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TELEVISION'S \$30 BILLION BATTLEFIELD

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TRADITIONAL MEDIA SEGMENTS—music, newspapers, magazines, and radio—have faced major disruption as a result of new digital pathways, formats, devices, and changes in consumer behavior. All media segments, that is, except for television. But its day of reckoning has arrived.

Over the next five years, approximately \$30 billion in profits could shift away from broadcast and cable networks, stations, and operators in the US. Studios, rights holders, and a galaxy of companies that stream video over the internet will be the winners in this changing landscape.

We knew this day was coming. (See [“The Future of Television: Where the US Industry Is Heading,”](#) BCG article, June 2016.) Though we didn't know its scope or timing until now, trends have established themselves sufficiently that we can generate economic models of the future US television ecosystem. It's taken longer for major disruption to occur in television than in other industries, but changes in distribution capabilities and costs, disruptive busi-

ness models, and shifts in consumer behavior are finally taking hold.

Economics, in other words, is trumping legacy. Broadcast and cable networks and stations will bear approximately two-thirds of the projected decline in profitability as advertisers shift their spending and consumers shift their subscription dollars toward an increasingly rich and diverse set of emerging video formats. Likewise, the profitability of operators will be squeezed by higher programming costs as well as lower consumer demand for 300-channel bundles.

But beyond the broad economic trends, the most intriguing issues will be the strategic choices of individual companies. While value will shift across the ecosystem, the impact on different companies will vary as much because of their choices as their starting position in the market. Unlike the ecosystems of other traditional media, the television ecosystem is complex and interconnected. Companies in similar positions today can

respond—and are responding—differently to these value shifts.

Changing of the Guard

Television has had a very strong run, beginning in the 1950s, as the most effective way for advertisers to reach mass audiences. That run survived the rising popularity of cable television in the 1980s, the introduction of satellite service during the 1990s, and the delivery of high-quality video over the internet starting in the first decade of the 21st century. But streaming is finally taking its toll as a wide variety of companies compete for eyeballs with traditional television networks, stations, and operators.

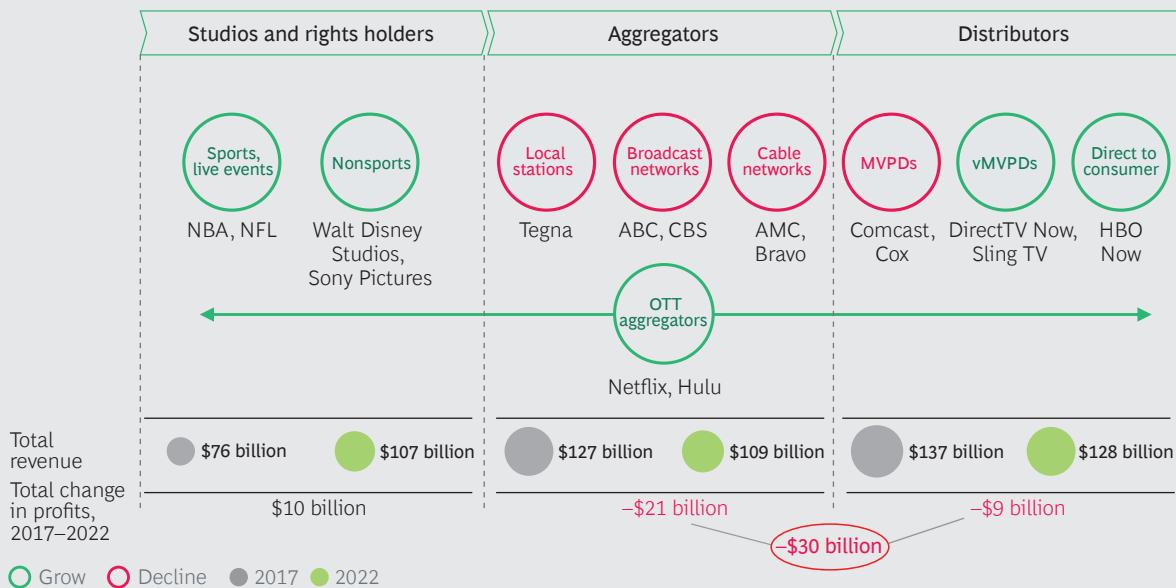
These competitors include over-the-top (OTT) aggregators such as Netflix and Hulu, direct-to-consumer (D2C) streaming services such as the NFL Network, and online-streaming companies such as Sling TV, DirecTV Now, YouTube TV, and Hulu Plus. (These competitors are clumsily known as vMVPDs, or virtual multi-channel-video-programming distributors. Their products are colloquially referred to as streaming skinny bundles.)

Traditional broadcast and cable television will continue to play a role in delivering news, sports, and additional live events, but even in those areas, other platforms are making inroads. (See *The Future of Television: The Impact of OTT on Video Production Around the World*, BCG report, September 2016; and *The Digital Revolution Is Disrupting the TV Industry*, BCG Focus, March 2016.) In news, Snapchat Discover, for example, serves as an alternative news source for young audiences. This ad-supported channel of short-form content from publishers generates 3.5 million viewers a day, more than Fox News, the most watched cable news channel. Meanwhile, in sports, Amazon won the rights to stream the NFL's Thursday night games.

Understanding the Impact of Changes to the Ecosystem

We wanted to understand the economic and business shakeout of these shifts in the US, so we projected the profitability of the major elements in the television ecosystem from 2017 through 2022. What follows are the results of the most disruptive scenario that we modeled. (See the exhibit.) (Note that many companies span multiple elements in the ecosystem. For now,

By 2022, Video Aggregators and Distributors Could Lose \$30 Billion in Profits



Sources: SNL; Ovum; BCG analysis.

Note: MVPDs, or multichannel-video-programming distributors, are cable and direct satellite operators. vMVPDs are virtual operators that deliver content over the internet. Companies listed above are examples.

we are treating each element as an independent economic entity.)

Studios and Rights Holders. At the left of the exhibit are studios and rights holders, which create the raw material of video production. They include studios that produce video content and sports leagues that sell broadcast rights. With the popularity of OTT services, demand is rising for video content. In 2017, for example, Amazon, Apple, Facebook, Google, Netflix, and other internet companies invested about \$17 billion in programming—more than the collective licensing deals of the broadcast networks. OTT services aired more than half the 500 scripted series produced in 2017. These providers stand to pick up \$10 billion in profits by 2022.

The entry of these players has led to rising prices and a disruption of industry economics. Video, for example, is not the core business of Amazon or Apple but a way to strengthen customer loyalty and sell devices, respectively. With different economic motivations, internet companies can often outbid traditional buyers of video content.

Traditional Aggregators. In the middle of the exhibit are traditional aggregators, the cable and broadcast networks and stations that buy content and sell advertisements. Within the ecosystem, cable and broadcast networks are the most vulnerable because of their dependence on advertising. Linear television viewing would likely fall by approximately 2% annually, putting further pressure on advertising rates and revenue.

Cable networks are more exposed than broadcast networks because they face the loss of carriage fees paid by cable operators. Cable network profitability could fall more than 5% over the next five years.

Distributors. Cable and satellite operators are the largest distributors, but their reign may be coming to a close. Household penetration of cable and satellite operators could fall from 77% to 48%, reflecting the loss of approximately 20 million subscribers as customers choose other, less expensive viewing options. These include vMVPD

streaming services such as Sling TV and DirectTV Now, D2C apps such as HBO Now, and OTT aggregators such as Netflix.

Household penetration of vMVPDs could rise from 4% to 26%. Bundles offered by vMVPDs tend to include a select number of high-demand channels and video on demand delivered over a broadband connection to a viewer's smart television, dongle-equipped traditional television, desktop, or mobile screen. Less expensive than a traditional cable package, these services also have an advanced, iPhone-like user interface. Although some setup is required, most customers report a fantastic user experience. Consumers also avoid average monthly set-top box rental fees of \$25.

Recognizing the changing landscape, cable and satellite operators have begun to offer these packages directly. While they lose revenue compared with 200- to 300-channel packages, they retain their broadband customers and likely achieve better margins.

D2C companies are producers that cut out the middleman and distribute their content through their own apps. These services are even narrower than the bundles offered by vMVPDs, generally providing a single stream of content, such as the games of one sport (NBA League Pass) or the content of one network (HBO Now). The household penetration of D2C apps could rise from 10% to 25% as customers pick and choose from a widening menu of choices. The Walt Disney Company's launch of a streaming service next year, with both library and new programming, will likely accelerate consumer demand for à la carte offerings.

OTT Aggregators. Across the bottom of the exhibit are the OTT aggregators, companies that gather multiple types of content under a single portal. OTT aggregators offer shows and movies under several different business models such as subscription (Netflix), ad-supported (YouTube), and subsidized hybrid models such as Amazon Prime. Like the D2C apps and skinny bundles, they have sprung to life without incurring the network costs of the distributors they are displacing. These high-profile

OTT aggregators are already present in more than half of US households.

Preparing for the Future

Even if the above scenario—the most disruptive of the three we analyzed—does not come to pass, the traditional television companies need a new playbook. Under our most optimistic scenario, cable penetration still falls by 7 percentage points, and the penetration of vMVPDs rises to 12%; advertising revenue stays flat or declines slightly for local stations as well as broadcast and cable networks.

Companies will succeed or fail in this shifting board game according to their choices about where and how to compete—and the execution of those decisions. Recent deal-making both responds to these impending structural shifts and tries to shape them.

Some of these moves are attempts to shift from the red circles in the exhibit to the green circles. For instance, Disney wants to acquire 21st Century Fox to create scale in

original content and to build a direct relationship with consumers through online services. Meanwhile, the AT&T-Time Warner deal seeks to harness the power of vertical integration.

Charter's acquisition of Time Warner Cable and Bright House Networks achieves scale and potential value in a structurally disadvantaged segment. The same logic applies to Sinclair Broadcast Group's attempt to acquire Tribune Media.

The future is still up for grabs for many companies. But not all of them have the scale to be the masters of their own fate. Their best option is to pick a partner with a constellation of complementary content and assets under the best possible terms.

THE REST OF the industry will be left to navigate through a shifting landscape in which simple adages such as “content is king” no longer apply with the same force. If \$30 billion does not get your attention, what will?

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