

[Transcript] Plain English with Derek Thompson / How Hollywood Drove Its Business Model Off a Cliff

You may find this hard to believe, but 60 songs that explain the 90s, America's favorite poorly named music podcast is back with 30 more songs than 120 songs total. I'm your host Rob Harvilla, here to bring you more shrewd musical analysis, poignant nostalgic reveries, crude personal anecdotes, and rad special guests, all with even less restraint than usual. Join us once more on 60 songs that explain the 90s every Wednesday on Spotify.

Today's episode is about the trouble brewing in the media and entertainment industry, which has in short order become one of the most interesting and truly perplexing business stories in the world. And if I had to boil down the perplexing interestingness of Hollywood to a single question, I think it would be this one. Why does everything seem so bad at the same time? So where do you want to start? I'm going to see Oppenheimer later this week. I'm breathlessly excited for that one. So let's start with the movies. The domestic box office is still in a recession compared to before the pandemic. Several big movies this year have already disappointed. A couple superhero movies, a couple Disney films, The Flash, New Indiana Jones, Over at the Watch, another excellent ringer podcast, Andy Greenwald said of the latest Indiana Jones film, which he did not like, that it was evidence that Hollywood was, I think this is the direct quote, feeding on the necrotic tissue of a dying culture, which is very disgusting, very dramatic, and pretty hard to argue with. The top films this year, by domestic box office are Super Mario, Spider-Man 8, Guardians of Galaxy 3, Little Mermaid 2, Avatar 2, Ant-Man 3, which is actually Marvel 32, John Wick 4, Creed 3, Transformers 7, and Indiana Jones 5. A lot of numbers. And yet despite Hollywood pouring billions and billions of dollars into the same small and really shrinking pool of franchises, this industry is seeing diminishing returns. So you think, okay, if people aren't going to the movies, maybe it's because they're just watching more TV. But of course, pay TV that is cable television, old fashioned linear television, is in accelerating decline. There are more court cutters every single year and nobody expects this business to recover ever. It will lose probably about 9 million customers this year, maybe 10 million next year, maybe 11 million the year after that. Pay TV that is cable television is on a straight line down. So you think, okay, wait, movies aren't doing so hot, pay TV isn't doing so hot. So clearly, all the money is in streaming. But streaming for these entertainment companies has been a total money pit. Disney lost \$659 million in its most recent quarter. That was an improvement. Losing \$659 million was an arrow pointing up. Comcast is projecting a peak loss of \$3 billion in 2023 for its streaming service Peacock. So you put all this together. It just looks like the entertainment industry has been walloped by this era of technology. In the last 10 years, Netflix has of course gone from a pittance to being the \$100 billion gorilla in Hollywood. But when you look at the Netflix effect on the rest of the industry, don't look at the cannonball, look at the ripples, it is truly a bloodbath. At the largest entertainment companies out there, that's Disney, Warner Brothers Discovery, Paramount, Sony, profits on their video media, their movies, their television went from \$23 billion in 2013 to about zero. Yes, zero dollars today. Now that zero includes some debt from the Warner Brothers Discovery merger and adjusting for that merger makes for some funny math. But basically in the last 10 years, the entertainment industry has gone from being very, very good and very, very big and very, very profitable to what the fuck is happening. So you think, wait a second, let's do the math. If the studios are spending all this money and they're not earning a profit, okay, lots of spending, no profit, well surely maybe

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that just means that the workers are doing better, right? Like all the money is just going to all these workers. That's why there's no profits left for the corporations. But look at the newspapers, the writers are on strike, the actors are on strike. And to be clear, they're not on strike because they're completely wrong, they're on strike because somehow this profitless or at least less profitable system isn't even working out for the majority of the people that it's paying. So you put it all together, movies are a mess, pay TV is a total nightmare, streaming is a total money pit and everyone is miserable. How did this happen? How did this happen? And could it actually

get worse before it gets better? Today's guest is Julia Alexander. She is the director of strategy for parrot analytics and a writer for puck news. And we attempt to answer the trillion dollar questions I've just asked. How did this happen? Could it get worse before it gets better? We discuss a brief history of Hollywood, how we got to this point, how Disney's plight in particular tells a coherent story of how streaming has so roiled this town, how the strikes fit into this picture and of course what these companies should do now. I'm Derek Thompson, this is plain English. Julia Alexander, welcome to the show. Thank you so much for having me. It's honestly an honor, an honor to be here, I think. That is really nice of you to say. So in the introduction that listeners just heard, I went on a little rant about how it just seems like everything in Hollywood is collapsing at the same time, movies aren't doing well, pay TV is declining, streaming is a money pit, the actors are mad, the writers are mad. I think it'd be useful to tell a story here of how we got to this moment. And I think that story begins in the years just before the Netflix streaming revolution, just before House of Cards and Netflix really establishing itself as a distribution for original programming. So take us back to the 2000s, right up to 2010. This is the peak of cable, the peak of pay TV. Why is that business, the existence of cable television so important and so lucrative for the entertainment companies that are somewhat struggling with the Netflix revolution today? There's almost a two-pronged answer to this, but I think in order to get into the second part, first we have to lay out some of the facts of the first part. If you look at the core of that business, this is a business that had even a margins of nearly 40% on a weighted average basis amongst the six largest cable companies. So when we talk about all these players that we're going to get into within the streaming wars, the Disney, the Paramounts, the Comcast within the NBCUni, they're looking at insanely high EBITDA margins. This is in comparison, if we think about it, to about an average of like 15% margins of the entire economy. And we look at these different sectors. And the biggest part about this is that when you look at the extremely low capital intensity of the cable system, the cable bundle that was happening within these companies, the revenue that they were actually seeing compared to the investment, when you look at an industries like oil, we look at industries that have much, much larger investment based on what they're trying to bring in on revenue, cable is printing money. And I think this is extremely important because when you think about why this was able to occur, which gets into the second part of this answer, cable was this beautiful socialistic almost experiment. It was this idea that you wanted your competitors to almost perform extremely well. You wanted ESPN, ESPN2 and ESPN3 to perform really well, because that bled down to the lower average from demand, lower average from viewership, lower average from overall subscribers within the pay TV model. And so the more people that were taking in this \$300 cable system, the less churn that you were seeing, and the less you had to

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worry about each one of your single titles performing, because there was this security blanket of revenue coming in that was creating these extremely high profit margins. And so the thing that existed by 2009, 2010, 2011 is the year that we really point to, because it was the year that ESPN has over 110 million subscribers. It is the basis for Disney being able to do a lot of the acquisitions that it then ends up doing in the film space and looking at where they are and monopolizing a lot of what became of the theatrical industry between 2012, 2013 and 2019. All of that started because there was this successful paid TV bundle that was able to give them the ability to even continue investing in these future avenues of revenue and profit that they wanted to explore. And let me pause there, because there's something that you said that I think is really important, and I've said this before on the show, but people don't appreciate the degree to which cable television was akin to a private sector tax system, that is basically every single household was paying into the same program. You called it socialism. I'm comparing it to the federal government. It's kind of the same thing. And this business where everyone is paying into the same cable ecosystem that's paying out \$7 to ESPN every single month, a dollar or two to TNT and TBS, these so-called carriage fees. It's just this fantastic way of bundling everybody's money and then distributing it in a socialistic kind of way to all these entertainment companies, just this sort of unique combination of that which we might call socialism and that which we might call capitalism. As you said, it was three times more profitable than the typical business in the economy, 40% profit margins versus 10 to 15% profit margins for the typical business. So this is just, it's an amazing business. It's amazing. Why did it fall apart? I mean, in many ways, I think it's a typical innovator's dilemma in a lot of ways. So what you see start coming up in 2011, 2012, and really 2013, 2014 is Netflix kind of come in. And the one of the advantages that we didn't talk about just now within the cable system, but it's really important is that not only were the content suppliers being paid really well to kind of sell their content, they were also in the distribution game, right? So Disney had ABC, Disney had ESPN. They're also producing content for those networks. Comcast was carrying all this, but they also had NBC Universal. And so there's this idea of vertical integration that was really helping to kind of create this flywheel effect that was really, really strong. What they started noticing in about 2011, 2012, 2013 was the average viewership on linear started to decline and it started to really increase on the digital side. At the time this included SVODs like Netflix, Hulu was barely a thing, CBS All Access was definitely- You said SVOD. I just want to just spell out the acronym. SVOD essentially just streaming video on demand, right? Yeah. And this was a service that was really based around the idea of subscription, right? This idea that you were paying \$10 a month and you're going to get access to the Netflix catalog. And so this was really picking up. We had increases in YouTube, right? This was the moment of the YouTuber economy that we think of starts in about 2012, 2013. So millennials, not even Gen Z, millennials are pivoting their attention to the internet in many ways for both their premium content, for their unscripted creator-led content. And most importantly, in 2007, 2008, the iPhone launches, 2010, I would argue more important than the iPhone launch, the App Store launches. And all of a sudden, you have this mini entertainment system in your pocket that has access to the internet. So you're not actively looking at TV as a way to kind of get your entertainment. You're splitting your attention. Your attention is no longer focused on this one box. It's going elsewhere. Netflix, the advantage to Netflix was they picked up on

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the need for both. They picked up on the need to kind of be the go all home for everyone. And so that's why you kind of see their subscribers really start to take off. We don't talk a lot about the fact that by the time Netflix decided to go all in on streaming, they had kind of hit the point of that tip over where they said, okay, we can pivot our DVD business to this without really taking on too much concern about what this is going to do to our core business, because we know that our core business is effectively being eliminated. And this is where we're seeing the future going. That was the brilliance of Reed Hastings. It was this moment of like, we have the subscriber base to do it. We have the kind of cash flow to be able to do it. And we really think we need to pivot into this. And we're going to take on some additional debt in order to do it. And we're going to really see that this is the future. They also had the advantage of two things at their feet. They had the advantage of Wall Street, who believed in it. Even if there were some bears, there was a lot of bulls. And two, they had one of the best systems of almost a 0% interest rate, right, when it came to borrowing money. And so this was an advantage that Netflix was able to do. But when we kind of look at the legacy companies, they're stuck with this innovator's dilemma. Do we look at Blockbuster and say, are we risking us becoming this if we don't pivot forward? And at the same time, they need to kind of figure out how to get into digital. So they do two things. They start licensing to Netflix, which is problem number one, but it was really strong for their revenues. They licensed Netflix. Two, they kind of leaned into digital with these TV anywhere apps, right, TV everywhere. But the problem with TV everywhere apps was that you made it much more cumbersome or much more problematic for the actual consumer. If they wanted to watch ABC, they had to get the ABC everywhere app. If they wanted to watch CBS, so now you're saying we have to almost like Pokemon, you have to collect all these different apps and you have to open all these different apps. The beauty of Netflix is that Netflix said, you want to watch friends or you want to watch high-prestige HBO programming like House of Cards, you're going to get everything you need in one app over your internet, on your phone, whatever it might be, on your iPad. Remember when the iPad app for Netflix was a big launch, all within one place for a very cheap fee. And so I think the misconception that a lot of these legacy companies took was they looked at that and said, therefore, there is strong demand for our content as well on our own individual apps, but they didn't actually learn from the TV everywhere, TV anywhere situation, which was consumers don't want a lot of apps. They want everything in one place and they're willing to kind of pay for it. This was the beauty of pay TV. They didn't necessarily want Bravo or they didn't necessarily want ESPN, but they wanted enough of it that they were willing to say, yeah, okay, we'll give you \$200. If this sounds familiar, it's because it's comparable to newspapers, right? This idea of like, I don't really want sports, but I am really interested in business, so I'm going to pay for the entire New York Times bundle in order to get access to it. And I think what you're kind of seeing happening to the legacy entertainment companies is really similar to what we saw happen to a lot of the newspapers and all the digital media companies really early 2000s. And now it's just playing out on a different type of stage, but it's really easy to draw those similarities. So Netflix takes off and all these entertainment companies, whether you're Disney or your Paramount or your HBO, your Warner Brothers are

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looking

at Netflix takeoff with a direct consumer streaming strategy and they say, we need to build that too. Right now we are developing content and we are selling our content into these windows. Sometimes we make a movie and then it windows, so to speak, it appears in a movie theater and then it appears on airplanes and then it appears on pay-per-view and then it appears on cable television and it appears as a DVD and all these different things are called windows and they're essentially selling their content into these windows and all those windows offer a new opportunity

to make money at that one time. And they say, wait, we can totally change our business strategy. What if rather than have this windowing strategy, we build a pipeline direct to the consumer and we say, if you pay to subscribe to our service to HBO now, then not only will we get money from you because you'll really, really want to watch, I don't know, girls, but also you'll stay a Netflix subscriber for the next month and the next month and the next month and rather than pay, rather than have this sort of windowing strategy, we'll have this subscriber strategy.

Now, I think if you went back to say 2014, 2015, when there was a low inflation environment, it was easier to build out these strategies and frankly, this part I think has forgotten a lot, consumers were screaming for it. Consumers were screaming for it. I remember I was in New York at an event where Richard Plepler was interviewing Lena Dunham. Talk about a flash in the past. Richard Plepler is talking to Lena Dunham and all of the questions from the audience were, why can't I watch girls on demand when I want to? Why do I have to buy HBO as part of a cable bundle? Just sell directly to me and he was like, well, we're thinking about developing it, we're thinking about developing it. People were clamoring for this stuff to come direct to consumer. Finally, it does and I want you to help us understand why hasn't this been a bonanza of profitability? Why were the entertainment companies wrong when they seem to have assumed that if they went from this old-fashioned paid TV windowing model to this direct to consumer model, they thought, oh, we'll all become Netflix, we'll all make a bunch of money.

Why weren't the profits there when they crossed the river?

Bear with me on this, both Derek and listeners, because we're going to go through it fairly, but also as quickly as possible because there's so many answers to this. I love that you brought up HBO, which then became HBO Now. That's kind of that first direct to consumer outside of HBO Go,

which you had still to have your tie-in to cable in order to access HBO. We use HBO Now a lot within our industry when we're talking different analysts, you're talking different executives.

As a reason of why streaming is really, really difficult on a per channel basis, people think of HBO Now, and you think about the stories, I'm sure people remember this, of having trouble logging in to watch the Game of Thrones finale or the Game of Thrones premiere, and we remember all these stories about these huge subscriber edition instances with HBO Now around these really big shows. What we don't often talk about, but is core to the HBO Now story, is the level of churn that HBO Now experienced at the end of every major show. If we remember correctly, for HBO, there weren't many major shows. This was pre-Casey Blaise taking over CEOs, pre them getting into more genre content like The Last of Us. This was HBO still as this very, very successful subscription video product within cable, but was not necessarily turning out the level of hits that they needed on a weekly or monthly basis in order to keep this at scale. When we look at the churn that HBO Now faced, this is your major

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problem. I like to compare this to the idea of being able to buy an article from a media organization. You go in and you say, hey, we really want you to bring you in as a customer. We're hoping that you'll eventually pay \$10 a month for us or \$100 a year for us. We're going to give you access to a free article or we're going to give you this article that you're looking for for \$1, no problem. What you're going to see in that week is 1,000, 2,000, 3,000 new subscribers. What you're also going to see that following week is churn of about 2,000, 3,000 subscribers. You're not actually able to create sustainable revenue or sustainable profit because you're spending so much on the customer acquisition cost of bringing those customers in. You're spending so much on trying to figure out how to retain them that you're actually spending more than you're bringing in. We think about this in terms of streaming. In 2022, US households added about 144 new subscribers, which was higher than the 100.

It was about \$18 million more than they added in 2021, but they saw an increase of churn to about 118 million subscribers, which means that your average level of churn was about 1.2. For every customer you're bringing, you were maybe losing a customer. That's really, really difficult to grow a business on. Now, when you're Netflix, you have won the first mover advantage. You have the ability

to say we're able to maintain this foothold. We're spending \$17 billion a year on content, both from the original standpoint. Their goal back in 2016 was to create a library that was 50% original content, 50% licensed content. Just recently, a couple of months ago, they hit 51.2% original content in the United States, so they surpassed that moment. Netflix was able to use this low interest rate environment. They were able to use this increased spending on content. They were able to use Wall Street being at their back until very recently to say we're going to take on a lot of debt to build up the library we need. Eventually, when this competition comes in, our offering is still really strong, and they're still making these strong licensing deals.

If you are Disney or Warner or NBC Uni in Paramount, not only are you saying, okay, we need to invest in our streaming product, and that's going to operate at a loss, we also need to continue servicing the linear side, because the linear side is what's helping us pay for the streaming side. That gets really complicated when what you're effectively talking about is a plane rushing towards the end of a runway. Not only are you saying, we're going to try to tape up the runway at the very ends that the plane can take off smoothly, you're saying, we're going to take a hammer, a jackhammer to this runway, and hope that that plane doesn't fly off the cliff, because we need to move these customers over at the same time. We need to try and figure out how to keep this revenue coming in so that way we can actually get through this transient moment. I think that's what gets lost in this conversation. It's not necessarily that these legacy media companies aren't creating a product that people want. We see with Disney Plus that they're adding new subscribers, even if it's stagnated recently. We're seeing even with HBO Max

as the Integrate Discovery Plus, that there is more activity within the app. You're getting people opening multiple times throughout the week versus just once a week. Typically, it's a Sunday or Friday, depending on new HBO show, new film, whatever it might be. There are moves being taken, but what they don't have the advantage of is these things that Netflix did, this low interest rate, this Wall Street in their favor. They didn't have all these

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different things that help Netflix move through their own transient moment and get back to where their stock is currently heading into earnings today as we record this. I think that's a really core part of this story, is that Netflix didn't have to worry about saving a very profitable business. They were ready to move on. They saw that they had reached the customer tipping point, that they were ready to go. They had the first mover advantage. I would argue most importantly, they said, we're going to spend less on US content, which is three, four acts as expensive as international content. We're going to create our bases out there. We're going to hyper-specialize the local content, and we're going to find ways to bridge these gaps together. What you get is this moment of being able to be the dominant entertainment force in all of these different countries. When Netflix says we want to have a billion subscribers, they know that that's not going to come from the US and Canada or even the UK. It's going to come from being in all these different countries and being hyper-dominant locally. When we talk about Squid Game, this idea of here's Netflix at its core moment. It has 200 million subscribers, a huge Korean show, everything that Netflix said they were going to be, they've become. The reason that Squid Game was super successful wasn't the fact that it traveled to the United States and there were Halloween costumes. It was that it cemented Netflix as the dominant form of entertainment in Korea, in a country that it hadn't really even invested in two years prior. We saw Netflix do this with unscripted and reality. When they come in, they invest where they need to invest. They invest in that format or in that country as much as possible, and then they slowly dominate. As they build up, when you're looking at where you're going to cancel, again, we bring back that churn, you're not necessarily going to cancel Netflix. You're not necessarily going to cancel that at a large scale, even if we freak out sometimes because they lose a million customers, which compared to 230 million customers, not really a huge concern in my opinion. You are going to cancel your Peacocks and your Paramount Pluses and they're already bleeding cash while they try to save the linear side and invest in streaming. I want to focus on Disney for a second. I think one way you can tell this story is that Disney was thinking something like, we've got one house on a sinking island. That's pay TV. We know that that island is sinking, and we want to build a new house that's going to be a big, better house. But I'll bet someone in that room the first time they had this conversation said, here's what the nightmare scenario looks like, Bob Iger. The nightmare scenario looks like this. The sinking house sinks faster than we think. The new house is more expensive than we think, and the cost of capital goes up. If all those three things happen, your company is in a lot of trouble. And any succession plan that you have, Bob, by the way, might be totally blown up because it'll look like your strategy just failed. That seems to me kind of like what happened. Pay TV is sinking faster than people anticipated and as a result, all these profits that the companies were counting on to build the streaming future, those were declining faster than they thought. The cost of building the streaming distribution system, as you said, was more expensive than they anticipated because of not just you have to add marketing and analytics and whoever is necessary for cost compliance, but also more churn. It costs more to acquire and keep the next marginal streamer, so the cost of building the new house is going up. And then finally, and this is, I think, so important, the cost of capital goes up as well because we go from Zerp, a zero interest rate environment, to a much higher interest rate environment. And that seems to me to be why companies like Disney are in so much trouble. I want to hold on Disney because Bob Iger,

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the CEO of Disney, made some really interesting comments in CNBC, I believe it was last week, where he at least intimated that he is open to selling off Pay TV, which has been the profit center of Disney for a long time, and maybe even finding a, quote, partnership for ESPN. Tell me what you heard from Iger that was most important in that CNBC video. What most struck you about what Iger said? Just want to give two quick data points because I think it really relates to where Iger is coming from. Between 2010 and 2020, viewership between that 18 and 24 cohort, right, so it's a very important cohort to advertisers, it's an important cohort from the trajectory of where consumer behavior is going to go for a lot of these media companies, these legacy media companies of yesterday are trying to remain legacy media companies of tomorrow.

That viewership on cable decreased by 70%. That viewership is gone, right? That viewership does not exist anymore. Now, if you're Disney, this is important because if we compare, if we look at Nielsen, they put out a gauge, it's a tool they put out to kind of examine streaming viewership in the US among some of the biggest players. There has been 0% increase in the viewership share for Disney Plus between 2021 and 2023. You'll get June. Why is this extra concerning? You're losing your core audience, your Disney. You need that 18 to 24 audience on the cable side. They're not looking at PTV. Also, you're not growing in the United States either. I think this is one of the biggest concerns Bob Iger faces. If you're saying that a lot of what we're putting emphasis on is Pixar, Lucasfilm, Marvel, right? You're kind of saying we have these big franchises. These big franchises are core to creating adoration for our entire company. It brings people to theme parks. It brings them to movie theaters. It gets them to sign up for Disney Plus, whatever it might be. The Pixar brand is becoming a direct to video brand in a way that's very concerning. You're seeing that the losses multiply in theaters. More importantly, and I think more scary in my opinion, is that the Star Wars and Marvel audiences are not necessarily declining at a scary pace, but they are contracting. They're not growing. This is the question that Disney is faced with. If you roll out your product in all these different countries and you're not really growing this core base, your general entertainment programming is not differentiated enough to get people to say, okay, we're going to leave Netflix and come here, or we're going to leave HBO Max and come here. You're not really able to increase this core franchise outside of it. What are you spending your money on to really be able to compete against some of these other competitors? And especially, what are you doing to not just compete against Netflix, but Fortnite and TikTok and YouTube? The beautiful thing about windowing when you talked about it

was that it idealized this idea of finite time. If you look at what you were talking about, you're in theaters, then you're at home, you're on airplanes. It was this idea of there's only certain avenues that you're going to be able to watch things, and what people are still tuning into is TV shows and films. In the span of the internet, that finite time becomes infinite, and that infinite time is fractured into 10,000 different charts of attention.

And so now what you're trying to say is, okay, we really need to find the best distribution pathway to maintain the largest attention share across all of our products. So if you kind of look at what you're holding onto, where do you start cutting those losses, those assets that are going to be losses, in order for you to invest in assets that are going to be innovative and lean into that new consumer behavior paradigm? If you look at ABC, ABC was bought in 1995,

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ironically, because Disney needed a larger distribution path. They needed something to say, we have all of this great content, and we really need a better way to expand globally and to be within this TV space at a larger scale. ABC realized that there was a lot of competition. This is ABC Twin Cities, and so they get acquired by Disney. Now, if you look at ABC, the model that existed in that pay TV cable bundle is going away, and the audience that is going to come into the audience that's not dying out is not paying attention to it. The issue is that Bob Iger has spent the last year, right, basically since he's come back, saying that anyone who's tied to satellite or to broadcast or to linear is basically in a lot of trouble because it's really hard to do that. He's been saying this over and over and over again. And now he's saying to people listening to his call, will you buy ABC? Will you come in and buy this? And it is going to feel very much similar to media. You likely have private equity come in, take it out of steel, really scrap it for whatever it's worth and then get rid of it. Just like newspapers. I mean, all the capital has done this exactly to declining newspapers. It really is amazing. I'm sorry to interrupt there, but you've made this point before, so I'll on ramp right back to you. It's amazing to see video entertainment become just the next chapter in the long book. This is what internet does to you, right? This is what internet did to newspapers. It takes what used to be a local publishing monopoly and it turns it into a marketplace of abundance. And that makes it much harder to own the means of distribution, which means that there's more overall content, but every individual piece of content is less valuable. So more total journalism, but it's harder to make money as a journalist. Then you see it. Chapter two happened to music. More music is being made than ever. 40 million songs, 50 million songs on Spotify, but the value of every individual spin goes from being relatively valuable in the sort of hardware album vinyl record world to much less valuable in the streaming world. And now it's happening to video, more overall video. The number of original shows has doubled now from about 300 to about 600 between I think like 2012 and 2022, but it's harder to make money if you're a writer or an actor on that show because there's less money to go around. It's just amazing the degree to which the story of, it's almost like, it's like the monkey's paw of abundance really. Like what the internet does to various media platforms is it turns them into marketplaces of abundance and then those industries have to enjoy both the benefits of abundance and suffer the downsides of abundance. And it's amazing to see that revolution.com for video. Sorry, I went on a little rant right back to you, Julia. No, no, I love it. I enjoy all rants all the time. And it's to your point, I mean, it's you had a conversation with my colleague at Pugmap, Melanie not too long ago about this and the idea that part of the reason the WGA is striking is that there are more writers on more shows, but actually they're making less money in general because of the way that it's kind of shaping up. I think what's really also important to talk about what you just really touched upon is this idea that you don't unbundle a great bundle unless you are 100% sure that you are going to be able to make up that scale and make up the revenue and profit coming from that scale on your own. And I think there was this idea because of the way that Disney had kind of monopolized a lot of entertainment. We don't really talk about how much Disney monopolized between the period of 2012 and 2019. They kind of came in on the ESPN cable side. They maintained the largest revenue shared of all the cable networks between that

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time period. They were the biggest at the box office in 2019. They had eight of the 10 highest grossing films in the United States. Then they would launch Disney Plus. They hit 10 million subscribers within the first 24 hours. So all of a sudden, Disney is like this thing that's going to be able to beat. The issue with what's happening with Disney I think is a really strong telltale story is that there's a limit to what you're going to be able to do. And the way I like to think about this is what is your total addressable market? And I think it is different from what they thought it was. If you are a Marvel Star Wars fan, that is the vast majority of Disney Plus, once you roll the service out in different countries, and this is why, by the way, I always refer to the Disney earnings as skew data, because every time they would have an earnings date, say we've hit 12 million new subscribers, 14 million new subscribers. And I would always point out, well, they launched in 10 different countries. That makes sense. If Netflix had 10 more countries to launch in, they would probably report similar numbers. This idea, and if Netflix, of course, had the brands that Disney had. And so there's this idea that Disney had all these investors, all of the shareholders, and all of Wall Street saying, what a great company. They're really going to hit that 240 to 260 million subscriber number that they projected, which also, by the way, I think Bob Shippek gets a lot of hate, but I think it's one of the dumbest things him and his team did, because the street doesn't care if you promise two times or three times a subscriber growth. They just want you to hit it, and they want you to show that it's driving strong revenue and it's profitable. But when you do come out and say, I'm going to hit 240 million subscribers, now that's your entire narrative. Now you have to spend way more than you were spending in order to hit that goal. Because if you go out and say, we're actually pulling it back, because our growth is slowing, and our numbers, which were based on when did Disney plus launch, right? November 11th, November 12, 2019. So their numbers are skewed based on the pandemic. So people are kind of going towards them, and they're saying, we're seeing this huge growth that pullback effect comes into play. Now Disney has to up their spending two, three, four times, just in order to meet their own numbers that they put out themselves. So that way Wall Street doesn't take them down a huge amount. One thing you're reminding me is that between this and what you said about Iger's shit talking pay TV, this is backward. I mean, I don't want to pretend that I'm anything close to Bob Iger's level of corporate executive genius, but you want to exaggerate the asset you want to sell and downplay the asset you want to invest in when you're talking to the market. You want to make the market think the thing that you want to sell is really, really valuable. So they overpay for it. This is something that Rupert Murdoch seems to have done very effectively with 21st Century Fox before he sold it to Bob Iger. And you want to be tepid and soft spoken about the benefits of the business that you're growing so that you can under promise and over deliver. And it seems like Disney has gotten both sides of that equation wrong. And that's a big part of the problems that they face. Just one other thing that you said that I wanted to throw it back at you. Do you think that the Netflix revolution, the streaming revolution was going to happen anyway? And so these companies had to react in an innovators dilemma kind of way to a technological change that was never going to benefit them. They were all immediately with the introduction of the internet and especially with the beginning of Netflix original programming, they were all going to be put in their back foot. That's possibly number one.

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Possibly number two is that no, actually, they made a mistake. Lots of these companies made a mistake by going in so strongly to direct to consumer. And more of them should have followed what I believe is like the Sony model of still trying to be a seller in a marketplace of direct to consumer builders. So that's the question. I hope it was clear enough. Do you think that these entertainment companies in say 2014 were just all kind of screwed given the revolution that was coming or were there real mistakes, strategic mistakes that they made?

I think it's actually a combination of both. I don't even think Netflix is the reason that they all said we had to pivot. It's certainly a big part of that reason. But I think a lot often we forget is that between 2015 and 2019, really right up until 2020, Netflix was operating at very negative free cash flow. It was a lot of debt that they were taking on, but Netflix remained, and this is where I get into it with who I think is the real issue, Netflix remained Wall Street Starlink. They were kind of like, ah, it's great. They're building towards this is the future of the internet and Netflix is the only one out here, which is also important. It's really hard to say we're going to come into a monopolized environment and we're going to just disrupt that monopoly. I think that's incredibly difficult to do, and I think Netflix has proved that.

But when these companies were looking at Netflix performance, it was great. They were also making a ton of revenue licensing to Netflix. I think the main problem was that you had Wall Street say, well, now everyone has to go into streaming. And so they were, I mean, two things were happening, right? The cable, the pay TV system was declining, but it wasn't declining as fast as people kind of misremember it as. It was actually holding relatively steady like penetration, household penetration only dropped below 89, 88% of pay TV within the last like three, four years. It was still relatively high and the subscriber term was not necessarily as problematic as it's become the last two years where we've really seen this huge drop off in kind of the subscribers to pay TV. But what happened? They severed their own arteries, right? They said, we're going to take our content

away from TV and we're going to put it on streaming. And so therefore you have to follow.

And now we're going to see the big question with this, by the way, sports. It's really going to be, you know, what happens with ESPN, which I think they need to bundle. I think they really need to find a strategic partner, but then bundle outside of Disney. And I think this gets to my second part of your question. My answer here, they inevitably had to go towards streaming.

It was the distribution funnel change. So people were on the internet. People wanted more of a direct consumer form of entertainment. They didn't want to be part of a pay TV bundle.

But I think the issue is saying all of these companies are going to work on their own.

And we've seen that course correction start to happen in the form of company consolidation.

So you've seen effectively, Discovery say we need an HBO Warner media partner in order to bundle our services, because now we can offer prestige entertainment, this kind of passive entertainment. By the way, passive or lean back entertainment makes up between 70 and 80% of all viewer viewing time on TV. So shows like Friends that you're rewatching or Dr. Pimple Popper is always the one people love to point out. Things on Discovery, that makes up 70 to 80% of all viewing time. 20% of it is active. It is like the bear. It is Wednesday on Netflix. It's these new shows. Those 20% are important because it brings in customer acquisition. But if you're looking at the United States where you've kind of hit the ceiling on your subscribers, which is why Netflix has rolled out this password sharing crackdown, let's say it hits 110 million total subscribers

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in the US, the main game then becomes keeping them. So you need that 80% lean back entertainment, which is your attention. I'll give you another one of my favorite statistics on this. My company, when we look at how shows would, paradigm analytics, when we look at how shows will perform on different platforms based on the audience demographic and the consumption affinity. So what these different viewers are watching across different platforms, a show like Succession, heavily talked about in the media, relatively decent viewership for a non-genre HBO show, but not a huge show by any means. Certainly one third the viewing of an average big bank theory show. But that series on HBO Max has about the same level of acquisition and retention amongst its consumer base, which means that the audience who's there for it is pretty much there for it already. On Netflix, that show does not do well as an acquisition title, but it has 20% higher retention value. And the reason I bring this up is because if you look at what Netflix is doing now, they're now talking to HBO and saying, we're going to license some of your shows, right? Netflix has a hits problem. And so what they've done to course correct, which I think is very smart under Bella Bajaria, their head of content, is go more middle of America. They've almost NBC-ified themselves, which is what they've done because they hired a bunch of people from NBC Universal. And so now they're doing these shows that really appeal at scale. And they're saying instead of trying to spend \$30, \$40, \$50 million on these prestige shows all the time, which is going to have a much smaller scale base, we're going to license from HBO at half the cost because they need to license us those titles. And so if you're trying to compete with that type of logic and where they have the first mover advantage, and you know you have to be in this direct consumer space, I think the bigger issue with all these companies was unbundling. I think there are bundles that could exist. You could create an entertainment bundle that is Disney NBC Paramount, right? You could create something where it's like none of them get the sports. The sports is like a different thing they figure out, but you're combining all of these situations, which effectively was Hulu. But Hulu, the problem with when it launched was that it was so mismanaged and companies were in and out. They didn't really know if they wanted to be in streaming or if they should still be in linear. And so you had a really rough launch where you caused more customer confusion than anything, and the advertising experience was really bad. And so Hulu has really had to fight those misconceptions about it. But that idea of everyone is in for 30% of it and they're putting their content on next day and they're putting their best content there. They create a truly differentiated product. Now you get back to the customer acquisition cost being much lower and a probable better profit margin compared to trying to compete every single day, spending three, four, five, six X on content every year just to keep that infinite level of intention. That's really hard to create profit, especially once you start thinking about being your own distributor overseas, having to hyper invest in territories where there's a 40% quota for local content. It just becomes much more expensive. They didn't have to think about this when they were either just suppliers or just distributors. Now they're both and they're also website operators and they're payment operators. And that's a lot of costs that was just not a concern in the PTB era. We had a decade of growth and now we might see a decade of consolidation. And I think that's absolutely plausible. My big question for you is, what happens to ESPN? I think what ends up having to happen with ESPN is also twofold, maybe even, you know, threefold. That's not a word, but I think one, it needs a strategic partner in the

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form of either an Apple, Amazon, or Comcast. And the reason I bring up those two is because there are assets that they're willing to trade each other, which makes that merger much, much more feasible. So if you look at Apple and Amazon, Apple wants to be in sports pretty heavily. Apple needs big sports to bring people in. We're going to see what happens with the MLS now that they have Lionel Messi and what happens with Inter Miami. Amazon likes the idea of creating a product that then, you know, betters the activity on Prime. So if they're in with ESPN Plus, you can maybe sell additional ads for toilet paper. You find ways to really bring in that Prime audience to ESPN Plus and you create additional revenue in that area. You also need those two types of partners because the cost of sports is increasing by insane amounts. A great example is F1, which saw a much stronger audience and a much broader audience thanks to Netflix's Drive to Survive. So the rights for F1 went from \$15 million, I believe, in 2019 to \$75 million in 2022 or just earlier this year or last year. So I mean, that's like a huge increase for this one sport. You're seeing that happen across the board. The NBA is saying they're valued at \$75 billion and you have Disney saying we would love to work with them in some capacity. Warner Brothers Discovery saying we don't need the NBA. They do need the NBA. The reality is that all of these different companies do need to own all of the sports, but they don't necessarily need to own it all on one platform. And so that's where... Give me a sense of... Can you just help me understand what Disney gets out of a strategic partnership with Apple or Amazon? Theoretically, I assume they get money in exchange for selling 51% of ESPN to some other company. But is that strategic? What is the strategic part of this partnership for Disney? It's not just money. And this may sound exaggerating or exaggerative, but I think it's survival. Again, if you look at the increase in cost in sports, but you also know, I mean, look at how pay to be... For all of what we talk about pay to be being on this huge decline, which it is, the fact that it's still in about \$72 million households is like impressive, considering how much these companies have severed what they've given to pay to be. And the reason that PTB exists as strongly as it does now, and I use the term strongly in huge quotation marks, is purely sports. I wouldn't even say it's news anymore. I have this whole thing about CNN, and is CNN really a necessity within PTB? Is it keeping people there? Not really, but the regional sports networks, which are undergoing their own strife and access to national sports are. And so Disney knows that sports are going to be crucial to both their domestic and global survival and being able to thrive in the next period. Once they get through this transient era, how do they remain a top dog? It's sports. The issue is that Disney, even with parks, this is why people are still bullish on Disney is that their cash flow is still strong due to the park's business. Even with that, they don't have the capital to compete with Amazon and Apple, and even Comcast on the sports side. And we know Comcast is heavily interested in sports, especially on Disney's spending front, when they have to pay Comcast \$9 billion next year in order to bring on Hulu. They have this call with them that they have to match. And so if you look at Apple and Amazon, the big advantage to them is that they're not core competitors to, I would say, Disney's business. I think Apple wants to be its prestigious brand. The biggest thing that can harm Apple is that it harms the brand, especially under Tim Cook, but they do want to sell this Apple One bundle. They want to sell more iPhones. They want to sell the idea of Apple being the service, and they want Apple TV Plus to be profitable. Sports helps that, and they have the

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cash flow, obviously, to be able to do it. Amazon wants to be ingrained in more homes and bring an older audience to prime like the retail service. Sports is one way to do that, especially as we force these consumers to now seek out streaming. So I think for Disney, if you can find a partner who's willing to go 50-50, or even if Disney's able to do 50-149, Disney still profits. Ideally, when we have to run those numbers, we have to model those scenarios off sports. But furthermore, they're able to create a bigger bundle. They're able to create a mini bundle that is still an ESPN, the general entertainment of the specialized entertainment of Disney Plus. So that's one area. Two, and this is maybe a little bit more out there, I think ESPN really, and I think this is true for Disney as a whole, but I think ESPN really needs to partner with a gaming company. So people are going to think I mean betting. I don't think that's true, although I would not be surprised if Disney does get into that in some capacity. But two, I think when we see where the attention share of people are going, it is more towards gaming. And so I think on the Disney Plus front, you bring in cloud gaming in some capacity, whatever it might be, to kind of really take advantage of Star Wars and Marvel content. The best Star Wars and Marvel content over the last five years in terms of consumer review have been video games. They've not been TV or film, which have actually dragged down the sentiment of the Marvel brand. And I think with ESPN, if you look at what sports are really profitable for you, it is kind of the Big Ten college football or whatever the college football league, I can't remember which one it is, league they have. It is Monday night football. And so if you look at EA, you look at their Madden franchise, you look at what you're kind of doing there. I do think a merger where you integrate more of these gaming capabilities, especially as we think about potential VR and metaverse applications going forward, which we know Disney is thinking about because they were a huge presence at Apple's big VR unveiling event. This idea of merging these worlds and also profiting off of these additional gaming businesses or finding ways to create profit off these gaming businesses that both use their own IP and use their own rights, I think is going to be crucial to Disney existing and thriving as a new media company in 2030. And I think that's the problem with Bob Iger's current stance and the team stance. It's thinking too much about what is streaming now. The answer to what is streaming now was a question that they should have been asked five years ago. It should have been like, what does this kind of look like? And it's hard to predict. If we could do it, we'd all be paid a billion dollars. But the idea that what we're going to do with streaming now is going to be what streaming is in 2030, it's not plausible, it doesn't make sense. So what does streaming have to be in order to be up there with Netflix, in order to compete with YouTube and TikTok and compete with gaming? How do we maintain a large place of the attention economy while decreasing what we're spending and really just playing this as strategically as possible? I think it's thinking beyond traditional entertainment. So it's cutting your losses, the ABCs, the FX distribution like the channel, cutting those losses to create revenue to invest in something that is adjacent to streaming, that is brought into the streaming bundle, that creates an additional perceived value for those consumers and then monopolizes their time for longer periods of time throughout every week and every month. And I think gaming and ESPN and sports as a whole is a huge part of that. Right. So essentially, Disney gets off the Sink and Island, it builds, it sounds to me like you're talking about a new cable bundle. Like if you put Disney Plus and Hulu and maybe ESPN Plus together, you're talking about something that pretty

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much

is a cable bundle for the 2020s and 2030s, but maybe with a gaming layer that builds on the Star Wars and Marvel licenses that they already own. My very last question for you is if we have this conversation in a decade, what will we say was the story of the next 10 years? So putting a couple elements together. One is that these entertainment companies probably built too many streaming products. There's probably just too much. We don't need a Disney Plus and the Amazon video and the Apple and the Paramount and the Peacock and the Hulu. Like there's just probably too many independent baubles on the iPhone, iPad, smart television. There just need to be fewer boxes and we're going to see, I think in the next few years, consolidation, fewer boxes, higher profits.

I also think that the strikes and you and I didn't talk about the strikes in the last 45 minutes an hour, but I talked to Matt Bellamy about the strikes and I do think that overall there's going to be a deal. It'll probably come this fall and it will probably overall, not a very brave prediction, but the writers will get some stuff they want. The actors will get some stuff they want. The producers will get some stuff they want, but overall it will raise production costs. Average pay for actors and writers is likely to go up. So production costs go up. We have more mergers. We have more consolidation. How is that all going to shake out over the next decade? How is it going to change the landscape of what we can sort of colloquially call television?

Well, I'd just like to say it now so that way in a decade I can point to and say,

well, I was right about that, is that I'll probably be wrong about a lot. So just pointing that out first. What I think the conversation that we'll have in a decade is that consolidation will absolutely occur. It's not going to occur amongst the companies that we think it's going to occur amongst. And the example of what I think a lot of media companies, and I include traditional

video entertainment media companies that we've been talking about in this format, are going to look like to a different degree across the board is almost what The New York Times has become. The New York Times is a lifestyle gaming brand that also has news. It supplements news, and it almost reminds me when you walk into a Barnes and Noble, which is by the way, is actually a business that's growing, and you walk through the candles and the blankets and the toys, you get to the back and you're like, oh, right, it's a bookstore. There's all these books that exist at the back of Barnes and Noble, and they kind of lead into this hot topic, is another company that's done this really well. And so I think if we look at what the consolidation looks like in order to monopolize people's payments, so that's the other thing we talked about within streaming. You'll remember this, Derek. I used to be analysts thought you might get five streaming services in a home. Then I went down to two streaming services.

My assumption is you get a Netflix and an HBO Max and a 2B. I think you have a lot of these fast systems that are still operating up in the bubble, but you do have these kind of free formats come in and people are like, oh, this is great. This is my lean back television.

So then what does that consolidation really look like? I think it's less of Disney and Warner Brothers or whatever it might be, and a lot more of Microsoft and Netflix. It's this idea of if Netflix is creating this strong content, they're monopolizing this viewership time, and we know that the rest of them is being spent gaming. If you're Microsoft, because they would obviously be the buyer, wouldn't you like to have some form of exclusivity of that, even if it's

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exclusive rights to IP for adaptation within gaming on your system, on your entertainment console? So you can sell more consoles. You can sell additional cloud-based stuff that that Microsoft is really leaning into in the Xbox division and do all this fun stuff. I spoke of this recently about Disney NEA, this idea that EA makes the best Disney content right now, but Disney is not profiting beyond just licensing out effectively the characters and the settings. If you're EA, if you're Disney, this idea of combining your companies so that what you can create within these platforms using cloud-based technology and looking at the console activity and looking at how younger people are engaging with media and entertainment as a whole, is there not a world in which you want to explore what that looks like? And I used to talk about this and say, you know, but this all depends on FTC regulation. And if there's one thing that we know that FTC chairwoman Lena Kahn hates, it's kind of these big companies coming together and merging.

But her track record hasn't been great, you know, including with Microsoft recently and Blizzard Activision. And so this idea of like, if you can get it across and you're actually not necessarily, you can make the argument that there are two different industries in some capacity, what you're creating is the entertainment future of tomorrow. And the way I like to think about this is if you look at 2010, right, Disney, this ties everything together. Disney is riding the wave of having 111 million subscribers at ESPN. They have this insane free cash flow from the pay TV bundle that is the basis of a huge chunk of their revenue, including parks. What do you do with that revenue? You buy Marvel and you buy Lucasfilm. And why do you do that? Because you need these franchises to grow across these different mediums and bring people back to the parks and really increase this kind of flywheel effect of their attention. The next step in that is not another, you know, film franchise. It's not a TV franchise. It's not even necessarily a YouTube franchise. So an example, that would be like Moonbug, which owns Coco Melon, a big, big kids thing. It's not even that it is within gaming, it is within that next step. And so if you're really trying to become a media company of tomorrow, that's where you have to focus a lot of your time and attention. I think that's really scary when you've just moved away from pay TV, right? Like you're still kind of in it. You're just figuring out streaming. And now if you're Disney, which has famously failed with gaming for the last decade and a half, now you're thinking, well, we have to be in this in some capacity and bring it to our consumers who are spending their time there. That's really scary. But I think that's necessary for a lot of these companies. You can see it with Warner Brothers Discovery, where one of their most profitable sectors remains gaming. And it's what they use for all of their film and television stuff. And I think that's just going to be the story of the next decade. I love that answer for so many reasons. I love that answer because, first of all, you took my question. You said, no, you need to think bigger. This is not just about the entertainment company's merging. This is about larger tech conglomerates seeing the value of entertainment companies or other companies within the entertainment space seeing the value of these companies and doing mergers. Two, you mentioned it. This ties into M&A concerns at the FTC. And it's going to be fascinating to see what happens if Disney and these other companies really do look to merge with these larger companies. And then finally, I love it because it suggests that my favorite show of the last few years, Succession, was incredibly prescient. What did Waco Roystar do? It looked to merge with a streaming giant outside of entertainment. And that is essentially what you're suggesting is that these companies are

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going to see themselves as part of the overall attention economy, not just what we understand to be the video entertainment economy. And that the mergers of the next decade are more likely to be unions, surprising unions within the entertainment ecosystem, rather than unions that just fit inside the narrow vertical of that, which we understand to be television.

Julie Alexander, thank you very much. Thank you for having me.

Plain English was hosted and reported by me, Derek Thompson, and produced by Devon Manzi.

We'll see you back here every Tuesday for a brand new episode. Have a great week.