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HBO NOW: Watch Out, Netflix!

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Introduction

Its claim to freshness and innovation had faded. Its slogan once proclaimed a vision of uniqueness: "It's HBO. So Original" (Home Box Office, 2015), but did it still? Was broadcasting company Home Box Office (HBO) truly different in today's entertainment market, and was the difference key to its success? In 2013, the Nielsen Company estimated that 28.4% of homes in the United States received HBO, 4% more than both STARZ and ShowTime, its closest premium cable competitors (Seidman, 2013). The entertainment industry was changing rapidly, though, and HBO needed a new strategy to ensure its continuing competitive advantage. In late 2014, the premium cable network announced its intention to enter the video streaming market with a new service, HBO NOW (Thompson, 2014). Would it be enough to keep HBO ahead of the competition?

History

Lured by the promise of distribution by satellite to multiple cable television provinces, cable mogul Charles Dolan first imagined HBO in 1971 (Edgerton & Jones, 2013). While his satellite distribution scheme was far from ready for testing and implementation, Dolan nonetheless convinced Time-Life to fund his new initiative. From this partnership HBO was born, not as the media conglomerate that it is now, but as a single channel distributed locally in Pennsylvania. It began with just 20,000 subscribers. Gaining popularity was an uphill battle for HBO and Time-Life, later known as Time Warner.

HBO's initial step was not only technologically innovative, but it was strategic as well: HBO became the first channel in the world to deliver content via satellite (Edgerton & Jones, 2013). It allowed the company to broadcast not only in Pennsylvania and nearby states, but eventually nationwide. Drawn by the relentless march of its advanced technology, all U.S. cable providers carried HBO by 1980. In 1981, to keep up with its new "pay television" competitors, HBO switched from a 9-hour per day broadcast schedule to a 24-hour per day schedule. The company filled the additional hours with original programs, movies, and children's shows.

The variety of programming offered by HBO soon became problematic, though, with numerous lawsuits contending that HBO and other innovative cable channels provided content inappropriate for all audiences (Miller, 2008). These accusations ultimately led HBO to become

the first channel in television to encrypt its signal, which resulted in many cable subscribers losing access to the channel (Edgerton & Jones, 2013). Backlash was instantaneous. Customers who had previously received the channel were outraged at its disappearance, and at the idea that they now had to pay additional money to access the channel and its original programs. This was the first step toward today's current premium cable market.

Since the transition to encrypted paid television services, HBO has continued as a creative leader in the premium cable market (Edgerton & Jones, 2013). Along with Cinemax, HBO was one of the first providers to offer multiple channels of its network. HBO2 and HBO3 were offered to HBO subscribers and extended the networks ability to air original content. In 1994, HBO became the first channel to transmit digitally. Throughout the 1990s, HBO became increasingly prominent in popular culture. Its original programs won several Emmy and Golden Globe awards, making HBO not only a premium cable competitor but a powerhouse in the general broadcasting market.

HBO has remained true to its founding principle—original content offered commercial-free and 24 hours a day. The broadcasting company has been a continual source for home viewing of box office hits (Edgerton & Jones, 2013). Since the 1980s, HBO has thrived as a pay premium cable channel, offered through all cable broadcasting companies. HBO's High Definition channel has continued to produce original television hits, such as the *Sopranos*, *The Wire*, *True Blood*, and *Game of Thrones*, among others. These hits and their strong followings have garnered over one billion dollars of annual earnings for HBO, along with numerous award nominations and wins.

Modern Day Television

When HBO was founded in the 1970s, television offerings were limited. At that time, customers desiring access to proprietary cable television programs could only purchase access through cable providers. Furthermore, cable content was distributed solely through stationary television sets. By the early twenty-first century, this was no longer the case.

The Nielsen Total Audience Report (2014) documented a shifting national trend toward alternative technological platforms for viewing content. Instead of relying solely on their televisions to receive video content, consumers were increasingly gaining access to preferred material through devices such as iPads, laptops, and gaming consoles. Streaming services such as Netflix made viewing content across alternative devices easy for customers.

Technological innovations and cultural shifts have caused significant changes, both evolutionary and revolutionary, in the TV and cable industry. On the supply side, new technologies lowered the cost of streaming video and eliminated the need for distribution channels, facilitating new entries into what had been a relatively closed industry. On the demand side, consumers switched their practices to individualized experiences accessing video everywhere, using the Internet instead of a regular TV. Suddenly, HBO—the historical leader in television and cable—found itself surrounded by other firms capable of pushing out new and innovative solutions to consumer preferences in ways that completely disrupted HBO's existing business model.

Americans were no longer limited to the traditional, high-priced cable packages offered through Comcast, DishTV, Verizon, or other cable companies; and many more individuals opted for the consumer-focused option of streaming services by companies such as Hulu, Netflix, and Amazon Instant Video (Strangelove, 2015; Baccarne, Evens, & Schuurman, 2013). Trends in earnings reports (see table below) revealed that customers were shifting from classic cable providers to streaming services. Customer-focused streaming providers, such as Netflix, allowed viewers to watch what they wanted, when they wanted it, and for significantly lower subscription costs. The new choices led many younger generation subscribers to cut the cable cord.

Table: Comparing Revenue and Subscribers in the First Quarters of 2008 and 2015

Company	2008-Q1 Revenue Increase	2015-Q1 Revenue Increase	2008-Q1 New Subscribers	2015-Q1 New Subscribers	2015-Q1 Total Subscribers
Comcast	14.0%	2.6%	494,000	199,000	22,400,000
DirectTV	14.0%	6.0%	275,000	60,000	20,200,00
Verizon Fios Wireline	9.6%	4.0%	263,000	133,000	5,800,000
Netflix	8.0%	31.7%	764,000	23,000,000	40,000,000

(Comcast Corporation, 2008, 2015; The DirectTV Group, 2008, 2015; Netflix, 2008, 2015; Verizon, 2008, 2015)

Moving HBO into the Future

The fact that HBO could only be purchased through cable companies imposed some limitations on its market. While cable customers only paid $10 more each month for access to HBO programming, those without cable needed to pay significantly more—they had to subscribe to basic cable before they could subscribe to HBO. With additional choices of brands, services, and prices, consumers increasingly sought innovative ways to watch video content without the expense of cable or satellite subscriptions. How could HBO reach this new generation of cord cutters? HBO believed it found the solution in HBO NOW.

In March of 2015, HBO announced that it would begin offering HBO NOW, a standalone streaming service that it had developed through a new business partnership with Apple, Inc. (TimeWarner, 2015, March 9), and that it was branching out from its existing cable broadcasting company. HBO had decided that its streaming services should be partnered with a technology brand, and who better than Apple to help reach a younger generation? HBO's opportunistic CEO Richard Plepler was drawn to pursue this strategic alliance based as much on Apple's ethos as on its technological prowess: "Culture eats strategy for breakfast" (LaPorte, 2015, p. 85). Apple's extraordinary marketing successes also attracted HBO (Frankel, 2015, March 9). Apple, after the introduction of the newest iPhone, broke nearly every record in profitability. In 2014, Apple was deemed to have set a new mark for the most profitable quarter ever reported (Apple, 2014). Apple, like HBO, had also struggled in the competition over TV streaming, and wanted to propel Apple TV (LaPorte, 2015). With over 50% of American adults and 60% of American teenagers owning an Apple product, it is easy to see why HBO chose to offer its streaming services, HBO NOW, exclusively through Apple for the first three months of the product's launch (TimeWarner, 2015, March 9).

Under the terms of the deal, people paid for HBO NOW service using their Apple logins—the same way they paid for songs on iTunes—and accessed HBO NOW through Apple TV or other Apple devices (Hagey, 2015). The cost of subscribing to HBO NOW was set at $14.99 a month—slightly higher than the cost of HBO to a current cable subscriber. Apple and HBO agreed to market the products together, while Apple handled billing inquiries (Hagey, 2015).

Since 1971, HBO had adopted a business model based on partnerships and product differentiation to limit the impact of rivals' responses to its own decision making. But with HBO NOW it had to compete "against firms who specialized in delivering digital content exclusively and, in some cases, had control over the devices on which that content was viewed" (Frick 2014). According to Frick (2014), the exclusive streaming partnership with Apple strengthened HBO's ability to distribute its contents; at the same time, it reduced the strategic options of its competitors.

> *HBO will likely pick up short-term revenue from cord-cutters eager for its content, but inevitably the move puts it up against a new set of competitors like Netflix, Hulu, Amazon, and even YouTube. HBO may be in a strong position in terms of content, but it faces new challenges in distributing it (Frick, 2014).*

The price of HBO's new streaming service—$14.99 a month—was much cheaper than a cable subscription, but more expensive than the historic cost of HBO to existing cable subscribers (TimeWarner, 2015, April 7). For decades, high fixed costs and the need to access limited distribution channels had limited the number of firms in the premium cable industry. Indeed, in many markets where people had only a single cable provider, HBO had operated as a monopoly. More recently, the market structure changed with companies like Netflix, Hulu, Amazon and YouTube (Google) using the Internet to convey much of what cable television offered in its cable packages. This new market environment placed HBO in direct competition with a small number of firms offering similar products nationally and internationally. In this new oligopolistic environment where decisions of one firm impacted the profits of others, HBO's strategic decisions about price were likely to evoke a response from one or more of these rivals.

HBO anticipated a significant increase in its subscription numbers, which along with its partner network Cinemax, stood at 138 million worldwide (Seidman, 2013). HBO hoped to become a compelling presence in the market already dominated by Netflix, who held 59 million worldwide subscribers. HBO estimated that the HBO NOW launch would be followed by approximately 1 million subscribers in the first two months (Time Warner, 2015, March 9).

Strategies to maintain a competitive advantage in an oligopoly market required more ingenuity than decisions in a monopoly market. In an oligopoly, firms influenced each other in myriad ways. So it was rational for HBO to expect that its competitors would do the best they could, given what HBO was doing. Although all major firms in the cable industry offered somewhat differentiated programming, decisions made by one firm were also likely to impact the profit of the others firms in the industry. As a result, every firm in the industry scrutinized reactions of its rivals when changing policies or making business decisions. For example, on June 10, 2015, Matthew Blank, CEO of CBS Corp., announced that Showtime would start offering its over-the-

top (OTT) services at $10.99 per month in the summer of 2015 (Blank & Bond, 2015). Shortly thereafter, Verizon announced plans to launch its GO90 mobile services in the fall (Moritz, 2015).

The increased competition put pressure on future prices for Subscription Video on Demand (SVOD) services. BGR, an Internet news site, reported a HBO consumer survey launched in the summer of 2015 that hinted at a possible price reduction for the subscription of HBO NOW to under $10 per month (Epstein, 2015). Pricing decisions made by HBO in this new oligopoly environment depended on many factors, including eased entry to and exit from the market, level of product differentiation, and intensity of rivalry. Traditionally, firms operating in an oligopoly environment spent significant resources on identifying dominant strategies and Nash equilibria to support their own strategies. By setting an initial price that was significantly higher than rivals' prices, HBO signaled its intention to compete based on product differentiation, expecting that consumers were willing and able to pay a premium for its original programs. If prices were lowered to under $10 per month, it would signal that a policy based on low-cost may be needed to retain profitable customers and accomplish its immediate subscription goals.

Next Steps

New opportunities and challenges loomed on the horizon for HBO. Should its expansion into streaming-only services be as successful as anticipated, it would be left with a decision on whether to remain connected to cable companies or to cut all ties for a standalone service only. With increased demand for its new product, HBO NOW, it was also likely that access would eventually move from Apple products only to various other technological platforms.

On the other hand, video streaming anytime, anywhere, opened markets to millions of consumers around the world where the price elasticity of demand may be very different than the price elasticity for most consumers in the U.S., creating opportunities for differential pricing in segmented markets where different target consumers can be charged non-uniform prices for the same product. However, differentiating pricing strategies would also require changes in the exclusivity deal with Apple.

HBO's strategic alliance with Apple was more than just a calculated risk. Time Warner CEO Jeff Bewkes saw it as "bet on quality, bet on design, and let the economics follow" (LePonte, 2015, May, p. 56). With questions of partnerships, market, and price strategies still unanswered, what would the future hold for HBO and its competitors?

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