Could Media Companies Be Losing Millions in Digital Revenue?

BY STEPHANIE PRANGE

As Halloween approaches, studios are facing a new kind of horror story.

In a shocking scene in August — starring Walt Disney Co. CEO Bob Iger — the studio revealed that its ESPN subscriber numbers had come in lower than expected. That led to a media stock bloodbath that wiped out billions in a day.

Are traditional forms of revenue — such as the cable fee-based model — upon which media companies' fortunes are based, collapsing under a wave of cord-cutting Internet subscribers (to Netflix and other services)?

Financial reporters began to talk of a "media meltdown" and wondered if the term "content is king" should be revised to "digital distribution is king" as the power in media seemed to shift.

The dilemma is not a surprise to many in the home entertainment business who have seen the rapid rise of digital services eat into the traditional disc business. In the home entertainment industry, the negotiation between studios and distributors has always been a matter of finding the right balance between the two.

Bruce Lazarus, MAI CEO

Without a physical product to track, how can media company executives determine if they are realizing the true value of their content or if their distributors' agreements are performing as planned. Or more to the point, as viewing habits change, methodically collecting and validating the accuracy of every payment from digital and cable businesses is becoming more important than ever.

In this endeavor of ensuring proper revenue payments, one firm has quietly loomed large, Media Audits International (MAI), which has been conducting contract compliance and subscriber audits for more than 30 years. A previously quiet exercise, ensuring payment veracity in the digital ecosystem has grown to the point where MAI auditors apply their IT, payments and contract expertise now to digital revenues generated by movie studios, cable companies, broadcast stations, ebook publishers and sports leagues.

"If you buy a cup of coffee at Starbucks for $2.12 and pay with $5.00, do you typically count your change? Of course you do!" said Bruce Lazarus, MAI CEO. "It should be the same with a studio's transactional VOD and EST business, except here we are talking about millions of dollars, not loose change. There's so much money involved now, you can't simply leave it to the 'honor system'."

However, the process by which such verification is done is quite a bit more challenging than counting change in your hand. Contract complexity, payment system limitations and anomalies, resource requirements, and a changing marketplace require vigilance by both content owners and distributors to ensure that distribution agreements are properly executed and managed. As a result, unlike services that can merely sample a large data set, MAI must collect all data, and turn around results quickly.

"We have necessarily evolved into a big data company with an extraordinary expertise in media," Lazarus said. "We extract data, and where there are anomalies in contract interpretation and payments, our clients are able to satisfactorily resolve these issues. We are the only scaled media audit firm in the world."

Just tracking domestic use is difficult, but it gets even more complicated when companies distribute content outside the United States. MAI is active there, as well. In addition to the United States, the Denver-based company offers audit services worldwide, including in Europe, Canada and South America.

Not only does MAI unveil payment discrepancies, its audit reports provide insight with regard to evolving contract language, a benefit to both the content owner and the distributor. The vast majority of distributors that MAI audits simply want to "get it right," according to Lazarus.

But what does "complexity" mean with contract terms?

"Over time, as consumers demand more permutations of how they can buy content, distributors compete to satisfy them. Therefore aggressive content owners may grant more and different terms. You multiply these types of offerings by the growing number of consumer choices, distribution platforms and territories, and our clients quickly realize the chance for payment issues to arise sharply increases," said Richard Taub, MAI's SVP of Digital Services.

"Contracts do not always pace well with changes in the marketplace, and content owners don't want the distributors to solely administer the interpretation and application of contract terms. Audit brings balance to this process," added Lazarus.

An unclear contract can become a revenue serial killer. As digital distribution grows — which few doubt will happen in coming years — the miscalculation in revenue today can cumulatively snowball for any content owners due to the differing interpretations of a contract — resulting in millions if not billions in aggregate undervaluation across all participants in the financial markets.

"As a result of an audit, our clients and distributors become aware of contractual weaknesses and can tighten up their contracts," Lazarus said, adding knowledge and data is key.

SVOD: the New Horizon

"Where data, compliance and knowledge are in especially short supply is in the expanding SVOD marketplace, as it's simply a newer world," acknowledged Taub. This became most evident in a recent *Wall Street Journal* article.

"Are Media Companies Charging Streaming Services Enough?" was the headline of a September opinion piece in the Journal written by Nielsen's Steve Hasker and Glenn Enoch, who wrote that $3 billion to $4 billion of estimated fees paid by SVOD providers to content owners could be threatening $100 billion in traditional revenues.

"The pricing needs to be revisited," they wrote.

Studios are starting to take notice. Speaking Sept. 16 at Goldman Sachs Communacopia confab in New York, James Murdoch, newly appointed CEO of 21st Century Fox, said the studio would adjust SVOD licensing.

"I think you'll see the business rules of how we license to SVOD players probably change," Murdoch said.

There, too, MAI is well positioned for content owners.

"You want to get paid on some kind of metric that rewards you for how popular your content is," Lazarus said. The key is usage data, which studios may or may not have included in their contracts.

"If you get usage data, you can make an educated guess at the real value of your content," he said. "If you don't, you are completely in the dark. The problem in the SVOD environment is that if you are a studio and you do a deal for a flat fee, it's not really tied to reception and value. Few studios anticipated Netflix's growth, and who knows how many retained upside for such an instance in their deals, and so undervaluation in one-time fees becomes more likely."

Indeed, audit should be part of this road map of the future. Lazarus anticipates that audit results of any variable term, whether payments or usage data, will help content owners design contracts that will more accurately reflect content value in the future.

And that might give the media horror story a very happy ending.

For more information on the services at MAI, visit http://www.mai-global.com.