Are digital consumers ready to hit pause on pay TV?

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Hanish: We live in an era of choices—not just what football team to support or what show to binge on this weekend, but also where, how, and when you watch your favorite team or show. With video streaming enabling unprecedented freedom of choice, it seems consumers are reassessing the value of paying for cable and satellite TV subscriptions, and a lot of people are asking themselves "What should I do?" Pay TV is increasingly under siege because it doesn't always deliver on a value consumers expect in the digital age and that's the ability to watch whatever they want, wherever they want, and whenever they want. In addition, since many pay TV subscription packages include hundreds of channels, and many of those unwanted content, discovery has become difficult to say the least. Today I'm here with Deloitte's Media and Entertainment Industry Leader Kevin Westcott (who also happens to be my boss) and the executive director for our research center for TMT, Jeff Loucks. We are going to dive into all of these questions around the evolution of pay TV and what's next for cable, satellite, and streaming. And you may remember Kevin and Jeff from our first season on our CES episodes, and we are thrilled to have them back on the pod. Kevin, Jeff—welcome to the show.

Kevin: Good morning Hanish.

Jeff: Thank you, Hanish. Glad to be here.

Hanish: Pleasure to have you guys on. So let's just dive straight in. Kevin, let's start setting the stage for our listeners. Can you give us a mini history lesson on the history of pay TV up until today?

Kevin: Absolutely. Pay TV had a fabulous business model—recognize that we got very close to about in the low 80 percent penetration of US households. And if you look over the last 25 years or so, we've been adding 1 million to 1.2 million US households every year. And with that high penetration, we had a built-in growth rate for pay TV; and as you know, we also had annual price increases for services, and then we had more and more televisions in our homes, so we had more boxes in our homes. So it was a built-in growth, which is part of the reason we saw so many channels being created. A famous musician once said, "Five hundred channels and nothing to watch." We ended up with so much content. And then we started seeing the availability of SVOD and other services. And initially you didn't see any decline in the subscriptions, but as many of you know, we started seeing Millennials who were getting more of their content digitally. And over the last few years we now see that Millennials and Gen Zers are actually consuming more than 50 percent of their content on nontraditional devices—that'd be laptops, tablets, or mobile phones.

So we are seeing a significant increase in that. And most interestingly, this year, we started seeing more content being consumed digitally also by Gen Xers, and we started to see whole movement that way. So what we now have is a term we've called the "MilleXZials," which are the 51-year-old and younger, down to 14—and that whole group is now acting very similarly, and that's 160 million people in the United States. So the good news is we have 160 million people behaving somewhat similarly; the bad news is they are acting differently than they used to, so the business models are being challenged. So it's kind of where we are today, and it's quite exciting to see what the future is going to bring us.

Hanish: I do love that term "MilleXZials," and I'm hoping we can come back to that, but that's an incredible amount of change in the last few decades alone that you've just gone through, which is one of the reasons why Deloitte has surveyed consumers on entertainment consumption habits over the past 12 years, and I'm super excited to have both of you together for this episode as you are the—let me put it this way—"the brains and the brawn" behind Deloitte's 12-year *Digital Media Trends* report, so to speak. And since we are now going to be referencing this report a lot in interview, Jeff, I was wondering if you could just give us a 30-second overview of what the survey is and where we get all of that data.

Jeff: Sure, Hanish. *Digital Media Trends* is based on a survey of over 2,000 US consumers who are age 14 and up. The survey was held in November 2017, so it's all very new data. And we weight the data to represent the US population as a whole, including by those generations. The questions focus on how consumers interact with media products and services. But we also ask about mobile technologies, advertising, social networks, and gaming. And ultimately, what the survey questions capture are consumers' changing behaviors (which Kevin mentioned), their attitudes, and, most importantly, today we're going to talk about what they value.

Hanish: That's incredible stuff and now with an incredible 12-year-old repository of data, media entertainment consumption habits, as you mentioned, device habits, and just so much more. So let's get back to pay TV. Kevin, you mentioned where we come from. Now let's talk about the state of pay TV today. I read the report and it seems the data is pointing toward one thing: subscribers perceive a widening value gap between what they expect and what pay TV providers are actually delivering to them. So to that point, Jeff, can you tell us a little bit more about this value gap?

Jeff: Absolutely. So the survey showed what we call a "value gap" between what people want from their pay TV services and what they actually get. So the average pay TV service costs about $103 per month, but consumers only watch about 13 channels and that's remained pretty consistent over time. So they are paying roughly $8 per channel and when we look it at that way, streaming services can look like a bargain because you get everything that you could want for anywhere from $8, $10, $12—and there is such a wide variety of different content, ranging from regular cable TV, live TV that you can get typically from a cable TV service, but now over the top to things like Japanese anime, film noir, and of course a lot of great original content. You already mentioned the difficulty of content discovery; if you've got 500 channels, it can be very difficult to find what you want—especially if you are only watching the content typically on about 13 of them. But the other area that pay TV really falls short is the choice of where they watch, how they watch, how much they can watch at one time. Binge-watching, which we'll probably talk about later on, is a huge phenomenon now that's being driven by streaming. All this is adding up to dissatisfaction with pay TV. About 70 percent of pay TV customers basically say they get too little value for their money.

Hanish: Wow! I mean just that word you ended on there, Jeff—"dissatisfaction"—it's a word I keep hearing. Is it a universal thing that is coming across, in terms of generations? I mean, there must be some people out there that still enjoy pay TV. Kevin, I'd like to turn to you on that one. I guess there are those out there that have never actually subscribed to pay TV.

Kevin: Absolutely. There is a group of folks who have never subscribed and there are those who "cut the cord" years ago, the early cord-cutters. You've heard of cord-nevers, cord-cutters, cord-shavers; all of those are examples of people reducing what they are paying for and how they are using it. If you look at the "MilleXZials" I talked about, across those generations, between 16 percent and 22 percent of that population have never subscribed, and when we ask them why they say, "I get all the content I want from the other digital services" and the value is perceived to be higher. As Jeff mentioned, if you think about $8 a channel through your traditional pay television subscription, that is not out of line compared to what people are paying for their streaming services. But people just feel that they're paying too much. So part of this is a perception because the value for 200 channels may be just fine, but the consumers feel like "I'm paying for all the stuff I don't use" and for those who have never subscribed—what I expect to see more and more of as the Gen Y generation starts to age is that they grew up digitally. So my younger children think every screen should be able to be swiped and everything should be on demand. They even asked me one time, "Why do I have to watch a commercial?" So their entire upbringing has been with digital technologies, and I would bet you when they establish their first household they're going to have a very high speed broadband, they probably won't have pay TV.

Jeff: It's funny you mentioned that, Kevin. I cancelled our cable about six weeks ago, and my two sons all they do is watch videogames, and if they watch something it's on a streaming service. It was only yesterday, after six weeks, that my older son said, "Hey, dad, where is the cable box?" And he didn't even want to watch anything; he just noticed that it was gone.

Hanish: That's brilliant. I mean, Jeff, just exactly what you've described there—it just epitomizes in the sense of just what consumers want—and Kevin, even as you said, in terms of just what kids are looking for, they're looking to swipe. It's really about what do consumers want, and they are seeing that come through and quite clearly in what you are describing there. And I correlate that back to the report. Having gone through the report that you guys put together, it kept on bubbling all the way through as I'm reading the stats: it's really about what do consumers really want. And if we bear that one in mind, Kevin, I want to ask you that big fundamental question: What do consumers really want?

Kevin: If I aggregate all of the findings from the survey this year around video, what people want is the content that they are looking for, they want to be able to discover it, they want to watch on whatever device they want, wherever they want, at whatever time they want. So, if you think about those who try to supply those demands, and that's a tall order, you start to think about what do video delivery companies do—we call it "pay TV" today, but in the future I think it will be different—[regarding] what they need to have. They need to be able to have a library of content that's on demand that I can go find. Consumers also want live television, they want sports. Sports has been a big driver recently of new streaming services. They also want news, they want community information. So you think about what do you need to put together? You need to have a package of content that is both the live information—the sports, the news, those type of things—and a library of content that spans broad enough to service everybody in the household whether for my young children, myself, my wife. We need to have something that actually fulfills those interests, and we have very diverse interests.

I would argue that consumers would like to have that with a single relationship with an added entity—single bill, single user interface. Right now many of us build that bundle ourselves. But now I have 10 invoices on my credit card every month and every one of those has a username and password that I have to go find and look up sometimes. I recently changed my home entertainment system and I had to go dig out all my usernames and passwords for the guys to program it and was shocked to find out I had 16 different services that I actually use. But I think that's what consumers want. I think they'd like to have a single bill or single user interface and all the content they want where and when and what device.

Hanish: What you've describe there, I would argue, is a pretty sophisticated buyer. You've got all of these various offerings, in some way you've curated those yourself. You've created your own bundle. In some way is that where you see the future of pay TV going in—that it's going to become the aggregator of all of these select bundles that you, as a user, could select and choose?

Kevin: Absolutely. I think that's exactly where it's going, and I don't use the word bundle when I talk about this; I use the word re-aggregation, and I believe there will be video aggregators that emerge. Some of them may be the existing cable companies or satellite companies, some of them may come out of the telco site, one of them or two of them may come out of Silicon Valley with the digital platforms; but I believe that that's where we are going to go, and we'll end up with a handful of these players who you'll make the choice saying, "I like this price and this user interface and this group of content better than someone else's offer," and you'll choose that. So we'll see a change in the way that the industry is structured because of that, because consumers are making those decisions; they are voting with their credit cards and pocket books.

Hanish: Right. I'll take that point and, Jeff, I want to ask you this one just exactly where Kevin left off there, in terms of what consumers really want, and are we seeing potentially where the industry could go with the aggregation of all of these potential services or the bundling of all of these services? In your mind and on what you are seeing come through from those reports, what are those evolving habits particularly for the consumers and some of those generations that are really driving the habits into the household? How's that truly affecting pay TV penetration into the home?

Jeff: Well one of the things that—to get back to what consumers really want, consumers want content—original content—that they can't get anywhere else, and that's what's driving a lot of subscription to these streaming services. So Netflix last year spent $6.8 billion creating their own content, and they won 24 Emmys last year, more than any other major networks. And so, part of the reason that people are signing up for the streaming services is because they are producing content that people love, that's winning awards, and that has really led to what many are calling the "Golden Age of Television." So content is driving a lot of this streaming behavior, and if you can't get it from your regular pay TV package, that's why you are adding and adding and adding, and creating your own bundle, if you will. And I completely agree that people don't really want to manage all of that. All that said, they want to make sure that they can get the content they want increasingly on mobile devices. "MilleXZials" are—not just Millennials but "MilleXZials"—are starting to watch more and more of their content including movies and regular TV shows on smartphones. People didn't really think that was going to happen, but that is happening increasingly. So we've got the need for original content; the increasing desire for anywhere, any device; and then, of course, you've got the fact that pay TV is very expensive. And so people are finding that they can dispense with the pay TV, sign up for various bundles—or rather, create their own bundles with various services—and then they've got everything that they need.

Hanish: You recently mentioned that you cut the cord, and I go back to, I think it's been like six-plus years since I cut the cord. I know that's just like an anecdote of you and I, but what are you seeing in terms of what's happening, in terms of the actual penetration into the household that we truly are seeing, as Kevin mentioned—these cord-cutters or cord-shavers or cord-nevers? What's really happening in terms of the amount of subscriptions in the household over the last few years?

Jeff: So what we found just last year is between 3.2 million and 3.5 million subscribers ended up dispensing with their pay TV service, so they cut the cord. And among respondents in our survey this year who said they don't have pay TV anymore, 27 percent said that they cut the cord within the last year and the estimates thus far look like that trend is accelerating in 2018. So, maybe a couple of years ago you could argue, "Is this happening? Is this not really happening?"Now I think there is clear evidence that people are cord-cutting, and they are doing so because they are adopting streaming services and paid streaming services.

Hanish: Wow! And Jeff, if I take what you've just said there with those numbers and what you said earlier with the likes of Netflix ploughing billions of dollars into original content and they clearly see the reward of that through the awards they're seeing, Kevin, taking those two factors, is there anything else that's also driving the decline in pay TV subscriptions?

Kevin: Yes. I think there are a number of factors. I mean, there—as I said, that we kind of got a little bit over 80 percent during the height—there is still a portion of the population that just cannot afford it. The cost of pay TV is too high, but there is—actually, if you look at our survey, 21 percent of the folks actually say that they don't find enough—they don't watch enough—television to actually justify the cost. And what they do tell us is they are getting everything they need and want from other services. It's interesting when we ask those, there is a high propensity to cancel—a very large number, percent, of people say they intend to cancel, but we don't see the same cancellation rates as the intent to cancel. Big reason there is that pay TV is bundled with home Internet, and home Internet access, especially from your cable company, is viewed today as a necessary utility in households. So over half of our respondents [where] we ask them if they did not cancel, over half of them say because it's bundled and as you probably know, when you cancel, your price does not go down significantly. What I think is going to change that dramatically is as we move toward more mobile broadband or even 5G. When I can deliver extremely high speeds to the house without having the subscription to a cable high speed Internet access, that's also going to change this industry quite a bit and not just for the home. I think 5G is going to be very revolutionary when it comes to content consumption, but I think one of the ones that we'll all pay a lot of attention to is what does it mean for home Internet access and pay TV.

Hanish: That's a fair point, and I love the fact that you touched upon 5G and mobile consumption and something, Jeff, you also mentioned that now more and more consumers are wanting—to view their content not just on the traditional form factor of a large flat panel but maybe on a mobile device. And I kind of go back to just even recently—and I am geeking out our audience here—but I tend to always check the speeds I have at home, and there are times when my mobile devices give me a faster speed than my Internet connection. And in the world of trying to get the best-quality visuals, getting 4K coming through on the channel, you're going to choose the technology that's going to give you the best viewing experience as well. What can happen when everyone has access to 5G technology?

Jeff: Well, 5G is going to take a couple of years to really reach the mainstream in terms of availability, but what's at stake for pay TV is nothing short of the entire bundle of services—Internet, TV, and phone. Again, 56 percent of subscribers say that a top reason they keep their pay TV is because it's bundled with their Internet. Now when you start thinking about, if they can get faster Internet from a telecom provider, especially when they can also get streaming services as part of their 5G connection, what are they going to do? And if you think about it this way, over 90 percent of our survey respondents own a smartphone, and they already have mobile data plans they pay for on top of their home Internet and their pay TV. I think a lot of them are going to be tempted to consolidate their cost by going mobile only, especially when that mobile service is very fast. And so the availability of 5G could encourage those still holding on to their cable and connectivity bundle to drop the whole thing.

Hanish: From what you've described, there are definitely some challenges ahead for pay TV with all the options that are coming forward for all of us as consumers. And with that in mind, Kevin, what do you think the providers really need to consider in the immediate term but also a little bit more medium term just to stay ahead of this—you and I—as consumers?

Kevin: I think the disruption that we've started to see—and some of that shows itself in cord-cutting, some of that shows itself in M&A transactions. I think we are going to continue to see the explosion of more OTT for services. The end of last year in the United States, there were almost 250 different services, and as you know, they've been launching one or two a week since the beginning of the year. So we created a lot of options for consumers. I think we'll continue to see that growth. We're seeing more and more scripted television or your scripted series being greenlit last year and this year, and I think what we will then start to see is some consolidation. So, if I'm a provider, what I do need to do? I need to make sure that I'm giving my consumer all the choice that they are really looking for; don't lock them into contracts and don't force them to buy bundles. Allow them to aggregate the content that they want, create a single user experience across all the platforms, have a single invoice or single bill to them that feels like a fair price, and go get as many customers as you can. This is going to be one on who can amass the most customers, because once I have all the customer information, then I know what they are watching live and what they are watching on SVOD and what they are watching on ad supported. I can then also promote shows, but I also now have more information about the consumer and I can make my ads more valuable. We all know that the advertising industry is under a lot of pressure right now. There are too many ads, they are not effective, and we even heard this year at the upfronts that they were seeing the ad load being reduced by the major broadcasters. So we are going to have quite a few less ads being shown to us. But if you are one of these pay TV providers, you have a large audience and you have deep insight to those audiences; my ads become more and more valuable, so I can target people very specifically. So I think those are the things that I would be doing if I were in their chair—to make sure that I'm paying attention to the consumers who are telling me for so long—they were a utility that could just put out whatever they decided was what they thought was right for the consumers. Like I said earlier, the consumers are now voting with their own money and saying, "This is what I want to see."

Hanish: So with that opportunity, Jeff, what else do you see as beyond using that data, beyond using that ability to truly personalize and give the consumers (to what we talked [about] earlier) what they really want? What are the other big opportunities you see?

Jeff: Well, one thing we should focus on is the fact that pay TV providers do still have a lot of advantages. The penetration rate of pay TV is declining, but it's still fairly high, and most Americans get their Internet from pay TV providers, and so they still have a lot of eyeballs. I agree that they not only can't lose more people, but they have got to start giving a reason for those who aren't part of pay TV to either join or to come back. They need to close the value gap, that means lower cost and more choice. In our survey, only about a third of customers prefer to have pay TV service the way they get it now, which is large bundles that are essentially picked by the provider. Well over 50 percent would prefer to pick their own channels or shows, and I think that to get consumers and have them stay you need to be able to allow people within the cable TV subscription to bundle their own networks and even buy their own individual shows and sporting events. That's going to be adding real value.

Hanish: I mean, I hear that. I mean, I'm sold. Where can I sign up? When I think that I can select the channels that I want, watch the programs that I want, I think to your point, that's a great opportunity for pay TV. But what does that also mean for the consumer? Will that mean that I have to pay more? I mean, I know right now there are advantages of—I know I don't have pay TV anymore, but certainly when I had pay TV—if I bought a certain number of channels, I got a whole lot of other channels. So do you think there is also a gap that the pay TV providers also need to be able to close in terms of just how new content will come to me? Because if I'm only subscribing to the channels I want, the interests I want, how am I going to learn about new content? And I kind of correlate that back to the amount of billions of dollars that are being spent on new original content. How do they close that gap?

Kevin: Discovery today is complex, and if I tell you about a new show you have to go look up, it may be in a different service that I haven't subscribed to. So I think discovery is one of those—you asked me what pay TV platforms can do—is to make discovery that much better. We've been using a scrolling guide since the early days of pay TV and it's not easy to find content. If we can get better recommending content, there are actually great opportunities for those folks who do have the subscribers; and as you mentioned, pay TV still has a lot of subscribers. If you make the experience better and introduce me to new content and use—we are no longer using keyboards and real controls—we are using our voice. So I think there is a great opportunity for them to advance those technologies and do a better job of introducing me to new content. So maybe I will watch more than the average of 13 channels, maybe I will try something new because it's been recommended to me.

Hanish: The question I've got then is, the onus—and you mentioned, both of you mentioned, some additional technologies [like] voice-assisted, etc.—is onus then going to be on the consumer to have all of that tech in the house or is it going to be on pay TV and the ecosystem that they can provide as a whole, with Internet connectivity, everything else, that they would offer that kind of bundle, in your mind, as to maybe what they could be doing as, again, addressing some of those challenges they have today?

Kevin: I think that the pay TV companies have to be able to put that type of technology on whatever platform the consumer wants to use. My college-age daughter watches most of her content on a laptop. It needs to be on the laptop. We know a lot of Millennials watch a lot of content on their mobile phones. It needs to be there. For me, I still enjoy the screen on the wall in my house. The technology needs to be there. The consumers are always going to have the freedom to buy whatever devices they want. I don't want to have a different interface on my big screen TV than I do on my phone—it should be similar. Discovery should work really much the same. So I think the challenge is there. The consumers are still going to buy whatever they are going to buy, and they may have a two-year-old mobile phone. They've got to be able to work with that. So that's where the challenge comes in, as they do have to support all those devices because that's what the consumers are looking for.

Hanish: There seem to be a high number of challenges that they've got ahead of us, but there are certainly a big number of opportunities. And I go back to sort of summarize everything I've heard around consumers definitely want that flexibility of what they can consume. So, choosing the type of content they want, as Jeff mentioned earlier—whether it's some anime or some film noir or a particular sporting type of content—they want to have the choice of the flexible format they have it on. You mentioned the large panel TV versus your daughter wanting it on her laptop. And then also location, and Jeff talked about that earlier in terms of just being on a mobile [phone]. So there is that element of flexibility that consumers definitely want and pay TV providers need to sit up and listen to. There is an element of, hey, with all of that flexibility and that self-curation, that I may be missing out on some great stuff out there. So pay TV needs to be able to think about how they push that curation through and what advantages they can take in terms of the personalization—the data they have about consumers—to really get that out there.

When I put all of that together, obviously the big thing that stills needs to be answered, and I think both of you touched upon that, is the perception of value. How do I close that gap of perception of value? Because I believe everything I've heard and what's coming from the report is that once that gets close, then it's a different world for the pay TV providers, which will clearly be a different world for us as consumers. So I think that's the phenomenal amount of information that we've gone through, and it's really useful in terms of the way the report that both of you talked about and the changing habits and attitudes of consumers are toward pay TV, and I'd definitely like to close with a fact [that] though there are those challenges, it seems an incredible amount of opportunity. And that world you described earlier, Kevin—of what are we able to do having that one interface, one username, one password—with all of my choices, again, I cut the cord six-plus years ago, but I'm ready. And I'm holding my hand up—sign me up to something like that. So, with that, I want to kind of say that's a wrap for today, gentlemen. I want to thank you ever so much for returning [to] the show.

Kevin: Thank you very much, Hanish.

Hanish: Thanks for tuning into this week's episode of User Friendly on the evolution of pay TV. Tune back in in two weeks for our next episode where we'll be exploring the implications of the 2017 Tax Act. And what tax reform means for companies in tech, media, and telecom. See you then.

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