



Hulu, to be or not to be

Los Angeles-based Hulu.com had finished 2008 with impressive growth in both viewership growth and market visibility. The video portal startup, established in 2007 with the backing of NBC Universal and News Corp., had 227 million video views and had become the sixth most visited online video web site. Popular media had taken notice and prominently featured the company. Even the harshest Hulu skeptics, like Michael Arrington of the popular TechCrunch blog, acknowledged its success.¹

But Jason Kilar, the CEO, was cautious about the future. Despite a stellar year, Kilar was concerned about the dynamics in the industry. He had been hired away from Amazon as an outsider to the media industry just over a year ago. At Amazon, Kilar had played a key role in its expansion into home video. He had joined Hulu on the promise that he would be allowed to run the company as an independent startup and not a simple offshoot of the big media conglomerates. Despite, or perhaps because of, this separate existence he had to negotiate aggressively and work through many roadblocks to get the variety of media content now available on Hulu.

He reflected on the inherent tension between NBC's and Fox's current TV and DVD businesses and the on-demand online video offerings of Hulu. Although NBC and Fox had been cooperative so far, Kilar understood the risk of having a business model that was merely a channel for their content with little negotiating power.

Growing viewership and buzz helped Kilar's independent position and the growth needed to be nurtured. On the other hand, lack of profits flowing back from Hulu meant that NBC and Fox could be increasingly concerned. Viewers would be shifting online away from the TV Ads without increasing media conglomerates' bottom line in any way. This meant that they could put limits on the shows available or demand further compensation for the video. In addition, each of the major networks had their own websites that hosted content as well.

Kilar also had to consider the rise of web2.0 sites. YouTube and similar sites had many more than 6 Billion video views across the world on a daily basis. Due to copyright restrictions, Hulu was only available in the US and the lack of active interactivity reduced its "stickiness" in the long run. On the plus side, the premium quality and the popularity of the traditional

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media content made advertisers more comfortable. Hulu was able to attract prime, blue-chip advertisers such as McDonald's, Bank of America and Best Buy.

And finally, the publicity and buzz around Hulu was gratifying but media providers would quickly lose patience if they didn't see a sustained, viable revenue stream. The current ad model was lacking in substantial revenues despite Hulu's ad slots being full as of early 2009.

Kilar knew that 2009 would be a key year for Hulu. To solidify Hulu's independent branding, he approved an advertising campaign that debuted on Superbowl Sunday with the tagline "An evil plot to destroy the world. Enjoy." In April 2009, ABC's parent company Walt Disney Co. joined Hulu as an equal equity partner giving a boost to the viability of Hulu as the main aggregator of premium online video.

Kilar wondered how Hulu should consider all the threats and opportunities that the dynamic and growing online video market provided. Given the limited dollar and human resources at his disposal, he needed to pick one of three paths below which would ensure that Hulu was independent, relevant, and profitable at the end of 2009 and in the years to come.

- (a) **Focus on current online distribution model -- Add more content, and generate higher revenue:** Kilar considered if Hulu should focus on getting higher ad revenue. They could capture more dollars per ad impression through better consumer targeting and by increased number of ad slots within a show. Hulu could also mimic iTunes or Netflix and charge for some of its popular TV shows at, say, 99 cents per episode. Alternately, a subscription model could be created to generate a steady revenue source. Paying consumers could be given access to some shows earlier while retaining the "free" side of the business. How would charging access fees and increasing ad intrusiveness impact viewership?

Hulu could continue to add more content partners and negotiate to have wider and deeper library available for the consumers. They could also go global and negotiate to show US shows abroad and vice versa. US shows are regularly syndicated around the globe but not the other way around. Hulu could capture an untapped ad market for international shows in the US. How could Hulu effectively monetize and grow the net level of revenue for the media companies? Could the media companies start giving preferential treatment to their own video sites over Hulu? Were they allowing Hulu to exist simply to create the market and not to make long-term profit?

- (b) **Focus on other channels of distribution -- Capture new sources of revenue in Mobile and other platforms:** The current internet distribution model is low margin by definition and the content is exclusive to Hulu for only two years. Hulu could look for partnerships or moves into other platforms such as mobile where users are starting to consume videos. Does Hulu have anything unique that cannot be copied or mimicked other than content? Could they be overestimating the online market and investing too much in a technology that might turn into the competitors' advantage? Could Hulu move to a distribution channel, say mobile, where they have greater margins and control over the content owners?

- (c) **Focus beyond distribution model -- Move into value added services and compete with web2.0 sites:** The balance of power rested with the media companies because Hulu operates as a distribution business that requires large scale to be viable and offers slim margins at best. Kilar questioned if Hulu should consider a move beyond a video portal into social networking and create a unique relationship with and between the users. Could this allow Hulu to create new monetization options or get active user feedback that could help shape the programming that the media companies generate and distribute? Will this shift the balance of power to Hulu from the conglomerates which traditionally “selected” the shows that they thought the viewers liked?

Hulu could also allow users to create customized channels where user-created clips from TV shows could be displayed alongside amateur video. This could allow users to create their own channels and following creating a high-level of interactivity and “stickiness” to the site.

An Overview of Hulu

Hulu is an internet video on demand service that offers content through streaming. The service is a joint venture of NBC Universal, News Corp, and Disney. Providence Equity Partners has also made a US \$100 million equity investment and holds a 10% stake in the company. Hulu is in the video aggregation and distribution business and does not produce any professional content on its own. Instead, it distributes the content owned by its major equity holders through its website.

The partnership started with NBC Universal and News Corp. as the main equity holders. It was announced in March 2007 and the name "Hulu" was chosen in late August 2007, when the website went live. According to various sources, the name “Hulu” was inspired by its Mandarin meanings of “interactive recording” and “a hollowed-out gourd used to hold precious things.” In April 2009, Walt Disney Co. took a 27% stake in Hulu becoming an equal partner with NBC and News Corp. As the joint venture between NBC, Fox, and Disney, Hulu has unprecedented and exclusive access for the next two years to the wide library of popular TV shows and movies owned by these companies.

Hulu requires no special software installation and can currently be viewed using popular internet web browsers and the Adobe Flash player, which most modern computers come equipped with. Following the example of many successful websites, the user interface is kept simple. The homepage allows browsing through the latest and most popular videos and enables search through the repository by broadcasting network, studio, popularity, or alphabetical order. Exhibit 1 shows a screenshot of Hulu.

Typically, Hulu has the last five trailing episodes for current TV shows and entire prior seasons are sometimes available for instant viewing. In addition, Hulu provides access to classic TV shows, such as “Remington Steele” and “The Dick Van Dyke Show,” which are rarely available on broadcast and cable television. Older full-length movies from Fox and Universal along with Sony and MGM are also available for instant streaming. Unlike the

broadcast channels, there is no “prime-time” slot and the users can create their own experience at a time of their choosing.

Hulu allows users to create customized clips out of the TV shows and share it with friends. The clips can be embedded in websites, personal blogs, and on popular social networking sites like Facebook and MySpace. Exhibit 2 highlights the younger, more tech-savvy Hulu demographic compared to that of a traditional media company ABC.

Hulu’s current business model depends on generating revenue through advertising connected with the online video. The ads are delivered in many different flavors: video clips that play before, within, and after the video, banners next to the videos being played, and overlay text at the bottom of videos. The in-video clips, which usually run 15-30 seconds, are used for full-length movies and TV episodes while the overlay text and banners are favored for shorter video clips. The total amount of advertising is substantially less than what a viewer would see for the same episode on TV. Typically, Hulu would render 2 minutes of advertising for every 30 minutes of video compared with the average of 8 minutes on a regular television broadcast. Hulu does not release any revenue or profit numbers but the general consensus in the industry is that it is not profitable yet. According to Arash Amel, an analyst at Screen Digest, Hulu generated about \$70 million of advertising revenue in 2008. He estimates that Hulu will earn about \$180 million of advertising revenue in 2009². He also speculates that Hulu is able to sell ads on about 80% of all video streams compared to around 3% for YouTube.

Hulu’s stated goal is to offer a wide variety of high quality content with a sleek, intuitive interface. Current industry estimates are that Hulu retains only 20-30% of its ad revenue with 70% going to the TV network and, if they are involved, 10% accruing to a third party distributor such as AOL or MySpace.³ Other than content, Hulu’s biggest costs are video storage, customer’s web interface, online transmission, and employees. It is betting on the popularity and wide usage of high definition content and utilizing a state-of-the-art Flash-based standard. This has led to a choice of expensive Adobe Flash Media servers along with the high-end Akamai as the content delivery network. This makes Hulu’s platform for delivering online video content 20-40% more expensive than some of the competitors who use other media server technologies, such as Microsoft’s Silverlight, and cheaper content delivery partners.⁴

Some industry experts, such as Henry Blodget who runs the business website “Silicon Alley Insider,” have estimated that the gross profit margin for Hulu, after paying content owners and third parties, was a mere 17% or around \$12 million in 2008.⁵ They conclude that Hulu didn’t make a profit because the gross margin excludes the significant costs of sales, platform development and delivery, and general administrative salaries and expenses. Exhibit 3 shows an estimate of Hulu’s income statement by “Silicon Alley Insider” based on somewhat optimistic assumptions for numbers like average ad sales price (CPM).

In a May 2009 interview at the 4A's Leadership Conference⁶ organized by the American Association of Advertising Agencies, Kilar responded to questions about Hulu’s business model and the prohibitive cost of distributing high-quality digital content by saying:

“If you are a small business, I think margins are very challenging in the online video space. It is also challenging if you don’t have a revenue model associated with your video... Scale makes the difference... [Hulu has] 380 million streams a month and 42 million users a month... When you obsess over an advertising service that really works and you are able to bring reach and size, people care about that... revenue does come in... One of the biggest costs other than the team is bandwidth... We are one of the top customers of services like Akamai and they treat us with that kind of respect... We are a distribution business which means that by nature of that we will have relatively thin margins... Turns out that you can be very good at scale with thin margins and that’s why frugality is so important to us.”

The new video landscape

With the proliferation of broadband internet and cable, additional channels to reach the viewer with video content have opened up. The traditional landscape to reach the viewer along with the changing distribution channels is depicted in Exhibit 4.

Web2.0 video

Web2.0 video sites such as YouTube enable consumers to watch videos uploaded by other users for free. YouTube debuted in 2005 and quickly gained a significant viewership because of the ease of sharing bite-sized consumer generated video clips. According to Nielsen, around 81M people visited the site in September 2008 alone. Despite the popularity, sites such as YouTube, have struggled to find a sustainable business model because of the significant fragmentation of the audience and the huge variance in content quality. YouTube, for example, sold itself to Google in 2006. In addition, YouTube realized the difficulty of generating revenue with inconsistent quality. In the early days, the popular clips on the site were illegal clips from the premium content providers such as NBC and Fox. YouTube benefited from these clips to establish an audience but these clips had to be removed once the copyright owners started enforcing their rights. It moved to upgrade its offerings in late 2008 by signing a deal with Metro-Goldwyn-Mayer Studios (MGM) for some of their full-length television shows and movies.

With the rise of YouTube and other web2.0 video websites, many of the traditional TV clips started being posted by viewers illegally. The instinctive reaction of traditional media was to sue and prevent the posting of their media. However, the difficulty of policing the web and the viewers’ strong preference to access media on their terms proved hard to fight. This led to networks making some of their content available through their own websites.

Companies such as YouTube don’t seem to pose a direct competition at the moment because their main content and value proposition is amateur video and low-quality (sometimes pirated) clips not the high-quality, professionally made TV shows and movies that Hulu delivers for free.

Digital Video Recorders

Nielsen data from July 2008 indicates that 25% of U.S. homes or about 28 million homes have Digital Video Recorders (DVRs). DVRs allow consumers, using a set-top box, to record and play back TV programming at a later time. In addition to viewing time convenience, watching pre-recorded content gives users the ability to skip through the commercials.

Most DVRs are offered by cable providers for a subscription fee of about \$10-\$15 along with a small monthly leasing fee for the hardware. A small percentage of the market players, such as TiVo, also charge about \$100-\$600 as a one-time cost for the hardware. Most of the revenue from the DVR is collected from the monthly fees but a growing percentage is being sourced from mining the viewing data that is available to the DVR service providers.

Some advertisers are wary of the value of advertising on shows that are heavily recorded using DVRs. They fear that the message doesn't reach consumers and create value due to ad-skipping and the time-sensitivity of some of the commercials.

In addition to the DVR efforts, all of the six major cable companies in the U.S. have banded together for "Project Canoe"⁷ with an initial investment of \$150 million. The goal is to create a platform to deliver targeted, interactive, and measurable TV ads to viewers through the cable set-top boxes. Together, the cable companies currently control about \$5 billion of the \$70 billion spent annually on TV ads. With better coordinated ad targeting through Project Canoe, the cable companies hope to triple their share of the TV ad spending to \$15 billion.

Cable Video on demand services

Cable providers such as Comcast Cable now offer video-on-demand service. Comcast, for example, launched its services in 2003 which has proven popular among its subscribers. According to Comcast, their customers had more than 6 billion on-demand views from 2003-2007, averaging about 250 million views each month. Subscribers can choose from movies, music, sporting events, TV shows and specials. Nearly 95 percent of the selections are available to viewers as part of the monthly service fee with no additional charges. The cable providers hope to establish their offerings as the first stop for consumers and to monetize using fees for some of the premium content such as first-run movies.

Traditional cable is married to its traditional way of doing business – where they sell channel packages and pay channels for carrying them. Also, the content is owned by the networks and they can create barriers if cable threatens their revenues or business models.

Cable operators are considering a "walled garden" approach to tackle the threat of online video. The video content would be made available, most likely for free, to cable subscribers. This approach would maintain the value of their current subscription offering while dissuading the users from cutting their cable TV. However, there are potential problems that need to redress before the approach is successful. The main issues are the interests of the content owners and the unclear revenue generation model. The content owners and distributors would want further compensation or greater control over the online distribution of their videos. If advertising is used as in regular cable programming, the users could simply migrate to sites such as Hulu which offer the same content without extensive commercials.

Internet Video on demand services

Internet video on demand services fall into two broad categories: video streaming or video downloads.

Downloadable services allow users to download the video to their own computers or media devices. The content owners control access using Digital Rights Management (DRM) which prevents unauthorized access or duplication of the digital media. The users typically prefer downloads for the ability to have the content always available without the need for an internet connection. However, Forrester has conducted surveys that indicate a real-world preference for streaming over video downloads.

Streaming internet video does not reside on the user's computers but instead on the service provider's data servers and is streamed through a broadband internet connection. Streaming is preferred by content owners because in addition to DRM control, the separation of the content file and the user allows a more robust and permanent access control.

Exhibit 5 shows the comparative data for the major online video sites as of April 2009. The notable statistic is the rapid increase of 490% in the number of streams that were accessed through Hulu between 2008 and 2009.

The increasing prevalence of residential broadband Internet connections in the U.S. is correlated to the rising use of streaming video services. The Pew Internet & American Life Project estimated in 2008 that 55% of U.S. homes, up from 47% in 2007, had broadband internet connections that allow faster connections making video streaming possible⁸. Exhibit 6 breaks down the broadband access by age and highlights the increasing use of broadband by the younger generations who are likely to be the first adopters of new offerings in the internet video space.

In the past few years, new services such as the Apple iTunes store and Amazon Video on Demand (VOD) have begun to offer high quality television shows and films for rental and purchase. Typically, the business model is to charge for a limited time license to view the videos. The content could be downloaded or streamed using an internet connection as the delivery mechanism. Services tightly control access and only allow the transfer of content to a limited number of computers, pre-approved set-top boxes or mobile devices.

According to the NPD group's "Entertainment Trends in America" report⁹ released in 2009, the average home video consumer spent about \$25 per month on various home video purchases and rentals in 2008. The largest share of 63% was for DVD purchases with 9% for video on demand services and 3% for digital downloads and internet streaming. The respondents were also surveyed about their shopping habits. 7% said that they digitally rented a movie for their computers or televisions from an internet service while only 3% bought a digital download of a movie.¹⁰ Of those who digitally rented a movie or show, 68% chose Netflix followed by iTunes at 21%. Of those who downloaded a movie, 65% chose iTunes followed by Amazon's VOD service at 17%.

Apple offers its iTunes users the option of downloading most of the latest movie titles for \$9.99. Short films cost \$1.99 to download. Since 2008, iTunes also allows users to rent a digital copy of relatively recent movies for up to 30 days with a 24 hour window to watch a

movie multiple times. Apple has signed deals with major movie studios to allow its users access to a wide range of new and classic movies. The digital rentals cost \$2.99 for older movies and \$3.99 for the newer movies with an additional \$1 charge for movies in high-definition.

Amazon Video on Demand service became available in March 2007 and was then called “Amazon Unbox.” As of May 2009, it offered more than 40,000 television shows and movies in standard and high-definition for either purchase or rental. The pricing structure is similar to iTunes but Amazon offers more titles overall. Most movies cost between \$2.99 and \$3.99 to rent while they cost \$9.99 to \$14.99 to purchase. High definition movie rentals cost \$3.99-\$4.99 per movie. Television shows are only available for purchase at \$1.99 per episode for standard definition and for \$2.99 each in High-definition.

Other companies, such as Netflix, that traditionally offered DVDs as the content delivery mechanism have jumped into the fray as well. Netflix is the largest online movie rental service with more than 10 million subscribers and offering over 100,000 DVD titles. It has subscription plans from \$8.99-\$16.99/month which allow subscribers to rent 1-3 DVDs at a time without any limitation to the total number of DVDs rented in a month. Netflix’s DVD subscribers now have access to on-demand video streaming for free. This currently includes over 12,000 titles of movies and some prior season TV shows available for streaming on a computer or a Netflix-enabled device.

Startups such as ReelTime use streaming technology that combines having their own expensive servers and bandwidth with a peer-to-peer (P2P) network.¹¹ Although usually associated with internet piracy, P2P offers a powerful way of delivering content both cheaply and quickly by using the idle internet bandwidth of a service’s users. For example, ReelTime delivers some of the video content but most of it is delivered from the computers of other subscribers who previously downloaded the content. Unlike other streaming services where new capacity has to be added with the increase in the number of users, the more subscribers that a P2P service like ReelTime has, the faster the downloads get because of a wider distribution of the content.

The internet video on demand industry is rapidly growing but still nascent with most players either privately held or a small part of large organizations. For instance, Apple announces financial information about its electronic devices but doesn’t offer many details for its iTunes video service. It announced in June 2008 that it was delivering 50,000 movie downloads per day¹² but didn’t specify the profit margin on these downloads. Other competitors do not release information about either the volume of users or the margins. Many industry analysts believe that the competitors only have a small fraction of iTunes’ volume.

The industry continues to be competitive and dynamic. All the internet VOD offerings are getting more sophisticated and aggressive as they enable viewing content, without any computer interface, directly on televisions using set-top boxes such as the Apple TV and TiVo.

Online video Piracy

Peer-to-peer (P2P) file sharing has been a threat to video since the days when Napster bit into the profits of the audio industry. P2P has gradually risen to a level where 9.5% of US online adults have used P2P file sharing for either audio or video. To date, video file sharing seems to be far behind audio file sharing giving some respite to content owners. However, increasing broadband penetration along with more sophisticated and higher quality piracy could affect the profits of the content owners.

According to Forrester, a survey found that only 8% of online adults had paid to download a video while 13% had watched an ad-supported movie online and 19% had watched a TV show the same way. They conclude that video streaming is a better solution to the current customer's needs than file-based video.

The Consolidation Trend

YouTube had started to become a force in the online video business in 2006 primarily with user-generated short videos. Online video consumption started growing at a much faster adoption rate than seen with DVDs or mobile phones. Illegal copies of popular TV shows started emerging on YouTube and consumers flocked to the site. To counter the uncontrolled dispersal of their priced content, the media companies decided to respond with their own websites that offered select shows from their lineup for on-demand viewing.

By early 2007, the media company websites were operational albeit with different interfaces and scattered, limited content. The media companies felt that these legal offerings were still less appealing to consumers than accessing P2P or web2.0 sites which offered more TV shows, albeit illegally, in one place. The executives at the media companies wanted the creators and distributors of content to retain control and to avoid the fate of the divided music industry buffeted by piracy. The competing conglomerates looked for partners to reach viewers with more content and with a simple, appealing, and consolidated touch point. The quickest way to capture a large audience was to offer the programming for free and cover some of the costs with a limited number of ads.

Collaboration among the top four media conglomerates did not come easily. Disney, with its prior internet and customer interaction experience, decided to invest in its own online properties. Viacom, the parent company of CBS, invested in Joost.com which utilizes a web2.0 approach for hosting and delivering prime CBS TV content. These moves by ABC and CBS left NBC and Fox to collaborate and Hulu was born.

Jeff Zucker who is the CEO of NBC Universal, one of the four equity partners in Hulu, responded to questions about Hulu's raison d'être and monetization plans in a May 2009 interview by saying¹³:

“The initial idea of Hulu was to not suffer the same fate that music had suffered... We had the same feeling as News Corp. and that's why we came together for this joint venture... [We wanted] one site that aggregated as much video as possible in one place and that trained people to legally view it online. That would be the future... You have to remember that YouTube was built on the back of one of our videos... 'Lazy Sunday' SNL video...Hulu is ahead of plan. We expect Hulu to be

cash flow positive for us very soon... [Hulu has] exceeded every expectation... Have to continue to figure out monetization...[We have]150 content partners...And now four equity partners...Half the day we spend bashing each other's heads in and half the day we spend being in business together...[For example,] we produce 'House' for News Corp."

Forrester Research predicts that online video ads will reach \$7.2 billion by 2012. Companies that provide compelling content and attract viewership will capture most of these dollars. Currently 25% of all online video viewers watch TV with a larger TV viewership of 33% among the advertiser preferred 18-34 age demographic. This is a trend that is viewed by some in the industry to favor the new online video business model.

Broadcaster's concerns with Hulu

The main sources of revenue for the television industry are advertising and subscription fees.

Advertising revenue online continues to be a small fraction of the regular television broadcasting. Although CPM (cost per thousand impressions) is higher for Hulu, the net is substantially lower because of low comparative viewership and the short length of the ads.

Due to the way internet evolved over time, many users associate it with "free," ubiquitous content. They seem to show little patience for advertising or restrictions that interferes with their "anytime, anywhere" viewing desires. Also, some in the industry question why cable companies should continue to pay the high fees for TV content if the television broadcasters offer it for free on the internet. The industry is concerned about the rising popularity of online video and of losing existing television revenues to it without adequate compensation. Consider that in March 2009, Hulu had about 42 million viewers which was almost twice the size of the audience for the most popular show on TV, Fox's "American Idol."

Jeff Zucker, CEO of NBC Universal, commented on his prior remarks about the cannibalization threat of digital video in a May 2009 interview by saying¹⁴:

"What I said was the problem that all these media companies face was that we were replacing analog dollars with digital pennies...I don't regret [saying] it at all because it was the truth...we're now up to digital dimes. I think that's progress, and I do think we've made some progress. We still have a 90-cent gap. We've got to change our cost structure...We've got to have 10 or 20 businesses that make up for it... We also then have to get to [digital] quarters."

With aggregator sites like Hulu, there is also a concern among the broadcasters that their individual branding might become less clear to consumers who seek out shows rather than broadcasters. The companies fear that they might lose some of their hard-won brand image built over many years of aggressive competition.

It has been speculated that re-run and syndication revenue could reduce because shows are just a few mouse clicks away. Broadcasters and cable companies are concerned but unclear about the longer term impact of online video on this lucrative syndication business.

The tension between content owners who want to maximize value from their content and the distribution channels like Hulu who want to give maximum access to consumers sometimes leads to public relations snafus. For example, in January 2009, Hulu pulled all episodes of a popular niche TV show “It’s Always Sunny in Philadelphia” from its website without any advance warning. The action caused controversy and concern among Hulu users especially because it was perceived by some as yielding to the TV network’s pressure without any concern for the users. Kilar apologized on the Official Hulu Blog¹⁵ with an entry titled “Customer Trust is Hard Won, Easily Lost”:

“On January 9, we removed nearly 3 seasons of full episodes of It’s Always Sunny in Philadelphia. We did this at the request of the content owner [FX networks, owned by Fox]. Despite Hulu’s opinion and position on such content removals (which we share liberally with all of our content partners), these things do happen and will continue to happen on the Hulu service with regards to some television series...we screwed up royally with regards to how we handled this specific content removal... Please accept our apologies.”

Lastly, old content was not shot in digital format but is still stored on analog tapes and other older systems. It is expensive and labor-intensive to digitize this content and bring it online. When potential revenue from the online distribution of this old content is unclear, it becomes harder for the media company to justify digitization in the first place.

Broadcaster’s interest in Hulu

The industry executives consider the online video trend and the consumers’ demands for easy access to video as unstoppable. Some consider that it is better to strategically, and in a controlled manner, surrender to the shift in the industry.

Exhibit 7 illustrates the changing dynamic in the broadcast industry where they need to control distribution better and engage the increasingly fragmented and demanding customer base.

Peter Chernin, the outgoing president of News Corp., speaking to a reporter in May 2009 about the need for getting into the online video space quipped¹⁶:

“You can’t protect old business models artificially.”

The main interest of the media companies is to control the distribution and keep the audience engaged on legal content. Surveys by Forrester have indicated that advertisers believe that online TV ads have better characteristics than that of regular TV¹⁷. This would imply that the media companies could charge higher rates for every ad impression. Online TV ads have better characteristics because they encourage a higher degree of user personalization, better engagement of the audience, accurate targeting of the ads, and greater measurability of ad efficacy.

Robert A. Iger who is the CEO of Disney, which joined Hulu in April 2009, talked to analysts in May about the imperative of participating effectively in the online video business through Hulu by saying¹⁸:

“Our feeling is that -- and some of this is instinct, by the way -- media consumption online is growing and will continue to grow. It is really important for us to establish ourselves there.”

In addition, much of the media content that could not possibly generate revenue on regular TV could actually generate revenues online because of the fragmented audience. The long tail model of focusing on delivering a large number of unique programs, each to a relatively small audience could work effectively for the media companies. It is possible to attract niche audiences online at little expense and extract value from the “stale” content.

The future moves

Being in a low-margin distribution business, scale is very important to Hulu’s success. They need to continue growth by adding new content, capturing new unique users, and increasing video streams.

Exhibit 8 underscores Hulu’s commitment to a great user experience and an ad-supported distribution model.

Working with content providers (predominantly the parent companies of NBC, Fox, and ABC), Hulu hopes to expand globally. Most of the top US shows get syndicated globally but many of the top international shows don’t make it to the US market. Hulu hopes to bridge that divide and capture new sources of revenue. Speaking to The Financial Times in early 2009, Andy Forssell, Hulu’s senior vice president of content acquisition and distribution said:¹⁹

“We’re having discussions in the top six to eight markets... we’re laying the groundwork... You have these hidden gems [like Green Wing] which the US audience just hasn’t seen before.”

The rise of the iPhone and the applications associated it with provide Hulu with an opportunity. Traditionally, the internet video space has been hard to monetize because viewers want free content with no advertising and without any form of content protection using Digital Rights Management (DRM). This strong preference leaves the content owners with little control over how the content is consumed which in turns reduces the interest from the advertisers. The mobile platform, however, is quite different. Users are accustomed to paying for services and content they value. A Hulu app on the iPhone, for example, could allow Hulu to open up new revenue streams and increased loyalty to its offerings.

However, things in the mobile space are not all rosy because of the dominance of the mobile carriers in the value chain. NBC Universal’s Chief Digital Officer George Kliavkoff discussed prospects of mobile phones being an important part of Hulu’s future growth plans at the “Online Media, Marketing and Advertising Conference & Expo” in 2007 by saying²⁰:

“The [mobile phone] carriers take 70 percent and content aggregators take 21 percent. That leaves 9 percent to content owners. Compare that to other markets, it doesn’t create enough incentives to create original content. That said, mobile

content still our biggest single opportunity. People will buy a song for 99 cents online, but for a 10-second ringtone, they'll pay \$3. That tells you a lot about how content on that medium is valued.”

The mobile ecosystem would consist of the content providers, Hulu, mobile carriers, mobile phone makers, mobile application developers, and billing services. Hulu would need the permission from the content providers to venture into a new channel of distribution. It would also require the collaboration of the phone carriers such as AT&T who would need to enable the high data transfer rates necessary for a satisfactory online video viewing experience. In addition, gadget makers such as Apple would play a key role in ensuring a crisp video rendition and reasonable battery life. Application writers on the gadget platforms could create apps that make Hulu more accessible and user-friendly on the phone. And finally, there would be a service for billing and sharing the revenue with members of the ecosystem.

A move by Hulu into social networking might solidify it as a go-to place for both user-generated and professional content. A successful foray would help solidify Hulu's independence and power. It could also help NBC, Fox, and ABC networks to gain advantage over their rivals (such as CBS) and also increase their share of the value chain by reducing the power of the cable and satellite companies.

With DVR companies such as TiVo able to charge \$10-\$15/month, there is a clear willingness to pay for services that make on-demand viewing easy. Hulu could provide means for viewing on-line video on home theaters which could pose a serious challenge (or partnering opportunity) to current DVR makers.

Case Setup

1. Which of the three options should Kilar chose? Why? How should he execute?
 - (a) Focus on current online distribution model -- Add more content, and generate higher revenue
 - (b) Focus on other channels of distribution -- Capture new sources of revenue in Mobile and other platforms
 - (c) Focus beyond distribution model -- Move into value added services and compete with web2.0 sites:
2. How should Hulu respond to the many competitive threats and internal challenges?

Exhibit 1: Hulu snapshot in May 2009

The screenshot shows the Hulu website interface. At the top, there are navigation tabs for 'TV' and 'Movies', along with links for 'Login', 'Forgot Password?', and 'Sign Up'. Below this is a search bar and a menu with options like 'Channels', 'Popular Episodes', 'Popular Clips', 'Popular Shows', and 'Browse'. The main content area is titled 'Most Popular Episodes' and includes a filter section on the left and a grid of episode cards on the right.

Filter results by:

- Browse**
 - Most Popular
 - Recently Added
 - Highest Rated
 - Release Date
- Programming Type**
 - All
 - All TV
 - All Movies
 - TV Clips
 - TV Full Episodes**
 - Games
 - Movie Clips
 - Movie Trailers
 - Feature Films
- Channel**
 - Action and Adventure
 - Animation and Cartoons
 - Comedy
 - Drama
 - Family
 - Food and Leisure
 - Home and Garden
 - Horror and Suspense
 - Music
 - News and Information
 - Other
 - Reality and Game Shows
 - Science Fiction
 - Sports
 - Talk and Interview
 - Videogames
 - Web
- Special Features**
 - All**
 - Closed Captioning

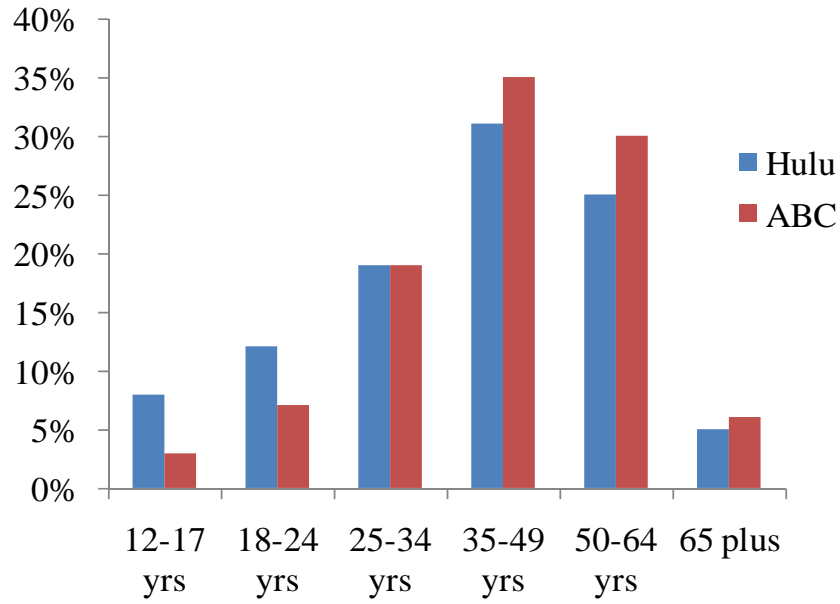
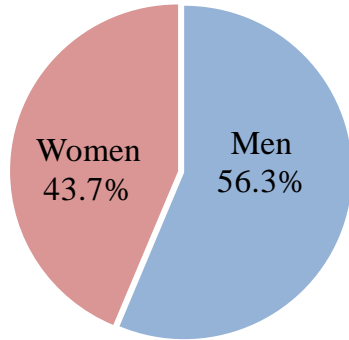
Episode Grid:

All Time	Today	This Week	This Month
1 of 610			
Family Guy: Stew-Roids Season 7 : Ep. 13 (21:54)	Family Guy: We Love You, Conrad Season 7 : Ep. 14 (21:54)	Family Guy: Three Kings Season 7 : Ep. 15 (21:54)	Family Guy: Peter's Progress Season 7 : Ep. 16 (21:49)
Family Guy: 420 Season 7 : Ep. 12 (21:53)	The Office: Casual Friday Season 5 : Ep. 24 (21:47)	The Office: Company Picnic Season 5 : Ep. 26 (21:50)	The Office: Cafe Disco Season 5 : Ep. 25 (21:49)
The Simpsons: Waverly Hills 9021-D'oh Season 20 : Ep. 19 (21:59)	The Simpsons: Four Great Women and a Manicure Season 20 : Ep. 20 (21:58)	The Simpsons: Coming To Homerica Season 20 : Ep. 21 (21:29)	House: Under My Skin Season 5 : Ep. 23 (44:03)

Source: Hulu.com

Exhibit 2: Hulu’s demographic data for March 2009

Number of unique viewers: 8.9 Million



Source: Nielsen Video Census and The Wall Street Journal

Exhibit 3: Hulu's income statement estimate for 2008

HULU KEY ASSUMPTIONS:

Mid-level scale, 10% distribution fees, 70% royalties, 100% videos monetizable, high CPMs.

VIDEO UNIT P&L (CPM)	2008		FUTURE?*	
	Estimates	Average est		
Ad Sales Price (CPM)		\$30.00		\$30.00
% of Videos Monetizable		100%		100%
Revenue (Effective CPM)		\$30.00		\$30.00
Distributed Videos %	50%		50%	
Distribution Fees (on Dist Videos)	10%	\$1.50	10%	\$1.50
Royalties (% of Rev After Dist Fee)	70%	\$19.95	70%	\$19.95
Bandwidth (CPM)	\$1.50	\$1.50	*Down 50%	\$0.75
Storage (CPM)	\$0.20	\$0.20	*Down 50%	\$0.10
Transcoding (CPM)	\$0.01	\$0.01	*Down 50%	\$0.00
Other (% of Revenue)	3%	\$0.90	3%	\$0.90
Gross Profit		\$5.95		\$6.80
Margin (% of Revenue)		20%		23%
SG&A (% of Revenue)		50%		50%
SG&A (CPM)		\$15.00		\$15.00
Operating Profit		(\$9.06)		(\$8.20)
Margin		-30%		-27%

COST ASSUMPTIONS

Bandwidth

Bandwidth Cost Per GB	\$0.08
Average Video Size (MB)	20
Cost Per Video Stream	\$0.00
Cost Per 1000 Video Streams	\$1.50

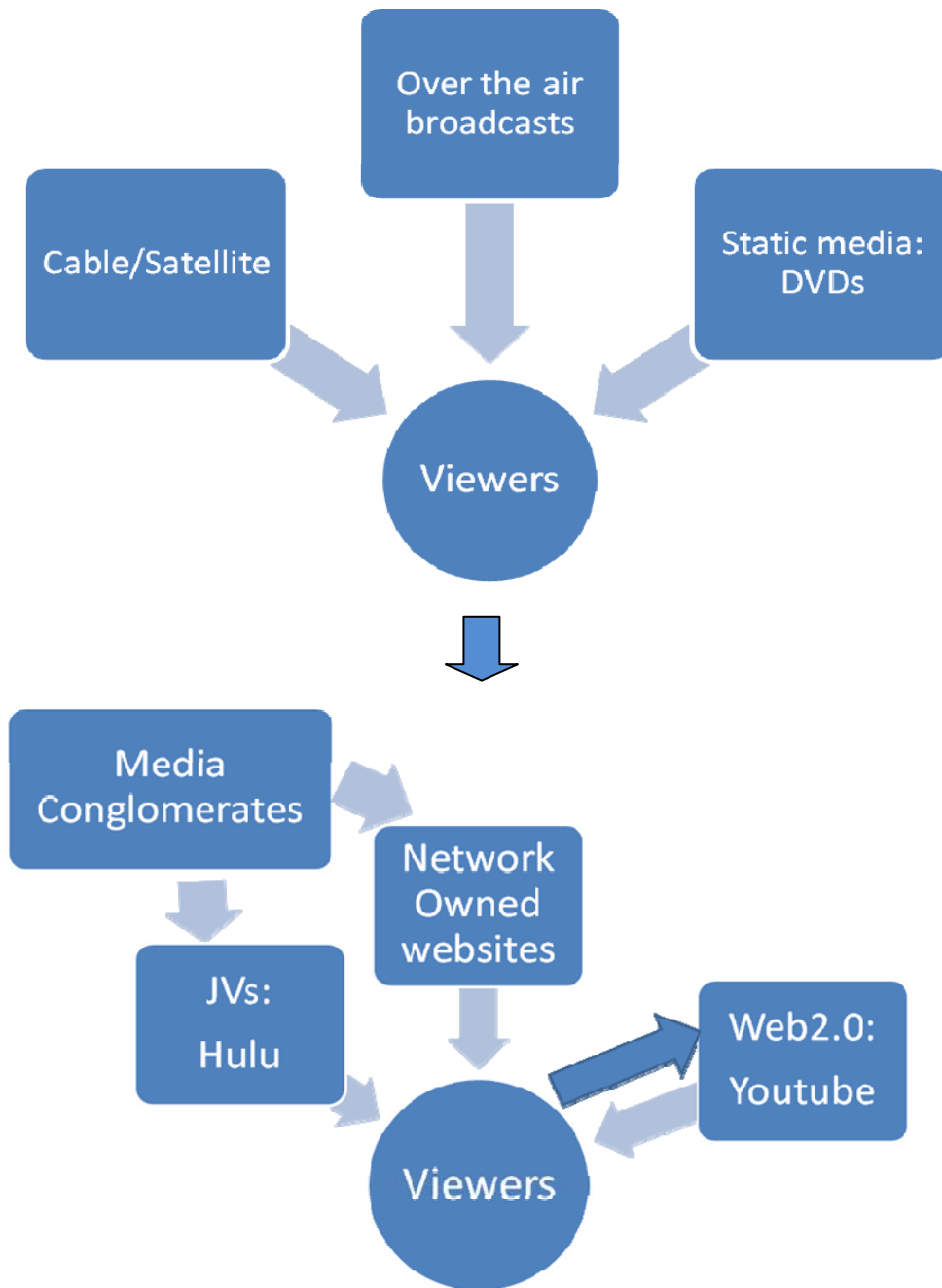
Transcoding

Transcoder	\$4,000
Videos/Day	1,000
Videos/Year	365,000
Life (Years)	2
Cost Per Video	\$0.01
Cost Per 1000 Videos	\$5.48
Average Streams Per Video	1,000
Cost Per 1000 Streams	\$0.01

Storage

Storage Server (7 terabytes)	\$8,000
Capacity (Videos)	40,000
Cost Per Video	\$0.20
Cost Per 1000 Videos	\$200
Average Streams Per Video	1,000
Cost Per 1000 Streams	\$0.20

Source: *Silicon Valley Insider*²¹. (Abridged version)

Exhibit 4: Changing channels to reach the viewers (consistency)

Key players in the online video industry:

Web2.0 (user-generated content) sites: YouTube

Traditional media companies: nbc.com, cbs.com

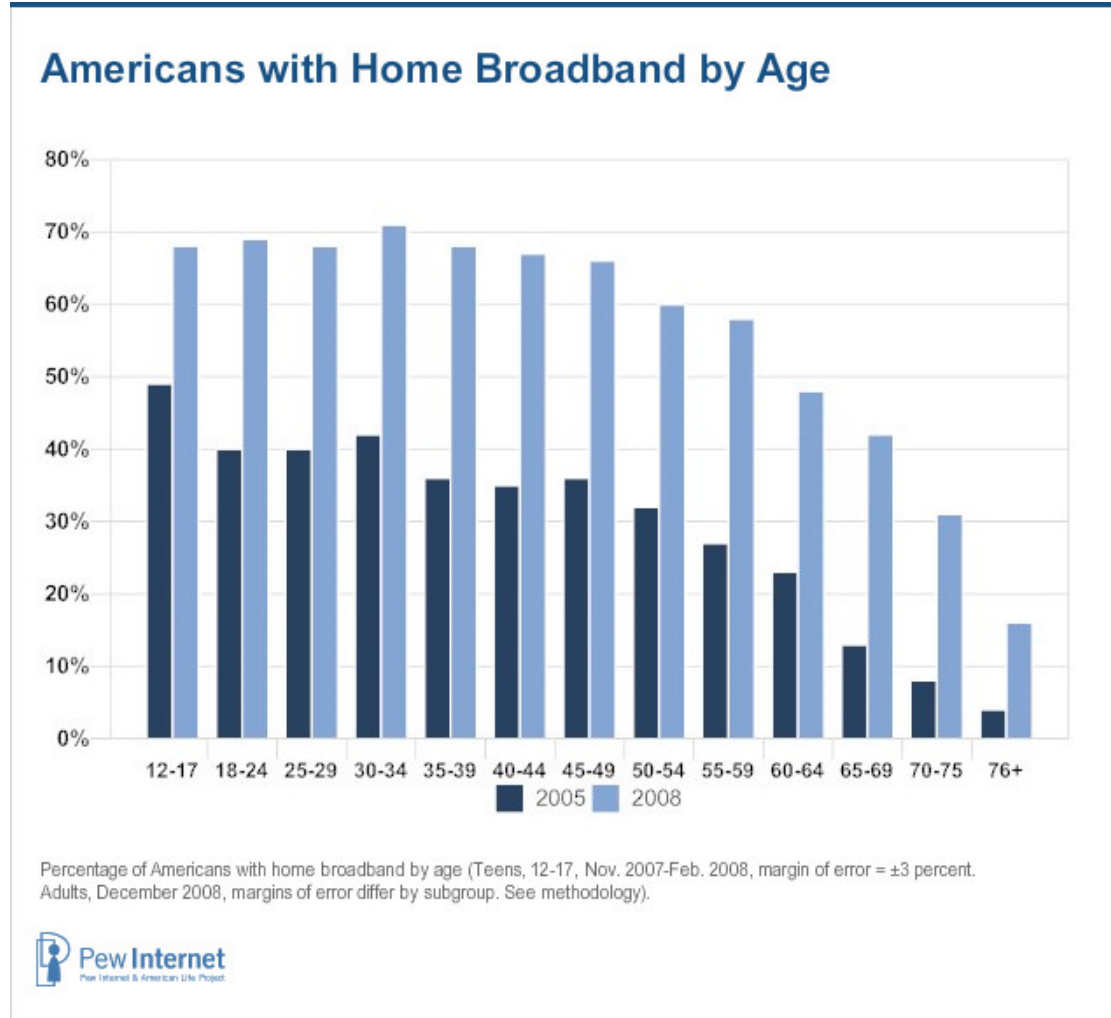
Internet companies backed by traditional media: Hulu.com, joost.com

Exhibit 5: Online video usage data for April 2009

Video Brand	Apr 2009 Total Streams in 000s	Month-over- Month % Change	Year-over- Year % Change	Share of Streams
Overall Online Video Usage	9,453,996	-2.3%	24.2%	100.0%
YouTube	5,490,204	0.2%	35.5%	58.1%
Hulu	373,290	7.1%	490.4%	3.9%
Yahoo!	203,628	-12.2%	-8.1%	2.2%
Fox Interactive Media	201,362	-3.0%	-38.8%	2.1%
Nickelodeon Kids and Family	175,917	-10.3%	15.9%	1.9%
MSN/Windows Live	164,422	-2.7%	9.8%	1.7%
ABC.com	148,830	-15.9%	144.8%	1.6%
MTV Networks Music	143,356	15.7%	359.6%	1.5%
Turner Sports and Entertainment Digital Network	130,559	-5.1%	60.0%	1.4%
CNN Digital Network	112,469	8.7%	32.7%	1.2%

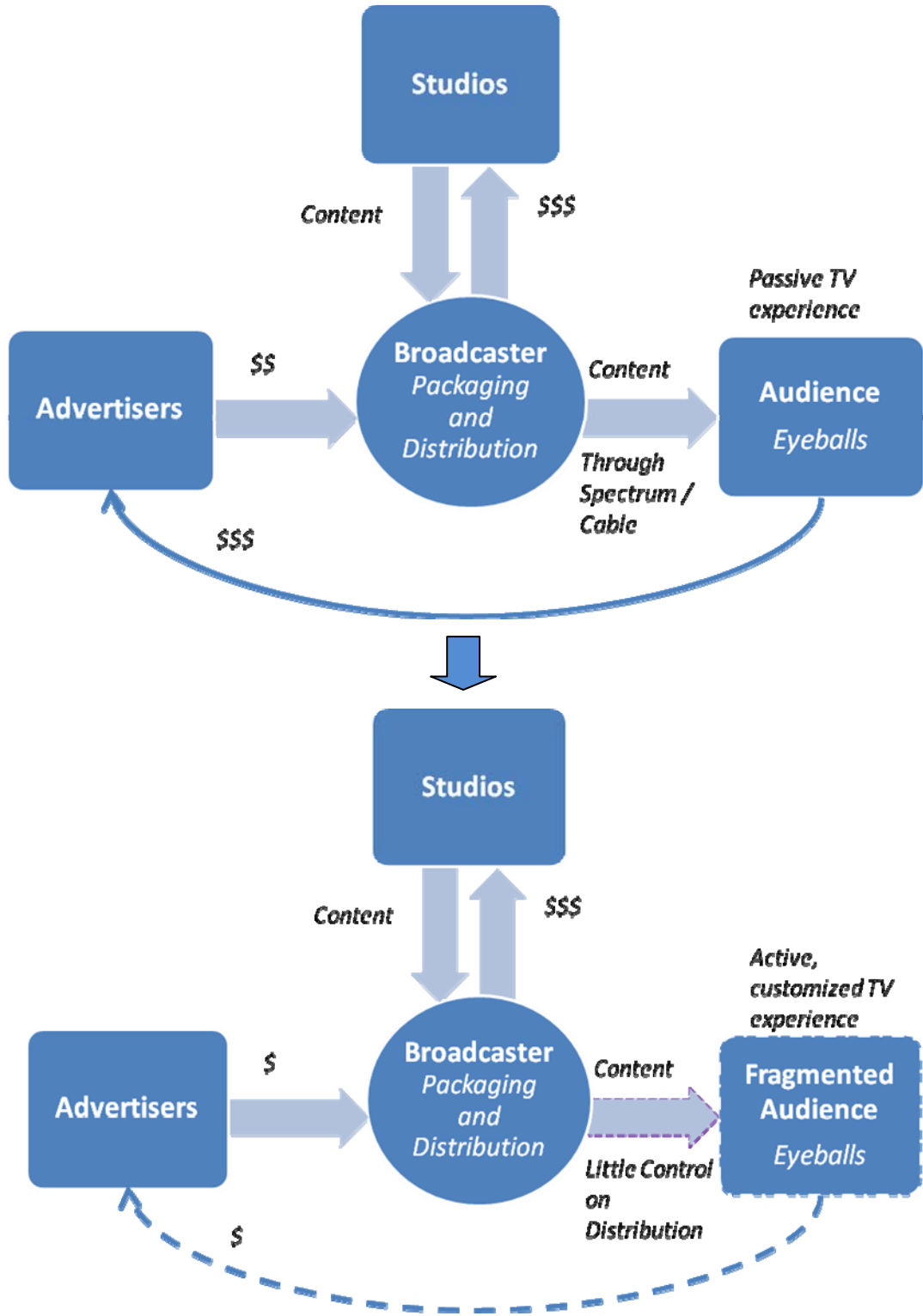
Source: Nielsen Data and AllThingsD.com

Exhibit 6: Demographic trends in home broadband access



Source: *Pew Internet & American Life Project*²²

Exhibit 7: Changing Dynamic in the Broadcast industry



Source:

Exhibit 8: Excerpts from Hulu's "About" page

Company

Founded in March 2007, Hulu is co-owned by NBC Universal, News Corp. and Providence Equity Partners. It is operated independently by a dedicated management team with offices in Los Angeles, New York, Chicago and Beijing.

Mission

Hulu's mission is to help people find and enjoy the world's premium video content when, where and how they want it. As we pursue this mission, we aspire to create a service that users, advertisers, and content owners unabashedly love.

User Experience

Hulu is focused on *quality and convenience* and strives to create the best possible online video experience.

- * Hulu gives users the ability to customize their viewing experience online.
- * Hulu allows users to watch favorites or discover new shows anytime — at home or on the road.
- * Hulu's search feature helps users find any premium video online even if it is not directly available on Hulu.com.

Hulu is *easy to use and share*. Simply go to www.hulu.com, and click on a video to watch right away.

- * Hulu does not require a download of any software. Users only need a Flash 9.0 enabled computer and an Internet connection to enjoy.
- * Hulu offers the freedom to share full-length episodes or clips via e-mail or embed on other Web sites, blogs and social networking pages.
- * Hulu's clipping feature allows users to select a portion of the video they would like to share.

Hulu is *free and legal* through an advertising supported model.

- * Videos are available for unlimited streaming; watch favorite shows and clips over and over, for free
- * Videos contain fewer ads than on TV. Advertisements appear during normal commercial breaks
- * Hulu acquires the rights to distribute its videos, making them available to users legally

Distribution

Hulu allows users to enjoy great videos on Hulu.com and on 35 other popular Web sites across the Web. Hulu videos are available on AOL, IMDb, MSN, MySpace, and Yahoo! in the U.S. as well as a growing network of personal blogs, fan sites, and other Web sites where users choose to embed the Hulu video player.

Advertising

Hulu gives advertisers an opportunity to associate their brands with premium online video content, connect with highly engaged consumers and extend their reach beyond Hulu.com to Hulu's distribution network. Additionally, Hulu offers and is committed to the continued development of innovative, new advertising experiences. Currently, Hulu partners with over 200 blue-chip advertisers including Johnson & Johnson, McDonald's, Visa, American Express, Best Buy, Chili's, DirectTV, GM, Intel, Nissan, State Farm, Unilever, Wal-Mart, Cisco, and Proctor & Gamble.

Source: Hulu.com

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²¹ “Hulu Profitable? Please” – Nov 17, 2008 – The Business Insider

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