Daniel Konstantinovic

The Daily: How Netflix's bets on ads, sports, and live experiences will pay off

Audio

On today's podcast episode, we discuss how Netflix's ad business is coming along; the streaming giant's first live sports broadcast; and its new retail, dining, and live experience destinations. Tune in to the discussion with our analyst Daniel Konstantinovic.

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Episode Transcript:

Marcus Johnson:

Ever heard of a clustomer? It's the result of marketers grouping customers with different behaviors into one big mass. But with Mailchimp, you can use realtime behavior data to personalize emails for every customer based on their browsing and buying behavior, turning your customers into customers. Intuit Mailchimp, the number one email marketing and automations brand. Visit mailchimp.com/personalize for more information based on competitor brands. Publicly available data on worldwide numbers of customers in 2021, 2022. Availability of features and functionality vary by plan, which are subject to change.

Daniel Konstantinovic:

So it really benefits them to have as many new people or just as many people as possible on the ad supported tier. So I think that's the goal. I think you widen the gap between ad free and ad supported TV or streaming rather, and you get a lot of people on the ad supported tier, which makes Netflix more money.

Marcus Johnson:

Hey gang, it's Thursday, October 26th. Daniel and listeners, welcome to the Behind the Numbers Daily: an e-Marketer Podcast. Made possible by Intuit Mailchimp. I'm Marcus. Today I'm joined by one of our analysts on the marketing and advertising briefing based in New York City. It's Daniel Konstantinovic.

Daniel Konstantinovic:

Hello. Thanks for having me.

Marcus Johnson:

Hey fellow, welcome to the show. Today's facts, where did the term freelancer come from?

Daniel Konstantinovic:

Oh, I feel like I might know this one. Either I'm going to know it or I'm going to be really off base. It's like a Ye olde like medieval term, right? Wasn't it for a night, a wandering night or something like that?

Marcus Johnson:

Yeah, pretty much there, mate. According to Merriam-Webster.com, freelancers originally referred to self-employed, sword wielding mercenaries. So literally freelancers. If that's true, why the hell are we still using this term?

Daniel Konstantinovic:

Well, when you're at a cafe and you're writing your pitches to send out to magazines and stuff like that.

Marcus Johnson:

With your second monitor.

Daniel Konstantinovic:

With your second monitor, yeah, people hate you. You need to sound cool and freelancer sounds cool.

Marcus Johnson:

That's true.

Daniel Konstantinovic:

You can be like... I'm just like back in the day, typing my silly little words.

Marcus Johnson:

Yeah, on my laptop without my swords. Swords is cooler. Bring the sword.

Daniel Konstantinovic:

Swords are cooler.

Marcus Johnson:

Bring the sword. Who are we kidding? Don't bring the sword for the love of God. Today's real topic, how Netflix is trying to make more money. Please place your bets. In today's episode first in the league. We'll cover everything going on with Netflix at the moment, no in other news today because we've got too much Netflix to consume. Danny, let's talk about the streaming giant and how they're doing. A lot to cover here, but I'll start with a broad question so you can take us in the direction that you want to. What is Netflix's biggest challenge at the moment?

Daniel Konstantinovic:

I wrote two things here. I feel like the biggest challenge in the immediate future is what they're going to do at Upfronts in the spring, which is this big advertising trading season when all the streaming services and TV networks give their pitches to advertisers. This is why you should buy ad space on Netflix.

Marcus Johnson:

What made you write that down?

Daniel Konstantinovic:

Well, we've been writing a lot about it because of the writer's strike and the fact that there's still an actor strike and the writer's strike closed kind of at the tail end of a fall TV production window. That means that it's going to be really, really hard for Netflix and others to create enough new content to trade on meaningfully in the spring. They're going to have to rely a lot on reality content or live video potentially, which is something we're going to mention later. But yeah, that's going to be really tough for them.

Marcus Johnson:

It does feel like they've missed their window. So like you mentioned, writers strike, they worked out a deal there, actor strikes still ongoing and negotiations have broke down recently between the actors in the studios. Studios say it's because of a viewership bonus the actors want. The actors say it's also because of an 11% rise in basic wages that the studios rejected. Alicia Wilkinson and Emily Stewart of Vox were saying they think if an accord isn't reached by the end of October, so in a few days it will likely end the studio's chances of salvaging the 2023, 2024 TV and movie season. Danny, it's hard to wrap your head around the fact that the writers strike start, which is now finished, but the actors one's still going on, but all of this started May 2nd, so by November 2nd that would mean the industry would've been on hold for half a year and it doesn't seem like we're close to them ending the actors strike, so tack on however many more months you wanted to that half a year, with the six months we've had already.

Daniel Konstantinovic:

Exactly. And the writers strike ending first almost benefits the struggling TV companies more because they can bring back things like SNL or Late Night. They don't need SAG in order to produce those shows, which are their biggest money makers. But yeah, the 2024 upfront season is really, really important for Netflix because it's going to be the second or maybe even third time that they've gone through these rounds of trading with advertisers. But this is when their ad business is really ramping up, right? They've done password sharing, they've raised the prices for other ad-free tiers. So coming into 2024, they really need a strong slate of content to attract advertiser spending, especially since all the other streaming services have live sports deals that Netflix doesn't have to get advertiser interest. Netflix is relying pretty much entirely on the premium scripted content, whereas if Apple doesn't have season two of Severance, they have the MLS that they are paying billions of dollars every year for, or Amazon has Thursday Night Football or whatever else. Netflix doesn't have that.

Marcus Johnson:

Okay, so you wrote down Upfronts new fronts in the spring and the second challenge?

Daniel Konstantinovic:

Just what the next revenue source is going to be because password sharing, I mean it's been a huge success for them, but it is only going to last so long in my opinion.

Marcus Johnson:

You mean the crackdown, the password sharing crackdown?

Daniel Konstantinovic:

Yes, the password sharing crackdown. So what they've done is they've made it so anybody who is piggybacking off of a mom and dad's Netflix subscription now has to pay for it themselves. It's been a huge driver of subscriptions and presumably to their...

Marcus Johnson:

Seems that way.

Daniel Konstantinovic:

Their ad supported tier, yeah, they added a lot of subscribers, but when that well runs out, what's next? Are they just going to keep endlessly hiking prices? I mean maybe, but it can't be the only thing, $1 or $2 every year. It's not really going to do for their revenue picture what they want it to do. It does not result in endless growth just pumping it up by $1 every year.

Marcus Johnson:

Yeah. Let's talk about the password crackdown for a second. So Netflix at least said that its effort to limit password sharing has helped it grow users, as you mentioned, 11%. They grew users in Q3 year-on-year. That means they added nearly 9 million new total subscribers in the quarter with growth across all regions. That near 9 million that they added is the largest quarterly customer gain since that ultra boost they got in Q2 2020 because of the pandemic. So pretty impressive and same for the US and Canada. Actually best numbers since that quarter Q2 2020. This Q3, they added 2 million new folks in the US and Canada. And Danny through three quarters, Netflix this year, through Q1, Q2, Q3, Netflix has added twice as many new subscribers as they did the entirety of last year and they still got Q4 to go as well. So it seems to definitely be having an effect, but to your point, when does that start to slow down? When do they stop seeing a lot of the windfall from that password crack down?

You mentioned prices as well. So Emma Roth of the Verge explains that Netflix just announced another price hike where you were talking about users on the 9.99 per month basic plan will now pay 11.99. Those paying 19.99 for the premium will have to pay 22.99, so that goes up a few bucks. But Netflix's ad supported plan like you mentioned, and also their $15.49 standard tier will stay the same. How do you see this price increase playing out?

Daniel Konstantinovic:

Well, I think Netflix, with all these new subscribers coming in due to the password sharing crackdown, I think they're trying to get as much out of them as possible. And if you think about who these people affected by the password sharing changes are, it's people who probably are not willing to pay a premium for streaming, right? It's people who were trying to get it for free, maybe because they don't want to budget it in, they can't afford it. So to them, especially with the ad free tiers getting more and more expensive because of these price increases, the result is going to be a lot of new subscribers for the ad supported tier, and that is Netflix's big goal because the more people they have watching ads, the more they can demand for ad space.

The ad supported tier has a much higher revenue per user than the subscription tier because what if you're a premium subscriber, you pay like 16, $17 a month to Netflix, but if you pay for the ad supported tier, you're paying a smaller monthly fee, but Netflix can make so much more money on that ad space, so it really benefits them to have as many new people or just as many people as possible on the ad supported tier. So I think that's the goal. I think you widen the gap between ad free and ad supported TV or streaming rather, and you get a lot of people on the ad supported tier, which makes Netflix more money.

Marcus Johnson:

Right. Yeah, they got rid of their basic ad free plan to widen that chasm between the ad free, which is more with ads, which is a fair amount less. And so now you're encouraging people onto that cheaper option because as you said, you get more out of them on a per user basis. And Warner Bros. Discovery recently made a similar tactical move as well raising its ad free tier by $2 whilst keeping its ad supported tier the same price to try and do the same thing. Also, they need to make more money, so the price increase kind of makes sense because they need to make more money to pay for higher writer wages, which are part of the deal resolving the writers strike.

And they also need to pay for a big content push because when they've saved money this year because production has stopped, but they're going to have to ramp it back up and pay some and then some to be able to get it back on track. Danny, surprising that Netflix last raised prices in January 2022. Seems like it was yesterday, but that's because a lot of other people have been raising prices as well.

Daniel Konstantinovic:

We predicted on the M&A briefing earlier in the year that because of rising interest rates there were going to be a lot of streaming price hikes, but I'm kind of astounded by just how many there have been and some streamers doing it more than once in a year and it's hard to keep track. I thought that Netflix for a second had done it more than once in a year, but yeah, since January 2022, I guess is the last time.

Marcus Johnson:

And I guess with everyone else doing it, it makes it more likely for them to do it because now they can say, oh look, everyone else is doing it. What do you want us to do? They're not the only bad guy.

Daniel Konstantinovic:

Yeah, and I mean you mentioned the writers strike and the extra cost there and the contract that the writers strike ended up producing was one that's going to require not just Netflix, but all the studios who make up the alliance of motion picture and television producers to pay something like 230 million extra per year in wages to writers on average, that was what the WGA said the contract was valued at, and we might be due for a similar one for the actors strike. So that's a lot of extra money per year and it seems that the actors may be asking for something valued even higher.

Because after the most recent breakdown in negotiations, SAG-AFTRA said that the streamers had turned down an offer which would've resulted in about 50 cents extra per subscriber on behalf of the streamers, which doesn't sound like that much at first glance, but then you look at Netflix's subscriber count, which is 247 million and that is over a hundred million, well over a hundred million in extra payouts that Netflix would have to be giving per year. So when that is looming and they have this extra cost because of the writers strike, there is really an urge for Netflix to figure out a higher source of revenues, to squeeze out more wherever it can.

Marcus Johnson:

Yeah, we're talking a lot about their ads tier. What did we learn about how the ads business is getting on?

Daniel Konstantinovic:

Well, they keep some news about this pretty close to the chest, but there's been a lot of good reporting around what Netflix has been doing with its ad supported tier and it's kind of an interesting place. I mean it's certainly doing well and meaningfully increasing Netflix revenues because their income I believe was up 20% year over year in this past quarter, so compared to Q3 2022. So it's doing its job, right? Like password sharing crackdowns and the ad supported tier are making money, but there's also reporting that within Netflix, they're not happy with how much money it's making, that they expected there to be a bigger immediate impact. If you look at the timeline for Netflix's ad supported tier, when they announced it and started having negotiations with advertisers, there were reports that they were asking for record high CPMs, the cost to reach 1000 users, that there were stories that they were as high as $65, which is extraordinarily high. That's extremely high.

Netflix said that's not true, and then numbers kind of settled around like $55, which was extremely high. Warner Bros. Discovery was also asking for that. And then come spring of this year, and there are stories that Netflix is not really happy with how much it's ad supported tier is making. It's not happy with how much it's charging for CPMs that it's had to lower CPMs to around $45 to get enough advertiser interest. And part of that is because it's a tough market right now. Companies are not really willing to spend a huge amount because of high interest rates, but also the market is so saturated. There was huge demand for Netflix to launch an advertising business for years and years and years, but when Netflix finally launches that ad business, Disney has one, Amazon is talking about launching one, Apple is talking about launching one. There's all these competitors and it's no longer just Netflix.

Marcus Johnson:

That's a great point.

Daniel Konstantinovic:

That have spending focused on it. It's being distributed across all of its competitors, so they've had to tone down their expectations and it seems like they're not going to be able to crank things up as high as they want, again this spring because of the strikes and the lack of content, but they do seem to be getting a lot of new subscribers there and more eyeballs just kind of equals more advertiser interest.

Marcus Johnson:

Yeah, tough timing economically, but also competitively, and it does seem as though it's not going as well as expected given how much they've had to bring down the prices of these ads for advertisers. But a point you just made right at the end there about signups, looking pretty good, all things considered. Netflix said memberships to its ad supported plan grew nearly 70% Q2 to Q3. Again, small base, but it's pretty decent growth. Netflix set accounts for the ad plan that's the cheapest tier, now account for 30% of all new signups in the 12 places, 12 countries, it's offered. Netflix is ad supported tier. When you zoom out though not just new signups, when you look at their total subscribers, US 6% ad supported tier accounting for 6% of its total US subscriber base as of September according to Antenna, that's up from 3% at the end of June.

So that share is growing even though it's still small. We expect Netflix to make about $800 million from ads this year in the US, 1.1 billion next year. So it's not a tiny amount of money, but it's nowhere near what they were hoping. Also, Danny new ad offering next year, users binging a show will be able to watch a commercial free episode sponsored by an advertiser, so that's something worth watching on the ad front.

Let's end the lead here, Danny, by talking about a couple of secondary initiatives, if you will. Primarily, they focus on streaming things on demands, but one of their initiatives lives within the realm of live broadcast. So Netflix is getting ready to stream its first live sporting event, which will be a golf tournament between athletes from its Full Swing and F1 Drive to Survive shows airing November 14th at 6PM Eastern if you want to watch. As Emma Roth and Richard Lawler of the Verge explain the competition called The Netflix Cup takes place at the Wynn Golf Club in Las Vegas and we'll see four groups. Each group will have an F1 driver and a PGA Tour Pro, so there'll be four pairs. They'll play an eight hole match, top two teams advanced to a final hole and compete for the first Netflix Cup title. What'd you make of Netflix's first live sports broadcast?

Daniel Konstantinovic:

I think it's going to be really interesting to watch. It seems like Netflix is not... I mean I could be proven wrong here, but it seems like Netflix is not very interested in the really high cost streaming rights deals that are being struck by all these other streaming services in the last year, and so they're trying to find what's their place in the streaming sports world if we don't have access to league games or races. And I think this shows them toying with the idea that we're Netflix, people come to us for premium content, premium scripted content. Maybe they don't come to us for live sports, but they come to us for events related to sports outside of the regular season, so things like this. Drive to Survive the Formula One show and the golf show Full Swing, which is modeled after the Formula One show, which is funny by the way that they seem like such opposites like speed racing and golf.

Marcus Johnson:

[inaudible 00:17:14].

Daniel Konstantinovic:

But these are two of their really big footholds into sports, and because they have that similar format, making something that combines the two of them and brings potentially those two different audiences into one event I think makes sense for them. I'm really curious to see how it goes because their first livestream attempts earlier this year went kind of notoriously poorly, so this is a chance for them to prove that they have the infrastructure in place now after those kinds of early slipups to create a live event that is worth tuning into like this.

Marcus Johnson:

Yeah. Let's move to the gaming ambitions. So Danny, you were recently noting Netflix is gearing up to launch a number of games based on some popular IP, Stranger Things, Black Mirror, Squid Games, reporting from the Wall Street Journal. Where is Netflix at with its gaming ambitions if we zoom out?

Daniel Konstantinovic:

So I would say that they're still in the early stages, but there finally seems to be some movement there. The big question is when will these games be available on TVs? That I think is the really big hurdle that Netflix needs to cross in order to see just how much consumer interest there is from their subscribers for games. The more I think... I was at first very optimistic about Netflix's gaming business. I thought it was a really smart move, but the more time goes on and the more other things in the gaming sector like the Activision Blizzard-Microsoft merger happen, the more I begin to worry that this isn't really going to work out for Netflix. They seem to be very focused on mobile games. I don't think that there is an audience for a subscription mobile game service in the way that there is for a service like Game Pass, which much of the Microsoft and Activision merger kind of revolved around.

I also think that their IPs are not so strong. I mean, I think the end of Stranger Things, which has a final season left is looming very heavily over the service. What is their next big thing going to be after Stranger Things? I don't know. I don't know that... Maybe Stranger Things games that you can play on your TV would appeal to people who are very deeply embedded in Netflix, but is that really appealing to a general gaming audience to drive subscriptions to Netflix or however they imagine gaming fitting into the revenue picture? I'm not sure.

I mean, I'm a big believer in the video game sector and I think it's really interesting, but it's kind of everything these streamers don't want. It's extremely high cost. It has extremely long production times. If you make a show in the fall, if you are quick enough, generally be ready for the spring. But if you start production on a video game, it could take years and years before you see a result, especially as you start to get into higher budget projects or larger scale projects that would really drive consumer interest. So less and less, I'm seeing the ways that it makes sense for Netflix and I don't know, I'm really curious. I would love to be proven wrong. I'm really watching it with a lot of interest.

Marcus Johnson:

Yeah, we'll see. It seemed odd that they were releasing games through the mobile app and not just having it part of your Netflix subscription, which you can just play games from the television, but mobile games does make sense financially because if you look at how people play games in the US, it's a bigger audience in terms of mobile, about 90 to 95 million Americans play games on each of the following consoles, computers and tablets. But those numbers are kind of flat. Nearly twice as many Americans play mobile games, and that number is climbing. How Netflix games are going, there was some research... So Netflix soft launched their gaming downloads through its own mobile app two years ago, according to a survey from research company Savanta, just over 20% of people had downloaded at least one game through Netflix. Nearly 80% said they would do so again, half of folks said, who had not previously heard about Netflix games said that they would give it a try.

Let's move finally, Danny to one other initiative going on. So a quick take from you on this one. Our Zach Stambaugh, you may have heard over on our Reimagine retail show, just wrote a piece noting that Netflix aims to combine retail, dining and live experiences in new destinations. It plans to call Netflix House according to Bloomberg. Zach explains that the concept will feature rotating installations, ticketed performances inspired by popular shows and restaurants, serving food featured on Netflix's unscripted shows, while also selling apparel and other items related to Netflix programming. Netflix plans to open the first two Netflix House destinations in the US in 2025 before expanding worldwide, Zach writes. Danny, quick take, are these Netflix House brick and mortar locations a good idea?

Daniel Konstantinovic:

Oh, I'm not sure. I think it's complicated. I think it's interesting to see Netflix do this. They've been kind of inching this way for a while. In Zach's piece, he wrote that they've experimented with a lot of popups and stuff like that. They have a retail website where they sell merch and goods related to their popular shows, and I think events make sense because there is a lot of movement happening in the event space. There are some big acquisitions that have happened recently. A lot is being spent on live events. And something else I should also add is that it seems like more and more traditional retailers are moving towards this idea that your store is not just a place you shop, but it's a destination, it's an experience, right? And this kind of plays into that idea. The things that give me pause about it, 2025 is really far off, so it's hard to know exactly what it's going to look like or how meaningful it'll be for revenues, especially since it's just two locations that are going to launch in 2025.

The other thing is that I think to really get interest in this, Netflix's brand image is really important. Consumers have to think of Netflix as a brand that they want to engage with, that they want to go to events around, and maybe they do because there are popular shows and popular celebrities attached to those shows that they could center events around. I do think that with these big price hikes, password sharing changes and things of that nature that are not really popular with consumers, and the writers and actors strike, which I think has made a huge dent in consumer sentiment towards a lot of streaming services. I think that the Netflix brand has diminished.

Marcus Johnson:

Interesting.

Daniel Konstantinovic:

And people may use the service very heavily because now Netflix is just synonymous with watching shows and movies. It's like the thing that you do, but I don't know that people have such an attachment to the brand of Netflix. I think it's just kind of something that you use because it's there, maybe even reluctantly use because the streaming experience is just becoming so fractured and difficult to use and hard to find the thing you want to watch. And I wonder, are people really going to be excited to go to the Netflix dining event location? I'm not so sure.

Marcus Johnson:

Yeah, it is kind of similar to the point you made about the ad supported tier and the timing of that release. It does feel as though maybe the timing of these new Netflix House experiences, maybe it's a bit late perhaps, especially by 2025. Maybe they've missed that window. All right, that's all we've got time for today's episode. Danny, thank you so much for hanging out today.

Daniel Konstantinovic:

Yeah, thanks for having me.

Marcus Johnson:

Yes, sir. Thank you. Thank you. Thank you to Victoria who edits the show. James who copy edits it. Stuart who runs the team. And Sophie who runs our social media. Thanks to everyone for listening in. I told Stuart who runs the team, that the Giants are a terrible team still, despite their painful 14-7 win against the Commanders, and he said, shut up Marcus, and just tell everyone that they should join e-Marketer on November 3rd for our next virtual event. Attention trends and predictions for 2024, where our leading analysts and executives from brands like Pepsi, Colgate, Palmolive, and Kendra Scott will explore trends like Gen AI, retail media, and more to help professionals to plan for the year ahead. And go to insiderintelligence.com/events/summit to register today, tomorrow, whenever you want, as long as it's before the event on the 3rd of November. We hope to see you guys tomorrow though for the Behind the Numbers weekly listen. An E-Marketer Podcast made possible by Intuit Mailchimp.