Ted Sarandos, Chief Content Officer, Netflix

With more than 36 million subscribers in forty different countries, Netflix is one of the leading subscription streaming services in the world, especially in the United States (HBO, for comparison's sake, only boasts 27.8 million subscribers). In the past few years, it's also emerged as a potentially serious player in the game for original content, shelling out $100 million for its first outing, a two-season commitment for an adaptation of the BBC miniseries *House of Cards*, which premiered to critical praise on February 1, 2013. Original series *Hemlock Grove*, *Arrested Development*, and *Orange Is the New Black* have followed with equally impressive hype, even if the company remains mum on the exact returns.

Ted Sarandos, who has served as Netflix's chief content officer since 2000, deserves notice in this context for two reasons. First, he's the man behind the content, overseeing an acquisition budget reportedly worth nearly $4 billion. This makes him the chief negotiator when it comes to licensing content from major studios whose executives remain leery about the service's potential to cannibalize more lucrative revenue streams. Second, Sarandos has an unabashed disregard for the traditional television business model. He says audience content development is flawed, metrics are outdated, marketing is too costly, and the future of television is one made up of taste-based algorithms. He mapped out some alternatives for us when we met with him at his office in Netflix's Los Angeles headquarters.

MEDIA INDUSTRIES PROJECT: *I read that you signed 3.9 billion dollars' worth of licensing contracts in 2011. Is that true?*

TED SARANDOS: We don't release public numbers on our individual contracts. The number you're referencing is a cumulative figure over the next several years. It is the impact of long-range deals as they continue to flow product through Netflix.

How does that compare to contract totals made by other licensers, such as cable networks?

HBO is at the high end of that number, but we're still slightly larger on a domestic basis. But, remember, we're now licensing content for Canada, the United Kingdom, and all of Latin America.

Can you talk about some of the challenges you face when licensing content?

I started with the company almost thirteen years ago when we were focused exclusively on our DVD business. In the United States the "first sale" doctrine enables a company, with little friction, to acquire a large library of movies and television shows and then distribute those titles because the original copyright holder does not have a perpetual license. In other words, a company can buy a DVD from the content provider and rent or resell that DVD until it breaks. As long as the physical media holds up, you don't have to keep paying for your right to rent or resell it.

As you move to the streaming business, however, the "first sale" doctrine doesn't apply. Instead, you have to secure a subscription video-on-demand [SVOD] television right to distribute the content. And that license has to be renewed constantly in competition with other SVOD players. Right now, every network is interested in holding, withholding, buying, or blocking SVOD rights as a way to create an atmosphere for their own VOD services, like the TV Everywhere initiative.

Windowing also posed a challenge to us when we first entered the streaming business. Every major studio had a pay-TV deal, which typically grants premium channels and cable networks exclusive rights to major releases for a period of nine years following the DVD release. For us, that blocked every major movie release from our business for nine years. We were forced to license titles that were in theaters ten years earlier.

So, as classic innovators, we started out with a product—our streaming business—that addressed the needs of only a few consumers. It was just an add-on to our DVD business. It didn't cost extra; at the time, it wasn't worth paying extra. But because we offered it, people started developing the habit of watching it. Then the content improved, delivery improved—no more buffering—and the licensing environment opened up. We shared a licensing agreement with Starz, which helped shrink that nine-year window down to six months. We made direct deals with producers like Relativity Media, Open Roads, and New Image. This helped secure some exclusive rights to keep content from going into pay-TV deals with HBO and others. We also created new markets: acquiring the rights to distribute television content one year after broadcast didn't exist before we invested in it. It wasn't the day-after transaction on iTunes. It wasn't traditional syndication. It was a new window we created with broadcast networks and cable channels to license their shows in a season-after model. It's an especially great market for cable channels. They can't really syndicate their shows to other cable channels, and most of the content is so serialized that it's difficult to syndicate at all. We secured exclusive rights to *Mad Men* partially because we outbid everybody else, but mostly because nobody else wanted it. Because we can get more viewing for that show than anyone else, we can pay more for it than anyone else.

Simply put, we continued to invest in television, and grow our investment in television, because, as a company, we really believe the *digital* future of television is *the* future of television. I don't think it's controversial to say that the Internet will replace the cable box as the primary delivery mechanism for television within the next twenty years.

How has your relationship with content providers evolved? Some love you. Others see you as a threat.

I don't seek to be loved. I seek to be respected. The reason why a network or a studio loves you is because you make them money. If I don't make them money, then I don't expect them to love me. But I do make them money, and, more importantly, I make them money in unintuitive ways. We offer a really great economic sweetener: a buyer for highly serialized content, which is very expensive to produce and very hard to monetize. *Mad Men* is the perfect example: I not only gave AMC a very high license fee for that show, but the ability to binge on seasons 1–4 helped launched the biggest premiere [season 5] in the show's history. It's the same for *Sons of Anarchy*. People will stream the seasons we have before jumping to the network to watch the latest season premiere. I realize not everyone jumps. Some viewers will just wait for the next season to premiere on Netflix. But on a net basis I think most people migrate to the network after binging on Netflix. So FX grows their audience, and we derive value from the license fee. And then the network is able to produce more seasons of *Sons of Anarchy*. It's win-win for everyone, including viewers.

But what happens to the value of your content once a viewer makes the jump back to the network?

We think about the value of content differently. I think marketing has way too much influence in the current entertainment economy. It's the biggest item in this town on anyone's profit and loss statement. Fill the seats in the theater on opening night. Make sure everyone gathers at the same time on the same night in front of the television. And let's just hope everyone likes it so numbers don't drop 80 percent the next night or the next week.

For me, I'm doing the exact opposite. I want everyone who watches something to love it. And I'm willing to let the content take a lot longer to resonate with audiences because there is long-term value in doing so: you can't get as much content that really matters to you from anyone else for just eight bucks per month.

During the early days of the Internet, when everybody else was spending big money on Super Bowl ads, we were investing instead in technology, on taste-based algorithms, to make sure every single user had a personalized, highly effective matching tool to use when they visited our site. For us, that's why breadth matters. We are trying to match tastes, and tastes are really specific—even in your own household. So imagine trying to do it across the country. We have to have a lot of titles to produce the results our customers want.

But to answer your question, we've had *Mad Men* for a couple of years now. Last night, what was the most watched episode? Episode 1, season 1. There are new people coming to our shows every day. Plus we have thousands of titles. If you start watching *Mad Men* on AMC, you'll find something else on Netflix to watch. Our website, which is so personalized, will help you find something that you're going to love. What I really want you to do is find a show in which you'll just get lost, a show that makes you want to watch "just one more episode," even though you know you have to get up early tomorrow morning.

We are uniquely able to build our business model around that sort of behavior. If we pick the shows right and we invest heavily in the right kind of content, we'll make the viewers' dreams come true. We connect people to media in a way filmed entertainment has lost to video games and the web. We are restoring a sense of connection between consumers and content. I think audiences have lost that emotional investment in content because television can no longer provide them access in the way they want it, or in a way that matches current lifestyles. Restoring that sense of connection is the biggest shift in the economy of entertainment.

How have your metrics evolved with the launch of your streaming service?

Here is what the data from our DVD business tells us: We know what we shipped to you, and we know when you returned it. I have no idea if you watched it. I have no idea if you watched it twenty times.

With streaming, we have insight into every second of the viewing experience. I know what you have tried and what you have turned off. I know at what point you turned it off. If there's a glitch in the soundtrack or something wrong in the code, the data is so refined that it can detect mass quantities of people stopping at the same point and signal a red flag within hours of the content going live. That's a much more efficient quality assurance process. We don't have to wait for someone to complain. We don't have to go back to the file and watch every second of it to find and correct the problem. It's very sophisticated.

How do you use this data when negotiating licensing deals? Do you share any numbers with content providers?

We share some high-level viewing data—how many viewers and how frequently do subscribers view content. We don't really use the data to tell us what we should and shouldn't have on the site. We use it to indicate how much I should or shouldn't pay. In other words, if I can get an enormous amount of viewing, I'll pay an enormous amount of money.

We invest in a lot of content for really small audiences too, because it's still valuable for subscribers who are really engaged fans of a particular program, and, therefore, it's a valuable investment for us. We're fortunate because we have unlimited inventory space. It allows us to value content in more ways than just mass numbers.

For a lot of other buyers, the threshold is very high for what makes it on the air because they only have so much space they can allocate to programming—there are a finite number of hours in their schedules. In that world, new series usually succeed or fail because of marketing—did they get enough viewers in the right window to make it a success? Again, those windows are way too small. It has little to do with the actual quality of the content.

Our data draws from viewer behavior to bring a bit more science to that calculation. So, really, we can bring some equilibrium to a business that otherwise doesn't have it.

Does this logic apply to your original shows too?

Yes. I don't care if you watch our shows Wednesday night at 8 P.M. or Sunday morning at 10 A.M. Yet others will spend more money trying to get you to watch their shows at a particular time than they'll spend on the show itself. For us, we pick the shows by intuitive, data-driven hunches. The good example is our production *House of Cards.* David Fincher is directing. Beau Willimon is the showrunner. Kevin Spacey and Robin Wright are starring in it. It's based on a piece of intellectual property that we know very well. We can draw real data pools of people who love Kevin Spacey movies, David Fincher movies, the original *House of Cards,* political thrillers, and on and on. You wind up with a very predictable pool of viewers. If the show is executed well, we know how many people will watch it.

Does all this data make the current ratings system look suspect?

The current ratings model makes no sense whatsoever. It doesn't reflect human behavior at all. By design, I'm sure. If people really wanted to know who is watching what when, it's completely knowable. Digital cable boxes capture the data. It's all there. It's much better business for people not to know.

Can you elaborate on that critique?

My kids watch absolutely nothing on the linear grid. They watch everything on our DVR or on-demand. And there is no ratings credit for that behavior because they don't watch it live and they don't watch it three days after or even seven days after the original broadcast. Yet my daughter is the most engaged *Gossip Girl* fan on the planet. She should count for four viewers! But she doesn't count at all because she doesn't watch it in a way the current measurement system values. She likes to stack—to marathon on a Saturday afternoon—and that's the way the entire CW audience watches content.

Our own data supports this trend. For people watching television, especially younger viewers, they're no longer connected to a linear grid. They very much consume television on-demand: when they want it, where they want it, and how they want it. Also, the shows that work well for us, like *Mad Men,* don't necessarily draw the highest television ratings. Yet we know viewers of *Mad Men* on Netflix are much more engaged than viewers of the show on AMC. It's ridiculous to base the value of content on such a flawed measurement system.

What's your window to determine success?

Our economics are based on the length of the license—one to five years, depending on what the deal is. It's no more or less valuable for us if you watch it on either end of the deal.

It's the same for original content. It's no cheaper for me if you watch it all at once or watch it over the several-year license that we have the show for. It's more important to me that if you're someone who is going to love it, you watch it eventually. And if we think you're going to hate it, we don't even show it to you.

What are your primary policy concerns?

Privacy is in our blood. We are a Silicon Valley–based intellectual property company that was born on the Internet. We will not have credit card leaks or data leaks. We know the importance of protecting privacy; it's what we do.

We are actively lobbying to change the Video Privacy Protection Act. Congress passed this law in the eighties when a Supreme Court nominee's [Robert Bork] video store rental records were leaked to the press during his confirmation hearings. Your rental history is now legally protected, but it's such an antiquated law written at a time before Facebook popularized the idea of sharing. I have two teenagers at home, and they share everything. We're living in a culture of sharing, recommending, and curating. You can share the music you listen to on Spotify. You can share the books you're reading from Amazon. You can share the news you're reading from the *Washington Post.* But this law makes it impossible to do the same for the videos you watch on Netflix. Yet we can do it in every other country in the world. We connect Facebook accounts to Netflix accounts, and people love it! Of course, if you don't want to do it, you just tick a box. It's simple.

It's a fixable problem, and we're working with Hollywood and the MPAA [Motion Picture Association of America] and with Congress to address privacy in a commonsense way that doesn't shut down the Internet or compromise free speech. We've done some amazing things in the world. I'm sure we can figure this one out too.

[*Editor's Note:* In January 2013 the U.S. government amended the 1988 Video Privacy Protection Act to allow social-media sharing of video-viewing histories from sites like Netflix when users consent to such disclosures.]

What do you see as the key sources of tension and/or misunderstanding in the relationship between Hollywood and Silicon Valley?

Hollywood believes Silicon Valley wants to commoditize all content, and Silicon Valley thinks Hollywood is their grandfather who doesn't understand how the world works. Both of those things are untrue.

Silicon Valley is trying to monetize content in the same way as all other distributors. But they also understand the more friction you add to transactions, the less frequently transactions happen. Critics of Silicon Valley argue Google wants to monetize everything, so it's all just a search result and the company won't support piracy initiatives because they will slow down Google's ability to accomplish these goals. But when you carefully consider the process of DNS [domain name system] blocking, you realize that it's a flawed process. You want to block "*Black Swan* Free Download" from appearing in a search result. Fine. But what about the kid who is performing in a local production somewhere called *Black Swan?* You get a poor search result in your hometown, because of the mechanism in place to block one thing also blocks this other thing. I'm not saying there isn't a solution—it can be done—but there isn't anything sinister at work in Silicon Valley either. It just wants to ensure the process produces the right results with as little friction as possible. There has been a bunch of work done to hide kiddie porn and illegal gambling, but those terms are pretty straightforward, whereas movie titles and the words "bit" and "torrent" in any combination prove more difficult to block effectively.

I hate to say it, because it has an economic impact, but a lot of anti-piracy efforts are just sport. Technology is great because it constantly evolves. But it also means that for every successful technological solution to piracy, a countertechnology will emerge. Look, the things we license from the studios—the content we spend millions and millions of dollars to protect—no one is stealing it. Most piracy happens in the theatrical window, and yet the studios continually focus heavily on content online. It's also much easier and cheaper to rip a DVD than it is to try to steal a file from us or from anyone else online. Focusing so much attention on the Internet is like nailing the upstairs windows shut but leaving the front door open.

Can you talk a little bit more about the unique challenges you face in different territories?

The biggest thing country to country is trying to address different windows. Remember, the United States is the only place with the funky pay-TV block where a movie is licensed for nine years. Everywhere else has just one pay-TV window. It's eighteen months, and then it's open buying. So we'll bid for titles when they come up, and we'll bid competitively. We'll even bid in the first window and pick a few titles off here and there.

Already we are pretty serious competition in the U.K. television market. We've been able to secure exclusive rights to some television series from the United States, making us the premiere window in the United Kingdom for *It's Always Sunny in Philadelphia* and for *Breaking Bad.* We are the only place U.K. viewers can access those shows.

In Canada we are the premiere window for *90210, Damages,* and the BBC show called *The Hour.* We have a number of similar deals where we bring foreign content into different markets around the world, including the United States. It's been an interesting sweet spot for us. As we expand internationally, people get a little less nervous about us in the market place. They increasingly see us as another opportunity to distribute content globally and less like a regional threat.

Who are your key competitors?

It's a little bit of everybody, honestly. We compete for consumers' time and attention. Comcast wants to make us obsolete by improving TV Everywhere. That's fine. They just shouldn't be able to do it for free. We pay a very large fee for streaming rights, and if they're willing to pay for them too, then we're just straight competitors. I'll still bet on us over them.

Obviously we also compete with HBO for content and subscribers. They're probably our strongest competitor because their product is so similar to our own. People say our investment in original content makes us more and more like HBO. I think it's the other way around. HBO is becoming more and more like us by making their content available on-demand and on mobile platforms. Our current challenge is to make better originals more quickly than they can perfect what we already do so well.

Actually there's a flaw in that logic. Bundling constrains the market for premium television. You can't have HBO if you don't have 125 dollars' worth of cable. Netflix is direct to consumer. For eight bucks a month, you can have the content you want when and where you want it. I would argue that makes us far superior. We're not behind a big, expensive cable pay wall. How many more people would have HBO today if bundling was out of the equation? Of course, there's the argument that bundling actually works in HBO's favor, but I really don't believe that's true.

I don't know what to think of Amazon as a competitor. We're real competition—for content and subscribers—in the United Kingdom, where they own LoveFilm. But they have this funky product here where they are adding streaming to freight, which risks contradicting their core business. I wonder if they're just trying something new? I wonder if they're dabbling? I wonder if they're thinking about the loss of revenue over time from physical media? I wonder if they see the streaming service as a way to feed content to the Kindle? Right now, they are hard to read because they do so many things. But they also are really smart about e-commerce and interface design.

We have set the bar very high for competitors in terms of content costs. I don't think you can get in on the cheap anymore.

What's your brand? If it's not TV, it's HBO, but what is Netflix?

What is HBO anymore? What does that mean to you? Quality? What kind of quality? PBS quality? Something trendier, more cutting edge? I'm wrestling with this all the time because so many other channels now do it better than HBO. FX is better at it. AMC is better at it. By better, I mean the shows are better. I really loved *The Sopranos*, and I really, really like Bill Maher, but that's what, two in twenty years? HBO no longer has an exclusive grip on "quality" television.

So you're saying its moment has passed?

It's a very risky business to put all of your chips in a handful of baskets. You have to be really good at it. You have to spend a lot of money on it. HBO spends a lot of money on development, but the shows are fewer and farther between. I think *Luck* is an example of how things can go wrong. I think *Girls* and *Veep* can go either way. It's hard to continue to say HBO is not TV when FX and AMC have become just like HBO.

Why venture into original programming?

There are a few reasons. If services like TV Everywhere and HBO GO gain traction, then they will start to attack us on the things we believe we do better than anyone else. Subscription. Personalization. Encoding. Multi-platform delivery. We need to differentiate ourselves on all fronts.

Our data and algorithms help us perfect personalization. Likewise, we manage that data, including credit cards, more safely than anyone else. We deliver content on more devices than anyone else. We give access to full seasons. TV Everywhere only provides the last five episodes. Hulu is completely random and differs from show to show.

Ultimately we want to produce original content, because it's time we have more control over the shows that matter most to our costumers. We've really come to appreciate the value serialized shows provide. So many people watch them and love them. Our data supports the trend, and that's why you see such an explicit investment in television on Netflix. We've been able to grow the audience for serialized content by recognizing their behavior and securing more and more highly serialized, well-produced, one-hour dramas.

Yet you discover pretty quickly that networks don't make very many of these shows anymore because they're expensive and they're perceived as difficult to monetize. HBO, Showtime, and Starz are making them, but they're also the people who least want to sell to us in the season-after model because we are direct competitors. So at a certain point I said, "Are we going to remain dependent on everybody else making good shows, or are we going to try to develop some of them ourselves?"

It would be much easier for us if HBO, Showtime, and Starz would just sell us previous seasons of their shows because they're proven and they're good at it and we would pay for them. But the truth is that they don't want to open that door. So it's time to figure out if we can become good at it ourselves.

Also, I think it's the direction the entire entertainment industry is heading—networks and cable channels will evolve into something like web channels, just like radio networks evolved into TV networks, and TV networks evolved into cable channels. Look at the widgets on a Samsung Smart TV. You see Netflix. You see Hulu Plus. You see MLB. It gives you a sense of things to come. Currently the problem is that network brands don't really mean anything. If they want to survive, broadcasters need to figure out how to make their brands more meaningful. Cable is better at this. Comedy Central, for example, will be very powerful in this new world.

When a creative comes in here and pitches a program idea, how is it different, or is it different, from them going to a network or a cable channel?

It's different today than it will be in a couple years. Right now, I'm trying *not* to build a big development infrastructure. The existing development departments in networks and cable channels are typically risk management. If a show doesn't work out, it's *not* because they didn't invest millions of dollars into development. They spend $8–$10 million on a pilot that they screen to sixteen people and decide not to make it because of how it tested. It's not a good investment, but people do it.

What I said I would do early on is vet the projects better. Let's shift the development burden to the producer. If they'll invest a little more in the project and bring it to us better developed, a couple of scripts, talent attached, a bible, then we can make a bigger commitment to them, meaning I won't give them anything short of a full-season commitment. It's how we got David Fincher to jump in with us. We gave him a two-season commitment for *House of Cards*. Nobody else would do that, and they all thought we were nuts when we did. But I feel much better spending what we did knowing that I'm going to end up with twenty-six hours of content that at worst is going to be mediocre, and I highly doubt David Fincher would create a mediocre product. So that was the bet. That's as far as I wanted to bet creatively. It had the stars attached. It had scripts written. It had a showrunner. It had a bible. It had executive producers with great track records. We could have done the same thing as networks and literally spent $8–$14 million just to shoot that pilot. HBO did that with *Newsroom*. It had the most expensive pilot in history. I wasn't going to take the risk of spending all that money and ending up with nothing to watch.

So that's how we're different: If producers are willing to develop a little bit more, we're willing to make a much bigger commitment.

Why do you stick to the formula of a season being thirteen episodes?

No reason, and we won't always. *Arrested Development* is only ten. *Lilyhammer* was only eight. We have flexibility with running times too. Remember how long the negotiations between AMC, Lionsgate, and [Matthew] Weiner delayed the season 5 premier of *Mad Men* because, among other things, they disagreed over two minutes of run time? I don't care about that. I want the show to be really great. If it runs over, or if it runs short, it's fine, as long as it's just enough time to tell the story perfectly.

How much of your business do you see original content becoming?

It's a very small percent now in terms of total spending.

Do you want to talk about that percent?

No. *[Laughter]* It's single-digit though. But with success, there's no reason why the number won't grow dramatically, especially if we're good at it and people watch. Then it's a good use of our money.

I think *Lilyhammer* is a really good example of what we can accomplish. *Lilyhammer* was not a mainstream project. Half of the dialogue is in Norwegian and subtitled in English. But with a fraction of the marketing budget and using our own tools on the website, we built a really nice-sized audience for the show. We're definitely doing a second season, and its success is indicative of what we can do on the site with other original content.

Can you tell us a little more about the algorithms you use?

Our algorithms are incredibly precise and draw from multiple data points. The star rating is a dependable indicator. You watched this show, and you rated it five stars. If you rated the show but didn't stream it because you saw it in a theater, on a DVD, or you just rated it because you like a particular actor it features, the algorithm weighs the rating slightly less. Similarly, if you only partially watch something and rate it, the algorithm degrades the ratings value too. We account for all of those behaviors. Star ratings also are one of our internal metrics. How closely can we predict the rating you give a film or television show? We can predict within half of a star or quarter of a star.

We also have implemented a lot of predictive mechanisms: People who love X, Y, and Z also love these films but hate those films. We've made really incredible strides to predict what people watch right after they finish something else. Basically, it's a statistical push based on what other people have watched and really enjoyed immediately after viewing the same program you just finished. There are some really wonky results here too, like right after somebody watches *Thelma and Louise* they are much more likely to watch a Geena Davis movie than a Susan Sarandon movie.

Algorithms drive our entire website—there isn't an inch of uncalculated editorial space.

How are you promoting your original content if algorithms run the site?

We treat it the same way you might promote a lesser-known movie. First we identify attributes of the production that we think best matches the taste preferences of a large population of customers. We call it a "cold start." Then we immediately replace our attributes with attributes culled from the first couple hundred people who rate the program. So our marketing improves.

You will get a more prominent presentation for *House of Cards* if you're in a group of people the data indicates as likely viewers. But if you never watch anything but *Dukes of Hazzard*, you probably won't see an ad for *House of Cards*. *[Laughter]* We love that you love *Dukes of Hazzard*. It's not a personal judgment. *[Laughter]*

Are you dabbling in these various genres based on what your data suggests about your audiences, or are you trying to test what will really stick, a sweet spot of sorts?

I don't want our brand to influence our programs, and I don't want the programs to influence our brand. Netflix is about personalization. Making our brand about one thing over another risks polarizing our costumers. Tastes are just way too broad for us to even consider it. If you ask five people what they love about Netflix, they will give you five dramatically different answers. So we have to be really careful to ensure our brand is really about the shows *you* love, not about the shows we tell you about. If you've seen any of our external marketing for *Lilyhammer,* for example, it's mostly about the show. Netflix is downplayed.