2010 Media Industry Perspective

It has not been easy to be an executive in the media and entertainment industry over the past year. In fact, as 2009 ends, it is difficult to think of another sector that has faced so many fundamental challenges. As we wrote last year, many companies in this sector were already suffering through profound shifts in their businesses prior to the recession. Traditional media audiences were shrinking, pressure on pricing was increasing, and digital revenues were not growing fast enough to make up the difference. The economic turmoil of 2009 only exacerbated these structural issues. As a result, virtually every media and entertainment company is now searching for the right combination of strategic responses amid unprecedented uncertainty regarding existing business models and prospects for future growth.

As 2010 begins, the industry is truly at a Darwinian moment, in which the evolutionary process will rapidly distinguish between winners and losers. The view of Booz & Company's media and entertainment practice is that the companies that will define the next wave of industry growth will require competencies that are substantially different from those that ensured success during the analog era. Previously, winners were defined by their strengths in content development, packaging, and distribution—all key for an entertainment world characterized by scarcity. The digital era is characterized by unprecedented levels of consumer choice, ubiquity, and interactivity. To succeed in this more dynamic environment, companies need to acquire and build new skills. They must excel at developing deep audience insights; building consumer relationships across multiple platforms and user environments; creating targeted content, applications, and advertising opportunities; and managing a mix of monetization models across advertising, subscriptions, and commerce.

As we look forward to 2010, we see certain key developments shaping the strategies of leading media and entertainment companies. We have highlighted 10 of these below, as we believe they provide vital perspective as to how companies need to orient their growth agendas and prioritize their capability-building efforts.

1. Although most companies have cut costs in the past year, ongoing structural changes in the media and entertainment industry will require continued vigilance on cost reduction—even as advertising and retail markets stabilize.

Many media and entertainment companies have undergone one or even two rounds of 10 to 20 percent cost reductions, typically focused on streamlining the organization. But these have simply not been sufficient to offset the multiyear declines in their top-line revenue. And such reductions are likely not enough to counterbalance the changes still to come: The outlook for ad spending includes more alternatives for marketers, continued shifts toward digital, and greater orientation toward accountability, while the fragmentation of consumer viewership and spending means that "hit products" (e.g., TV shows, video games, films, and music) are no longer big enough to make up for underperforming brands and products in a given portfolio. The mandate is therefore clear: Companies must continue to reshape and restructure their businesses.

Most companies have expended much of their recent cost-related effort on *how well* they operate. Our view is that they can achieve more substantial cost savings by focusing on *what* activities they undertake (the mix of initiatives) and *how* these activities are executed (the workflow). Only through a rigorous examination of these structural and strategic costs will companies be able to replace large legacy operations and achieve more radical models characterized by new processes, smaller workforces, and lower-cost ways of connecting with audiences.

This shift will require management to increase its focus on areas that can drive both efficiency and effectiveness, especially workflow redesign and automation (in both sales and editorial), outsourcing and shared services, and procurement. It will also require the development of new content models that rely more on variable than fixed costs, and better align costs of content with different levels of revenue generation.

2. As share battles increase and competition intensifies in digital, there is now a permanent fissure between the industry's "victors"—which have superior strengths in their business models, financial positions, and brands—and the "vulnerable," whose capacity to adapt, invest, and shape their future is considerably more constrained.

The recession, as well as structural changes caused by digital technology and excess advertising inventory, has permanently changed the dynamics of this industry. The victors are those companies with a more diversified revenue

mix, leading brands, and strong cash flow. The vulnerable are companies that are shackled with entrenched cost structures and excessive debt, those that rely too heavily on advertising-driven models, and those with insufficient top-line revenue. This environment will lead to more consolidation opportunities for the victors and more closures or sales for the vulnerable.

This fissure will also exert significant influence over the development of digital business models. Recent developments such as the spurt of cable network deal activity in late 2009 highlight the importance of revenue models that are effectively *advertising plus*—that is, hybrid combinations of advertising with subscriptions or transactions. Given consumers' increasingly discriminating and fragmenting consumption patterns, cable networks themselves perhaps also presage the branded-content models that may ultimately thrive in the digital arena—targeted, loyalty-focused, high-quality content offerings supported by both advertising and subscription revenue streams.

Merely shifting analog content online—whether giving it away via advertising or charging for it—is not likely to work. The vast majority of publishers still face so much competition that paid content alone will not provide an adequate solution to their monetization challenges. In fact, for many players, paid content will likely prove to be a long and winding road to a very small house. Smart companies will focus instead on building new revenue streams rather than just migrating old models to digital.

Booz & Company's recent study with American Business Media ("A Roadmap for Profitable Revenue Growth") identified two likely paths for the victors in the digital era; most victors will excel at both of these. The first path, providing marketing solutions, focuses on tapping marketer spending in areas such as custom content and lead generation. The second path, providing user-driven solutions, focuses on delivering insights and workflow offerings above and beyond basic editorial content, for which end-users will pay a premium. The study also found that leaders in marketing solutions not only generated new revenue streams, but also gained share in their core advertising businesses.

3. Media and entertainment M&A activity will continue to increase as long as the economy remains stable and credit is available.

Media M&A activity has been accelerating steadily since the summer of 2009. And although larger deals such as Comcast–NBC Universal may grab the biggest headlines, we expect most future media acquisition activity to be concentrated on smaller, more strategic deals. Strong companies will pounce

on complementary brands and other assets sold off by vulnerable rivals, along with other target acquisitions that can add important growth-oriented capabilities in technology or services to their portfolios. Private equity will also become more prominent in the deal flow.

This ongoing consolidation and portfolio realignment will have three anchors: branded content (especially cable networks, video games, and studios); technology and advertising/marketing services; and digital businesses. We expect smart, strategic buyers to focus primarily on acquiring coherent capabilities, rather than on portfolio diversification or cost synergies. Through this lens, Disney's acquisition of Marvel can be viewed as not just the purchase of additional content and entertainment brands, but rather the expansion of Disney's well-developed capability—monetization of character-based franchises focused on kids, girls, and tweens—to new audiences of boys and young adults.

Our recent research has demonstrated that companies with greater portfolio coherence (that is, those whose business units have mutually reinforcing capabilities that distinguish the company as a whole) outperform their peers in terms of operating margin. The three anchors above form the initial filter for the types of capabilities that will likely be viewed as most attractive for investment; these can then be further tailored to a company's unique strategic situation.

4. The traditional value chain of marketers, agencies, and media companies will continue to evolve, unravel, and be reconstituted in more heterogeneous combinations.

As the battle for advertising share intensifies and more of marketers' money moves toward digital, the traditional lines of responsibility in the sector have blurred. Large, category-leading media companies are developing "media as service" strategies to support direct relationships with major clients and deliver an expanding range of marketing solutions. Examples include Meredith, ESPN, MTV Networks, NBC Universal, and IDG—all of whom are working to establish more consultative positions and develop solution-selling approaches for key clients.

This media-as-service trend will intensify in 2010, for several reasons. Most major marketers will want campaigns that can offer more cross-platform integration, feature digital more prominently, and are anchored in greater levels of consumer insight. At the same time, media companies need to drive additional ad-related growth—from legacy sources as well as from higher-growth digital and promotional budgets. In 2008, Booz & Company

suggested as part of its “Marketing & Media Ecosystem 2010” study (conducted in partnership with the Association of National Advertisers, the Interactive Advertising Bureau, and the American Association of Advertising Agencies) that media companies would eventually develop category management–style capabilities allowing them to work more closely in collaboration with major marketers, similar to the retail teams that many consumer packaged goods (CPG) companies deploy to work with retailers such as Target and Walmart. In 2010, we expect to see leading players strengthen their focus on these kinds of “sales plus service” structures.

At the same time, major marketers will continue to develop their own media assets, especially in digital. Key examples include some of the world’s most recognized brands: Volkswagen, Nike, General Mills, Johnson & Johnson, Procter & Gamble, and Hewlett-Packard. This is one of the sector’s most provocative and disruptive developments; it represents yet another challenge to long-standing advertising-centric business models. The more media that marketers build on their own, the less they will buy.

When major advertisers such as Kraft (which spent approximately US$800 million in paid media in 2009) are planning to expand their own magazine and digital publishing efforts because of such publications’ attractiveness as vehicles for customer acquisition and activation, media companies need to take the threat seriously. Our view is that these initiatives will continue to gain in prominence because marketers want their brands to be associated with utility, community, information, and entertainment that go beyond the product as well as the store experience. Digital delivery platforms now allow marketers to achieve this on an unprecedented scale. Media companies need to figure out how they can turn this development into a positive—either by using their skills to develop “private-label” media offerings for marketers or by using their integrated media properties to enhance the value of marketers’ own media.

5. Media sales and marketing teams will need to go beyond basic advertising placement in order to drive breakout growth.

Marketers’ spending on below-the-line programs is now two to three times greater than their spending on paid media. For example, total spending on consumer promotions and shopper marketing (defined as marketing to consumers in “shopping mode” as opposed to those consuming media at home) reached more than $130 billion in 2009, roughly equivalent to spending on broadcast and cable television network advertising, newspaper advertising, and online advertising combined. Even as digital spending growth on online display advertising ebbs and flows, digital spending on

consumer promotions and shopper marketing programs has continued to accelerate. Tapping into this additional spending will require new go-to-market approaches in which media and entertainment companies work directly with marketers and their agencies to integrate manufacturers' content into branded experiences for shoppers, including at retail.

The Meredith Corporation is one of the more aggressive media companies in terms of focusing on below-the-line spending to capture new revenue. Through a mix of database marketing, customer relationship management, online marketing, mobile marketing, and other agency services, Meredith has built an integrated marketing services business worth more than $175 million that plays beyond traditional advertising. For Kraft, for example, Meredith's Genex unit has produced the iFood Assistant, one of the most popular iPhone applications. This app provides more than 7,000 recipes tailored to consumers' tastes, as well as an in-store planner to help users navigate store aisles to find the required ingredients for these recipes. Meredith has also teamed more broadly with Kraft on other custom content offerings, including targeted e-mail campaigns and a print magazine with an online edition.

As part of Booz & Company's recent shopper marketing study with the Grocery Manufacturers Association ("Shopper Marketing 3.0: Unleashing the Next Wave of Value"), we interviewed executives from retailers, CPG manufacturers, and agencies. CPG manufacturers and retailers consistently expressed a desire to better align their investments across the full marketing mix, including brand advertising, promotions, and shopper marketing. Just as with advertising campaigns, they are open to partnering with media companies that can deliver unique insights, reach, and engagement with their target shoppers; innovative approaches to influencing shopper behavior; and measurement capabilities.

For many media companies, this development is an opportunity, but also a threat. Although "Shopper Marketing 3.0" confirmed that brand preferences are key to influencing which items make the shopping list before consumers head to the store, it also revealed an expanding set of factors in digital that influence shoppers, such as social media, digital coupons and circulars, and manufacturer and retailer websites. Moreover, because 59 percent of purchase decisions are made in the store and brand preferences are highly malleable, manufacturers and retailers are experimenting with options beyond traditional advertising to drive measurable results. To date, this has had the most significant impact on print advertising and local media spending, as marketers have responded to retailer pressures to shift spending into their programs or conduct ROI analysis to evaluate advertising against an

expanding set of digital options—many of which they can build themselves, rather than buy.

6. Media metrics to measure spending effectiveness, with a greater emphasis on results, are evolving across the marketing mix and at all stops along the path to purchase (at home, on the go, in the store).

Today, media metrics are still focused on inputs (for example, impressions, reach, and engagement) rather than outputs (such as impact on brand equity, net promoter scores, or sales lift). Furthermore, Booz & Company's "Marketing & Media Ecosystem 2010" study showed that although more metrics have become available, they are not necessarily the ones needed to help marketers make better decisions. Marketers still require more output- and results-focused metrics to better manage their media mix or to increase digital spending , especially as it relates to brand-oriented programs.

Consider two of the most important growth priorities for leading marketers: digital and in-store. In digital, metrics for display advertising are still primarily rooted in inputs—"click-through" continues to be the predominant metric, with engagement-oriented approaches such as "dwell time" (i.e., the amount of time a consumer dwells on an ad) beginning to gain traction. In contrast, metrics for in-store programs such as promotions and shopper marketing have focused on specific outputs, such as sales lift and category share. As marketers and retailers evaluate how to scale investments in digital and promotions, they will need metrics that address outputs as well as inputs.

Media companies have an opportunity to leverage their digital audiences to build deeper engagement, deliver greater insights, and provide measurable results. For example, media companies that build community and nurture registered relationships with their audiences can take advantage of those assets to deliver new services to marketers. In addition, they can start to measure the results of digital campaigns, both current assets and new offerings that they develop, either on their own sites or as private-label media for marketers.

Today, marketers and retailers make greater use of databases, often hiring third-party vendors such as Dunnhumby, which works with companies like Kroger to analyze shopper data and develop campaigns that target offers more closely to shoppers' observed behaviors. Media companies have an opportunity to build their own assets and provide similar services, while providing a more engaging brand experience through content integration. They already have experience with various pieces of the puzzle in terms of

producing custom content and integrating brands into premium environments, such as microsites, contests and sweepstakes, and e-newsletters. The next step is to broaden their focus from creating premium ad-supported opportunities to serving a broader set of marketing needs more closely tied to below-the-line priorities such as consumer promotions and shopper marketing. By combining these insights with measurable and statistically valid ways to assess the impact on key dashboard metrics for marketers (e.g., store traffic, trial, sales lift, category share), media companies can then help marketers build a more robust picture of the impact of integrated campaigns. Media companies need to work with marketers' agency partners to develop these solutions or build their own.

7. Analytic approaches to content decision making are gaining traction, beginning in digital and ultimately influencing magazines, newspapers, and perhaps other traditional media too.

Editors and programmers have significantly more data about and insight into consumer interests and behaviors than ever before in the history of media and entertainment. Search traffic, social networking, and blogs, along with other elements of the daily clickstream, now provide a 24/7, real-time window into what resonates with audiences. Yet the primary approach to content development remains rooted in an analog workflow that is often too expensive, too slow, and too unilateral to adapt to the dynamics of digital consumption and monetization.

To be clear, we are not suggesting that a numbers-driven approach to content decision making will ever fully replace the people-oriented editorial experience. But the digital platform does enable editors and others to more precisely measure (and perhaps even anticipate) content appeal more accurately than any other medium. Editorial can benefit, as advertising already has, from more sophisticated analytics. We expect to see media companies incorporating data on consumers' Web behavior to help editors and other executives make better decisions about content development, how broadly to cover stories (expanded coverage or limited), and how to present those stories (video, audio, text, or interactive media). Although these changes may initially face significant internal resistance in some creative organizations, over time they will be regarded as tools critical to managing the cost of content (including the deployment of creative resources), increasing consumer engagement, and strengthening advertising as well as paid media opportunities.

8. Social media outlets are becoming important distribution hubs for content, given consumers' propensity to share content, links, and networks.

Social media are enabling new monetization and distribution opportunities for entertainment and information offerings at compelling levels of scale. For example, the Facebook application FarmVille, created by social gaming company Zynga Game Network Inc., is the fastest-growing social game in history, reaching an impressive 11 million daily users in a little over two months. Social networks can now support this kind of quiet, quick business-model innovation, which plays off the consumer desire for personalization, interactivity, and community. Zynga counts roughly 27 million daily users for all its game titles accessible through social networks such as Facebook, MySpace, Bebo, and those available via Apple's iPhone. And FarmVille is the key reason that Zynga is reported to be generating revenues of more than $150 million in 2009, largely from sales of virtual goods.

In addition to enabling new business opportunities, social media are important to publishers as channels for driving media consumption. Publishers are recognizing that social media are a critical source of traffic to their digital sites, in some cases as important as search engines. Because of this, we expect more entertainment, news, and information publishers to focus on "social media optimization" as a new capability for growing their audiences. In the near term, this will mean providing the tools that encourage users to share content more easily. In the long term, the challenge will be to target specific groups of users whose social networks are the most powerful, influential, and effective in order to drive traffic back to publishers.

9. Mobile is emerging as another high-growth platform for media companies, thanks to the rapid penetration of smartphone devices and growth of applications.

With mobile Internet adoption growing faster than desktop Internet access did, media companies face an imperative to continue to innovate and deliver a high-quality content experience on small screens. But the content experience in mobile is focused on applications, not Web pages. Even more than the fixed-line, PC-centric Internet, mobile devices are being used for tasks, meaning that growth in media usage is likely to be monetized primarily by local search, location-based services, social media, targeted forms of promotional marketing, and paid entertainment services such as sports and games.

The mobile Internet experience is evolving rapidly away from Web pages to downloadable applications, and it eventually may migrate again to cloud-based services. The race is therefore on to build digital relationships with consumers, deliver winning experiences, and grab a position of greater

influence within this rapidly evolving ecosystem. As the battle intensifies between the Apple iPhone/iTouch ecosystem and that of Google Android in terms of devices and applications, media companies need to evaluate how to position themselves for greater growth in this medium through the right mix of mobile-focused organic investment, partnerships, and acquisitions.

10. The rapid expansion of online video, along with new "tablet" devices and readers, will compel media and entertainment companies to regain control of the customer interface in order to better monetize the digital experience.

To date, much digital content from professional publishers has been focused on essentially repurposing an analog media experience (a magazine, a book, a TV show, a newspaper) for the Web with fairly limited innovation or rethinking of the content experience. And for the most part (Hulu being a rare exception), media companies do not control the customer interface in digital. Rather, it is others_such as Apple, Google, and Amazon—that play this key role.

This development may change with the increasing importance of e-reader platforms and related devices. E-book sales showed a compound annual growth rate of 57.8 percent between 2002 and 2008, and Forrester Research expects sales of e-readers to double in 2010, bringing cumulative sales to 10 million by year-end. This explosive growth is compelling publishers to revisit how they think about monetizing and designing their offerings for these new platforms, as well as their role in digital distribution. In our view, their strategies need to take into account consumers' unmet needs for convenience and mobility, the benefits of flexible pricing for content, and the value of a more dynamic and personalized digital media experience.

It is in this last dimension—improving the consumer experience—that media companies need to intensify their efforts, and several are moving to do so. We foresee dramatic changes in 2010, as leading media players begin providing consumers with a more enhanced digital experience that they cannot get in analog media (e.g., accessing library content, being able to post comments, pulling up related content, getting alerts on live developments, accessing statistics, and linking to related activities in social networks). Time Inc. recently announced plans for a Sports Illustrated edition specifically designed for tablets—an experience that gives consumers function and utility that goes beyond the magazine as well as the website. It is precisely this kind of thinking, which marries content and applications to the feature functionality of specific new devices, that will drive growth in digital paid content as well as premium marketing opportunities. As companies look to make money

from these new platforms, they must understand how to develop attractive applications, how to create a user interface that consumers find compelling, and how their brands can best be positioned in an interactive environment.

Moving Beyond the Recession

The global recession is accelerating a permanent change in the media and entertainment landscape. Although no one welcomes an economic downturn, media and entertainment companies can and will weather the current storm, and some will emerge with significant opportunities for growth. That said, events of 2009 make it abundantly clear that players in the sector must aggressively address the way they create, distribute, and monetize content. They need to make substantial changes, and they need to move decisively.

A final word about the scope of these challenges: In some ways, the biggest issue facing media and entertainment companies is not one of strategy; it is one of change management. Many senior executives recognize where they need to take their companies. And they recognize the need for new processes, new services, and radical shifts in organizational and operating structures. However, the implementation of those changes often becomes the fundamental stumbling block, involving major disruptions in talent, innovation, and culture. Change is never easy, especially when it involves new roles and responsibilities, and new ways of working. The actual business of retraining staff and managing the transition to new skills is perhaps the essential challenge for organizations in this highly creative, people-driven sector.

As media and entertainment companies reinvent themselves for a more digital future, they must realize that this transition will impose tremendous pressure on their current workforce—and many employees will not make it to the journey's destination. It may seem elemental, but senior managers need to ensure that their teams understand why change is important and how they can benefit from it (for instance, by developing new skills, enjoying more decision-making authority in a flatter organization, and experiencing more growth than in years past). Senior managers must commit to communicating these messages repeatedly while also recognizing situations in which explicit injections of new talent as well as new physical ways of working (including altered layouts and new locations) can contribute positively to accelerating change efforts. In this context, the transformation of media businesses is truly Darwinian: Companies must adapt in order to survive and ultimately thrive.

Our global media and entertainment practice is currently helping some of the world's top companies navigate this shifting marketplace. We look forward

to building our relationship with you and your company, and finding ways to help you achieve your goals in 2010. Past letters have prompted many executives to call or write us with their own thoughts, comments, and reactions. With this letter, we expect even more input, owing to the rapid changes that are reshaping your businesses in new and profound ways. We look forward to hearing your thoughts and continuing the dialogue.

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