We Now Disrupt This Broadcast
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Summary

1. Book by Amanda Lotz covering the TV industry from 1996-2015 initially focusing the development of original programming for cable and its effects then moving to the changes in the television business brought about by internet distribution.

Key Takeaways

1. A company's <u>business model</u> and <u>competitive environment</u> really illustrate why it makes a lot of the choices it makes; broadcast TV has a business model build around advertising so they cared about ratings and popularity and not critical acclaim so there wasn't a lot of great television. Then, as cable tried to lure <u>new subscribers</u> (new business model!) amid a growing abundance of choice (a lot of competition!), great television became the rule, not the exception.
    a. Different <u>incentives</u> and <u>business / revenue models</u> drive programming decisions.
    b. Broadcasters weren't blind to innovation; it is just their business model handcuffed them and limited opportunity.
    c. Cable channels reimagined television by pursuing <u>distinction</u> as a strategy and it worked until it didn't; became a paradox as it was hard to stand out due to the amount of distinctive series.
    d. Viewers preferred programs geared toward targeted interests so cable could succeed with this strategy because they were funded with subscriber fees as well as advertising dollars once they proved they could connect with these more targeted interests and demographics; this changed competitive strategies for all of television.
        i. This resulted in broadcast going form an 800lb to a 300lb gorilla.
    e. HBO and Showtime were first services to make extensive programming available on demand given they were subscriber funded; <u>customers felt like it added value to the subscription</u>. Ad supported channels for more cautious and often lacked the rights; audience measurement tactics also not designed to count this so couldn't derive value from it so they were in no rush to offer it.
    f. Advertiser supported channels really struggled when time <u>was commoditized</u> as their business models were tied to live, or near-live viewing; viewers finally had the tools they needed to push back.
    g. A lot of broadcaster / cable norms were also limited by the abilities and limitations of earlier distribution technologies and led to the norm of a schedule.
    h. Different approaches to video on demand: subscriber funded channels didn't care when a viewer watched (HBO launched first on-demand service in 2001!); making library of programming more readily available meant someone would find something they wanted to watch and didn't have to expand programming costs (<u>Cost leverage!</u>).
        i. Broadcast / cable channels had to deal with advertisers and couldn't get paid for it.
2. In television <u>1996</u> marked the end of an era: when it was normal for television shows to gather a large and diverse mass audience; ABC, CBS, and NBC had ~40 years to rule and then the CW (merged from WB & UPN) and Fox started to siphon off viewers.

    a. Television went from medium for mass audiences to one that spoke to an array of niche tastes and interests. Mass audiences still occur (i.e. Superbowl) but are in frequent. Television as a medium did not weaken, but has changed.
    b. Cable helped drive this transition by moving from ancillary, second-tier status to televisions innovative core and profit center. The second change begins in 2010 with internet distribution which disrupted both broadcast and cable.
3. Internet for television and its impact: a new way to transmit programming and it didn't kill television but instead had capabilities that prior technologies lacked (broadcasting, cable, satellite). It allowed audiences on-demand access outside of a schedule. This changes the business of television in terms of what shows are made and how audiences watch.
    a. Marc Andreesen: people always freak out about new distribution technology, but it usually improves the experience and / or widens the market.
4. Technology has always been important and an overlooked story is the evolution of cable service providers into internet providers and are monopoly providers as the internet has become a crucial resource for modern life and their market power is unchecked.
    a. Consumer demand for this is very inelastic and its complemented by a bundling strategy with phone and video.
    b. Posit: in 2004, cable channels did $34B in revenue and cable service providers did $57B, or $23B more; In 2016, cable channels reported $75B of revenue and $15.7B of profit and cable providers had revenue of $108B and $21.5B in profits.
        i. Is Distribution King? In 2014, Profits of cable providers were greater than those of country's major music labels, broadcast networks, newspapers, magazines, film production, and cable networks combined.
    c. The "wired" television history of the United States has been replicated few places elsewhere: Denmark, Netherlands, and Argentina. Most other places gave way to satellite distribution and this becomes important when cable providers transition to internet service providers.
5. Cable channels can be very different depending on their business model whether they are ad supported (i.e. USA), subscriber supported (i.e. HBO), or a combination of both (i.e. AMC). Another distinction is whether they are general interest (more like broadcast) or niche (i.e. narrow and specific audiences and underserved by broadcast).
6. Economics of satellite versus cable: satellite paid higher fees to the channels they carried thus having higher programming costs and they priced their services lower to win customers resulting in lower profit margins; it cost $1.5M to launch a satellite and secure orbit position, but infrastructure was less costly to maintain than wires and distribution plants cable had to maintain.
    a. Cable margins may have been higher, but higher Cap-X too; wonder which one had better ROIC and FCF?
7. When cable companies transitioned to digital their investments outpaced cashflow and they needed to finance with debt, lowering their credit ratings and making borrowing more expensive hurting cash flow later. Stocks got hammered, but the market DID NOT APPRECIATE the potential of internet service as a new revenue stream for cable companies. This investment was $87B and financed by debt and subscriber fee hikes.
    a. Alternative Histories: if cable had NOT upgraded to digital in the late 1990's, satellites would have quickly passed cable without the upgrade making it more like the rest of the world. Then the telephone companies would have challenged satellite as internet service grew in importance and would not have had much competition. Buoyed by internet

revenue, the telephone companies would have been in a stronger position to offer video services to compete with satellite.

        i. Telephone companies seemed well positioned, but evolution of technology to send data over coaxial cable kept competition in flux.

    b. Cable service providers were punished by investors who thought they would be killed by the internet. It just wasn't clear cable service providers were positioned to be dominant provider of home internet service and it would be a very lucrative business.
        i. <u>Lesson</u>: You really have to evaluate the claims of internet destroying something and try to think through scenarios.
        ii. In addition to being profitable, it further embedded the companies into the home of subscribers and allowed for a bundling strategy.

8. A lot of people assumed broadcast and cable competed but mistook the competitive dynamic; they had different business models to some extent (advertising vs. sub fees) and became more commonly owned so they were sibling divisions serving a parent conglomerate.
9. Creating original programming was a good way to build a channels <u>brand</u> and stand out among the abundance; the combination of a clear brand and original programming was valuable to all the ways cable channels earn revenue. A brand and original programming created a positive feedback loop for the channels that pursued this strategy.
    a. A clear brand makes a channel a reliable destination, driving more viewers and advertising revenue.
    b. Original programming drove subscriber demand allowing you a better negotiating position for subscriber fees with cable service providers as opposed to channels that merely offered something else to watch.
10. Cable channels were not initially found on every cable system so this inconsistent carriage led advertiser to regard cable channels as better suited for local and regional advertising, limiting revenue from ads.
    a. Concerns about reach and perception drove advertisers to pay about ½ as much to reach 1,000 households as a they did on broadcast; in 1996, is was $5.95 versus $10.40 and this disparity still existing today.
    b. This hampered the budget for original programming development; had inferior economics to broadcast because they were paid half as much.
    c. Some cable channels (i.e. TNT) went into original movies which resulted in better advertising rates ($13-16) and they could show film many times amortizing the cost across time slots.
        i. Less risky than original series because they are cheaper, but less reward.
11. Much of broadcast dominance resulted from the habits and behaviors it created in viewers; they were accustomed to tuning into broadcast and see what was on. <u>This is interesting because habits are changing, but never underestimate their power!</u>
12. Cable original series was hampered by inferior economics relative to broadcast as discussed above, but they lacked the promotional budgets to allow viewers to find the series.
    a. Cable would eventually have an ability to target more particular tastes or audiences relative to broadcast, but this would take time to develop.
    b. Early original series were low budget and financed by co-productions such as Silk Stalkings (USA / CBS) and La Femme Nikita.
        i. La Femme Nikita couldn't have been made without financing from international partners.

        ii. Warner Brothers later cancelled series as they didn't see much opportunity to make additional revenues so once there were enough episodes to make to sell into other markets they were done.

13. USA Network was a pioneer in original series development.
    a. They tried to capitalize on known content by doing TV adaptations of theatrical films and sometimes drawing on the IP of the studios that owned USA – Universal and Paramount such as The Big Easy and Weird Science.
    b. They realized benefits of original programming: it brought attention and awareness to the channel (i.e. brand) and helped in negotiations by touting the depth of its original programming to increase per subscriber fees.
        i. In the late 1990's, revenues from subscriber fees was 40% of revenue and original programming would likely increase advertising fees as well.
    c. Ordered Season 1 of La Femme Nikita without having a pilot complete; aggressive move.
14. Contradictory interests at play early in the development of original cable series: the standard practice of splitting risk and reward between studios producing the series and channel distributing it became troublesome.
    a. Finding a studio to produce it or a cable channel to air it was difficult; studios lacked <u>incentive</u> to produce content unlikely to be sold in markets after it was first licensed.
        i. Subsequent series would prove that cable originals could be profitable and new markets (i.e. SVOD) would emerge.
15. Shows that turn out being milestone in television history were one risk averse executive away from NOT being made ("alternative histories"). Never forget about all the shows NOT being made.
16. HBO initially focused on special one-off events and did not adhere to a schedule like broadcast networks but this strategy (long ago) with regular programming could help reduce churn.
    a. People may not want this anymore and it is argument against binging.
17. HBO realized early on it needed to make different shows for different subscribers instead of making shows that appeal to all.
    a. Discussion of The Larry Sanders show and Arli$$ where one was critically acclaimed and the other poorly reviewed; keep in mind depending on the "job to be done" one show may fill a void for a subscriber another one doesn't.
18. Cable also had an advantage because they gave creative talent more leeway and less micromanagement; HBO let the painters paint. They saw original programming as a retention device or churn reducer.
19. There was a value to experimentation in original cable series; if it didn't work you could shut it down and if you did you may have something great on your hands.
    a. You need to take risks to succeed; Amazon believes in this.
20. Video spared technological disruption longer than print / audio because of the relative file size.
21. FX worked on developing original programming in the early 2000s to improve its advertising rates and subscriber fees; it needed cable subscribers to know it existed and care to have it.
    a. Fox brought in Sony to coproduce the Shield and gave them international distribution rights in return.
    b. The Shield was interesting because it allowed advertisers to reach men who couldn't be reached on television or only through sports which was expensive.
    c. The Shield ended being a home run as it earned revenue in additional markets (international), selling over 250,000 copies of each season on DVD (Roughly $60M at retail), and the sale of the series to the Spike cable channel.
22. Discussion on the success of the USA original series Monk.

a. Monk was distinct series and a grand slam both critically and commercially for Universal Cable Productions, the studio that owned the IP.
b. It was sold in multiple markets and new media; very uncertain but it resulted in outsized rewards.
c. USA gave a lot of free reign to creators as it couldn't offer similar salary.

23. Syndication is a term for selling a series in other markets after it airs on the outlet that licensed it; when cable emerged it became another market for selling series especially dramas.
24. Discussion of Mad Men on AMC.
    a. Significant doubt the series would work given it was highly serialized and couldn't be watched out of order so studios didn't see much monetization opportunity in international, cable, and domestic syndication.
    b. AMC approached Lionsgate who didn't have a TV studio and the $50,000 license fee per episode was able to entice them and in other cases this wasn't big enough for a larger studio.
    c. Mad Men cost AMC about $26M a year and the ad revenue was estimated at around $12M per season (book has math backing it up) and this was less than half the cost. The way it got made up was it raised subscriber fees by $0.02 per subscriber between 2007 and 2010 by 95 million subs at 12 months equal $22.8M a year.
    d. Netflix later paid $1M per episode for exclusive distribution rights; Each episode costs Lionsgate about $300k more than AMC paid, but Lionsgate would earn about $500k in international market so it made a lot of money.
25. Discussion of The Walking Dead on AMC.
    a. This was a show that drew an audience comparable with that of broadcast TV and drew solid audiences in the 18-49 demographic.
    b. This was the first series made by AMC Productions, the cable TV's own studio; Company sold the Walking Dead multiple times.
    c. This hit helped raised subscriber fees $0.15 or $1.7B in revenue and helped AMC go public.
26. The success of some of these series caused cable channels to create their own studios to participate in the economic upside rather than outsourcing production and ownership.
    a. Several cable channels followed AMC's lead with A&E Studios, Turner Original Studios, Crown Media Productions, joining Universal Cable Studios and FX Productions who started in the early 2000s.
    b. **Owning series became increasingly important for balancing revenue streams and were set up to take advantage of new distribution channels created by Netflix and others.**
    c. **Even NBC who had a TV studio created Universal Cable Productions because the skills sets and practices of broadcast vs. cable series were different as well as the budgets.**
    d. **The cost of channels to get into the studio business was small. It added roughly about 30% to the cost of the series; the cost over the former license fees and most networks already had development executives for the few series it sought to produce and streamlined the production process by wearing two hats: notes to creatives and ensuring the studio and channel understood the series in the same way.**
27. As various changes in TV and media diminished advertising revenue, companies built on selling audiences to advertisers needed to diversify revenue streams.
    a. Expanded segments of their business on selling IP, developing and licensing series because of new internet players.

b. The niche interests satisfied by these cable series could be aggregated and shown to a global audience; on demand viewing was the real driver for this making serialized dramas much more valuable.
c. Self-production also allowed for better control and reduced program costs complemented by the economic upside.
d. FX networks said by establishing a studio you went from a dual revenue stream to a three-revenue stream business: ads + subs + licensing.
e. Emergence of Netflix who sought to license series made owning series more valuable; companies who weren't global may even find licensing more lucrative.

28. The big 5 media companies (Disney, Viacom, News Corp, NBC, and Time Warner) all owned studios, broadcast networks, cable channels as well as other forms of media and these multiple revenue streams helped conglomerates offset the consequences of a changing competitive environment.
    a. Global channels often helped by leveraging prior IP and development costs incurred (i.e. local version of Jersey Shore).
29. Transition from broadcast to internet distribution required adjustments in the practice of making television and the strategies for monetizing it by going from national boundaries to global.
    a. Programs structured episodically were more valuable in syndication as they could be aired out of order.
    b. Tradeoff in how talent was paid by internet distributors: cost plus vs. a back end.
    c. Having so many choices contributed to audience fragmentation.
    d. This also drove changes in broadcast retransmission payments allowing the broadcast networks to enjoy dual revenues streams by 2010 and raising cable service providers costs considerably; drove dissatisfaction of cable customer lock in and lack of choice.
        i. Huge economic adjustment as broadcast noted cable was getting this.
30. By channels expanding and many pursuing their own distinctive content, this strategy no longer allowed them sure-fire success.
    a. Just as the switch from analog to digital cable led to distinctive programming, the abundance of distinctive programming moved toward a surplus.
    b. The change to internet distribution would cause companies to question all the strategies they had pursued before and knew about the medium.
31. The transition to internet distributed television.
    a. The most profound change caused by internet distribution (as well as VOD and DVR) involved freeing television from the constraint of a schedule, allowing viewers to have control over what to watch and when to watch it.
        i. This was crucial for managing the surplus of series; freedom of scarcity of an enforced schedule combined with a surplus of series created a new TV environment.
        ii. Ben Thompson actually states that Netflix (or internet distribution) "digitized time". This feels like the same thing as the above and removing scarcity from the equation.
    b. Companies rooted in TV's past would be hard pressed to compete no matter how distinct the content; Is content still king?
    c. Rather than TV and new media facing off they quickly became neighbors.
        i. Internet distributors needed legacy content to woo customers to their services; legacy television realized distributors were a new revenue stream so a symbiosis emerged.

ii. This change in behavior likely accelerated the demise of broadcast and multichannel norms.
iii. Internet distribution was welcomed too because it didn't compete with legacy TV for advertisers; this share was being taken by YouTube and direct mail than with advertising television budgets.

d. Internet distribution didn't kill legacy television but expanded viewer choices and control over what they watch expanding the market in effect.
e. **The "immediacy" or "liveness" that we thought were once integral to the experience of television were revealed to be a by-product of its previous distribution technologies.**
f. Cable had the technology to do this, but didn't want to secure the audience desired programs that would have made them the innovators. They didn't want to pay for it.
g. Studios wanted to stay in the old model as they could sell and re-sell television shows; they didn't like VOD.
h. VOD affected risk and reward between channels and the studios. Studios retained ownership but faced pressure form later windows (i.e. Netflix) in putting things on demand because it would decrease the value.
    i. Co-ownership between studios and channels made this more confusing (especially if commonly owned) because each were pursuing the best divisional outcome.

i. Internet distributed services didn't share data so studios weren't sure if they were undervaluing content; again disintermediated.
j. **How to you measure success of internet TV? Is it viewers over what time period?**
    i. **Lack of schedule rendered ratings meaningless.**
    ii. **How do you value a show that becomes part of a library in perpetuity?**

k. Shifting business practices went from selling series repeatedly around the world you needed to self-produce series for international audience.
l. Also changes creative aspirations: instead on making shows people want to watch on a Sunday night you need to make shows people would watch and talk about 10 years later.
m. Revenue sources: FX went from 55% of channels revenue from advertising in 2004 to 34% by 2015 and broadcast networks went from fully ad supported to relying on retransmission fees: 15% of broadcast revenues by 2013 and will be 25% by 2019.
n. **Good analogy: the passenger rail industry did not act when the airline industry emerged. It saw itself as only a train business and not in the human transportation business and so the airlines dominated them. Broadcast and cable channels are no longer in the TV industry but are video content providers.**
    i. Stealing market share from far away markets as was covered in McKinsey book. A good type of growth for the business stealing it.
    ii. This is why Netflix says they compete with Fortnite; have the right view of competition.

o. Argument for ESPN being $30 without the bundle may not make sense. ESPN could change what it was willing to pay for sports league licenses; or leagues could launch their own portals like WWE. Saying it would be $30 doesn't allow for reconfiguration of TVs business model that may be necessary (cheaper programming or another way?).
p. Hulu JV couldn't work with so many owners not wanting to sacrifice the status quo.

32. Ascension of Netflix
    a. Transitioned from DVD by mail to streaming and in doing so went from mostly films to 70 / 30 television.

   b. Licensing back catalog was low risk to studios because most series were off the air and not in demand; these deals were a gift for the studios. Many of these deals were low-risk, short-term experiments with a limited subscriber base.
      i. Low opportunity cost to licensing that content.
   c. With its data, Netflix likely was valuing content better than the studios and for license renewals they were more particular with what they wanted. By this time, studios were addicted to this revenue stream.
      i. Part of this driven by the fact studios are disintermediated from their customers and didn't have data.
   d. Cable disrupted broadcast norms with strategy of distinctive programming, but Netflix challenged both by enabling completely new viewing practices.
   e. Netflix was distinguished from legacy tv in that it was on-demand access, subscriber funding, and global reach. It was building a library.
      i. Involved different strategies than creating a schedule.
   f. Netflix pioneered cost-plus strategy for content by buying out full scope of rights. This additional percentage was rumored to be 90% for prestige projects, but closer to 25% for most.
      i. Only bought US rights for House of Cards but went global after.
33. Revenue splits for a drama after its initial release: 41% international licensing; 34% US Broadcast licensing; 17% Syndication reruns; 8% portal licensing.
34. OTT never ended up killing television; it just changed how it was distributed. Just as TV used to be distributed by broadcast waves, cable wire, and a satellite beam before it, so internet protocols found a new way to distribute it.
   a. This new protocol allowed capabilities previously impossible for previous technologies.
35. Cable service providers became internet service providers with a monopolistic position in one, but not the other (video).
36. Many people blamed cable service providers (distributors) for expensive tiers of many channels but it was the conglomerates (i.e. Viacom) that held more desired channels as ransom for less desired channels. "Bundling at the supplier level".
   a. People got annoyed but was of greater consequence for channels than service providers as it could hurt in two ways: lost sub fee and household that could be sold to advertisers.

What I got out of it

1. A great history of television evolving from (i) broadcast dominance and business model supported by ads to (ii) cable pursuing distinctive programming to develop a brand to grow its subscribers fees and advertising revenue to (iii) internet distribution which now changes how all these players will do business in the future. They have to consider themselves in the video content business not just the TV business to survive. They need a more wholistic view of competition.
2. Cable service providers (distribution) actually seem to have the most dominant position given they are internet service providers and video is just one leg of the stool. This still seems like a good position to be in. Is Roku in this position now, or Company's with billing relationships with customers (iOS)?
3. Cable companies realizing the importance of owning content as it could give them more upside (i.e. selling internationally, to OTT), another source of revenue, and more optionality. They may have considered going international but emergence of OTT really thwarted that.
4. OTT distribution really freed TV from a schedule which affected a main revenue model (advertising) and will change viewing habits and future business models forever.

Further Reading
Captive Audience: The Telecom Industry and Monopoly Power in the New Gilded Age
Inside the Rise of HBO: A Personal History of the Company that Transformed Television
Linking Industrial and Creative Change in 21st Century U.S. Television

The New Cable Model: Why It's Better to Own Than to Rent (Analysis)

Key Takeaways

1. FX pioneers a low cost, talent friendly model to building its TV Studio and owning the content than renting it.
    a. Can capitalize on ancillary revenue such as international sales, syndication sales, DVDs and merchandise.
2. Traditional studios didn't think money could be made from a cable comedy so they ignored the space; FX realized half hours could make sense if you made them cheaply and owned them.
3. Comedy tends to have lower ratings in first run but golds up better; so this model doesn't make sense for licensing because you can't capitalize on ancillary revenue.
4. FX also found it difficult to do co-productions because they can make comedies cheaper (~$400k to $700k per episode) and a network sitcom cost 4x that.
5. Ownership can lead to costlier flops but also affects decision about what gets renewed.

What I got out of it

1. There is always value in an underappreciated niche (i.e. cheap comedies) if you do it right and have the right monetization strategy.

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