



# Media industry embraces streaming transformation



**Direct-to-consumer (DTC) streaming services are creating tremendous opportunities for legacy media companies while, at the same time, transforming the industry and driving new finance, tax, marketing, regulatory, and operational requirements.**

In this paper, we explore the complex business issues that legacy media organizations face in launching and operating a video streaming service, and discuss areas they need to address to make a successful leap to DTC content delivery and monetization. Additional papers in this series will take a deeper dive into these key challenges.

## **The challenges include:**

- Winning the customer
- Optimizing the DTC-ready operating model
- Managing international complexity
- Dynamic revenue models
- Intelligent finance transformation

## Market forces

**M**edia companies with rich content libraries are well-positioned for streaming success, but launching a DTC streaming service is not just a simple change in their distribution model—it's a fundamental shift in the way their business works.

To compete successfully, these historically business-to-business (B2B) companies need to build and scale a business-to-consumer (B2C) operating model in which the economics are vastly different. The rapid move to streaming resonates throughout the content ecosystem—legacy media companies launching services, as well as producers licensing content to streaming providers—but under a different business paradigm.

Entertainment giants have long relied on a linear model with well-defined release windows and licensing structures to license and distribute their film, television and home entertainment content. But in the streaming ecosystem, many are struggling to drive revenue and capture a bigger share of consumers' wallets.

Subscribers have embraced new streaming services from top brands, with more expected to emerge throughout 2021. With the increasing number of streaming options, price wars and the cost of high-quality content, there is no direct line of sight to profits.

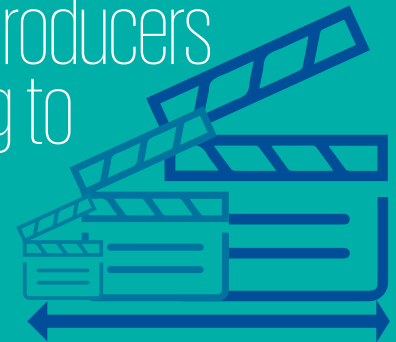
Layer in differences in production and content valuation, profit participations, deal structures and changes to the value chain, and charting the path to profitability becomes even more complex. There's also the analytics piece to determine the number of total streams, who is watching, what they're watching and for how long, and to incorporate that data into the revenue model.

The audience potential for streaming services extends far beyond the U.S., and the international market is a key battlefield. There is tremendous opportunity for subscriber growth, but international is also more challenging to navigate with varying regulations, language and local-content considerations, and tax regimes.

For streaming video providers, the value chain extends from creation through delivery and customer experience. This requires new skills and introduces a variety of operating and business considerations that media companies have historically entrusted to their business and distribution partners.

Even studios and content producers that are not launching streaming services of their own are seeing their business models transform by the growing number of streaming platforms. (See sidebar).

## All content producers are adjusting to streaming impacts



**While most attention focuses on content producers launching streaming services, the transformative shift toward streaming is upending the business models of all content providers — whether or not they're launching streaming services of their own.**

**For example, executing contracts in which content reaches the consumer directly through a streaming platform creates new challenges. As these arrangements cross borders, there is complexity with regulatory compliance that has historically been managed by third-party distribution companies.**

**To accommodate the implications of streaming contracts, studios and content producers may need to adjust their legal entity reporting structure to allow for the relevant information to be captured as content is moved, domestically and internationally, through the organization.**

**Specifically, the allocation of streaming revenue by jurisdiction is important for the determination of local and VAT taxes, foreign currency translation and exchange, and statutory reporting requirements. This information has historically been captured and reported by third-party distributors under the business-to-business model. That structure likely won't accommodate the organization's financial reporting and regulatory compliance needs under a DTC streaming arrangement.**

# Winning the customer

## Market Drivers

As the streaming market evolves, the question of 'who is our customer' may seem simple, but the answer is complex and subscriber data only tells part of the story.

Providers have to identify:

- Who actually influences the purchasing decision?
- What is the right metric for customer engagement?
- Do traditional measures like monthly active users (MAUs) or daily active users (DAUs) have value in the streaming ecosystem?

There are equally weighty questions about how content creators build and maintain their relationship with customers and the larger viewing audience. Marketing, billing, customer service, and customer retention are all critical capabilities, as is having strong analytics to understand consumer preferences and behaviors.

Data about consumer viewing habits and the popularity of specific titles can provide compelling opportunities for DTC providers agile enough to understand the data and generate insights quickly. Knowing which content resonates with specific customers and demographic groups will help influence future content decisions, and can improve customer attraction and retention. But balancing data collection and data privacy can be tricky.

## Keys to Success

- The interrelationship between the value chain, operational model, and customer engagement must be balanced delicately.
- Providers must define the customer, and the data used to understand success metrics, keeping these questions in mind:
  - How do you engage with the customer and protect customer data?
  - How do you provide and maintain customer support and service channels?
  - How do you drive more profit per customer?



### Actionable insights:

Customer data and payment

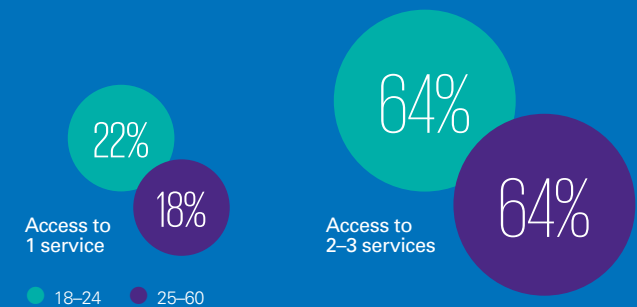
processing requires new skill sets, and introduces data privacy risk issues. Advanced analytics can help providers maximize the value of their customer behavior data, but also requires being a good steward of the vast amounts of data they collect.

Providers must avoid issues common to cable companies, such as churn. Personalizing content and recommendation engines offers tremendous opportunities in optimizing the customer experience.

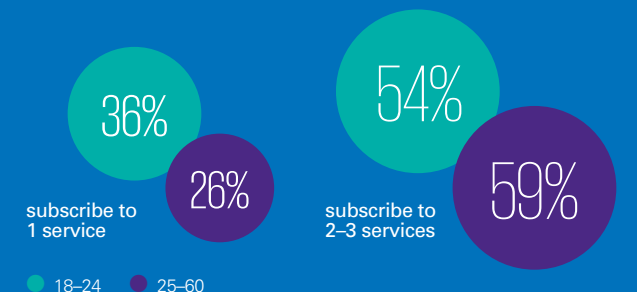
A recent KPMG survey exploring consumer preferences indicates consumers are gravitating to a small number of services to meet their entertainment needs.<sup>1</sup> Most prefer a broad content mix, but price sensitivity is a significant concern. Customers are also starting to show signs of fatigue in juggling multiple subscriptions to cobble together their desired entertainment mix.

Across age groups, the majority of people subscribe to two to three video streaming services, and currently pay under \$40 for their combined subscriptions. When considering additional streaming services, most would be willing to increase spend by up to \$20, and others indicated they would not be willing to increase their monthly cost at all.

**How many video streaming services do you currently have access to, whether you are the primary subscriber or not?**



**How many video streaming services do you currently subscribe to (as the primary subscriber)?**



# Optimizing the DTC-ready operating model

## Market Drivers

Reaching consumers directly—rather than through third-party distributors—represents a major operational change for content providers that includes establishing new technology infrastructures, billing relationships, customer service functions, and stronger data governance and compliance frameworks.

Streaming requires an operating model that allows providers to serve domestic and international audiences efficiently and cost-effectively. The dramatic shift from a B2B to a B2C orientation depends on a DTC operation that's frictionless, integrated, and well controlled.

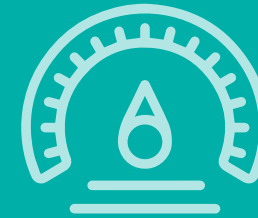
Content providers also need to blend previously independent entities, such as production, distribution and other business units, which were traditionally siloed in a B2B environment or performed by external partners.

## Keys to Success

Meeting these goals requires providers to master a variety of new skills including:

- Technology to support content delivery through a mobile-first customer experience
- Direct marketing to consumers
- Customer service, communications and problem resolution
- Billing procedures to support a DTC subscription model
- Capturing detailed viewing data, and having the deep analytic capabilities to create value from the data
- Understanding the return on content—how much a given title contributes to the value of a subscription
- Differentiating yourself from the competition with a distinctive content proposition

Another critical challenge is determining the metrics that help providers evaluate the performance of their operations and the value of their content in a streaming environment. This varies for different providers, with some using content to attract customers to drive revenue in other business units.



## Actionable insights:

Regardless of the business model, deciding what to measure—and how to measure it—is a key operational issue.

Future key indicators might include return on content and an ecosystem multiplier.

Consumers expect a frictionless environment with the ability to watch content anytime, on any device, at a price they consider reasonable.

Providers should place a high priority on the accuracy of data for reporting, maintaining the integrity of information for billing and customer service, and strict adherence to regulatory expectations. Operations must be well controlled to ensure accuracy, integrity, and compliance.

# Managing international complexity

## Market Drivers

International distribution presents a number of operational and reporting challenges. Some early considerations include operating structures, rights ownership, taxes and transfer pricing, the amount of U.S. versus non-U.S. content, and where that content will be produced.

As content providers explore new business models, jurisdictions are introducing new taxes on digital services and trying to extend taxes on wireless data services to video streaming.

Providers need to create an operating structure (either regional, local, or a blend depending on market size) and identify which entity is going to engage with the customer. This will largely be a business or operating decision, based in part on how much local content a streaming service will offer.

Additionally, for large territories that have a significant amount of local content produced or available in that jurisdiction, there may be different considerations around ownership of the content or licensing agreements. For example, a large territory that produces a significant amount of local content may have its own tax structure with production incentives and advantages. In that case, it may be beneficial to maintain a legal entity in that territory.

## Keys to Success

- International taxation is a critical success factor that's complicated, in part, by the fact that DTC business models are still early in their development and unproven.
- Providers need to plan for international taxation and transfer pricing while maintaining enough flexibility to adjust as new laws are enacted and others evolve.
- One potential advantage for providers is that, depending on where the entity is domiciled or located, considerations regarding tax reporting will likely be more straightforward internationally, where VAT plays a larger role, than it does in the U.S.



## Actionable insights:

Flexibility is key. Because streaming deals cross borders, regulatory and compliance controls need to be carefully considered. Providers are basing decisions on what current tax regimes look like – both in the U.S. and abroad. But those are changing, especially as it relates to digital services.

The streaming business has not reached full market maturity. Because many of the current competitors are pouring billions into ramping up, we believe ultimate success can only be achieved on a global scale.

# Dynamic revenue models

## Market Drivers

Some consumers prefer lower-cost ad-supported services, while others will pay more for ad-free premium offerings. Viewer data can help providers optimize the content mix for various segments and price points. SVOD is the most prevalent option, but price sensitivity is making ad-supported options much more appealing to consumers:

- AVOD – a no-cost, advertising-supported model
- Subsidized subscription
- Ad-deferred – reduced subscription rate, in exchange for agreement to watch some ads
- Tiered subscription model with various ad options
- Free ad-based services

Consumers—especially younger consumers (18-24)—prefer an ad-free streaming offering, but are often willing to sit through ads to reduce subscription costs according to KPMG customer streaming survey.<sup>2</sup>

Most new providers view their streaming services initially as loss leaders as they try to attract consumers. Providers with other revenue sources may be able to sustain DTC losses longer if they can use their consumer relationships, and the data those services generate, to drive revenue in other divisions.

Some providers will also need to consider the channel and partnership economics as the apps for DTC offerings are served up on different platforms for a price, as well as the big partnerships that have been struck between wireless providers and streaming services.

<sup>2</sup> KPMG survey, How consumers choose streaming video services

As providers begin to bundle multiple offerings, the economics surrounding bundles add another layer of complexity.

## Keys to Success

- Ultimately, pricing is a function of market capture, and therefore, it's a race to win the consumer.
- Striking the right balance between content, pricing, and ease of use is the sweet spot for most streaming services.
- The lack of sophistication in the way ads are served on streaming platforms is a major frustration for consumers who tire of seeing the same ads repeated over and over again.
- More effective analytics can address this challenge and, as a benefit, increase each ad's value to brands while also reducing consumer frustration.

## Actionable insights:

Data capture and quality can have a significant impact because the ability to identify true, validated, unique viewers would give the advertiser greater confidence on the reach of their ads and spend.

Cobbling together the right mix of content at the right price is increasingly challenging; however, introductory promotions for free or discounted streaming subscriptions offer incentives to consumers to test drive newly launched services without adding to their monthly spend.

# The resurgence of the bundle

The number of streaming services has exploded. For consumers, managing content offerings across multiple services can become tedious, and expensive. Curation and aggregation are increasingly important. We may see a return of the intermediate bundlers in the form of highly accurate recommendation engines, curation across platforms, specialty brands, or even fractionalized membership streaming models.



As pricing for streaming services moves toward sustainable models, niche operators may welcome the return of the bundlers. One option is a bundler that makes arrangements with one of the streaming titans for premier content at a premium price per view. We may also see lifestyle brands stream content targeted to their desired consumer profile.

A bundler can utilize data analytics and artificial intelligence to drive recommendations and curation to segment the market and improve profitability. We may also see the advent of “super” bundles that encompass more than just video streaming, including music, audio books, and other forms of digital entertainment. Bundlers could not only help provide recommendations but also support superior targeted advertising for the streaming services that allow it.

# Intelligent finance transformation

## Market Drivers

The streaming business has upended long-established models including content licensing and release windows, ultimate calculations, distribution costs and fees, and revenue models. The economics of a particular title and its influence from a revenue perspective is also unclear and hard to measure.

The economics are vastly different in the streaming business, and most providers are still struggling with a path to profitability. Building a dynamic and automated finance organization that is more responsive and analytically oriented is essential. For example, traditional content licensing deals and corresponding commissions or royalties reported on a lag have given way to a much different revenue model with subscriber additions and losses reported hourly, resulting in millions of transactions.

The finance function must be very creative in determining title profitability, and predictive, with an increased focus on automation and analytics. This includes using predictive data to better understand pricing, not just revenue.

## Keys to Success

As studios distribute their content directly to the consumer, they have to address a variety of nuanced considerations:

- Aligning content production and distribution under the DTC operation, which owns licensing and marketing promotions for all titles and content
- Creating success metrics that measure growth, progress, and churn accurately in a dynamic operating environment
- Updating and automating the financial reporting model and adding data and analytics capabilities.
- Measuring growth, progress, and churn. And with customers likely to add and drop subscriptions based on the seasonal availability of high-profile original programs, is churn a relevant metric for streaming providers?



## Actionable insights:

Pricing analysis is much more difficult in a streaming environment. Focusing on competitive pricing, scalability, and smooth customer

relationships to reduce churn will help streaming providers sustain profitability and evolve with their customer base, but that's a complicated proposition.

Providers need to build systems that can bill, collect, and report each individual transaction with millions of consumers spread around the country. Having access to real-time data can facilitate more predictive analysis around revenue and pricing.

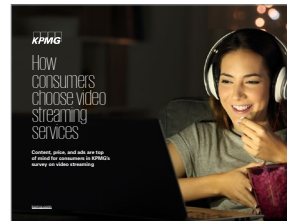
DTC providers also face the business imperative of understanding their financial obligations as they create a service and establish pricing models that impact state and local sales tax, and other indirect tax returns that these entities didn't have to concern themselves with in the past. Failing to anticipate or account for tax payments in the jurisdictions in which they serve customers, for instance, can create revenue leakage through costs that were not budgeted when the service was established.

DTC providers will need a full awareness of their operating costs under a streaming model before they engage with consumers.

# Related content



[Optimizing the DTC-ready Operating Model](#)



[How consumers choose video streaming services](#)

## About the Authors

**Michelle Wroan** is the KPMG National Media Industry Leader, and an experienced Audit partner with a 25-year tenure at the firm. Her responsibilities include representing the firm in the marketplace, developing marketplace strategies, leading the growth and success of the firm's media industry practice, and helping ensure clients receive outstanding service. Michelle leads a team of professionals that provide services to film, television, music, broadcasting, sports, publishing, and advertising companies, helping them evolve and transform in the face of rapid industry disruption. As new competition, major changes in advertising, evolving content distribution models, and shifting consumer expectations create new challenges and risks, Michelle's experience in the industry allows her to manage new risks and spot new opportunities.

**Benson Berro** is the KPMG Deputy Tax Industry Leader for Media and Entertainment. He has more than 20 years of audit and tax experience, and leads integrated teams of KPMG Tax professionals who provide tax advisory and compliance services to clients ranging from publicly traded multinationals to private equity owned and closely held businesses. He primarily focuses on the media, entertainment, and technology industries, with a strong focus on clients engaged in the production and distribution of motion pictures and television programming. He has extensive experience with the various federal (Section 181 and Section 199), state (refundable/transferable tax credits), and foreign tax and investment film production incentive regimes.

**Danny Le** is a principal in the KPMG Technology Enablement practice, specializing in media and technology. Danny has been working with some of our top clients to develop and implement their DTC business models. He specializes in privacy and security to achieve a successful and sustainable business. He has experience working with many of the underlying technology platforms that drive the DTC business. Danny serves various technology platforms, studios, production companies, as well as talent management agencies in expanding their business. Danny serves on a few media and entertainment industry boards and non-profit organizations. In prior years, Danny has also worked in Asia and Europe with KPMG.

# How KPMG can help



Direct-to-Consumer streaming services create tremendous opportunities in the B2C product space. At the same time, the services introduce new finance, tax, marketing, and operational requirements.

Our media and entertainment influenced capabilities help clients redefine customer strategies, manage tax implications domestically and internationally, optimize operational models, define profitability metrics, and transform finance departments to handle the implications of the DTC model. Our team is made up of experienced finance, tax, operations, and technology professionals who specialize in helping media and entertainment companies drive value from DTC.

Drawing on our deep experience and forward-looking perspectives, we understand that DTC will escalate the performance of many companies while being a drain on others. Those that do not consider all five elements of customer, international complexity, operations, revenue models and finance transformation will find difficulty in reaching sustained profitability and success. We work with media and entertainment companies to develop, deliver, and support DTC transformations that are required in this new market.



## Strategy

- Establishing a DTC strategy and operating model
- Evaluating customer interactions and targeting audiences with content
- Developing a value chain and organization that organizes production through provision
- Assisting management with defining their DTC revenue model



## Customer

- Defining the end customer, their behaviors, and analytics to identify them
- Incorporating protection of customer data with seamless engagement and customization
- Developing an end customer support and service channel
- Using the data on customers to maximize profitability



## Finance and Tax

- Transforming the finance function to handle the complexities and speed of the DTC model
- Defining title profitability from ancillary services and purchases rather than just performance
- Devising the most efficient international tax strategies and executing their implementation
- Automating the finance and tax functions to handle millions of transactions
- Developing an operating structure that incorporates rights ownership, taxes, and transfer pricing

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