



BRITISH SCREEN ADVISORY COUNCIL BRIEFING PAPER
INTERNET VIDEO-ON-DEMAND: MARKET STATUS UPDATE

September 2008

Introduction

This paper is concerned with the delivery of film and TV content over the open public Internet to home consumers and is a companion piece to the previous BSAC briefing paper on TV-based ‘on demand’ services delivered to a set-top box (February 2008). It is not concerned with IPTV (Internet Protocol TV), which we define as the deployment of TV services over a closed network using Internet Protocol.

Although the underlying communication technology used (Internet protocol) is the same as that used on the open Internet, IPTV services are normally deployed over relatively secure closed networks to special dedicated set-top boxes that are connected to the customers’ TV set. Because these services use a closed network rather than the public Internet, the service provider is able to control the quality of service delivered much more effectively.

Because the public Internet is a “network of networks”, consisting of millions of interconnected networks, it is much more challenging to ensure quality of service – particularly for delivery of large digital video files.

The device normally used to access open Internet content is the PC, but it is increasingly feasible to receive Internet video on other broadband-connected devices such as games consoles (e.g. Microsoft’s Xbox 360 and Sony’s PlayStation 3), dedicated set-top boxes (e.g. Apple TV, Vudu, Netflix’s Roku), and hybrid set-top boxes that are able to receive traditional digital TV and the Internet (e.g. Freesat set-top boxes have this capability specified). There is even an emerging class of TV sets that have a direct Internet connection that enables them to receive video services directly, although relatively few have been sold to date.

Paid-for Online Video Services

Movies first began to be offered on a commercial pay-per-view ('digital rental') basis over the Internet for viewing on PCs in the late 1990s. CinemaNow, one of the pioneers and longest survivors, began in 1999. Movielink, set up by five of the Hollywood majors, followed in 2002. However, the market did not show signs of significant life until Apple began offering video via its iTunes application in October 2005.

In September 2006, Disney became the first major Hollywood studio to offer new release movies on a download-to-own basis through iTunes and sold 500,000 in the first eight weeks. iTunes quickly became the dominant US store for Internet-delivered movies and TV shows, despite initially only having support from two major US studios (Disney plus a more limited selection from Paramount). The only other service to gain significant commercial traction has been the Xbox Live Video Marketplace, launched by Microsoft in late 2006. This enabled owners of a broadband-connected Xbox 360 games console to digitally rent movies or purchase TV shows on a download-to-own basis.

All the major studios finally came on board iTunes in January 2008, making new release movies available in the US – initially only for digital rental. A deal to offer new release movies for download-to-own on the same day as their US DVD release followed in May 2008 and by June 2008 Apple was able to report a run-rate of 50,000 iTunes movie transactions per day.

Apple began offering movies for rental and retail via the UK iTunes store in June 2008 and Screen Digest estimates that it already controls over 60 per cent of the transactional digital movie market in the UK. In second place is Microsoft, which has made movies available to UK customers through Xbox Live since December 2007. British consumers have been able to purchase TV shows via iTunes for a longer period of time – since August 2007. Consequently, Apple enjoys an even higher (90 per cent) share of the UK download-to-own market for TV programming.

iTunes and Xbox Live Video share one notable characteristic. They are mass-market device-based services from very deep pocketed companies with interests in other markets. iTunes is designed primarily to integrate into the ecosystem of Apple's iPod/iPhone products as well as Macintosh computers and the Apple TV set-top box, while the Xbox games console has no PC component at all, and is designed to directly plug broadband-delivery into the living room TV screen. A key lesson from the relative success of these services is that consumers tend to buy devices and screens, and then buy digital content from services serving those devices/screens. This device-driven phenomenon is the primary reason why virtually all pure stand-alone PC/web-based services have struggled and remain trapped in what we have termed the 'digital ghetto'.

Part of the explanation for the dominance of Apple and Microsoft in the paid-for market for online movies and TV shows is that their core business interests lie elsewhere. In other words, these companies have developed their digital content strategies primarily as

a means of driving some other mainstay profit centre – in Apple’s case, to drive the sales of high-margin products like iPods and in Microsoft’s case to boost the sale of games consoles, which in turn bring profits from the sale of games. By approaching the online video service as a ‘value-add’ to other businesses, they can justify selling content to the consumer at close to break-even or even sometimes at a loss. This is in stark contrast to stand-alone services that are faced with the same high wholesale prices and minimum guarantees for content deals plus significant distribution costs, but have no other means of generating a profit.

The market for Internet-delivered movies is not large; Screen Digest estimates it will be worth less than £4m this year and no more £50m in the UK by 2012 – less than two per cent of the total UK home video market in the same year. We believe around 55 per cent of the 2012 total will derive from download-to-own retail transactions, with most of the balance coming from rentals. The subscription business model has only gained traction in the very specific field of online sports content, the only content category apparently perceived by consumers to have sufficient value to warrant such a financial commitment.

Online sales and rentals of TV shows should generate about £18m in the UK this year and are likely to be worth a little more than the movie market in 2012 at a projected £76m. By our estimations, subscriptions to online sports services (mainly football) will generate another £23m.

Free Online Video Services

In the last few years there has been an explosion in the volume of free-to-the-viewer video content made available online, mostly with the hope of generating revenues from advertising. Much of this video is distributed via user-generated content (UGC) sites, such as YouTube, and social networks like Myspace and Bebo. Indeed, online video traffic of all kinds in the UK (and most other markets) is still dominated by Google’s YouTube, which has effectively seen off the competition from most other rival UGC services. However, YouTube and MySpace, while generating high volume video consumption, continue to have a tough time attracting video advertisers because of the perceived low value of their content.

When it comes to premium TV content, all the major UK broadcasters have launched online TV outlets that allow viewers to catch-up on recently broadcast programming. However, it is the BBC’s immensely successful iPlayer service that now dominates online TV traffic in the UK. We estimate that the iPlayer will account for around 40 per cent of all free-to-view online TV streams consumed in the UK this year.

While the online video audience has been growing fairly rapidly, broadcasters have struggled to effectively monetize this audience by attempting to serve ads in and around the video content. At the same time, they have faced significant delivery costs (bandwidth, ingest, storage, etc) and, in many cases, high wholesale prices for content with stiff minimum guarantees.

The fundamental problem with online video is the cost of servicing each viewer. Unlike traditional broadcast technologies, the one-to-one unicast nature of online distribution means each audience view request carries an individual delivery cost for the service provider. To break even, the service provider must generate more advertising revenue per view than the per-view delivery cost. Although the cost of video delivery (usually largely paid to a so-called Content Delivery Network such as Akamai, Limelight Networks and Velocix) has been falling, it remains a stubbornly critical factor in Internet video economics.

There is also the challenge of selling the available online video advertising inventory. Generally speaking, ad buyers (as well as agencies and media planners) are having a tough time understanding how online video advertising would fit into their campaigns. This is heightened by the way that changes in consumer behaviour and technological advances in entertainment consumption are forcing them to rethink their understanding of audience behaviour. Part of the explanation for the difficulty in managing this transition is the shift from the 'aggregated' TV environment, where advertisers are guaranteed high volume audiences around a single screen in the home for a particular length of time, to a 'disaggregated' online video environment, where viewers are each relating with video content on a personal, single screen, and often accessing that content across a range of websites or services, on a range of devices, in a very personal entertainment journey.

Although there is now an educative conversation taking place in the TV sector between broadcasters, production companies and ad buyers, the industry is still very much in a period of transition. There are often tensions between a given company's traditional TV division and the same company's internet/new media arm. One emerging trend is for online video advertising to be bundled as part of a TV programme's overall sponsorship deal (multi-platform sponsorship) or bundled as a component of the primary TV ad sales effort. While this may prove more effective in utilising the available advertising slots, it may also act to depress the cost per thousand (CPM) rates that can be achieved for the online video inventory.

Screen Digest estimates that free-to-view online TV in the UK will generate just under £30m of advertising revenue in 2008, relatively low figure that takes into account the dominant share of viewing being taken by the BBC iPlayer. This should rise to just over £90m in 2012 – about 2.5 per cent of traditional TV advertising revenues in the same year.

Concluding Remarks

The reality today is that digital media service provision as a stand-alone proposition is rarely a profitable business. In the paid-for segment, the most successful companies are those that utilise online video to support another already profitable business. In the free-to-view segment, much of the activity is being prompted by defensive manoeuvring –

being in the space because competitors are and attempting to counter viewer 'leakage' to rival services.

The two categories of company that are currently profiting from the online video business are (1) owners of valuable content, and (2) technical enablers of the services, many of which have received significant outside investment.

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