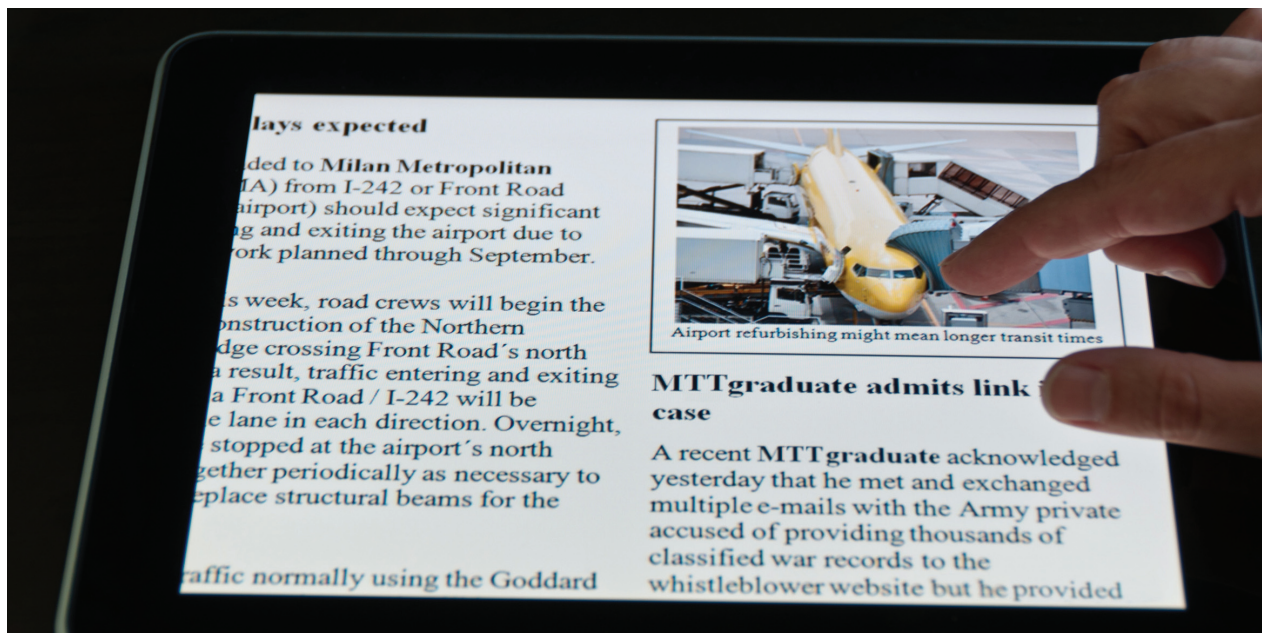


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Making Digital Content Pay

The Billion-Dollar Question for Publishers

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EXECUTIVE SUMMARY

The print publishing business has been struggling for the past several years: Revenue from both subscriptions and advertising sales is down significantly, as readers desert print and advertisers follow them online. And so far, the effort to make content pay online hasn't come close to replacing that lost revenue.

Still, digital paid content can become commercially viable, if publishers can find a way to develop truly differentiated offerings for which users are willing to pay. Doing so requires that they unleash a new wave of product innovation. Simply making users pay for content that was previously free will not suffice. In fact, successful offerings that are based solely on content—even well-differentiated and unique content—will be rare. Publishers must not only differentiate their paid content from their free content; they must also provide customers with a better user experience, offer premium and complementary services on top of their content, and build the right pricing models and packages around their content. These packages will likely move to “brand subscriptions” that encompass all the publisher’s content platforms—online, mobile phones, e-readers, tablet computers, and, of course, print.

HIGHLIGHTS

- Publishers must re-create the two-pronged business model in the digital world. Advertising alone will not be sufficient. Paid content is a growing market. In the next several years, publishers will get up to 25 percent of their revenues from digital paid content offerings.
- Successful offerings will feature more than content—the norm will become new user interfaces, interactivity, and dedicated services and product offerings bundled together.
- We will likely see increasing differentiation in product offerings based on platform—the Internet, mobile apps, e-readers. The Internet will become the commodity channel, and e-readers will move to a premium position in which price may potentially eclipse the price of print.
- Successful publishers will continue to produce compelling content while also controlling the customer experience and the customer data they generate about those interactions. Winning the battle over ownership of customer and user data will become critical, particularly for newspaper and magazine publishers, but also for book publishers, as sales of e-books continue to increase.

THE DIGITAL CHALLENGE

Everyone in the industry knows the story: Paid circulation of printed content in mature markets is in serious decline. In Europe, overall newspaper and magazine circulation has dropped almost 2 percent in the past five years, and in the U.S., it has fallen more than 15 percent since 1995, and more than 7 percent in the past five years alone. More and more print readers, especially younger ones, are shifting to online content, a trend that is accelerating rapidly and affecting all print sectors in most mature markets. Magazines and newspapers that are organically increasing their readership and advertising are becoming a rarity.

These developments present a huge challenge for publishers. As they lose

print subscribers, ad revenues decline, leading to a double drop in income. At the same time, most online content is free, and current and expected online advertising revenues go just a small way toward making up for lost print revenues, especially given how cyclical advertising revenues typically are. It is no wonder that most publishers are now thinking hard about how to make digital content pay.

These trends have their origins in the late 1990s, when print publishers began moving online in increasing numbers. Yet it has become a topic for serious discussion in the C-suite only recently, thanks in part to a new understanding of the consumer as a reliable source of revenues. We have seen some successful and some not-so-successful implementations, both of which have created a great deal of media buzz. It is time to analyze the current trends in paid content and to determine what works and what doesn't, online and elsewhere in the digital realm.

THE CRITICAL QUESTIONS

The bottom line is that paid content can be made a commercial success. Already today, many successful digital paid content offerings are on the market. Publishers that want to maintain their current revenues, grow their businesses, and invest in the future must reestablish the two-pronged model—earnings from both consumers and advertisers—that worked so well for them in the past. Indeed, it is widely accepted that charging for content is the only way to go.

Thus, the critical overarching issue publishers must contend with is not *if* consumers will ever be willing to pay for digital content, but *how* to get them to do so. In considering that issue, publishers must ask:

- How large will the market for paid digital content actually be, both in the next few years and in the long term?
- Which kinds of paid content will work online, and which will not?
- How will free and paid content coexist online and on new devices such as e-readers and multipurpose tablet computers like Apple's iPad?
- Who stands to gain most from paid content—traditional publishers or newer players like Apple seeking entry into the value chain? What can publishers do to gain more of the value?

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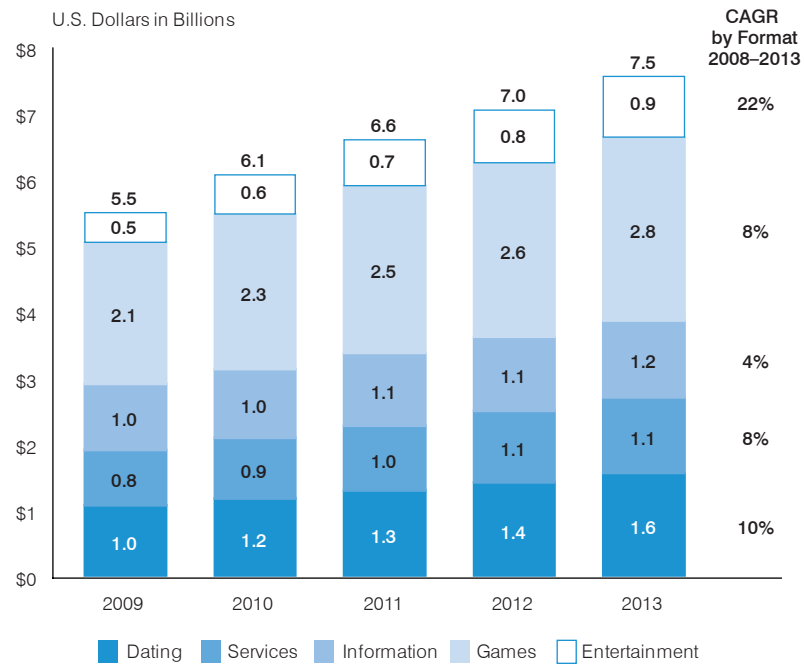
WHAT WE KNOW

The experiences of pioneers in the paid digital content space suggest the initial potential for paid content. Overall market estimates for paid online and mobile content in the U.S., for example, indicate that the market is still relatively small, but it is expected to grow quickly (see Exhibit 1).

Our own calculations suggest that paid digital content will make up between 10 and 25 percent of

all future revenues of the typical business-to-consumer publisher. We also believe that it will grow quickly over the next three to five years—potentially compensating for the losses in print circulation revenues, if not for advertising losses. The difference between 10 percent and 25 percent, however, is significant. How can publishers maximize that percentage and reap the full potential of paid digital content?

Exhibit 1
Growth Estimates for the Paid Content Market in the U.S. Suggest Cautious Optimism



Source: Booz & Company analysis

WHAT DOES NOT WORK

Several attempts to make money through paid content on the market have failed notably. Introducing pay walls in front of content that was previously free has been tried frequently, with very little success. A recent example is Freedom Communications Inc., which has tried charging for previously free content several times but has always ended up removing the pay wall. Another well-known example is *The Times* in the U.K.: After a pay wall was launched, 90 percent of its online readers left the site.

Introducing pay walls for content that is undifferentiated and easily

available at no cost—or that was previously offered at no cost—does not work; readers just go elsewhere. Even simply asking users to register before they are given free access to the content is often enough to send them elsewhere, and more complicated pay mechanisms do not seem to work in most circumstances.

The bottom line: Simply asking customers to pay for stand-alone content is going to work only in very rare cases. Differentiating such content in the eyes of consumers is next to impossible, especially given the number of alternatives available online. By extension, the “freemium” model, in which users get a certain amount of content free but must pay for the rest, will also fail, because users will not bother with it if they can go elsewhere for very similar content. Only content that is highly differentiated, such as

high-profile commentary, in-depth financial analysis and background, and exclusive interviews, may work in such a model. However, the revenues that can be generated through differentiation are for most players insignificant—unless they have the journalistic strength of the *Financial Times* or the *Wall Street Journal*—and do not justify the effort on their part, or the aggravation such models cause readers.

Clearly, few publishers will survive by selling content alone, even differentiated and unique content. Publishers need to think hard about what they can offer in addition to content if they are to convince users to pay. This is not a quick and easy decision. It will require true product innovation in the digital world and new pricing models that few publishers have yet imagined.

Introducing pay walls for content that is undifferentiated and easily (or previously) available at no cost does not work; readers just go elsewhere.

WHAT DOES WORK

Experience to date suggests that publishers have four ways to differentiate content online, and thus develop a successful paid content model.

- *Pure content play.* Content that publishers expect consumers to pay for must be differentiated from free content. This can best be done in one of two ways: Publishers can build a “one-stop media shop” that offers consumers a truly deep media experience. Alternatively, they can specialize, creating highly specific vertical offerings that concentrate on specific areas of interest, such as business, health, or sports. The *Financial Times* recently launched its seventh such niche site, a news and analysis site covering the pension sector, as it continues its efforts to become less dependent on display advertising.
- *Content and related applications.* A further way to differentiate

content and thus justify the price tag is to offer a substantially better user experience. This works best in new device environments such as the iPad, where interactive elements can be seamlessly integrated with the content. In Web-based environments, this is more difficult, although some publishers, such as PopSci Genius Guide in the U.S., have met with some success using this model.

- *Content and complementary services.* Adding premium and complementary services that meet individual needs on top of the content can significantly increase the perceived value. Examples include news sites that offer exclusive conference calls and chats with journalists and health sites that offer live video streaming or services such as personal workout plans and access to experts.
- *Content and partner products and services.* Publishers can partner with outside providers of add-on products and services to create innovative, integrated offerings that could include tickets to relevant events or accessories on top of the content. Naturally, the products and services must be linked to the content—selling tickets to games

on a vertical niche offering devoted to ice hockey, for example.

These four elements of a successful paid content offering should not be considered in isolation. Indeed, combining them into exclusive new offerings will make them much more compelling, and only increase the willingness of consumers to pay for the content offered. A case in point: ESPN Insider. Produced by ESPN, a sports-oriented U.S. cable television network, ESPN Insider is a premium content service targeted primarily to players of fantasy sports. The site provides access to exclusive content, including articles and videos, as well as gaming tools and partner offerings like tickets to professional sports events. Users pay a monthly or yearly subscription fee, and in return, they also get a subscription to ESPN’s print magazine.

The more elements publishers add to their offerings, and the more fully developed those elements are, the more differentiated and thus valuable their offerings will be. The best offerings will excel on every dimension, providing differentiated content together with a superior user experience and highly relevant premium services.

Publishers can partner with outside providers of add-on products and services to create innovative, integrated offerings.

WHAT COULD WORK IN THE FUTURE

Any number of new devices are coming on the market—not just e-readers but also tablet computers such as the iPad—and they will further transform the media consumption experience, and further complicate the challenge of how to convince consumers to pay for content. For the first time, users will have a credible choice between the standard browser-based content they are accustomed to getting free, and a much richer media experience that they will likely have to pay for, all on the same device. Publishers will therefore have to create truly differentiated content, and at the same time explicitly distinguish between the various free and paid digital offerings they present to consumers.

Publishers can approach this new challenge in three ways:

Differentiation. Publishers can offer their “commodity content” free on traditional Web sites and smartphone apps, while encouraging

users to pay for value-added content on e-readers and in print. *Time* magazine and some Hearst publications are taking this approach—in some cases even charging more for the e-reader version than they do for the print magazine.

Parallel play. The growing number of ways to consume media will lead to a strategy in which publishers will offer “brand subscriptions,” allowing subscribers to access the same content on a variety of channels. *GQ* magazine is taking this approach by offering a paid iPhone app that essentially replicates all the content available in print, with just a few additional features. Here, the goal is to serve traditional readers as they move online, while attracting new ones.

Bundled play. The goal of this strategy is to encourage current customers to increase their spending by offering higher-priced packaged combinations of value-added content and services, on a

variety of platforms. For example, in addition to its standard print and digital subscriptions, the *New Republic* magazine recently began offering subscriptions to its “TNR Society,” which includes archives, databases, and other content, as well as the standard digital and print subscription contents. By offering both low-cost and premium subscriptions, the magazine developed a coherent product and pricing bundle that not only gave consumers a choice, but gave the company opportunities to upsell to subscribers. Indeed, the package quickly became the magazine’s most popular subscription offer; it already accounts for 46 percent of all subscribers.

Once these new offerings are in place and successfully launched in the marketplace, “commodity con-

tent” that is currently given away will likely serve primarily to drive traffic to the paid offerings. That will require finding the right balance between the goal of generating traffic from free offerings and that of converting that traffic to a paid model. Ultimately, publishers should plan to gradually reduce their free online offerings even as they continue to direct consumers to their paid offerings. If that paid content offers a significantly better user experience and additional features, it could even be priced at a premium compared with print content.

As publishers work to add paid content to new platforms such as the iPad, a key issue will be how they can most profitably gain access to customers. Publishers currently offering paid content through the iPhone or iPad must pay some share

of the revenues generated to Apple. In the case of *Sports Illustrated*, for example, users must download a free app from Apple’s App Store, and then buy single issues of the iPad version of the magazine through iTunes; Apple takes 30 percent of the total cost, and retains the critical data on user behavior and preferences the publisher would otherwise be able to use to sell other products and services. Other publishers, however, have managed to bypass Apple. The *Wall Street Journal*, for instance, offers a free iPhone app, through which users subscribe to the content directly, sending all revenues to the publisher. These two options offer a glimpse into the coming battle to capture value across the digital content value chain.

WHERE'S THE VALUE?

Offering attractive paid digital content is not enough. Publishers face the real risk of being overtaken in this market by a variety of other players, including content aggregators like Apple, Google, and Amazon, and to a lesser extent telecom operators and device manufacturers. To outflank these rivals, publishers must make strategic decisions regarding which parts of the emerging digital content value chain—from the creation of content to the devices and connectivity infrastructure—they want to play in and control (see Exhibit 2).

Publishers determined to continue simply creating content and depending on the publishing software that requires will ultimately lose control over the customer relationship and user experience, and end up sharing revenue with third parties that own the rest of the value chain. In the case of Amazon's Kindle e-book reader, for instance, publishers pay 30 percent of

the revenue from the sale of the books to Amazon, which controls steps 4 to 10 in the value chain. The percentage Amazon receives for distribution and sales is close to the cost of these activities in the physical world. Even so, this remains a massive defeat for publishers, who lose the all-important access to their customers—and with it the customer usage data and insights they could leverage to expand to the digital world the two-pronged model by which they receive revenue from customers and advertisers.

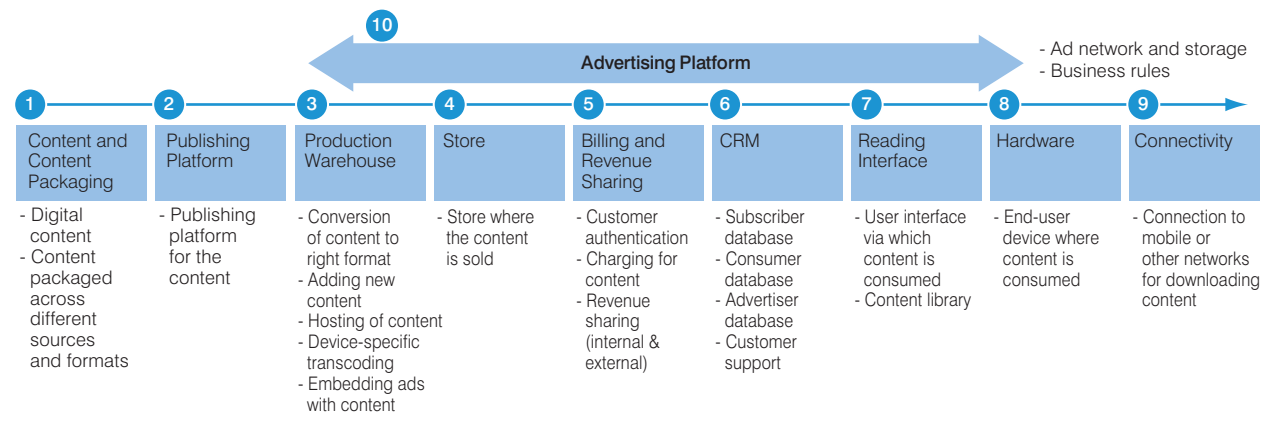
Most publishers will want at least to control the user experience, which is more important for newspapers and magazines than for books. The layout and look and feel of newspapers and magazines is at the core of the product's value. Thus publishers will likely prefer to maintain control over their own content applications, such as content applications sold in third-party application stores, including the embedded proprietary reading interface. By doing so, publishers can compete not only through content but also through the user interface. Already, the *Wall Street Journal*, *Sports Illustrated*, and the *New York Times*, among others, have their own

iPad applications. However, selling content applications on third-party stores still forces publishers to give up a share of both their content and their advertising revenues, and cedes control over customer data to the third party.

Others will want to go further, disintermediating third parties entirely by establishing their own stores and thus retaining control over customer data—in practice, becoming retailers of digital content. In such cases, publishers won't need to share the content revenue or the advertising revenue, of which third parties usually get 40 percent. There are several examples of such a play on the market—including Relay, Pubbles, and Zinio—and we expect to see many more such launches in the near future. Building the retail play, however, requires new capabilities, which not all publishers can acquire.

We have also seen bundled hardware and content offerings in some markets, where the publisher orchestrates or owns the hardware as well, and sometimes even packages it with connectivity. Playing in this game would allow the publisher to influence

Exhibit 2
The Digital Content Value Chain (Example)



Source: Booz & Company analysis

LOOKING AHEAD

Even as publishers make their bets on the paid digital content they want to offer and where to position themselves on the value chain, a trial-and-error phase will likely continue for some time. That should come as no surprise: The print industry waited hundreds of years to develop the right combination of technology, processes, and content to arrive at its current business model. Arriving at the proper paid digital content model will not happen overnight.

Creating a successful model for the creation and sale of online content will involve a structured, three-step process:

1. Find the sweet spots. Certain kinds of content have much greater potential to attract paying customers than others. Three key factors play a role in determining what will work and what won't.

- *Exclusivity.* The content must be truly exclusive and not easily replaceable by substitutes.
- *Target audience.* Some kinds of content have a natural target audience that is more willing to pay for the content than other audiences.
- *Popularity.* Certain content areas are more popular than others, and attract larger audiences.

Publishers should begin their efforts to promote paid content that satisfies these criteria.

2. Build winning concepts.

Identifying the right content areas is a critical start, but good content alone is not enough. The content must also be enhanced by developing several other factors:

- *A clearly differentiated user experience.* This might include interactive elements in news and magazine applications.
- *Deeper content offerings.* These should go beyond the standard in certain carefully targeted topics,

such as sports, finance, cooking, or health, to name a few.

- *Add-on services.* Publishers can enrich content with premium and complementary services such as conference calls with journalists or live video streaming.

Combining these elements into new creative solutions is a real step forward.

3. Define the right pricing mechanism. Pricing the content is critical for success. Too often, publishers give away new features and upgrades on top of content that's already free, hoping these gifts will increase the audience, while others add new products to existing packages without increasing the price. Both options can kick off a death spiral in which costs will increase faster than revenues and thus eventually flush away all new profit potential created by more sophisticated and better-paid offerings.

Instead, publishers should look to differentiate their content offerings, creating a variety of products and

CONCLUSION

The outlook for paid digital content is promising. Currently, the market is not large, but it will grow enough to offset at least some of the lost print revenues. Given the grim alternative, publishers should waste no time deciding whether to enter this market. It is already critical to their very survival.

In the short term, we expect a wave of new, enhanced versions of iPad content applications to appear on the market. Most publishers did not have enough time to prepare properly when the iPad was launched, but this work is ongoing, and the next wave will significantly speed up the paid content play.

It is also likely that we will see an increasing differentiation in product offerings among the different platforms (the Internet, mobile apps, e-readers). The Internet will become the commodity channel, and e-readers will move to a premium position—where prices may potentially eclipse the prices of print. In addition, integrated offerings bundling print, online, mobile, applica-

tions and other value-added services will grow in importance.

The battle over ownership of the customer and user data will become critical. Publishers will build more models that bypass companies such as Apple and Amazon, which currently control most user data, and develop much more strategic positions for themselves than those we see today.

Gaining an edge in the paid content business will require smart players to innovate in both products and business models, and then combine those innovations to match the scale and breadth of their print business. In the future, bundled pricing models, new products that transcend old media silos, “pull” offerings (those determined in large part by consumers), and auction-based ad sales models will become the norm. As new products appear in the marketplace, their success will continue to transform the organizational structures that publishers have come to depend on for decades.

The new game will be played with different rules, new winners will emerge, upstarts will come and go, and some old players will disappear. Success will depend on the strategic decisions publishers make now.

packages at multiple prices, to make sure they are capturing the full value of their content.

Careful adherence to this process will help publishers define the paid content packages they should offer first. Typically, we have seen publishers launch eight to 10 paid content initiatives as the first outcome of this process. These have included significant upgrades to the user interface (such as the content application for a newspaper), vertical services built on certain carefully selected content topics such as specific sports, and service offerings for niche segments like real-time business news. Some of these will be small but easy to implement, some will be large potential game changers, and others will fail.

Every new paid content offering will help publishers learn what works and what doesn't—an essential lesson in the effort to build the winning paid digital content portfolio of the future.

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