External Analysis of Time Warner Inc. in the Entertainment and Film Industry

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Introduction

Time Warner Inc. is an American media corporation specializing in three major segments: Networks, Film & TV entertainment, and Publishing. Currently, the Film & TV Entertainment segment of the company generate $12,018,000 in revenue and $1,228,000 in annual profit, making them the second most profitable of the three operating segment behind Networks. This is about 40% of the company’s revenue and 19% of the company’s income.\(^1\) In order to understand the profitability of this company, it is important to see how the company neutralizes its external threats within the Film & TV Entertainment segment as well as takes advantages of opportunities within these segments. These areas can be evaluated through the use of a Porter’s Five Forces industry analysis and a PESTEL analysis.

Porter’s Five Forces

By analyzing Porter’s Five Forces model we can see that the Film & TV Entertainment segment of Time Warner fits into the “bigger picture” of the industry as a whole (appendix A).

The strongest of these five forces is the competitive rivalry Time Warner Inc. faces. The main competition for Time Warner consists of News Corporation, NBCUniversal, Viacom Inc., and The Walt Disney Company. Overall, these companies make up 81.2% of the industry, with Time Warner only capturing 9.8% of the total market share (appendix B).\(^\text{ii}\) The main reason this is so important to understanding the profitability of the industry is because of the size of the companies in competition. It is expected that the growth within the industry in the future will be based off two main things: acquisitions and advertising expenditure\(^\text{iii}\). In order to help neutralize parts of its competition and continue to reach the public with its product, Time Warner Inc. has begun negotiating with companies like Samsung and Apple in order to package its product with theirs. One example of this is the discussion between Time Warner Inc. and Apple regarding the inclusion of HBO Go as part
of Apple TVⅣ. This would mean that, along with the inclusion of a Time Warner app to be included with products like Samsung’s SmartTVⅤ that Time Warner could directly streamline a significant amount of programming to its customers for a lower price and with added convenience. This is important to the competitive landscape of the industry because whether or not Time Warner partners with someone to allow its programming access, someone else will. Time Warner Inc. could gain first-mover advantage by being one of the first to make one of these partnerships and lessen the presence of its rivals in the market.

The threat of new entrants is another of the Five Forces which, in recent years has proven to be high and continues showing growth. The reason for this is because of the growing number of on-demand media streaming sites. While Time Warner Inc. currently has licensing agreements with some of these suppliers such as Netflix an Amazon the stakes are slowly growing, thereby putting entertainment providers at risk. To explain, Time Warner currently receives 5% of its operating income from licensing agreements with subscription services and it is expected that this number will begin to growⅥ. This means that by gaining revenue from these media providers, Time Warner is also eliminating some of the opportunity for the advertising revenue it can gain by using its TV and Film entertainment in other ways. Another important thing to note is that both Netflix and Amazon have begun, albeit on a very small and limited scale, to produce programing by themselves. This creates more competition in the market. The largest barrier to entry which Time Warner was able to maintain was the extremely high cost of production. By providing their content to subscription services they have allowed these services to eliminate much of the cost of production and subsidize parts of that production with the income they receive. By looking at the chart in appendix C, one can look at the major barriers which may deter new entrants, however online services such as Netflix and Amazon, based off the nature of the way they provide their product are able to overcome many of these barriers because they already have the new technology needed and are able to provide it at a relatively low cost.
One of the more complex aspects of TV and Film Entertainment industry is that, because of the growing number of media available, many of the competitors and new entrants are also substitutes because of the economies of scope they are creating through a varied mix of delivery channels. Aside from the increased use of internet to deliver TV and film to consumers as discussed in the previous two paragraphs, other entertainment substitutes have started to take steps to become more competitive. One of the substitutes I see as an increasing threat in entertainment is theatre. This is because of its increasing availability. For example, the showing of plays in movie theatres is a trend which growing in popularity. Because of how difficult it has been in the past to see world-class theatre, the opportunity to see top-quality shows with the comfort and superior a/v of a movie theatre has become very appealing to people who otherwise might not have the opportunity.

The bargaining power of customers within the industry is moderate. Consumers can choose to spend their money with one of the many companies providing TV and film entertainment. Customers may choose from many choices of product available. Customers may choose between different subscription networks, broadcast networks, and many different films. This creates huge impacts on the ratings which, in turn, affect advertising expenditure. The interrelationship between the two makes the choice of the customers very important to the company. While many of the costs of the film and entertainment industry are charged at a premium to the customers, they are paying for is higher quality. This means that bargaining power of the customers comes into play when companies do not produce a high quality product and customers switch, meaning that advertising expenditure drops and therefore the competition has the opportunity to capture it. Companies are beginning to see this as one of the biggest hurdles they must overcome. The increase of delivery methods has further segmented the consumers into many different categories (ie. Techno-savvy consumer vs. consumers who don’t even have internet). Time Warner is beginning to understand that unless all these segments are satisfied they will not be able to stay competitive. One solution
to this could be creating an economy of scope by expanding into more mobile services as a way of delivering their product. This keeps the value of their product higher allowing them to please more people and stay competitive\textsuperscript{viii}.

The bargaining power of suppliers within this industry is very low overall. The suppliers for this industry is listed as celebrity and sports agents, fine arts schools, IP licensing, and performers and creative artists. While the absolute major players in each of these supply areas obviously maintain some control when it comes to those suppliers with the absolute best quality, however for the most part, Time Warner and other companies within the industry and able to maintain such a high level of control that many of these suppliers are left at the will of the industry.\textsuperscript{ix}

**PESTLE Analysis**

Politically, the Film and Entertainment industry is subject to the FCC and the regulations imposed upon it. Obviously this is something to keep in mind when producing TV and film as FCC fines can range up to millions of dollars. Another important thing to keep in mind is the policy control the FCC has. Recently, the FCC just declared it legal for cable companies to do-away with unscrambled channels. This means that companies are no longer required to transmit certain channels which can be accessed by anyone, only cable subscribers with set-top boxes\textsuperscript{x}. While there are still rules in place which will make the previously unscrambled channels accessible, the times are changing and cable providers will now be able to garner more revenue due to the increase in the need of cable subscriptions to even access some of the most basic cable. This will definitely affect TV and film production because now that consumers will be forced to have access to more channels than they previously had, allowing for greater distribution of products and an increase ad sales.

Economically, the environment within which Time Warner operates in is a very expensive one. The industry alone exceeds $35,597,000,000 in annual revenues and being
able to capture just a small portion of this is very valuable, however such a large amount of money at stake creates a very risky environment.\textsuperscript{xv} In addition, the high cost of production helps keep major players at the top and deters others from entering the industry. The industry also has an extremely high cost of capital; however this cost is generally a one-time expenditure. Even with the high risk, the large companies, such as Time Warner, will still be able to increase revenue as broadcast cable continues to shrink and more people are forced to subscribe to companies in order to access programming\textsuperscript{xii}.

The sociological environment under which Time Warner operates in is relatively stable for the entertainment industry. The industry has to deal with attitude changes, obviously, just like everyone else but online other industries pressured with things such as “going green”, the Film & Television industry is able to adapt very well and not allow it to be a huge impact.

Technologically, Time Warner must be able to adapt with the many changes taking place throughout the industry. With a large segment of entertainment taking place through internet platforms and streaming, the industry has found ways to adapt to growing concerns from advertisers that this would cut out opportunities for advertising as they could be eliminated through pirating. Other technological advancements include the use of mobile devices as well as new video formats allowing for higher quality. 71% of respondents to a survey done by Motorola shows that consumers what to take advantage of new technology and be connected to cable via their mobile advices and “take cable with them\textsuperscript{xiii}.” Being able to adapt to this new technology associated with online streaming, different formats, HD televisions, and 3D televisions is one of, if not the most, important key to success when it comes to staying involved and relevant in the industry. Appendix E shows how many different mediums are used in order to view television programs, aside from just a regular television set in order to see the new technologies companies must keep up with.
Legally, the industry toes an interesting line regarding what it may or may not produce. Although regulators such as the FCC and organizations such as the MPAA act as watchdogs, protection by the freedom of speech counteracts that. This has played a huge part, as much of Time Warner’s revenues come from subscription services which allow it to still produce programs the FCC does not allow for to be broadcasted without special subscription. One very interesting topic which has recently changed the legal environment for Time Warner is the FCC’s decision that cable providers (such as Time Warner) may now buy phone companies in their franchise areas. The reason that this ruling may be so important is because it helps company’s such as Time Warner integrate into other fields and create bundles which may allow them to generate more customer loyalty and raise switching costs, thereby generating another barrier to entry.

The environment plays a very small roll in this industry. The main way environment plays a factor is during production. Location and climate during production may raise or lower costs, but as most production takes place in relatively stable areas, this doesn’t seem to cause many issues.

**Conclusion**

After examining the external environment under which Time Warner operates it quickly becomes apparent that two of the most integral keys to the profitability of this company are related to capital and the ability to adapt to technological changes. This has to do with the high cost of production associated with the TV and Film entertainment industry as well as all the changes taking place in how this industry delivers its product to the consumer. Overall, Time Warner has the ability to continue to compete in the industry and maintain profitability as long as it can continue to be innovative in the ways it adapts to changes in technology and takes these changes into account in order to maintain a relatively high market share in the industry.
Appendix A

Porter’s 5 Forces Analysis

**Threat of Rivalry**

- Extremely high threat of rivalry
- Industries compete based on product and advertising expenditure
- Customer loyalty is difficult to gain

**Threat of Substitutes**

- Moderate
- New technology allows for different subs to become readily available
- Many different entertainment outlets available besides Film and TV entertainment

**Threat of Buyers**

- Low (people need entertainment)
- Switching costs for consumers may be relatively low
- Viewer ratings drive opportunities for profit

**Threat of Suppliers**

- Low threat from suppliers
- Supply far exceeds demand

**Threat of Entry**

- Threat of entry is low
- High entry and exit costs

Appendix B

<table>
<thead>
<tr>
<th>Major players (Market share)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time Warner Inc.</td>
<td>9.8%</td>
</tr>
<tr>
<td>Viacom Inc.</td>
<td>19.6%</td>
</tr>
<tr>
<td>NBC Universal</td>
<td>16.0%</td>
</tr>
<tr>
<td>News Corporation</td>
<td>8.2%</td>
</tr>
<tr>
<td>The Walt Disney Company</td>
<td>27.4%</td>
</tr>
<tr>
<td>Other</td>
<td>18.8%</td>
</tr>
</tbody>
</table>

Source: www.edinfield.com
Appendix C

<table>
<thead>
<tr>
<th>Barriers to Entry checklist</th>
<th>Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competition</td>
<td>High</td>
</tr>
<tr>
<td>Concentration</td>
<td>Medium</td>
</tr>
<tr>
<td>Life Cycle Stage</td>
<td>Growth</td>
</tr>
<tr>
<td>Capital Intensity</td>
<td>Medium</td>
</tr>
<tr>
<td>Technology Change</td>
<td>High</td>
</tr>
<tr>
<td>Regulation &amp; Policy</td>
<td>Light</td>
</tr>
<tr>
<td>Industry Assistance</td>
<td>Medium</td>
</tr>
</tbody>
</table>

SOURCE: WWW.IB/SWORLD.COM

Appendix D

Pestle Analysis

Political/Legal:

• Government/non-government regulatory industries such as FCC and MPAA create difficulties in creative production aspects
• Drive up costs of production

Social:

• Cultural trends affect what viewers enjoy

Technological:

• Increased use of online and mobile devices for viewing
• Different in-home entertainment formats such as HD and 3D
• Fios, wireless, mobile
• Production Equipment

Environmental:

• Few environmental factors aside from production location

Economic:

• High entry/exit costs
• High production costs
• High cost of capital
Appendix E

CONSUMER TV/VIDEO VIEWING HABITS

<table>
<thead>
<tr>
<th>Activity</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled broadcast TV</td>
<td>84</td>
<td>88</td>
</tr>
<tr>
<td>Recorded broadcast TV</td>
<td>45</td>
<td>50</td>
</tr>
<tr>
<td>Short video clips, e.g., YouTube</td>
<td>47</td>
<td>44</td>
</tr>
<tr>
<td>DVD/Blu-ray</td>
<td>29</td>
<td>30</td>
</tr>
<tr>
<td>Streamed on-demand TV shows</td>
<td>30</td>
<td>33</td>
</tr>
<tr>
<td>Downloaded content</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Streamed on-demand movies</td>
<td>25</td>
<td>23</td>
</tr>
<tr>
<td>Pay-per-view</td>
<td>13</td>
<td>12</td>
</tr>
</tbody>
</table>

TV/Video. Percentage of consumer usage (more than once/week).

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