New SVOD Entrants All Making Critical Mistake: Optimizing for Wrong Outcome(s)

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When you walked into Les Moonves' office, you saw a huge board showcasing the CBS primetime programming line-up vs. their broadcast network peers. Of course, there was competitive programming beyond what aired on broadcast TV, not to mention other forms of entertainment. But "what mattered" was which broadcast network had the most viewers, especially within the adults 18-49 demographic, which is coveted by advertisers. More eyeballs than others meant your network commanded more ad dollars than your peers – that was "winning." Beyond ratings/ad dollars, broadcast network execs needed to ensure they had enough "must-have" programming (aka NFL) to justify ever higher retransmission content fees. The goal in the linear TV world was literally how to spend the least to drive the highest advertising and retransmission consent fees.

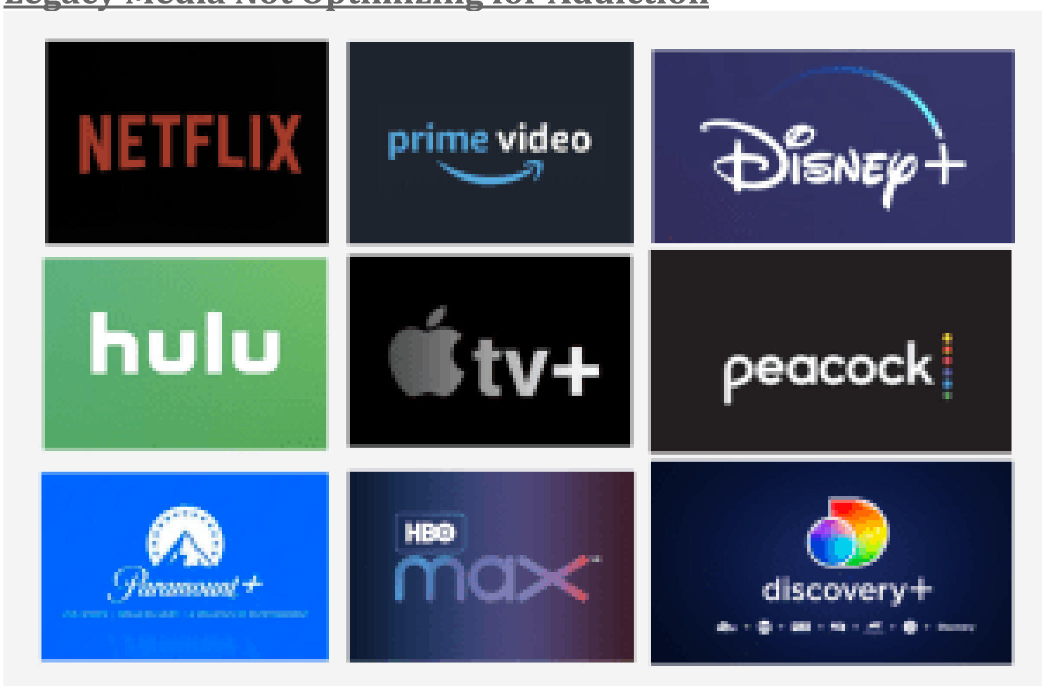
Conversely, you never heard a network TV exec state their goal was to dominate all TV time spent, let alone all entertainment time spent. That mindset simply did not even exist in the linear TV world.

The War for Time: Driving Addiction

Now shift gears to the Internet. We will never forget our first meeting with YouTube co-founder Chad Hurley, who remembered that the “aha moment” for YouTube that drove exponential engagement was when they created related videos next to the video you were watching – driving users to get lost in the world of YouTube. Now think about all the major tech giants (and the want-to-be tech giants). Every one of them wants users to spend as much time as possible in their ecosystem. Each tech platform keeps expanding the number of things for users to do on their platform to increase engagement: from Spotlight at Snapchat to podcasts at Spotify, to Reels at Instagram to B2C messaging at WhatsApp to more content at Netflix to paid podcasts and movies/TV at Apple. While none of the tech companies will say they want consumers to be “addicted,” the reality is algorithms, game mechanics and push notifications are all specifically designed to capture as much time per day as humanly possible with the goal of getting users to come back every day (if not every minute).

The tech giants have many different ways of monetizing time spent spanning advertising, subscription, transactions, device sales, etc. Regardless of how they monetize, all believe the more time you spend in their world, the more consumer wallet share they will ultimately capture. Maybe the best example is Amazon, where they clearly do not make money on Prime Video discreetly, however, Amazon execs repeatedly talk about how subscribers who use Prime Video spend substantially more across Amazon. Amazon is now upping the content on Prime Video meaningfully, spending $11 billion on Thursday Night Football (over 11 years) and $8.5 billion to acquire MGM. It is abundantly clear that "winning" the war for time and attention requires incredibly deep pockets and long-term thinking.

Legacy Media Not Optimizing for Addiction



Virtually every legacy media company has realized they have to pivot to streaming, with linear TV in secular decline as cord-cutting accelerates (*albeit, a few companies, such as Sony, have realized being a content "arms dealer" to the streaming world is far more compelling than entering the streaming wars themselves*). Legacy media's streaming offerings are all decent offerings product and tech-wise, but none are focused on driving addiction. They are focused on driving subs (*repeatedly sacrificing ARPU through discounting*) and balancing investment in streaming offerings with their legacy multichannel video profits. Failure to optimize for addiction starts with underspending on content, including the diversity/breadth of content. For years, we would go to industry cocktail parties where legacy media executives would chide Netflix for overspending, saying they could spend far less if they simply focused on quality over quantity. Yet, when you look at Disney's rapid evolution in the first 18 months of Disney+, it is abundantly clear that they now realize just how hard it is not only to capture subscribers, but to drive ARPU and keep those subscribers from churning. It requires far more content than Disney anticipated, leading to a doubling of planned content spend. Hopefully Disney will soon realize the importance of creating a unified streaming experience vs. the four-pronged approach of Disney+, Hulu, ESPN+ and Star (*would give users far more reason to never leave the world of Disney streaming*).

In a similar vein, Discovery+ was never going to have hundreds of millions of subscribers on its own. In turn, as part of the Warner Bros. Discovery transaction, we would not be surprised to see Discovery+ folded into HBO Max in late 2022 to add genre breadth and depth.

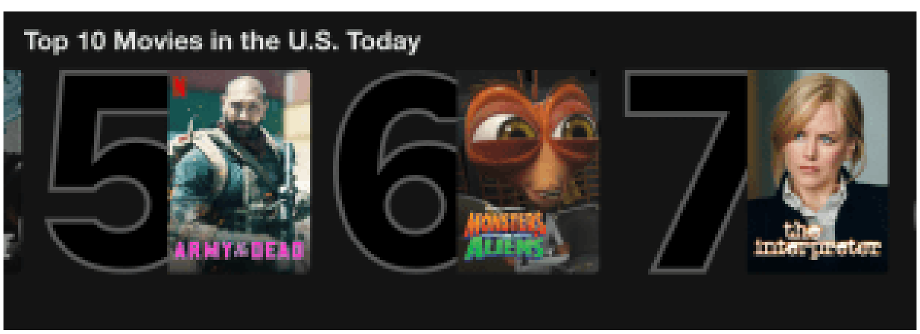
But consolidation alone is not enough, it really comes down to driving addiction vs. profits. Margins and profitability need to take a backseat with all focus placed on capturing more of a user's daily entertainment time spent. To Disney's credit they have gone further than others have been willing to go in putting streaming usage ahead of profits, but even they need to be more aggressive (*with everyone else far, far behind*).

Weekly vs. Binge Releasing

Failure to optimize for addiction goes beyond content spend. Releasing episodes of a TV series weekly can help build social buzz (*not to mention stretching limited content budgets*), as it surely did for Disney+'s WandaVision or HBO's Westworld; both are complex series with lots of viewer debate over the storylines and

“easter eggs” within each episode. Yet, by releasing episodes weekly, you are preventing a subscriber from getting lost in your service. In many ways, legacy media executives are still acting like they are competing in a linear TV world – where every series they, and others, offered was released weekly.
How many people only turned on Disney+ once a week to watch each new episode of The Mandalorian? We suspect a large number of people would have binged the series in far less time than eight weeks, leading to Disney+ capturing more time spent per day per subscriber. Instead, those same viewers left Disney+ and went to competitive streaming services or other forms of entertainment altogether (Fortnite, Roblox, etc). If you work so hard to acquire a subscriber/viewer, why do you want them going elsewhere 30-60 minutes later?

The challenge of binge releasing is that users will finish a series sooner, requiring a service like Disney+ to have even more content. If Disney cannot keep users busy after binging a series such as The Mandalorian, the risk of churn rises meaningfully (*stretching it out over eight weeks helps reduce churn for two months of the year, even if it sacrifices addiction*). Binge releasing drives engagement and builds addiction, which should enable higher ARPUs over time, but requires substantially greater spending on content.



An abundance of content, enabling binging and the underlying technology to surface content for subscribers creates a serendipity to Netflix that is missing from the other streaming services. The consumer behavior towards Netflix is similar to the days of turning on the TV and channel surfing to find something to watch. While there is certainly high profile content that consumers seek out when it launches, most of the time consumers are simply heading to Netflix to find something to watch or to continue watching something they started recently. Netflix works extremely hard to engage users with content new and old in hopes of capturing as much of their daily time as possible. We suspect very few people went to Netflix yesterday to seek out The Interpreter from 2005 or Monsters vs. Aliens from 2009 (see screenshot embedded above right), yet both are top 10 movies on Netflix. In contrast, the other streaming services act more like weekly appointment TV akin to linear broadcast networks, where you would tune in weekly to your favorite series.

Sports vs. Entertainment Programming

Now think about sports. Peacock has sports, Paramount+ has sports and now HBO Max is entering the sports world following WarnerMedia's recent NHL deal. Sports are must-watch live content that bring a defined audience of diehard fans. That is obviously great for boosting sub counts, as EPL fans and WWE fans are highly likely to subscribe to Peacock. Yet, it does not really build addiction. If you are a WWE diehard, Peacock is not enough, you need a multichannel video subscription to watch WWE content on FOX and USA. If you love European soccer, you need Peacock for EPL, but you need Paramount+ for Champions League and Serie A. No streaming service controls an entire sport – even ESPN splits UFC between ESPN, ESPN+ and ESPN PPV. With limited-to-no catalog value beyond the live airing window and rights geographic region-specific (vs. global), we find it hard to believe sports is the best use of programming spend today. Maybe at a certain scale it makes sense, but the price/value of sports is so high relative to other forms of entertainment programming.

Exclusive Theatrical Windows vs. Day-and-Date Releasing

With blockbuster movies, there is no doubt pre-pandemic that studios could make more money by releasing them in theaters exclusively for several weeks. Avengers: Endgame generated over $900 million in profits to Disney; it is simply impossible to replicate those discreet economics via streaming subscriptions gross adds or churn reduction. However, in the context of building addiction, high profile movies have the power to bring in new subscribers as HBO Max has clearly shown with its day-and-date release strategy. Disney has seen similar benefits when it has chosen to include movies such as Hamilton or Soul at no extra cost, versus a $30 surcharge for premium access. If you are optimizing for near-term profits, day-and-date movie releasing on streaming and theaters is impossible, but if you are looking at building your subscriber base at ever higher prices, enabling consumers to watch new movies at home is incredibly powerful (we illustrated how Disney could double film profits **here** and compared Disney and Warner's film businesses to Netflix **here**).

Advertising vs Ad-Free

Legacy media companies have sizable ad-sales teams that they want to leverage. Hulu generates upwards of $10/sub/month from its ad-supported subscribers and Discovery has talked about how it is generating more from its ad-supported tier subs than its ad-free subscribers due to the demand for connected TV advertising. HBO Max recently launched an ad-supported tier that offers the service for a $5 discount ($10 vs. $15/month) and Paramount+ is set to drop the price of its ad-supported tier even lower in the weeks ahead. Legacy media sees the opportunity to scale faster with a lower priced streaming service, in addition to boosting their legacy video business as advertisers will undoubtedly be forced to buy linear TV inventory if they want the more coveted connected TV/streaming ad inventory (*reminds us of when advertisers wanted to buy Howard Stern, but were forced to take 3 am inventory as well*).

Light streaming ad loads are certainly better than the heavy ad loads we have all experienced on linear TV. That said, it is hard to believe you need to lower the price of a service and jam in 5+ minutes of advertising to drive subscriber adoption, when Netflix without ads is nearing 70 million US subscribers at an ARPU last quarter of $14.25. While many consumers may opt-in for the ad-based SVOD tier, all signs point to time spent per user per day being less. So while it boosts subs and ARPU, it lessens addiction. Even Amazon, which is one of the largest advertising companies in the world, has not created an ad-supported tier for Prime Video, with IMDb TV an entirely separate product.

We love AVOD as a standalone product offering to monetize long-tail content (Tubi, Pluto, Xumo, etc), but we struggle to believe hybrid AVOD/SVOD is the best to drive long-term subscriber addiction.

Bottom Line: tech companies are using content and programming to capture even more time spent per day driving addiction to their platforms, whereas legacy media companies are all now trying to become tech companies but they are failing to recognize the most important element of "winning" tech companies, which is controlling as much time spent per user per day as possible.

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