Harnessing the Value of VOD

Tabitha Elwes
Partner

Kim Chua
Manager

On-demand delivery of video content over broadband will undoubtedly be one of the most disruptive changes in the television industry over the next decade, with wide-reaching ramifications across the media, telecoms and technology industries. In this article, we discuss the likely impact of VOD on viewing patterns, advertising spend, and business models, and explore the key issues for the many stakeholders in the VOD value chain.

Viewing gets personal

Early evidence indicates that consumers love VOD, particularly if it is free – and even more so when it is available on their TVs (not just their PCs) at the touch of a button.

- BBC iPlayer's viewing has grown steadily since its launch in Christmas Day 2007, and by March 2009 total views had passed 390 million[1].
- Virgin Media introduced iPlayer on its platform in May 2008, and the response confirms the popularity of VOD – over half of its subscribers use the VOD service, and those subscribers alone watched an average of one VOD show a day in December 08[2] ; iPlayer accounted for 15m views in March 2009, equivalent to 10 per month per VOD user[3].
- In the US, Hulu, the JV between NBC Universal and Fox, has enjoyed early success with revenues of US$70m and a margin of 15% in its first year, demonstrating that an ad-funded, professional content service can be successful.

Case Study: Hulu

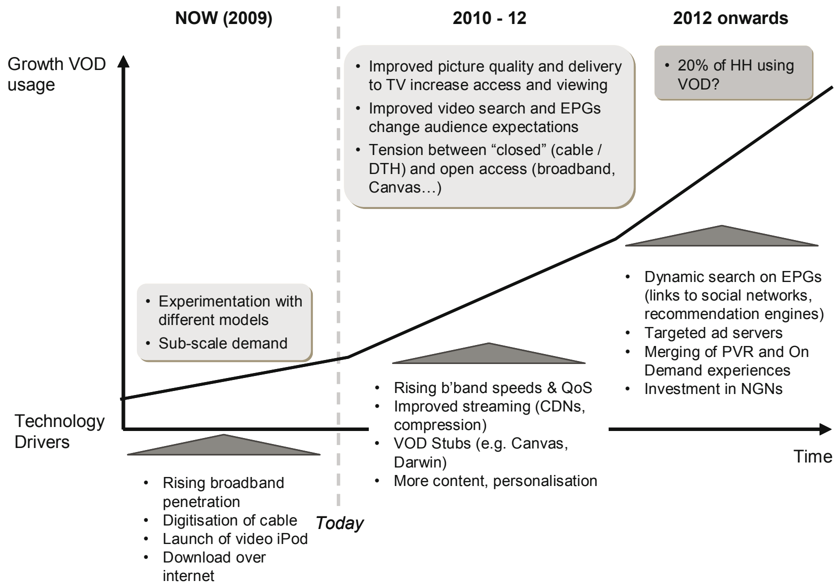
- Over 33 m Unique Monthly Viewers
- 380m views in March 2009 (2.5/week/UU)
- 75% of users watch Hulu off-site
- 5-6 unskippable ads per 30 min programme plus sponser pre-roll
- Revs ~$70m, 15% margin year 1, est $180m year 2
- Expected to launch in the UK in September

However, the VOD market is still in the early stages of development - for VOD to become mainstream and mass market, a number of technical and service enablers need to be in place.

- In the near term we need to see improvements in the delivery of content over the internet through increased broadband speeds, use of Content Delivery Networks (CDNs), improvements in compression technologies and buffering, all of which will improve quality of service
- The consumer hardware needs to be more widely available, particularly next generation set top boxes and integrated digital television sets that will enable VOD to be delivered to the TV
- More content has to be available and models for archive and special interest content need to be developed
- Economic models such as subscription, micro-payments and targeted advertising need to develop to counter piracy and allow both rights owners and platforms to monetise content effectively
- In the medium term, we see the need for services to evolve to embrace personalisation, social elements such as recommendations and chat, and technologies to enable targetting.

[1] BBC Annual Report and Accounts 2008/09e
[2] Virgin Media Investor Presentation 11 Nov 2008
[3] bbc.co.uk

Technical and service innovations to drive VOD uptake



Although there are issues to be resolved, we believe that many of these technical and service changes are imminent. For example, in the UK, one of the most advanced and competitive digital media markets, we observe the following:

- Digital Britain sets out the ambition for all households to be able to receive broadband at 2Mbps by 2012 (Universal Service Commitment)
- Infrastructure providers such as Akamai and BT's Content Connect are rolling out CDN and CDN-style services to improve content delivery
- Various consumer devices to bring internet VOD to the TV are in development; notable examples are Project Canvas (a potential JV between BBC, ITV, and BT); Project Darwin (from Sky, using their HD box); IP Vision, providing a hybrid DTT and over the top VOD content service; Apple TV; games consoles such as Microsoft Xbox and Nintendo Wii, and next generation Ethernet enabled iDTVs from the likes of Sony and Samsung
- Terrestrial broadcasters are investing to develop their catch up services; Anthony Rose, Head of Digital Media Technology at the BBC, has set out his plans for iPlayer to be personalised and his vision for iPlayer "going social"; commercial players are rumoured to be in discussion with video platforms such as Hulu and You Tube
- There is early experimentation with inserting advertising in VOD streams – Virgin is trialling this with John Lewis, Royal Mail and Kelloggs, and Sky is developing the capability to insert targeted, un-skippable adverting into video delivered via their PVRs
- BARB is evolving its viewing measurement to include VOD viewing from 2011

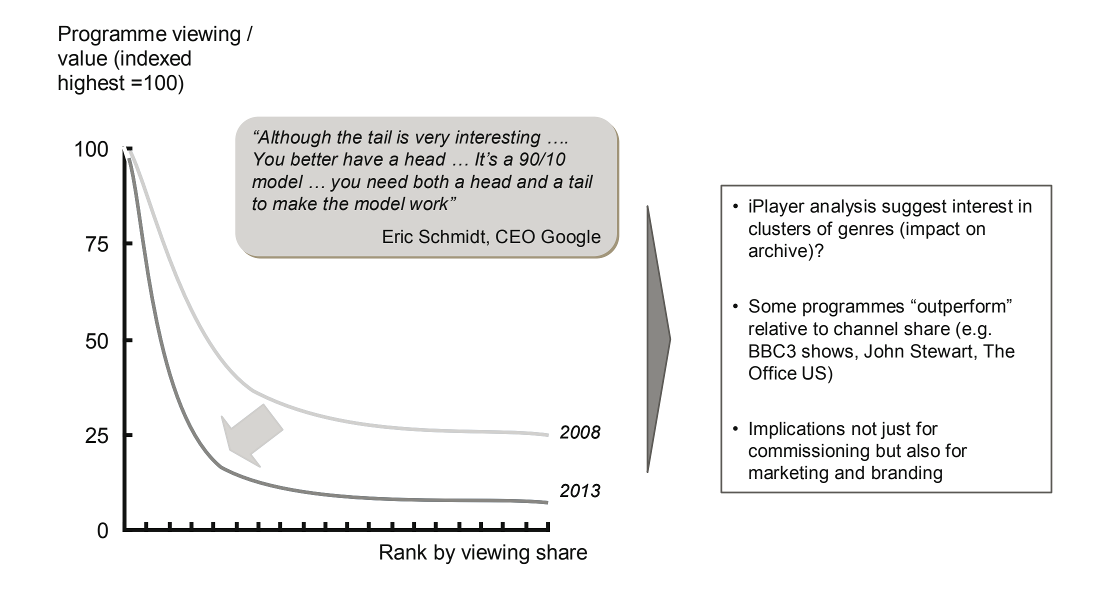
Our view is that all of these changes will drive the take-up of VOD. We believe that in five years, over 50% of households could have the capability to access VOD on one or more of their TV sets, and that up to 10% of UK viewing could migrate from linear broadcast to on-demand. Beyond this, we expect the proportion of on-demand viewing to keep increasing as viewers alter their viewing behaviour and as VOD functionality becomes ubiquitous. Indeed, we believe that within a ten year horizon 20% of viewing could be on-demand using a mix of PVRs, Push VOD and genuine VOD.

The hits will get hotter…

So how will VOD affect the shows people watch? To date early indications are that the bulk of demand is for free or advertising funded catch up programming. Demand is strongest just after linear broadcast and declines rapidly thereafter.

We think two types of programming will win out. First, the traditionally prime-time, mass market hits will concentrate even more viewing as people are no longer constrained by schedules and no longer need to choose between shows during prime time. This could erode demand for day time and post prime time programming.

Top 20 programmes by viewing share, now and projected

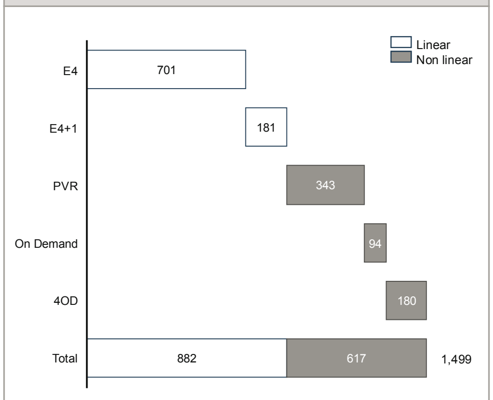


Secondly, there is early evidence of success when on demand is linked to 360 degree digital exploitation targeting special interest groups. This works particularly well with programmes aimed at youth demographics, who are early adopters of VOD, have high expectations about consuming content on their own terms and who are interested in creating special interest communities around certain content.

- Skins, the teen drama broadcast on E4, has increasing proportion of viewing from non linear delivery – whilst linear viewing fell compared to the previous series, viewing via non linear sources increased significantly
- Heroes in the US is watched more online or via PVR than through live TV, and has spawned a plethora of successful spin-offs such as Heroes Evolutions, the reality game based around the series

We believe that this polarisation of viewing hot-spots will translate into what broadcasters and content aggregators are willing to pay for content.

Skins Series 3 viewing by distribution method



Source: C21 Media 1 April 09

Reversal of viewing fragmentation

Our view is that increased consumer take-up of VOD could favour the terrestrial broadcaster with their portfolio of digital channels.

The reasons for this are as follows:

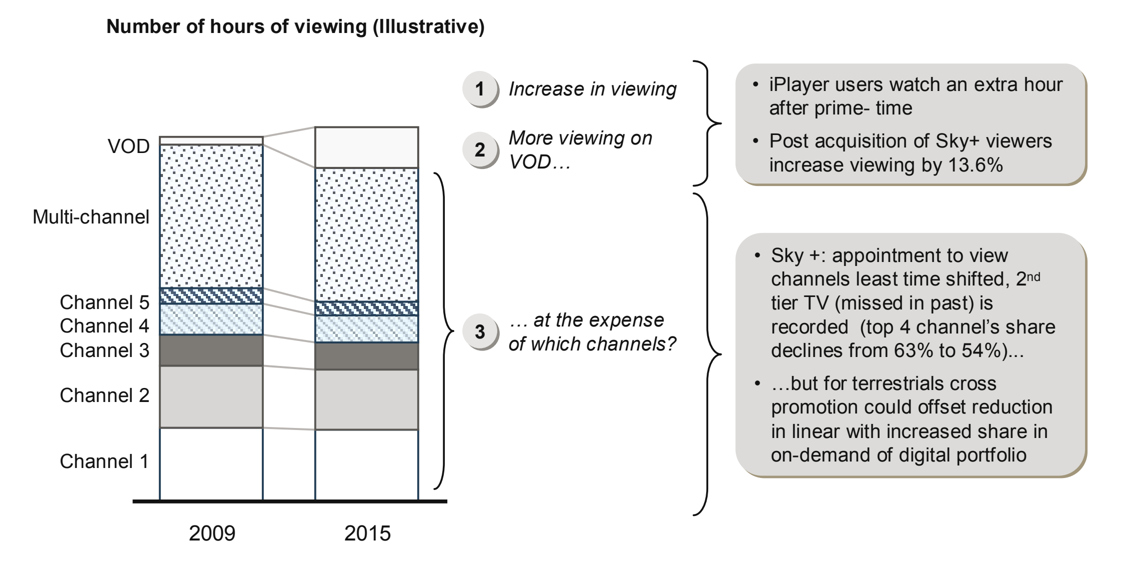
- Audiences will be less prone to channel-surfing and 'just watching what's on' if they are able to choose to watch their favourite programmes (or their friends' recommendations) at their convenience. Digital channels which rely on channel-flicking for much of their viewing, will suffer
- The top broadcasters will benefit from the power of cross-promotion, from linear to on-demand, driving viewers to their on-demand services and raising the profile and awareness of other shows
- Personalisation and social network functionality within each on-demand service will increase stickiness and the amount of viewing through each service
- Viewers will have limited tolerance to learn, use and personalise multiple VOD interfaces and services, and most will limit themselves to service provided by trusted broadcasters and platforms.

We note that our expectations for change in viewing share due to VOD are different from what might be inferred from changing viewing patterns due to the introduction of PVRs. Data on viewing habits from Sky households before and after they acquired Sky+ showed, first, that PVR increased overall viewing, and, second, that this viewing was captured by second tier channels (i.e. channels outside the top four)[4]. In fact, the Hallmark channel, with its line-up of US drama, was the most channel that benefited most as a result of PVR timeshifting.

Whilst some of these lessons can be translated to the VOD world, such as the increase in overall viewing, we think that the spontaneous nature of VOD compared to the premeditated nature of PVR affects the types of programmes and channels which will benefit from VOD. The psychology of PVR is 'record to watch later' which is quite different from the instant-gratification psychology of VOD, which is around 'what appeals to me now'.

Therefore, channels with a high reliance on repeats and undifferentiated 'in fill' programming will be the key losers in an on-demand world.

Expected changes in viewing share



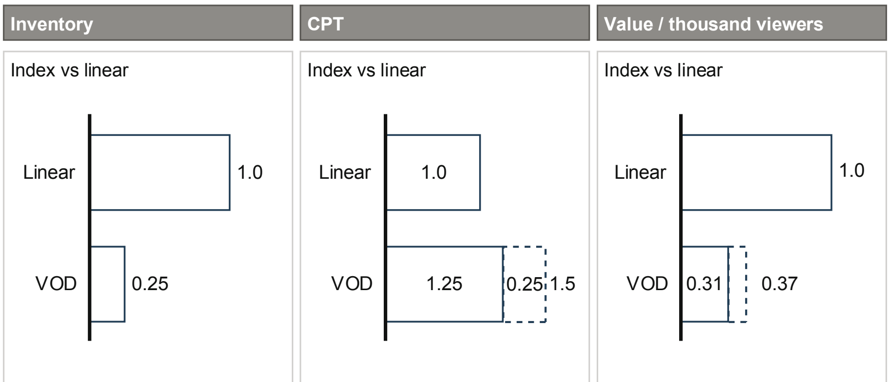
[4] Starcom 2008

Today's crisis of monetisation

The television industry is in crisis, hit both by the economic recession as well as by longer-term structural changes which are shifting advertising spend to online; a move that has been particularly marked in the UK.

Currently, the economics of on-demand are poor in comparison to linear broadcast. Lessons from the US (Hulu and ABC.com) suggest that on demand content can carry only about a quarter of the advertising minutage of television (a reflection of lower reach but potentially lower audience tolerance to advertising in the on-demand space). Although CPTs are higher, they are only 25% - 50% higher (and the gap is expected to narrow) and so do not compensate for lower inventory. On this basis, a viewer watching a show on-demand is only worth 30% - 40% of a viewer watching a show linearly.

Comparison of today's economics of on-demand compared to linear



This creates a dilemma for commercial broadcasters; they don't want to lose share in an on-demand world but in driving share they potentially erode their economics. However, it must be remembered that VOD advertising is still at an extremely early stage of development; and there may be factors that can improve the economics of VOD.

Monetising VOD… by growing VOD advertising

Online VOD advertising is embryonic; advertisers still see it as 'experimental' rather than a core plank of their media mix. Furthermore, current VOD advertising offers advertisers and media buyers only a tiny fraction of its ultimate potential. To fulfil its advertising potential, a number of enablers need to be developed:

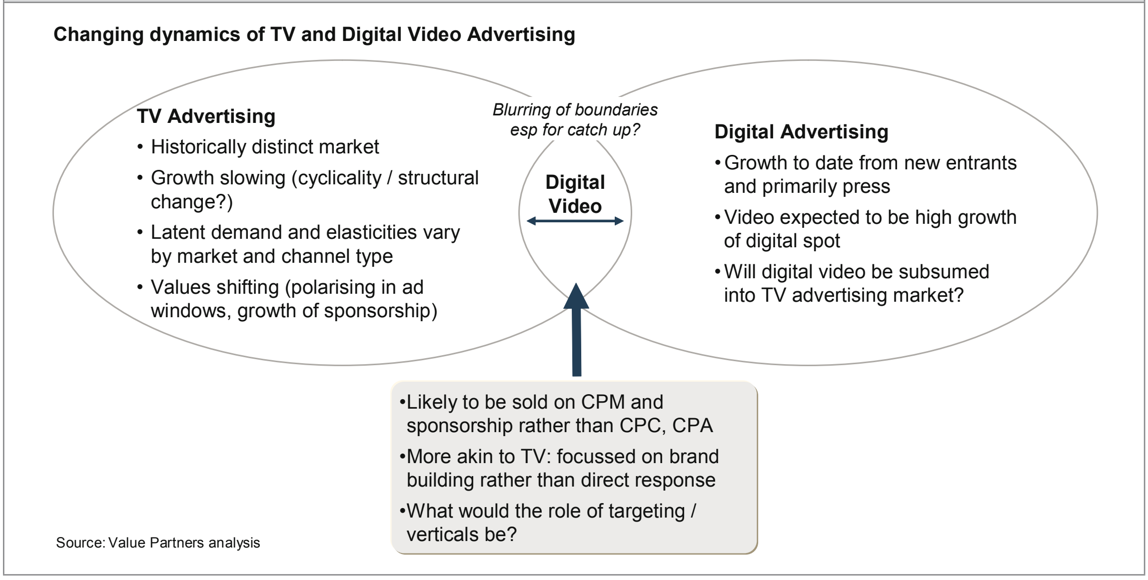
- A universally recognised and trusted viewing measurement system to measure viewing via VOD; in the UK BARB is planning to roll this out in 2011
- Moving online VOD to the TV
- Technologies to enable advertisers to serve targeted advertising to viewers based on their profiles, viewing habits or internet habits. This would combine the best of online advertising with the best of television advertising: immersive rich media video ads served to a highly targeted and relevant audience

These enablers will help to improve the economics of VOD:

- Increasing advertiser uptake: as advertising through VOD becomes more widely recognised and measurable, more advertisers will be willing to shift adspend to this medium
- Increasing inventory: audiences have lower tolerance for ads in a 'lean forward' PC environment; on the TV the tolerance is likely to be closer to linear TV levels
- Increasing CPTs: today's online VOD CPTs have a scarcity premium, but no premium to reflect sophisticated audience targeting and interactivity

Going forwards, we expect the boundaries between TV advertising and VOD advertising to blur, as VOD becomes more mainstream.

Changing dynamics of TV and Digital Video advertising



Monetising VOD… through Micropayments

VOD may also pave the way towards new business models, to reduce the industry's reliance on advertising. For example, as online VOD moves to the TV, there may be the opportunity to introduce micropayments for VOD content (the production community is pushing hard for this). Commercial broadcasters could charge very small amounts, 5p or 10p per show (the price of a text), for catch-up and archive content, or offer new supplementary content (eg 'behind the scenes' footage). For this model to work, there would need to be an easy to use and trusted payments collection process to enable single-click content purchasing. Alternatively, an 'unlimited viewing' option at £2–£3 per month could be offered and the proceeds split between the players.

Issues, challenges, and opportunities

For all players in the broadcasting ecology the growth of VOD means changes; some of it quite significant. For many this creates opportunities, but VOD is a discontinuity; success is not a given.

For terrestrial broadcasters

On-demand changes the broadcaster-viewer relationship, from an impersonal 1-to-many broadcast approach to a one-to-one interactive and personal relationship.

- How does this affect what programmes are commissioned and how programmes are made?
- What re-skilling and re-orientation is required for broadcasters to maximise value from VOD advertising and to build their new one to one relationship with the viewer?
- How does this affect broadcasters' multichannel strategy?
- How might this affect distribution costs?

For multichannel broadcasters

On-demand changes the economics of multichannel broadcasting:

- Does on-demand affect the viability of some channels?
- How does this affect the multichannel business model (eg free and ad funded vs subscription)?
- How does this affect the amount broadcasters pay for secondary rights?
- How does this affect the amount broadcasters are willing to pay for DTT and DTH transmission?

For producers

On-demand changes the producer-broadcaster-audience relationship

- How will on-demand affect the types of content commissioned by broadcasters? E.g genres, budgets, level of interactivity?
- How will this affect the sharing and windowing of rights with broadcasters?
- Does on-demand open up opportunities to reach audiences without broadcasters as the 'gatekeeper'?

For pay TV operators

On-demand offers audiences added choice and functionality – this could be an opportunity or a threat.

- Does on-demand pose a threat to basic tier pay TV subscribers?
- How can on-demand be harnessed to enhance the pay customer proposition?
- Can on-demand delivery help to manage the distribution costs of the business?

For ISPs

On-demand will increase the load on ISP networks, both in terms of new customers and increased traffic from each customer.

- How can ISPs monetise this - can ISPs charge content providers for the safe delivery of content? Can ISPs charge customers for receiving content?
- Does this open up opportunities for ISPs to move into content aggregation, rather than remaining a 'dumb pipe'?

For equipment manufacturers

Consumers will need to buy new equipment in order to access VOD on their TVs – on demand creates a whole new reason for people to upgrade their set-top boxes or television set.

- How quickly will demand for on-demand devices grow?
- Will the on-demand world be dominated by one standard, or is there room for a number of standards to co-exist?
- How can equipment manufacturers position themselves to create maximum value from the 'upgrade wave'?

About Value Partners

Value Partners' media practice has worked with leading blue chip media companies for over 15 years, with a particular focus on broadcasting, digital media and publishing. Incorporating the former Spectrum Strategy Consultants, Value Partners is at the forefront of the convergence trend, which means we can help our clients to adapt their business models in an increasingly and complex business environment, to maximise impact and returns from digital media. We provides support across six key areas: Strategy, Policy and Regulation, Operational Improvement, Technology, Programme Management and Commercial Due Diligence.

Founded, in 1993 Value Partners is a global management consulting firm that works with multinational corporations and high-potential entrepreneurial businesses to identify and pursue value enhancement initiatives across innovation, international expansion, and operational effectiveness. It comprises two sister companies: Value Partners Management Consulting and Value Team IT Consulting and Solutions.

With 15 offices across Europe, Asia, South America and MENA, Value Partners expertise spans corporate strategy and financial business planning, cost transformation and organisational development, commercial planning, technology decisions, and change management. Its 3,000 professionals from 25 nations, combine methodological approach and analytical frameworks with hands-on attitude and practical industry experience developed in executive capacity within their sectors of focus: media, telecoms and IT, luxury goods, financial services, energy, manufacturing and hi-tech.

For more information on the issues raised in this note please contact tabitha.elwes@valuepartners.com, kim.chua@valuepartners.com or one of our offices below.
Find all the contacts details on www.valuepartners.com

Milan
Rome
London
Munich
Helsinki
Istanbul
Dubai
São Paulo
Rio de Janeiro
Buenos Aires
Mumbai
Shanghai
Beijing
Hong Kong
Singapore