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2015: A Video Space Odyssey *Value Shifts in the TV and Video Ecosystem*

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EXECUTIVE SUMMARY

Changes in consumer behavior, driven by new technologies, are profoundly reshaping the TV and video ecosystem. Consumers will continue to enjoy video over traditional TV in large numbers, but most of the future growth in viewership will take place on new screens like PCs, tablets, and smartphones, and through new, nonlinear video formats. Social media will rise in importance for video as a place to talk about, share, and distribute content. As a result, companies in a wide variety of industries are viewing TV and video as an ever more important way to gain access to and control over expanding value pools that are converging in the rapidly evolving, overlapping and more competitive TV and video ecosystem.

The consequences of these changes are significant for the strategies of TV and video players, both to preserve their current value and to capture the new value that will arise. Competition is intensifying as companies in media, communications, and adjacent industries—e-commerce, games, and betting, for example—seek to grab their share. Meanwhile, those that provide the infrastructure for all this activity will face significant challenges—that is, unless they can leverage content, an increasingly valuable asset, to differentiate their core value propositions.

Ultimately, success in the new ecosystem will depend on several factors. High-quality content, and the rights to that content, will remain critical, as will the ability to aggregate and offer to advertisers the largest audiences possible. Players that can gain much deeper insights into their audiences' preferences and consumption habits stand to benefit by offering greater value to advertisers. The growing complexities of the evolving ecosystem also place new emphasis on alliance and partnering capabilities—no single player, however strong it may be in its core business, will be able to succeed on its own.

FROM ONE SCREEN TO MANY

For decades, the television in the family room has been the focal point for entertainment consumption around the world. Whether connected over the airwaves, or by cable, satellite, or broadband, the TV set will likely remain consumers' number one device for viewing video content for years to come. But more and more, consumers are watching video through new services and on a variety of different screens—smartphones, PCs, laptops, iPads, and other

tablets—and it is these new services and screens that will be driving much of the growth in video-related usage and revenues in the coming years.

This evolution is driving change not just for consumers but for content producers and distributors too. Back in 2001, a popular TV series such as *The X-Files* ran first on broadcast TV (in this case on the Fox network in the U.S.), followed by an initial rerun during the summer. And then the consumer waited, first for the home video release and then for syndication on TV.

Today, these video release windows have narrowed and the distribution options have expanded. Take, for instance, Fox's hit *Glee*, which launched two years ago. New

episodes of *Glee* premiere on Tuesday evenings exclusively on broadcast TV. Now, consumers can watch the same episode 24 hours later via ad-supported streaming over the Internet on Hulu (co-owned by News Corporation, the owner of Fox, and by NBCUniversal, Walt Disney, and Providence Equity Partners), as well as on Fox.com. This same episode is simultaneously available on Apple iTunes and Amazon.com for video download purchase. For the current season of *Glee*, these are the only available options. To watch past seasons of *Glee* and other older, “library” content, consumers can use Netflix's streaming service or purchase DVDs.

These changes in how content is distributed—to which screens and

New services and screens will be driving much of the growth in video-related usage and revenues in the coming years.

when—are reshaping the once stable relationships among content producers, media packagers, network operators, and device manufacturers. The outlines of the new, more digital video ecosystem are becoming clearer each day. That ecosystem will invariably include greater interactivity, mobility, choice, and personalization for consumers and more diversity in business models among players.

The changing habits of a younger, more digital generation—a cohort we call “Generation C” because its members are connected, community-oriented, and always clicking¹—are the catalyst for the shifts now shaping this ecosystem. These consumers spend a growing share of their viewing time watching digital screens rather than traditional TVs. This shift to new screens is further supported by enormous growth in the generation of video content. In November 2010, Google reported that users were posting more than 50,000 hours of

video content to YouTube every day. Consumers are also increasingly supplementing their viewing of linear TV—the traditional distribution model, which adheres to a strict, broadcaster-determined, time-specific programming schedule—with time-shifted, on-demand viewing enabled by digital video recorders (DVRs), expanding video-on-demand (VOD) options, and the proliferation of online streaming services such as Hulu, the BBC iPlayer, and Netflix.

The impact of these developments is reverberating across the video ecosystem with increasing intensity. As the example of *Glee* illustrates, traditional video offerings now coexist with an expanding set of alternatives: iTunes video downloads, Netflix streaming, online catch-up services such as Hulu and RTL Now, “TV everywhere” applications from cable network operators like Time Warner Cable, and even mobile TV offerings such as TV Max from Orange/France Télécom.

The evolution of these trends in the coming months and years will have important strategic consequences for the companies that make their money from producing, aggregating, and distributing video. As in any disruptive period, there will be winners that are able to innovate and adapt, and losers that stagnate and die. And there will be sweet spots—some already tantalizing in their potential—that will be captured by players that can create distinctive content and consumer brands, control the consumer interface, build devices that open up more viewing opportunities, and develop applications that enable new user experiences and expand revenue opportunities.

This perspective presents our multidimensional view of the forces reshaping television and video, with particular focus on evolving strategies, spending priorities, and value expectations and drivers in the evolving ecosystem.

BEYOND LINEAR TV

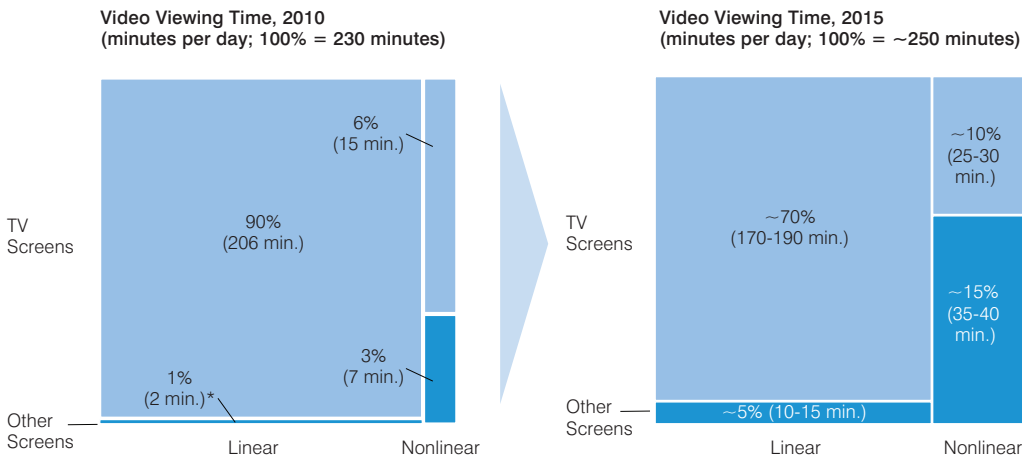
Thanks in great measure to rapid advances in TV and video infrastructure, consumers are radically changing how and when they watch video entertainment. In Germany alone, the number of nontraditional screens over which consumers watch video—including PCs, smartphones, tablets, and interactive TVs—is expected to grow from 90 million in 2010 to more than 210 million in 2015.² In 2015, German households will have an average of 5.3 different screens on which to watch videos and perform other interactive activities, including social networking, video gaming, and e-commerce. Despite this proliferation of devices, Germans still spend 90 percent of their average daily video consumption time watching linear TV. We expect that linear TV will remain by far the dominant platform for video in 2015, although nonlinear sources

will more than double their share of viewing time to 25 percent of the total (*see Exhibit 1*).

Meanwhile, the average U.S. household still watches about four hours and 17 minutes of regular television a day. This dwarfs the average time spent daily watching video on DVR playback (just 24 minutes or so) or online video (about nine minutes).³ But shifts in video consumption patterns are likely to accelerate at a faster rate than many in the industry predict. By 2009, more than a third of TV viewers around the world were watching at least one TV show a week on a non-TV device.⁴ In the U.K., nonlinear video formats already account for nearly 20 percent of total video consumption, driven by strong household penetration of DVRs as well as adoption of the BBC iPlayer, a free service that

Exhibit 1
With media consumption in Germany slightly growing, the share of nonlinear viewing will more than double

**GERMAN VIDEO VIEWING TIME
(EXPERT ASSESSMENT)**



* Estimated.
Source: SevenOne Media 2010; expert interviews; Booz & Company analysis

allows users to consume current TV and radio shows online, catch up with programs from the past week, and even download TV shows to computers and smartphones for later offline viewing.

Technological advances, mass-market penetration of new devices, increased broadband speeds, and easy-to-use set-top boxes will all encourage alternative viewing. Apple expects to sell as many as 40 million iPads globally this year alone,⁵ and the company's download platform, iTunes, ranks among the top 10 retailers of consumer videos in Germany. With broadband speeds of up to 120 Mbps rolled out in many European countries, the infrastructure needed to support alternative video services and related distribution is already widely available.

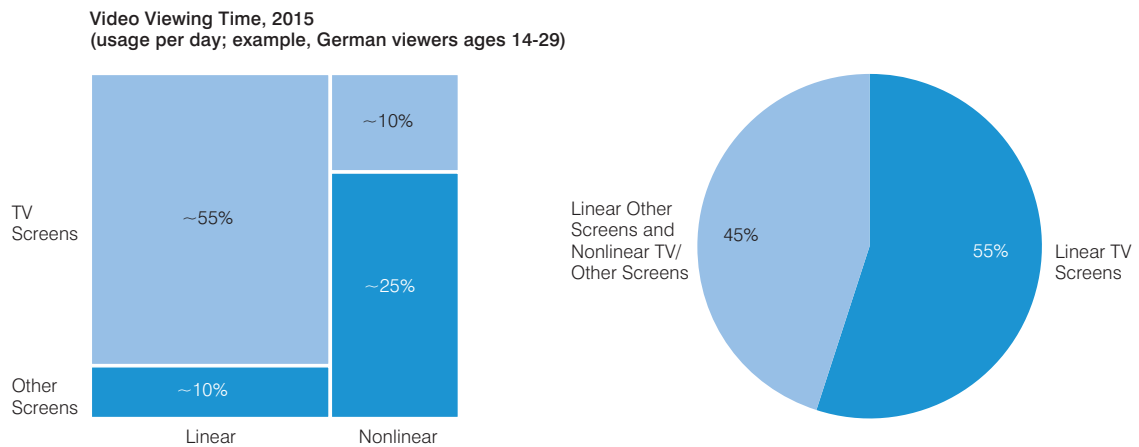
Younger consumers, defined as those under 30, are at the vanguard of new video viewing habits everywhere. For example, by 2015, younger viewers in Germany are expected to spend almost 50 percent of their viewing time watching nonlinear video sources and regular TV on nontraditional screens (*see Exhibit 2*). Their changing behavior is being driven to a large degree by their rapid and persistent adoption of digital services for all kinds of entertainment. Internet usage among people ages 14 through 29 is already 2.3 times greater than that of older people. And the young also like to multitask, watching their TVs while monitoring social networking sites on their PCs and texting on smartphones.⁶

The preference of younger consumers for interactivity in all their media

consumption will be the nucleus of the ecosystem's overall movement toward devices and platforms that promote interaction. Social media, for instance, not only is consuming more time but also is having an enormous influence on what younger viewers watch: Nonlinear content is discovered, recommended, and curated by friends on social networks such as Facebook and Twitter. In fact, referral traffic from Facebook and Twitter is currently growing faster than traditional search engines as a source of video views.⁷ At current rates, Facebook will surpass Yahoo within the year to rank second only to Google in referral traffic to online video content.

Exhibit 2

By 2015, Younger Audiences Will Spend Only Half of Their Video Watching Time on Linear TV



Source: SevenOne Media 2010; expert interviews; Booz & Company analysis

A NONLINEAR WORLD

These trends are not passing unnoticed by content providers. Television networks and film studios, in particular, are using Facebook in innovative ways to promote their content and experiment with new business models. For example, after a successful pilot with *The Dark Knight*, Warner Bros. is expanding its Facebook movie rental service, charging US\$3 to \$4 per rental for movies such as *Inception*, *Yogi Bear*, and the first two Harry Potter films. NBC hopes to use social networks to spur the e-commerce potential of its new reality show, *Fashion Star*; viewers of the show will be able to purchase the clothing produced by contestants vying to win a multimillion-dollar contract to place a new fashion line in top retail stores, and the network will receive a split of the clothing sales

revenue (see “*Making Friends with Video*,” page 8).

Recent developments indicate how far-reaching these trends are likely to be. Hulu, the U.S. online player, is attracting consumers with its time-shifted video offerings. Launched in 2008, Hulu has rapidly drawn a large audience—now close to 15 million unique visitors per month—to time-shifted TV shows on alternative devices.⁸ Meanwhile, Netflix has already attracted more than 20 million U.S. consumers; more than a third of all new Netflix subscribers are enrolled in the streaming-only plan (see *Exhibit 3*). This service is delivered “over the top”—independent of a specific infrastructure such as a cable network—not just to alternative devices but also to traditional TV sets through Microsoft’s Xbox, for instance. With such deals, Netflix is further pushing its reach, increasing its availability on TV screens, and adding value for the owners of such boxes (see “*Netflix and Its Competitors*,” page 9).

In the U.K., BBC’s iPlayer has extended its distribution even further. Launched in 2007, this Internet television and radio service is now integrated into a wide range of devices and offerings. Platforms served by the iPlayer include BT Vision, Freeview, Wii, and PlayStation consoles, as well as mobile platforms like Android and BlackBerry. U.K. national cable TV provider Virgin Media recently released an iPlayer application for its own digital video recorder. The service is reportedly responsible for 5 to 10 percent of all U.K. Internet traffic,⁹ showing the enormous reach that traditional broadcasters can achieve with the over-the-top model. Though the service was first launched to make BBC content available online, the impact of the ability to time-shift TV shows can be seen in the country’s overall viewing behavior: Twice as much nonlinear video is consumed in the U.K. as in other European countries, including Germany.¹⁰

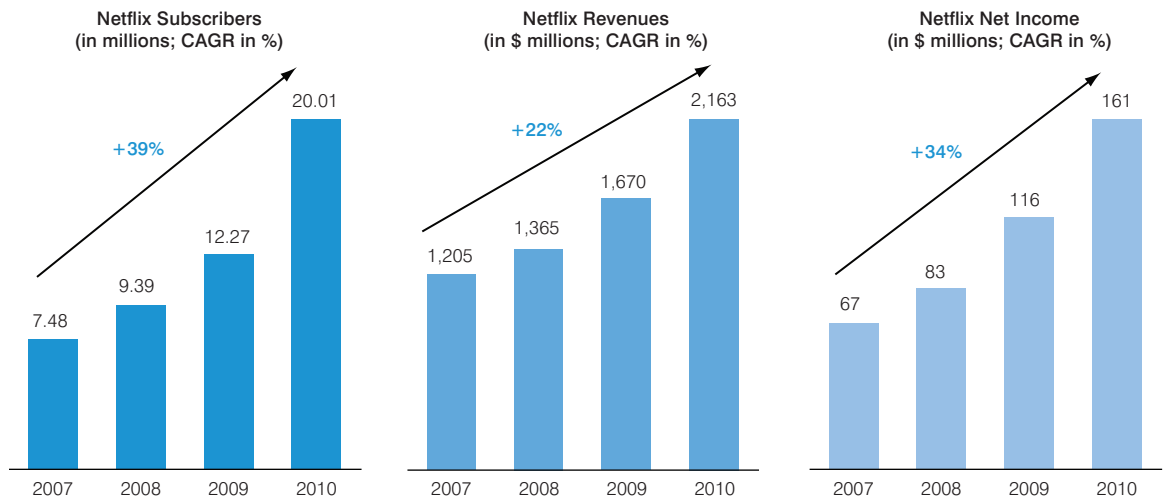
These shifts in video consumption affect not just TV but other media

and marketing sectors as well. Video content is becoming a much more significant part of the Internet experience, representing as much as 30 percent of the time consumers will spend online by 2015. As a consequence, media companies—whether based in television or in newspapers, magazines, or digital media—are all

looking to bulk up their online video offerings as advertisers shift more of their spending to the Internet. Online video has already become a major growth priority for leading marketers, which are attracted to its high-impact combination of sight, sound, and motion—features that are perfectly familiar from TV but that

can now be married to the Internet’s promise of measurability, targeting, and interactivity. As a result, video is expected to be the highest-growth area in the global online advertising market, increasing by 40 percent in 2011 and then growing 19.6 percent a year on average through 2016.¹¹

Exhibit 3
Netflix Has Experienced Dramatic Growth Since Shifting Emphasis to Video Streaming



Source: Netflix annual/quarterly reports; Booz & Company analysis

Making Friends with Video

The number of visitors is rising much more quickly for social networking sites in the U.S. than for Internet portals such as Google and Yahoo and even video sites like YouTube and Hulu. So a number of forward-looking TV networks are already working on ways to integrate social media into their promotional efforts. This should come as no surprise, given that TV and video already make up a substantial portion of the conversation on many social media, judging from Facebook's yearly top status trends, for instance. TV networks, acknowledging that consumers want to chat in real time with their friends while watching shows, are already taking advantage of this activity to promote live viewing.

Oxygen, an NBCUniversal cable network targeting young women, managed to increase the ratings of its biggest show, *Bad Girls Club*, by more than 50 percent by offering a "social viewing party" enabled by Twitter and other social media. And in hopes of capturing the interest of fans looking for a more interactive experience, it is augmenting the TV experience through forums on social networks where viewers can "interact" with the content and one another, thus engaging those fans more deeply while capturing more demographic data and insight about them.

NBCUniversal has also launched "Fan It," an effort to enlist social media users to help promote the company's TV shows. After signing up for the program on NBC's website, participants earn points by chatting about shows with friends and steering them to related links. The points can be redeemed for rewards like sneak previews of shows, NBC merchandise, and entry into contests to win prizes. USA, another NBCUniversal cable network, has started a similar program, tied to its show *Psych*, which allows fans to earn points on the show's dedicated website by watching videos, playing games, and reposting content to social networking sites. Points can then be redeemed for prizes.

The goal of these efforts is to provide an interactive user experience by getting fans to communicate among themselves about the shows. This, in turn, reinforces brand affinity for the shows and provides the opportunity to learn more about viewers, who are likely to be more willing to share personal information in this context.

Netflix and Its Competitors

What is the most disruptive new player in the TV and video ecosystem so far? Probably Netflix, the U.S.-based distributor of rental DVDs and streaming video-on-demand movies and TV shows, whose revenues have increased 22 percent annually over the past four years to \$2.16 billion in 2010. The company got its start in the late 1990s mailing DVDs to consumers on a subscription basis; in the mid-2000s, it launched an offering to stream video directly to subscribers' homes, proving early on that an over-the-top VOD model could work and even reach mass-market penetration. Indeed, between 2007 and 2010, Netflix almost tripled its subscriber base, to 20 million, bringing it to the level of many other premium pay-TV outlets in the United States.

With the shift in its primary business model, Netflix is now increasingly competing in the premium pay-TV market, which includes premium cable networks such as HBO and Showtime that produce their own original content and license Hollywood feature films, as well as other VOD services offered by cable and satellite companies like Comcast and DirecTV. In this space, the quality and release dates of content matter greatly, given the many channels through which consumers can watch movies and TV shows. So Netflix has been busy making deals with content providers—including premium networks such as Starz and Epix, and studios such as CBS, Disney, MGM, Warner Bros., and, most recently, Lionsgate—to ensure that it has enough high-quality content to drive subscriber growth.

To date, Netflix has grown by anchoring its video offerings in library content—movie-catalog and prior-season TV shows—seeking to augment rather than replace its customers' core television offerings. There are, however, signs that its strategy is beginning to shift. The recent deal for the TV series *House of Cards* highlights the company's new willingness to acquire non-library content: Netflix outbid networks HBO and AMC to secure the exclusive first-run rights for 26 episodes of the series, which stars Kevin Spacey, for about \$100 million. High-profile deals such as this one are certainly aimed at differentiating Netflix from a host of competitors, including Amazon, Hulu, and even Facebook.

CONVERGING ON VIDEO

For a long time, “convergence” has been an overhyped industry buzzword. But with broadcast, broadband, and mobile technologies growing ever more interconnected, telecommunications, technology, and device players are all truly converging on video as a major source of growth in an effort to compete against traditional video packagers and distributors. The rationale for doing so lies in a combination of factors. The video value pool itself is large. It is a “sticky” medium that drives lower churn, so it is a valuable component in packages with other services. And it is increasingly viewed as a gateway to other high-growth services such as e-commerce, advanced advertising, and gaming.

Consider the overlapping moves being made in a major market such as Germany. The incumbent telecom operator, Deutsche Telekom, is aggressively investing in its IPTV offering, called Entertain, which is being sold as part of a package with fixed voice and broadband. With the flagship premium football (soccer) content it distributes on both IPTV and mobile devices, Deutsche Telekom is now competing with Sky, the market’s traditional pay-TV operator. At the same time, Deutsche Telekom operates the over-the-top paid video platform Videoload, thereby competing directly with Maxdome, a platform operated by broadcaster ProSiebenSat1. Both, in turn, are battling Apple’s iTunes

Telecommunications, technology, and device players are all converging on video as a major source of growth.

service, the leading paid video streaming and download platform in Germany, which accounted for more than half of the emerging German online video market in 2010 and is expected to more than double its volume in 2011.¹²

Three factors are driving the trend toward convergence: First, technological advances are making it possible to integrate more and more features into digital devices. For example, Microsoft's Xbox video game console now offers online and multiplayer gaming, direct access to Facebook and Twitter, and movie streaming. It also supports videoconferencing, as well as on-the-go access to online games and other services via smartphones logged into the Xbox Live portal.

Second, consumers are rapidly adopting new platforms for their video experience. Some are motivated by a

desire to enjoy an integrated entertainment experience and are willing to pay a premium price for enhanced services. Others, however, are looking primarily for lower-cost alternatives to traditional cable packages. These price-sensitive and typically younger consumers are finding great appeal in à la carte and pay-as-you-go alternatives. While this particular segment is likely growing, there is no evidence yet to suggest the widespread threat of "cord cutting." The reality for the average consumer is that it is still difficult to fully replicate the offerings of traditional TV networks and cable operators through over-the-top alternatives. Perhaps the bigger risk for the platform players is that new consumers who would have subscribed in the past are instead opting for over-the-top alternatives. Recognizing that threat, cable operators have begun developing their own alternative distribution platforms.

Finally, suppliers from various segments of the ecosystem are increasingly ready and eager to enter one another's core markets. Some are fueled by the desire to expand their hugely successful business models to other areas. Others, including the telecom operators and broadcasters in more mature markets, are driven by stagnating and, in some cases, shrinking core markets, and are urgently looking for ways to inject top-line growth. Players seem to assume that the ability to control the TV and video experience carries a strategic premium, simply because there is no other medium—indeed, no other product or leisure activity—with which the average consumer spends more time and money than TV and video. So every player increasingly sees the ability to control the TV and video experience as a key access route to creating and capturing value.

WHERE'S THE VALUE?

We see the TV and video ecosystem as having three increasingly overlapping sectors: the TV and video core markets (driven primarily by free-to-air broadcaster advertising revenues, cable and pay-TV user fees); adjacent markets; and communications markets (fixed and mobile voice as well as broadband). Adjacent markets are made up of several sectors—including related devices and other media advertising, e-commerce, and betting and gaming—each with more or less direct links to the TV core markets. Altogether, the western European ecosystem took in €619 billion in revenue in 2010, a total that is expected to grow at an annual rate of 4 percent over the next five years to €753 billion in 2015¹³ (see Exhibit 4).

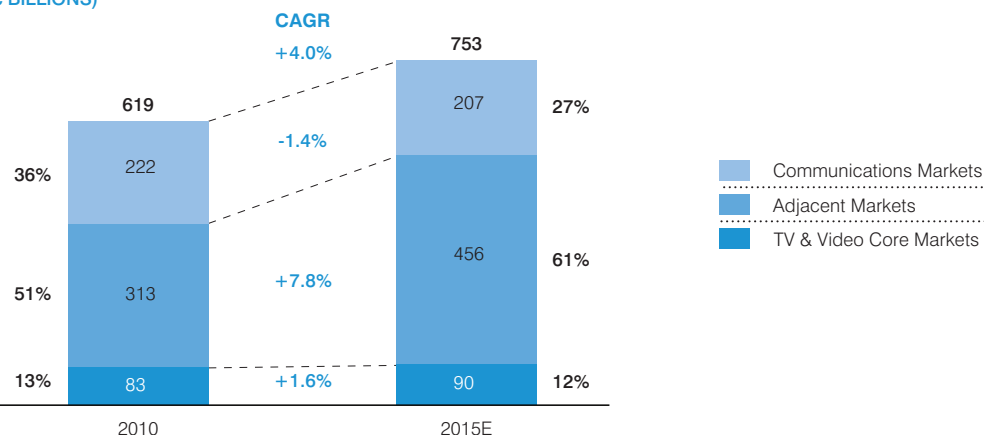
How that revenue is distributed among all the different components of the three sectors, however, will change significantly by 2015 (see Exhibit 5).

The TV and video core markets are expected to grow at an annual rate of just 1.6 percent over this period, led by advertising revenues and consumer spending on pay-TV—including premium TV channels like Sky and Canal+—and video-on-demand. This forecast reflects our belief that the wholesale destruction of value under way in the music industry is unlikely to occur in TV and video: This industry maintains better control over the IP technology, its networks are more secure, and its advertising model, based on the enduring and unique capability of TV to aggregate and retain eyeballs, is more robust. Moreover, subscription-based services will soon provide a great deal more information about individual viewers and their viewing habits, allowing for much more targeted marketing techniques.

Adjacent markets, which include products from device makers and interactive services such as video gaming, gambling, and e-commerce—interactive TV platforms that enable purchases from home—could be the biggest winners. The sector's overall revenues are expected to grow by 7.8 percent a year over the next five years. E-commerce will show the largest increase, growing from €105 billion in 2010 to €165 in 2015 and increasing its share of the total market from 17 percent in 2010 to 22 percent in 2015. This growth of adjacent markets, however, will be fueled by a range of new offerings: hybrid TV services, for example, that enable shopping via the TV screen and the traditional remote control; interactive features such as voting and betting, especially when tied into programming such as sports; and the packaging and selling of consumer data gained through interactive advertising or other opt-in services such as online communities linked to TV series and movies.

Exhibit 4
Growth Opportunities in the TV and Video Ecosystem Will Lie Primarily Outside the Traditional Core Markets

WESTERN EUROPEAN TV & VIDEO ECOSYSTEM REVENUES & GROWTH, 2010-2015
(IN € BILLIONS)



Source: Ovum; Forrester; PricewaterhouseCoopers; ZenithOptimedia; Informa; Booz & Company analysis

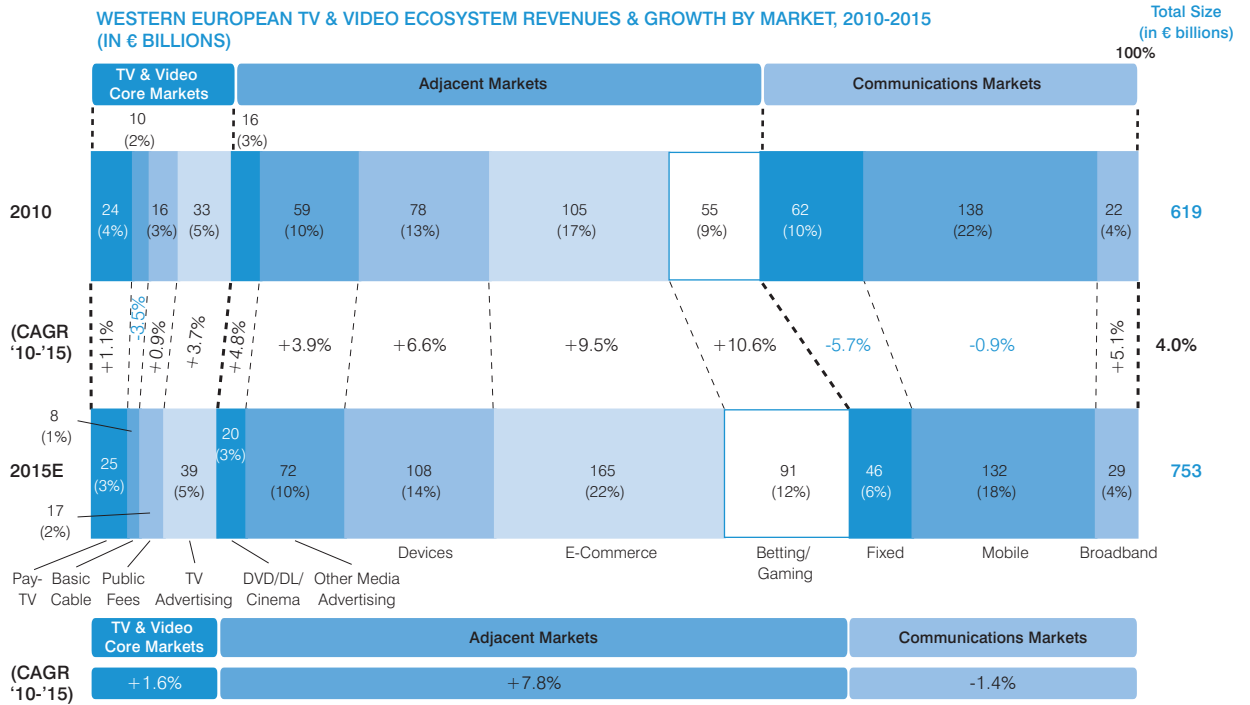
The communications markets are likely to suffer the most over the next few years. This sector's revenues in western Europe are expected to decline slightly, from €222 billion in 2010 to €207 billion in 2015, and its share of the overall ecosystem's value will likely drop from 36 percent to 28 percent over the same period. This will lead to an increase in competition in TV core markets, as large communications players look for growth outside their own markets—in TV distribution or e-commerce, for example—or at least strive to decrease churn by relying on the higher customer stickiness of bundled products.

Though the general outlines of growth and change in the value pools of the TV and video ecosystem in western Europe are clear, the opportunities becoming available differ among markets. Much depends on how each market is currently structured—how the TV infrastructure varies from country to country, for instance. The U.K. already has a very advanced satellite pay-TV market, while Germany has been slow to upgrade its TV infrastructure and adopt pay-TV business models. So there is more room to grow in the core video value pools with pay-TV in Germany, for example, than in the United Kingdom. This is borne out by Sky's aggressive growth targets and

RTL's new pay models (subscription-based HD+ and the recently launched RTL Now paid catch-up iPad app for nonlinear streaming of series and shows).

In other markets—Italy and the Czech Republic, for example—current broadband penetration is still below the European average, so the related value pools and infrastructure player revenues are expected to grow sustainably for some years to come. Such national differences will affect how and where the coming changes in revenue distribution play out. But the adjacent players will be the most important growth drivers in virtually every geography.

Exhibit 5
By 2015, the Sources of Value in the TV and Video Ecosystem Will Shift Dramatically



Note: Numbers may not add up due to rounding.
Source: Ovum; Forrester; PricewaterhouseCoopers; ZenithOptimedia; Informa; Booz & Company analysis

COMPETITIVE DYNAMICS

Limited growth in core TV and communications markets, combined with the rise of new players, will lead to a much more competitive landscape across the entire TV and video ecosystem. In Germany, for instance, digital media companies like Facebook, Amazon, and Apple will likely increase their share of the market's revenue from a current 22 percent to 32 percent in 2015.

This increase will be driven largely by the fact that they play in high-growth segments of the market, such as online advertising, e-commerce, devices, and digital downloads (*see Exhibit 6*). Although devoid of local flavor, these large U.S.-based companies are in a good position to capture a significant share of this growth.

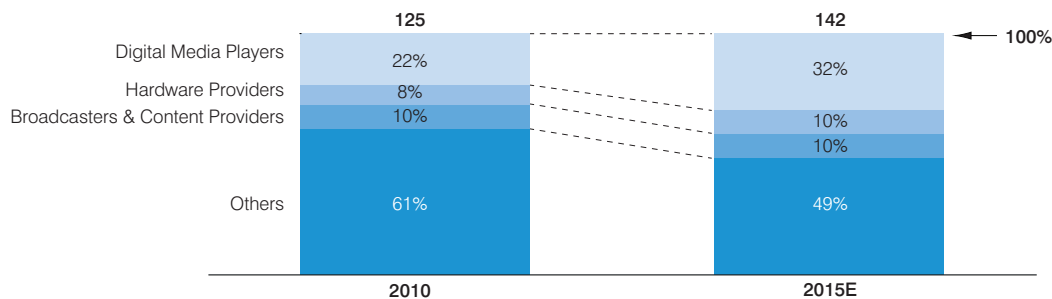
Their success will likely come at the expense of local players, most of which are struggling to build significant momentum with their own offerings. For example, the plans of free-to-air broadcasters RTL and ProSiebenSat1 to create a German

video streaming platform similar to Hulu have recently been put on hold by Germany's federal cartel office. Local social networks such as StudiVZ and Lokalisten.de have not been able to match the growth and business expansion of Facebook. However, many of these national platforms are still in the early stages, and a number of them, such as the video download platforms developed by RTL, ProSiebenSat1, and retail giant Media Markt, are solidly funded and backed by strong brands.

The overall trend is toward a greater focus on product innovation for every

Exhibit 6
Digital Media Players Will Gain a Larger Share of Revenues in the TV and Video Ecosystem over the Next 5 Years

SHARE OF VALUE IN TV & VIDEO ECOSYSTEM BY OWNER
(GERMANY, 2010-2015; IN € BILLIONS)



Notes: Digital media players include Internet aggregators and others; broadcasters and content providers include commercial broadcasters, pay-TV broadcasters, public broadcasters, transaction-based broadcasters, and content providers; "others" include cable, direct-to-home, telecom/IPTV, and others. Numbers may not add up due to rounding.
Source: Booz & Company analysis

player across the video ecosystem. These efforts are pushing the boundaries not only of traditional industry definitions but also of rights ownership and established rights windows, exposing some simmering tensions between programmers and distributors as they grapple with the need to adapt to a more digital and portable TV landscape (see “Opening a New Video Window”). Nowhere is this truer than in the rapidly developing video applications space expanding around the iPad. Here, U.S. cable TV operators such as Time Warner Cable and Cablevision are launching applications in support of their “TV everywhere” strategies, which permit subscribers to gain access to streamed video of live channels and to video-on-demand offerings. The cable operators view such offerings as a key extension to their existing services and critical to keeping current customers from migrating to streaming services from Netflix, Hulu, Boxee, and others. The channels themselves, however, have flatly rejected this claim—in the belief that delivering streamed content to an iPad is entirely different from sending the same content to a set-top box and therefore constitutes a completely separate and monetizable right—and have threatened legal action to end the practice.

Opening a New Video Window

The changing ways in which consumers access video entertainment are driving significant transformation throughout the TV and video ecosystem, perhaps nowhere more profoundly than in motion pictures. As the studios look to offset declining DVD and TV licensing revenues, higher-growth digital distribution channels are creating opportunities for them to rethink traditional release windows—the segmented distribution periods that give each outlet, such as home video, video-on-demand, pay-per-view, and others, exclusive rights to distribute a film—to explore alternative revenue streams and take advantage of shifts in consumer consumption patterns.

For years, the studios have been considering the potential benefits of compressing release windows to better monetize the up-front marketing spend that accompanies a theatrical release. Continued film piracy, both bootleg DVD versions of films and illegal digital downloads, has also created incentives for Hollywood to test new monetization models. In one high-profile example, in 2010, Disney chose to release *Alice in Wonderland* on DVD just three months after the movie’s theatrical release, shortening the traditional window by a month and angering theatrical exhibitors, which feared cannibalization of their ticket sales.

The decline of DVD sales in the U.S. has increased studios’ willingness to experiment with release windows. According to Veronis Suhler Stevenson, unit sales of DVDs dropped 8 percent in 2010 and retail prices shrank 1.5 percent. Since peaking at \$26 billion in 2006, spending on DVDs shrank 5 percent annually through 2010; during the same period, spending on Internet downloads increased at an annual rate of 81 percent to \$1.2 billion in 2010.

In an attempt to offset lost DVD revenues, studios are now contemplating a new “premium video-on-demand” window that would allow consumers to watch films at home within six to eight weeks of theatrical release for a likely price of \$20 to \$30 per viewing. Providers such as DirecTV and Time Warner Cable are in negotiations with major Hollywood studios to create this new service. The window’s popularity remains to be seen—it largely flopped in a recent test Disney ran with *Tangled* in Turkey—but it undeniably represents a challenge to exhibitors and will likely reinforce declines in DVD sales, negatively impacting major DVD retailers like Walmart and Amazon.

Even as the studios evaluate this new super-premium release window, they are experimenting with when to permit Internet streaming in the overall distribution time line for video content. The growing base of Internet video consumers has given online streaming players increasing clout in negotiation with the studios, which has opened up earlier release windows. In late 2010, for example, Netflix struck deals with independent studios Relativity Media and FilmDistrict to stream films before they hit premium pay-TV. Other deals with Starz and Epix have allowed Netflix to stream content within the premium pay-TV window (see “Netflix and Its Competitors,” page 9). It remains to be seen whether new standard windows for streaming and even “premium streaming” will be established or whether the digital media players will find it hard to sustainably enter the long-standing relationships between content producers and distributors.

CHALLENGES IN THE NEW MARKETPLACE

The many players in each of the three sectors of the TV and video ecosystem will be competing for a growing number of eyeballs watching a rapidly diversifying number of screens. How best can they maintain or grow their stakes in this valuable market?

Programmers, Networks, and Content Producers

Legacy content and distribution players such as ProSiebenSat1, RTL, CBS, and Sky have created long-standing, successful business models through which they capture revenue from both advertisers and consumers. The challenge for them now will be to preserve and develop their models, even as their audiences and their advertisers disperse. Part of the answer lies in strengthening their ability to capture dual revenue streams, from advertisers, networks, and distributors as well as consumers.

The strength of broadcasters has long been their reach, but they must now work harder to ensure the growth and loyalty of audiences for their most popular shows by building both

brands and communities—through social networking, for example, and by capturing more granular data and insight about those audiences. Pay-TV operators such as Sky can do this with more detailed subscriber profiles, while free-to-air channels like RTL can do it through their early efforts to create a subscription-based HD+ satellite model and by leveraging direct-to-consumer digital offerings.

Networks also need to embrace new technologies that allow them to follow their viewers to new platforms. Strategies like the BBC's iPlayer suggest that some companies in the ecosystem are placing bets that a great deal of value can be found in ubiquity and are doing deals to expand their distribution. Pay-TV provider Sky Germany, for example, is not only distributing content via its proprietary set-top box but also offering an iPad application to its subscribers.

If broadcasters are to keep growing, they must seek revenue opportunities that go beyond traditional

The challenge for legacy players will be to preserve and develop their business models, even as their audiences and advertising base disperse.

advertising and subscription models. Some TV players appear to be well positioned to tap into less obvious advertising-related value pools, if they can build on their strong brands and sustainable reach. For instance, they might try to bridge the gap between consumer awareness, driven by traditional on-screen advertising, and actual retail transactions by venturing into promotions—such as creating incentives for consumers to visit a particular retail chain by offering digital coupons.

Infrastructure Players

The owners of the technology and networks over which video has traditionally been distributed, such as Kabel Deutschland in cable and France Télécom in DSL and fiber, will be deeply affected by the changes in the TV and video ecosystem. Many of their traditional communications businesses are already saturated and in danger of becoming commoditized, just as the number of potential distribution channels is proliferating. And control over content is becoming a critical differentiating factor.

At this stage in the development of the TV and video ecosystem, companies making large investments in any type of infrastructure—fiber, long-term evolution (LTE), or satellite—may find themselves in an all-or-nothing competition as most players move into bundling communications with entertainment. Many of Europe's cable TV operators sell more than 50 percent of their services as triple-play bundles, and many of their competitors are following suit,

matching these heavily discounted deals. This makes it increasingly unattractive for consumers to source different communications services, such as broadband and TV, from different suppliers, so a growing number of households will source all communications services over a single broadband connection.

Infrastructure players, therefore, must move decisively beyond their current role as providers of content that is created and aggregated by others. The key to their future success lies in their ability to differentiate themselves by leveraging their infrastructure assets and their ability to control the customer interface and manage the customer relationship, and then combining these strengths with strong content offerings. They must also extend their distribution reach beyond their traditional platforms, providing customers with a variety of ways to view content and with new paid services such as video games. Both efforts will require a high degree of innovation and the ability to establish and manage effective partnerships with content providers and technology players alike.

Dutch cable operator UPC, for example, cooperates with commercial broadcaster RTL to integrate RTL's service to access programs already screened on UPC's digital interactive platform. Leveraging this well-established platform for more content benefits UPC and offers RTL the possibility of monetizing its linear content anew.

Digital Media Players

The new players entering the TV and video ecosystem, such as Apple, Netflix, and Amazon, are in a strong position to capture a significant share of its growth over the next several years. They already tend to dominate the fastest-growing areas of the ecosystem—most notably, devices, e-commerce, games, and online advertising. And they do not run the risk of significantly cannibalizing their other businesses. Moreover, these new players have already driven much of the growth in the ecosystem over the past several years—YouTube's strength in advertising linked to video is a case in point—and they have maintained their edge in innovation, a critical capability in this fast-changing arena.

That said, even the giants of digital media are having difficulty generating success in the ecosystem. Google, for example, has yet to gain real traction with Google TV. The company wants to install its proprietary software on Internet-connected TVs and set-top boxes, combining the power of the Android operating system and the Chrome browser to aggregate a variety of content, integrating broadcast TV, the Web, and its own YouTube content. The goal is to create an end-to-end experience that would allow for searches across all of this content, and then to sell ads against the content with increasingly targeted precision, much as it does with its Web-based search advertising. However, TV and device manufacturers appear unwilling to cede “start page” position on their devices

to Google, opting instead to use Google's Android operating system to power their own Internet-enabled functionality.

Similarly, Apple has derived little real success thus far from the Apple TV device. Yet according to recent reports, Apple is close to launching a Netflix-type cloud-based video streaming service catering to users of its mobile devices.¹⁴ Assuming that Apple can work out an attractive revenue sharing model with content providers (comparable to the App Store), the new service could both spur additional device sales and provide Apple with an all-inclusive video offering that will be hard for Google or other tablet manufacturers to match.

Still, the digital media players need to resolve some key issues around content access and monetization if they are to further increase their share of the ecosystem's value. Netflix has succeeded to date in part for two reasons: It has been willing to pay the market rate for its stable of movie-catalog titles and library TV series after waiting until properties have "windowed out," or by scooping up syndication rights and then streaming them. And it has largely avoided competing for more expensive feature film and first-run television rights

that remain the domain of the pay-TV networks. These moves have helped it amass a large content offering that it can offer attractively to consumers through subscription. But gaining the rights to more valuable content will be key to its further subscriber growth. Recognizing that need, Netflix is already taking steps to move into original content with the acquisition of the drama series *House of Cards*. By committing to stream and promote an original series with no built-in audience or track record, however, Netflix is also introducing a whole new level of risk and cost into its business model.

Google is also recognizing the value of more distinctive, professional video. It recently embarked on a major strategic overhaul of its YouTube service to make it more TV-like and watchable, including a \$100 million investment in original video content designed specifically for the Web.

Control over content remains a critical competitive advantage in the battle for video value. Today, traditional players still control much of the most valuable content: feature films, TV series, and sporting events. We expect the networks that currently rely on these content sources to be willing to drive license fees to

new levels to outbid new players and maintain their leverage over content as long as they possibly can. Some of them will also seek to increase the number of original productions airing on their networks, giving them greater control over costs and downstream monetization and rights opportunities.

Many digital media players are evolving their offerings and business models quickly. Video streaming service Hulu was initially launched as an entirely advertising-supported online platform. Less than two years later, it debuted Hulu+, a subscription service similar to Netflix, and it is on track to exceed 1 million Hulu+ subscribers in 2011. Similarly, the Scandinavian Hulu imitator Voddler quickly lined up some top content partners, including Disney, DreamWorks, and Sony Pictures, and has attracted 850,000 customers to date. Yet it reported losses for 2010.

It is still early days for the pioneers of online video. But those that are flexible and fast enough to iterate their business models in real time, and savvy enough to move beyond a reliance on advertising to other revenue streams, have much to gain in the intensely competitive TV and video ecosystem.

To further increase their share of the ecosystem's value, digital media players need to resolve some key issues around content access and monetization.

SIGNPOSTS OF AN EMERGING LANDSCAPE

Changes in consumer behavior, driven by new technologies, will reshape the TV and video ecosystem profoundly, and its new competitive dynamics will challenge every player involved to rethink how and where it can capture the ecosystem's new sources of value or defend the position it has already staked out. We believe that there are a number of important signposts that can guide all players as they craft their strategies for future growth.

In most markets, the supply of distribution will outgrow the supply of high-quality content. Consumers will have more and more choices among platform and service providers, and for how and where to source video content. Most markets will see intense competition among cable TV, IPTV over DSL and fiber, digital terrestrial

television (DTT), satellite, and broadband to deliver video services over the top. Rolling out the necessary infrastructure will be limited by resources and shareholder expectations.

But the quality of content will be limited by the available talent—growth in this area always seems to have a natural limit—so there will likely be a power shift to the providers of attractive content. For content producers and rights holders such as the Hollywood studios, Endemol, FremantleMedia, and the major sports leagues, the number of outlets through which to monetize their franchises will increase. It will become increasingly important, especially for infrastructure providers, to secure a strong position in content and to offer more than mere distribution services, both to consumers and to content providers. The alternative may well be the rapid commoditization of their infrastructure-based services.

Reach—the ability to capture the largest potential audience possible—will remain a critical success factor. In a media landscape with increasing

audience fragmentation, mass-market reach will be more valuable than ever in building brands and serving up the audience to advertisers. Research indicates that scheduled video entertainment based on strong content franchises—television as we know it today—will remain the most effective way to build large audiences. For programmers and channels, this implies that they need to build on their traditional strength in packaging content to generate reach. And they need to protect their traditional advertising-based business model by selling this reach to advertisers and carefully managing the migration of rights windows as digital expands. Finally, they must leverage their strong channel and TV show brands across every distribution platform, while simultaneously creating new ways to monetize their brands and audiences.

Combining reach with consumer insight and interactivity will unlock real value for advertisers. Adding interactivity to the video experience will redefine the home entertainment experience for consumers. It will also open up completely new avenues for

advertisers. Already, the combination of TV and online advertising is gaining share in the media mix of many leading advertisers. Advertisers value video advertising for its wide reach and its ability to connect to consumers on an emotional level. Combining this strength with online's more precise targeting capability, its ability to generate direct responses and even transactions, and its capacity to measure consumer behavior with greater precision will significantly enhance the value of video advertising. Traditional TV channels and network operators as well as new entrants—particularly those originating in digital media—will be the beneficiaries here.

Providing a seamless user experience across devices and video formats will become an important differentiator in the consumer market. New features will enhance and reshape the consumer video experience, promot-

ing convenience, interaction with and among the audience (as social media becomes more integrated into the ecosystem), and consumer insight. That insight will allow players to provide their audiences with more personalized services, ranging from content (via recommendation engines, for example) to advanced advertising. The most likely scenario is that these new features will be developed first for nontraditional video screens such as tablets, laptops, and smartphones; then they will spread to the television as it becomes a more connected device. This trend will favor players that are familiar with the user experience around these new devices, particularly those coming from the digital media space. Many players have begun trying to carve out their positions; services such as Netflix hint at the transformational potential of these new video efforts.

Alliances and partnerships will be critical to success. In its attempt to launch Google TV, the search giant seems to have underestimated the importance of content and the strategic significance of the start page. With only a limited number of device makers, broadcasters, and rights holders signing up for the concept so far, the offering has failed to develop mass-market appeal. There is an important lesson to be learned: No single player will be able to deliver the video experience of the future on its own. Therefore, the willingness to forge partnerships and alliances, even with competitors when necessary, will be critical. The ability to think through, understand, and make deliberate choices about where to compete and where to join forces will become one of the most critical capabilities for success in the evolving TV and video ecosystem.

Endnotes

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