



A not so linear future?



Introduction

Ofcom published recently its review of viewing habits in the UK, finding that 25% of adults in the UK have sacrificed sleep to binge-watch TV shows receiving the most press coverage.¹ Such binge viewing has proliferated with internet-enabled on-demand TV, and a wide range of opinion exists as to what increasing on-demand consumption means for the future of linear TV. The purpose of this paper is to explore the relationship between linear and on-demand TV, and, in particular, what effect pure-play on-demand providers such as Netflix and Amazon Video will have on existing cable/satellite TV subscription providers.

1. <https://www.ofcom.org.uk/research-and-data/multi-sector-research/cmr/cmr-2017>

Pure-play on-demand cannot entirely replace linear TV

The primary difference between linear and on-demand TV is that the former provides live broadcasting of scheduled content, whereas the latter provides content accessed by the viewer as and when they want to watch it. The Ofcom review mentioned above found that around 91% of people in the UK still watch live, linear, TV.² There are three compelling reasons why there will always be a place for linear TV:

- Whilst on-demand providers are ideally placed to deliver content such as TV boxsets and films, viewers will always want to watch some content such as sports or news live.
- On-demand cannot compete with certain types of content available on publicly available linear TV channels, such as shows like The Great British Bake Off, X Factor, and Strictly Come Dancing. Although these could conceivably be watched after the event on catch-up or on-demand, the experience is not quite the same – people want to share in the moments and conversations at the point those programmes are first broadcast.³
- On-demand TV requires the viewer to make a deliberate decision about what to watch, whereas linear TV enables a viewer to sit down, switch on the TV and flick through the channels to find something interesting, or perhaps mindless, to watch.

That said, on-demand TV may still erode linear TV, but the extent of that erosion will be based on the quality of content.



2. Ibid

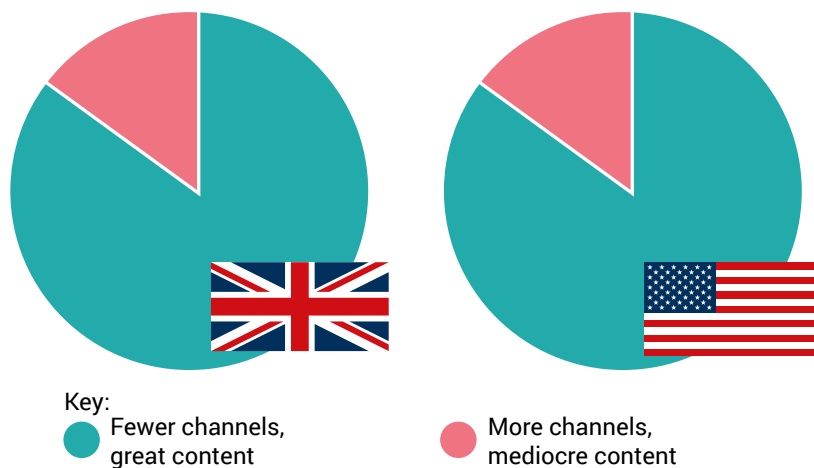
3. Although a pure-play on-demand provider such as Amazon Prime could conceivably purchase the rights to such shows, it would struggle to create the same effect as the show would no longer be publicly available.

The great content battle

A recent ContactEngine study found that most people would be willing to sacrifice the number of channels available to them in favour of fewer channels with higher quality content, as shown in Figure 1.

Figure 1

Great content matters



As noted in Section 2 above, viewers would not have the same experience if they viewed certain types of content on-demand, but this is only part of the reason those shows work on linear TV. The other fundamental reason is that much of this content is available publicly – it is broadcast on channels that are required under UK law to be made publicly available. However, the vast majority of linear TV channels are not publicly available ones, and it is these that pure-play on-demand providers present the greatest risk to.⁴

For the purposes of example, assume that an individual has access to both commercial linear TV channels and one or more of Netflix, Amazon Prime, or YouTube. All else being equal, at the point in time the individual decides to watch TV, they will choose to watch the content they desire the most.

However, everything else is not equal – unlike commercial TV channels, the business models of pure-play on-demand providers are not based on advertising revenue so the viewer can watch content ad-free, offering a significant advantage.⁵ In addition, in the case of Netflix, which makes an entire season of a given show available at once, the viewer can seamlessly watch multiple episodes one after the other. Netflix's rationale for this distribution method is entirely centred on viewer retention – they believe people want to watch only one show at a time, and that spreading viewing over an extended period would increase the risk that another show will take primacy in the viewer's schedule. Netflix would rather their viewers watch an entire season and then move on to another.⁶

4. BBC, ITV, Channel 4 and Channel 5 are each public service broadcasters in the UK.

5. For the purposes of clarity, although public-service broadcasters in the UK, ITV, Channel 4 and Channel 5 operate as commercial enterprises and as such their broadcasts include advertising.

6. <http://uk.businessinsider.com/netflix-refuses-to-release-a-weekly-show-for-these-reasons-2016-1?r=US&IR=T>.

25% of adults lose sleep to TV binge-watching!

Given the nature of internet-delivered on-demand, these providers also have the ability to learn about their user's viewing habits and target content according to those preferences. Indeed, Netflix claims to have anticipated the success of its House of Cards series because it knew a significant number of viewers who enjoyed political dramas also liked both Kevin Spacey and films directed by David Fincher – as noted by Netflix, “we know what people watch on Netflix and we're able with a high degree of confidence to understand how big a likely audience is for a given show based on people's viewing habits”⁷ It is important to note that this was in 2012. The volume of viewing-related data held is even larger now, making predictive analytics for a given show's success more robust.

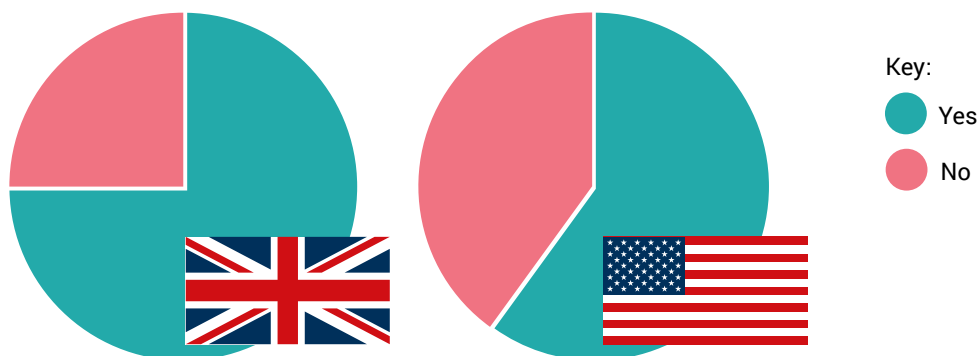
The future of commercial linear TV channels will therefore be based on their ability to produce content of at least equal quality to that made available by pure-play on-demand providers. Just as importantly, the content must be compelling enough that viewers are willing to sacrifice the convenience offered by on-demand. It is no surprise, therefore, that focus is shifting to creating exclusive original content that will not be available on other channels or providers.

What this means for linear TV subscription businesses

As shown in Figure 2, a recent ContactEngine study revealed that around 25% of people in the UK, and 60% in the USA, have considered cancelling their TV subscription in favour of a pure-play on-demand services such as Netflix or Amazon Prime. Note that Figure 2 represents sentiment rather than action.

Figure 2

Have you considered cancelling your TV subscription in favour of pure-play on-demand services?



7. <https://www.wired.com/2012/11/netflix-data-gamble>

There are good reasons why viewers may consider, but not act on, cancelling their TV subscription in favour of pure-play on-demand services. The first is that TV subscriptions typically come bundled with broadband and landline, as well as a lengthy contract which is not that easy to cancel, but it is more cost effective than buying each element separately. An even more compelling reason is that a Netflix subscription costs around £8 a month and is easily cancelled, with Amazon Prime costing slightly less. These price points represent a relatively small percentage increase on the cost of a TV subscription bundle, and so it is financially viable to have both a TV subscription as well as a Netflix and/or Amazon Prime subscription. This could result in pure-play on-demand TV providers not eroding the number of TV subscriptions as quickly as some might expect. However, with TV subscriptions becoming ever more expensive, and household incomes becoming more squeezed, the discretionary spend on a TV subscription will become increasingly difficult to justify over cheaper on-demand alternatives.

Rather than losing customers to pure-play on-demand providers, the biggest challenge for TV subscription providers may be that, if pure-play on-demand services do erode commercial linear TV channels, then they will have to convince customers to pay the same or more for fewer channels. Again, this will come down to ensuring those channels that remain have content of the highest quality.

60% of people surveyed in the USA have considered cancelling subscription TV in favour of OTT services.

A note on sport

Live sport currently gives TV subscription providers a material edge over pure-play on-demand providers. A L.E.K. study in 2015 noted the significant influence of live sport on the willingness of consumers to pay TV subscriptions, noting that “27% of survey respondents would trim or cancel their TV subscription if the ESPN channels were OTT-only”.⁸ In the UK, Sky and BT share the distribution rights for lucrative Premier League football matches.

8. L.E.K. (2015) Over The Top TV Trends. Available at: https://www.lek.com/sites/default/files/virtual-mvpds_mvps_ott-tv_over-the-top-tv_over-the-top-tv-market-trends_ott-series-part2.pdf

Both the Premier League in the UK and NFL in the USA are cognisant that over-the-top streaming has an important role to play in growing their respective audience bases, but both draw a distinction between the domestic and non-domestic TV audiences for commercial reasons. For example, it is possible for people outside of the USA to pay an annual subscription to watch NFL games via live streaming on the NFL Direct app, but people within the USA cannot.⁹ Although financially risky, it is conceivable that the governing bodies of major sports could decide to stream content directly to both domestic and non-domestic paying viewers, removing the protection that those sports currently offer TV subscription providers.¹⁰

A more credible risk is that a pure-play on-demand provider steps in to purchase the rights to broadcast lucrative sports via live streaming on their service. There is some indication that this is indeed a credible risk – in 2017, Amazon won the rights to stream 10 Thursday-night NFL games to its users.¹¹ Although 10 games may seem a small number, if the move proves successful for Amazon by attracting additional users to its Prime service, then it has the financial resources to compete with the major broadcasters for the rights to all NFL games, as well as other sporting franchises around the world as and when they are next available for sale.¹²

Conclusion

On-demand TV has undoubtedly facilitated a significant change in people's viewing habits. The ability for on-demand to be delivered over-the-top has allowed pure-play on-demand providers such as Netflix and Amazon to deliver content to users without the need to invest in downstream infrastructure. This has enabled those providers to operate markedly different business models, and ultimately offer cheaper subscription rates, than cable/satellite TV subscription providers like Sky in the UK and Comcast in the USA.

On the face of it, pure-play on-demand providers should significantly erode the cable/satellite TV subscription business. However, as per the reasons discussed in this paper, pure-play on-demand providers are not a directly comparable replacement to cable/satellite TV. Rather than eroding the cable/satellite TV subscription business itself, it is more likely that pure-play providers will erode the number of channels available on cable/satellite TV – cable/satellite customers will have to pay the same if not more for less.

9. <https://www.nflgamepass.com/en/>

10. By streaming directly to viewers, the governing body would take on the financial risk of attracting paying customers that the TV subscription provider previously bore. This could result in lower revenues for the sport than are received under current arrangements.

11. http://www.espn.co.uk/nfl/story/_/id/19078771/amazon-wins-rights-livestream-nfl-thursday-night-football-replacing-twitter

12. Of course, the franchises themselves could live stream in their domestic markets, but that may ultimately result in them receiving lower revenues than are generated by the existing distribution rights auction process.

One approach to make paying more for less more palatable is ensuring remaining channels provide content that the customer cannot access elsewhere, such as Sky does today with its Sky Atlantic channel. Another approach is to focus on the broadband element of a subscription package, like Virgin Media appears to be doing in the UK with its fibre network.

If on-demand is important to customers, then so will be a fast and reliable internet connection, and if on-demand continues in popularity, then a fast and reliable internet connection will be important to more-and-more people and may take priority over the channels available via the cable/satellite subscription itself.

The speed of internet connection is of particular relevance to the USA, as if net neutrality regulations are abolished as is proposed, then this could have a materially negative effect on pure-play on-demand providers - with cable TV subscription providers also being internet service providers, they would be able to preferentially discriminate internet speeds in favour of their own TV services, including their own on-demand services. This could, however, result in the alienation and ultimate loss of customers. Nonetheless, it is no wonder that Netflix and Amazon are vehemently protesting against the abolishment of net neutrality.

One further consideration for the future is that convergence may occur between the pure-play on-demand providers and existing cable/satellite TV subscription businesses, such as Amazon live-streaming more than just sport and perhaps even entering the downstream infrastructure business. This idea is not so far-fetched, with Amazon rumoured to be looking at becoming an internet service provider in the UK.

It is of course impossible to predict the future precisely, and much of the above is logical speculation. However, there is one truism that represents a risk that is common to all companies in the TV industry, and that is time, or rather a lack thereof. The following quote from Netflix summarises well the nature of the time risk for the industry: *“we compete for a share of members’ time and spending for relaxation and stimulation, against linear networks, pay-per-view content, DVD watching, other internet networks, video gaming, web browsing, magazine reading, video piracy, and much more.”*

Compelling content is a must to win that competition.



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Email info@contactengine.com
Contact +44 20 33 940 840

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Registered Office: The Clergy House, Mark Square, London EC2A 4ER

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