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## The Upshot

TV DRAMA

# Netflix vs. Amazon, and the New Economics of Television

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It's been a busy week for the companies in the business of trying to revolutionize how we watch television.

Netflix struck a deal to make its video streaming service available through set-top boxes offered by three cable companies; said it would raise its prices for new customers; and publicly objected to a planned merger of Comcast and Time Warner Cable. HBO struck a deal to offer its shows on a formidable Netflix competitor, Amazon Prime. Oh, and while we're at it, AT&T and the Chernin Group said they would introduce a new, \$500 million venture to compete in the same crowded market.

To make sense of the changing tides of media (and especially television)

economics, remember this simple idea: To be successful in the evolving world of media, a company needs to control either the content, or the pipes. If it has neither, it's a mere middleman, consigned to low or no profitability.

Somebody has to create compelling things that people want to watch, whether it's "Game of Thrones" or an N.F.L. game. The rewards of creating that content are great; if you succeed, you have leverage with whoever will do the distributing, whether a cable network like HBO or AMC or a digital service like Netflix or Hulu.

Similarly, whoever controls the ultimate means by which people get information and programming into their living rooms has a great deal of power. That could in theory be your local phone company or a satellite provider, but in practice for most people in the United States it is the cable company. This, too, is no easy thing to establish. Whereas content creators must navigate the ever-shifting winds of Hollywood, the company controlling the pipes has to spend billions to lay wires under the ground of major cities.

If you possess one or the other of those things, desirable content or a means of distribution, you have a strong starting position in the inevitable negotiations over licensing deals. Otherwise, you are at a major disadvantage.

Twenty years ago, HBO was closer to being a middleman, taking movies made by studios and charging high cable fees to bring them to your cable dial. The problem with that strategy was that it left HBO vulnerable to changing technology. As on-demand movies got better, and as people began consuming more video online, HBO was at risk of being squeezed by the movie studios who provided content and the cable distributors who controlled the pipes.

So HBO began more aggressively developing its own content, eventually scoring major hits like "Sex and the City" and "The Sopranos," ensuring that cable operators (owners of the pipes) would need HBO as much as HBO needed them.

HBO's new deal with Amazon appears to be a way to make some extra

money from the back catalog of older shows, while not cannibalizing people who may want to subscribe to get the hottest, newest shows, including “Game of Thrones” and “True Detective.” Their deal, said to be worth more than \$300 million for a bunch of shows, many of which aired more than a decade ago, shows how having original content has given HBO leverage.

A couple of years ago, Netflix and the video offerings of Amazon Prime were facing the same challenge that HBO did in the 1990s, operating solely as middlemen between producers of content and the people who want to consume it. Each has now taken a page from the HBO of the 1990s, and started trying to come up with the type of original content that will give them leverage with cable companies.

That’s why Netflix has produced “House of Cards,” “Orange Is the New Black” and a new season of “Arrested Development.” (Not all of its programs have been that successful. Did you watch “The Ropes” or “Bad Samaritans”?).

Amazon’s original programming, still early in its development, has generated less buzz — “Alpha House” is the closest thing to a success so far — but is following very much the same strategy.

Surely Netflix’s success on some of those shows contributed to the company’s confidence that it could raise prices without losing too many customers. And surely the sense that it is creating products consumers want helped embolden the company to take an assertive stance against consolidation in the cable industry.

We might all think we would make brilliant studio titans, but creating great TV series is harder than it sounds; my colleague David Carr’s recent column on Yahoo’s efforts captures the challenge. But if you want to make money distributing video on the Internet, it may be the only way to go.

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