BSAC Business Briefing

The Evolution of the OTT TV Market

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Cutting the pay TV cord?

Over the Top (OTT) television has become a shorthand term for a range of different online video services that may circumvent existing pay TV and broadcast business models, using the Internet as a means of distributing 'Over The Top' of those legacy services.

The context of OTT growth is a slowing global pay TV market. Whilst still the dominant business model, pay TV operators all over the world are now experiencing slowing growth rates in their core subscriber metrics. To date, North America is the only region where there are signs that the traditional pay TV sector is actually contracting in size, prompting fears that consumers are genuinely starting to 'cut the pay TV cord'. However, the industry has justifiable concerns that 'cord cutting' will eventually spread to all markets around the world as OTT alternatives become more attractive.

The largest European pay TV operator by subscriber count is Liberty Global, which has been building scale through a series of acquisitions. Close behind Liberty is Sky Europe, which operates in Italy and Germany as well as the UK. All of the other top ranked pay TV players in Europe are primarily known as 'telcos' – but most use a variety of different distribution technologies to deliver their video services to paying customers (cable, satellite, IPTV and terrestrial). And all the leading operators offer a variety of services – broadband, telephony, mobile, etc. – in addition to TV, generally as part of a 'multi-play' bundle.

OTT market scale

To illustrate the scale that the leading OTT players have now achieved, it is worth noting that both Netflix and Amazon would rank amongst the ten biggest pay TV players in the European market measured by absolute number of subscribers. However, it is debatable whether this is a justifiable comparison as the business models of each are distinct from traditional pay TV operators in several ways. Moreover, OTT video services could just as validly be compared to 'channels' that are carried by pay TV platforms – and indeed, a growing number of operators are integrating Netflix as a 'channel' within their content offering.

The European online video market is now worth about €8 billion in total, with the largest part of this being advertising revenues generated by services like Google's YouTube. Close behind in revenue terms is subscription payments to online services, such as Netflix. The remainder of the market total – and by far the smallest element - is derived from transactional spending on movies and TV shows via services such as Apple iTunes and Sky Box Office.

By way of comparison, the European online video market is worth a little under half the value of that in the US. Online video market growth – and the associated hype around subscription video on demand (SVoD) in particular – has prompted a flurry of industry activity. More than 56 new online video services have been launched in Europe alone since the beginning of 2015. Unsurprisingly, standalone SVoD services accounted for the largest proportion of this total, but there were multiple ad-funded free to view services as well.

The changing market for online video advertising

Despite new launches, the advertising-supported online video market is still dominated by YouTube, which continues to generate growth in viewership and revenues on a different scale to the 'catch-up' services offered by commercial broadcasters. The success of YouTube has prompted a growing number of traditional media companies to acquire operators of YouTube channels and build so-called Multi Channel Networks (MCN's) with the intention of capturing the 'eyeballs' of a younger demographic. Notable examples of these deals include Disney's acquisition of Maker

Studios, RTL's investment in Broadband TV and ProSiebenSat1 buying Collective Digital Studio.

However, the online video market is evolving fast and YouTube is no longer the only significant 'game in town'. Notable newer entrants into the market, Snapchat and Facebook, have enjoyed explosive growth in video views on their own platforms and look likely to rival YouTube's scale. Consequently, leading media companies are now looking to develop multi-platform strategies that maximise advertising opportunities across a growing number of these evolving online video outlets.

The rise and rise of SVoD

It is fair to say that most of the current industry excitement about OTT TV is focused on the SVoD business model. Ranked by SVoD spend per broadband household, the UK is currently the sixth highest performing market in the world – behind only the US and all the Nordic markets. Unsurprisingly, there is a strong correlation between this metric and the date at which Netflix entered and developed its presence in each respective market. The UK was one of the first international territories targeted by Netflix and its growth here has been impressive. It is now second only to Sky in terms of total video subscriptions (traditional pay TV and new SVoD services), having overtaken Virgin Media some time ago.

There is a clear underlying consumer demand and propensity to pay for subscription video. Since 2010, the total number of video subscriptions of all kind sold in the UK has increased by 65 per cent. Because SVoD services tend to charge a lower monthly fee than their traditional pay TV counterparts, there has been a smaller rise (30%) in total subscription spending over the same period – from £5.7 billion to £7.5 billion. By far the majority of these revenues are still being captured by the traditional pay TV players, such as Sky and Virgin.

In January 2016, Netflix launched in an additional 130 countries, bringing its total number of territories up to 190. Unlike broadcasters and pay TV operators, Netflix is fundamentally an internet platform and as such is able to move at a pace that conventional providers cannot. Netflix is now genuinely operating at a global scale and is on course to attract over 120 million subscribers by 2020. This subscriber total would give it greater reach than any other premium channel in the world, overtaking HBO and Showtime. Amazon is now explicitly following a similar strategy and in December 2016 announced that its Prime Video service was now technically available in over 200 countries, albeit with a less developed content offering than its competitor.

The new content battleground

Both Netflix and Amazon have adopted a strategy of aggressively investing in content rights to drive their subscriber growth. Netflix recorded a total content spend of

almost $5 billion dollars in 2015, rising to $6 billion in 2016. This level of expenditure makes it one of world's leading investors in programming rights, outspending major traditional players like the BBC, Discovery, HBO, ITV and pay TV giant Liberty Global. Similarly, Amazon has already overtaken ITV in content spending terms and is on course to exceed the BBC's programming budget.

The focus of Netflix's content strategy – and by extension Amazon's – has increasingly moved towards original content rights that can be offered to subscribers on an exclusive basis. Both companies are striving to produce a series of high profile TV shows and – to a lesser extent – movies, which can be used as the cornerstone of marketing campaigns to attract new subscribers. Given their expanded international footprint, they also need to amass a growing library of rights that can be exploited on a global basis.

Netflix commissioned 600 hours of original content in 2016, up from 450 in 2015, and is on track to make 50% of its output original content. The company is also moving to internationalise its production efforts in order to provide more local TV shows, so as to improve its appeal to audiences in key markets. Netflix now has productions underway in nine different countries.

Netflix content availability varies from country to country, but the choice of TV shows offered in the UK has been rising – with an increasing focus on drama. Over the 12 months from September 2015 to September 2016, the number of drama titles within the Netflix proposition increased from 119 to 179, boosted by the expanding library of local titles from around the world.

The 'Netflix effect' – how pay TV operators have responded

Taking an 'if you can't beat them, join them' approach, a growing number of traditional pay TV operators have struck deals to offer Netflix through their set top boxes alongside their existing channels. As of July 2016, 28 different pay TV providers around the world had made active partnership deals with Netflix. Particularly notable was the Netflix carriage deal announced by Comcast, the world's largest cable group. This was followed by a similar agreement with Liberty Global, which will see Netflix's pay TV distribution footprint expanded dramatically.

The benefit for these operators is to supply Netflix to their subscribers without them needing to leave their ecosystems, thereby reducing the risk of cannibalisation. From Netflix's perspective, these kinds of deals provide a low-cost, low-friction route to subscriber acquisition.

The perceived threat from OTT services has prompted legacy pay TV providers to pursue a range of strategies designed to enhance their competitiveness. An early approach was to enable subscribers to view their core pay TV services beyond their set top boxes by offering apps that allowed consumption of their content over a multiplicity of different devices (smartphones, tablets, games consoles, smart TVs, etc.). Most, but by no means all, operators now offer this kind of 'multi-screen' service (e.g. Sky's Sky Go).

A more recent strategic response from operators has been the creation of complete standalone OTT TV propositions, which can be considered ‘virtual pay TV’ platforms in the sense that they provide packages of linear as well as on-demand premium channels, but delivered over the Internet to consumer-owned connected devices rather than a conventional set-top box. These virtual pay TV services are designed to provide direct competition to the likes of Netflix and to appeal to a more cost-conscious and lower-age-band demographic. As such, they feature a more limited choice of channels than the legacy pay TV offer to keep pricing lower: so-called ‘skinny bundles’ of channels.

Some virtual pay TV propositions are differentiated from their parent company with a novel brand, while others maintain their pay TV operator branding. Examples of the former include Sky’s NOW TV in the UK and Dish’s Sling TV in the USA. Most recently AT&T, which owns the US direct-to-home satellite service DirecTV, joined the virtual pay TV trend with the 30 November 2016 launch of DirecTV Now – clearly maintaining the brand association.

In the ‘Netflix era’, the most advanced pay TV operators now typically follow a two-tier product strategy. At one end of the spectrum, they seek to retain and appeal to high-spending customers with a ‘full-fat’ proposition. This is likely to include sophisticated Ultra High Definition (UHD) set-top box technology, advanced electronic programme guides, the widest choice of programming and flexible multi-room delivery solutions. A great example of this approach is Sky’s recently rolled-out Sky Q platform. Then, to simultaneously serve the lower-end of the market that might not have been previously targeted, the same company will make a ‘lighter’ virtual pay TV proposition available – as exemplified by Sky’s NOW TV platform – which gives flexible access to a more limited range of popular content across multiple devices.

A fragmenting SVoD environment

Within the SVoD space, Amazon has emerged as the single biggest direct competitor to Netflix. Responding to Netflix’s international expansion, Amazon announced its own global launch of the Prime Video service on 14 December 2016. However, the e-commerce giant is not the only company to mimic the ‘general entertainment’ SVoD model pioneered by Netflix. There are a growing number of local and regional services taking this approach. Notable examples include the pan-Asian platforms HOOQ and iFlix, Molotov.tv in France and Maxdome in Germany. Interestingly, both iFlix and Molotov.tv have received equity investments from Sky.

The perceived potential of the SVoD market has also encouraged a proliferation of more specialist thematic propositions to come to market. Examples include MUBI, a specialist independent movie outlet that positions itself as an expert curator of “Great Cinema”; CuriosityStream, a documentary service; Crunchyroll, a dedicated provider of Japanese anime animation; and hayu, NBCUniversal’s platform for reality TV shows.

Traditional channels have also become increasingly excited by the new distribution avenues enabled by the Internet and particularly the possibility of engaging directly with consumers. However, they face a delicate economic balancing act and must be careful not to disrupt their existing terms of business with pay TV operator partners, which most channels depend on. Consequently, most premium channels initially took a conservative approach that was firmly rooted in continued partnership with operator business partners. Although consumers were offered the chance to view the channels via their own connected devices, they were required to 'authenticate' access using their existing pay TV provider credentials. In the US, the term 'TV Everywhere' was coined to describe this approach, examples of which include Showtime Anytime and HBO Go.

More recently, these premium channels have become braver and begun to roll out direct-to-consumer services. HBO was the first major US channel to by-pass pay TV operators with a streaming service offered directly to subscribers. CEO Richard Pleple called this service – branded HBO Now to differentiate from the existing HBO Go offer – the company's 'millennial missile', as it directly targeting cord-cutters and 'cord-nevers' (i.e. those who had never previously subscribed to any form of pay TV service). There was always a risk that his would cannibalize the core service and upset key relationships with cable and satellite commercial partners. However, early data suggested that HBO Now subscribers were almost entirely incremental to the existing cable network business; fewer than 1% of initial subscribers had previously taken the channel via a pay TV provider.

Other networks, such as Showtime and CBS, followed suit with their own direct-to-consumer OTT services. HBO has followed the Netflix model in looking to launch variants of HBO Now outside the US. However, the complex patchwork of existing HBO rights deals makes this kind of international expansion a challenging opportunity.

Ever increasingly, channel owners have been experimenting with the 'unbundled' direct-to-consumer route to market. These include thematic services, such as from sports specialists Eurosport and WWE. One interesting variant is the OTT 'channel bouquet', which Discovery has launched under the DPlay brand. This is structured to enable consumers to subscribe directly to a bundle of Discovery's channels for a single monthly payment. Going even further is Disney, which has launched Disney Life to offer subscriptions to a bundle of Disney games, music, apps and eBooks, as well as movies and TV shows.

The era of 're-aggregation'?

As channels and platforms increasingly exploit the Internet to take their services directly to subscribers, there will almost certainly be a requirement for new aggregators to emerge and simplify the consumer proposition. It is surely untenable to expect viewers to manage dozens of different applications, payments and authorisations to secure access to their chosen video services.

One aggregation attempt vying for success is the 'app store' model pursued by Apple in the latest incarnation of its Apple TV product. Another approach is the virtual pay TV platform created by Sony; called Vue, this is similar in concept to the OTT services from pay TV operators (such as NOW TV, Sling TV, etc.), which were discussed earlier, and provides skinny channel bundles via the PlayStation-4 console and other connectable devices. Finally, there is the interesting 're-aggregation' proposition developed by Amazon: alongside its own Prime Video general entertainment SVoD service, the Amazon Channels scheme allows customers to manage a growing choice of third-party linear and on-demand services, with the retailer taking responsibility for customer service, billing, device compatibility, content serving and device infrastructure.

Ben Keen

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