As content providers rationalize distribution options and preserve the financial models for sophisticated shows like "30 Rock" (pictured), they can learn plenty from companies that have survived disruptions in the past.

NBC PHOTO: MARY ELLEN MATTHEWS

Lessons From HOLLYWOOD

By BRUCE LAZARUS

SOMEWHERE DURING IN THE SPAN OF TIME between the invention of television and the Internet, there was a brief period when I watched some very unusual public services announcements in movie theaters. The PSAs warned consumers about the impending demise of local movie houses and dire consequences to the survival of the American family.

The culprit was pay television. Plunking down money for broadcast TV was unconscionable, the ads claimed. Cable TV would destroy the theater experience.

As we all now know, the message couldn't have been more wrong. The motion picture business racked up nearly $10 billion in ticket revenues in the U.S. and Canada and over $28 billion worldwide last year, according to market analysis of Motion Picture of Association data. That's up from $2 billion in 1975.

I'm reminded of those dire warnings today because of a new kind of confusion in the business that was exemplified recently when I visited a certain media company. I asked one of the executives who met with me about how the firm was managing content that could be received on nontraditional platforms, like Hulu or the Xbox.

To my surprise, my source told me that different business-development and new-media divisions managed those distribution deals. While some content was offered free with specific windows of availability via one Web site, it might be offered to consumers in a micropayment format on a different Web site.

It's clear that the rush to deliver online video through as many distribution channels as possible, without differentiating online content from what's viewed or heard on traditional media, could undermine the consumer experience and profitability of the content owner. Yet there are some clear "rules of the road" that can help financial managers avoid those pitfalls.

Before considering some solutions, it pays to consider the huge questions that are plaguing media companies these days, and which in some cases are prompting the irrational behavior.

For example, will multiple system operators and the channels they carry manage to save their subscription revenue stream with services like TV Everywhere, which require consumers to verify that they are subscribers of a video distribution platform before they access TV network programming online?

Did Hulu take an unnecessary risk by building an untested, ad-supported online service before moving to a pay model? (That transition is expected to take place this year.)

If the gravitational pull of free online video content causes a precipitous drop in cable subscriptions, will business models for popular TV series like *30 Rock* and most sports productions become unsustainable?

And will newspaper publishers ever lure consumers *en masse* with online subscription offerings?

Finding the Answers

We need look no further than the "pay television" that those movie theater PSAs warned about to see historical evidence that subscription and micro-payment business models can be effective.

NEXT GEN AUDITS AND LICENSING AGREEMENTS

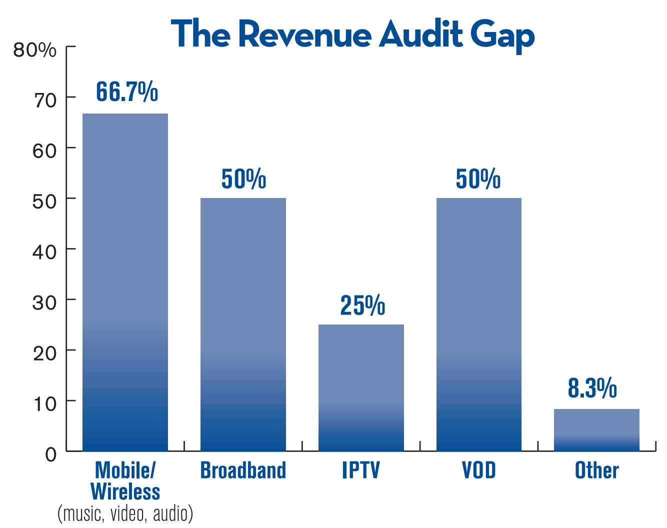
Content companies will need to pay particular attention to provisions concerning the evolution of distribution platforms.

THE WIDENING ARRAY of distribution choices causes particular challenges for legal departments, which must ensure that licensing agreements maximize the value of content libraries and distribution platforms.

For this reason, Most Favored Nation (MFN) clauses – insuring that video content providers are receiving equal, if not better, treatment than any other client – are likely to remain an important element in content-licensing agreements. The cable industry's carriage agreements have long relied on MFN obligations to ensure programming subscription fees remain consistent across cable systems. In addition to the contract provision, content distributors may also require annual "Letters of Certification" to legally document their MFN status.

In addition to paying special attention to the language contained in the contract, such as "net effective rate calculation" and "non-economic terms," content companies will need to scrutinize provisions concerning the evolution of distribution platforms.

In some instances, the agreements may forbid the content company from exploring alternative distribution platforms. In others, content companies may inadvertently surrender control over the pricing and other terms by which a licensee is distributing the owner's content using alternative media.



During Fall 2009, Cable Audit Associates survey respondents were asked what revenue streams were not being audited, and 25% reported that IPTV (subscription digital television service using Internet Protocol) was not monitored.

Avoiding a "Norm"

Unless they are successfully guarded against, such provisions could become the norm for other licensed distributors that seek the same new media opportunities under an MFN.

A more subtle consequence of the MFN provision can be the stifling of creativity. When MFN provisions don't differentiate between content owners, aggregators or distributors, it can hamper efforts to customize an agreement to suit specific marketing and financial needs. For example, developing highly targeted content for different markets cannot be treated uniformly across all geographies and all licensees.

Financial managers also need to ensure that carriage agreements adequately address their verification requirements. While auditing has proven to be a successful tool to insure accuracy in payment, it also has the capacity to change B2B relationships between content companies and their licensed distributors.

Audits Deemed Effective

In a recent cable TV survey conducted by Cable Audit Associates, 90% of respondents said auditing improved their subscriber reporting and financial transparency, and two-thirds said they believed that the audit function has improved contract compliance and administration. The survey also found that, despite auditing's role in improving the revenue-recognition and contract-management processes, the majority of content companies have yet to establish audits for their new media business ventures, including video on demand, online and mobile.

The appreciation for the role that auditing can play in new media ventures is also shared by the newspaper and magazine industry. A recent survey by the Audit Bureau of Circulation and its ABC Interactive subsidiary found that publishing companies agreed on the importance of third-party auditing in order to increase the credibility of new media platforms, noting that it is likely to be demanded by advertisers.

The same conclusion can be extended to the importance of including provisions for auditing micro-payments. In the cable TV world, micropayments are used for PPV, premium channel, subscription video on demand and basic or digital-tier subscription transactions. Typically, content licensors will use their internal audit teams or a third-party service to audit a distributor's customer billing records and other data to verify accurate payments, address billing discrepancies and comply with Section 404 of the Sarbanes Oxley Act, which governs the adequacy of internal control structures and procedures for financial reporting.

Financial transparency is not a natural phenomenon. An investment in the creation and distribution of online content requires an equal but less glamorous investment in developing financial systems and the audit function. And both will improve the bottom line.

– By Bruce Lazarus

Netflix and Amazon have already established online purchasing behavior, and now they're extending it to the TV. It is an evolution, not a revolution.

iTunes was such an brilliant antidote for the music industry because it molded hardware, software, packaging, marketing and sales solutions into a convenient and valuable service that appealed to customers.

In a similar way, companies such as Netflix and Amazon are being integrated into TVs and set top boxes. They've already established online purchasing behavior, and now they're extending it to the TV. It is an evolution, not a revolution.

Tips for the Navigators

Fortunately, the lessons learned by Hollywood studios and the recording industry provide some insights for financial managers trying to rationalize content strategies for an ever expanding variety of distribution options.

1. BECOME INTEGRALLY INVOLVED IN MANAGING NEW-MEDIA OPPORTUNITIES – Hollywood responded to the challenges of disruptive technologies like cable by making sure its financial management community was integrally involved in ensuring the preservation of brand value while exploring new revenue opportunities such as pay per view.

2. RE-ENERGIZE THE APPEAL OF TRADITIONAL DISTRIBUTION METHODOLOGIES – Hollywood's investments in research and development yielded innovations like Technicolor, Panavision, surround sound and 3D, which have helped to enhance the in-theater experience and differentiate it from the small screen

3. VALUE CONTENT CONSISTENTLY – It is important for financial managers to ensure that their companies prevent irreparable harm to particular brands of content by valuing it inconsistently. This requires adopting a holistic approach toward pricing and other aspects of the business model rather than having individual silos make decisions independently from one another.

The Walt Disney Co. provided an example of how this can be done recently, when it overhauled the marketing unit within its studio division, so that one team of marketers is now dedicated to the promotion of one film through all its distribution windows.

Maximize the value of each distribution vehicle, and prioritize the windows that offer the greatest return on investment.

4. PRESERVE BRAND VALUE – While we may disagree with some of their tactics, organizations like the Recording Industry Association of America and the MPAA have placed a major emphasis on fighting piracy, especially since consumers acquired greater access to duplication and distribution technologies. These measures help to reinforce consumer perceptions concerning the content provider's property rights and asset value.

5. MAKE IT EASY FOR USERS TO FIND YOUR CONTENT – As consumers, we have grown accustomed to joining communities that provide programming solutions. The interactive guides supplied by cable MSOs and other digital television service providers make it easy to navigate to our favorite TV programs.

Apple has created the iTunes store as a destination for iPhone and iPod users, just as MySpace and Facebook have created communities built around social networking. Consumers will require similar navigational aids for finding their preferred online programming.

They will also need to differentiate between legitimate and illegal sources for licensed content and feel secure before sharing personal information required for a micro-pay experience.

6. ENSURE AN EXPERIENCE THAT'S EQUIVALENT TO THE COST – A consumers' brand experience ultimately determines its value. As we saw with the innovations that kept TV households coming back to the theater, preserving brand value also entails providing a competitive quality experience. Online video quality continues to improve, underscoring the importance of innovations that can enhance the television experience, such as 3D television.

The Internet is littered with failed attempts to distribute quality and differentiated programming through business models that weren't well thought out. In contrast, there are brands that have expanded dramatically by harnessing the potential of new platforms.

Some of the biggest Hollywood brands, like Disney, whose movies I enjoyed as a boy, and some of the country's oldest movie theater chains, including National Amusements, serve to remind us that how we respond to the challenges posed by disruptive technologies will determine a company's place in the future as well as in history.

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THE STATE OF CONSUMER CHANGE

Five in 10 consumers using iPhone and iPod Touch devices use the mobile Web more frequently than they read printed newspapers (ComScope/Admob market research report, June 2009).

About 20% of Americans say they are watching less TV delivered through traditional broadcast or paid cable-type providers in favor of online video (Conference Board Consumer Internet Barometer, Sept. 8, 2009).

15% of viewers say they would consider cutting out traditional means of watching TV altogether (Consumer Electronics Association, 2009 customer survey).

The value of consumer electronics components that can be connected to the Internet will increase by 23% a year over the next five years, totaling more than $10 billion in 2014 (ABI Research).

While most online viewers would prefer to watch video for free, a significant minority is willing to pay in order to avoid at least some advertising, suggesting acceptance for a hybrid model of reduced advertising along with smaller fees ("Fee vs. Free for Online Video," eMarketer, Oct. 21, 2009).

The U.K.'s *Telegraph* attributes more than 30% of total revenues to its e-commerce platform (New Business Models for News Project, City University of New York Graduate School of Journalism).