BSAC Briefing Paper

Internet Video-on-Demand: Market Status Update

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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. 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 or IP) 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 traditionally used to access open Internet content is the PC, but a rapidly expanding number of other consumer devices are now broadband-connectable and therefore able to receive Internet video. These include all three current generation games consoles (Nintendo's Wii, Microsoft's Xbox 360 and Sony's PlayStation 3), set-top boxes dedicated to delivering Internet video to the TV (e.g. Apple TV, Zillion TV, Roku), hybrid set-top boxes that are able to receive traditional digital TV and the Internet (Freesat satellite TV set-top boxes have this capability specified and a growing range of Freeview digital terrestrial receivers also do – and of course the much-discussed Canvas proposition originated by the BBC has this functionality at its core), and a variety of portable/hand-held gadgets including portable video players (notably iPods), handheld games consoles, smartphones, and the arguably new category being defined by Apple's new iPad product. There is also an emerging class of TV sets that have a direct Internet connection that enables them to receive video services directly. Indeed, this feature is becoming increasingly common across high-end models from leading manufacturers.

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. The now defunct Movielink service, 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 the US 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 was the Xbox Live Video Marketplace, launched by Microsoft in late 2006 - and in 2009 rebranded as the Zune Video Marketplace. 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. More recently Sony has achieved growing success with its PlayStation Network service offering paid-for video downloads via the PlayStation 3 console.

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 commanded almost 60 per cent of the transactional digital movie market in the UK last year. 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. Apple enjoys an even higher share of the UK download-to-own market for TV programming, accounting for 85 per cent of the market in 2009. Sony's UK version of its PlayStation video store launched too late in 2009 to make a meaningful impact on the year's figures.

iTunes, Zune Video Marketplace and the PlayStation Network 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 Mac computers and the Apple TV set-top box, while the Xbox and PS3 games consoles have no PC component at all, and are 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, iPhones and iMacs, 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. These difficult commercial parameters have resulted in no less than 42 different online movie stores going out of business in 2009 alone.

In the US, more and more service providers, such as Amazon VoD and the Roxio CinemaNow-powered online movie platforms, have tied up with a growing list of consumer electronics manufacturers to deliver their content directly to the living room TV. This follows from the combined success of Apple, Microsoft and Sony’s platforms in driving consumption by offering digital movies in a compelling hardware-plus-content ecosystem environment, making it easier for consumers to view downloaded or streamed movies directly on the living room TV, or to be able to move content onto portable devices. As more connected TV models appear on the UK market, we expect a similar pattern to emerge, with services being ‘pre-loaded’ and ready to run from the main screen.

The market for Internet-delivered movies is not large; Screen Digest estimates it was worth almost £16m in the UK last year – less than one per cent of the total UK home video market in the same year. Of this total consumer spend, around 63 per cent was generated via download-to-own retail transactions, with the balance coming from VoD rentals.

Screen Digest recently downgraded its forecasts for the global online movie business as a whole, primarily because the download-to-own part of the market has failed to fulfil its potential. We argue that there is so far no compelling use-case to drive a mass download-to-own market. In other words, there is little ‘convenience’ or ‘service’ aspect–-crucial elements for a retail business in the digital era. Meanwhile, the VoD rental proposition tends to offer a more convenient consumer experience. Moreover, it is cheaper than download-to-own, and often offers superior product line-up in terms of title availability and choice of high definition versions. This raises the very real danger of a further consumer migration away from download-to-own to VoD beyond 2010, which will not be good news for content owners because of the inferior per transaction margin delivered via the rental business model.

Online sales and rentals of TV content – as distinct from movies – generated £22m last year. With much lower consumer pricing per show than for movies, this market is almost 80 per cent download-to-own. Again, the market is dominated by Apple, with neither Microsoft's Zune or Sony's PlayStation Network yet offering TV shows on a transactional basis outside the US. Growth in the paid-for online TV market has certainly slowed with the proliferation of free 'catch-up' online TV services (see below).

By our estimations, subscriptions to online sports TV services (mainly football) generated another £18m in 2009. However, there is also a growing trend for pay TV operators to extend their footprint "over-the-top" by using online TV as a distribution platform to bolster their core subscription business. BSkyB has employed the open Internet to deliver VoD services for some time, first introducing a PC-based VoD service as early as January 2006. Initially offering VoD downloads only, it was later expanded (and re-branded as Sky Player) to include simulcast streaming of live Sky channels in addition to VoD.

All the features of Sky Player – including the simulcast streaming of channels – is available free for Sky customers as a value-add to their existing package, but only to those taking the Multi-room TV package or the top-tier broadband access subscription. Subscribers on lower-tier packages have on-demand access to programming consistent with eligible channel bouquets.

Sky Player is also available as a standalone subscription for customers opting not to have a dish/set-top box. BSkyB hopes to generate a meaningful incremental revenue stream from these 'non-dish' subscribers as well as driving other subscribers towards Multi-room and higher value broadband packages. It also generates some revenues from movies and TV shows offered on a transactional basis.

The most significant recent development is that Sky Player is now available via the Xbox 360 games console. This means that the once-PC-only service is now easily viewable on a TV set. To access the service, Xbox 360 owners must connect their consoles to broadband and subscribe to the Gold tier of Microsoft's Xbox Live online service (£40 per year) – as well as meet the normal Sky eligibility rules.

Other deals to allow Sky Player to be used via several brands of broadband-connected Freeview box and connected TV sets have also been announced and we expect a similar agreement for access via Sony's PlayStation 3 games console to follow.

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. 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 user-generated content services.
When it comes to premium TV content, all the major UK broadcasters operate their own online TV outlets that allow viewers to catch-up on recently broadcast programming.

However, it is the BBC's immensely successful iPlayer service that still dominates online TV traffic in the UK, accounting for around 60 per cent of all free-to-view long form online TV streams consumed in the UK last year.

With the online video audience growing fairly rapidly, broadcasters have been working 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.

A 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 has been falling, it remains a declining, but persistent factor for many in Internet video economics. However, it is possible to achieve the right mix of content and ad sales to build the basis for a long-term, scalable business.

Competition in the online TV space has also been intensifying. Google has stepped up its efforts to make YouTube a viable service by adding full-length TV shows from Channel 4 and Five; it also hosts short-form 'clips channels' for most broadcasters. Microsoft has likewise been bolstering the full-length TV show offering via its MSN web portal. It recently licensed a range of archive programming on a non-exclusive basis from RDF, All3Media, BBC Worldwide and the Digital Rights Group.

A new entrant to the market is media services company Arqiva, which surprised many observers by purchasing the content management platform developed for the stillborn Kangaroo joint venture and using it to launch a consumer online TV service called SeeSaw. Arqiva has struck deals to offer catch-up programming from Channel 4 and Five plus older content from BBC Worldwide.

Screen Digest estimates that free-to-view online TV in the UK generated £54m of advertising revenue in 2009, a total inevitably depressed by the dominant share of viewing being taken by the BBC iPlayer. This compares with total traditional TV advertising revenues in the same year of £3.05bn and total Internet advertising revenues of over £3.5bn. The market is controlled by the broadcasters (led by ITV), which collectively have an 80 per cent market share.

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