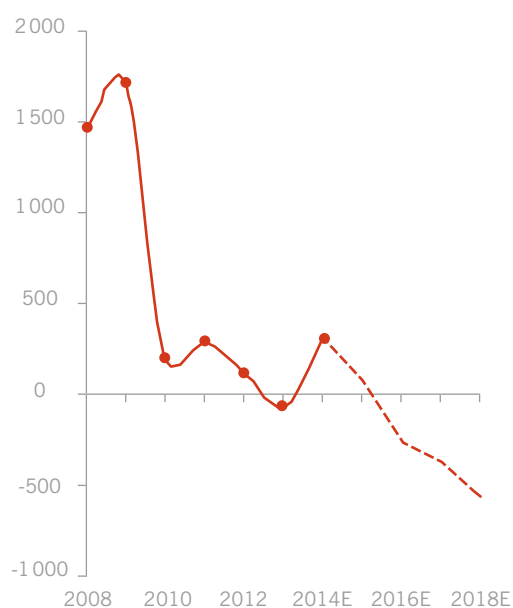


Number of TV subscriptions reached a plateau, expected to decrease

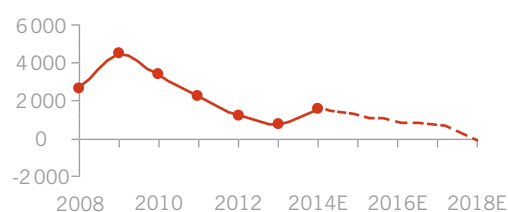


Growth in subscriptions expected to slow, East-West division can be observed

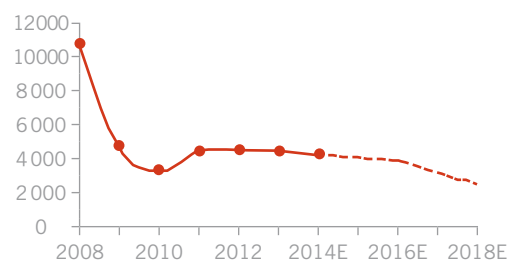
Net additions in TV subscriptions ('000s)



Western Europe – Net additions in TV subscriptions ('000s)



Eastern Europe – Net additions in TV subscriptions ('000s)



Source: Ovum, BCG Analysis

A major shift in viewing patterns to non-linear consumption is occurring. Another significant trend is a shift in viewing patterns, from linear “appointment TV” content consumption to on-demand consumption.

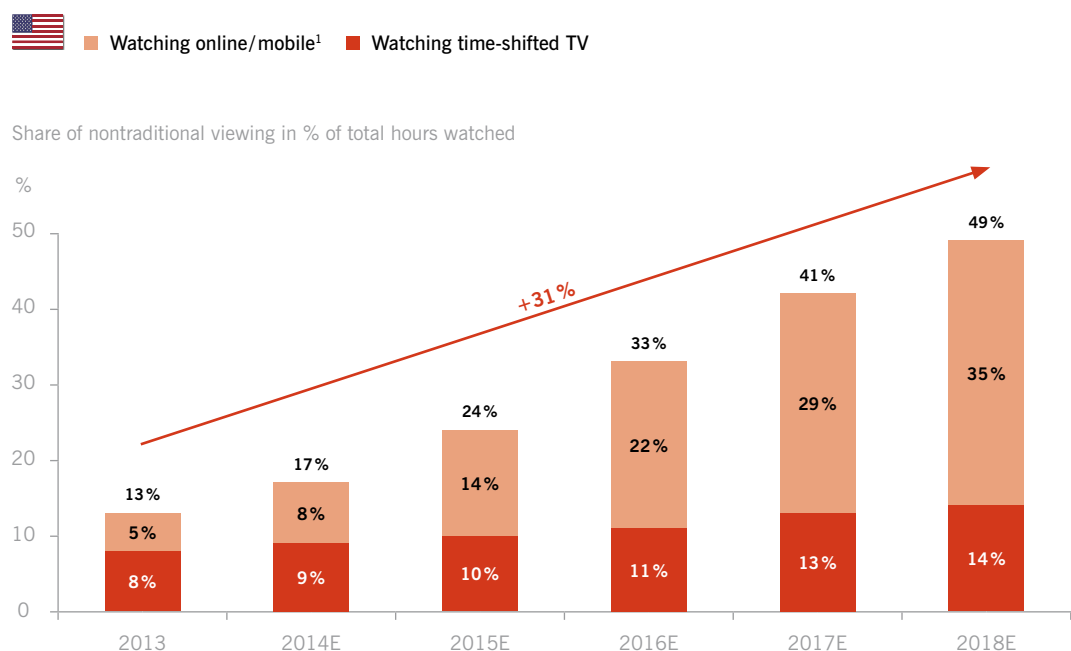
The shift in viewing to online pathways, which cater to an on-demand content experience, as well

as the development of “free” video-on-demand services by distributors, have spurred this trend. By the end of 2015, fully one-quarter of all viewing hours will fall under the nonlinear banner; that is, viewing via online, mobile, or time-shifted TV. By 2018, nearly half of all entertainment viewing in the U.S. is expected to be nonlinear.

THE ELEMENTS OF CHANGE

Exhibit 2.8

SHIFT TO ONLINE AND MOBILE VIEWING IS ACCOMPANIED BY AN ACCELERATION OF NONLINEAR VIEWING



U.S. is leading the way but the EU is quickly following in terms of nonlinear growth

1. Includes watching using multimedia devices, the Internet on a computer, and a smartphone/tablet
Source: Nielsen 2014

It's important to note that nonlinear viewing works better for some content types than others. Sports and news, for example, remain time-sensitive events that most users continue to watch live. Entertainment content, on the other hand, is a more evergreen experience, in some cases better

appreciated when viewed "in bulk" since it is easier to follow the plot lines (and also to get to the payoff that might otherwise be stretched out for months). In the UK, for example, drama series are regularly time-shifted: about 40 percent of all viewing is now nonlinear.

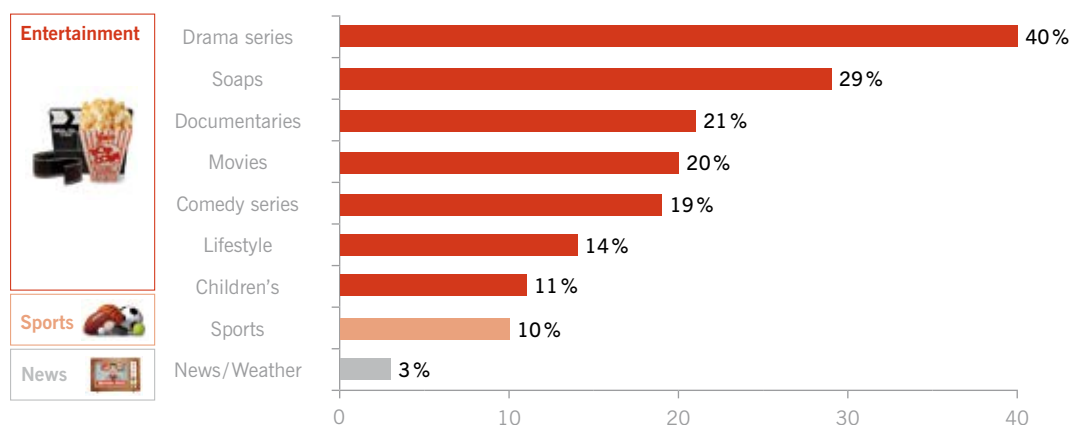
DRIVER OF NONLINEAR GROWTH IS SERIALIZED ENTERTAINMENT

Exhibit 2.9



Share of time-shifted viewing as % of total genre viewing

% of time-shifted viewing



Source: Ofcom CMR 2014

Value capture is beginning to follow viewers online. While still in the early stages, value is beginning to follow viewers. As we have seen in digital transitions in other industries – music, newspapers, and radio among them – it takes time for the economics to catch up with consumption. But it inevitably does.

Within the online value chain, three primary business models have emerged:

➔ **Advertising-Supported Video on Demand (AVoD).** These services offer free access to a large library of movies, TV shows, clips, and other video content. As with traditional FTA TV, content costs are supported by advertising revenue. Video is typically streamed (instead of downloaded for later viewing), requiring an active online connection. Examples include Germany-based MyVideo and U.S.-based YouTube and Hulu.




➔ **Transaction-Based Video on Demand (TVoD).** Content on these services is available to own or rent for a one-off fee. Video is distributed via streaming or via downloads that can be stored on the user's own hardware and viewed later (when an Internet connection may not be available). Examples include Apple's iTunes Store, Maxdome's store in Germany, and Amazon's Instant Video shop.

➔ **Subscription-Based Video on Demand (SVoD).** For a monthly fee, this group of services offers access to a library of content – generally a mix of movies and TV shows. Video is usually distributed via streaming, requiring an active online connection. Examples include Germany-based Watchever and Maxdome (specifically, its subscription offerings) and U.S.-based Netflix.

THE ELEMENTS OF CHANGE

Exhibit 2.10

THREE PRIMARY BUSINESS MODELS EXIST IN THE ONLINE ECOSYSTEM

	Description	Examples of VoD players
AVoD (advertising supported)	<ul style="list-style-type: none">• Free access to a large library of movies, TV shows, and clips• Includes advertising as a means of creating revenues for OTT platform• Usually distributed via streaming	
SVoD (subscription-based and advertising supported)	<ul style="list-style-type: none">• Access to a library of movies/TV shows for a monthly subscription fee• Usually distributed via streaming	
TVoD (transaction-based, ad free)	<ul style="list-style-type: none">• Paid acquisition or rental of electronic copy of offered video material• May be distributed via download or streaming	

Source: BCG Analysis

For each of these business models, the future holds a great deal of potential. In the U.S., the lead market for online and mobile video services, advertising revenue has increased seven-fold

between 2010 and 2015 and will then more than double by the end of 2018. Meanwhile, we expect transaction-based and subscription revenue to nearly double over the next four years.

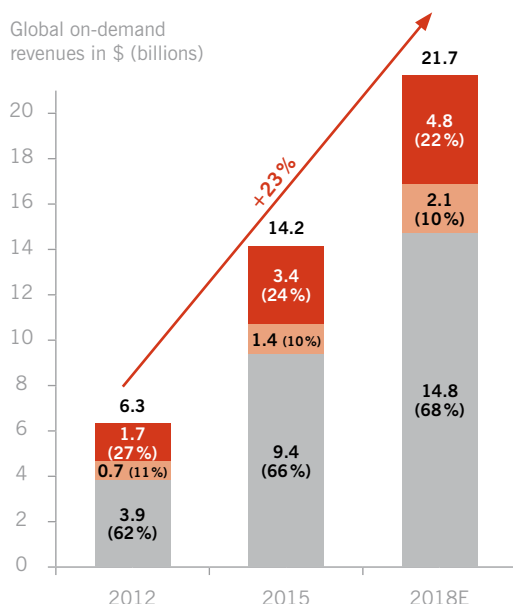
ONLINE ECONOMICS ARE SCALING QUICKLY

Exhibit 2.11



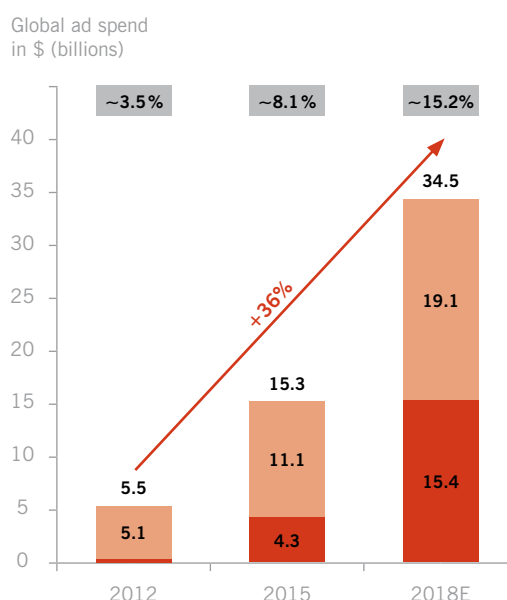
Online and mobile revenues to grow rapidly, dominated by SVoD

EST TVoD SVoD



Advertising revenues to follow viewers to online/mobile video

Desktop Mobile Share of total online advertising spending



Source: Magna, Ovum, BCG Analysis

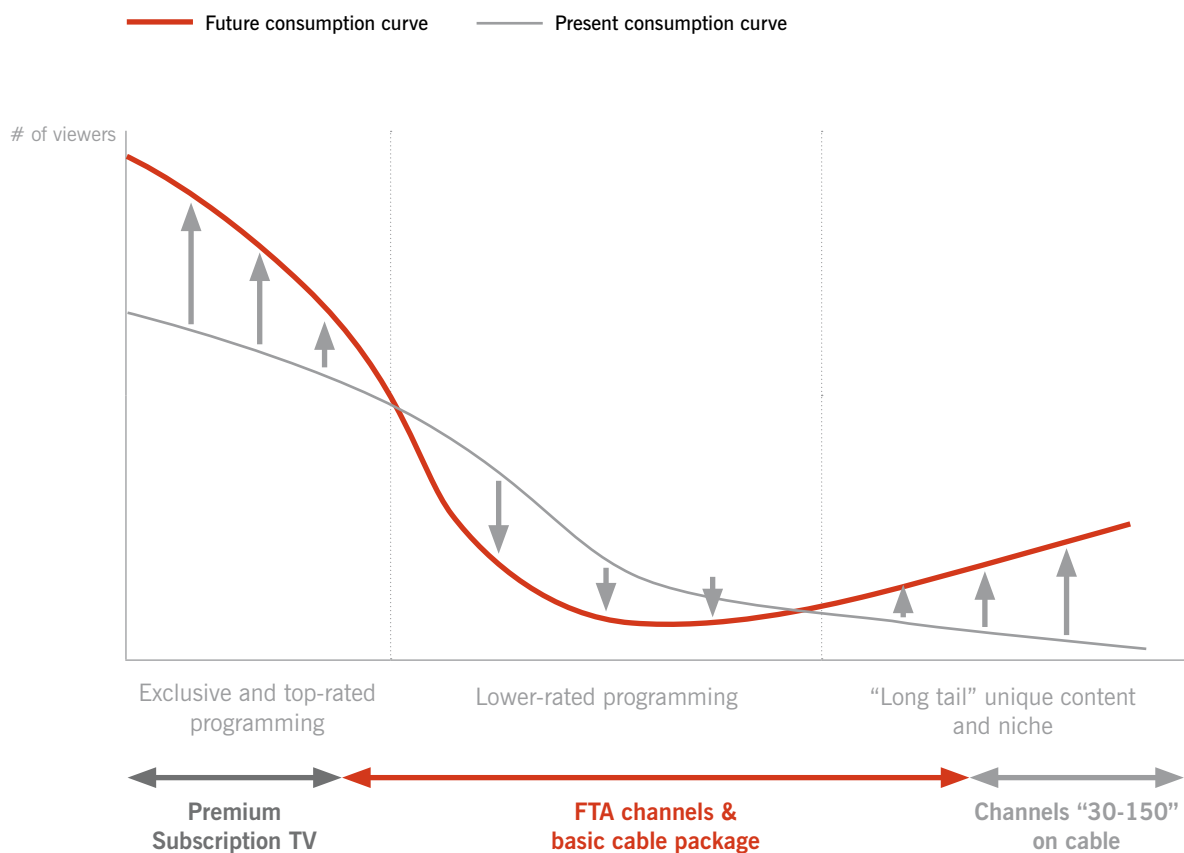
The profile of valuable content is changing.

The shift of viewing and economics to online and nonlinear formats is beginning to have a profound impact on what content is considered valuable. In particular, commoditized second-run entertainment programming – once the darling of the video content world – is becoming somewhat less valuable. There are two key reasons for this: the volume of new original content has grown significantly and consumers have more opportunities to catch up on programs before they reach syndication.

Meanwhile, audiences are shifting very large event content, or content that appeals strongly to a small but avid fan base. This type of content sits at the bookends of our spectrum: compelling mass entertainment and compelling niche entertainment. As a result, there has been significant erosion in viewing for the commodity programming in the middle.

THE ELEMENTS OF CHANGE

Exhibit 2.12 **TOP-RATED AND UNIQUE/NICHE CONTENT IS BECOMING MORE VALUABLE, MID-TIER LESS ATTRACTIVE**



Source: BCG Analysis

The distribution of value across the supply chain is relatively stable but slowly shifting to content creators and rights holders. For some industry players, the changing value of content is also coming at a cost. In the UK, for example, FTA channels have seen their sports content costs nearly double between 2008 and 2013. In the U.S., cable operators and other distributors have seen their content spending increase at a compound

annual growth rate of nearly 10 percent between 2006 and 2012. Indeed, for many distributors, content investments will grow faster than sales revenue over the next several years, putting pressure on their margins.

It is perhaps not surprising, then, that the distribution of industry value – while still split roughly equally between the different player types – is

showing signs of a shift. While the overall pie continues to get larger, content creators and rights holders are seeing their relative share grow, from 33 percent of the total in 2010 to 36 percent in 2014. These changes might not be dramatic, but they do signal a potential rebalancing of power – one that will enhance the bargaining position of content creators.

Key industry players are changing their business portfolio as they seek to get ahead of shifting control points. In the FTA and Subscription TV value chains, the three key groups of players – creators, broadcast networks, and distributors – had aligned incentives and were mutually dependent upon one another to deliver content to the consumer. The creators cofunded and developed content; the networks aggregated that content (and audiences) and provided the programming that distributors bundled into packages and delivered to subscribers over their cable, satellite, or telecom networks. But in the online ecosystem, traditional relationships are not necessary for the delivery of video content.

As a result, we are seeing the beginning of a serious battle for key assets along the value chain – with content and online distribution becoming the focal points.

UPSTREAM EXPANSION INTO CONTENT

» *How It Is Happening.* Online content aggregators and infrastructure-based distributors are acquiring or creating their own production capabilities and developing original television shows and movies. This content is then made available to subscribers via the company service infrastructure.

» *Rationale for the Move.* Expansion into content ensures access – and in most cases, exclusivity – to high-quality content, especially in entertainment. This helps players not only to differentiate themselves but also to mitigate, at least to some degree, the spiraling costs of content.

» *Examples of Which Companies Are Doing It.* Sky entered into a partnership with Znak & Jones, an international TV production company, in 2014; Amazon launched Amazon Studios in 2010.

EXPANSION INTO ONLINE

» *How It Is Happening.* Content creators, FTA and Subscription TV channels, and distributors alike are developing or acquiring capabilities to gain traction in the new online value chain. For traditional players, the acquisition of a digital content company can enable a relatively quick – if often costly – entry into the new content ecosystem.

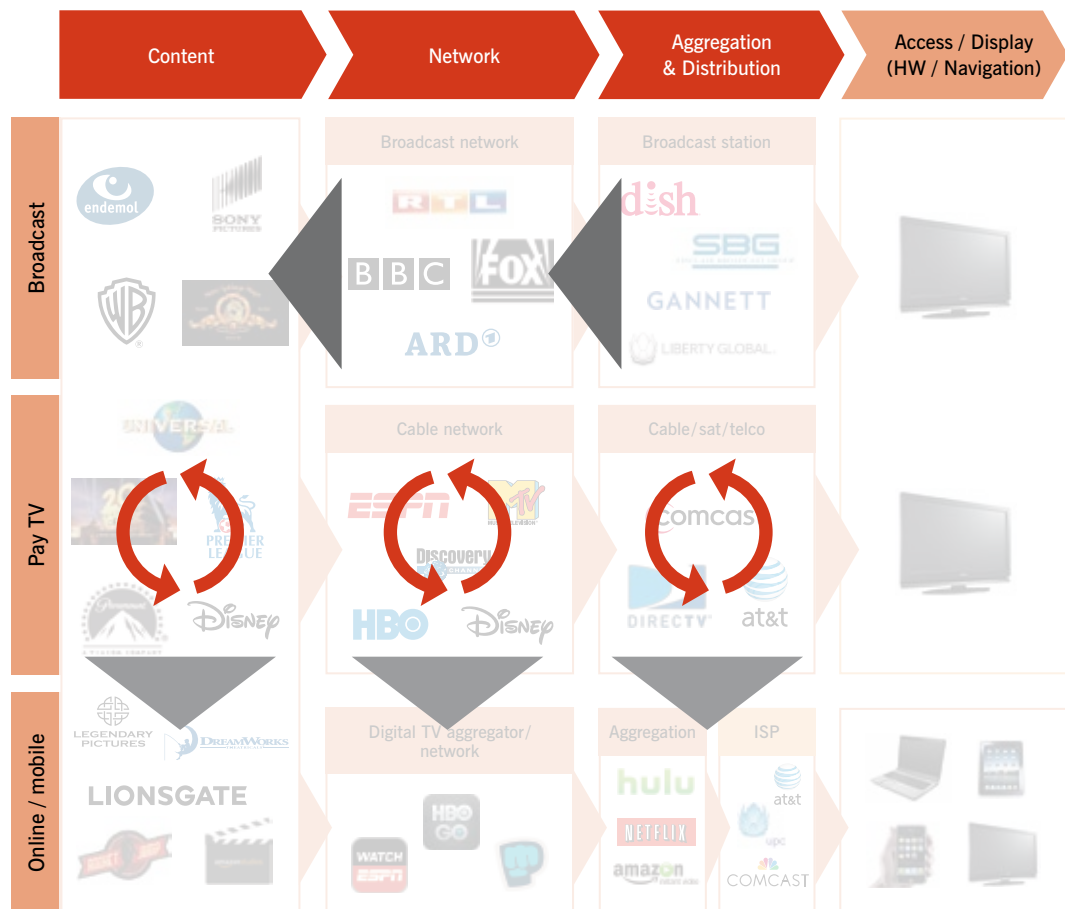
» *Rationale for the Move.* Expansion into online enables traditional players to improve viewers' access to content via increasingly popular pathways, provides additional opportunities to promote and monetize content, and helps players keep pace with competitors. Most important, this strategy hedges against the risk of becoming irrelevant in an online-centric world.

» *Examples of Which Companies Are Doing It.* Virtually all. RTL Group acquired StyleHaul, an MCN for fashion, beauty, and lifestyle; CBS launched CBS All Access, a subscription-based video-on-demand service offering more than 6,500 episodes of the network's shows; The Walt Disney Company acquired Maker Studios, which produces videos for YouTube channels. The list goes on.

THE ELEMENTS OF CHANGE

Exhibit 2.13

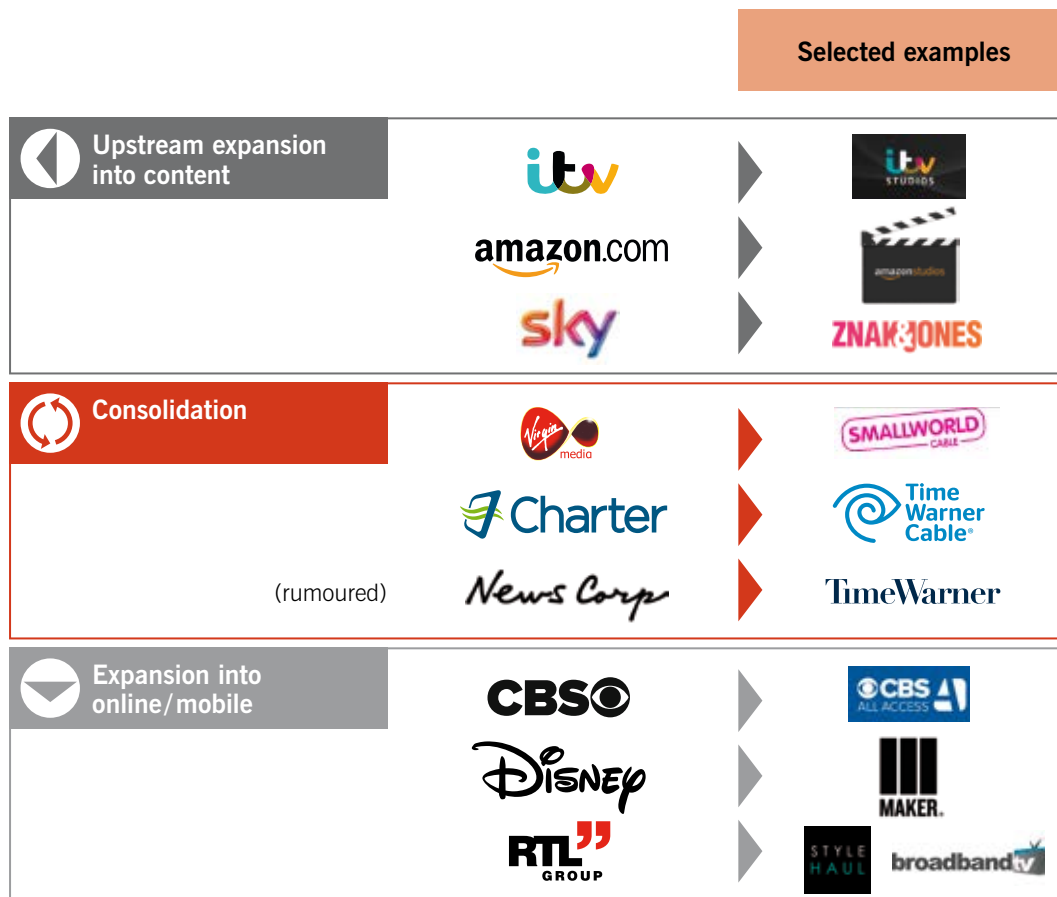
TRADITIONAL OWNERSHIP STRUCTURE SHIFTING HIGHLIGHTED BY VERTICAL AND HORIZONTAL EXPANSION



First-order implications for key players

Together these trends may change the television industry, and already, we are starting to see their combined pressures affect many of the business' traditional players. We are also beginning to see how the trends can benefit and create opportunities for the industry's new "attackers."

Within the traditional FTA and Subscription TV value chains, one of the first-order implications may be the misalignment of economic incentives. Content creators and rights holders, broadcast networks, and distributors have all historically relied on each other – their businesses wouldn't work otherwise. And while the relationships could get complex, their incentives were largely aligned in ways that benefited everyone.



In the Subscription TV value chain, for instance, content creators licensed their content on an exclusive basis to broadcast networks that, in turn, charged carriage fees to distributors that received fees directly from consumers. When content costs rose, the increased costs were passed along the chain to consumers. And conversely, when consumer prices were raised, some of the increase was passed along the chain back to the studios.

But we are starting to see signs that this inter-dependence may not necessarily hold true in the future. Some players may be able to make their businesses work without relying on their traditional partners – and perhaps work even better.

THE ELEMENTS OF CHANGE

Some of the initial implications that are starting to emerge in some markets include the following:

- » Traditional FTA and Subscription TV distributors are starting to see a reduction in the strategic importance of their physical video infrastructure. This infrastructure has always been a key source of competitive value. The capital required to build these pathways for delivering video – and the regulatory burden that invariably had to be tackled – ensured Subscription TV that distribution was a scarcity that only a few players could provide. But this is not as true now – and will be less true in the future – as the new wave of online content aggregators can take advantage of the broadband connectivity that consumers are already paying for.
- » Broadcast networks are also feeling pressure from these trends. Distributors are pushing back more vigorously on proposed carriage-fee increases as their own ability to raise prices is challenged. Meanwhile, the strategic value of the linear network – the programmed structure of TV shows that determines what a consumer can watch at any point in time – is declining in the face of the increasing ease by which consumers can decide what they want to watch and when they want to watch it.

- » Content creators and rights holders are not unaffected, either. While the online value chain presents new sources of revenue, the ripple effect of pressures in the FTA and Subscription TV ecosystems may reduce revenue from these traditional sources. This group of players has always relied on strong TV buyers to grow their revenue and promote their content assets. If broadcast networks are weakened, the creators will need to find new buyers that not only can write them a check but help them find a large audience as well. Some players, of course, will have an easier time of this than others, depending on the type of content they control.

Yet these are still the early days of the new content landscape, and historically, predictions of tectonic shifts in the television industry have turned out to be wrong. Whether the potential for misaligned interests will create fundamental changes in industry structure – or not – will depend on a variety of factors, including the actions that individual companies choose to take, as well as the steps that regulators in different markets take not only with respect to the television industry but also more broadly.

In Part 3, we explore the alternative ways in which the industry could evolve and the implications for the different types of players. »



A large, stylized number '3' in a mustard yellow color serves as the background for the page. It is positioned on the right side, with its top and bottom loops extending towards the left edge.

part 3

SCENARIOS FOR
INDUSTRY EVOLUTION

SCENARIOS FOR INDUSTRY EVOLUTION

SCENARIOS FOR INDUSTRY EVOLUTION

Given the forces at work in the television industry and the trends emerging from them, we believe it is critical to stimulate thoughtful discussion about the nature of change the industry is facing:

➔ While industry shifts for the last several decades have been evolutionary, will they continue to be so in light of these changes?

➔ If the changes are revolutionary and will disrupt the structure, conduct, and business models of the industry, how will the industry work in the future? Where will critical business assets and value shift?

In this part of the report, our goal is to help contribute to this discussion by exploring the different ways in which the industry might evolve. At a high level, we believe that these changes will be disruptive in many but not all markets. We also believe that there will be no single industry structure across markets.

Instead, we think there are five possible end states for the industry structure and that most markets will be a blend of two or three – but not all. In this section, we will describe our view of these scenarios and examine how value and influence will shift for each.

It is important to note that the development of the industry in any given market cannot be exactly predicted. Where among these scenarios a market

ends up will depend on a number of factors: the specific nature of the trends in that market, the starting point of the industry, and the actions that leading companies and regulators take to shape the evolution of the industry. We believe, however, that the following five scenarios bound the range of potential outcomes – and provide a good starting point for framing the discussion in any given market.

Scenario 1: Gradual evolution within the current industry structure

Historically, new developments – whether driven by technology or by new content types, market entrants, or consumer behaviors – have contributed to the evolution of the industry without significant disruption. The roles, relationships, and interdependencies among content creators, broadcast networks, and distributors have remained essentially intact. And at each stage along the value chain, incumbents found opportunities to continue to grow successfully.

In this first scenario – the base case – the industry will continue to evolve in a natural and gradual process. Incumbents, particularly within the FTA and Subscription TV value chains, will all benefit – perhaps not growing as much as they would were these changes not taking place, but still gaining in ways that are attractive.

Consumers will continue their migration to non-linear content and streaming-capable devices. Some cord cutting, shaving, and slicing will continue to occur, but most consumers will use online services in addition to – and not instead of – their existing TV service. Online channels and content aggregators adopting every business model – AVoD, SVoD, and TVoD – will carve out a healthy and growing share of value. Meanwhile, traditional players will continue to enter the online space, but they will do so largely under existing rules and relationships, through TV Everywhere services (such as Sky Go and WatchESPN) and through small, modest investments in online diversification (such as Disney’s investment in Maker Studios).

All three content ecosystems – FTA, Subscription TV, and online – will remain intact and healthy. Most players at each content stage – creation, aggregation, and distribution – will adjust, find opportunities to grow, and maintain their relevance and importance within the chain. And the relationships among players will remain largely in place, without significant disintermediation.

Traditional players will, of course, need to make adjustments in order to thrive in the new environment, and those that do not will suffer. But the majority of the incumbents will find ways to take advantage of the new distribution pathways, access devices, and consumer behaviors on the basis of their strengths in packaging and delivering content. The easier and more convenient they make access to their content, the better they will create value from the new viewing experiences. We are already seeing evidence of some players taking this approach and benefiting from it.

We expect this scenario to have the following impact on value chain players and their content-related assets:

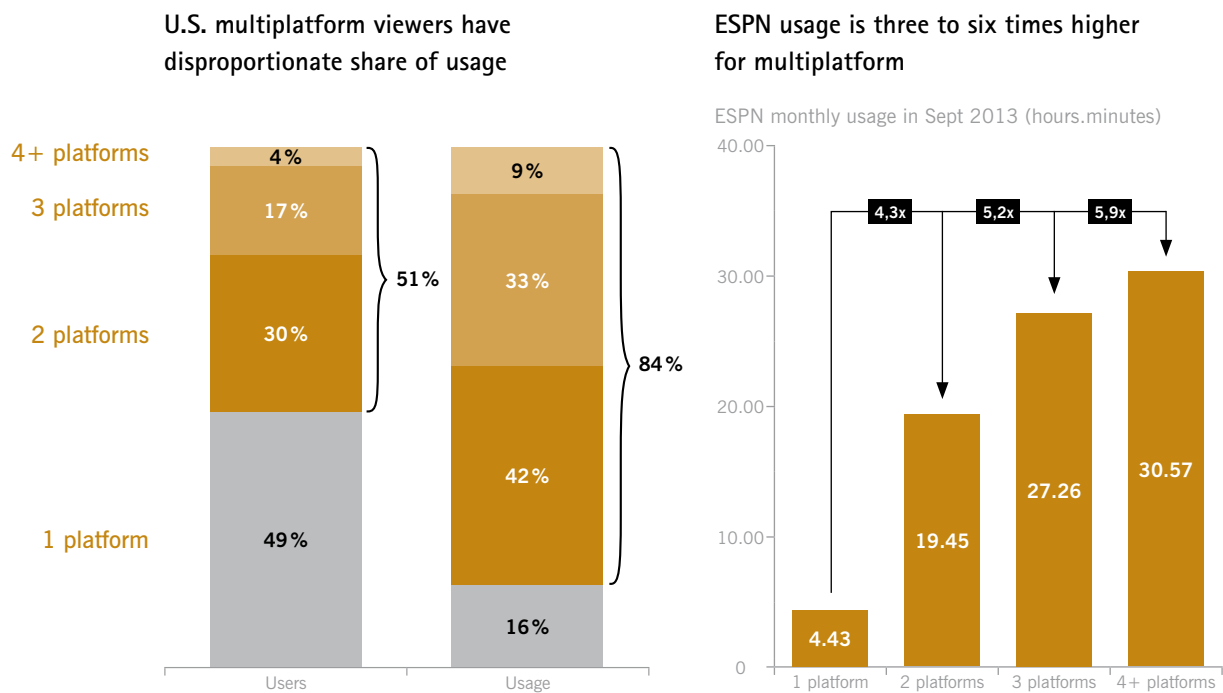
➔ *Content Creators and Rights Holders; FTA and Pay TV Channels.* Leading content creators and the broadcast networks that package their content into channels will continue to grow in importance and value.

Content creators that make compelling TV shows – whether for niche or mass audiences – will become more important as the increasing set of viewing opportunities will increase the downstream value of desirable content. Meanwhile, increased viewing opportunities will also lead to a demand for more original content, boosting the importance and value of successful studios. Those that produce or control the rights to serialized dramas will be especially well positioned, as this format works particularly well in a nonlinear world. As discussed in Part 2, in some markets such as the UK, dramatic series are already time-shifted 40 percent of the time.

Broadcast networks that can provide exclusive, top-rated, or unique content will enhance their brands with consumers and become increasingly valuable to both infrastructure-based distributors and the new breed of online content aggregators. ESPN, for example, has substantially increased viewing by making its content available across platforms, primarily through its authenticated TV Everywhere application, WatchESPN. On average, viewers who access ESPN via four or more platforms spend nearly six times more time watching its content than viewers who use a single platform.

SCENARIOS FOR INDUSTRY

Exhibit 3.1 **MULTI-PLATFORM CORRELATED TO HIGHER LEVELS OF CONSUMPTION**



Source: ComScore, Arbitron, Goldman Sachs Global Investment Research 2014, ESPN

➔ **Infrastructure-Based Distributors.** With new online entrants able to deliver smaller and cheaper bundles of content, or even à la carte offerings, some cord cutting and cord shaving is inevitable. Already, growth in traditional TV subscriptions is slowing, and in Western Europe, net additions are expected to slow year after year from 2014 on – and beginning to turn negative by 2018.

Yet while the physical infrastructure for content delivery – operated by cable, satellite, and telecom operators – may not be as crucial a content asset as it once was, in the base case scenario, content creators, broadcast networks, and distributors

align themselves with authenticated multiplatform offerings to capture new viewing under existing business rules. TV Everywhere – a model that allows consumers to access their subscription content on an authenticated basis across all platforms and devices, both in the home and outside of it – is an example of this approach.

However, creating these services will lead to continued increases in content costs for distributors, and not all of them will have the resources to play this game – which biases toward scale and is likely driving the increased pace and intensity of consolidation we are seeing among distributors.

Indeed, recent consolidation moves – and attempted moves – in the European Union (involving, for example, Vodafone and Kabel Deutschland in Germany, Zon and Optimus in Portugal, Unitymedia and Kabel BW in Germany, Ziggo and UPC in the Netherlands, and the merger of Sky UK, Germany, and Italy) clearly signal the importance of a scale game in this context.

➔ **New Online Networks and Content Aggregators.** As online content continues to drive meaningful viewership numbers, the players that make it available – from the MCNs that support creators to the online aggregators that provide an easy path to viewers – will assume an increasingly important role in the industry. And they are likely to generate increasing revenues. Clearly, some traditional content players have already come to that conclusion: Comcast, Dreamworks, ProSieben-Sat.1, and Time Warner have all made recent investments in MCNs.

But for the overall structure of the industry, the primary theme in this scenario is peaceful coexistence. The picture is similar to that seen in the development of the Subscription TV value chain: new content creators, channels, and distributors came on the scene and found success, yet players in the FTA chain also increased revenue, margins, and in many cases, value.

Scenario 2: Disruption driven by the rise of multiplatform navigation

Through the different stages of the TV industry, navigation has evolved – from the printed guides that once were dominant (daily newspapers, *TV Guide* in the U.S., and *TV-Digital*, *TV Magazine*, and *TV Choice* in Europe) to the electronic pro-

gram guides that today are the key mechanism for program discovery and choice and that are now supplemented by social media referrals and recommendations.

Yet currently, none of these navigation layers provide a single source of navigation and curation. Social referrals are incomplete and electronic program guides are pathway dependent. Within the Subscription TV value chain, for example, they will typically provide information about, and access to, FTA and pay networks – and only in very select cases, online services. Those will require external navigation and access. Consumers who want to watch both Subscription TV content (via their cable, telecom, or satellite provider) and online content (via Internet-based services) are required to switch between different input ports on their TV sets and search through a different program guide for each service. This is a less-than-optimal consumer experience.

This second scenario is centered on the challenge – and the opportunity – navigation presents. In it, infrastructure-based distributors succeed by extending their navigation into the emerging online ecosystem, so that it curates all of the video a consumer has access to – independent of whether that content is part of the services the distributor provides. For instance, in Germany, a consumer who subscribes to Unitymedia's "Horizon" service has seamless access not only to Horizon's own video library but also to the content offerings of Sky, YouTube, Maxdome, and others. And they have that access across different devices: television sets, tablets, and smartphones alike. In these instances, a consumer would be able to search for programming across a full spectrum of providers – their cable, satellite, or telecom provider, as well as Netflix, Hulu, iTunes, YouTube, and other online services –

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through a single interface and without changing the settings on their TV.

By offering this single point of navigation across pathways and devices, infrastructure-based distributors would retain their standing as the “front door” to the world of video content and continue to “own” the customer relationship. However, opening up their navigation interface, and providing access to content regardless of whether it is part of a distributor’s paid service, means a fundamental shift in strategy for most incumbents – a move away from their current focus on defending and growing their own video service.

For many viewers, this kind of comprehensive, multiplatform navigation would be very compelling. And traditional distributors, with their significant customer relationships and available budget, are well positioned to deliver it, becoming new-era curators of video content and differentiating themselves in the process. Infrastructure-based distributors would not only remain relevant in the content value chains but also actually improve their importance and power.

Liberty Global and Comcast have already started down this path, making first attempts in deploying a broader video-content navigation layer.

Exhibit 3.2

MVPDS HAVE MADE FIRST ATTEMPTS TO DEPLOY A BROADER VIDEO CONTENT NAVIGATION LAYER



LGI's latest set-top box with interactive features from live TV to catch up and VOD (own TVOD service and third-party services)

- Automated, catch up with multiple recordings in parallel
- Smart search engine facilitating discovery
- Downloadable applications



Interactive content navigation layer covering linear TV channels, catch-up, and VOD

- Latest episodes of U.S. top-100 shows always saved for catch-up viewing
- Smart search across the whole content offering, with voice search
- Downloadable applications



We expect this scenario to have the following impact on value chain players and their content-related assets:

➔ *Infrastructure-Based Distributors.* Robust all-inclusive navigation coupled with the ability to stream all video content, independent of its source, on every device – especially TV sets – is a “killer-app” in the new multipathway world we are entering. Distributors that make this significant transition will be well positioned to enhance their relationship with consumers and serve as the first and only place consumers go to view content. In addition to preserving their role as the primary gateway to viewing, they will be better able to serve their customers, as the information they collect on individual viewing behavior – stewarded effectively from a privacy and consumer-protection perspective – will allow them to make relevant and compelling program recommendations. That same information will also enable them to provide next-generation targeting for video advertising, benefiting both consumers and advertisers alike by increasing the relevance of the advertisements consumers are exposed to.

Successful pursuit of this approach will significantly increase the relative position of distributors – not only within their traditional Subscription TV value chain but also across value chains, including the emerging online ecosystem. With that greater standing and stronger negotiating position will come the corresponding financial rewards.

However, not every infrastructure-based distributor will be able to pursue this approach. The required investments are significant, and this approach favors large players in strong financial positions. One likely outcome of this scenario, then, is further industry consolidation.

➔ *FTA and Subscription TV Channels.* The increased (or retained) importance of distributors as the primary gateway to video content will change their relationship with broadcast networks and potentially impact, perhaps significantly, the fees that these networks receive.

To date, FTA and Subscription TV channels have been able to raise carriage fees on a year-in and year-out basis, with distributors passing along the increases to consumers. Yet with their relationship with viewers extending across all content, independent of pathway, distributors will be in a better negotiating position with respect to these fees. They will also become increasingly indifferent to what video services consumers chose, as they will be able to create similar financial value by providing highspeed data services and video navigation to cord-cutting consumers who only want to watch online programming.

These dynamics will affect different broadcast networks differently. Those networks that source compelling original content – either must-see mass entertainment or high-engagement niche content – will continue to command premium licensing fees and to increase their viewership and related advertising revenues. Those that either do not source compelling original content or rely on previously aired, second- or third-run content will suffer.

Meanwhile, all broadcast networks will need to find new ways to promote and create awareness for their new programs. In a shift to a single point of navigation and significant nonlinear viewing, the importance of data-driven recommendation engines, social recommendations, and search will increase – and the power of the network brand will diminish.

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➔ *Content Creators and Rights Holders.* Under this scenario, leading creators and rights holders will continue to increase in importance and value. The ease of finding the content a consumer wants to view, whenever and wherever he or she desires to view it, increases dramatically with a single, well-designed consumer interface for all video programming across all viewing devices. And the cream – the great sports, mass-entertainment, and niche programming – will rise to the top, with more broadcast networks competing to acquire it.

➔ *Online Content Networks.* This scenario is a boon for MCNs, most of which struggle to create awareness among potential viewers. The existence of a single point of content navigation and access, with best-in-class recommendation engines, creates the opportunity for online-only programming and channels to find audiences – while circumventing the costly marketing and promotion vehicles of the FTA and Subscription TV ecosystems.

➔ *Online Content Aggregators.* A unified, multiplatform navigation interface shifts power – and related economics – away from these new, emerging players. The primary relationship with consumers, and key data on their viewing, now resides with traditional Subscription TV distributors. While a Netflix, Hulu, Zattoo, MyVideo, or Maxdome will have access to consumer viewing patterns for the content they provide, Subscription TV infrastructure-based distributors will have the bigger picture: visibility into all of a consumer's viewing behavior across all services and platforms. Over time, this broader relationship with the consumer and deeper understanding of their viewing may cause the disintermediation of some online players, much as some broadcast networks are likely to be disintermediated.

Scenario 3: Disruption driven by exclusive entertainment content

In this scenario, traditional infrastructure-based distributors and online content aggregators invest in exclusive sports and entertainment content. The idea is this: by providing programming that is available only on their platforms, they can differentiate their offerings and drive customer acquisition.

Consumers' choice of providers, then, will be far more influenced by their content preferences, while other factors, such as pricing, navigation, and the mode of delivery (online or via traditional infrastructure), will be less important.

Exclusive content strategies – both limited and full scale – have long been in place. British Telecom secured rights to Premier League games in order to build and strengthen its TV business, using the content for a new football-focused channel with interactive features, which it included in higher-tier packages. That said, BT's exclusivity is "limited," as its games are available through Sky as well, just under pricing disadvantages to Sky's customers vis-à-vis BT's.

DirecTV's long-standing relationship with the NFL for its out-of-market broadcasting rights is a more complete example of content exclusivity, as the package is not available via other distributors. And larger online aggregators, such as Amazon and Netflix, aren't just buying exclusive distribution rights but are increasingly creating their own entertainment content and owning it across viewing windows. Such exclusivity doesn't come cheap. For Netflix, spending on original productions is

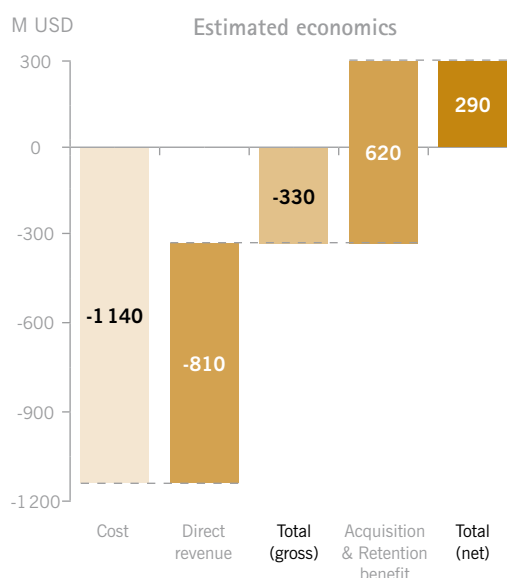
DIRECTV USES ITS EXCLUSIVE OUT-OF-MARKET NFL GAME RIGHTS TO DRIVE SUBSCRIBER ACQUISITION AND RETENTION

Exhibit 3.3

DirecTV offers access to all NFL games...



...which have enormous value as a subscriber acquisition and retention tool



Need to take customer acquisition and retention into account to make it profitable

Source: DirecTV; Atlantic Equities Report, 2012; BCG analysis

expected to increase from \$5 million in 2012 to \$543 million in 2017, representing 12 percent of its annual content expenditures.

We expect this scenario to have the following impact on value chain players and their content-related assets:

➔ **Content Creators and Rights Holders.** This scenario increases the value of sports rights and entertainment content as their role in determining success in the downstream distribution battles

becomes even more important. Content creators that can scale their businesses to feed the growing appetite for original programming will be particularly well positioned – and examples of this are already appearing in certain markets. Lions Gate Entertainment has scaled its production capability to meet the demand of new buyers across the value chain – delivering, among other shows, *Orange Is the New Black* for Netflix, *Mad Men* for AMC, and *Deadbeat* for Hulu. In the process, EBITDA more than tripled between 2010 and 2014 before some recent volatility.

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➔ *Infrastructure-Based Distributors and Online Content Aggregators.* In this scenario, exclusive programming – not infrastructure, navigation, or other elements – becomes the basis of competition and the most critical asset for both traditional distributors and online aggregators. Content costs will rise for these players as they move upstream into the world of content funding and development, and smaller distributors and aggregators, with smaller budgets, will be at risk of losing market share.

Yet those players that are able to make substantial investments – and the right investments – will have an opportunity to increase their importance and value. Larger satellite players, in particular, may find this approach the most appealing of all the potential options available to them. Unlike wireline-based distributors, most of these providers lack high-speed data infrastructures and cannot pursue the integrated navigation path or strategies that trade off the value of their video business with consumer broadband and enterprise communications services.

➔ *FTA and Subscription TV Channels.* With exclusive content now a key strategic asset for traditional distributors and online aggregators, broadcast networks will face more competition for exclusive original content – and likely, increasing licensing fees. The networks will find themselves needing to increase their spending on signature content, with greater bargaining power – and greater value – shifting to content owners.

Scenario 4: Disruption driven by the direct-to-consumer strategies of content creators and broadcast networks

This fourth scenario finds content creators and broadcast networks circumventing both traditional distributors and online aggregators to go direct to consumers. Instead of subscribing to cable-, satellite-, or telecom-based video services, or even in some cases online-based services such as Netflix or LoveFilm, consumers will access video programming directly from studios, such as Sony and Disney, or networks, such as HBO and Premeira.

In some ways, this scenario is a step “back to the future” to the early days of FTA television, when there was no distribution role that stood between viewers and broadcast networks. Consumers made individual choices about which channels to view, independent of an intermediary that bundled channels into tiered packages.

There are many inherent challenges in this scenario. Content creators and broadcast networks will have to absorb significantly more risk. For one thing, they will be bypassing the downstream elements of the value chain that provide certainty around revenues and absorb the incremental costs associated with viewer promotion, acquisition, and customer service. Moreover, for many broadcast networks, breaking out of the bundle means putting at risk the significant economic subsidy they receive from households that pay for traditional TV bundles – and thus contribute to the carriage fees channels receive – yet don’t even watch their programming. Then there are the array of operational capabilities that will need to be developed – from pricing to e-commerce to robust digital products and experiences.

Still, for all the potential downside, there is one big, compelling advantage to taking the direct-to-consumer route: by working without the middleman, certain content creators and broadcast networks have the opportunity to capture more value from core viewers than in today's bundled world. Overall, the likelihood of this scenario depends on the degree to which content creators and broadcast networks pursue this path (how many of them try it, how extensive their efforts are, and how successfully they tackle the challenges).

We have started to see the beginnings of this direct-to-consumer approach in several markets (albeit currently, many players are only testing the waters). Sky Online offers a standalone streaming service in the UK and elsewhere. In the U.S., HBO and Showtime have introduced standalone SVoD services (with HBO Now and Showtime Anytime), as has the FTA network CBS, whose for-pay direct-to-consumer service, CBS All Access, offers subscribers more than 6,500 on-demand episodes of the network's shows, as well as live TV. Sports leagues, such as Major League Baseball and the National Football League, have also begun to offer direct-to-consumer streaming and content services as well.

We expect this scenario to have the following impact on value chain players and their content-related assets:

➔ *Content Creators and Rights Holders; FTA and Subscription TV Channels.* This scenario will divide the content universe into "haves" and "have nots." Players with a critical mass of content and strong consumer brands that represent it – the haves – have a high likelihood of success. This is why the first companies into the fray are those such as HBO and Showtime that possess deep movie

and original entertainment libraries. Similarly, one would expect companies such as ESPN (for sports) and Disney (for kids) to have a high chance for success should they pursue a direct-to-consumer model.

On the other hand, content players without both of these attributes – the have nots – will likely fail in this model. Lacking strong brands that stand for a specific content genre, they will have to invest heavily to attract viewers. Lacking enough content for any specific genre, they may disappoint the viewers they attract.

➔ *Infrastructure-Based Distributors and Online Content Aggregators.* If content creators and broadcast networks can "go it alone," distributors and aggregators will be disintermediated and likely decline in importance and value. Traditional distributors will suffer a loss of subscribers, and declines in average revenue per user, due to cord cutting and cord thinning. In the online ecosystem, subscription-based aggregators will lose subscribers, and advertising-based aggregators will lose viewers. All will suffer financially, although players that operate broadband infrastructure have a key asset they can utilize to try to maintain value via different leverage points.

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Scenario 5: Disruption driven by online content aggregators moving into linear streaming of broadcast networks

One of the mainstays of the traditional distribution business is its linear streaming of a rich set of broadcast networks. Indeed, the desire to watch “live TV” is a major reason viewers do not cut the cord. In this final scenario, leading online aggregators move into linear streaming business by licensing network content from the key FTA and Subscription TV channels in their markets. In combination with online-only programming, traditional TV catalogue programming, in-season TV content, and the ability to watch all of this in nonlinear fashion, these players can create AVoD and SVoD services that are richer and more flexible than those available from traditional infrastructure-based distributors.

Depending on the market, online aggregators that embrace this approach enjoy another key advantage as well: the ability to develop their offerings on a clean slate. For traditional players, decades of legal agreements and regulation tuned to a predigital streaming environment mean interlocking tiering and rights issues that can contain innovation. By negotiating all of their broadcast-network relationships at the same time, online aggregators may be able to license agreements that avoid some of these issues. And depending on the specific regulatory rules in individual markets, they may also be free to pursue a broader range of business models and services than traditional players.

For instance, online aggregators may be free to create a wider set of alternative consumer offerings, such as smaller, lower-cost programming bundles of linear channels – offerings that can be more

closely tailored to individual viewer needs or bundles of linear and nonlinear content that are not available in the market today. For many consumers, this may result in a “best of both worlds” value proposition – spurring them to cut the cord with their existing, infrastructure-based distributors.

A growing list of companies – including Dish Network, Magine TV, Sony, and Zattoo – have already started packaging live linear channels for online delivery, bypassing traditional cable and satellite providers. None of these players have fully integrated nonlinear services, such as SVoD, though some, such as Sony with its Playstation Vue service, do enable users to time-shift programming and watch in nonlinear ways when they want to. And while the current offerings do not provide anywhere near the channel selection viewers typically get with a traditional TV bundle, this is more a matter of a player’s business model and willingness to invest rather than a structural barrier.

We expect this scenario to have the following impact on value chain players and their content-related assets:

➔ *Online Content Aggregators.* By creating services that surpass traditional video bundles, online aggregators would have the potential to disintermediate infrastructure-based distributors, winning over their customers – and their subscription revenues. However, not all online aggregators will be able to play: this scenario favors the development of national, regional, and potentially global players that have the ability to invest in the programming, platforms, consumer marketing and acquisition, and analytics (to mine viewing data for insights and opportunities) that will be critical to success. Smaller and more focused players would likely not survive this transition.

➔ *Infrastructure-Based Distributors.* This scenario represents the most negative outcome for traditional distributors. In it, online aggregators largely replace them in their core video business and significant value shifts away from them – at least in the context of video. However, many traditional players – those with robust broadband, communications, and nonvideo services businesses – are well positioned to shift the focus of their financial base, emphasizing these other services as the transition to a new distribution landscape, centered around online aggregators, unfolds.

Traditional players without other, growing business, will be more negatively affected. Having a primary reliance on their video offerings, and not being able to compensate for the shift of value to the digital aggregators, they stand to lose market share – a sizeable amount of it and potentially much more.

➔ *FTA and Subscription TV Channels.* With both online aggregators and traditional distributors licensing their programming, leading channels that curate original mass-market entertainment or sports content – or engaging niche programming – will realize attractive growth and increasing influence. Yet as the prominence of online aggregators increases, the shift to nonlinear viewing will accelerate – meaning greater pressure on those channels that do not offer compelling mass or niche content.

➔ *Content Creators and Rights Holders.* Under this scenario, creators and right holders will see increased value as the incremental economics that online aggregators bring into the FTA and Subscription TV ecosystems flows to them through the value chain. At the same time, the accelerated transition to nonlinear viewing – the heritage of the online

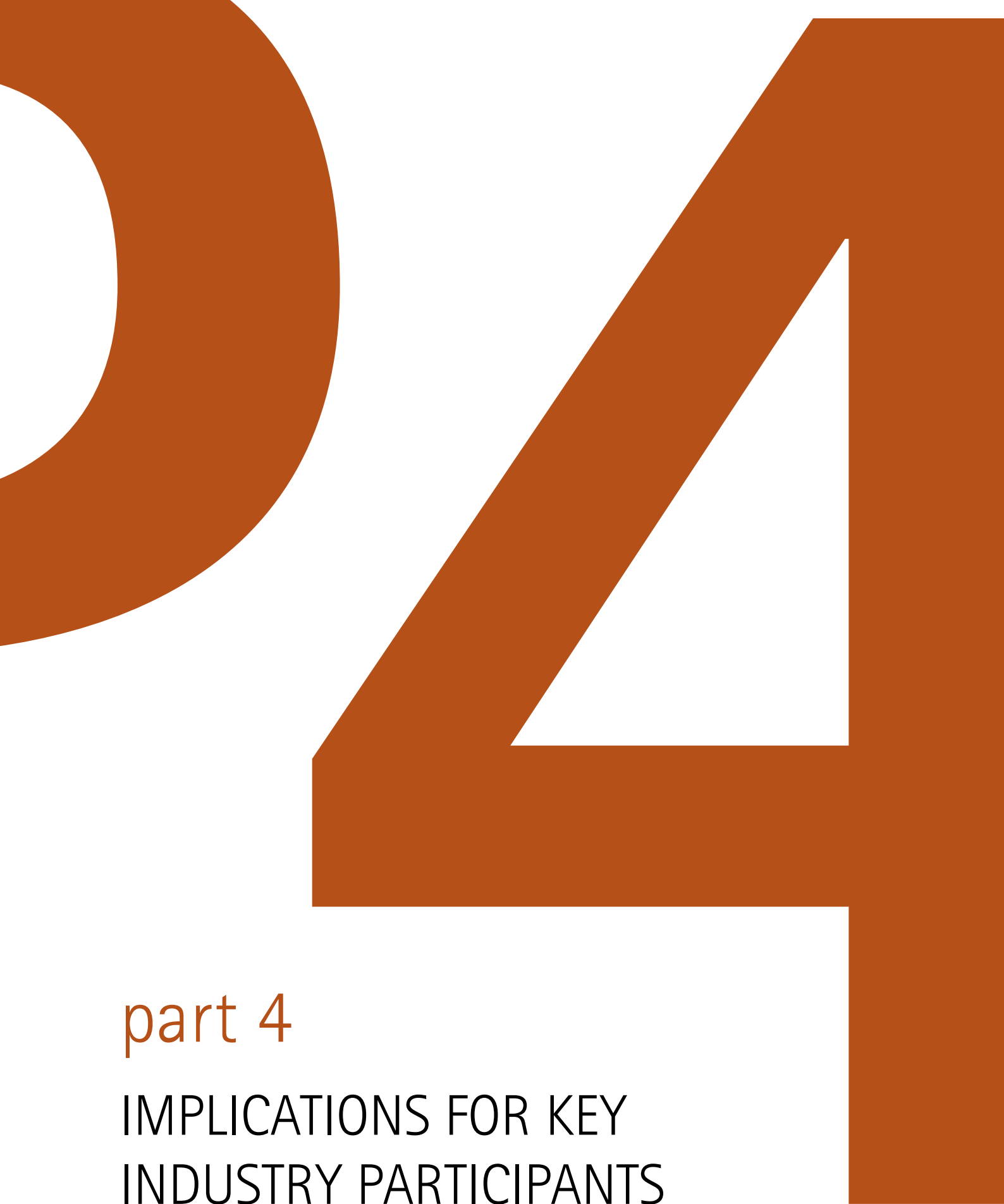
aggregators – will also enhance content creation economics.

There is no single answer. Most markets will evidence a blend of these scenarios, but with one or two as the dominant driver of the industry structure. And the market structure will also vary significantly across markets. For example, relatively mature video markets, such as the U.S. and UK, are much more likely to see disruption from online aggregators and from direct-to-consumer plays by content owners due to the relatively developed state of their broadband connectivity infrastructure and consumers' corresponding adoption of online pathways and nonlinear viewing.

By contrast, markets such as Brazil, Turkey, and Croatia have significantly less developed online video capabilities and have seen, so far, less change in consumer behavior. This gives thoughtful and proactive traditional players a greater opportunity to shape the market ahead of its development. In this context, the navigation and exclusive content scenarios look more likely – or potentially, traditional players could even leapfrog all of the scenarios by forestalling the emergence of an independent online value chain.

In our final section, Part 4, we turn from scenarios for how the industry could evolve to the imperatives these alternative industry structures create for different types of players. We also suggest some of the actions companies along the value chain might consider – either to shape the outcome or to position themselves to adapt to it as it evolves. »





part 4

IMPLICATIONS FOR KEY
INDUSTRY PARTICIPANTS

KEY INDUSTRY

The scenarios in Part 3 described how the television industry might evolve. While there is still legitimate room for debate around which scenarios will play out in which geographies, it is hard to argue that a prudent path is to assume that the first scenario – gradual evolution within the current industry structure – will define competition, control points, and value in the future as it has in the past.

It is from this starting point that this section suggests some implications and related potential actions for industry participants at the different stages of the value chain. Depending on where a participant starts, there are either “shaping” actions that should be taken to influence the evolution of the industry in its market or “positioning” actions that should be taken to prepare for some of the scenarios.

Specifically, we will discuss our views on these implications and actions for each of the key groups of players:

- » Content creators and rights holders
- » Broadcast networks
- » Infrastructure-based Subscription TV distributors
- » Online content aggregators

Implications for content creators and rights holders

Content creators and rights holders are facing, in general, the best range of outcomes across the different scenarios. In almost all cases, the related value of their content increases. And in some cases, their relative importance and ability to serve as a control point increases as well.

Sports rights holders. Across all scenarios, the holders of sports rights will continue to be in an advantaged position. They own must-have content that is of key strategic value across all of the different scenarios. As a consequence, the value of these rights will increase.

The high value of sport content may also enable those that control it to create their own networks and content offerings and offer them direct to consumers. Increasingly, the seeds of this approach can be seen in different geographies. In the U.S., for instance, the National Football League, National Basketball Association, National Hockey League, and Major League Baseball are all developing direct-to-consumer subscription and advertising supported offerings. While such efforts have been slower to evolve in sports leagues outside the U.S., examples such as Basketball Bundesliga Live (BBL) – a partnership between Basketball Bundesliga and Deutsche Telekom – have made an appearance.

This strategy will not work for every rights holder in every market. And even where it is possible, it will be critical for rights holders to navigate the unique set of competitive and regulatory dynamics within specific markets to define a path to success. But with this caveat, sports rights holders should continue to mine incremental value from their

rights negotiations, to split rights across formats and pathways, and to pursue opportunities to build their brands and enhance their direct-to-consumer offerings.

Entertainment content creators and rights holders. Similar to sports rights holders, the entertainment content community is, in general, in an advantaged position and should see the value of their content increase across all of the scenarios. Certain formats in particular, such as serialized dramas, are increasingly well positioned to take advantage of consumers' adoption of time-shifted viewing.

Of course, to maximize this value, entertainment players will need to think strategically about how to manage the increasing number and types of windows for their content – not only across time and geography but also across pathways and roles in the value chain.

For players with strong brands and a critical mass of genre-specific content, the opportunity to pursue direct-to-consumer services should also be actively considered. In pursuing this path, they will need to address the trade-offs between near-term monetization opportunities and the longer-term potential of building an independent path to consumers.

Those without the necessary brand strength or critical mass of content will have the imperative to focus on developing more refined windowing approaches. The increasing number of distribution pathways, consumption formats, and business models increases the opportunity for windowing the inherent value of their content.

One interesting windowing issue that is likely to arise raises unique challenges. This is the increasing array of opportunities to provide exclusive content to a single player in one of the value chains. For content creators, the challenge is to effectively value exclusive entertainment content in advance of knowing whether, and to what degree, it is compelling and with which audiences. It may represent a shift from a hit-driven business model to a more stable – albeit with less upside – approach to content creation.

Hit shows achieve their extraordinary value because of their broad distribution across the widest possible range of windows. While it is conceivable that a broadcast network or online aggregator might be willing to pay a premium for exclusive access to a hit show, the paradox is that it is the broad distribution that proves the show's hit value. Given the very high failure rates of new entertainment content, as described in Part 2, finding a fair price in advance is almost impossible.

Implications for broadcast networks

FTA and Subscription TV broadcast networks will face more pressure as consumers shift to the online ecosystem and as the risk of disintermediation from content creators and rights holders, traditional distributors, and online aggregators becomes more palpable. The key factor that will differentiate performance among FTA and Subscription TV networks will be the degree to which individual players build hit-driven or niche portfolios that distinguish their brands. Networks such as AMC and the Food Network in the U.S. are effectively pursuing this strategy and consequently are improving their position for the future, as that future evolves.

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FTA channels. Leading FTA networks are primarily competing on hit content today and have a strong starting point across scenarios. However, there are some key considerations for them to take into account. For one thing, the traditional sources of “lead in or lead out” advantage – in which a highly rated show or sports event “anchor” creates greater awareness, sampling, and viewership of ancillary programming – will decrease over time in most scenarios.

Then there is nonlinear viewing. It should be a strategic imperative for FTA channels, across all scenarios, to embrace this new style of viewing, and to create online products and services to maximize the reach of their content, getting it to as many consumers as possible. By developing the right approach to these platforms, they can create greater awareness and sampling for their must-have content. And through effective management of nonlinear experiences, FTA channels potentially gain the flexibility to incubate new generations of leading entertainment programming.

Indeed, in the U.S., FTA players such as ABC were among the first FTA channels to embrace new platforms; even a decade ago, ABC content was available on iTunes. Today the network has a myriad of strategic time-shifted and online content plays, including Hulu, ABC.com, and WATCH ABC TV Everywhere app. ProSieben, a German TV network group, has explored a similar strategy with the launch of MaxDome, an SVoD service, and MyVideo, an AVoD service.

This move to embrace new modes of consumer engagement should also enable these players to access additional pools of value. ABC’s initiatives are occurring under a variety of business models (SVoD, AVoD, and apps authenticated as part of a pay-TV bundle) and with a variety of partners – traditional distributors, online aggregators, and other broadcast networks, among others.

Few FTA networks should attempt to create direct-to-consumer services on their own. Most of these players provide a mix of general entertainment, news, and sports programming, and while their individual shows and live events may be compelling and their brands strong and well known, few have sufficient critical mass of any single type of content – a prerequisite for becoming a direct consumer destination in a world of comprehensively aggregated television content. Instead, their focus should be the ubiquity of their content, available on a network-branded basis across all of the different pathways and business models.

Subscription TV channels. Compared with their FTA counterparts, Subscription TV networks will need to adopt very different strategic approaches to positioning themselves relative to the various scenarios. In general, Subscription TV channels are much more content and genre-focused than FTA channels. But even among the Subscription TV players themselves, strategies will differ, as their starting positions, in terms of brand and content strength, vary widely.

Those Subscription TV channels with compelling entertainment or sports content, as well as strong brands, are in a pole position relative to the changes that are coming. Whether they are

leading massmarket brands (such as HBO in entertainment, Sky Sports in sports, and Canal+ in film), or niche brands (such as the Food Network and AMC), these channels have the opportunity to go direct to their consumers as a go-to-market approach operating in parallel to pursuing viewers through infrastructure-based distributors and online content aggregators.

Depending on their specific genre or niche, Subscription TV players may also have the opportunity to develop alternative products, services, and revenue streams beyond pure advertising-supported and consumer pay video. The Food Network, for example, has expanded its presence into a popular online destination for recipes, FoodNetwork.com, and will continue to have an opportunity to expand into adjacencies such as the sale of cookbooks, cooking products, and packaged food.

Any broadcast network that does not produce or otherwise source engaging first-run video content – either mass-market or niche – will need to focus on its programming mix. A channel centered on low engagement programming or previously aired TV shows will be on the wrong side of almost all of the scenarios. In those markets with several hundred video channels, it is unlikely that all of them will be able to make the necessary transition in time or that the underlying economics of the television industry would support the creation of enough new, original content for everyone. Thus, making the shift soon isn't just wise, but vital.

Implications for infrastructure-based Subscription TV distributors

The implications and related actions for infrastructure-based distributors will vary – significantly – depending on whether a player has broadband capability or not.

Video-only distributors. As broadband speeds that accommodate HD-quality television reach ubiquity, the strategic position of infrastructure-based distributors without a broadband business, or with low quality broadband, becomes tenuous across all scenarios. Historically, these players – predominately, but not exclusively, satellite-based – have leveraged their unique ability to offer the richest set of pay TV channels to nearly every household in a market in order to build market share and drive attractive economic returns. But these players are particularly vulnerable to cord cutting and cord shaving in a world of nonlinear viewing and increasing subscription costs, and increasingly they are susceptible to share shift as consumers make video choices on the basis of broadband providers first.

The choices these players should consider include the following:

➔ *Build, partner with, or acquire broadband capability and related non-linear services.* Just because the current platform does not provide a robust two-way experience does not mean that this is a permanent condition. BSkyB has created an integrated broadband-and-video offering through Sky Broadband. Dish Network has gone down a different, but related, path with its Sling TV offering in the U.S. And prior to its acquisition by AT&T,

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DirecTV had partnered with the telecom giant to create integrated broadband-and-video offerings. In executing this approach, players should also deploy the integrated multipathway navigation interfaces discussed earlier in this report.

➔ *Compete on exclusive content.* Another opportunity to differentiate one's video distribution service is on the basis of exclusive content. For over a decade, English Premier League rights have been used as such a strategic asset by a number of distributors in the UK market. For video-only distributors, this approach can help them retain their competitive advantage in an environment where infrastructure-based video distribution is de-emphasized.

➔ *Merge with strategic broadband players.* Rather than continue to fight a potentially losing battle, strategically aligning with a broadband player can be a sound option. In many cases, video-only players still enjoy one of the largest, if not the largest, video customer bases in their market. For broadband players, the opportunity to acquire those customers and drive scale and buying power can be very attractive. Meanwhile, such a move insulates video-only players from an exodus of subscribers to the online ecosystem. These are among the strategic considerations behind the AT&T-DirecTV merger in the U.S.

Distributors with broadband capability.

Large, well-positioned Subscription TV distributors with attractive broadband services should move aggressively to pursue multiplatform navigation (Scenario 2 in Part 3 of this report). The strength of their current relationship with consumers, the quality of the services they currently provide, and the scale

of their customer-service and field-support organizations positions them well for this strategic pivot – as long as they move quickly and maintain the pace.

The prerequisites and benefits of this move are as described in our discussion in Part 3. Yet the challenges in taking this approach and executing it effectively will be significant for many operators, and warrant special attention here:

➔ In many cases, the execution of an “open” navigation strategy, covering content both inside and outside the distributor's walled garden, requires a significant change in mind-set and culture – both among a management team and across a large organization that has long been focused on building and protecting core video subscribers.

➔ Pursuing this approach will also create significant conflict with key business partners, most notably broadcast networks and set-top-box providers that will act to prevent this shift.

➔ Equity markets – analysts and investors – may be slow to understand and reward this pivot in its early stages. After decades of focusing on metrics such as revenue generating units and video subscribers, they may have difficulty adjusting to a strategy that de-emphasizes protecting the traditional video offering.

➔ Depending on the specific market or geography, there may also be licensing and regulatory issues to be addressed.

Finally, it will likely be important for these distributors to consider approaches to investing in, or owning, key elements of proprietary content. However, this will need to be pursued on a highly selective basis. Players must carefully balance the trade-off between owning video content and related rights that have the potential to strengthen the core broadband subscriber base while also ensuring that key content has the broad reach and access necessary to maximize its value.

Small Subscription TV distributors. These players will be in a challenged position relative to all scenarios other than gradual evolution. They do not have the scale required to design and implement the technical changes necessary for integrated video navigation and curation. As a consequence, they will be dependent on third parties to develop these capabilities and license them on attractive terms. And with lower margins than the larger players (in most geographies), due to higher content costs and a smaller customer base over which to amortize fixed operating costs, many of them will have to carefully think through the strategic choice between remaining independent and participating – as a seller – in industry consolidation.

Implications for online content aggregators

Online aggregators are carving out leading positions in nonlinear experiences. And many are building attractive economics and related valuations.

As they look at the potential scenarios described in Part 3, aggregators, too, have a fundamental strategic choice: to protect their leading position in nonlinear viewing experiences in the online value chain or to directly attack infrastructure-based distributors by licensing linear FTA and Subscription TV channels and providing them to consumers. This choice will, and should, vary across markets on the basis of the following:

- » The competitive position and financial strength of online content aggregators in the market
- » The degree of maturity for the market's infrastructure-based distributors (household penetration of Subscription TV, degree of consolidation, quality of network architectures, and level of consumer satisfaction)
- » The regulatory frameworks that define the conduct and structure of industry competition

KEY INDUSTRY PARTICIPANTS

In addition to the overarching question of future direction, online content aggregators face a number of more tactical decisions:

➔ *Whether to Pursue SVoD, AVoD, or a combination of both.* We are still in the early days of the online value chain, and there are major debates within the industry about which revenue model is better. Some players, such as Netflix, have staked out a very strong ad-free position for the future. At this stage of evolution, consumer pay is more tangible and near-term, and advertising – as it does for all new content forms – is taking time to develop. In the context of this debate, we would pose the question of whether there is sufficient direct-consumer-pay economics for an SVoD-only approach to be the predominant business model for the online aggregators. As viewer shifts start to impact advertising spending in the FTA and pay TV value chains, content creators will demand increasing license fees for their content in the online value chain. And advertising is a likely source for this incremental value.

➔ *Whether – and How – to Expand Internationally.* Most leading online aggregators derive the bulk of their revenue from a single geography (YouTube and Netflix are key exceptions). Video content rights, locally produced content, and consumer viewing preferences vary dramatically by market, and given this, the strategic importance of international content rights and a global platform remains unclear. Determining the best market expansion strategy to drive scale, though, will have a myriad of benefits within the online ecosystem, irrespective of the role of international content versus local content. This will be a key battleground.

Tuning in to the future

While there are a range of alternative scenarios for the future of the television industry, we believe that the future is more likely to be revolutionary than evolutionary. The well understood roles within the different value chains will see a significant degree of disruption – and for the players that have traditionally assumed those roles, change will be required.

These disruptions and changes will undoubtedly occur in different time frames and at different levels of intensity in markets around the world. But within these differences, there are also similarities:

➔ In almost every case, the role of content – who creates and owns it, how it is packaged, and who delivers it – is at the center of determining how the industry will change. This will shift value to content creators and rights holders in all scenarios and in all markets. In some instances, it will also give these players the ability to shift the direction of a market's evolution toward a specific scenario.

➔ Infrastructure-based distribution will likely decline as an independent source of competitive advantage and as a related control point in video. There are too many alternative pathways that content creators and broadcast networks can utilize for distribution to remain a barrier.

➔ Content aggregation – independent of infrastructure-based distribution – will increase in importance. Consumers will continue to need platforms and services that make discovering and accessing content easy and manageable. And the fight for share in the context of navigation and access will be a major battleground across the historically independent value chains.

Individual companies will need to make difficult choices about what path to pursue. Regulators will need to make choices regarding how – and even if – they should change the current rules by which the industry works. All of this must be done in advance of a clear view of how the industry will, or should, work.

GLOSSARY OF TERMS

AVoD. Advertising-supported video on demand is a business model where an online content aggregator offers free access to a large library of video content, including movies, TV shows, and clips (the content may be professionally produced, user-created, or both). YouTube is an example of this model in action.

Broadcast networks. This term includes FTA and Subscription TV channels that aggregate units of content into a stream of programming. While broadcast networks sometimes create content internally, through their own production arms, they are the chief buyers of content from third-party creators and rights holders.

Content creators and rights holders. These are the studios, sports leagues, and other players that either shepherd content from idea to production or control the rights to content (licensing them to other players that wish to produce or distribute the content).

FTA. Free to air was the first business model to emerge in the television industry; it broadcasts content over the airwaves in unencrypted form. Revenues are derived from either advertising (in the U.S.) or from public tax levies (the model in many European markets).

Infrastructure-based distributors. Playing a key role in the Subscription TV ecosystem, these companies own and operate the physical means to deliver content to viewers: the cable systems, satellite fleets, and IPTV networks. Traditionally, their business model has been to aggregate dozens and even hundreds of channels into bundles sold – and delivered – to viewers in return for a monthly subscription fee.

IPTV. Also known as Internet Protocol television, IPTV delivers video content via IP networks, generally those of major telecom companies, instead of via cable, satellite, or terrestrial systems.

Multichannel networks. Commonly referred to as MCNs, multichannel networks are a new breed of content player that provide production and promotion support to the creators of online content. This support often includes funding, digital rights management, music clearances, and studio and editing facilities. MCNs – whose ranks include the likes of Vevo and Collective Digital Studios – also assist with the monetization of content. While their agreements with creators can vary, an MCN will typically share in the revenues generated by the content and, in some cases, may own the content outright.

Nonlinear viewing. An “on demand” method for consuming content, in which viewers are no longer locked into fixed schedules set by programmers at broadcast networks. Instead, viewers choose when they want to watch content. While non-linear viewing isn’t a new concept (the videocassette recorder and digital video recorder have long made it possible), online pathways are accelerating the trend by making it exceptionally easy for viewers to access the content they desire, when they desire it.

Online content aggregators. A new type of content distributor, borne by the rise of streaming-quality broadband, these players aggregate content from creators and broadcast networks (and increasingly are creating their own programming) and deliver it to viewers via online pathways. Since delivery relies on the Internet, consumers can access content without using – or subscribing to – the services of traditional cable, satellite, and telecom operators.

Subscription TV. The second of the two traditional video ecosystems to emerge (after FTA); Subscription TV is the aggregation and delivery of multiple pay channels (for example, ESPN) and premium channels (for example, HBO) through a distribution infrastructure – cable-based or relying on satellites or telecom IPTV. Typically, subscribers of these services will pay distributors (the cable companies and so on) a monthly fee in return for the ability to access a bundle of broadcast networks.

Premium subscription channels. These broadcast networks emerged from the Subscription TV ecosystem as new, direct consumer-pay services on top of the government-funded and commercial networks included in Subscription TV packages. For an incremental monthly fee, customers can add “deluxe” content to their bundle of channels, whether that content involves recent theatrical films, highprofile sports, or some other “high value” programming. Examples of premium subscription channels include HBO in the U.S., Premiere in Germany, and BSkyB in the UK.

Pure-play digital services. These companies do business with their customers solely online, relying on the Internet to distribute their products and services.

SVoD. Subscription-based video on demand is a business model where for a monthly fee, an online aggregator will provide access to a library of content, generally distributed via streaming. U.S.-based Netflix and Germany-based Watchever are examples of content players that have embraced this approach.

TV everywhere. This business model enables traditional distributors and Subscription TV channels to make content available, on an authenticated basis, across an array of platforms and devices. Essentially, viewers “verify” their underlying home-subscription service to the relevant channel or service before enabling access to it via a smartphone, tablet, or other means.

TVoD. Transaction-based video on demand is an online business model where aggregators make content available to own or to rent in exchange for a one-time fee. While an Internet connection is required to download the content, once it is on the user’s device it can generally be viewed without a live connection. Players that have adopted this approach include Apple and Maxdome.

Windowing. Under this strategy, content rights are split across platforms, geographies, and time periods. The idea is that by doing so, content creators and rights holders can maximize the value generated by a single unit of content across multiple buyers.

IMPRINT

Liberty Global commissioned The Boston Consulting Group to author a study on the topic of the evolving Television industry in the context of the overwhelming trends toward digital distribution and time-shifted viewing. The objective of this work is to contribute substantively to a dialogue which is high on the agenda of industry leaders, policy-makers and regulators, by providing an assessment of the key trends shaping industry change, the implications for shifts between roles in the industry, and a perspective of the different potential ways the industry could evolve. The report takes a quantitative angle on each of these dimensions, and provides empirical evidence on both demand and supply side dynamics influencing this change.

This study reflects BCG's thoughts on the topic of the future of TV, supported by industry analyses, expert interviews and case studies based on publically available information. In the process of writing the study, BCG and Liberty Global co-hosted a 2015 Davos workshop with more than 25 industry leaders on this topic. The study provides a basis for discussion for key stakeholders across public and private sectors.

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