WebTV insights and perspectives

A web 2.0 phenomenon is coining new TV usage patterns

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WebTV insights and perspectives – A web 2.0 phenomenon is coining new TV usage patterns

> WebTV already today plays a major role in web entertainment

> Accessibility, interactivity, community and personalization features are key differentiators from WebTV against IP- and particularly traditional TV

> WebTV audiences are commercially highly attractive, monetization is mainly achieved through advertising-funded revenue sharing

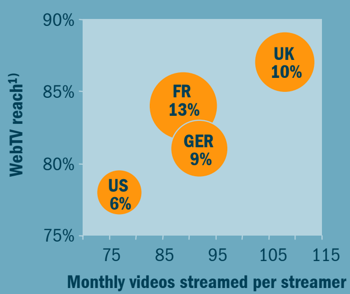
> In the long run, WebTV is likely to converge with IPTV and become direct competition to established TV operators and broadcasters

Throughout the world, WebTV usage has soared over the past three years. In the US, the number of videos streamed over the web to the PC has increased by 66% in 2007, reaching more than 10 billion videos viewed in January 2008, according to comScore video metrix. Similarly, all European countries have experienced double to triple digit growth rates. At the beginning of 2008, the UK is leading European WebTV consumption with more than 3 billion videos viewed per month. Germany and France are rapidly catching up with 2,5 and 2,1 billion, respectively. In line with these figures, Nielsen estimates the average video viewer to spend more than two hours watching WebTV per month. The growth in WebTV consumption, in turn, is driven by both rising user numbers and increased user activity. In Germany for instance, comScore reported 70% of the online population to be video streaming at least once a month by April 2007. Nine months later, at the beginning of 2008, WebTV reaches more than 80% of online users. In addition, the number of monthly videos viewed per video streamer has risen by almost 50%. By now, it clearly exceeds 90 videos viewed – German WebTV users are watching more than three videos per day.

Not surprisingly, media companies all along the value chain are trying to stake their claims of the growing market and move into WebTV on their own. Majors like Disney are establishing direct customer contact through the creation of own branded portals (e.g. Disney Online), or seek to contract with established WebTV players (e.g. Hulu and Joost). Operators are moving into User Generated Content (UGC), like e.g. Comcast with Ziddio, or enlarge their web presence with premium video on demand (VoD) portals (e.g. Deutsche Telekom's Videoload). Some broadcasters even do both, like ProSiebenSat.1 with MyVideo and Maxdome, or provide their contents to established players (like ZDF does with Zattoo). Publishing houses integrate WebTV players into their online directories (e.g. Spiegel Online), and also established portal players are creating extensive video offerings (e.g. AOL or Yahoo!). Yet still, "traditional" media companies are clearly outnumbered by the multitude of WebTV start ups that have been created over the past years, such as Metacafe, Vuze or Veoh.

Consequentially, the WebTV boom is fueled both on the supply and demand side. "Increases in broadband penetration have significantly enlarged the targetable WebTV audience", states Alexander Mogg, broadband and media expert at Roland Berger Strategy Consultants. "While at the same time, WebTV players have consistently grown in numbers and improved their offerings through better contents and usability. This, in turn, attracts new users and raises overall WebTV activity in the net", so Mogg. Today, WebTV is accounting for more than 10% of all internet traffic, according to Cisco estimates. As such, it is the third most important source of online traffic, exceeded only by email/file transfer and peer-to-peer downloading. Clearly, WebTV has developed into a mass application that can build on its own stars, culture and userbase. Lonelygirl15 telling her worries (> 70 million views) or funtwo playing Pachelbel's Canon on his electric guitar (> 44 million views) are only two of the manifold examples that have found their way into the hearts of a rapidly growing WebTV audience.

ONLINE VIDEO USAGE PATTERN 2008 – WEBTV ALREADY TODAY PLAYS A MAJOR ROLE IN WEB ENTERTAINMENT



Main WebTV drivers

> Increasing broadband penetration

> Extended and simplified accessibility

> Enriched user experience

> Improved and free/low cost content offerings

> Decreasing cost of online video storage and transmission

Size = % of total online time spent video streaming 1) % of online users streaming videos at least once a month

Source: ComScore 2007/2008, Roland Berger Strategy Consultants

WEBTV COMPETITIVE LANDSCAPE – TRADITIONAL MEDIA COMPANIES, INFRASTRUCTURE PROVIDERS, ONLINE PLAYERS AND WEBTV START-UPS ALTOGETHER COMPETE FOR THE UPCOMING REVENUE POTENTIAL

	a Studios	b Operators	c Broadcasters	d Publishers	e Online players	f Start-ups
Initial situation	> Face UGC and web 2.0 trend > Primarily create and deliver contents, thus losing margins to distributors	> Face declining ARPUs > Recently (Telco) or long time established (CableCo, Sat) TV platforms	> Face almost stagnating free TV advertising revenues > Fear competition on share of time and wallet	> Face stagnating print media consumption > Constantly generate contents for core businesses	> Have enjoyed rapid growth over the past years > Can build on extensive online footprint	> Mostly unprofitable at present > Venture capital funded
WebTV rationale	> Opportunity to establish direct customer contact > Add advertising to revenue portfolio	> Realization of synergies with core products (IPTV, Digital Cable/Sat) > Add advertising to revenue portfolio	> Exploitation of cheap distribution channel > Prevent WebTV competition from establishing own TV brands	> Leverage content base to enhance offer of online portals > Prepare for move on TV screen	> Accelerate future growth > Monetize on networking effects from existing audiences	> Exploitation of market opportunity > Create scale
Core assets	> Content ownership > Negotiating position	> CAPEX and OPEX capacities > Infrastructure control	> TV brands > Cross-media-potentials	> Media brands > Cross-media-potentials	> Online brands > Audience-flow control	> Flexibility > By insiders for insiders
Examples						

Source: ComScore 2008, Roland Berger Strategy Consultants

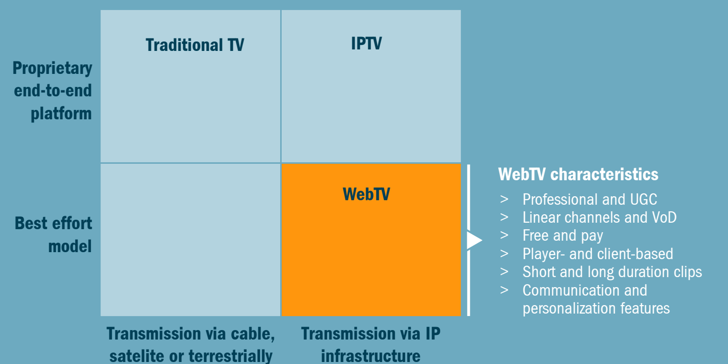
Yet what is behind the current WebTV drive? Who is watching WebTV and how can the audience be monetized? Is it a temporary phenomenon or will WebTV establish itself as a real alternative to "traditional" TV and IPTV?

WebTV has several unique features as compared to IP- and particularly traditional TV

Technologically, one can first distinguish Web- and IPTV from "traditional TV". Both Web- and IPTV are transmitted via a bidirectional IP infrastructure, whereas "traditional TV" is broadcasted terrestrially, via satellite or cable. However, WebTV still clearly differs from IPTV in such that WebTV providers do not guarantee a picture quality that is equal to or better than "traditional TV". WebTV is offered by independent providers "over the top" of the Telco's network, whereas IPTV products are provided by walled garden infrastructures, using the proprietary end-to-end platform of the operator. Hence, WebTV is a "best effort" model in which the provider can hardly influence the quality of service (QoS) over the public Internet – a drawback, which however becomes less and less relevant with higher bandwidths and increased network capacities. Nevertheless – for now – WebTV is mainly targeted at PC screen usage, whereas IPTV is usually consumed on the TV screen.

In terms of content, there is still a lot of discussion about which online services shall be subsumed under the term WebTV. Differentiations are being made between user generated vs. commercial contents; VoD vs. linear channels; free vs. pay; player- vs. client-based; short vs. long duration clips, etc. We, however, broadly classify any IP-based moving picture service, that is not an insulated IPTV model, under the term WebTV. "Convergence is also taking place between formerly distinct online video or TV services", states Alexander Mogg. "We can observe all-embracing WebTV offerings like Telefonica's TerraTV, which comprise the whole range of online moving picture services under one brand. Many of the established players are expanding product lines and services or reinvent themselves as full-line providers", so Mogg.

DEFINING WEBTV – IP BASED TRANSMISSION OF MOVING PICTURE CONTENTS IN A BEST EFFORT SERVICE MODEL



Source: Roland Berger Strategy Consultants

Furthermore, for consumers, WebTV in the first place means open access to the world of digital, IP-based television via a standard internet connection. "WebTV has opened the advantages of next generation TV services to the whole internet population. Enlarged content libraries, on demand accessibility and time-shift functions are only some of the features that together comprise WebTV's value proposition to all internet users", says Alexander Mogg. "As a consequence, large online communities have grown around the basic content offerings. Today, users and particularly teens use WebTV offerings as a form of social interaction." In 2007, 75% of all WebTV users have received video links from friends, 57% have forwarded links themselves, according to a PEW survey. Providers are responding through the integration of ever more extensive communication and personalization features into their offerings. MTV Networks' In-Video comments ("Vomments"), YouTube's "active sharing" or Imeem's "shared playlists" are only the latest manifestations of that trend.

WebTV's characteristics are attracting a commercially highly attractive target group

Studies indicate that young adults and particularly teens make up the most active group of WebTV users. Percentages of video streamers within these age clusters range between 75% and 90%, depending on the type and date of study. The share of active WebTV users then gradually decreases with increasing ages. Striking, however, is that among the 65+ year old internet users still 39% claim to be video streamers themselves. Looking at gender-specific usage patterns, men are slightly more active WebTV users than women. Women on the other hand show a tendency to watch longer than men (50% of women consume more than 15 minutes of WebTV contents daily, compared to 43% of men, according to ZEM). In terms of education, college graduates and active students are clearly more likely to be video streamers than the rest of the population. SurveyU found 93% of current students to be WebTV affine. Furthermore, people in higher income classes (>50.000 USD), are significantly more active WebTV users than those in lower income classes (<30.000 USD), according to PEW.

"General WebTV user demographics are highly attractive to advertisers and content owners. The broad audience is crowded with young early adopters and mindsetters that bring along a high purchasing power", concludes Alexander Mogg. "However, given the broad range of specialized vertical WebTV portals and the high accessibility of their contents, the WebTV audience is much more fragmented than e.g. in traditional TV." As a consequence, several promising niche audiences are evolving and become increasingly addressable. Particularly, content consumption patterns differ significantly between the various target groups. This, in turn, induces the need and opportunity for the design of a fitting value proposition to both users and advertisers.

Furthermore, besides the attractive user base, the product characteristics of WebTV itself are offering advertisers additional value particularly over traditional TV. As with IPTV, the bidirectional IP infrastructure makes a direct user response to interactive ads possible. Advanced user tracking and recognition tools facilitate highly targeted, personalized addressing of users, which – if user concerns of privacy infringements are properly and proactively addressed – features enormous increases in both awareness and click-through rates as compared to traditional advertising. Contextually targeted ads are already being inserted into online videos with the help of tagging and speech-to-text technologies. In the future, dynamic object recognition techniques will even facilitate picture-based product placement tactics. Finally, the obvious use of moving pictures enables the transmission of emotional messages to the same degree as commercials on traditional TV. As a consequence, many dedicated online advertising formats have evolved around WebTV, like pre- mid- and post-roll ads, companion units, overlays or handraisers. And ad formats on WebTV prove financially interesting already today – the big players are realizing cost per mille (CPM) rates comparable to those of print media in the respective country.

WEBTV ADVERTISING FORMATS – LITTLE INTRUSIVE, HIGHLY INTERACTIVE ADS ARE EVOLVING, AS DEMONSTRATED BY JOOST'S HANDRAISER CONCEPT

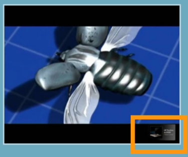
1 Selecting video

> Selection of video
> Full-screen mode opens
> Title and navigation box of selected video appears

2 Pre roll

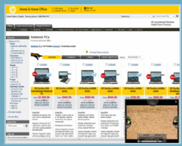
> 30-second pre roll advertising plays
> No interaction possibilities with the ad
> Usually very emotional, little fact-based messages

3 Handraiser



> Pre roll related, clickable icon (handraiser) appears on the bottom corner of the screen
> User is asked if more information on products advertised in pre roll is desired

4 Extensive product information



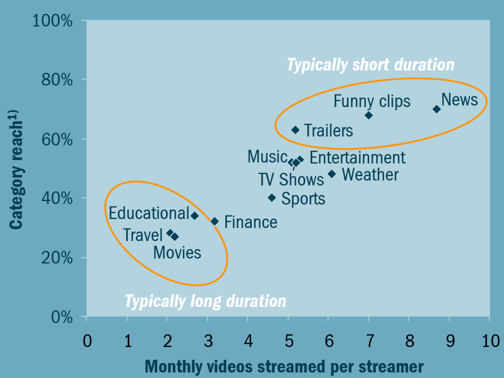
> Clicking on handraiser induces shrinking of full-screen player
> Additional window with interactive product information is opened, while video keeps playing in smaller screen
> Page can be closed at every moment and video restores to original size

Source. Joost, Roland Berger Strategy Consultants

Short-duration long tail clips are still the most popular WebTV contents

According to the online publishers association, news, funny clips and movie trailers are – at present – the most popular content categories in WebTV. 60% of WebTV users are watching these categories at least once a month. 45% access contents from the news category more than weekly. WebTV users hence still seem to favor short duration clips over longer contents like movies or educational videos – comScore estimates the average online video duration at only 2,8 minutes. "WebTV consumptions patterns – by now – differ from traditional TV and IPTV. Instead of relaxing in front of the screen, users mainly follow a "dip-in and dip-out" behavior – proactive browsing through short duration and primarily long tail contents", states Felix Iblher, Telco expert at Roland Berger Strategy Consultants. "Consequently, VoD clips are much likelier to be consumed online than linear channels offerings," so Iblher. The reasons for the present difference in WebTV viewing patterns as compared to traditional TV can mainly be found in the nature of watching "best effort" TV over the internet. "Due to the still low deployment of highspeed internet connections, watching long duration contents over the internet can be very frustrating for the users. Lower picture quality and long downloading/streaming times favor established TV services as the dominant longer duration medium. Furthermore, users are still reluctant to watch movies on the PC-screen, which is usually not embedded in a comfortable living-room environment. Recent attempts at bringing PC contents to the TV-screen, in turn, are still in its infancy and have not yet gained full user acceptance." states Alexander Mogg. "The latter, however, may quickly change as market diffusion of high-end TV flat screens is taking off. These, unlike conventional TV screens, enable great viewing experience of high resolution online contents."

CONTENT CONSUMPTION PATTERNS [US] – SHORT ONLINE VIDEOS LIKE NEWS, FUNNY CLIPS AND TRAILERS ARE STILL THE MOST POPULAR CONTENT TYPE



Short content popularity

> Low deployment of highspeed internet connections (16+ Mbit/s)
> Slow roll-out of professional content WebTV offerings
> Only gradually decreasing reluctance to watch movies on the PC
> Attempts of connecting PC content to TV-screen in its infancy

1) % of WebTV users watching videos of respective category at least once a month
Source: Online publishers association 2007, Roland Berger Strategy Consultants

UGC players are leading in WebTV, yet commercial content offerings are on the rise

Throughout the world, Google's YouTube is outperforming its competition in terms of all relevant online video performance indicators, be it the number of video streams, the unique audience size or the time spent per user. In the US, in March 2008, the UGC-focused portal has streamed more than twice as many videos as the remaining top-10 WebTV players altogether. In Q1 2008 only, the number of YouTube videos streamed in the US has grown by 38%. But also in Europe, YouTube is far ahead of the competition in all relevant markets. This, however, does not necessarily predict a future predominance of UGC-focused players in WebTV. Rather, commercial content players are increasingly invading the market place. The growth of Fox interactive media's MySpace, for example, which has closely traced YouTube's UGC hype over the past two years, is clearly fading out. Similarly, many of the UGC-focused and venture capital funded portals like Metacafe.com or Break.com have lost their leading WebTV positions in the US to commercial content owners like Disney, ESPN or CNN. "In the recent past, many of the large and established media players have moved into WebTV, either through acquisitions, the creation of own portals or the syndication of their contents to existing players", comments Hannes Wiese, media consultant at Roland Berger. "WebTV is potentially moving from UGC libraries without particular content-focus to a highly organized, TV like experience", so Wiese. "Navigating through online libraries is becoming similar to simply switching the TV channel."

The low speed/tardiness of this change is mainly due to the necessity to negotiate regional content licenses – a problem, which the manifold UGC players never had to face. In contrast, they have benefitted from enormous networking effects through their rights free worldwide content deliveries.

TOP FIVE WEBTV-PLAYERS BY COUNTRY – GOOGLE CLEARLY LEADING IN TERMS OF AUDIENCE SIZE AND NUMBER OF VIDEOS VIEWED

1	Google sites	Google sites	Google sites	Google sites
2	Fox Interactive Media	BBC sites	Dailymotion.com	Vivendi[1)]
3	Yahoo! sites	Microsoft sites	Groupe TF1	ProSiebenSat.1 sites
4	Viacom Digital	Yahoo! sites	Amazon sites	RTL
5	Microsoft sites	Fox Interactive Media	Yahoo! sites	Fox Interactive Media

1) Mainly driven by the success of World of Warcraft gaming videos

Source: ComScore 2008, Roland Berger Strategy Consultants

Fierce competition between localized and global players is evolving

The solution to the content licensing issue will furthermore have significant implications on the strategic positioning of local versus international players. Many local players could already establish themselves next to their omnipresent global competitors. BBC in the UK and ProSiebenSat.1 in Germany can serve as two examples of regionally focused broadcasters which successfully managed to lever their local TV experience to the web. The users, correspondingly, see WebTV more and more in competition to traditionally localized broadcast TV, rather than as a stand-alone web 2.0 application. As a consequence, also the demand for localized content and design in WebTV is rising.

Not surprisingly then, most of the US-based players like AOL or Yahoo! are responding through the creation of locally adapted offers themselves. Whether this will suffice to compete against local players in the long run, however, is still to be seen. While the global players can build on extensive scale and brand strength in WebTV, their local competitors rely on existing relations to local content providers and proven experience in traditional TV.

Key Trends – WebTV is going professional, mobile, and on the TV screen

We see three major trends that are evolving around WebTV at the moment – Professionalization, Mobilization and Convergence.

1. **Professionalization** – Contract structures between content owners and WebTV players are becoming increasingly professionalized and standardized. Advertising-funded revenue sharing on country level is developing as the prevalent business model. Minimum guarantees are typically incorporated in contracts involving premium content from producers with strong brands, ensuring a sufficient return on their investments. With thus facilitated enlarged and premium-oriented content offerings, new usage patterns are evolving. The recent entries of the majors into WebTV might hence also be seen as first indicators for an upcoming increase in short tail consumption over the web.

2. **Mobilization** – Mobile networks are experiencing significant increases in bandwidth capacity and the equipment of handsets with TV-capable screens is soaring. WebTV players respond to the rapidly upcoming mobile content usage through the implementation of mobile compatible microsites, new video formats (3gp) and mobile software clients. In parallel, mobile carriers are lowering data tariffs and try to monetize on the increasing mobile broadband usage through the creation of own, dedicated mobile content offerings. As a consequence, mobile video usage is taking off and the global user base is forecast to continue to grow with CAGRs up to 100% over the next five years, reaching almost one billion people in 2012.

3. **Convergence** – WebTV is starting to become an integral part of the living room entertainment sphere. Integrative devices like Linksys' Kiss 1600 or United Internet's MediaCenter enable users to comfortably access, navigate and stream WebTV contents on their home televisions. In parallel, established players like Apple are creating their own devices as TV-extensions for their contents (Apple TV). In that way, WebTV begins to move away from a separated web application to a real alternative to traditional TV – thereby constituting new competition on share of time and share of wallet for traditional broadcasters. However, many steps remain to be taken before entering the mindset of living room occupants accustomed to traditional TV.

Future outlook – WebTV will benefit from multi device accessibility and position itself in direct competition to established operators and broadcasters

The future development of WebTV offerings will be highly influenced by multi device accessibility and multi screen consumption patterns. Laptop/PC, Mobile and TV screen will become similar in importance but have different implications on the design of WebTV offerings. "Established WebTV players will try to leverage their existing contents and infrastructures to harvest market share in mobile video and TV consumption – Either through adaptation of their existing clients, web pages and contents or through the creation of new, parallel offerings." expects Alexander Mogg. "At the same time, new players will enter the field with specialized content or webpage/client offerings for Mobile or TV screens."

Particularly, the comfortable future accessibility of WebTV offerings on the TV screen will create competition to established operators and broadcasters. WebTV players will offer HD megahit VoD libraries or aggregate their contents in premium and niche linear content offerings. "Enriched with WebTV capabilities like interactive advertising, time and place shift functionalities, socialization and personalization features as well as publishing and communication possibilities, these mainstream products will constitute a significant competition on media time and budgets to established premium offerings." states Mogg. "In parallel, highly specialized niche WebTV offerings will become a true alternative to traditional niche TV channels."

"With growing bandwidth allowing for better picture quality, and IPTV operators increasingly integrating browsers functions into their offerings, WebTV is even very likely to completely converge with IPTV from a TV-consumer perspective in the long run" concludes Mogg.

However, although loaded with premium or high quality niche contents, a significant part of the WebTV offerings will probably remain free in the future. "Ad-funded revenue sharing models encompassing expensive premium libraries are already reality in the US and will soon become standard in the eyes of the consumer" expects Felix Iblher. "Willingness to pay for contents will consequently further reduce while supportiveness for ads is likely to grow as formats become more subtle and relevant due to personalized targeting." In comparison to traditional TV, however, ad load is likely to remain rather small as significantly higher CPM rates compensate for lower exposure. Furthermore, although streamed over the TV screen, WebTV players will still want to remain attractive to the online audience whose ad supportiveness is significantly lower than on TV.

WebTV induces pressure to act now for operators and traditional media companies

As with traditional TV and online entertainment in general, there will only be room for a limited number of dominant WebTV players both on local and international level. The path to dominant player status needs to be paved right now, as the pie is presently being cut and shared among WebTV start-ups, media companies and operators. WebTV-specific brands are already establishing themselves in the minds of the consumers since reach is close to saturation in most developed countries. Furthermore, consolidation of players has started already – prominent examples include Google's acquisition of YouTube and Fox Interactive Media's takeover of MySpace.

For traditional media companies, on the one hand side, this induces the imminent need to formulate strategies against the upcoming competition on share of time and wallet. On the other hand, there is still a corresponding window of opportunity to exploit new revenue fields through the establishment of own WebTV brands. Now media companies need to take a clear stance in cross-media-strategies. Launching converged WebTV products to leverage their brands, or accelerating market diffusion and growth through well targeted acquisitions are only two of the possible actions to be analyzed in depth.

For operators, the current WebTV state exercises pressure on taking decisions regarding the future positioning against the new "over the top" competitors, which could potentially harm long awaited IPTV-subscription and VoD-download revenues in the near future. Strategic options range from cooperating (e.g. through co-marketing, integration of services, improved access to TV and mobile, or optimized delivery – like the high quality (HiQ) service from Swisscom and Zattoo) to imitating (i.e. implementing own WebTV offerings, e.g. as a way to follow a well defined upselling strategy) and defending (e.g. through improving attractiveness of own core products, acquisitions of existing WebTV players or toll-models for network capacities).

Wrap up – Nine key hypotheses on WebTV

1. WebTV has soared over the past three years – Today, it is a mainstream online application and plays a **key role in web entertainment**.
2. The WebTV **audience is commercially very attractive**. However, user bases are much more fragmented than in traditional TV – A differentiating value proposition to both consumers and advertisers is therefore crucial to drive revenues and profitability.
3. While UGC is still far from drowning, **commercial (premium) content offerings** are on the rise – Yet content licensing issues need to be resolved before a rollout in relevant scale becomes feasible.
4. The majority of WebTV offers will probably remain free in the future. Accustomed to **advertising-funded revenue sharing models**, users will only be willing to pay for the most current (talk-of-the-town) and time-exclusive contents (e.g. sports, live events and blockbusters/ series that have not yet been shown on TV).
5. Supported by its short formats and on-demand accessibility, Web TV will fast **move to mobile devices** – But adaptation of site design and localization of contents need to be improved in order to compete with ARPU seeking network operators.
6. Through integrative devices, WebTV is becoming an integral part of the **living room entertainment sphere**. However, initial attempts to bring WebTV on the TV-screen have not yet gained full customer acceptance – Cooperation with device manufacturers, operators or service providers is necessary in order to quickly harvest a significant share of TV consumption time.
7. Once on the TV-screen, WebTV will position itself in direct **competition to established players**. Then it will benefit from differentiating factors like interactivity, on-demand accessibility as well as extensive communication- and personalization features.
8. With increasing bandwidth capacities, growing user adoption to integrative devices and the integration of browser applications in IPTV offerings, **WebTV is likely to converge with IPTV** in the long run.
9. **Operators** and traditional **media companies** must **react now** in order to keep WebTV companies from establishing their brands in the minds of the consumers. Otherwise, they leave the field open for aspiring competitors on media time and budget and will increasingly be overtaken by once impotent WebTV players.

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The InfoCom Competence Center at Roland Berger Strategy Consultants provides comprehensive strategic consulting services and implementation expertise to the telecommunications and media industry.

We support our clients in the following issues:

Overall strategy: From finding the right strategy for the core market and tapping adjacent segments and media channels to formulating new game strategies, or diversifying into new markets – we help our clients develop an overall strategy to ensure that they are properly equipped for the future.

Implementation: From breaking down the overall strategy into practical strategies for the business divisions, launching products and services, ensuring the optimal product portfolio to controlled strategy implementation using our program management system – we help our clients implement their ideas beyond the conceptual stage, ensuring that tangible results are achieved quickly.

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We look forward to hearing from you and would be happy to discuss any of the issues raised here or answer any questions you may have. You can reach us at +49 (0) 89 9230 8649.

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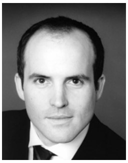

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