When the M&E industry keeps evolving, how can companies pursue profitable growth?

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Media and entertainment (M&E) companies must develop effective differentiation strategies while balancing growth and profit ambitions in an increasingly challenging environment.

A thematic shift is underway in the media and entertainment industry as companies adjust away from an aggressive investment and expansion mindset, most notably in streaming media, and refocus on a more disciplined growth agenda. Intensifying competitive pressures, an uncertain economic outlook and evolving consumer behaviors are all serving as catalysts for M&E change.

External forces: Macro weakness impacting consumer spend and advertising

EY economists expect the US economy to enter a recession in 2023, impacting consumer spend as discretionary income shrinks. As the pullback materializes, M&E offerings — many of which are considered expendable by consumers during tough times — face headwinds. Cord-cutting continues to accelerate as households move to lower-cost or free streaming alternatives. Advertising revenues are under stress as marketers reduce their spend in response to the softer outlook. Even streaming growth slowed in recent quarters. Savvy — or cost-conscious — subscribers have learned to churn on and off platforms, taking advantage of the flexibility promoted by direct-to-consumer (DTC) players to manage the monthly outlay for entertainment content.

$70b

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Industry forces: As legacy M&E models fade, will new-generation businesses produce profitable growth?

The secular decline of the linear content delivery model — the industry's cash flow engine — is beginning to strain the financial results of the major media companies. At the same time, the industry has moved with urgency, spending tens of billions of dollars annually to build and scale streaming services on a global basis. Following a burst of new service launches over the last five years, streaming revenues for the companies that publicly release financial information via securities filings and/or company press releases now total nearly $70 billion a year in the aggregate. The growth of streaming as an attractive substitute for pay TV has, in effect, accelerated the very cord-cutting that is pressuring the industry's longtime reliable linear profit machine.

Until recently, the streaming formula was relatively straightforward: Launch the service, spend heavily on fresh content, draw in subscribers and watch the stock price soar. However, by early 2022, competition intensified and the market fragmented. Some streaming services reported subscriber losses, while others experienced sharp slowdowns in growth as markets appeared to plateau — especially the US.

Financially, while revenue growth was impressive during the DTC launch phase, profits were a somewhat distant vision for many industry leaders. Investors took notice of the cash burn triggered by the capital investment needed to build a scaled streaming service. They began to focus less on subscriber counts and more on the long-term prospects of the transformation underway in the industry and its impact on company valuations. A reset was in the making.

M&E companies need to chart a new way forward

The EY team recently partnered with global economic forecasting firm Oxford Economics to survey 150 M&E senior executives to understand the current industry imperative further and inform our outlook and perspectives for 2023. The participating companies ranged from $100 million disrupters to multibillion-dollar industry giants. By type, the survey included companies from nearly all industry subsectors. The research explored the opportunities and challenges M&E leaders face today and their priorities as they pivot from a growth-above-all mindset to an approach that balances growth with profitability and cash flow generation.

Overall, based on our EY industry experience and insights from our targeted executive survey, we believe that M&E companies should focus on the following four key themes:

1. Reinvention is a never-ending process that requires both strategy and execution excellence.
2. Customer centricity is the core organizing principle.
3. Operations must be structured to support scale and profitability.
4. For many players, portfolio optimization and industry consolidation will be essential to improve competitive positioning.

Chapter 1

For M&E companies, reinvention never rests

If strategy is the blueprint for reinvention, execution powers its construction.

The economic and demand factors facing M&E companies today are forcing management teams to develop strategies that address disruption and refine the organizational structures and processes necessary to bring those strategies to life.

Planning and execution must be dynamic in today's fast-moving landscape as consumer habits shift, competitors launch new offerings, and investors seek financial performance that balances growth and profits.

Clarity and uncertainty

Our survey revealed that 84% of M&E leaders have clarity about the strategic objectives for their companies, and 65% have developed a comprehensive strategic plan to achieve their goals. However, uncertainty remains elevated across the industry and within the C-suite. Nearly half (47%) of M&E executives believe they must reinvent their business model to meet the challenges and opportunities of the market today.

Q

To what extent do you agree with the following statements about your business strategy?

Consumer is in control

The need for reinvention is powered in large part by changing consumer preferences and behaviors. A majority (64%) of respondents to our survey say their customers no longer want to interact with legacy media business models that seem outdated today, while 51% think the way they engage with customers will be different in the future. Over half of M&E leaders (53%) indicate that they intend to act over the short term to diversify their company's business mix and update their go-to-market proposition to capture new growth opportunities.

Alignment is essential

Aligning business unit teams and corporate functional leaders to a shared strategic vision is a priority for media executives — the best strategies will not succeed without buy-in from across the enterprise. Nearly two-thirds (63%) of our survey respondents from the largest M&E companies (over $10b in annual revenue) say that achieving company-wide support on strategy is a critical initiative over the next 12 months. This is true, especially for diversified media companies operating distinct divisions that face differing growth outlooks, cash flow trajectories and investment requirements, potentially creating internal tension and competition for resources.

Measuring progress

Assessing performance against goals and targets set in the strategy is an important driver of effective change. Overall, 45% of M&E leaders and 60% of the industry's largest players state that designing and tracking key performance indicators (KPIs) is a priority for the year ahead. A refined set of KPIs, particularly around customer behavior (e.g., engagement, churn), provides management teams with the visibility required to enable confident and fast decision-making.

When considering longer-term investments, more than half (51%) of M&E leaders say they struggle to measure ROI accurately. Capital intensity is rising throughout the media industry as companies push into new markets. To understand the value-creation potential of major capital outlays, management teams are working to construct analytical frameworks that reflect the evolving economics of media.

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Chapter 2

Customer centricity is the principal driver of nearly all efforts

M&E companies have intensified their efforts to adapt to changes in consumer expectations and consumption trends.

Providing a valuable experience — encompassing fair pricing, appealing products and services, and convenient support — is critical to winning and retaining customers.

Delighting customers has become even more important as large components of the media industry have moved from wholesale distribution to direct-to-consumer relationships and switching costs for the customer have evaporated.

Q

To what extent do you agree with the following statements about your customers?

The customer is everything

Our survey shows that customer centricity has become the organizing principle underpinning M&E strategic and operational initiatives. Nearly all respondents (90%) say that their transformation efforts are designed and implemented with the customer in mind. But despite the strong focus on improving the customer experience, 40% of M&E executives say they do not fully understand their customers today. The opportunity to unlock benefits is based on a better understanding that the customer is there for those companies willing to invest.

Bundling to improve engagement and retention

In a DTC world where consumers have the power to sign up and churn off streaming services at will, M&E companies are highly focused on increasing engagement with their content and platforms to strengthen the customer relationship. According to our research, 52% of M&E executives are prioritizing the launch of bundled offerings. In streaming, this includes consolidating distinct streaming services into a single app populated with a more robust content offering and delivered at an attractive relative price. The trade-off of building a supersized streaming app, with associated savings in technology and marketing spend, is the potential cannibalization of distinct, overlapping subscriber bases that exist today. M&E leaders are weighing the benefits of reducing fragmentation, rationalizing the marketplace and leaning into bundles.

Going beyond the pure streaming bundle, 51% of M&E leaders plan to invest in omnichannel customer experiences. To further strengthen the customer relationship and raise switching costs, media companies aim to attach to their streaming bundles other services from within their business portfolios or partners.

Data is vital

Understanding who your customers are, how they behave and how to reach them is essential to success in a customer-centric environment. 65% of respondents say that accessing data and improving the visibility of data is a top opportunity in the next 12 months. Yet only 58% of M&E companies say they fully use available data to inform decision-making. Despite the need, about half of respondents say building or enhancing customer data capabilities is not a critical priority for their organization. Investing in analytics capabilities to turn raw data more quickly into actionable insights and upskilling the talent base to capture the benefits of information are critical going forward.

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Chapter 3

Transforming business operations to support scale and improve profitability

As M&E companies reinvent their businesses and double down on customer centricity, they also need to transform their business operations to support responsible growth ambitions.

Transformation efforts will span the entire enterprise, ranging from finance, analytics and digital operations to engaging with the workforce differently so that employees are motivated and productive.

Transforming the operating model provides the foundation

Effecting a shift to profitable growth begins with a transformation of the operating model. M&E companies are revamping guiding principles across key dimensions such as their go-to-market approach, global vs. regional considerations, centralized vs. decentralized decision rights, and how their operating model impacts business functionality across people, processes and technology. About 50% of our survey respondents indicated that increasing efficiency and reducing costs are critical to achieving their goals. Furthermore, approximately two-thirds of those executives said they are prioritizing related initiatives over the next year. Examples include 65% taking steps to simplify the organization and 40% exploring a transition to centralized support services.

In parallel, companies need to act quickly to improve financial results. Approximately 50% of survey respondents stated that they are looking to improve working capital management to bolster their cash position. In addition, many more are identifying areas of opportunity to reduce discretionary spend. Now is the time to evaluate corporate functions, support models and organizational designs to build the right operating model to support future growth.

People deliver the results

We are seeing significant changes across the talent marketplace and the growing importance of employee experience and engagement models across the workforce. To successfully transform operations, it is critical to attract, develop and retain top talent. As we know, strategy without execution is meaningless, and execution without the right people is impossible. However, over 50% of our respondents feel their workforce has inadequate skills and that ineffective training is a substantial barrier to executing transformation initiatives. Interestingly, there is a gap in how that translates to employee investment. Only 12% of our respondents said that investing in their employees is an important element in achieving their strategic goals. M&E companies that take action to invest in that development can increase the likelihood of a successful operations transformation.

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Challenges in innovation and transformation

Share of participants who consider extremely/very significant

52% Inadequate skills and training

51% Inability to measure return on investment (ROI)

39% Lack of leadership buy-in and prioritization

39% Lack of understanding the customer

38% Lack of investment capital

36% Burden of legacy systems/processes

35% Absence of feasible strategic partners or business alliances

Chapter 4

What's next for media and entertainment companies?

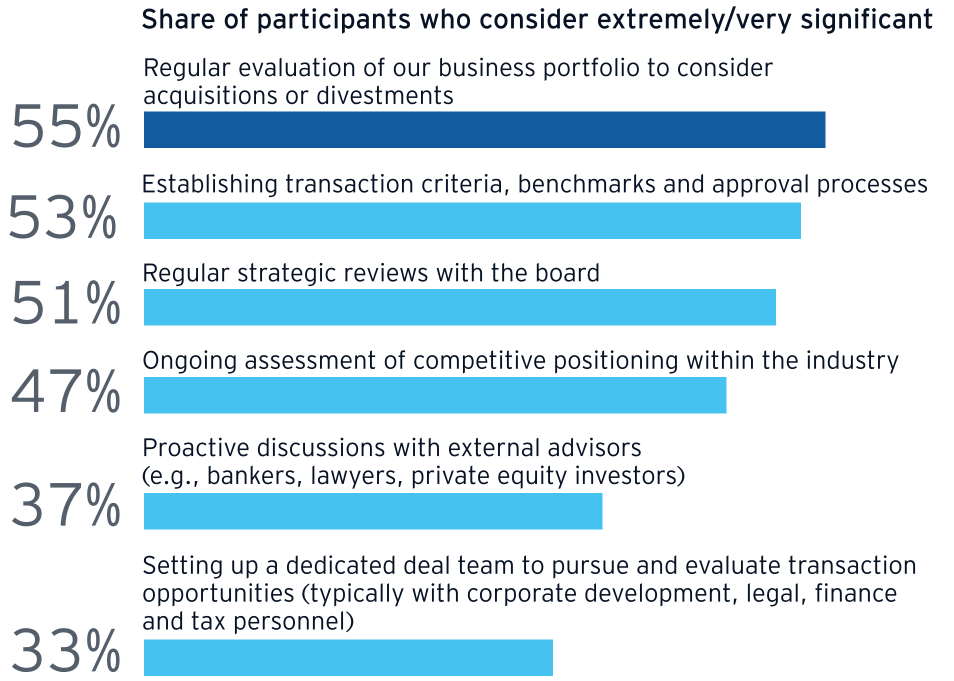
For many, portfolio optimization and industry consolidation will be critical to improving competitive positioning.

In addition to direct business model changes in both the front and back offices, many M&E companies are evaluating various M&A opportunities, including acquisitions, divestitures and partnerships or other strategic ventures.

Cost synergies from business consolidation are an important source of cash to fund future product and service investments. In the past year, strategic activity across industry sectors has slowed, partly due to difficult conditions in capital markets and regulatory uncertainty. However, we believe that the companies that are ready and willing to pursue deals will position themselves for midterm and longer-term success.

Q

To what extent has your organization prioritized the following steps towards engaging in M&A activity?



Connecting M&A with business goals

The heightened role of customer centricity is consistent from an M&A perspective as well, with 75% of executives saying customer satisfaction is top of mind when considering deals. With the challenging economic environment and deal market downturn, executives are wary of making large strategic moves; those that have a clear view of customer outcomes arising from M&A have an edge in the competition to create differentiation and separation in the market.

> "We are seeing a proliferation of commercial agreements, joint ventures and alliances across both large and small M&E companies looking to build capabilities or enter new markets on a quick and capital-efficient basis.

Alliances emerging as an appealing alternative to M&A

With M&A more difficult to pursue and the era of cheap capital seemingly in the past, companies are considering other inorganic growth options. Over 50% of our respondents stated that forming partnerships is necessary to realize their long-term goals. We are seeing a proliferation of commercial agreements, joint ventures and alliances across both large and small M&E companies looking to build capabilities or enter new markets on a quick and capital-efficient basis.

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Evaluate now, and be ready to execute tomorrow

Linking strategy to execution is not easy. Continuously evaluating the market and identifying opportunities that support your short- and long-term objectives are critical precursors to moving with conviction when the time is right. Being iterative and purposeful in considering M&A and partnership opportunities is top of mind: 55% of respondents say they conduct ongoing evaluations — allowing them to be ready to execute deals — with 60% likely to engage in such activity over the next 12 months.

Disruption fuels the media and entertainment industry. Innovative technology, changing consumer habits and the emergence of fresh competition all force M&E leaders to become comfortable operating within a dynamic and uncertain environment. By embracing reinvention, focusing on the customer, prioritizing disciplined business execution and remaining strategically nimble, M&E companies will be well-positioned to achieve sustainable and profitable growth.

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