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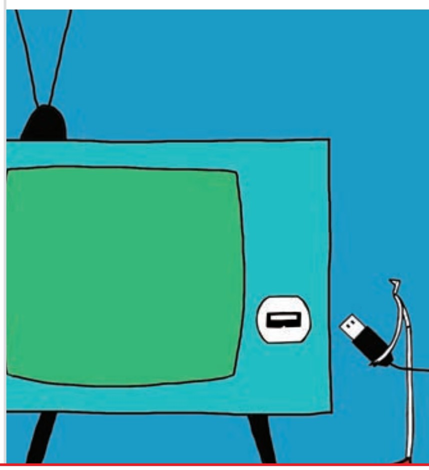
by Christopher Vollmer, Sebastian Blum, and Kristina Bennin

Each month, YouTube draws 1 billion unique visitors who watch a combined total of more than 6 billion hours of video. Attracted by this massive user base, which is equal to 40 percent of the worldwide online population, a new breed of company—the multichannel network (MCN)—has emerged in recent years. MCNs aggregate thousands of digital video channels and large communities of content producers, partnering with YouTube to syndicate and monetize their content as well as distributing videos on their own websites. For example, Maker Studios, the largest MCN, has 55,000 channels and more than 5.5 billion video views monthly. About 80 percent of the Maker Studios audience is in the highly desirable 13-to-34 demographic, and half of it originates outside the U.S.

These numbers have captured the attention of major media companies, which are now trying to get in on the action by buying stakes in MCNs or acquiring them outright. In 2013, DreamWorks Animation paid US$117 million to purchase the youth-focused AwesomenessTV. In April 2014, Disney purchased Maker Studios in a deal that could total nearly $1 billion if certain performance milestones are met. And in the autumn of 2014, Otter Media—a joint venture between telecommunications giant AT&T and media and entertainment portfolio company the Chernin Group—acquired a majority stake in Fullscreen, valuing that MCN at a reported $200 million to $300 million. For established players, these deals all follow a similar strategic logic: Secure a leading content and distribution position in the digital video ecosystem as audiences and advertisers begin to shift online.

However, if these investments are to truly drive growth, media companies will need to rethink their old playbook. The same strategies that drove success in broadcast TV, cable, and film won't be sufficient to expand, monetize, and integrate MCNs. For one, the content is markedly different. Although MCNs are typically organized by programming genres similar to those of cable/pay-TV networks—such as news; sports; entertainment; and lifestyle interests like cooking, shopping, and fashion—the tone and production value of MCN content emphasizes an unfiltered "authenticity" that is designed to appeal to a young audience. Most important, MCNs produce content that is designed from the start not just to be watched, but also to be shared on social media.



And it's not content alone that sets MCNs apart. These new, high-growth companies have succeeded in building large audiences on YouTube by moving rapidly and being willing to experiment and innovate. Big media companies therefore aren't just buying digital market growth when acquiring MCNs. They are hoping to add a variety of attractive, digital-first capabilities that they have struggled to develop from within, by leveraging the creative talent, technology, and ideas that make MCNs so appealing to the next generation of video consumers.

Of course, larger players bring many capabilities to the table that can complement MCNs and make their business models more viable. They're typically better at monetizing content (via both advertising and subscriptions), they know how to package and integrate brands across distribution platforms, and they have well-established relationships with marketers and the advertising-buying community. The big media companies also have significant intellectual property—such as brands and characters from television and film—that MCNs can access and distribute via their digital channels. And large companies can also accelerate MCN revenue generation in other high-growth areas,

Illustration by Justine Beckett

such as gaming, e-commerce, merchandising, and licensing.

As both sides begin to see the value in combining their complementary capabilities, more deals are likely to move forward. The following strategies can help large media companies make multichannel networks a growing and profitable part of their portfolios.

• **Platform diversification.** In general, YouTube is the principal platform used by MCNs, yet thus far, MCNs that depend on YouTube alone have struggled to build a sustainable, stand-alone digital business. Currently, MCNs reportedly share about 45 percent of their revenue with YouTube and pay an additional 35 to 40 percent for creative talent. As a result, MCN margins may lie between 15 and 20 percent, but this arrangement leaves little room for profit, because they also have to invest in technology, marketing, sales, overhead, and so on. So although YouTube will remain a must-have partner for MCNs in the foreseeable future, it shouldn't remain their only partner. Options include other major digital platforms such as Facebook, Yahoo, and AOL, as well as other digital video services such as Hulu and Netflix.

In addition to seeking distribution alternatives to YouTube, media companies should consider building out their MCN's digital properties under the MCN's own brands. For instance, they could use YouTube to acquire online video users, and then migrate these fans to other, wholly owned digital assets with more favorable economics. Large media companies' experience in pushing content and audiences across different channels and driving cross-promotion should give them an advantage here.

• **Global expansion.** Cisco projects that consumer Internet traffic from video use will account for 79 percent of all traffic worldwide in 2018 (up from 66 percent in 2013). In the U.S., millennials are increasingly likely to watch online video in place of traditional television. But the effect is even more pronounced in emerging markets. According to a 2013 Nielsen report, some 15 percent of mobile users in Brazil and 17 percent in China watch videos online three times a day. These users in emerging markets will play an ever more important role in driving digital video consumption. Media companies partnering with MCNs should actively pursue these new audiences, even as they continue to grow their positions in the U.S. and Europe. To do so, MCNs should broaden their content offerings to suit markets around the world, especially through mobile video, and focus increasingly on pursuing local partnerships.

• **Content creation.** MCNs already aggregate and create their own content through their "maker" communities. But media companies should prioritize investment in more original content, supporting their MCN partners in moving from pure aggregator to aggregator–producer—similar to how Netflix has produced original programming such as the series *Orange Is the New Black* and *House of Cards.* The goal is to more cost-effectively create distinctive content that still appeals to younger audiences who are seeking alternatives to traditional video programming. Armed with data from their thousands of online video channels, MCNs can generate insights on what's working, what's being viewed, and what's being shared. Such insights are not typically a strong suit of incumbent media and entertainment companies, which still largely use viewer metrics and programming development processes that lack a digital-first focus.

• **Monetization.** Advertising dollars are beginning to follow the growth of MCNs. Major buyers like Verizon Wireless and Mondelēz International, for instance, have recently shifted double-digit portions of their television ad budgets to online video. But for media companies looking to monetize their newly acquired MCNs, the focus should not be solely on selling ads. Several lifestyle-focused MCNs have begun to explore business models that go beyond digital advertising, such as product placement and sponsored reviews—especially where they can match the tone of the clips they precede. Others are pursuing B2B partnerships in content production.

Finally, licensing and merchandising is emerging as a potentially attractive revenue stream, in which an MCN personality or content brand embeds products or merchandising into the programming, such as Kohl's move to launch a new juniors fashion line—the S.o. R.a.d. Collection—via a Web video series developed with MCN AwesomenessTV titled *Life's S.o. R.a.d.* Another example is Endemol Beyond's Michelle Phan, YouTube's top beauty guru, whose most popular episode has garnered more than 50 million views. Phan struck a deal with global cosmetics firm L'Oréal to launch her own cosmetics line. The brand speaks authentically to Phan's core audience, and the video star credits her young followers with inspiring her to develop the new products. Likewise, the makeup line's dedicated online store boasts features targeted at young shoppers, such as the ability to upload and share selfies of their makeup looks. Media companies will need to pursue these kinds of opportunities aggressively in order to maximize the revenue generation potential of multichannel networks.

Large media companies recognize how important digital video is today and how important it will be tomorrow—and they know that they'll need new digital capabilities that have thus far eluded them if they are to succeed in the rapidly transforming video ecosystem. Increasingly, they see MCNs as their way in. But the question is whether they, as owners, can support and eventually expand MCNs and their business models so that growth is not just sustained or even accelerated, but turned into profit. +

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