Business + Strategy

hulu

Case Analysis

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Abstract

This report is focused on Hulu and its current position in the online content distribution industry. In this particular industry, Hulu's suppliers and owners are also its competitors. As the online content distribution industry becomes increasing popular, Hulu must implement the strategy that best allows successful growth, without infringing on its owners' territory. Analyzing Hulu's situation with respect to the current condition of the industry will give a more accurate outlook on Hulu's capabilities for expansion. In order to promote growth, Hulu has to contend to the interests of the content viewers, content suppliers, and advertisers. Through a set of creative recommendations, Hulu will be able to capture more market share and ultimately become the most prominent website and over-the-top subscription service in the industry. Recommendations for Hulu are to improve its original content, cater to niche markets and to implement its own advertisement consultant division. These recommendations will allow Hulu to grow by respecting the interest of all parties without creating issues with its owners.

Hulu Overview

Hulu is a website and over-the-top (OTT) subscription service that offers ad-supported on demand streaming of videos, TV shows, movies, webisodes, and other new media, trailers, and clips from a over 350 networks and studios. As an OTT service, Hulu has the unique ability to offer online delivery of video and audio without the Internet service provider being involved in the control or distribution of the content itself. Hulu offers video in Flash Video format that ranges from standard to HD quality. Viewers can watch Hulu content from hulu.com or from a variety of other websites including AOL, MSN, MySpace, Facebook, Yahoo, and Comcast's xfinityTV. Although the majority of Hulu's content comes from established networks and studios, Hulu has recently started to create its own video content, including originals such as "The Confession" and "A Day in the Life." Currently, Hulu is offered only in the United States and Japan.

The firm was founded in March 2007 as a joint venture between NBC Universal (Comcast/GE), Fox Entertainment Group (News Corp), and Disney-ABC Television Group (The Walt Disney Company), with $100 million USD equity funding by Providence Equity Partners for a 10% stake. In June 2007 Hulu named Jason Kilar CEO of Hulu; he was formally an executive of Amazon, where he was the Senior Vice President of application software.

Hulu offers two services, its basic Hulu platform and Hulu Plus. The basic Hulu service is free, can only be viewed on computers, and is completely ad-supported with content providers receiving between 50-80% of the advertising revenue. Hulu Plus is offered as a monthly subscription service for $7.99 USD per a month. The service not only offers more content to viewers, but also has less-advertisements than the basic service and allows viewers to watch Hulu on computers, internet-connected TVs, blue-ray players, set-top boxes, mobile phones, and tablets.

Hulu provides advertisers with the opportunity to associate their brands with premium online video content and connect with highly engaged consumers. Through Hulu Plus advertisers can extend their scope to not only computers, but also the plethora of Hulu Plus enabled devices offered in the marketplace. At the moment more than 1000 advertisers have utilized Hulu's service, including, McDonald's, Visa, Pepsi Toyota, Microsoft, GEICO, Honda, State Farm, Allstate, Unilever and Procter & Gamble.

Industry Analysis

Michael Porter's Five Forces

Hulu is a member of the online video industry, and more specifically the industry that streams licensed content such as TV shows or movies. Players in this industry acquire content from content generators, generally TV networks or movie studios, and then stream this content and generate revenue through subscription payments or through targeted advertising. This is a growing industry. In August 2011, 180.9 million US users watched 6.9 billion online video sessions. This pertains to websites such as YouTube as well, but shows how about half the country is going to the Internet to watch video. Online Video advertising had revenues of $2.16 billion in 2011, has expected revenues of $3.06 billion in 2012, and is expected to grow to $7.11 billion by 2015. This shows how much room for growth the industry has.

Supplier Power

High: Hulu's suppliers are the various TV networks that create shows, which are traditionally broadcasted on Cable or Satellite. Hulu is very dependant on the networks to license out their shows and movies for Hulu's use. They are very leveraged because they can also show their content on cable, something they have

been doing for years successfully. So if Hulu doesn't negotiate favorable terms the networks will simply not license their content to Hulu. What further complicates matters is that these networks also own Hulu and don't want to see Hulu grow too big, as Hulu's growth cannibalizes the ratings of the networks on other mediums such as Cable. Although Hulu is beginning to create their own content, thus becoming their own supplier, people don't go to the site to watch these shows because there is no quality guarantee. While people may watch an NBC show without knowing too much about it because of NBC's track record for high quality shows, they won't do this for Hulu because Hulu has no such track record. As of now many of the views of Hulu-created shows are impulse driven because a viewer happened to be watching a network show.

Buyer Power: End Consumer

Medium: Hulu's existence actually increases buyer power, as it creates another legal channel to watch content. Currently the end consumer, TV watchers, can choose to watch shows on traditional Cable or Satellite, they can watch Hulu for free or use Hulu Plus, they can use Netflix, they can watch content online directly from certain networks' websites, or they can find illegal streams or downloads of the show, if they are savvy enough. The buyer wants to watch the medium that is most convenient to him or her, and has many options to choose from. The reason that it is only medium, however, is that the content providers, the Networks, still get to decide what mediums their content gets shown on and the end consumer has no say in that decision. They can certainly influence that decision buy choosing to watch shows only through certain channels, but in the end the Network is more insulated than the consumer and as of now the consumer will probably just adapt to whatever medium the Network chooses to air their content on.

Buyer Power: Advertisers

High: Hulu considers the companies that advertise on its website to be buyers as well as the end consumer. They have a lot of power because they don't need Hulu as a medium to advertise their product. They can gain significant exposure by advertising online through banner ads, sidebar ads, and search related ads, as well as traditional advertising in print media or cable and satellite. In short, advertisers have options. So Hulu needs to prove to the advertisers that their ads bring value to them at a fair price, and the advertisers have a lot of power in deciding what that price is.

Substitutes

High: The major substitute for watching TV on the Internet would be watching it on traditional Cable or Satellite providers. The reason that we consider this to be a substitute and not a competitor is because of the drastic difference in price point, and the fact that Cable and Satellite are not Over The Top services. Cable and Satellite are offered at a much higher price, but they provide services Internet TV cannot currently such as live sports and local news. They also have first choice for all content. They offer a wider range of services, their feeds are more reliable than most Internet feeds, and they are ingrained in the American home, so they are a very big substitute. Besides them, other substitutes could include anything an end consumer could use their disposable income on to relax in their own home. People can watch movies, they can listen to music, or the can read books in their leisure time instead of watch TV. Some consumers may also choose to spend their money on video games to play on in their spare time. However, people would probably pick TV over any of these alone.

Barriers to Entry

High: In order to break into the market three things in particular are needed, and none are easy to build up and acquire. The first is licensed content from the networks, which is expensive and handed out with a great deal of discretion from the Networks. The Networks are not going to allow their shows to be streamed on any website because doing this hurts their other revenue streams through cannibalization and simply creates another person to pay. In order to acquire content a streamer either needs to prove to a Network that they can give that Network exposure to a demographic they weren't reaching before, which is unlikely given how widely information is disseminated on the Internet, or generate their own content, which has no guarantee of acquiring an audience to watch.

The second thing a streamer needs to do is buy server space to hold the streaming service. The space is needed to not only store the content they acquire, but ensure that it will be shown quickly and at a very high quality. While this is relatively easy to acquire, server space at this magnitude is very expensive, and makes creating a streaming service require a great deal of capital.

Lastly, the streaming service will need a large network of targeted advertising to make money off the streaming. This requires managing a large and demanding group of advertisers, and also requires the service to be able to prove that the advertisements are targeted and reaching an appropriate demographic. This is required because without the advertisements being targeted it is hard to believe that the streamer would be able to charge enough for the ads to be salient. Such programs to target advertisements are rare and currently not easily acquired, making another barrier. The streamer could choose to charge a subscription fee rather than advertise, but this requires for the streamer to already have enough content to make a subscription worth it to the end consumer, which would require a very large amount of capital to acquire all that content from the start. All these things are hard to get or expensive to do, making entry difficult.

Competition

Medium to Low: As was previously stated in the Buyer Power section, there are a lot of different ways that content can be shown online legally. This includes but is not limited to Hulu, Netflix, Amazon Prime, Love Film in the United Kingdom, and content shown on the websites of certain Networks such as ABC and FOX. Despite all of these players, however, competition for Hulu is not all too high. This is because Hulu offers two things together that no other competitor can: the instant gratification of being able to watch a TV show the day after air and the consolidation of content from many networks in one place. If a consumer wants to watch a show on Netflix or Amazon, they have to wait anywhere from eight months to a year and a half after it airs to watch it. But if they go to a network website to watch it immediately, they an only choose from that Network's shows. Hulu's ability to offer both these things differentiates it from all other players in the market and diminishes the competition.

cost & value Drivers

Hulu looks beyond its end-users when defining its customer base. In fact, the company considers the following three groups to be customers to whom value must be delivered: consumers, content providers, and advertisers. In this section, we focus primarily on Hulu's value proposition to end-users, since the presence of these users on the site is necessary to deliver value to advertisers and content providers. The section will also briefly review how Hulu delivers value to advertisers. Because of the unique dynamic between Hulu and content providers, which can act not only as suppliers, but also customers, substitutes and, even in some cases, owners, we will review value drivers to this segment in greater depth in the problem analysis.

Value Drivers: Users

Convenience

Convenience is perhaps the most significant value driver that Hulu offers its users. We consider the numerous ways that Hulu provides a convenient and flexible viewing experience below.

Any time- The Hulu platform relaxes the scheduling constraints inherent in traditional broadcasting by allowing users to watch shows whenever they choose. Viewers can begin a show at any time of day or night, and can pause and resume programming as they wish. Such flexibility is particularly valuable in the current market given the lot of professional, familial and social demands that individuals may experience during television's "prime time" hours. Further, by providing viewing flexibility, Hulu users are not forced choose between two competing television programs, as they would with traditional television. Users can instead watch one show as it is broadcast and access the other when it is added to Hulu, usually the day after the 'live' broadcast.

Any device- Whereas traditional cable subscribers may only be able to watch programs on

their television sets, Hulu Plus users can access content on myriad devices, including computers, mobile phones and tablets. Moreover, Hulu allows consumers to seamlessly transition between devices; user viewing information is synced between platforms such that a user who watches part of a show on one device may resume the program on a different device without the hassle of fast-forwarding or re-watching ads. Because syncing is executed wirelessly, an individual need not even own the device on which they would like to watch Hulu content; rather, users may log-in with their account information on any internet-enabled device to access their programming. Such flexibility may be particularly valuable for consumers who have different platform preferences in varying contexts. For example, a consumer may prefer to view programs on his laptop while he is at home, but may find tablet access more desirable while traveling.

Anywhere- Related to the "any device" value proposition, Hulu offers its Plus users the opportunity to view their content anywhere that an Internet connection is available. By making it possible for consumers to watch their favorite shows while, for example, riding public transportation or waiting in line, Hulu differentiates itself from traditional television or DVR broadcasts, which usually constrain subscribers to in-home viewing.

Aggregated content (Depth of Line)- Some networks have responded to the increased demand for online content by streaming select programs through their respective websites, e.g. ABC uses ABC.com to stream ABC shows, but not shows from any other network. While this strategy increases convenience for viewers relative to traditional broadcasts, it requires consumers to navigate between multiple sites if they wish to view programming from different sources. Hulu maintains its value-advantage in this regard by aggregating programming from numerous content providers into a single web destination. This high level of integration increases convenience to consumers in several ways. First, when consumers visit Hulu, they can access a comprehensive list of content available from all Hulu sources; this eliminates the need for users to visit multiple sites to determine what shows they are most interested in watching. Second, a Hulu viewer watching one show can be immediately directed towards other similar shows, even if these recommended shows are provided by a different network than the original program; this increases consumers' ability to identify, and access, new shows that they may enjoy. Third, users avoid the hassle of learning how to use several network websites.

Advertisement Frequency and Relevance

Hulu increases value to consumers by both shortening the length of commercial breaks, and by making them more enjoyable.

Ad Frequency- Hulu drastically reduces user exposure to advertisements; whereas the typical thirty-minute primetime broadcast is interrupted by eight minutes of commercials, Hulu's streams of the same shows include only three minutes of advertisements. As most consumers prefer to minimize their time spent viewing commercials, Hulu's high programming-to-commercial ratio, relative to traditional broadcast, provides significant value to users.

Ad Relevance- Unlike traditional broadcasters, Hulu is able to target advertisements to viewer interests and preferences

based on user-provided data and historical viewing patterns. Hulu users may also switch from one advertisement to another using the "Ad Swap" feature if they deem an advertisement to be irrelevant or uninteresting. These targeting efforts improve the viewing experience for limited number of ads that consumers do watch; with Hulu, consumers are not forced to waste time watching ads that have no relevance to their interests or needs.

Content Availability

Unique Offerings- Further, Hulu provides content, such as foreign-produced series and original programming, that is not available through other channels. To the extent that consumers enjoy these unique offerings, Hulu is able to provide additional value.

Speed of turnover- Hulu is able to offer additional value to consumers relative to other online competitors, namely Netflix and Amazon Prime, by availing shows soon after they are broadcast. While Netflix and Amazon Prime tend to post content after it becomes available on DVD, usually several months after initial release, Hulu offers many episodes the day after they premiere. For consumers who like to stay current on their programs, or who are simply eager for the follow-up to a suspenseful cliffhanger, this quick turnaround time can provide considerable value.

Customization

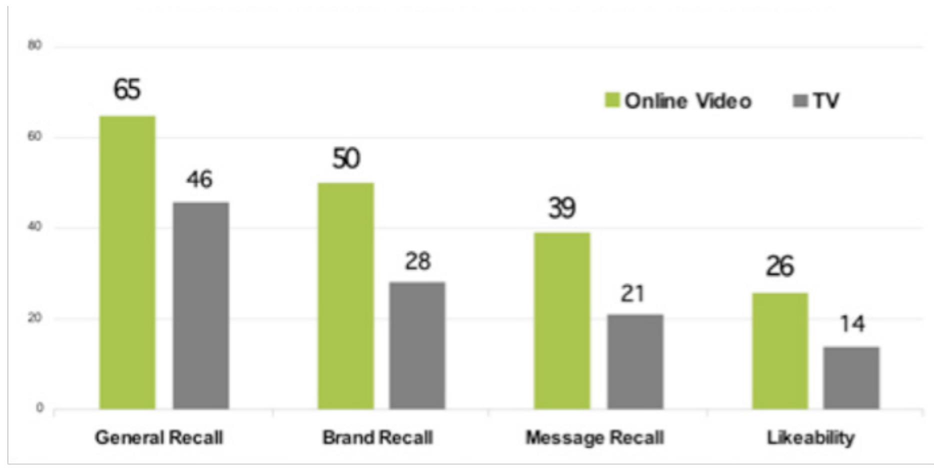
Hulu customizes the television viewing experience in numerous ways. First, the firm has developed capabilities to recommend new shows to users based on demonstrated preferences. Data from users' social media networks is also leveraged to generate additional content recommendations. This ability differentiates Hulu from traditional broadcasters, which can, at best, only provide broad recommendations to viewers of one show based off their interest in that single show. Second, Hulu individualizes its landing page so that registered users are presented with a display of new episodes from shows in which they have previously designated an interest. Finally, as described above, advertisements are tailored to individual user characteristics.

Value Drivers: Advertisers

Advertising Effectiveness

Advertising through Hulu is estimated to be twice as effective as traditional broadcast marketing. The firm has implemented several strategies to achieve this level of advertising efficiency, all of which convey value to advertisers. As described earlier, Hulu has developed market-leading algorithms and software to match advertisements with target users. Under the Hulu system, marketers can be assured that their ads will reach their intended audience and, further, that ad space (and costs) will not be wasted on individuals who are unlikely to be influenced by the commercial. Similarly, Hulu providers value to advertisers relative to network-specific streaming sites by offering a broader customer pool, which allows for greater specialization in terms of targeting.

Moreover, because Hulu presents its viewers with fewer ads than traditional media channels, consumers may be more likely to pay attention to, and remember, those ads they do see. Advertisers may also derive benefit from consumer's ability to interact with commercials on Hulu. In the simplest cases, viewers using Hulu can click on an advertisement and be



immediately redirected towards the product website to obtain more information or even make a purchase; these actions can be completed without interrupting a user's viewing experience, as content is paused as soon as an ad is clicked. Creative marketers have leveraged Hulu's capabilities even further by incorporating games or other interactive content into the ads themselves. In all of these cases, advertisers benefit from being able to engage their consumers on a higher level than that which traditional media allows.

Cost Drivers

Revenue Sharing instead of Licensing Fees

Reports suggest that Hulu's content providers waive licensing fees for the site, and instead receive between 50 and 80% of net advertising revenues. Under this arrangement, Hulu's programming costs reflect the content's precisely, as the firm only pays a content provider when a program has generated advertising revenue. This feature puts Hulu in a more favorable cost position than many of its competitors and substitutes, which have typically had to buy content in "bundles" containing a mix of high- and low-quality programming. These bundles essentially force content distributers to pay for content they do not want, and which may generate little or no return. Revenue sharing also reduces upfront and fixed costs for Hulu, thereby reducing the firm's risk of adding a new show. The marginal cost model may also benefit Hulu relative to competitors that rely on licensing fees, given that such fees have risen drastically in recent years. For example, estimates indicate that while Netflix paid $1.1bn in licensing fees in 2010, these costs rose to $3.9bn in 2011.

Partner Streaming

In some cases, network partners use their own servers to stream ads through Hulu. Such instances, which may account for up to half of Hulu's revenue, earn the firm its 30% revenue split while costing almost nothing (i.e. Hulu does not pay for network costs). These conditions are a considerable contributor to Hulu's profitability.

Economies of Scale

One of Hulu's major costs is its network and streaming infrastructure. However, once the streaming systems are operational, marginal costs of streaming are predicted to diminish because of economies of scale.

Vertical Integration

As Hulu begins to vertically integrate by developing more original content for distribution, the firm will gain substantial cost advantages. As previously described, Hulu currently pays 50-80% of advertising revenue to content providers. When Hulu becomes both the content provider and the content distributer, it will be able to capture all of the revenue that the site generates, and will secure a significant cost improvement from its current situation and the situation of its competitors, e.g Netflix (we assume that costs of production are sufficiently low to not offset savings from vertical integration).

Problem. . . Analysis

Hulu faces a strategic problem as it seeks continued growth in featured content and new subscriber generation. Currently, in order to offer more content, it must negotiate better/more contract agreements with content providers. Some of televisions major content providers (FOX, NBC, Disney/ABC) acquired equity stakes in Hulu in order to generate extra advertising revenues from viewers who miss the live broadcast, persons without access to cable, and in order to adapt with changing technology.
This relationship allows Hulu to avoid paying for expensive licensing agreements in exchange for a revenue sharing model. However, as Hulu continues to grow in popularity, content providers are afraid of cannibalizing their current revenue stream and are staving off the coming shift in television viewing as much as possible in order to enjoy the most profitable form of advertisement (live tv). Hulu generates large advertising revenue per viewer (roughly 14.3 cents per half-hour show), second only to live broadcast viewing . As online viewing gains in popularity, the balance of power will continue to shift in Hulu's favor. However, Hulu must dynamically maintain its market presence in order to continue its success.

Hulu is also starting to face a wide variety of competition in the digital media market. New competitors are beginning to enter the market despite the high barriers to entry. These new entrants, such as GoogleTV, as well as established competitors, Netflix and Amazon Prime, threaten Hulu's dominant market share and are hampering Hulu's subscriber growth rate. Hulu must combat new entrants through further increasing barriers to entry as well as attempt to create substantial user-switching costs, while continueing to deliver an innovative high value product. If Hulu fails to maintain and improve the current relationship with its content providers, as well as combat the onslaught from strengthening competition; hulu could soon become obsolete.

recom mend ations

After strong analysis of the industry and company situations, it is to our knowledge that Hulu can overcome its current struggles by implementing some of our recommendations. Our recommendations are focused on capturing more market share in the TV streaming industry, which will result in higher profits and sustainability for Hulu.

First, it would be to Hulu's benefit to continue producing and improving its own TV shows. These shows can be used to fill the time gap between the airing of a new network show and the time when Hulu can stream it. One of the biggest challenges for Hulu at this point is being able to stream hit shows as soon as they come out. Hulu is at the mercy of the TV networks, which own the shows and hold the power in releasing them to Hulu. Hulu has faced "difficulty in convincing TV and cable stations to hand-over programming in a timely manner." In the time that Hulu has to wait for shows from the network, it can be earning revenue by streaming new content, such as its own show, instead of waiting around for the network. The way Hulu can do this in a profitable manner is by creating a show with a popular actor or actress. For instance, Hulu can capitalize on un-hired talent, such as members of the cast of HBO's Entourage. Entourage was one of HBO's top shows, starring Adrien Grenier, Jeremy Piven, Kevin Connolly, Kevin Dillon, and Jerry Ferrara. Of course, the cost of hiring one of these actors varies individually, but even hiring the cheapest member would bring attention to Hulu's show because of the popularity the cast gained in Entourage. Adrien Grenier, who played Vince, would be a great choice for Hulu because of the star lead role he had in Entourage. Many TV viewers are at least familiar with the show and have an idea of who Adrien Grenier is. By utilizing this talent, Hulu can attract the attention of two consumer groups: those who know the actor and want to see him in Hulu's original show, and those who want to see the actor but never got the opportunity to because of the required subscription fee to HBO. Hulu will no longer have to share as much ad revenue earning stream time if it is to create a hit "TV" show, but they must commit to making a high quality product.

Every show generates revenue for Hulu, but through advertisements. Hulu does not establish licensing agreements with TV networks, but instead kicks back 50-80% of the revenue earned by advertisements. By creating its own show, Hulu can keep all the revenue generated from advertisements to itself. Also, the creation of a Hulu original will allow Hulu to differentiate itself from possible entrants to the online content distribution industry. Hulu will have a competitive advantage over those possible competitors because it offers more value by streaming its own show in addition to the shows from the TV networks.

Hulu should focus on creating suspenseful or action packed shows versus sitcoms. People will generate more "buzz" for suspenseful shows, such as Lost. Also, this may give Hulu the opportunity to offer edgier content than a TV network, but still concentrate on high quality. This will draw more attention to the show. In terms of promoting these Hulu originals, Hulu should utilize word of mouth marketing by mentioning and advertising the show in other Hulu advertisements for other TV network shows streamed on Hulu.

Another recommendation for Hulu is to engage and cater to niche markets. One market is underperforming TV network shows. If a show were underperforming on a TV network, it would be advantageous to both the network and Hulu to start streaming the show more on Hulu instead of cutting the show all together. This allows the TV network to broadcast a more profitable show at that time slot and it provides Hulu with an offering to a specific market that enjoys the show. It creates extra value for Hulu as it can reach those customers who otherwise would not have been reached at all if the network just decided to end the show. In doing so, Hulu can then offer more advertisement space and continue to fill the gap as it waits to stream the hit shows from the networks. Another niche market Hulu should cater to is international shows for multilingual/cultural persons. Cable and satellite networks offer channels directed toward specific languages. Hulu could do the same and in turn attract more viewers. Both markets provide a greater marginal benefit to Hulu than the associated costs of streaming this content.

The last recommendation for Hulu is to establish its own advertising consulting department. Hulu's advertising is very advanced and targeted, utilizing its ad selector and ad swap infrastructure. The advertising is much more focused and efficient by giving the viewer the option of which advertisement to view. The viewers' general recall, message recall, brand recall and overall likability is significantly higher than that of TV advertising. Giving viewers more control over the advertisements they watch creates a more enjoyable experience and provides data about consumer interests and preferences. By matching these interests with specific shows, Hulu efficiently targets its viewers with relevant advertising. In turn, this allows Hulu to create valuable market trends that it can sell to advertising and marketing companies that work directly with the TV networks. Selling this information will not only capture more revenue for Hulu, but it will benefit Hulu's relationship with the TV networks. The TV networks will want to continue working with Hulu so it has access to the market trends that are equally as valuable to the TV networks and their viewer retention. Overall, it creates a great long-standing relationship between Hulu and the TV networks.

(1) http://www.hulu.com/about
(2) Primetime hours in the United States are generally considered to be the period between 19:00 to 22:00 in Central and Mountain Time and between 20:00 and 23:00 in Eastern and Pacific Time.
(3) http://www.fastcompany.com/1670893/hulu-plans-ipo-but-where-in-finances-does-cash-income;
(4) http://www.fastcompany.com/1670893/hulu-plans-ipo-but-where-in-finances-does-cash-income;
(5) http://www.variety.com/article/VR1118038960
(6) http://www.dailytech.com/Study+Netflix+Hulu+Subscriber+SignUps+to+Decrease+Throughout+20122013/article24392.htm
(7) http://www.fastcompany.com/1670893/hulu-plans-ipo-but-where-in-finances-does-cash-income; http://www.businessinsider.com/hulu-ceo-talks-ipo--here-are-the-financials-2010-7
(8) http://www.businessinsider.com/hulu-ceo-talks-ipo--here-are-the-financials-2010-7
(9) http://www.betabeat.

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