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SUBSCRIBER ACQUISITION AND RETENTION IN AN OTT WORLD

As the OTT video space catches fire, providers across the competitive landscape have two main concerns: Getting new subscribers, and keeping the ones they have. Those two basic market elements drive virtually every single decision by executives in the streaming video industry.

And, at least here in these early days of OTT, getting subscribers and keeping them appears to stand as a major hurdle, at least based on third-party research. After all, the OTT market—where signing up for service, or canceling service, requires only a few clicks—is much different than the wireless market, for example, where credit checks, smartphone purchases, and two-year contracts can tightly tie a customer to a provider for the long haul.

Further, as over-the-top video services continue to multiply, they are also keeping key parts of their own math mysterious: OTT services generally don't talk about how much they spend to get and keep subscribers, how long those customers stick around, or how many subscribers leave each year.

Nonetheless, it's clear that players in the OTT space have their work cut out for them. How might OTT providers better attract and retain customers? What customer-acquisition levers are available to competitors in the space? And which retention strategies are working, and which are not?

This Fierce eBrief will seek to answer these questions and more in two parts.

MEASURING THE OTT SUBSCRIBER

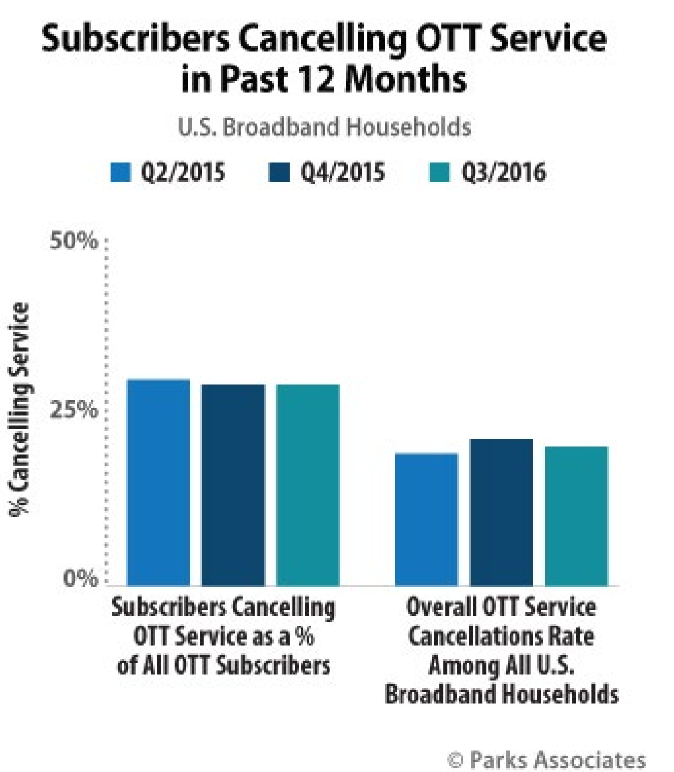
By Rob Pegoraro

While traditional pay-TV providers and wireless operators may not like talking about how many customers cancel service, they do disclose those digits. OTT? Not so much.

"These guys don't release that information," said Dan Rayburn, executive vice president at StreamingMedia.com and principal analyst at research firm Frost & Sullivan. "You look at Sling TV, PlayStation Vue, DirecTV Now—none of those guys give out churn."

Third-party estimates offer one obvious reason for this opacity: The figures aren't flattering.

"As of the beginning of 2017, 19% of all broadband households and 29% of households subscribing to an OTT video service had cancelled one or more services within the past year," noted Brett Sappington, senior director of research at analyst firm Parks Associates.



Those figures may not be that surprising, though.

"Churn is pretty high for OTT as it is easy to sign up and cancel services," wrote Deana Myers, who heads up OTT research at S&P Global Market Intelligence's SNL Kagan research unit.

Both Sappington and Myers saw some positive trends, however, especially for the biggest and best-known OTT providers.

"We are seeing that overall cancellation rate is stable or even declining, though very slightly," Sappington said. Although he did not share churn rates for individual services, he added that cancellation rates have dropped at Amazon, Hulu and Netflix over the past two years.

Myers agreed that Netflix was "on the lower end of the scale," with smaller rivals on the higher end.

CUSTOMER-ACQUISITION COSTS AND TACTICS

A high churn rate also need not be a problem if services don't spend much to sign up customers. So far, however, that does not seem to be the case—especially once you get past Amazon and Netflix.

For example, AT&T's DirecTV Now has been especially generous, offering a free Apple TV ($150 at retail) to new subscribers who pre-pay for three months of service or a free Roku Premiere ($70) to those who prepay for two months. It waited until July to launch a traditional ad campaign for the service, after it had picked up 500,000 subscribers in seven months.

Roku—the most successful of the linear, live OTT services with 1.7 million subscribers, according to industry sources who talked to Bloomberg—has opted for a cheaper version of the free-hardware tactic. Prepay for two months and get a free Roku

AT&T has bundled its DirecTV Now service with a free Apple TV.

Express, a $30 value; prepaying for three months yields a Roku Premiere.

A July 2016 report from the consulting firm Cartesian predicted that customer-acquisition costs, then "often below $100," will rise as the number of competitors increases. Parks Associates' Sappington concurred with that thinking.

"It is much more difficult for services to capture viewer's attention today than it was two years ago," he said. "So, they have to spend more to do it."

And throwing freebies to new customers may not be a viable long-term solution, he added: "Consumers that are influenced by promotions are some of the most likely to jump at promotions offered by other services."

Smaller services that can't offer free-gadget bait or bankroll blockbuster original series must find other ways to get attention in the market—sometimes by advertising on traditional pay TV.

"This year, we've expanded our marketing efforts into more traditional channels like print, television and radio," wrote Chris Frantz, director of digital strategy at CuriosityStream. "We do our best to align ourselves with like-minded publishers and have run placements with the New York Times and WSJ as well as sponsorships on NPR."

He said the science-minded OTT documentary service, with subscriptions starting at $2.99 a month, tries to keep customer acquisition costs down by partnering with such content sites as PBS Digital Studios. It mainly tracks the resulting sign-ups "via a combination of promo codes and landing pages."

CUSTOMER LONGEVITY

The last piece of the puzzle is getting customers to stick around. That, too, remains largely undocumented.

"The average length of subscription among all broadband households is just over 30 months," Sappington wrote. Parks doesn't break that down by services, but he noted that Netflix does better than most: "The industry average for all services except Netflix is just over 21 months."

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Since some new entrants haven't even been around for 21 months, he expects that average to climb. And giving subscribers something they can't get elsewhere can be a big part of that.

"Netflix (and others) are showing that a steady stream of original or exclusive content is a powerful tool in retaining subscribers," Sappington wrote.

Services that stream linear TV, like DirecTV Now and others, may not be able to offer many exclusive shows, but they can expand their perceived value by adding more channels, such as the local stations and regional sports networks that have traditionally been hard to find on OTT. Those actions, however, also increase providers' carriage costs.

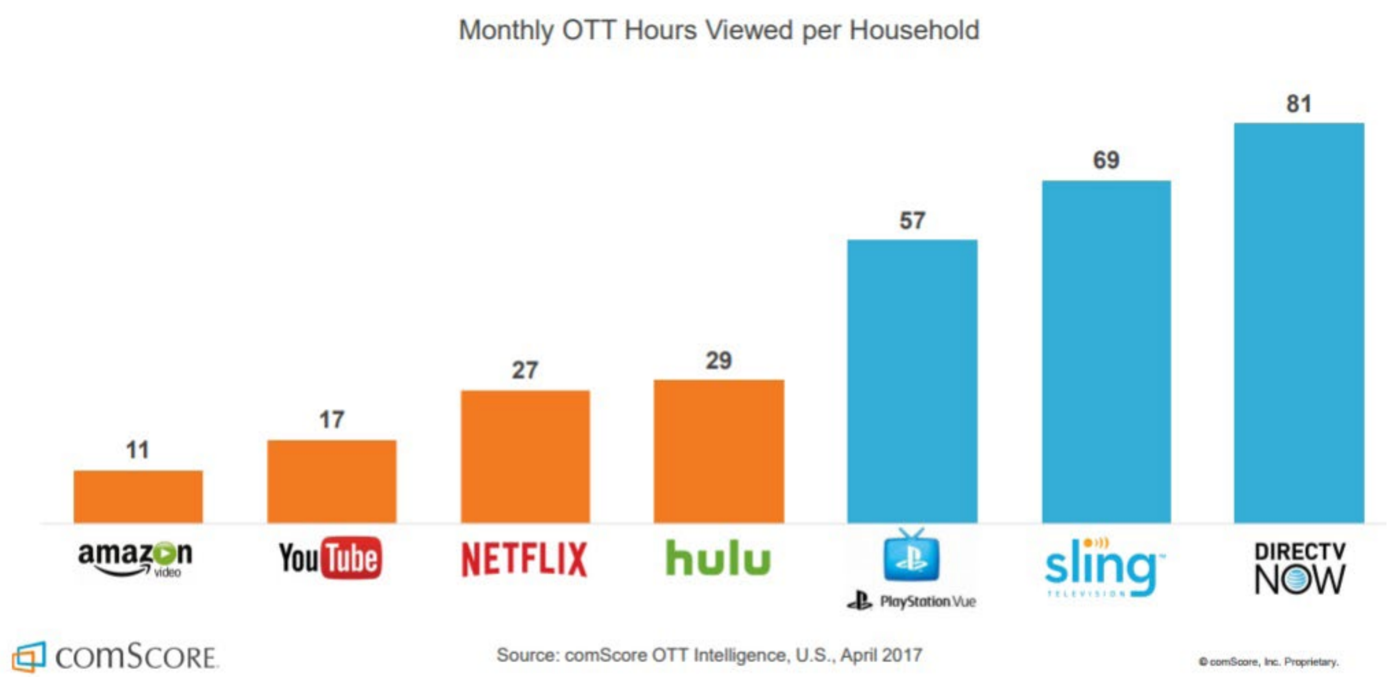
And as CuriosityStream's Frantz noted, encouraging repeat viewing itself enhances retention. "If users take the time to watch our content, they tend to stick around," he said.

Indeed, a recent comScore report showed that Netflix, Hulu and the linear services Sling TV, Sony's PlayStation Vue and DirecTV Now all did well on that front.

Specifically, Hulu and Netflix averaged 29 and 27 hours in April, respectively, in all-streaming households—but Vue, Sling and DirecTV Now racked up 57, 69, and 81 monthly viewing hours, respectively. Amazon Video was well behind, with just 11 hours.

Rayburn noted that Vue, Sling and DirecTV Now also all benefit from the backing of large parent firms. He put that in pessimistic terms: "You can't be a standalone live, linear service in the market and actually survive and not burn through cash if you don't have some larger entity behind you."

Sappington expressed more optimism in the concept but also counseled patience for anybody investing in it: "Ultimately, OTT video is a long-term play, requiring several quarters or years to secure a growing, core base of customers." ●



ComScore in April 2017 reported on the number of hours Americans viewed various OTT serivces.

A NETFLIX CASE STUDY

By Kendra Chamberlain

Netflix finished the second quarter of 2017 with over 100 million subscribers around the world, in an earnings announcement that beat expectations for both subscriber growth and revenues. The company has steadily grown its domestic and international subscribers over the past 10 years, and in the process has pioneered an entirely new mode of viewing entertainment: over the top.

Most of the company's recent growth has come from new subscribers across the 190 or so countries that Netflix entered in 2016. But Netflix attracted a million new subs in the U.S. market during the second quarter—and impressive feat in the U.S.'s highly competitive streaming video market. Those results are testament of Netflix's sweeping efforts aimed at keeping subscriber engagement high and churn low.

"Netflix is clearly the No. 1 streaming service in the world," said Tony Gunnarsson, senior analyst in research company Ovum's global OTT video research and forecasting team. "It's clearly the one that consumers have picked out and held up and said, 'this is the one we like the most.'"

Online marketing, one-month free trial offerings, and its nearly ubiquitous device support have all helped Netflix gain subscribers. But over the years, Netflix has refined its strategies beyond these softer tactics with hard, data-driven science.

"The reason Netflix has been so successful is that they've adopted a trial-and-error approach to determine what works," Gunnarsson said. "Data analytics comes into play here. Being an online streaming company, they have better insights into how customers use the service."

But how exactly has Netflix developed its domestic and international subscriber bases, quarter after quarter, and what data-driven tools has it employed over the past decade?

LEVERAGING DATA

While the company certainly had a first-to-market advantage, Netflix's impressive growth is due in part to its keen ability to constantly improve its service by examining viewership data and using that data to guide the company's efforts in quality of experience and quality of service improvements—part of what Netflix calls its "culture of experimentation."

In Netflix's early days of DVD shipping, it relied heavily on the star rating system to help predict what users might want to watch. In fact, the company's famed $1 million Netflix Prize contest in 2006 was aimed at improving the accuracy of its star ratings predictions for DVD rentals. As streaming video gained popularity, and more of Netflix's service moved online, the company has been able to capture, analyze and act on the troves of data it collects. Netflix collects data on when, where and how each member watches content, tracking user navigation and content discovery, and even tracks which titles were displayed but not played.

Viewership data can be used to better understand things such as how navigation or cover art may affect a user's likeliness to watch a specific video; how video rankings can impact discovery; and importantly what types of content to invest in. To this end, Netflix's introduction of user profiles has given the company a huge advantage over more traditional entertainment services by enabling the company to tease apart viewing behaviors of different users within the same household, which adds a further level of granularity to its data.

EXCLUSIVE AND ORIGINAL CONTENT

Not surprisingly, Netflix's content library is an important piece of its subscriber acquisition and retention strategy. In the early days of streaming video, Netflix supplemented its movie catalog with seasons of TV networks' old shows – and that inadvertently gave birth to an entirely new mode of consumption: binge viewing.

But when other SVOD OTT service providers began competing for rights (and consequently driving up the price of content), Netflix pivoted its strategy towards prioritizing original and exclusive content.

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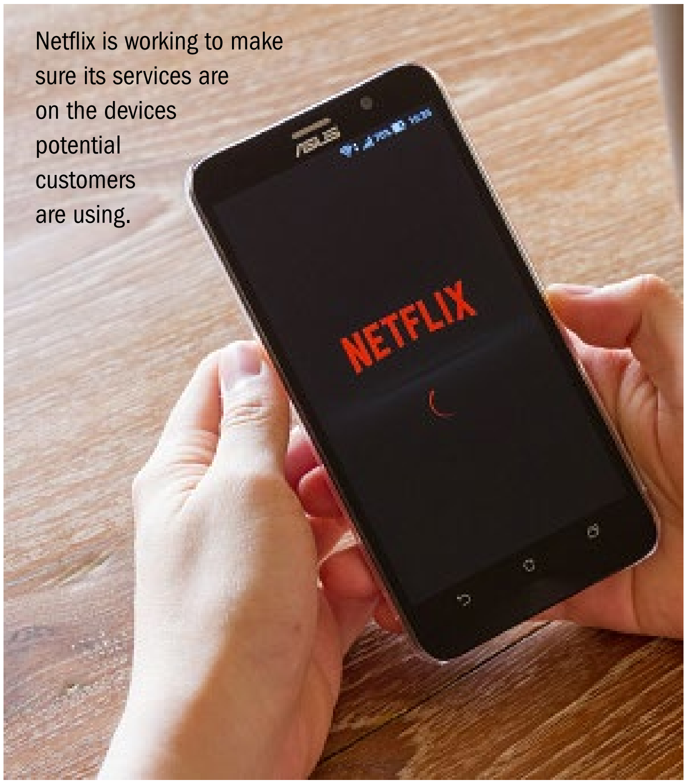

Netflix is working to make sure its services are on the devices potential customers are using.

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> -Colin Dixon, founder and chief analyst, nScreenMedia

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Netflix is able to use data to guide the content-creation process, a tactic that the traditional TV networks initially balked at. But Netflix's original content strategy—which this year will total $6 billion in expenses—has propelled the company to new heights in recent years. This year, the company received some 91 Emmy nominations, affirming Netflix's thesis that data-driven content creation would help the company rival the likes of HBO in original series.

Data-driven content creation has enabled Netflix to target specific demographics and content genres. And the more of its originals are considered must-see—by its subscribers, or the reviewers, or the awards organizations—the more subscribers the company can sign up, and the more engaged those viewers are once they've signed up. This contributes to what Netflix execs call the "brand halo."

"Just as the presence of interesting original content is a differentiator for Netflix, the volume and frequency of additions of new originals is also an effective tool to influence viewers," said Brett Sappington, senior director of research at analyst firm Parks Associates. "By introducing several new original titles each month to the service, consumers feel that they have a regular supply of new options for viewing. For subscribers, cancelling the service would mean the possibility of missing out on the next 'Stranger Things' or other big Netflix hit."

ALGORITHMS AND RECOMMENDATIONS

Netflix also pioneered a whole new way for consumers to discover content: data-based content recommendations. Using viewing data, the platform is able to select a number of titles that a given subscriber is likely to enjoy watching. By constantly refreshing this list, and adding in more subsets of data to the feature, Netflix has become a master at recommendations, and by extension, content discovery, according to a 2015 report published in the ACM Transactions on Management Information Systems Journal. The company claims personalized recommendations saves over a $1 billion per year.

"The detail and depth of its personalization is one of Netflix's greatest tools in retention," Sappington said. "As long as consumers are able to quickly find something interesting to watch, they will spend more time on Netflix and be less likely to swap out Netflix for another service. By personalizing the interface to such an extreme degree, Netflix is able to maximize this engagement and minimize the friction, and time, involved in moving viewers from login to watching something interesting."

Netflix uses a variety of algorithms that operate in orchestration with one another to guide a consumer towards finding something to watch. Each bar on the Netflix homepage can be governed by a specific algorithm that takes into account different data sets to generate lists. The genre rows, for example, are generated by Netflix's personal video ranker (PVR) algorithm, which organizes content across the entire catalog based on each user's specific tastes. The PVR algorithm also factors in wider popularity measurements to help better inform the ranking. Similarly, the "Trending Now" row capitalizes on short-term trends that can impact what users want to watch; ranging from things like watching

Christmas movies after Thanksgiving, to an uptick interest in movies starring Robin Williams after the actor passed away.

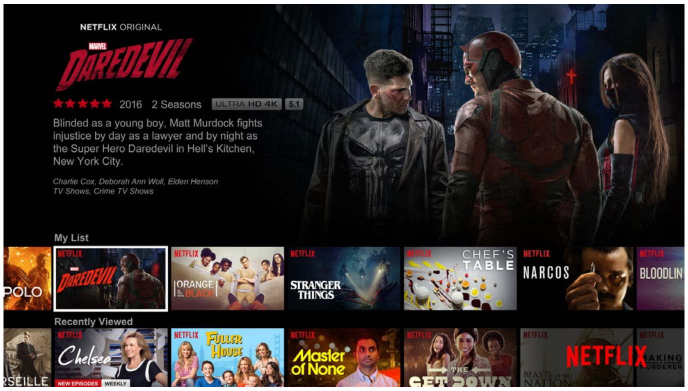
Content discovery has become an increasingly important piece of Netflix's service as it has been reducing the size of its content library over the years, and has moved away from licensing non-exclusive content in favor of creating its own originals.

UI AND UX

Ease of use in content discovery is a crucial component of subscriber retention for Netflix. The better the recommendations, the more time subscribers will spend on the service, and the less likely they are to cancel.

Netflix is famously eager to tweak other aspects of the user experience, from cover art, personalized title ratings, and rotating content lists to keep the content selection fresh for viewers and to keep the viewers engaged with the service. Each of these tweaks helps the company achieve what it calls "moments of truth": when Netflix's platform is able to help a subscriber find something to watch within a few seconds.

A key metric for Netflix is engagement—how many hours consumers spend on the service each day—and how Netflix can push that number higher. By conducting extensive A/B testing around big and small changes to the overall Netflix experience, the company is able to surgically tweak aspects of the



Netflix has refined its user interface to show content that subscribers are interested in.

experience in ways that boost engagement, and therefore improve retention.

"We also use data to build Machine Learning and other statistical models to improve QoE. We use experimentation broadly across Netflix to improve many aspects of the service, including user interface design, personalized recommendations, original content promotion, marketing, and even the selection of video artwork," Nirmal Govind, director of streaming science and algorithms at Netflix, wrote in a blog post last month. Features like automatic next episode play and the "skip intro" button are great examples of small tweaks to the UI that translate into longer viewing sessions for subscribers.

Another important consideration for boosting engagement is making sure the streaming experience is as smooth as possible. Netflix looks at metrics like the rebuffer rate, measuring how often playback is interrupted, and the average bitrate per session, which indicates how clear the picture was.

"Understanding the impact of QoE on user behavior allows us to tailor the algorithms that determine QoE and improve aspects that have significant impact on our members' viewing and enjoyment," Govind wrote in a separate 2014 post about streaming quality.

And there are other ways for Netflix to improve upon the user experience. Using data (again), Netflix has a pretty good idea of what content is popular in what areas, and even at what times of day, which helps Netflix determine how and where to cache its popular titles, making title retrieval easier. That's especially important for Netflix during peak times for internet traffic. The company has also implemented new encoding techniques to make streaming video more efficient and more smooth across a variety of network conditions. Netflix is currently working on optimizing video for mobile delivery, which will help mobile-reliant subscribers in markets with less wireline broadband penetration.

INTERNATIONAL MARKETS

In the United States, Netflix has had to respond to an increasingly competitive streaming landscape. Netflix penetration has hit over 54% of U.S. broadband households, according to a March report from Leichtman Research Group, which has caused Netflix's domestic subscriber growth to slow considerably. The company is now extending its device reach to include pay TV set-top boxes in order to sign up new subs.

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-Nirmal Govind, director of streaming science and algorithms, Netflix

"It's actually an essential strategy for growth here in the U.S.," nScreenMedia's Dixon said. "They're trying to get people to sign up for Netflix who really aren't online that much, who are very comfortable with what they know. To get those people, you have to go where they are, and where they are is on pay television."

But Netflix is facing new obstacles across the 190 or so new markets the company entered in 2016. In these new international markets, Netflix has had to shift its subscriber acquisition strategies in response to things like poor broadband penetration, language barriers, varying consumer expectations, and billing complications.

Netflix's credit card requirement, for example, "worked well in some places and not so well in other places," said Dixon, pointing to Latin America. "I think they learned from their experience that they had to change their approach depending on the specific locale."

Netflix has also had to make its content available in as many languages as possible to boost subscriber acquisition in markets across Latin America, Europe and Asia. Netflix has ramped up its subtitling in response to international market launches, and is now busy building up production facilities around the world to flesh out a global content creation pipeline.

And while Netflix's second quarter saw its international subscriber numbers surpass its domestic subscribers for the first time, Dixon noted the company still has plenty of work to do to boost penetration in its newer markets.

"In Southeast Asia, where the predominant device used for watching is a smartphone, Netflix doesn't play so well against the competition," Dixon said. "Pricing is a challenge in Southeast Asia. So they've got a lot to learn in that market. Whether they will be able to adapt and be successful is another question." ●