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MEDIA

Punching Above Its Weight, Upstart Netflix Pokes at HBO

By DAVID CARR and RAVI SOMAIYA FEB. 16, 2014

On the night of the Golden Globes ceremony last month, Netflix and HBO held dueling parties at the Beverly Hilton hotel. Bono and Julia Roberts mingled underneath a bejeweled tent as Netflix, the upstart streaming service, joined forces for the party with the Weinstein Company and celebrated a small piece of history — its first Globe, for “House of Cards,” its splashy entrant into original programming. At HBO’s party, Matt Damon and Lady Gaga sipped drinks by the pool as the cable network toasted its two awards, pushing its total to 101.

If there is a rivalry between the two companies, it is by many measures a mismatch — certainly in terms of creative achievement (HBO has also won 463 Emmys, to three for Netflix). But that hasn’t stopped Wall Street and the entertainment media from salivating at the story line: Netflix, the brash Silicon Valley interloper, driven by metrics and technology, not to mention a checkbook that makes seasoned Hollywood players blush like teenagers, taking on HBO, the East Coast establishment player, in the rarefied and profitable world of quality television.

The competition is energizing the medium. Cable networks like HBO and Showtime, and streaming services like Netflix and Amazon Prime, are spending lavishly on programming and embracing new technologies, giving producers incentives to take creative and financial risks and generating an upward spiral in quality.

The result, said Mike Vorhaus of Magid Advisors, a research and consulting firm, is “an arms race in programming.” Both Netflix and HBO are “seeing the best pitches from the best people,” said Rick Rosen, head of the television division at William Morris Endeavor.

As a business, Netflix is gaining momentum and blowing through the stock market’s expectations. It has a market value of $26 billion, a share price that has more than doubled in the last year, and it now has 33.4 million subscribers in the United States, five million more than HBO has domestically. Early this month, Netflix borrowed $400 million to finance an aggressive expansion in Europe. “House of Cards” was one of the big stories in television last year, and its highly anticipated second season was released with much fanfare on Friday.

HBO broke out its operating income for the first time earlier this month — a move it says was a coincidence — and showed its own very profitable muscles. It made $1.8 billion in operating profits in 2013, compared with Netflix’s $228 million. It has a huge international presence, with an estimated 100 million subscribers worldwide, and a trove of remarkable content that is the envy of the entire industry, not just Netflix.

Jeffrey Katzenberg, the chief executive and co-founder of DreamWorks Animation SKG and a former chairman of Walt Disney Studios, played down the idea of a rivalry, calling it “a media invention.”

“The fact is that Netflix has exploded in its success, achieved what really three or four years ago people would have said was an impossible level of subscription, and HBO has gone up, too,” Mr. Katzenberg said. “I think there’s a fiction here that somehow Netflix gains are HBO losses.”

But to services like HBO and Netflix that are supported by subscriptions, and not advertisers, talk means buzz, and buzz draws new customers. That’s why Netflix is punching up, constantly comparing itself to a more established brand that for consumers represents high-quality programming. Ted Sarandos, Netflix’s chief content officer, put it plainly a year ago: “The goal is to become HBO faster than HBO can become us.”

Reed Hastings, chief executive of Netflix, has been routinely provocative. In a recent earnings call, he pointedly tweaked his counterpart at HBO, Richard Plepler. Asked about HBO's endorsement of password-sharing for its own streaming service, HBO Go, Mr. Hastings joked that perhaps Mr. Plepler wouldn't "mind me sharing his account information." He then joked that his rival's password was "Netflix" followed by an expletive.

In private, Mr. Hastings has been known to confide to executives at Time Warner, HBO's parent, that the comparison to HBO benefits Netflix, and that he sees it as harmless mischief.

Mr. Plepler declined to comment specifically on Netflix, saying that "competition has been a part of our landscape for many years." He added: "And it isn't a zero-sum game. There is going to be good work done by our competitors as there has been in the past."

Mr. Sarandos said HBO represented more of a North Star to his company, a rival that can help Netflix elevate its game. "It's like in sports, where rivalries make both teams better," he said.

"The truth of it is they are a real guiding light," he said, adding, "They've shown the world that they can grow a premium subscription content service to 130 million subscribers, and so we're looking at that saying that that's a number that we're striving for." The consumer wins in the end, he said.

Time Warner executives do not share Netflix's view of a friendly rivalry, and privately express frustration at a comparison they believe is spurious and fueled by Netflix, which they say is more like Amazon or Hulu than HBO.

Nonetheless, it remains a seductive contrast. Mr. Plepler is a suave, politically connected executive who came up through the corporate ranks, and attends White House dinners. Mr. Hastings is a Silicon Valley entrepreneur who has a master's in computer science from Stanford and the kind of hubris that can accompany those credentials.

Netflix uses reams of data to make big bets on original content. HBO continues to follow its gut and experience, and draw on longstanding relationships with industry stars, to nurture ideas to the screen.

Mr. Sarandos has said that he does not believe in development, but instead grants creative freedom to writers and directors. He has become known in Hollywood for writing enormous checks with few of the traditional balances.

"They made the largest single order for original TV content in the history of the TV business," Mr. Katzenberg said, referring to a deal struck last June, "three hundred hours of original content from us, in one order."

"House of Cards," Netflix's most lauded original production, was delivered nearly fully formed — with two scripts and a comprehensive outline of its plot, a staff of writers and the director David Fincher attached — for about $200 million. Its producers received interest from several outlets, including HBO, but decided to make it with Netflix — in part because its financial firepower allowed it to commit to two seasons in advance, and in part because it left control in the hands of the writer and director, not development executives.

"I think they're very surgical in their approach," said David Glasser, president of the Weinstein Company, which will show "Marco Polo," a series about the 13th-century explorer, on Netflix this year. "You know very clearly the vision they have."

People familiar with HBO's process say it reviews a larger quantity of pitches, with about one in five making it to the pilot stage, and usually only after close consultation with development executives. Of the pilots, about 60 percent will be broadcast. That model, one person said, allows it to find and develop lesser-known talent like Lena Dunham, the creator of "Girls."

The channel's relationship with the creative community ensures it will continue to prosper, Mr. Plepler said. He cited "the line at the door of people who want to do things with HBO," and pointed to coming projects with Mr. Fincher, J.J. Abrams, Martin Scorsese and others. "That is our greatest advantage and one we intend to press on," he said. It is not alone in the premium cable space. Showtime has almost doubled its audience in the past 10 years and has a bona fide hit in "Homeland."

As Netflix moved aggressively to present original content, however, it became a threat to some of the very media companies it relied on for its movie library. The studios toughened their negotiations, and a deal that it had with Starz expired in 2012, stripping out many of its movies. Netflix now has its own deals with some studios for movies.

HBO has deals with four Hollywood studios locked in for several years, Mr. Plepler said, and about 78 percent of HBO viewing is in movies. A visitor to HBO is often greeted with more familiar contemporary titles than one browsing Netflix.

That contrast explains the enormous marketing push behind “House of Cards.” To Netflix, it is much more than just a television show; it is also a way to build a business and a brand. Other entertainment companies complain that Netflix does not release viewer figures and has been able to simply declare the show a hit. The press has gone along, they say, romanced by its status as an insurgent.

Mr. Sarandos said the company had no reason to release its numbers, especially since its programming is all on-demand with no specific time slot, and he has no advertisers or cable partners to please.

Some of Netflix’s strengths are also potential weaknesses, too. Signing up for Netflix requires only an email address, a credit card and $8. But what is easy to get into is also easy to get out of, and the company has significant churn. It does not have to negotiate with cable companies to carry its content, but that has made it vulnerable to a recent slowdown in streaming speeds, which means low-quality playback and longer load time for viewers. And Netflix’s vulnerability would only increase if Comcast succeeds in buying Time Warner Cable.

While Netflix has used a good portion of its revenue to build scale and secure enough programming to dominate television over the Internet, other players are seeking their share. Amazon has its own streaming service, Amazon Prime; its new pilots have been well-received, it has money to spend and it recently signed a streaming deal with 21st Century Fox. Disney’s chief executive, Robert A. Iger, recently voiced a determination to “out-Netflix Netflix” by creating its own binge-ready programming. And

Hulu is owned by the television networks themselves.

For all their differences, though, HBO and Netflix seem to be learning from each other. HBO's new drama, "True Detective," was delivered with eight scripts written, and a director and stars attached. Netflix, said a person familiar with its processes, has hired more production executives and is taking a keener interest in the development of the shows it buys.

"These companies are morphing into the middle," said Jeremy Zimmer, head of United Talent Agency. "The technology companies are working hard to develop good content and the smart content companies are embracing innovative technologies. The idea that one has to cannibalize the other is counterproductive."

That sentiment was echoed from the White House last week. President Obama stopped Mr. Plepler at a state dinner to ask for advance copies of "True Detective" and "Game of Thrones" to watch over the holiday weekend. Then on Thursday, the night before Netflix released the new season of "House of Cards," a message appeared on the president's Twitter account: "Tomorrow: @HouseOfCards. No spoilers, please."

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