

# The Media Landscape

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groupm



**GroupM**

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# INTRODUCTION



# INTRODUCTION

The overall intent of this paper is to view the media landscape through the prism of the expenditure of large advertisers and to examine some of the key protagonists that impact media supply. Inevitably this leads us to comment on the role of media agencies, like ours. In this introduction we highlight the facts as we see them and address our own role in the system.

Our starting point was that large advertisers faced challenges that were different from all advertisers' challenges. Our methodology was simple: Perform an analysis of the spending of GroupM's clients in our top 15 markets during 2018 to dig deeper into where the money is going, and isolate the unique challenges of large advertisers. We adjusted to recognize major merger activity late in 2018, mostly impacting the data for The Walt Disney Company, Comcast, AT&T and 21st Century Fox.

GroupM and its peers serve the largest brand advertisers globally, regionally and in individual markets. These advertisers cut across a broad sweep of "new economy" and "old economy" enterprises. As the largest market participant, it is reasonable to suggest that our clients are a proxy for all advertisers of this type. However, the groups of advertisers we service may underinvest in digital media relative to those advertisers we do not service. Were we to include those advertisers in our analysis, it would likely reinforce the prevailing narrative that the media world is now dominated by a very small group of very large companies, mostly notably Google and Facebook. Without question, those companies are significant to the world's largest brands, but not to the extent that they should dominate decision-making, as they do for some.

Putting this caveat aside, we thought it would be useful to analyze how our clients allocate their paid media investments to learn four things:

1

Who are the largest suppliers?

2

How is spend allocated between global, regional and local sellers?

3

What is the market position of Google and Facebook for our clients, as opposed to all advertisers?

4

What is the overall allocation between media types around the world?

In addition to these high-level observations, we have written a series of short essays that discuss the current and future status of the world's most significant media companies.

## WHAT DOES THE DATA TELL US?

1. Google
  2. The Walt Disney Company
  3. Comcast
  4. Facebook
  5. Bertelsmann
  6. ITV
  7. CBS
  8. Viacom
  9. Publitalia '80
  10. SevenOne Media
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# WHAT DOES THE DATA TELL US?

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In GroupM's top 15 markets as defined by total billings, Google and Facebook represent 19% of the total. This includes all of Facebook's individual platforms and the Facebook Audience Network, as well as all Google search, display and video, including any revenue ultimately repatriated to publishers. Net of that "repatriation," the total is close to 17%.

Google is the largest supplier to our clients. Facebook is fourth. The pair is separated by The Walt Disney Company and Comcast. Had the merger activity of 2018 not taken place, Facebook would have been second, with a big gap to Google and a slim one to Comcast.

Most readers would find this somewhat predictable, although many might have guessed the Google/Facebook share at around 25% or more.

In some ways, the rest of the top 10 make for equally interesting reading:

5. Bertelsmann – the owner of RTL Group
6. ITV – the UK's largest commercial broadcaster (some GroupM bias here, as our market share is particularly high in the UK)
7. CBS
8. Viacom (a merged CBS/Viacom will be in 5th place, fractionally behind Facebook)
9. Publitalia '80 – the Italy-based sales house that primarily represents its parent company, Mediaset
10. SevenOne Media – the Germany-based sales house that primarily represents its parent company, ProSiebenSat.1 Group

TF1, "New" Fox, Fox and News Corp. combined, Discovery and AT&T round out the list of \$500 million partners. For context, our total investment with Amazon, Twitter (roughly equal) and Snap totaled \$500 million, less than 15% of the Google/Facebook total but roughly equal to the total of Hearst, Meredith and Condé Nast. Snap is rapidly closing in on Verizon Media—the once mighty Yahoo and AOL.

Perhaps surprisingly, our investment with Microsoft and LinkedIn makes our global top 20 and is our third-biggest digital-only partner. In 15th place overall is out-of-home giant JCDecaux, with a similar volume to Amazon and Twitter combined and three times the size of the total of Clear Channel and OUTFRONT. The out-of-home giants, including Global, are making progress in turning static analog units into addressable digital sites, and it seems logical that the share of the medium will continue to grow. High-impact, highly viewable media is a scarce resource these days.

In GroupM's top 15 markets as defined by total billings, Google and Facebook represent 19% of the total.

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43% of billings in our top 15 markets are TV, including the digital delivery of legacy TV companies.

In audio, iHeartMedia is one and a half times bigger than Spotify, but for context the two together are smaller than just Bell Media in Canada and much smaller than JCDecaux. It appears the second audio age has not yet significantly impacted advertiser channel selection.

In terms of year-over-year growth rate, Amazon, Snap, Twitter, Facebook and Google lead but in percentages that are significantly lower than those shown in their public filings. This reflects the long tail as well as the continued reliance of many large advertisers on television. Inflation in that medium caused by constrained supply places some break on growth in media, where supply is anything but constrained. It's also true to say that new businesses, notably those commonly referred to as direct brands, start their growth journey with native digital businesses and only become drivers of legacy media when the reach or response ceiling is reached in what they perceive as the most accountable channels. Perception, by definition, is in the eye of the beholder.

Our experience outside the Western markets differs by market. Digital channels dominate in China, in part because of the extreme constraints on choice in TV. In India, digital is growing fastest, but both the TV and newspaper markets remain highly significant.

Our largest Chinese partners are those that would be expected:

- Tencent
- Alibaba
- Baidu
- CCTV
- Shanghai Television

Tencent ranks 16th on our global list, and Alibaba 28th. This is in no way indicative of weakness at Alibaba; rather, it demonstrates the long-tail/short-tail disparity and the company's direct relationships with large advertisers on its platform. Zee Network in India ranks 18th. Altogether, the top 20 suppliers represent less than half of our global billings, with hundreds of others accounting for the remainder.

When considered by media type, 43% of billings in our top 15 markets are TV, including the digital delivery of legacy TV companies; 37% of billings are digital, which includes search, social, video and display for all sources, excluding legacy TV; 7% are print; 6% are out-of-home; and 4% are cinema.



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In aggregate then, it turns out the world is every bit as complex as we might expect. Some additional observations follow:

- Video as a single format remains dominant. Within that, full-length programming remains the first choice of context. It's not surprising that video tops investment, given that it is a high-cost option but also a massive driver of customer/prospect activity in every other channel.
- Single-market players (especially in video) remain extraordinarily important to advertisers.
- Google and Facebook are every bit as dominant in digital overall, but account for less than half of digital display and video.
- As for the “third forces” in digital, all of Amazon, Microsoft and Snap are important and growing, but remain fractional players. Just as significant is The Trade Desk, the only meaningful global competitor to Google as a programmatic intermediary.
- Advertising as a share of total marketing in Asia, at least for our clients, appears to be a significantly smaller part of total promotional spend than in Europe and North America.
- The current decade won't be the decade of Latin America; Televisa (at 37) is the only seller from the region in the top 50. (GroupM does not operate in Brazil.)
- Among legacy newspaper companies, only News Corp ranks in our top 30. It is joined by Associated Newspapers (UK) and The New York Times in the top 100.

Video as a single format remains dominant. Within that, full-length programming remains the first choice of context.

# THE GREAT DISRUPTION



# THE GREAT DISRUPTION

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These are dangerous days for advertisers—at least those who have used television as the foundation of their communication strategy. With shifts in viewing habits, commercial impressions in the most viewable, highest attention media are in free fall across the world. The problem is universal and if the viewing behavior of younger audiences is a harbinger, things are not going to get better.

The simple truth is that Google and Facebook on the one hand and Netflix on the other have structurally undermined a century-old economic model: the former two companies by advertising-led monetizing of intent and social interaction in the absence of content, and the latter one by monetization of content in the absence of advertising.

In the former instance, massive outflows of cash combined with a diversion of attention from print media eviscerated the legacy publishing model. In the latter, the creation of an appetite for ad-free video diverted time, attention and money from traditional television. Enabled by the ubiquity of cheap broadband, Netflix led the over-the-top (OTT) revolution that threatens to undermine the business model of ad-supported television.

As the third decade of the 21st century begins, the question is: How long can these companies continue to thrive? Consider the following:

At the heart of Google's business is a trifecta of unique characteristics:

- A monopoly on intent and search in most regions
- A virtual monopoly on ad-supported short-form video
- Control of the infrastructure of the 75% of digital advertising not controlled by Facebook

These activities and Google's market position are reinforced by signals from Gmail, Maps, the Google Play Store, the Chrome browser and the Android operating system.

At the heart of Facebook's business is an equally compelling collection of attributes:

- A monopoly on social actions in most regions
- A near monopoly on messaging in Western markets, with market shares far in excess of Twitter and Snap
- A share of social advertising exceeding 80%

These activities and Facebook's market position are reinforced by both consumer opt-in and the company's ubiquitous view of identity enabled by "log in with Facebook" and the presence of Facebook pixels on publisher, advertiser and commerce sites alike.

The simple truth is that Google and Facebook on the one hand and Netflix on the other have structurally undermined a century-old economic model.

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Google and Facebook provided market-beating utility with zero economic or technological friction, which disrupted highly inefficient legacy markets in information and communication.

Netflix is as disruptive but less dominant. The company has what may be a durable market share but a less clear path to meaningful profits, as content costs continue to rise and producers wrestle with the choice between vertical integration of production and distribution and becoming content arms dealers with a focus on the highest bidder. We discuss Netflix specifically later.

The position of these three companies in the West, at least, seemed impregnable only two years ago. Now they continue to grow in both volume and share, but at decelerating rates and with clear vulnerabilities that may demand or impose significant change.

In the case of Google and Facebook, the data assets that laid the golden egg of targeted advertising are now questioned. Do they know too much? Are they reliable custodians? Is the method of acquisition an invitation to social harm? Has the resultant market dominance acted as a brake on competition and innovation? Is power that was conventionally the province of the state safely transferred to the enterprise?

In short, what competition has failed to disrupt is now the bull's-eye of regulatory interest across the world. It seems that those regulators have identified consumer harm, the enablement of criminality and the undermining of democracy as sufficient reason to demand radical change. The UK government published a white paper (a prelude to regulation) entitled “Online Harms” in April 2019. The problem for Google and Facebook is that the efficiencies inherent in global technology standards are no protection at all against local and enforceable regulation in everything from data use to definitions of free speech and tax treatment.

The regulatory swirl also impacts the “big bets” of the big players: specifically, Facebook’s Libra cryptocurrency project, which, in spite of high-minded ambition, has been greeted with guarded suspicion by some and unguarded incredulity by others. Aside from these specifics, there seems to be little appetite for these companies to become more powerful than they are today.

It’s worth stepping back and asking how Google and Facebook achieved their market positions, and why they became so attractive to advertisers.

Most succinctly, the answer is this: Google and Facebook provided market-beating utility with zero economic or technological friction, which disrupted highly inefficient legacy markets in information and communication. They did so with quality and speed sufficient to engender exponential growth, and with that growth erected insurmountable barriers to competitive market entry.

In the case of advertising specifically, Google and Facebook were able to leverage active and passive intent and behavior signals at super scale on and off network in a way that created value for the biggest advertisers and, most importantly, for millions of businesses and enterprises.

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They did this with effectively zero marginal cost of media (that's what user-generated content does) and, just as importantly, did so with "performance" related charging "per something" that created a more or less compelling perception of reduced risk to P&G, Joe's Pizza and everyone in between, including Booking.com and eBay.

The fact that Google served all advertiser constituencies is central to its success. An unlimited supply of inventory, impressions or queries massively increases the possibility of having inventory that's just right (relevant) for someone. Equally, when the principal mechanism for trading that inventory is via auction, the seller is massively advantaged by maximizing the number of bidders for each available lot.

Finally, of course, businesses that achieve massive penetration and network effects are also advantaged in their ability to bring new products and services to market. They are easier to test, refine and roll out; the costs of periodic failure are de minimis; and the ability to replicate features of competitors gets easier with a scaled engineering capacity and customer footprint.

Both Google and Facebook have acquired and refined every bit as much as they built. Facebook and Messenger are "homegrown" while Instagram, WhatsApp and Oculus are not. Google created its underlying search engine but was far from first to market with either auction-based keyword sales or the commingling of organic and paid listings. YouTube was acquired, as were Android, DoubleClick and Invite Media, the underpinning of Google's programmatic platform.

It's not altogether surprising that many competitors, commentators and regulators are calling for some variation of a break on growth or a breakup of corporate entities. Both companies are admired and valued by users, advertisers and the host of enterprises that probably would not have existed had they not been created. For some, though, the price is just too high; they see that the efforts made by the companies to de-weaponize their platforms have fallen short. Of course, the reason for that failure is that the platforms can never exert absolute control over access to their platforms or the content that appears on them. More accurately, they cannot do so without incurring costs that will hobble their progress.

So far, regulators have been content to fine Google and Facebook. The sums are large in any normal corporate context, but little more than an inconvenience to these companies. It seems certain that the fines will rise and the calls for breakup will get louder in 2020. Europe seems emboldened to act, and multiple antitrust investigations are now underway in North America. If the U.S. election cycle in 2020 can be shown to be impacted, even if U.S. political and regulatory bodies sit on their collective hands, the EU can be relied upon to make an increasingly hawkish approach.

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Regulation is easily the biggest threat. A boycott by advertisers is no threat at all; advertisers go where the customers are.

## Who or What Threatens Google and Facebook?

Regulation is easily the biggest threat. A boycott by advertisers is no threat at all; advertisers go where the customers are. The limit of their caution is to avoid the poorly lit neighborhoods. The small businesses that drive perhaps half of Google and Facebook revenue are focused on ease of buying; most others (including many large advertisers) are pragmatic about user-generated content—if that’s where the consumer goes, there go we.

Of greater significance is what Facebook and Google might do to themselves. Facebook’s announcement of the consolidation of the data engines of WhatsApp, Messenger and Instagram in the name of end-to-end privacy should be seen alongside its energetic development of Instagram commerce and Libra. Messaging, storefronts, commerce and currency represent a radically evolved model for the company. These initiatives will be viewed by some politicians and regulators as aggressive moves, and may see a backlash as a result.

At Google, the threats are three-pronged. Regulators appear focused on their ownership of Android, the social consequences of YouTube and their market dominance in both search and the ad tech ecosystem. Google’s grip on app revenue is also loosening, as a number of major developers are bypassing the Play Store—because they are able to and perhaps because they believe Google is in a less-strong position to enforce its gatekeeping position.

Google realizes that the cash cow of search is challenged by Amazon in product and by vertical players in travel and finance. It may also come to realize that the perceived toxicity of YouTube, born out of a “one-in-a-million” failure rate, may eventually make that business an unacceptable cost to the company.

It’s possible that Google will hold station in search and shift the YouTube brand entirely to curated content and a virtual multichannel video programming distributor (vMVPD) on a global basis in order to protect its ownership of Android and position in ad tech. In that configuration, Google can maintain its runway at a reduced level of controversy as it builds its credentials as a dominant player in ad-funded video and becomes the “anyone but Amazon” partner to those with e-commerce aspirations. In turn, this may enable the longer-term bigger bets of both Google and Alphabet to play out successfully in cloud, autonomous vehicles, health care and other associated life science endeavors.

Smaller companies could also pose threats, if minor ones in the near term. In advertising specifically, Twitter and Snap are resurgent and valuable to advertisers, but, like Pinterest, they are still small. Snap seems to be on the way to a full recuperation from a near-death experience only a year ago and is most likely to erode the share of Facebook, while Pinterest is more likely to provide advertisers some options with respect to search and Instagram. Snap already has a

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significant share of time spent among those under 30 and a rapidly improving video product that shows signs of being the video platform of choice for professional short-form content. The latter has all but eluded Facebook. Snap has avoided brand and social safety crises and data mishaps. Advertiser-friendly, its revenue development in video and stories is impressive and showing the fastest growth rate among our clients, albeit from a low base. E-commerce is the next frontier and could provide hockey stick growth.

Elsewhere, TikTok has zoomed into public consciousness (sadly, Vine is dead). However, there is a view that TikTok is “born toxic” and that its commercial growth may be forever hobbled because when you allow people to do bad things, that’s what they will do.

More broadly, all eyes are on Amazon and the multimillion (billion) dollar question: Is purchase data the highest fidelity signal of all? If so, and if Amazon disrupts the ad tech status quo following its acquisition of the ad-serving assets of Sizmek, both Facebook and Google will find a new competitive threat. Advertisers great and small will have a new route to market. If this is true, and if Amazon survives its own regulatory distraction, then publishers will have another power player to deal with, which may be to their long-term advantage. Amazon’s owner is at least predisposed to publishers. We cover Amazon further later on.

Across all of these titans—Google, Facebook and Amazon—the bargain becomes ever more complex for the largest advertisers. Business performance is commingling with ethical concerns, many channels to market are also competitors, and the information asymmetry between the platforms and their customers has never been greater. The walls of the walled gardens get ever higher.

## What Can We Learn from China?

Baidu, Alibaba and Tencent are often seen as the Chinese analogs of Google, Amazon and Facebook. It’s an easy but incomplete comparison. Baidu’s business is centered on search and video and is highly advertising dependent. Tencent’s core revenue sources are gaming, in-game purchasing, payments and share of service revenues. Alibaba is perhaps the most interesting. Unlike Amazon, the world’s biggest e-commerce marketplace has had advertising at its core almost from inception. Alibaba built and maintains storefronts, marketplaces, logistics and a promotional ecosystem in which almost every brand in China participates. If Tencent represents one version of a future Facebook (as we referenced in our “Opportunity and Hazard” paper), then Alibaba may represent a future state of Amazon, at the expense of every one of its digital and analog competitors.

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IF CONTENT IS KING,  
WHO WEARS THE CROWN?





# IF CONTENT IS KING, WHO WEARS THE CROWN?

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For a very long time, “the media industry” could simply be thought of as content creators (e.g., individual writers, directors, actors), studios (the financing, production and commercialization of content), packagers (e.g., TV or radio networks), distributors (owners of the “last mile” connection, or of the direct consumer relationship, including cable/telecom/satellite operators, theaters for films, or retailers for home video) and consumer electronics companies (typically hardware manufacturers).

While discrete functions continue to account for large shares of industry revenues in countries around the world, new subscription video on demand (SVOD) services with business models combining these functions have emerged en masse in recent years. The concept of combining the aforementioned functions into an integrated business is not new. Consider that once upon a time, the world’s major film studios signed talent to all-encompassing employment contracts, made movies and then exhibited them in theaters they owned. In some instances, studio owners attempted to control different aspects of this value chain all the way through to the hardware, as illustrated historically by RCA (the original owner of NBC) and today reflected in Sony’s portfolio of businesses.

Efforts to change business models—including function combos—can coincide with changes in technology and often with changes in regulations. In 2003, Disney launched a video delivery service called MovieBeam, intended to take advantage of new developments: radio spectrum licensed to broadcast stations for digital content delivery and falling prices for set-top boxes and hard drives. Disney’s movies were to be delivered directly to consumer homes using digital spectrum stored on those devices for access, but the service never made it much beyond the test phase.

In subsequent years, other content owners created similar offerings relying upon over-the-air delivery via broadcast signals to specialized set-top boxes. Italy’s Mediaset, for example, launched Mediaset Premium in 2005, pairing pay-per-view services with other premium content. However, the potential for set-top devices was truly amplified once they could access content from the internet. This led to the characterization of related services as “the internet bypass” around the same time. When this became a practical reality for many homes by the end of that decade, it enabled the rise of Netflix and other similar services.

Netflix was commonly viewed as nonthreatening in its earliest days. Time Warner’s final CEO Jeff Bewkes’ now infamous sobriquet for Netflix—the “Albanian army”—suggested it would never be capable of taking over the world.

In fact, Netflix was initially looked upon favorably by studios as a source of incremental revenue for library content that would bid up costs for everyone else. Few were concerned about Netflix’s stated ambition to “become HBO before HBO becomes us.” Before long, Netflix would have its own meaningful capacity to produce content, integrating the functions of studio, packager and distributor.

For a very long time, “the media industry” could simply be thought of as content creators, studios, packagers, distributors and consumer electronics companies.

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Netflix was able to build a massive business, which, while not particularly profitable nor cash-flow generative, clearly demonstrated that vast numbers of consumers are willing to access content through a different interface than the interface they use to access other content.

It remains true that Netflix and other SVOD services do not own all aspects of distribution, as can be the case when studio-network owners deliver content via broadcast services. This is because the physical layer of distribution via an internet service provider (ISP) is still typically owned by infrastructure companies, whether traditional cable/telecom operators or mobile carriers. However, woe to an ISP that chooses to block access to an SVOD service with popular content. The risks of regulation where it doesn't already exist and opportunistic competitor reaction are typically real, so financial terms between SVOD services and ISPs are reasonably achievable. Similarly, Netflix does not own any hardware for a consumer to access its content, but then again, the declining costs of making hardware opened up opportunities for the likes of Roku and placed pressure on manufacturers of TV sets to make access to SVOD services relatively easy.

Against this backdrop, Netflix was able to build a massive business, which, while neither particularly profitable nor cash-flow generative, clearly demonstrated that vast numbers of consumers are willing to access content through a different interface than the interface they use to access other content, that it is possible to deliver a high-quality video experience, and that consumers are willing to pay for the privilege of receiving it.

This outcome, alongside the relative successes of Amazon's Prime Video and Hulu, illustrated what was possible in the disruptive act of going "direct to consumer." They have incentivized consumers to "cut the cord," eliminating or downgrading traditional TV subscriptions, and in so doing have threatened the highly lucrative TV business model that had sustained studio owners. Those owners' financial results were, and to a large extent remain, highly dependent on selling bundles of networks to distributors who are decreasingly able to force consumers to buy large packages of content (regardless of whether consumers actually want them) and pay continuous price increases.

Fear around loss of those revenue streams has largely driven the strategic choices of video-centric studio owners and content packagers in recent years. In the past few years, among the U.S.-based global conglomerates (the dominant owners of global film studios), we saw Fox dispose assets; Time Warner sell itself outright to Disney and AT&T, respectively; and most recently, CBS and Viacom (Paramount film studio owner) announce a merger.

Among non-film studio owners, we saw Discovery and Scripps combining and a growing number of joint ventures among European network owners as well. These companies have their roots in traditional broadcasting or cable networks rather than in content production. Does this make them different than companies that own major film studios? Probably not, at least if they are willing and able to invest in content sufficiently. However, those with film studios will generally have an advantage because of the libraries of premium content to which they have ready access, and because of their capacity to make more.

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Of course, this is no minor obstacle. Investments in content are one thing—studio owners know how to do this—but keeping up with Netflix, whose investors are willing to support growth without positive cash flow, is daunting. Further, these companies need new investments in technology services, whether outsourced, hired in-house or acquired (as Disney did in buying BAMTech for several billion dollars). They also need massive investments in customer service and support operations, and ongoing spending on the infrastructure required to keep their streaming services running smoothly. In addition, traditional network owners must deal with internal conflicts when they balance the need to invest heavily in new services versus supporting the incumbent distributors or their worsening-but-still-dominant legacy businesses.

If there is one advantage most of these companies possess, it's that they are nothing if not commercially focused. This extends to a focus on commercials themselves. By contrast, Netflix appears institutionally allergic to conventional advertising. Traditional owners of TV networks supported much of their legacy businesses through ad revenue. While many made mistakes in depending too much on advertising (worsening the consumer proposition with too much commercial clutter), they hopefully will learn from these mistakes in traditional media and keep their streaming services relatively uncluttered.

In this space, the CBS–Viacom combination is particularly intriguing because it could come closest to presenting a relatively infrastructure-light “media company of the future.” They bring together integrated studio production capabilities for a wide range of content types and experience with direct-to-consumer content packaging via CBS’ All Access and the Showtime OTT app over the past five years. With enough new content investment—perhaps funded by selling some of its broadcasting, publishing or cable network assets—and enough tolerance for a significant cash burn, ViacomCBS could begin to look more like Netflix than any other media owner. However, the companies must first go through the painful process of merging and, eventually, fully develop an integrated strategy for the future.

Still, Disney is undoubtedly the 8,000-pound gorilla (or mouse) among this group of companies, given its acquisitions and prioritization of direct-to-consumer services. During its most recent earnings call, CEO Bob Iger described the launch of Disney+ as the most important product launched in his time as CEO of the company, and he further articulated the motivation underpinning Disney’s efforts by stating (in context of talking about Hulu Live), “what we also are doing is setting ourselves up in a way that we can be resilient, probably more resilient than any of our competitors should the traditional side erode so significantly that it’s not as viable as it has been as a business. And that will enable us to pivot pretty quickly by moving even more product from the traditional channels over to the nontraditional channels.” If there is any risk to Disney realizing its goals, it is that the company’s margins may fall by more than investors anticipate as the company devotes ever-increasing resources to this space while concurrently helping accelerate the relative decline of its traditional higher-margin businesses.

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It's inevitably going to be true that heavy investments in original, high-quality, popular content will help ensure a studio, network, platform or other media owner is successful in building its business.

Among the next tier of companies—those lacking traditional film studios—Discovery stands out for its geographic breadth. It is substantial in the U.S. and Nordic markets, and significant in many other countries. This arguably provides the company with a better sense of differences within and across countries, and exposes it to a wider range of business models to evaluate for its core markets. If this leads to more experimentation across the company's apps, it will probably help Discovery find superior business models or otherwise be more attuned to different ways to run its business going forward.

This advantage is somewhat offset by Discovery's relative lack of scale in any one country, at least compared to the infrastructure-based media owners (Comcast and AT&T), or Disney or ViacomCBS. While Discovery may develop new streaming services with niche appeal, it is less likely going to develop one with comparably broad appeal. It remains to be seen whether a large collection of niche businesses can be as proportionately large to a parent company as a small collection of large streaming services.

European-based media owners face a similar challenge, as none of them alone are likely to be particularly large on their own, or large enough to launch with large libraries and plans to launch massive volumes of original content. We could very well see more formal combinations among many of these companies, leading to more organizations that look like Bertelsmann's RTL does today. Already, Mediaset owns major networks in Italy and Spain and now has a large holding in Germany's ProSiebenSat.1 Group. Further, the UK's ITV is regularly considered an acquisition target. On the other hand, such combinations may not be sufficient, as those referenced here tend to cross borders and cultures and won't necessarily support scale in producing and distributing content in the same language when compared with Netflix.

Viacom's Sumner Redstone is often credited with coining the phrase "content is king." We're inclined to agree, even if we can't identify exactly which part of the industry this should refer to. It's inevitably going to be true that heavy investments in original, high-quality, popular content will help ensure a studio, network, platform or other media owner is successful in building its business. However, it is harder to say which of them is better positioned to capture an outsized portion of the industry's profits. That's a good thing for consumers and marketers, because at least it increases the odds that industry participants will continually innovate their offerings to compete for as much revenue—and profit—as possible.

A last word on Netflix is necessary. The emergence of rival streaming services increases the cost of content acquisition, removes high-value content from the platform and creates competition for share of entertainment wallet. Rising costs and competition could result in reduced subscriber growth and deeper losses. In that event, investor reaction could result in a far from desirable new season of "House of Cards" for Netflix.

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# THE DREAM OF THE '90S IS ALIVE: CONVERGENCE 2.0



# THE DREAM OF THE '90S IS ALIVE: CONVERGENCE 2.0

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The fact that telecom companies have tended to buy into ad-supported media owners more than the other way around is important because of what it says about how these companies may be managed now and into the future.

Facilities-based telecommunications companies have become increasingly important players in advertising over the course of the past 20 years, leading to a modern-day realization of the concept of “convergence,” a popular theme within the telecom, media and software industries in the 1990s. While bundling services (packaging and distribution) to tap potential efficiency synergies was a popular rationale for a time, more recent arguments for these combinations involve visions of pairing data from mobile services with content to produce more valuable advertising inventory.

The fact that telecom companies have tended to buy into ad-supported media owners more than the other way around is important because of what it says about how these companies may be managed now and into the future. Decision-makers at the top of these companies rarely grew up around advertising, and so may not always have nuanced insights into the business. Expansion into advertising-related businesses may be more about revenue diversification or absolute cash-flow growth, at least for companies that began as telephone or cable service providers and that must now support pensions for retirees while meeting the expectations of investment-grade, fixed-income investors pursuing dividend yields. They may also overestimate the value their direct-consumer relationships and data bring to the media they sell, at least initially.

Further, telecommunications companies are often very hierarchical, conservative and rigid, as might be expected of a highly regulated sector whose products are paramount over people, and which is expected to never fail, obliged to provide consumers (as well as governments) with continuous service. Such attributes can bring some advantages, including disciplined operating styles, which are far less common in media companies. Those same media companies are much more likely to operate as fiefdoms, to be more tolerant of a wide range of personalities within their organizations and more fluid in their operations. This could be expected from a sector where creativity is considered a critical competence and where the core products are ultimately people.

These attributes are based on observations of the industry over the past couple of decades, though we recognize that they will not all apply to every one of the companies we include among these groups. Each company referenced here has taken a slightly different approach to maximizing the benefits of its capacity to distribute content, while not losing what makes the content and related ad inventory so special to consumers and marketers alike.

Let’s start with the biggest of this group in terms of advertising revenue and the one that arguably pursued convergence most aggressively the earliest: Comcast. Like other historical “cable operators,” Comcast invested heavily in digitizing its infrastructure through the late ‘90s and early 2000s, and gained scale as a multichannel video programming

# THE DREAM OF THE '90S IS ALIVE: CONVERGENCE 2.0

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distributor (MVPD) primarily through acquisition. By the early 2000s, Comcast had a small portfolio of national cable networks alongside its local cable inventory. Based on the conventions that emerged in the United States, this meant the company was able to sell two minutes of advertising per hour on each national cable network it carried within the footprint in which it operated. While Comcast initially overestimated the relative interest that national advertisers would have in its inventory, there was evidently a view that its legacy operations could add more value to cable networks' national inventory (or at worst, benefit from a diversification of revenue streams).

This led to a failed attempt to buy Disney in 2004; the company was successful in first buying U.S.-based cable networks and a film studio from Vivendi, and second buying the NBC broadcast network, its local station portfolio and related cable networks. Functionally separating the MVPD side of the business from the content-focused assets on the other side operating as NBCU, Comcast has mostly been able to manage these two sides of its businesses distinctly, albeit similarly well over the past decade.

What comes next for Comcast? International expansion is one direction, as evidenced by the recent acquisition of another MVPD, UK-based Sky, which provides a meaningful footprint in the UK, Ireland, Germany, Austria and Italy. There were also reports of interest in India's Zee, which subsequently sold a stake in the company to a financial buyer rather than a strategic one. Sky already had its own strategy in place as a stand-alone company, but it appears that many of its initiatives—including the expansion of original content production, a streaming service and addressable advertising capabilities—are moving forward as aggressively as they were before the transaction.

Within the United States, Comcast appears to be continually improving its advertising businesses on the MVPD side, as evidenced by its investments in what is now FreeWheel, alongside ownership of billing systems company Strata and an investment in NCC. Of potentially greater strategic importance, NBCU is launching an advertising-supported streaming service named Peacock in April 2020.

Comcast has generally benefited from its pursuit of limited synergies across its divisions. A streaming service might be expected to produce conflicts if it were fighting for subscribers with a sibling MVPD business. Then again, an important part of the service's model is that existing MVPD subscribers will have free access to the service, which presumably mitigates risks. To the extent that the two sides of the company continue to maintain their current balance—operating separately and collaborating where it makes sense to do so—the future of the company will be favorable.

AT&T offers a meaningful contrast to Comcast. It is not only the second-largest mobile services provider, but also the owner of the biggest MVPD

Functionally separating the MVPD side of the business from the content-focused assets on the other side operating as NBCU, Comcast has mostly been able to manage these two sides of its businesses distinctly, albeit similarly well over the past decade.

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AT&T has taken a relatively novel approach in looking to secure access to inventory from outside media networks during joint carriage negotiations, this to expand the pool of ad inventory it can add value to and resell.

(with the former DIRECTV satellite-based service and its homegrown U-verse offering). After completing the acquisition of Time Warner last year, it appears to be pursuing value by combining content packaging and distribution in different ways. Much of the rationale for the combination centered on creating greater value with Turner's national ad inventory, under the premise that more and better data would drive up inventory pricing and, ultimately, company revenue. By contrast, Comcast was able to realize significant value primarily by improving the operations of its acquisitions.

AT&T's argument presupposes that it will be able to add unique data to Turner's inventory despite constraints on doing so, including a limited ability to apply data from the company's mobile networks and the limited footprint of its video distribution network. The latter issue means it must extrapolate from any data that the service collects in order to apply it to national inventory. It further assumes that significant numbers of the large advertisers who buy national TV will be able to identify superior value from the data appended to their inventory.

On the other hand, AT&T has taken a relatively novel approach in looking to secure access to inventory from outside media networks during joint carriage negotiations, this to expand the pool of ad inventory it can add value to and resell. Further, its efforts tie in the former AppNexus—an ad tech company acquired last year—to sell more video inventory to digital buyers (whose budgets, planning and buying processes better align with what it's selling) may prove more successful than selling data-enhanced TV inventory to TV buyers.

Overall, however, AT&T has a difficult path forward managing the former Time Warner. Aggressively, each of its former division heads has now left or been dismissed, and the company is integrating the three primary businesses (Turner, Warner Bros. and HBO) at no small risk to operational success. Further, the company is also pushing down a path of launching an SVOD service, much like Comcast and Disney. Unlike Comcast and Disney, AT&T is likely to be more cautious about incurring massive costs to build out a service that almost certainly will be money-losing if it is to compete well with Netflix. Reinforcing the nature of this challenge, the recent involvement of activist investment firm Elliott Management with AT&T is a reminder that companies need to be as mindful of investors as they do of customers and regulators.

American entities with legacy infrastructure are not the only ones to have established themselves as media companies with a focus on premium video content. Vertical integration has been common in countries such as Canada for an extended period, with several of the dominant media companies—including BCE, Rogers and Quebecor—each owning TV networks and the infrastructure to deliver content to consumers' homes in different and mostly non-overlapping parts of the country. Rapid audience declines and the entrance of global competitors



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(Netflix) catalyzed them to innovate their use of data and addressable advertising capabilities.

Outside North America, this kind of broad vertical integration between legacy forms of content distribution and content packaging is relatively rare. While more companies are entering the video distribution business around the world, few have made meaningful investments in content packaging or production.

Globally, infrastructure-based companies have made a bigger push in digital services. From a starting premise that mobile services providers supply consumers with a primary means of accessing the internet (their handset), these companies have the capacity to gather data on those consumers and make it possible for publishers and advertisers alike to reach consumers. Companies around the world have invested in related opportunities. However, to date, outcomes have been mixed.

Singtel has probably invested earliest in the broadest global footprint of digital advertising opportunities through its Amobee business, which is effectively a rollup of ad tech businesses, including Videology, Turn, Adconion and Kontera. There are limited synergies between Amobee and Singtel given its limited footprint (network operations in Singapore and Australia, primarily); this makes this initiative more of a diversification play. However, to the extent that the parent company continues to find value in its investment and provides Amobee with resources to grow, it could fare well as other smaller companies in ad tech falter.

In absolute terms, Verizon has made the biggest bets in this space, first with its acquisition of AOL and secondarily with Yahoo to form Oath, now Verizon Media Group. In the United States, those properties represent around 5% of digital content consumption and a meaningful presence in the ad tech space. In many markets around the world—well outside of Verizon's footprint of infrastructure—its media entity is a significant player. However, whatever potential Verizon's management once saw in owning a network that produced a significant amount of data around consumers, it never quite attempted to combine that data with much of its media inventory or other tools. While there is much that Verizon could probably have done legally, practically it will never likely be worth the risk of compromising the trust of its subscribers to generate a small amount of incremental advertising revenue. Consequently, Verizon Media Group is left to fend for itself within a broader corporate entity. This could actually prove to be an advantage. As with Singtel's ad tech investments, by avoiding the glare of public investors, this business can be protected if it can sustain its current scale and establish the right long-term strategy without requiring significant new resources from its parent company. As a reasonably large media owner, it would be well positioned if either Facebook or Google falter.

While more companies are entering the video distribution business around the world, few have made meaningful investments in content packaging or production.

# THE DREAM OF THE '90S IS ALIVE: CONVERGENCE 2.0

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Most infrastructure-focused companies around the world will be content to focus on the historical scope of their operations rather than on advertising going forward.

It is worth noting that it was Verizon's prior CEO who bought AOL and Yahoo, and with a change in management came a change in the company's relative focus on this space. In that sense, Verizon's management is more in line with most other telecoms around the world. While Verizon has held on to its investment in a digital advertising business, others have divested. Australia's Telstra sold its Ooyala division in 2018 after buying various assets in this sector beginning in 2012. Norway's Telenor similarly pushed into ad tech via the acquisition of Tapad in 2016, but subsequently wrote down the value. In general, it seems more likely than not that most infrastructure-focused companies around the world will be content to focus on the historical scope of their operations rather than on advertising going forward.

INDIFFERENCE MAKES THE DIFFERENCE



# INDIFFERENCE MAKES THE DIFFERENCE

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Most of the media industry's largest companies operate in what economists call "two-sided markets"—economic platforms that maintain relationships with two distinct groups, each of which provides the other with benefits.

Most of the media industry's largest companies operate in what economists call "two-sided markets"—economic platforms that maintain relationships with two distinct groups, each of which provides the other with benefits. These media owners provide an environment for consumers (one of the two groups) to access content. Consumers then provide their attention to marketers (the second group). Across much of the industry, media owners are careful to balance the interests of both groups of constituents, although this balance can vary significantly.

The purest of these "two-sided" companies within the media industry are media owners who find an optimal balance in providing content without charging consumers, other than for their time in exposure to commercial messages or in some cases for use of data about them or their behaviors. These purists rely primarily on marketers to fund their operations. This is true for free-to-air TV networks, most of the radio industry, Facebook, Twitter and Snap.

Two-sided markets are still at play in instances where media owners look to balance advertising revenue with directly or indirectly generated revenue from consumers. This is true for the magazine industry, ad-supported pay TV and U.S. broadcast networks, which generate revenues from retransmission consent fees. For these companies, the health of their advertising business is a significant determinant of the health of their total business.

However, there are other media owners who skew far from advertising and depend primarily on revenues that are more directly related to spending by consumers. Technically, their advertising businesses operate in two-sided markets, but the bulk of activities undertaken by these companies operate in more conventional one-sided markets. For them, if advertising suddenly no longer existed or if the advertising economy deteriorated significantly, their core businesses would not meaningfully change.

These companies' potential (or actual) indifference to advertising can enable them to approach investment choices, prioritize resources and otherwise make decisions with a heightened consumer focus, at least relative to the aforementioned companies balancing the needs of advertisers and consumers. This is important because these companies have an outsized capacity to influence expectations on the rest of the industry. Media owners in two-sided markets must sustain their existing dependence on advertising revenue and navigate the product trade-offs they've made, heavy ad loads, use of consumer data for a third party's benefit, etc., while also evolving with the consumer expectations increasingly shaped by their competitors in the one-sided markets.

Consider Amazon. With around \$9 billion in ad revenue in 2018 and perhaps \$13 billion during 2019, Amazon ranks as the third most important seller of digital advertising globally, after Google and

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Facebook. And yet, advertising will represent only around 5–6% of Amazon’s total revenue, and not even 10% of its first-party revenue. To be clear, Amazon is investing heavily in establishing itself as a media owner, but its motivations for doing so and its options are different than those of its competitors. A primary motivation for Amazon is to continually capture a larger share of consumer wallets. It does this by spending on features that consumers care about, such as fast shipping and low prices. High-margin advertising revenues help subsidize both. However, if advertising growth depended on sharing data that pushed some privacy boundary the retail side of the business believed to be too far, the company would undoubtedly choose not to share the data.

Prime Video, for example, seems unlikely to ever have much advertising. Prime Video helps reduce churn among subscribers to Prime, who in turn buy more products from Amazon’s retail operations. Decision-makers likely believe that including ads on Prime Video would not provide enough revenue to offset the lost value for Prime subscribers who would be put off by having advertising on the service.

It’s true that Amazon has launched new ad-supported initiatives such as Freevide (the formerly IMDb-branded VOD offering), and it has made some other advertising investments like its recent acquisition of Sizmek. The latter transaction provided Amazon with an inexpensive way to deepen relationships with advertisers who want to use Sizmek’s ad servers or dynamic creative optimization (DCO) products. However, Amazon seems overall unlikely to pursue more meaningful transactions involving purely ad-supported companies. Speculation on Wall Street that Amazon might want to buy a company such as Snap seems fanciful for this reason.

Still, Amazon is likely to remain a major player in the advertising industry because of its size versus other ad sellers, although advertising’s relative lack of importance internally may cause Amazon to move slower than many of its competitors. Offsetting this is the fact that the company has long time horizons, meaning it will make choices that do not necessarily require an immediate payback. If Amazon has a unique perspective on the ways that marketers could work with them (to support both parties in the long run), the company might be better positioned to invest in related initiatives versus its most direct competitors.

Netflix provides a more extreme example of indifference to advertising because it has essentially none—and it is unlikely to ever have any in the company’s current form. At a cultural and fundamental level, Netflix is philosophically opposed to incorporating what consumers would definitively call “advertising” into its service. The company’s management team has been clear about this for as long as it has been asked.

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Traditional media owners will be required to spend more on content to stay competitive, and this will result in permanently lower operating margins.

Only in a scenario in which a bigger company bought Netflix and replaced senior executives with new people is it plausible to imagine that Netflix might ever attempt to establish meaningful advertising-related revenue streams. And despite its recent fallback, at Netflix's current market capitalization, a takeover is a highly unlikely scenario for the foreseeable future. We recognize that Netflix will allow limited brand integrations, and presumably will establish opportunities for studios to promote their content ahead of other content—much like a trailer before a movie in the cinema—but even then, only under circumstances in which a consumer would consider the sponsorship to be like content.

As a result, when we think about the direction Netflix might move and how it may invest, we can think solely in terms of it spending money on content and physical distribution (for easier access via program guides, TVs and other electronic device interfaces). This would be focused on getting more consumers to spend more time with its content. On that dimension, the company potentially has significant room to run, with more disruption for traditional owners of video-related services yet to come.

Netflix has benefited from a negligible cost of capital, as investors have presumed that at some point in the future, the company will be a dominant incumbent provider of video services for its subscribers. By that point, it would conceivably have superior pricing power and could then grow into the profit margins that investors expect. This is an optimistic view, to be sure, and one that can't be proven wrong for an extended period. For now, the company can generally continue to gain access to resources and deploy those resources toward ever-larger content investments, at least for as long as we can see into the future.

This is what makes Netflix so important to the advertising industry. Its heavy content investments allow the company to capture audience attention, thus causing incumbent TV networks to respond by investing more heavily themselves. Netflix is also forcing incumbents and competing streaming services to think twice about ad loads—or about including them in the first place. If there is an advertiser benefit tied to the rise of Netflix, it's likely to be higher quality content and less clutter on ad-supported media. But the downside to date is declining viewership with the incumbents, especially with younger audiences, constrained advertiser reach to consumers and, at the same time, scarcity-driven price inflation.

To date, for traditional media owners, Netflix's impact is probably negative on balance. Traditional media owners will be required to spend more on content to stay competitive, and this will result in permanently lower operating margins. Any positives are limited because advertising budgets are probably unchanged by virtue of Netflix's existence (beyond heightened advertising by Netflix and emerging competitors

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themselves). And, industry-level subscription revenue probably won't go up much either, at least not in the world's most mature television market, the United States. Total consumer spending on video services has flattened, now divided among incumbents as well as Netflix, Hulu and others.

The establishment of consumer-friendly services can't all be bad news, and eventually ad-free content's share of consumer time will top out. And even at substantially higher levels of consumption, will it necessarily harm the industry? The presence of ad-free media owners will not necessarily mean weakness for ad-supported media owners. Consider countries with public service broadcasters, such as the BBC in the UK. And yet, despite the BBC capturing a substantial share of TV and radio consumption in its home UK market, national television is not proportionately smaller in the UK than it is in the U.S. To the extent that ad-free SVOD services become similarly widely viewed, it therefore follows that their presence will not necessarily impact traditional ad-supported television by much.

Further, public or community-based broadcasters—particularly those that either avoid advertising or maintain very limited ad loads—are important entities to monitor for other reasons when thinking about the evolution of the industry. Unconstrained by any reliance on commercial objectives, as long as these entities are well resourced and guided by consumer interests left unsatisfied by the marketplace, they are important sources testing new concepts. Consider college radio stations in the United States streaming radio in the early 1990s, or, back to the BBC, the early launch of streaming video in the form of iPlayer in 2007. More recently, U.S. public broadcaster NPR—and its content suppliers—invested heavily in podcasts and went a long way toward establishing their current popularity.

Media owners of all types will continue to innovate if they have a vision and access to resources. Not caring about advertising can be helpful if it means the media owner is finding novel ways to engage with consumers. Advertisers can then find novel approaches of their own to capitalize on the trends the indifferent media owners identify, and they should be better able to deepen relationships and make more of a difference to their customers as well.

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Despite many similarities between Alibaba and Amazon—namely the focus each had on e-commerce, historically—the contrasts between the companies are significant. The businesses look at advertising very differently. To understand why, consider Alibaba’s roots.

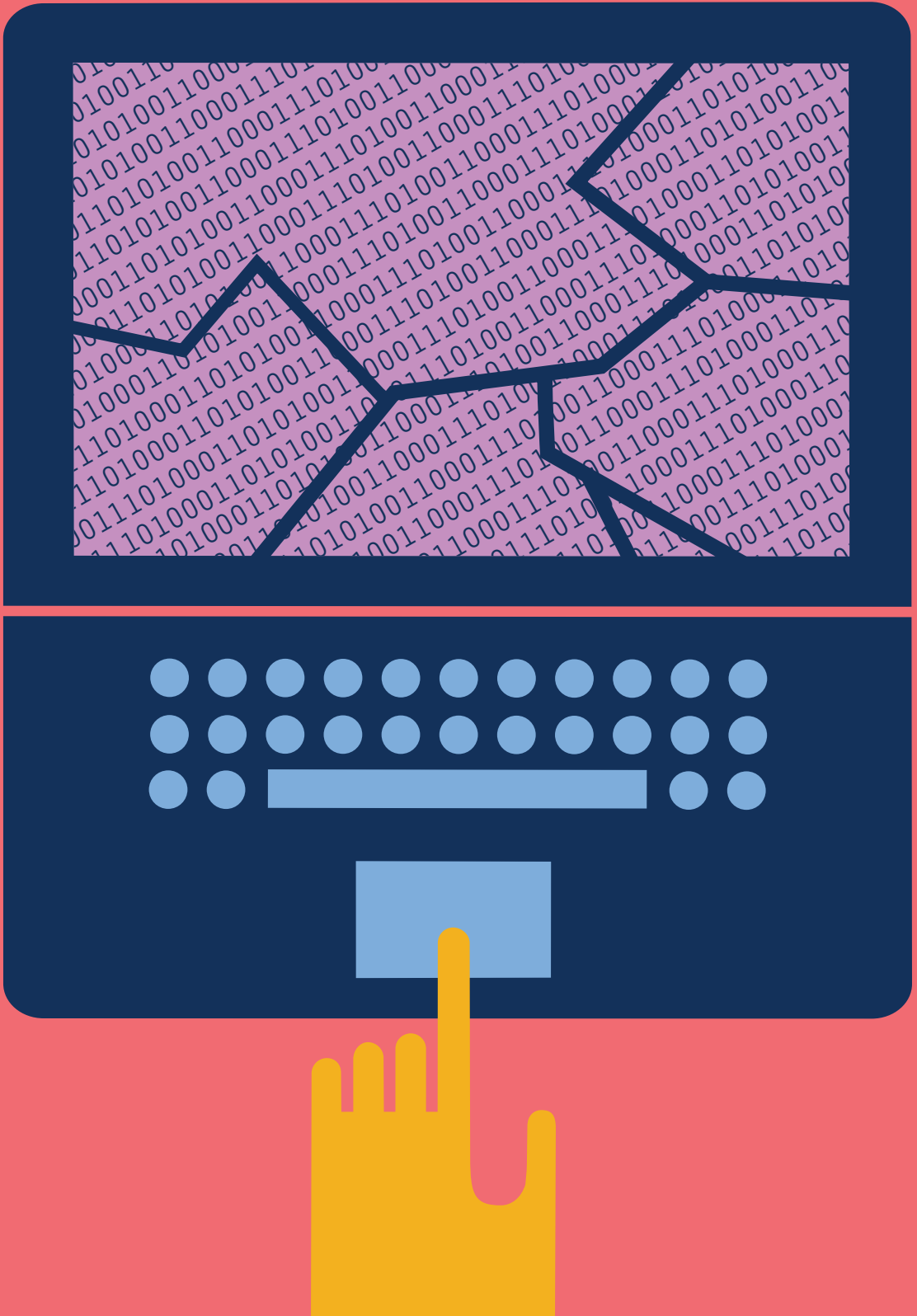
U.S. GDP has doubled since 1999, the year Alibaba started. But China’s GDP has increased tenfold in the same period. The development of Alibaba and the growth of China are inextricably connected. The state laid the foundations of infrastructure development and declared itself open for business and entrepreneurs. Alibaba set about inventing a modern Chinese consumer economy that provided international and domestic manufacturers—who happen to be brand owners—access to a rapidly urbanizing and economically viable population at a scale not seen since the United States after World War II. It did so by leveraging China’s physical and telecom infrastructure to open the long tail of Chinese cities for trade, building four things:

- 1** Its own end-to-end logistics operation
- 2** Taobao, a marketplace that connects millions of merchants with customers anywhere (launched in 2003)
- 3** Alipay, a payment mechanism that became a trusted payment platform for a population barely served by banks and credit card companies (launched in 2004)
- 4** Tmall, which gives major brands and businesses storefronts, digital infrastructure and logistics, all within the Alibaba ecosystem (launched in 2008)

Advertising served specific ends here: Alibaba chose to use advertising to drive the commerce “flywheel” on its platform. In many ways, this choice closely resembles the trade support platforms operated by Walmart, Tesco and other data-rich Western retail giants.



# THE CONTINUING RELEVANCE OF MEDIA AGENCIES



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It is clear that the global landscape is getting more complex rather than less. It is evident, for example, that the media market is fundamentally local and that budgets are allocated and transacted on that basis. Within any given market, shares of individual vendors vary widely, as does the volume of inventory that can be traded via automated systems.

Aside from brand and social safety, an area where the leadership of media agencies is clear, perhaps the greatest advertiser challenges are in budget allocation and attribution. On the one hand, the walls of the walled gardens are rising; on the other, the ability to create “data clean rooms” within those walls is increasing. The challenge for everyone is that attribution across media types is of far less interest to the seller than to the buyer. Allocation and attribution are massively compromised by the balkanization of data, and without the custom models built by agencies and advertisers together, any answer is partial at best. The fact that this process varies by market (as well as the data/regulatory environments of those markets) simply adds to the complexity.

Advertisers also have an uneven and inconsistent relationship with data and marketing technology. In the case of the latter, media agencies provide a layer of capability, experience and peripheral vision that sooner or later can be of inestimable value to their clients. It's hard to build and maintain a “tech stack”; it's easier if a single marketing cloud vendor can fulfill many objectives. That's certainly simpler than advertisers taking on the noncore function of systems integrator. Challenges arise at two levels: first when each component of the tech stack is not best in class, and then when a switch is required. By their nature, large agencies have visibility across the supply chain and of switching and onboarding processes and implications.

Data presents challenges of its own: cost of acquisition, regulatory compliance, respect for the consumer, and risks related to data being used by sellers of media to the benefit of others in the category as a result of pervasive pixels placed on advertiser digital properties. Media agencies have particular expertise concerning the prioritization and safekeeping of the data sets that thread the needle between relevance and compliance, which can also be applied to audience segmentation and directly to the purchase of media inventory. They also have a record of high standards of data security.

# THE CONTINUING RELEVANCE OF MEDIA AGENCIES

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It would be naive to dismiss in-housing; it is real, and for many marketers it has increased the speed and accuracy of decision-making. It is our view that in the environment described, in-housing is at best a partial solution, as most often it is restricted to channels that allow automation. Media in its entirety is a system of connections between brands and consumers, and it needs to be optimized in its entirety. It is also easier to execute in some markets for some channels than for all markets in all channels. In turn, this can create unfortunate incentives if attribution models are skewed to favor the channels and creative assets are managed by one party rather than another, and if different markets have different priorities caused by organizational structures rather than business needs.

As media agencies, we are significantly invested in the success of our clients. It is obvious that their success is likely to prolong our relationships, and potentially increase the breadth and depth of our assignments. Part of being invested in that success is adapting to organizational constructs that our clients favor. Consequently, we find ourselves as partial enablers of in-housing, which, on the surface at least, is not in our interests. It is what might be called a “learning moment” for our sector—in which scope and reward rise with collaboration and proof of expertise rather than by right.

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