

MEDIOLOGY

WHAT'S THE PROGNOSIS FOR SVOD?

One of the burgeoning challenges that broadcast TV networks and national cable programmers are facing is competition from subscription-video-on-demand (SVOD) services. Here is our latest take on this important subject.

Background

It all began quietly enough when Netflix, which started as a DVD-by-mail service in the late-1990s, changed its focus to ad-free streamed content in 2007. In short order, Netflix was joined by Hulu and Amazon Prime. Although Hulu, currently a joint venture of ABC, NBC and Fox, began as an ad-supported service featuring predominantly network TV fare, it got into the ad-free SVOD business in 2010. Amazon Prime began primarily as a free shipping service, but added unlimited streaming in 2011.

Judged by any standard, the growth of SVOD services in the past five years has been both impressive and rapid. In 2010, only 20% of U.S. TV homes subscribed to any of these services—17% of which was though Netflix. By the end of 2015, Netflix had more than doubled its penetration, reaching 39% of U.S. TV homes. Amazon Prime has shot ahead of Netflix in terms of subscribers (54 million versus 45 million), but because many subscribe to this service for free shipping and other perks on the site, it is difficult to pinpoint the reach of its SVOD component alone. All told, we estimate that in the fourth quarter of 2015, 50% of U.S. TV homes regularly accessed content from one or more SVOD services, including lesser players like Sling TV, HBO Now and CBS All Access. We expect further growth, with total SVOD user penetration rising to 57% of all U.S. TV homes by the end of 2016. Most of these gains will be spurred by Amazon, Hulu and the newer SVOD services; Netflix, which is now surging in international markets, will see its U.S. growth rates diminish (see Table I).

The Extent of SVOD Usage

To date, Nielsen has been unable to identify SVOD content properly and, according to reports, is only now ramping up an audio-based "recognition" system that will enable it to provide metered readings of all SVOD viewing on a service-by-service and show-by-show basis. Pending the availability of such data, we have utilized reports on total streaming hours released by various parties, as well as tallies of such activity from Sandvine (a networking equipment company) and other sources, to come up with our own estimates of the current extent of SVOD usage. For example, if one takes data provided periodically by Netflix, it appears that a typical U.S. subscriber home probably

Table I
PERCENT OF U.S. TV HOMES
ACCESSING SVOD SERVICES
 2010-16

4th Qtr.	Netflix	Any SVOD¹	Avg. # Svcs. Per SVOD Home
2010	17.3	20.4	1.07
2011	19.8	24.1	1.22
2012	21.9	28.6	1.21
2013	27.4	36.1	1.54
2014	35.0	40.4	1.50
2015	38.5	50.1	1.55
2016	41.0	57.4	1.67

¹Includes Netflix and all other SVOD services.

Source: Media Dynamics, Inc.

streams Netflix content about 1.6-1.8 hours daily. This translates into roughly 52 minutes per day for an average resident within each home. In contrast, surveys indicate that video streaming activity by Amazon Prime subscribers is considerably less frequent, as many subscribe mainly for free shipping, not necessarily for SVOD. Surveys indicate that upwards of half of Amazon Prime subscribers do not access SVOD content at all on a monthly basis.

Information from Sandvine provides some additional insights. According to Sandvine, Netflix accounted for approximately 37% of “downstream” broadband streaming activity in 2014, which can be interpreted as in-home usage via TV sets, PCs, tablets and other devices. Interestingly, YouTube ranked second in Sandvine’s analysis, while Amazon Prime and Hulu trailed well behind, garnering only 3% each. Also noteworthy, though not surprising, Netflix content was involved in only 3% of smartphone activity (YouTube and Facebook led with 21% and 16%, respectively). In line with such findings, we believe that in-home broadband usage probably accounts for 90-93% of Netflix streaming.

How does a typical adult actually allocate his/her total viewing time by platform? We have made our own independent projections, on a total population basis, including those who do not have access to SVOD. As shown in Table 2, we estimate that a typical adult living in a TV household now watches 321 minutes of TV content per day. Of this, approximately 87% consists of traditional in-home viewing exposures (both live and delayed), while traditional out-of-home viewing accounts for an additional 2-3%. Streaming video represents 10% of an average adult’s daily TV diet, with Netflix still the dominant platform, garnering about three-fifths of the total (see Table 2).

Since SVOD penetration is well above par in households headed by younger to middle aged adults, especially those with higher incomes and educational attainment, streaming constitutes a considerably higher share of viewing in such homes. While an

Table II
AVERAGE HOURS OF DAILY TV/VIDEO VIEWING PER ADULT
 Spring 2016

	Mins.	% Total
Traditional In-home TV ¹	279.0	87.0
Out-of-home TV	8.4	2.6
Streaming Video		
Netflix	20.8	6.5
Amazon	4.5	1.4
Hulu	3.3	1.0
Other	4.7	1.5
<i>Total Streaming</i>	<i>33.3</i>	<i>10.4</i>
Grand Total	320.7	100.0

¹*Includes broadcast network, local station, syndicated and cable fare, plus all delayed viewing of such content. Includes viewing in someone else's home.*

Source: Media Dynamics, Inc.

average adult still devotes 87% of his/her viewing time to linear in-home TV, the corresponding percentage for the younger/affluent portion of the population is probably on the order of 70-75%. Older, lower income adults, on the other hand, devote over 90% of their typical TV day to traditional TV viewing.

SVOD's Impact on Linear TV

There are a number of theories about the SVOD phenomenon. One school of thought believes that, thanks to rising ad clutter on traditional TV, a large part of the population—especially younger, better educated adults—is fed up with commercials and is rebelling by fleeing to SVOD, particularly Netflix. While an aversion to TV ads is undoubtedly part of the motivation to subscribe to Netflix, we believe there are two, more crucial factors. The first is the formulaic, highly predictable nature of broadcast network fare, and the resulting desire for different, edgier content (which can be found in much of the original programming produced for SVOD services, as well as on some cable channels). The second is the obvious appeal of being able to watch content on demand.

A recent analysis of Netflix users, reported in our research annual, **TV Dimensions 2016**, sheds some light on this topic. Using GfK MRI data, we isolated a sample of 2,700 adults who had streamed Netflix content in the past month, and examined their viewing claims for a large number of linear TV shows. In line with other sources, these Netflix streamers skewed young, with a median age of about 39 years, and they were 40% more likely than the norm to have household incomes of \$100,000+.

The most interesting findings in our analysis concern the ways that Netflix streamers al-

located their viewing of broadcast network, cable and syndicated fare, compared to the total adult population. They were far less likely to watch early morning, daytime or early evening news content on the broadcast networks, probably because most Netflix streamers (who are younger and more affluent) are at work or school and therefore not available for sustained viewing in such dayparts. As a result, Netflix streamers registered below the norm as viewers of 58% of the broadcast network's total day programming output. This is not to say that Netflix streamers shunned all broadcast network entries. Indeed, they were more inclined than all adults to watch primetime shows like *Modern Family*, *The Big Bang Theory*, *Family Guy*, *Gray's Anatomy* and *Castle*, which more closely fit the types of programs they enjoy on SVOD and cable. However, they were far less inclined to take in top rated but formulaic series like *NCIS* and *Law & Order: SVU*. When their exposure to cable shows was ascertained by GfK MRI, Netflix subscribers were found to be above average viewers of 63% of the programs, including not only obvious choices like *South Park*, *Tosh.0* and *American Horror Story*, but also ESPN's *Around The Horn*, E!'s *Keeping Up With The Kardashians*, and HGTV's *Love It Or List It*. Indeed, even *Duck Dynasty* rated slightly above the norm among Netflix users.

What do such findings tell us?

First and foremost, they do not support the notion that Netflix subscribers have dumped broadcast and cable TV fare, and are no longer reachable through linear TV. To be sure, they are fairly light viewers of many daytime and early evening TV shows, but this is not unusual. Non-Netflix subscribers with the same age and income characteristics are also lighter than average viewers in these dayparts. Moreover, Netflix subscribers are above-par consumers of most cable shows. When Nielsen finally starts reporting on the kinds of programs that Netflix and other SVOD service subscribers watch, we fully expect that linear TV (broadcast and cable) content will account for a majority of their average viewing day. While a typical adult Netflix subscriber views, say, 52 minute per day of its content, plus an additional 20 minutes of other SVOD fare, this will likely be augmented by about 180 minutes of linear TV shows, including sports, primetime shows, news, reality and talk shows, and documentaries. Why? Because most people need more than movies, sitcoms and dramas from TV, and such content is to be found almost exclusively on traditional TV.

Putting all the evidence together, it seems to us that Netflix in particular, plus Hulu, Amazon Prime and other SVOD services, have been competing most strongly with primetime broadcast network programming, but not so much with the networks' fare in other dayparts, nor with cable in general. Over the past several seasons, the broadcast TV networks' average minute 18-49-year-old primetime ratings have declined by about 7-8% on an annual basis. We suspect that roughly 65% of this audience loss was due to defections to SVOD, while the remainder could be attributed to general rating fragmentation, mostly going to cable. Obviously this is not a positive development for the broadcast networks, and it is unlikely they will be able to turn things around in primetime unless they radically alter their program development strategies, stop thinking that they are still "mass audience programmers," and seek out a new breed of producers who can create intellectually challenging content.

On the plus side, it is important to recognize that broadcast network primetime programming, while generating a lot of buzz, is only one component of the overall and much larger linear TV picture. In fact, depending on the demographics, only 8-15% of a typical adult's total TV viewing time is devoted to the broadcast networks' primetime program lineups. Even if the networks lost every one of their average minute primetime viewers to SVOD—a very unlikely development—this would not mean the demise of traditional TV as a whole. TV is simply too big and diverse for that to happen.

A Peek at the Future

As we have noted, Netflix and other SVOD platforms have undoubtedly made inroads against the broadcast TV networks, particularly in primetime and among younger adults generally. However, competition is brewing in SVOD. Amazon recently announced a \$9 a month stand-alone streaming option (Amazon Prime membership not required) targeted specifically at Netflix. Moreover, it is likely that those who pay Amazon solely to stream content will probably use the service more frequently than is now the case with Amazon Prime members, thereby giving Netflix, et. al. more competition.

Meanwhile, as Netflix's expansion in the U.S. market slows, its focus seems to be shifting. Netflix recently declined renewal of a large library of movies, which probably accounted for about 10% of its streaming activity, on the grounds that the same titles are available on other SVOD platforms and on cable. At the same time, Netflix announced plans to significantly expand its original series and special program content and, not surprisingly, it raised its monthly subscription rates from \$8 to \$10. Meanwhile Hulu grabbed the movie package dropped by Netflix as soon as it became available.

Finally, the TV "Establishment" is at last wising up about SVOD. CBS has announced the launch of a new *Star Trek* series on its own SVOD service, CBS All Access. The first episode of this latest incarnation of the sci-fi classic will be aired in primetime on the CBS TV network, garnering ad dollars and promoting the new service to millions of Trekkies. Later, the full series will be available only to All Access subscribers.

The significance of CBS's *Star Trek* gambit cannot be minimized. We estimate that the network can break even on the show's production costs if it recruits 4-5 million subscribers to its SVOD service. Thereafter, CBS will likely run the series on its primetime network lineup at nominal cost (mainly talent residuals) and, for 95% of the available TV audience, *Star Trek* will be a "new" series, even though technically it's a rerun. With most or all of its production costs already covered by the SVOD launch, *Star Trek* should be a very profitable primetime venture for CBS, with further revenues down the line in the syndication market. Meanwhile, additional skeins of new episodes will go into production, funded by SVOD subscribers in the same way.

Unlike Netflix, the broadcast TV networks and some of the major cable programmers are well placed—both in terms of experience and the existence of available content—to expand rapidly into the SVOD area. If CBS's outcome with *Star Trek* is positive, other networks will begin to launch original primetime series in the same manner, exploiting two revenue streams to make them less reliant on ad dollars while increasing

their profit margins. In addition, existing reality, sports, talk, news and other content can be recycled through SVOD to capture added revenues from aficionados of such programming. At the same time, the networks and major cable entities will become less willing to license their new program content to rerun on Netflix or other competing SVOD services. This may entail a financial sacrifice in lost SVOD fees, but it will limit the competition's ability to further fragment the networks' ratings and limit their ad dollar yields. Forced to initiate more original content, SVOD services like Netflix and Amazon will have to greatly increase their program procurement costs, and at greater risk, since many of the new shows will not be as popular or long-lived as might be hoped.

To sum up, look for:

1. Many more SVOD players to compete not only with linear TV, but also with each other. Many of the new ventures will be initiated by established TV entities like the broadcast networks and cable programmers.
2. As Netflix and other SVOD players are forced to create expensive and risky original content, their business models, which rely on a single revenue stream (subscriber fees), will be modified. Some will offer lower subscription rates for ad-supported programming (Hulu already does this), others will raise their rates for ad-free viewing, and some may do both. As more original programs are launched, and as more SVOD services join the fray, the category's churn factor will rise, with many subscribers switching from one service to another. This will make it more difficult for SVOD services to be profitable, which may result in further subscription fee increases and more audience defections.
3. Linear TV will continue to suffer audience attrition, not only among the younger and better educated segments, but also among older viewers, once SVOD services launched by the broadcast networks and cable entities begin to offer news, talk, sports, reality and documentary content that appeal to such an audience.
4. While linear TV will continue to be the dominant platform for branding advertisers in the short term, network TV and cable programmers will need to accelerate efforts to free themselves from reliance on ad revenues. This process is already underway, with revenue gained from the retransmission fees that cable and satellite distributors pay to stations (which are shared with the networks). Profit sharing pacts that networks have with independent producers also yield significant incomes in the syndication aftermarket. The question is, will SVOD be another path to still-greater non-advertising incomes?

As the SVOD story continues to unfold, we will continue to monitor its developments and report on them in future issues of **Mediology**.