Online Video Threats and Opportunities for Pay TV Operators

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Market dBrief™

Online Video

Threats and Opportunities for PayTV Operators

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This Market dBrief™ draws its data from TDG's new report:

PayTV Service Providers and OTT Delivery: How Soon is Now?

This report reveals how incumbent TV service providers can take advantage of online video to provide new and enhanced products for their customers. Using data from recent TDG research, it analyzes consumer appetite for operator-provided online video services, including features, likely demand at various price-points and the impact on existing subscriber TV service subscriptions. It also offers recommendations as to how PayTV operators should enter the OTT video market and examines the extent to which current proposals measure up against consumer expectations.

For more information, or to purchase the report, please contact us at sales@asktdg.com or 469.287.8050.

Online Video – Threats and Opportunities for PayTV Operators

PayTV operators continue to struggle with online video – is it foe or friend; a threat or an opportunity? In reality, it is both, meaning that PayTV operators must act both defensively to protect themselves from emerging Over-the-Top video competition, and offensively to exploit their content relationships and build a branded presence in web video delivery. This white paper addresses both perspectives and features research and insights from TDG's latest broadband media report, *PayTV Service Providers and Online Video Delivery: How Soon is Now?*

Perspective 1 – Online Video as a Competitive Threat

With the rapid uptake of online video and dramatic improvements in the quality of delivery fueled by innovations in advanced, adaptive codecs from the likes of Move Networks and Microsoft, it was inevitable that some online video distributors would look beyond PC delivery and instead turn their attention to delivering online video "over-the-top" (OTT) of incumbent PayTV services and directly to the television. This was made all the more inevitability by the proliferation of ancillary TV platforms including game consoles, digital video recorders (DVRs), and Blu-ray players.

As broadband connections find their way into the living room, the PayTV set-top box is no longer the only platform capable of reaching the TV. Mainstream consumer electronic platforms will soon feature Internet connectivity as a standard feature – especially video platforms – both to enhance core experiences and to deliver web-based entertainment to the TV. Yes, web video directly to the TV. As far back as 2004 TDG predicted that 2010 would be the year that online video would reach the living room via embedded CE solutions. It seems we were right.

A number of companies are already working to exploit the emerging OTT opportunity, either to supplement current PayTV services or to replace them outright. In this early market, OTT players already encompass a number of different companies and models, ranging from CE manufacturers such as Panasonic and Apple to content providers like CinemaNow and Kylin.TV. At the same time, most incumbent PayTV operators still do not see it as a legitimate threat, a sad but true comment about their strategic state of mind.

An excellent example of a major company looking to exploit OTT video delivery is Sony. With assets that span blockbuster Hollywood movies, PCs, Blu-ray players, the PS3 game console and, of course, Bravia TVs, Sony is looking to use the Internet and its PlayStation Network to create a virtual storefront to which all of its

CE devices will connect and through which it will deliver a wide variety of media content directly to connected consumer electronics.

Last year, CEO Sir Howard Stringer made their OTT vision quite clear:

> *"Sony's unique position in electronics and entertainment will enable us to provide specialized offering for Sony customers directly to their television outside conventional distributors and without the need for any set-top-box. This is an industry first…and it will happen this fall."* [1]

Sir Howard was true to his word. In November 2008, Sony released *Hancock* directly to BRAVIA-connected TVs before it was made available on DVD. This is just the tip of the iceberg; an early example of how major brands throughout the home media value chain will exploit the presence of Internet-enabled CE platforms to deliver their content to the living room (be it original or simply aggregated).

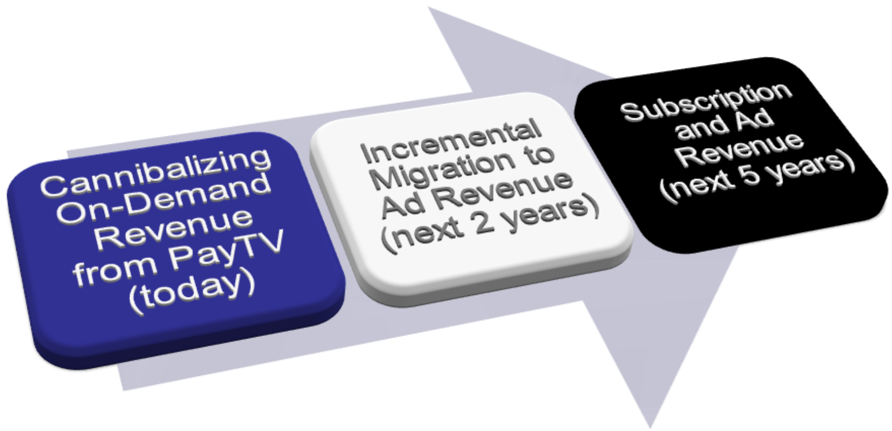
1.1 Online Video Delivery – Show Me the Money!

There is an ongoing discussion regarding to what extent and by what means web video delivery can best turn a profit. Will it be from per-viewing fees, subscription charges, advertising, as some combination of these models? Today online video purveyors are testing a wide variety of revenue schemes, none of which has yet proven profitable. Among the most compelling models at this point seem to center around advertising subsidies as opposed to user fees. The most successful ad-based model to date has been Hulu.com, rumored to be selling around 50% of its ad inventory at $35-$40 CPMs – not bad for a relatively embryonic web video aggregator and distributor.

While there is thoughtful disagreement about which model will ultimately win out, the trajectory by which revenue sources in general will evolve is more clear (see Figure 1 below). For example, game console-based movie services are already beginning to siphon revenue from PayTV providers' on-demand systems. In the next three years, significant gains in OTT ad revenue will follow significant gains in OTT video viewership. By 2014, OTT services will be mimicking the business models of today's PayTV operators who derive substantial revenue from a combination of subscriptions and advertising. Much of this revenue activity will be at the expense of traditional PayTV operators – unless, that is, they react to this threat now.

[1] From CEO Howard Stringer's presentation on Sony's mid-term corporate strategy given in Tokyo on June 26, 2008 (http://www.sony.net/SonyInfo/IR/info/Strategy/pdf/presen_01.pdf).

Figure 1 – Evolution of OTT Video Revenue Sources



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1.2 An Example of Today's OTT Services: Netflix and Video Streaming

But what exactly is the consumer proposition for OTT video, especially with PayTV operators offering hundreds of channels from which to choose? To answer this question, let's take a look at a recently launched OTT service that quickly earned repute: Netflix.

The Netflix streaming strategy is novel: make sure subscribers can access content on whatever device they may be using, whether it's a PC, a TV, or a mobile device (TDG expects Netflix will look to exploit the mobile channel in the next few years). While its streaming service first launched as a PC-only offering, it provided an ingenious way to tap into growing demand for streaming video in general and to hypothesis test the appeal of a TV-based streaming service in particular.

The TV streaming service launched in 2008 and required the purchase of a sub-$100 Roku Internet STB. Within just a few months (in early 2009), Roku reported more than 100,000 units had been sold, an encouraging sign. But unlike prior OTT video efforts, Netflix did not stop with a single (proprietary) platform, and quickly announced a downloadable client for Microsoft's Xbox 360. This proved to be a major success for Netflix: within just three months, Microsoft reported that more than 1.5 billion minutes of Netflix movies and TV had been consumed by over one million Xbox 360 users.[2] This same Netflix streaming client is now available on

[2] "Xbox Live tallies 1 million Netflix Watch Instantly Activations, 1.5 billion Minutes Served," Richard Lawler, *engadget.com*, February 5, 2009.

LG Blu-Ray players, TiVo DVRs, and will soon be available as a widget on Intel/Yahoo! powered TVs[3] (and this is just a cursory list of the hardware partnerships Netflix is set to announce).

With a combination of the latest movie releases (via mail-order DVD rental) and on-demand streaming (via a more limited library of titles), Netflix is beginning to look more like a premium movie channel. But how does Netflix stack up against the likes of an HBO? As noted in Table 1, Netflix provides very good value; something which, in these difficult economic times, is not escaping the attention of the consumers.

Table 1 – Netflix vs. HBO as a Premium Movie Service – A Comparison

Netflix	HBO
Mail-order DVD service include more than 100,000 titles.	Broadcasts more than 5,000 movies a month (mostly library titles).
Streaming services include more than12,000 movies and shows available.	On-demand services include hundreds of shows and 720 HD movies a month.
Also includes Starz Premium Content • Streamed on demand • Starz channel streamed live to the PC	Also includes HBO Premium Content • Broadcast live on HBO channels • Available on demand
New release DVD movies available through mail-order with 48 hour turnaround.	Movies broadcast 30-45 days after DVD release.
Streaming services delivered on specific game consoles, DVD players, TiVos, or Roku iSTBs at no additional cost to the subscriber.	On-demand services delivered on PayTV operator-provided STBs only.
Streaming services can be played back on PCs and properly-enabled TVs.	No support for PC viewing.
Access to everything, both mail-order rentals and unlimited streaming content, for $8.99 month.	Access to everything for $18.99/month.
	If you do not have digital TV service, total HBO costs could top $45/month.
More than 10M subs 10 years after launch.	30M subs 36 years after launch.

[3] TDG briefing with Russ Schafer, Yahoo! Senior Director of Product Marketing for Connected TV and Desktop, March 3, 2009.

Perspective 2 – Operators Standing By to Launch Their Own Online TV Services

As TDG has long predicted, online video (whether over-the-top to the TV or viewed on the PC) is now beginning to erode the value propositions of such marquee service provider offerings as VOD and DVR. In the last few months, however, operators have made a number of announcements regarding their intentions to bring their unique television services to the Internet. Generally, these new efforts center on bringing subscription-only PayTV content online but only to be accessed by those which subscribe to the PayTV service.[4] Companies such as Time Warner Cable intend to make this content available for free to current PayTV subscribers, as an *entitlement* (TWC's language, not ours). Operators are investing a great deal of energy in creating an virtual fortress online within which their (authenticated) PayTV subscribers can enjoy TV-to-PC content and behind which cable networks such as Discovery, Disney, and Viacom would feel comfortable making their content available.

But how receptive are consumers to such services?

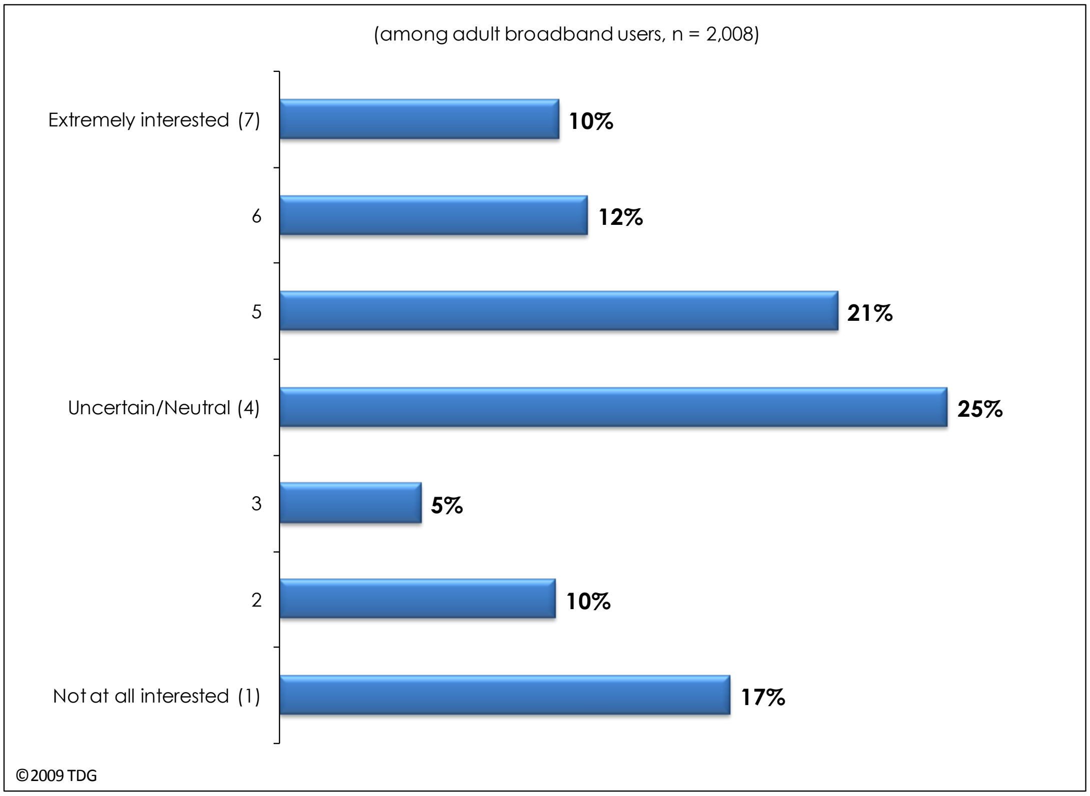
In December 2008, TDG fielded a very unique primary consumer project focused on evaluating interest in a wide variety of "new video" services, including a PC-based video service that featured the same content and features consumers enjoy from their PayTV services. The specific characterization of this service was as follows:

> *"Imagine that the same TV programs you currently view on your TV could also be enjoyed on your PCs – as long as your PC is connected to the Internet, you would be able to watch all your home TV programming on all of your PCs – desktop and notebook – regardless of time or location."*

Respondents were then asked of their interest in such as service. As illustrated in Figure 2, their answers are encouraging.

[4] "Cable Firms look to Offer TV Programs Online," *The Wall Street Journal*, February, 20, 2009.

Figure 2 – Interest in TV-to-PC Video Services



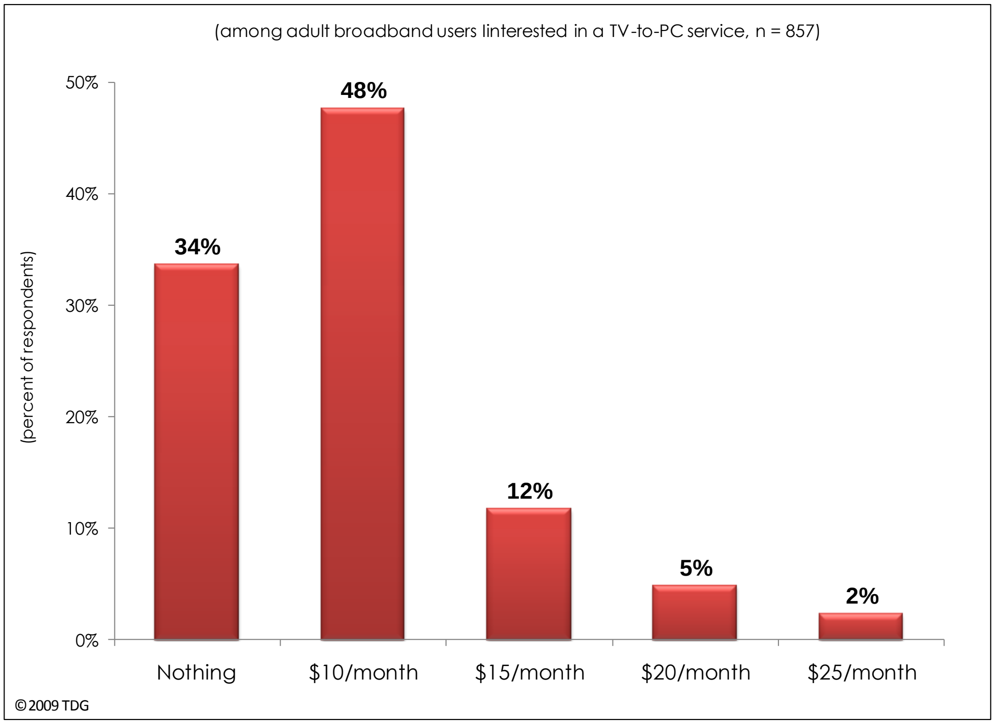
As illustrated above, 43% of adult broadband users are interested in such services. Perhaps more surprising is the fact that, though total interest varies by age, a sizeable percentage of each age segment is interested in a TV-to-PC service. For example, 56% of those between the ages of 18 and 24 are to varying degrees interested in a TV-to-PC service (not unsurprising given the proclivity of the young for online services). However, even 35% of 45-54 year olds are interested in such services. Given that virtually all adult broadband users also subscribe to a PayTV service, this provides a compelling case for the extent to which a TV-to-PC service (as defined) would resonate among consumers.

We next asked those interested how much they are willing to pay for such a service, specifically:

> *"What is the maximum amount you would pay per month for this type of TV-to-PC service? Again, we'd all like it to be free but we're interested in what you think this service would be worth."*

The answers to this question are summarized in the figure below.

Figure 3 – Price Consumers Would Pay for a TV-to-PC Service



Of the 43% of adult broadband users interested in a TV-to-PC service (as defined), 66% are willing to pay $10 or more each month for the service. Given that several service providers plan on making these services available for free to their subscribers, a persuasive argument can be made that this strategy is leaving significant money on the table.[5]

So how much money are we talking? Let's assume that this simple TV-to-PC service was made available to all digital TV subscribers in the U.S. for a flat charge of $9.95 per month. Further, let's assume that cable providers are able to achieve 17% penetration of the service over a 5-year period (not at all unreasonable given primary data and current trends). This combination would yield approximately $1.1 billion in revenue in the fifth year of deployment – nothing to sneeze at, for sure, especially in these tight economic times.

[5] "Cable Firms Look to Offer TV Programs Online," Sam Schechner & Vishesh Kumar, *The Wall Street Journal*, February 20, 2009.

Conclusions

Over-the-top delivery of online video directly to the TV is inevitable. At first, it will siphon revenue from value-added PayTV services such as VOD and PPV. Over time, however, it will threaten TV services more generally – that is, if operators are unable to cut OTT's Achilles' heel: the necessity of unfettered and open last-mile broadband access to the home. This speaks to the larger and as-of-yet undecided issue of network neutrality; an issue which is beyond the scope of the white paper. Nonetheless, the threat from OTT services is very real and PayTV operators are wising up to this fact. But that's only one perspective regarding online video; the second speaks to the opportunities that online video offers today's PayTV operators.

Given recent announcements, it seems clear that PayTV operators have recognized that the time to enter the online video market is now. Given growing consumer appetite for online video, operators must engage with their customers in this new medium or risk losing them to the manifold competition of the Internet.

This being noted, it would be a mistake to assume that the only target of web delivered video is to the PC screen. Netflix and many others are proving that consumers want this content on their TV screen as well as the PC. In TDG's quantitative research, consumers speak loud and clear of their preference for watching web video on their TV and the need to bring web-like enhancements to the TV viewing experience. Yesterday's passive TV experiences will increasingly fail to satisfy the needs of consumers and PayTV operators that act to bring this experience back to the TV screen will have a leg up on the competition.

Related Reading

For a more in-depth look at these opportunities, please see *PayTV Service Providers and Online Video Delivery: How Soon is Now?*

We hope this dBrief has helped you gain a greater understanding of the broadband video market and its challenges. But it doesn't end here. We invite you to take a few moments to visit our website and see for yourself how deep the research goes and how vast the data is.

At TDG, our mission is to help you locate your target audience of today, and point you towards your consumers of tomorrow. We apply our extensive research to your specific strategy. Ultimately, our success lies in helping you find yours.

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We look forward to speaking to you soon.

About TDG

TDG is the leading voice in the digital video ecosystem providing market planning and research services to keep our clients In Front of the Curve™. Since 2004, TDG has helped more than 250 technology leaders, media companies, and service providers to master the quantum shifts impacting how consumers access, navigate, distribute, and consume broadband media - whenever and wherever they may be.

For more information about The Diffusion Group, visit our website at www.asktdg.com.