

Generating Growth in the Media Industry: How Cable MSOs Can Adapt and Thrive

In part two of this series, L.E.K. Consulting examines how traditional cable Multiple System Operators (MSOs) can draw from best practices by social and casual games companies to achieve new levels of success.

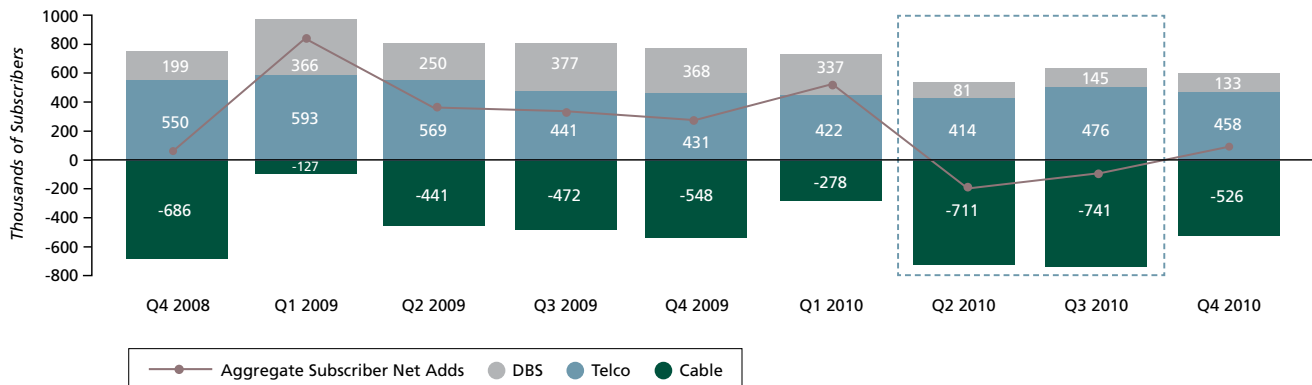
Because of the trend toward cord cutting and cord shaving, pay TV subscriptions fell for the first time ever in Q2 2010, followed by further contraction in Q3 2010 (see Figure 1). With the looming threat of over-the-top (OTT) content delivery challenging the pay TV subscription video revenue model, traditional cable MSOs look more vulnerable than ever.

The Challenges

Cable MSOs are finding it difficult to adjust to consumers' shift toward online consumption, and they face three primary challenges going forward:

1. Cable subscriptions will likely continue to fall as OTT providers gain traction (see Figure 2). The number of U.S. households utilizing OTT options has significantly increased during each of the last three years, and steady continued growth is expected. By 2020, it is predicted that nearly 14% of TV consumer households will be using OTT content, potentially capturing a significant portion of the pay TV audience.

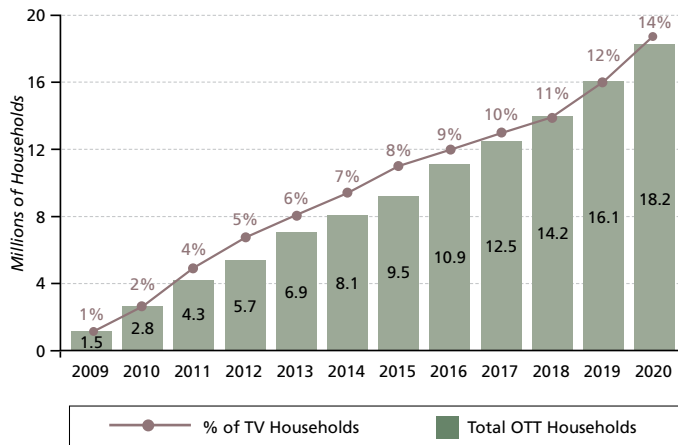
Figure 1
U.S. Cable Subscribers Net Additions (Q4 2008 – Q4 2010)



Source: SNL Kagan U.S. Multicultural Summary

Generating Growth in the Media Industry: How Cable MSOs Can Adapt and Thrive was written by **Dan Schechter**, a Vice President and Co-Head of L.E.K.'s Global Media, Entertainment & Technology Practice; and **Brad Finkbeiner**, a manager in L.E.K.'s Los Angeles office. Please contact us at mediaentertainment@lek.com for additional information.

Figure 2
U.S. OTT Projections (2009 – 2020)



Source: SNL Kagan MSO Summit

2. Pricing cable MSO services will become more challenging as consumer options increase. According to SNL Kagan's November 2010 Multichannel Bundle Pricing Report, cable MSOs are presently adapting to subscriber losses by evaluating and adjusting prices in local markets. For example, a major cable MSO's TV-internet-voice bundle costs \$145 per month in Los Angeles while the same package costs \$129 in San Diego. However, wholesale nationwide adjustments will be difficult to make as more consumers gain the option of cancelling or downgrading their cable service in favor of OTT content.
3. Margins are in decline due to escalating programming costs as affiliate fees for the most important content providers continue to go up. Additionally, the most highly rated channels are concentrated in the hands of the top-five cable network groups—ABC Networks, Viacom, A&E, Discovery and Scripps—leaving the cable MSOs with less leverage to negotiate affiliate fees. Though there is a myriad of other fragmented channels (long tail content) available for distribution, such content is unable to effectively reduce subscriber churn and drive growth in the business.

Lessons from Social and Casual Gaming

Major cable MSOs will need to find new and innovative ways to win in this emerging landscape, and social and casual games provide some good examples of how cable MSOs can evolve.

A. Expand TV's Social Experience Beyond the Living Room

Cable MSOs are uniquely positioned to create an online community, similar to a blogosphere, in which viewers can watch, read about and respond to programs dynamically, whether they watch online or through cable. This network can serve as a hub for viewers to gain access to (and participate in) conversations about programming.

In doing this, the industry can draw on the experience of Causes, a successful Facebook social app with over 17 million monthly average users according to AppData.com. Causes was able to expand charity and activism beyond traditional platforms by linking environmental, political and socioeconomic issues to social networking and gaming. Consumers using Causes can discuss issues, share their experiences, post media and sign petitions leading to the viral growth of a "cause."

When a user takes an action to support a "cause," he or she earns points that advertise the user's level of involvement to others. By creating an interactive community and encouraging the accumulation of points, Causes has been successful in retaining users who are interested in charity and activism. Similar efforts by cable MSOs could expand the social viewing experience of TV from the living room to the overall community by encouraging users to share opinions and program suggestions through a social app or network.

B. Make "TV Everywhere" Social

Time Warner Cable's TV Everywhere iPad app has gained significant interest from viewers. One possibility for further increasing the app's popularity is to offer the ability to connect it to social networking accounts, which would provide a fluid medium for sharing TV content. For example, if a viewer uses the app to tweet about a show and attaches a clip of the content, that may encourage the viewer's followers to watch the same program.

Apple has been experimenting with such social network sharing features in their iTunes Extras platform, launched in 2009. Sony, one of the first to adopt the iTunes Extras platform, recently released features designed to enhance viewers' experience with interactivity. For example, the owned version of Will Ferrell's comedy "The Other Guys" allows viewers to search the movie for a specific word. The search application retrieves all uses of the word in the script along with a link to the exact moment in the movie in which the line containing the word is spoken. A "clip & share" function then lets the viewer post these scenes to social networks.

C. Experiment with a Freemium Model

Under a freemium model, the consumer would be offered credits to try any movie from the MSO's Video on Demand (VOD) catalog (this is the model used by Sony's Vudu service) or allowed to watch selected VOD movies that are supported by advertising. Subscribers can opt to upgrade to a premium cable subscription to get unlimited access to the VOD catalog or can watch movies in the catalog on a pay-as-you-go basis.

A successful example of such a model can be found in Rovio's casual game Angry Birds, which has seen more than 100 million downloads. Players can start by sampling a free ad-supported version of the game with limited functionality and can later upgrade to a paid version with additional themes and functionality. Rovio also generates revenue by allowing users to purchase a special one-time-use (pay-as-you-go) feature called "Mighty Eagle," which allows frustrated players to advance to the next level of the game without having to successfully complete the previous level.

D. Know Your Customers and Deliver Relevant Content

Cable MSOs own the last mile access to the customer, which gives them a unique opportunity to build a database of customer preferences for programming and advertisements. Social features, such as allowing users to "Like" content, invite their friends to watch, and give feedback on whether an ad was relevant to them (similar to what Comcast does on its Xfinity platform) will allow MSOs to keep track of viewer preferences.

Cable MSOs can learn from successful companies such as App-savvy – which reaches more than 293 million people performing 1.4 billion social activities each month – and connects those people with brands based on their social activities. The company provides hyper-targeting capabilities such as displaying relevant branded ads immediately after users perform a particular social activity or engage with an interactive social ad.

MSOs can build similarly targeted calls to action and increase participation in social media efforts by motivating or requiring viewers to sign in with an email address and pertinent demographic information, and offering incentives to those who participate. Building a database of digital consumers and their preferences can provide significant leverage in promoting new shows and series. It can also serve as a great demographic targeting and lead-generation tool for advertisers, who may be willing to pay higher CPMs for more effective targeting.

E. Build "Highly Social" Customer Service Operations

Social games leverage the relational aspect of media to generate loyalty; focusing the cable MSO employees on the longer term relationships with the customer instead of the transactional aspect can achieve similar results. Cable MSOs can develop advanced social analytical abilities to measure the influence of their followers, rather than just the sheer number of followers. Developing and leveraging tools (such as Klout) can help understand the influence of individual followers and bubble up the top issues that get circulated in the community.

The pay TV industry is undergoing dramatic changes due to the emergence of new players, alternate digital distribution options and increasing content costs. Potentially disruptive activities by alternate video providers such as Netflix and other OTT players are challenging the traditional pay TV industry business model.

L.E.K. can assist cable MSOs in identifying lessons from social and casual gaming that can be used to overcome the headwinds currently facing the industry, as well as those that provide the potential to capitalize on new growth opportunities.

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