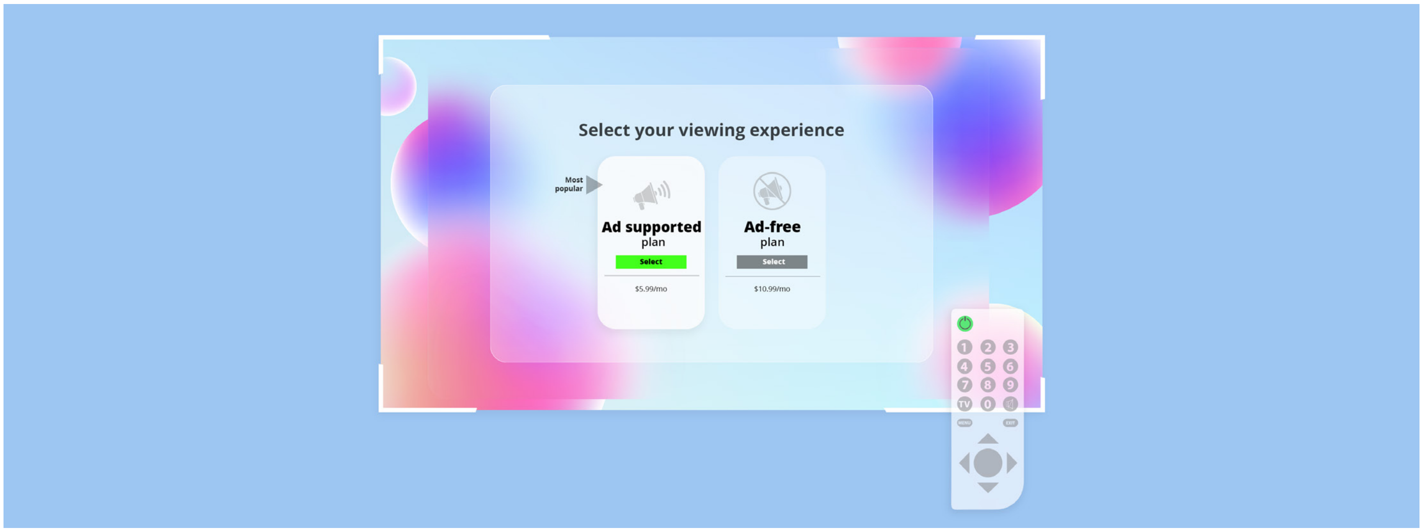


Everyone's watching: AVOD finds an increasingly receptive audience

AVOD's appeal surges as price-conscious viewers become more willing to watch ads in exchange for discounted or free streaming video.

Paul Lee, Jeff Loucks, and Kevin Westcott

CONSUMER AND INDUSTRY economics are making the case for ad-funded streaming video services increasingly compelling. Deloitte Global predicts that, by the end of 2023, approaching two-thirds of consumers in developed countries will use at least one advertising video-on-demand (AVOD) service monthly—a 5% increase over the prior year. It further predicts that, by the end of 2023, all major subscription video-on-demand (SVOD) services in developed markets will have launched an ad-funded tier to complement ad-free options. By the end of 2024, half of these providers will also have launched a free ad-supported streaming TV (FAST) service. And, by 2030, it is expected that most online video service subscriptions will be partially or wholly ad-funded, catching up with emerging markets where ad-funded video-on-demand has always been the norm—an evolution that Deloitte Global predicted in 2020.[1]

We also note that ad-funded tiers from SVOD players will be joining existing ad-funded streaming services from broadcasters in most markets that have existed for over a decade. (Our analysis includes all platforms that offer professionally produced content, but excludes platforms that host user-generated content as this reflects a different business model, often predicated on low production costs.)

Consumers will seek out discounts amid rising content prices and other inflationary pressures

In developed markets, many streaming video services offered an ad-free experience as part of the benefit of a subscription. The expectation was that once viewers had become used to viewing without the interruption of ad breaks, they would never go back.

However, the proliferation of streaming services, each with its own set of must-watch content and rising fees, has made the fully ad-free experience harder to afford for many households, even among consumers in the wealthiest countries.

A single premium, ad-free subscription ranges from US$5 to US$20, a monthly cost affordable to many households.[2] However, when tentpole content—the most popular and talked about programming—becomes split across four or five providers, subscription costs quickly add up. For example, when HBO Max launched in the US market in 2020, it featured *Friends* and *The Big Bang Theory*.[3] *Modern Family* is now available on Disney Plus.[4] *Schitt's Creek* became available on Hulu in the United States as of October 2022. In all cases, these major series were previously hosted on different platforms.[5] Additionally, inflation has also climbed steeply, erasing income gains for many consumers.[6] The combination of these factors is nudging the mass market adoption of AVOD.

Advertising-supported tiers typically offer consumers a 50% discount in exchange for between four and 10 minutes of ads per hour. Viewers trade ads for more affordable access to favored content. Consuming commercials is just one option taken to cut cost: Another common choice is an annual up-front payment to get a couple months for free.

Deloitte Global has been polling consumers across multiple markets, asking which service tier they would choose when signing up to a new streaming video service. Across all markets, most consumers indicated they would choose an ad-supported tier, either at half price, or free (figure 1).

In addition to ad-supported, discounted SVOD, 47% of consumers across developed markets already watch ad-supported streaming services based exclusively on professionally produced content, most of which is typically free (figure 2). These are usually offered by national broadcasters or studios.

Some consumers might grumble that, post price rises, the only streaming service tier that fits their budget has ads. After all, advertising is already ubiquitous by default in most media, from broadcast TV, to mobile games, to live concerts. Cities teem with digital billboards; retail chains have in-store ad networks. So, introducing ads to streaming video is a change, but not a revolution. Furthermore, the ad load for AVOD services from former SVOD providers is likely to be moderate, with about four minutes per hour being standard in 2023. Ad minutes for broadcast TV, by comparison, may be double or even triple this during peak time.

Content providers will look to AVOD for subscriber and revenue growth

For "traditional" SVOD providers that launched without ads, a key reason for introducing advertising

FIGURE 1

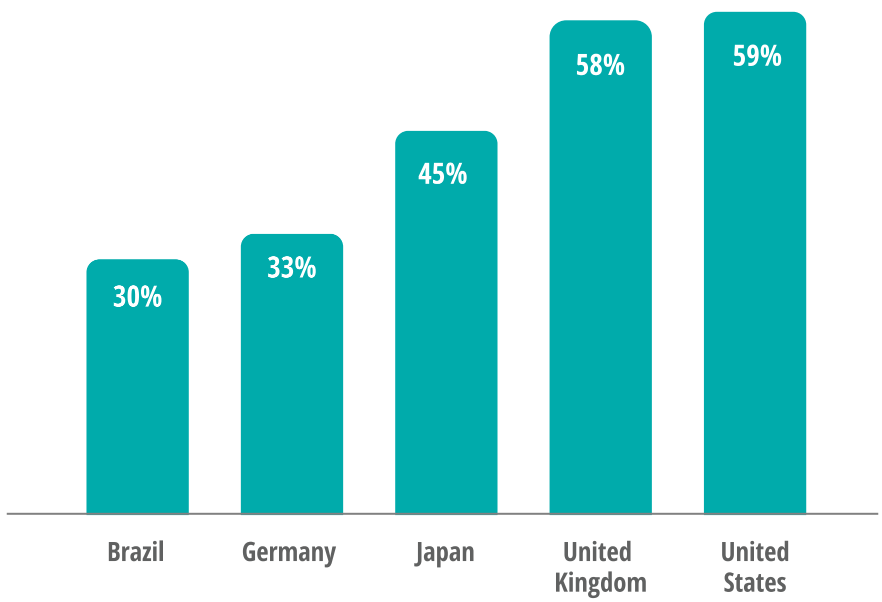
In most countries, consumers prefer ad-supported video options that remove or reduce subscription fees

	Brazil	Germany	Japan	United Kingdom	United States
No ads/ monthly fee	40% R$40	38% €12	30% ¥1,500	39% £10	41% US$12
6 minutes of ads per hour/ monthly fee	26% R$20	21% €6	15% ¥750	17% £5	25% US$6
12 minutes of ads per hour/no monthly subscription fee	34%	41%	55%	44%	34%

Source: Data from Kevin Westcott et al., *2022 Digital media trends, 16th edition,* Deloitte Insights, March 28, 2022.

FIGURE 2

Nearly half of consumers watch ad-supported streaming video services



Source: Data from Kevin Westcott et al., *2022 Digital media trends, 16th edition,* Deloitte Insights, March 28, 2022.

is to maintain growth, especially in developed markets in which net subscriber additions have become particularly challenging in 2022.

AVOD both offers an entry-level price option to new subscribers, and also a lower-cost option to existing subscribers who might otherwise cancel (churn from) a service. Since 2020, churn has become a fundamental challenge to SVOD players. In the United States, cancelation rates have hovered around 37% since the start of the decade. In most other markets, churn rates are just a little lower but the impact of churn on profitability is equally debilitating, given subscriber acquisition costs (figure 3). Cost or perceived value for money has become the primary typical driver of cancelation in 2022 and may be even more influential in 2023.

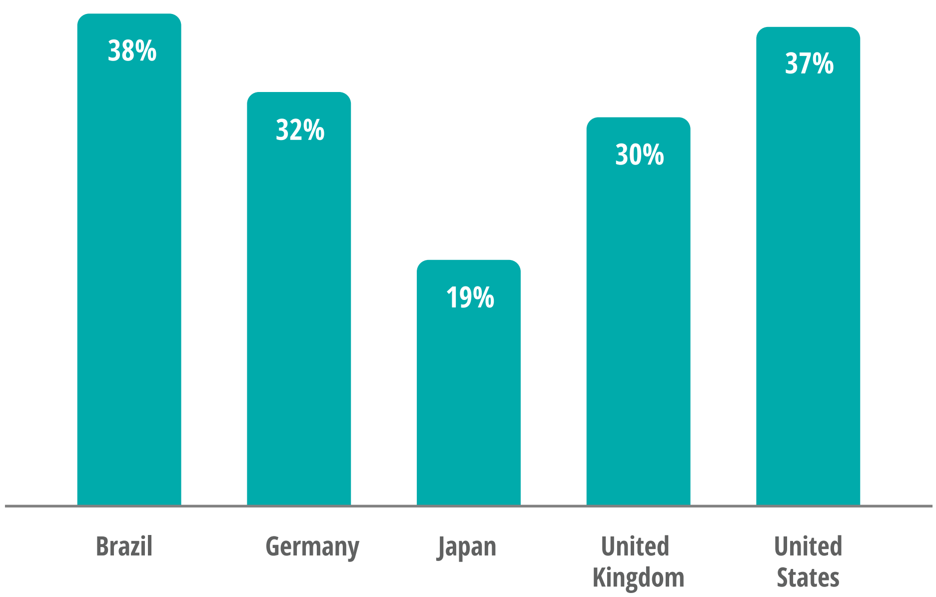
A fundamental driver for adding AVOD is to generate an additional revenue stream from advertising. As of mid-2022, many VOD-only content players were operating at a loss, with profitability contingent on adding users. For traditional broadcasters, AVOD offers an additional source of revenue, drawn from linear ad budgets, and, importantly, online video ad budgets that would previously have gone to online-only video providers.

In offering AVOD, providers are addressing pent-up demand from advertisers, who highly value the ability to show their ads on a large TV screen, as this tends to have more impact than the same ad shown on a smartphone. In recent years, the decline of viewing of broadcast TV has reduced the supply of younger viewers watching ads; AVOD,

FIGURE 3

Churn is a serious problem for SVOD providers in developed markets

Percentage of consumers who have canceled at least one streaming video subscription in the past six months



Source: Data from Kevin Westcott et al., *2022 Digital media trends, 16th edition,* Deloitte Insights, March 28, 2022.

which is predominantly watched on TV sets, and which is generally adept at aggregating 16–34-year-old viewers, addresses that demand, at a premium price and with targeting. In the US market, CPMs for AVOD could readily be more than US$50. In European markets, they should reach US$30.

THE BOTTOM LINE

AVOD's resurgence is healthy for the wider television industry. For SVOD providers, it unlocks an additional revenue stream and could reduce churn; for broadcasters, it raises the profile of a service they've been offering for years; for consumers, it enables continued, lower-cost access to their favorite content, albeit with the (minor) wrinkle of having to watch ads. While AVOD is not for every viewer, it's likely to appeal to the majority, even in the wealthiest of markets.

The transition to AVOD won't however be a walk in the park. Consumers should be migrated gracefully. SVOD providers may need to restructure, add sales capabilities, reformat existing content, commission differently, measure ad impact, and change culture.

One of the biggest challenges will to be make ad breaks as enjoyable as possible. This isn't just about a low volume of ads per hour; variety is critical. Repetitious ads, even in small quantities, are tedious. The range of commercials shown should be similar or superior to that for traditional television. For this to happen, content providers should replicate the ad sales organization and culture that traditional broadcasters have had for decades. For some SVOD players with a traditional broadcaster heritage, this should be easier; for streamers that have never sold advertising, the learning curve will likely be steeper.

Content that was commissioned for an ad-free service may require reediting to identify natural breaks to show ads. By contrast, library content that was originally edited to include ad breaks at regular intervals may not require any changes. Some licensed content may not permit the insertion of ads, so agreements may need to be revised. Content providers may also need to replicate the episodic release of content that broadcasters have perfected over the decades such that their tentpole releases are popular enough to drive the national conversation. For this to happen, new content should be teased and released at regular intervals, rather than a season at a time.

New arrivals to the AVOD market should note that its size will vary by market, with the United States leading in the long run, as it's the largest TV ad market globally. The US TV ad market, at a forecast US$70 billion in 2022, is 10 times bigger than the United Kingdom's.[7] Furthermore, in markets such as the United Kingdom, SVOD-to-AVOD converts will compete with existing ad-funded services from national broadcasters whose outputs have for many years driven the national conversation.

The introduction of ads into services that previously lacked them should be considered a progression, not a step backward. In the long term, funding the content that consumers want to see requires a blend of subscription and advertising revenues. This has long been the norm—not the exception—for almost all media. The virtue of the AVOD model is that it is inclusive of everyone, regardless of income. People may well love an ad-free experience, but not if it makes content unaffordable.

Endnotes

1. Jeff Loucks, Mark Casey, and Craig Wigginton, *Ad-supported video: Will the United States follow Asia's lead?*, Deloitte Insights, December 9, 2019.
2. As of 30 September 2022, in the US market, Apple TV+ cost US$4.99 per month and Netflix's Premium tier was US$19.99; See: Apple TV+, "Plans and pricing," and Netflix, "Plans and pricing," accessed October 26, 2022. Deloitte TMT Predictions is an independent publication and has not been authorized, sponsored, or otherwise approved by Apple Inc.
3. Warner Media, "HBO Max launches today," press release, May 27, 2020.
4. Disney + Hotstar, "*Modern Family*," accessed October 26, 2022.
5. *Hulu Press*, "Hulu acquires US streaming rights for *Schitt's Creek*," April 28, 2022.
6. Ira Kalish, *Weekly global economic update*, Deloitte Insights, September 28, 2022. In the United States, for example, "average hourly earnings across all industries were up 5.2% from a year earlier, matching the lowest reported since December. With inflation running above 9%, this implies a significant loss of purchasing power for workers."
7. Jon Lafayette, "GroupM sees US traditional TV ad revenue dipping 0.4% in 2022," *Broadcasting+ Cable*, June 13, 2022; *Thinkbox*, "£1 billion more invested in TV advertising in 2021," March 9, 2022.

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