WHITE PAPER

Telecom and Media Players are Coming Together to Win the OTT War

Rohit Sehgal, Randy Petway, and Sanjib Dutta

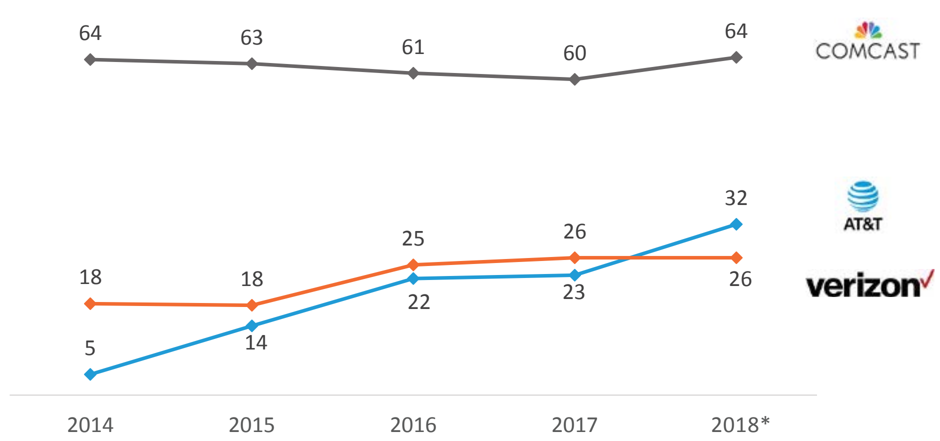
virtusa®
Accelerating Business Outcomes

Wide penetration of smart devices, omnipresent connectivity, and the advent of media over-the-top (OTT) players are significantly impacting the media industry. There has been a major shift in video consumption from linear TV to non-linear streaming services offered by OTT players like Netflix and Hulu. To retain their customer base, traditional media companies are fiercely competing with OTT players to create superior, original content.

The media industry isn't the only one feeling the impact of OTT competition; players in the telecom industry are also significantly impacted by OTT disruption. Over the last few years, telco OTT players have acquired a significant share of voice and messaging revenue traditionally held by Telecom Service Providers (TSPs). The loss of voice and message revenue was offset by growth in the data services business that kept overall revenue stable for TSPs. However, as the market continues to evolve around disruptive technologies, like eSIM (see our whitepaper eSIM – Gateway to Global Connectivity), and competing products, like Google Project Fi and Comcast Xfinity, even data services are at risk of getting commoditized. The disruptions pose a considerable threat to TSPs' direct ownership of their customers.

As TSPs look to protect their entrenched position in this disruptive marketplace, they also have an excellent opportunity to push new services into the market. A key strategy that TSPs have been executing over last few years, is to diversify into adjacent businesses, such as media, to explore new revenue streams (see Exhibit 1).

Source: Company Annual Reports, Statista



**AT&T and Comcast 2018 numbers include estimated revenues from Time Warner and Sky (awaiting approval/finalization) respectively.*
Comcast was one of the first companies to diversify into media in 2009, aquiring 51% stake in NBC Universal. They bought the remaining 49% stake in 2013.

***Exhibit 1:** Media Revenue as % of Total Revenue for US Communication Giants*

This particular use of business adjacencies, through mergers and acquisitions, gives media firms access to TSPs' large customer bases, while enabling TSPs to better serve their customers (see our whitepaper, The Death of Business as Usual and the Unraveling of the Vertical Industry Structure). The result is an enhanced customer experience that allows the combined entities to compete with their common enemy, the OTT players (see Exhibit 2).

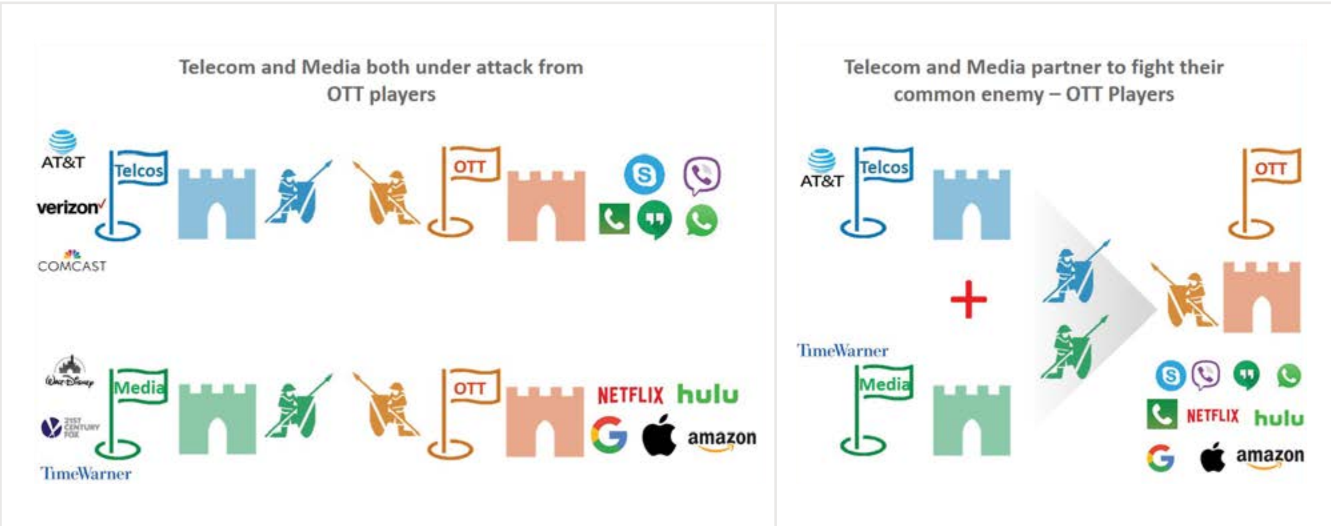


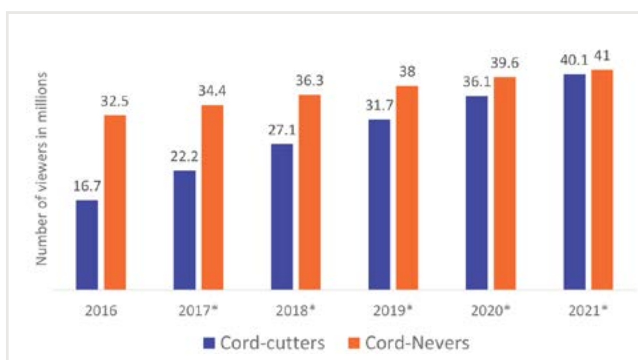
Exhibit 2: *Telecom and Media M&As to Win the OTT Battle*

Ubiquitous internet and OTT content is changing the way media is consumed

Ubiquitous high-speed connectivity, smart devices and availability of extensive OTT content are enabling a fundamental shift in consumers' video consumption behavior from "watching what's on" to "watching what I want, when I want, and where I want". This transition – from linear, time-slot based consumption on TV to 24x7 on-demand, nonlinear binge-watching across a wide array of connected devices such as desktop, laptop, tablet, smartphone, and television – has led to a significant uptick in "cord-cutters" and "cord-nevers" (see Exhibits 3 and 4).

Source: Digital Market Outlook

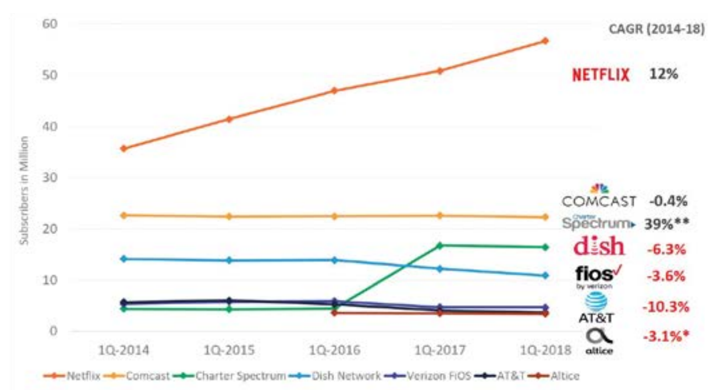
Exhibit 3: *Internet Penetration in US*
(% share of population)



Source: eMarketer

Exhibit 4: *Cord-Cutters and Cord-Nevers Growth Trend in US*
(in million)

According to industry estimates, in 2017, OTT video services in the US cumulatively clocked a revenue of $20 billion. OTT players are rapidly capitalizing on this demand and this number is expected to grow to $31 billion by 2022[1]. By tapping into changing consumption patterns and providing superior content in cost-effective way, OTT players have a clear and effective plan for growing their customer base. In Q1 2018, Netflix's subscriber base in the US exceeded the combined subscriber base of all cable and satellite service providers (see Exhibit 5).



***Altice CAGR: 2016-18**
****Charter completed the acquisition of Time Warner Cable and Bright House Networks in Q2 2016**

Source: Statista, Company Websites

Exhibit 5: *Subscriber Growth Trend in US: Netflix vs. Pay TV Providers*

Monthly Plan Price (in US$)	***2018***
Netflix Standard Plan	**10.99**
Comcast TV Rates (Digital Starter)	90.00
Charter Spectrum Triple Play Select	89.90
DISH Network DISH America's Top 120	89.99
Verizon FiOS Triple Play	79.99
AT&T DirecTV Select Pack	78.00
Altice USA (Altice One)	79.99
Average Cable Price	**84.60**

Source: Company Websites

Exhibit 6: *Pay-TV vs. Netflix Plan*

There are three key reasons why media OTT players have made substantial inroads into the media value chain:

First, a significant portion of the OTT subscription base in the US is primarily driven by the cost of the service; a monthly OTT media subscription costs 70% to 80% less than the cheapest cable or satellite programming subscription options (see Exhibit 6). Media OTT players stream content directly to the customers by leveraging the data pipe provided by TSPs, bypassing traditional media distributors like cable and satellite service providers. Cable and satellite service providers, on the other hand, grapple with the exorbitant cost of building the backbone infrastructure and installing and maintaining set-top boxes at customer premises, which makes media subscription services (aka Pay TV) over their distribution channel very expensive for customers.

Second, OTT players have a wide collection of popular video content available for non-linear viewing that allows customers to binge-watch their favorite shows conveniently, anytime and anywhere. While Pay TV operators have certainly stepped up to provide their own "anytime, anywhere" services, those services still have very limited content and sometimes are channel-specific that constrain the viewer's access to content depending on whether the user has access to that channel through his Pay TV subscription. In contrast, media OTT players provide a one-stop shop that contains content from a variety of networks, across a diversity of genres and provide the same level of access to all subscribers.

---

[1] *www.forbes.com/sites/dbloom/2018/06/05/streaming-video-2017-revenues-pwc-netflix-amazon-hulu/#69413ed75edb*

Lastly, OTT players provide an interactive user interface that enable them to personalize content and recommend shows and movies to customers based on the viewing history of the customer and latest trends from similar customer profiles. This ensures far superior customer experience compared to linear programming.

Changing media consumption behavior is disrupting the media industry value chain

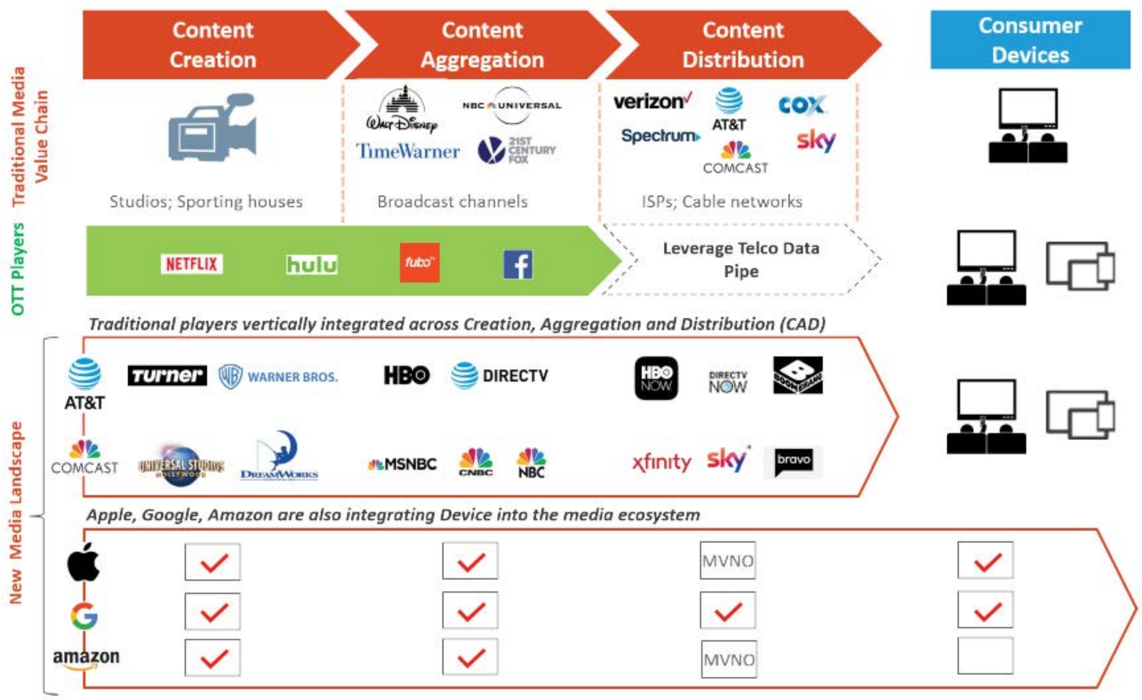
This digital on-demand content market did not evolve overnight. OTT players began their streaming service offerings by licensing a wide-array of popular content from big media houses. Many customers signed up for these OTT streaming services to supplement their existing Pay TV subscriptions, which had very limited on-demand content; OTT players were quick to realize that without original content, they would never be the first choice. As customers have become more willing to change their service provider for premium and original content, OTT players have been pouring money into producing their own original content.

For 2018, Netflix budgeted $8 billion for content creation, far ahead of HBO's $2.5 billion. Facebook, Google and Amazon have been spending significant money to create their own original content. Amazon has acquired streaming rights for Thursday night NFL football for 2018-2019 and Premier League soccer (2019-2022) for 20 matches per season. Undoubtedly, creating original content and acquiring streaming rights to major sporting and live events are paying off very well for OTT players. At the 2018 Emmy nominations announced recently, streaming colossus Netflix overtook the premium cable network HBO as the most nominated network, ending HBO's 17-year-long reign.

In the race to provide premium original content at a breakneck pace, the seven-decade-old model of siloed content creation, aggregation, and distribution has and is horizontally integrating. This began when key TSPs in the US diversified into the media distribution space by acquiring cable and satellite service providers. For example, AT&T acquired DirecTV while Charter Communications acquired Time Warner Cable. To control the complete media value chain and reduce time to delivery for original content, TSPs are also acquiring media creation and aggregation players (e.g. AT&T's $85 billion acquisition of Time Warner) to bundle their content with their distribution channels (see our blog post CSP's Achilles Heel – Quest for Content).

OTT players like Netflix and Hulu are already following a model of horizontal integration. They have collapsed the content creation and aggregation business by producing their own content and have democratized the distribution channel by leveraging the TSP-provided data pipe for content distribution. Given the success of media OTT players, many media houses are looking to launching their own streaming services to get direct access to their consumers. Disney, for example, will be launching its streaming service in the coming months. This direct-to-consumer model is an epic leap that will transform the media industry from a multi-tier B2B2C model to a direct-to-customer B2C model.

Tech giants like Google, Apple, and Amazon (rumored to launch a smartphone in late 2018) are taking horizontal integration a step further by assimilating mobile devices into the media value chain. This gives them full control over their respective media ecosystems. From a content perspective, Google has YouTube, Amazon has Amazon Prime, and Apple plans to launch its own streaming service soon. For distribution, Google can utilize its Project-fi or Google Fiber network, while Apple and Amazon can operate as Mobile Virtual Network Operators (MVNOs) by white-labeling the telcos (see Exhibit 7).



Comcast and Fox are currently locked in a bidding war for Sky. Sky had earlier planned to launch its service through its Sky Q platform, which would allow viewers to access pay TV channels and on-demand content without needing a satellite dish.

Exhibit 7: *The New Media Landscape*

Telecom and media players are coming together to fight their common enemy

The war between converged telecom-media and the OTT players is certainly expected to heighten. And while the combined force of telco and media will have several strategic weapons in their arsenal, whether that will help them regain their lost ground is anyone's guess.

In the near future, the media landscape is expected to become widely fragmented with multiple streaming services from telcos (AT&T, Comcast), FAANG, OTT players like Netflix and Hulu, and big media players like Disney. Content licensing across streaming service providers will be significantly reduced as content will be the key differentiator and core asset in the horizontally integrated media value chain. As a result, customers, who initially benefited because of the vast array of content and cheaper streaming service from OTT players, will eventually have to subscribe to and pay for multiple streaming services based on price and their choice of shows and movies. Until we see mega-mergers, or one company becomes a mega–media streaming service provider, devices like the Amazon Fire TV Stick and Google Chromecast will flourish and aggregate various streaming services.

IN CONCLUSION

Small media players who are left out of the horizontally integrated model will find it increasingly difficult to navigate this new ecosystem. These players will have to reinvent the way they have been doing business and rewrite the rules of content creation, aggregation and distribution. Their survival depends on:

- How effectively they tailor content specifically for target customer segments;
- How efficiently they use digital technologies (e.g., data analytics) for the right content to reach the right customer segment;
- How proactively they identify customer journey and touchpoints and ensure that customers can consume content across multiple devices/touchpoints; and
- Licensing their content to media giants in the converged industry

ABOUT THE AUTHORS

Rohit Sehgal

In a diverse global career that spans over two decades, Rohit has had several successful stints in business consulting, software product development, and services delivery. He currently serves as Senior Vice President and is the Digital Business Strategy Leader for the Telecom and Media unit at Virtusa. He works with global clients to help them re-strategize their business models by leveraging new digital trends. Rohit holds a postgraduate degree from the Indian School of Business (ISB) and a bachelor's from the Indian Institute of Technology (IIT), Delhi.

Randy Petway

Randy is currently Vice President at Virtusa, leading the Media & Entertainment and Information Services solutions team. He has spent two decades helping media, entertainment, and information services companies leverage technology and business process change to reach their business objectives. During the last ten years, Randy's focus has been on assisting companies to confront the changes brought about by society's transition to a digital world. Before joining Virtusa, Randy held C-level technology, operations, and sales positions with Ingenta (formerly Vista). Randy obtained his undergraduate degree at Rutgers College. He has also completed executive education programs at Rutgers Business School, and more recently, MIT Sloan School of Management and the MIT Computer Science and Artificial Intelligence Laboratory (CSAIL).

Sanjib Dutta

Sanjib is a Strategy Consultant in Virtusa's Digital Business Strategy team and works with clients to create and execute their digital strategies. He has worked in research and advisory, corporate strategy, planning, and sales operations roles in large and mid-sized global IT service companies.

GLOSSARY

OTT: OTT stands for "over-the-top" and refers to firms who provide services outside of the traditional method of delivery. In the context of this paper, it refers to firms who use TSPs' data pipes as a distribution method of their services.

Media OTT Players: Firms that deliver film and TV content via the Internet without requiring users to subscribe to a traditional cable or satellite Pay-TV.

Telco OTT Players: Third-party firms who deliver messaging service or VOIP calling parties, as an alternative to text messaging or voice service provided by mobile operators.

eSIM: eSIM allows consumers to store multiple operator profiles on a device simultaneously, and switch between them remotely.

Google Project Fi: Google Project Fi is a MVNO and automatically connects subscribers using Project Fi compatible phones to the best available network at the location.

Comcast Xfinity: Comcast Xfinity delivers TV, Internet, voice, and mobile service, all working together – anywhere, anytime.

Cord-cutters: In broadcast television, cord-cutting refers to the pattern of viewers, referred to as cord cutters, cancelling their subscriptions to multichannel subscription television services available over cable, dropping pay television channels or reducing the number of hours of subscription TV viewed.

Cord-nevers: A group related to cord-cutters, the cord-nevers, have never used commercial cable for television service, relying on internet sources from the start.

B2B2C: Business to business to consumer (B2B2C) is an e-commerce model that combines business to business (B2B) and business to consumer (B2C) for a complete product or service transaction.

FAANG: FAANG is an acronym for Facebook, Apple, Amazon, Netflix and Google.

Amazon Fire TV Stick: Amazon Fire TV is a digital media device developed by Amazon to provide integrated user interface to allow users to access to multiple streaming service from one interface.

Google Chromecast: Chromecast is a line of digital media players developed by Google. The devices, designed as small dongles, enable users with a mobile device or personal computer to initiate and control playback of Internet-streamed audio-visual content on a high-definition television or home audio system through mobile and web apps that support the Google Cast technology.

Linear TV: Real time television service that transmit program on fixed schedule. Almost all broadcast TV services count as linear TV.

Non-linear TV: On-demand programming, which is available to view at any time the user decides and not constrained by real-time broadcast schedules.