

Chapter 1

Executive summary

A 3-month strike by the Writers Guild of America brought much of Hollywood to a standstill in late 2007 and early 2008. The fact that revenues derived from Internet TV and video were at the heart of the dispute indicate just how important this sector is perceived.

Online TV and video is attracting major attention from broadcasters and content owners, who are reacting to a rapidly growing demand for these services from the public. Drawn by the sheer wealth of content available (most of it 'free'), the number of users of online TV and video services continues to rise.

Legitimate online TV and video services will generate revenues of US\$7.9 billion in 2013, almost six times the 2007 figure. Advertising will consistently outperform a la carte and subscription-based services in terms of revenue generation and North America will be the largest revenue-generating region, accounting for more than 60% of the global total by 2013.

Top 3 online video countries by revenues

	2007	2013
US	1,032.6	4,722.6
UK	119.1	842.4
Japan	56.7	605.5

Source: Informa Telecoms & Media

The sector is likely to go through a testing time in the short term as providers branch out into advertising and social-networking, and maintain the move beyond the PC to the TV. Growth in the number of viewers has been matched by a rise in the number of services available, with Internet start-ups, major broadcasters and consumer-electronics giants entering the market with an array of novel business models.

However, for even the most established providers, 2008 is likely to offer the clearest indication yet of which models will prove the most commercially productive. A key area of interest is advertising, which several providers hope will bring in enough revenues to support their bandwidth-hungry free video services.

The involvement of well financed players not traditionally associated with the TV sector has led to the drawing of inevitable conclusions about Internet TV viewing replacing traditional TV habits.

Some metrics suggest the increase in time spent watching video online has resulted in a fall in traditional TV viewing, although others point to a marginal impact. Large Internet TV players have argued that the proliferation of online video is not a threat to the TV industry and will instead only strengthen broadcasters that embrace it.

The 'over-the-top' moniker sometimes used to denote online TV comes from the fact that these services are accessed via the open Internet, so do not have their own network. Instead they operate 'over-the-top' of networks provided by third parties.

The online TV and video sector can be subdivided into several categories. These range from the hugely popular video-sharing sites such as YouTube, Dailymotion and Microsoft's Soapbox, to free catch-up sites operated by broadcasters and paid-for services offering movies and TV programmes such as Apple's iTunes and Amazon's Unbox.

Aside from these are several other hugely important services such as search, editing and creation as well as hosting and delivery. While these are largely legitimate services, there remains a large number of unauthorised services distributing and streaming full length video content or pay TV channels, without the appropriate rights agreements.

Amongst established networks and programme producers, those involved in children's and youth TV have been amongst the most active in the Internet and other forms of new media. This is unsurprising as it directly targets the demographic that is most likely to turn away from traditional TV viewing at a greater speed than any other. An online presence for kids TV content providers is therefore arguably more important than for some other genres.

Although the volume of video on the Internet is constantly growing, it appears users have so far had little difficulty locating it. However, to date, no single search method has dominated. According to a survey of US online video users, content is typically found via a recommendation from friends or family, by browsing a website or via a search engine.

Even so, refining a search method for online video content is particularly important for several of the newly launched sites that rely on advertising. With targeted advertising likely to dominate video sites, the advertisers will need to know that the range of consumers they are hoping to hit will be drawn to the video websites they invest in.

Piracy remains a big problem. Greater sophistication of pirate networks has made tracking the distribution of unauthorised content more difficult. For example, in South Korea, the most advanced broadband country in the world, all forms of entertainment content are available through unauthorised distribution. Problematic for the enforcement agencies is the shift away from P2P towards web-hard services. These are a form of closed file-sharing systems in which pirates store large quantities of unauthorised files online and distribute passwords for would-be downloaders to access the storage facilities.

Internet Service Providers (ISPs) have long resisted any attempt to attach responsibility for unauthorised downloading. But during the second half of 2007 and into 2008 there is a growing sense that some regulatory authorities now consider that ISPs must share responsibility for the uses made of their services. The safe harbour argument, under which ISPs are not held responsible for the actions of their users, is now deemed less compelling than in the past.

Arguably the most proactive move by any territory to limit copyright abuse came at the end of 2007 when French ISPs, music and film copyright owners and the government signed a landmark Memorandum of Understanding (MOU). Under the terms of the MOU, a government-sponsored independent enforcement body will be established to operate a system of warnings leading to the suspension or termination of Internet subscriptions used for illegal file-sharing. This was followed in February 2008 by an announcement from the UK government that ISPs need to take steps to tackle online piracy or face new legislation to compel them.

Abe Peled, chairman and chief executive of technology company NDS has commented that over the next five years all pay TV operators should embrace IP-based delivery technology, provided that they understood that it is only a 'complementary' medium best suited to on-demand and 'long-tail' content. He said that operators can "seamlessly integrate broadcast and broadband through the EPG."

However, according to hardware manufacturer Pace Micro Technology the greatest obstacle to achieving this vision is finding a cost-effective way to build hardware and software into devices so that they can receive content delivered both by broadcast and broadband.

Fitting content to the medium

In addition to offering a new platform to screen video content, the Internet has also become a training ground for new creative talent. Major networks and production companies are now using the Internet to search for new young talented video producers.

Warner Bros. has been the most aggressive of the major Hollywood studios in looking for original online content. It set up a digital production arm Studio 2.0 in 2006 and has subsequently announced several projects in development including soccer mom comedy *The Jeannie Tate Show*, adult puppet show *Simian Undercover Detective Squad* and a soap opera from director McG (*Charlie Angels*, *The OC*).

Meanwhile, platforms such as MySpace have been agreeing exclusive deals with content creators to stream shows, such as Iron Sink Media's scripted teen drama *Roommates*, on their sites.

US network CBS has given the go-ahead for a pilot from Rag Tag Productions after the producer successfully pitched a TV version of its successful web series *We Need Girlfriends*. This came a month after Rag Tag agreed a development deal with Sony Pictures Television in September 2007.

CBS is keen to promote content exclusively for online consumption. Shows such as *Clark and Michael*, written by Michael Cera, the teen star of *Arrested Development* and *Superbad*, highlight this.

ABC is also financing Internet-originated projects in the hope that a production can then be used for TV. One such example of this is Lorne Michaels' executive-produced *Sons & Daughters*, which was originally created online by comedian Fred Goss.

Not all producers see the TV screen as an essential end point. Vuguru is a digital production company formed by former Disney boss Michael Eisner's Tornante Company, which concentrates specifically on online projects. It has found success with *Prom Queen*, a teen murder mystery series, which is widely considered to be the first successful scripted drama series to debut online.

Share of total households by selected country with at least one PC at home (%)

	2000	2001	2002	2003	2004	2005	2006	2007
Denmark	65.0	69.6	72.2	78.5	79.3	83.8	84.8	85.5
Sweden	59.9	69.2	73.8	75.8	78.6	79.7	82.5	84.1
Japan	50.5	58.0	71.7	78.2	79.5	80.5	82.4	83.7
Korea	71.0	75.3	77.0	77.9	78.5	78.9	79.6	80.1
US	51.0	56.2	59.9	63.9	66.9	70.1	72.3	77.1
Canada	55.2	59.8	64.1	66.6	68.7	72.0	75.1	76.9
Germany	47.3	53.0	61.0	65.2	68.7	71.2	73.8	75.4
Australia	53.0	58.0	61.0	66.0	68.3	70.0	72.2	73.8
UK	38.0	49.0	57.9	63.2	66.7	70.0	71.4	72.6
Spain	30.4	35.0	40.0	47.1	52.1	54.6	56.9	58.4
France	27.0	32.4	36.6	45.7	49.8	53.5	56.2	58.2
Italy	29.4	35.8	39.9	47.7	48.4	49.1	49.9	50.6

Source: OECD; Informa Telecoms & Media

In addition to broadband growth, household PC penetration continues to rise and in some countries now exceeds 80%. According to Forrester there will be more than one billion PCs in use in the world before the end of 2008. By 2015 this figure is forecast to exceed two billion, equivalent to average annual growth in the period of 12.3%.

The changing face of traditional competition

In addition to the many developments in online TV and video, the traditional TV sector is also rapidly evolving, resulting in a blurring of the battle lines. A growing number of telecoms, pay TV and free-to-air operators have moved towards hybrid models that merge established broadcast platforms with broadband video.

Telecoms operators such as British Telecom (BT) and Deutsche Telekom (DT) have moved to integrate third-party digital terrestrial TV (DTT) services with broadband VOD. Telefonica and potentially several other major incumbents are going one step further, by either buying existing DTT and satellite TV networks or bidding for licences to build their own.

Satellite TV providers, meanwhile, including BSkyB in the UK and Spain's Sogecable, have added broadband to their bundles either by acquiring or partnering with telecoms operators. BSkyB, along with cable-TV rival Virgin Media, has also moved to use DTT to offer multi-play services to customers they would not normally reach.

In terms of DTT, free-to-air platforms have opened the door for start-ups that do not own TV or telecoms infrastructure to offer hybrid TV settop boxes that will work with any operator's broadband service. Freeview, the operator of the UK's DTT service, is also considering adding a similarly 'broadband-agnostic' VOD capability to its platform.

However, despite the variety of innovative models emerging, several observers are convinced that existing pay TV providers are still best-placed to take advantage of the convergence of TV and broadband in the short-to-medium term.

The company's alliance with Index gives it an opportunity to extend its reach to mobile, a platform that's becoming increasingly important to video. Initially CinemaNow has been working with Index to use the mobile platform as a marketing tool by, for example, sending text messages to customers about new films on the CinemaNow site. In the second phase of its mobile strategy, CinemaNow plans to make short-form video, and ultimately long-form content, available on a mobile phone.

Comparison of major Internet-based movie download services (December 2007)

Service	Movie DTO price range (US\$)	Burn to DVD
Amazon Unbox	2.99-14.99	No
Apple iTunes	9.99-14.99	No
CinemaNow	3.99-14.95	Yes
MovieLink	7.99-19.99	No

Source: Informa Telecoms & Media

CinemaNow faces growing competition in what is becoming an increasingly busy sector. In addition to long-term online-video rival MovieLink, the list of competitors keeps growing, with Netflix, Amazon and Apple the most notable recent movers.

MovieLink was launched in 2002 by five of the seven Hollywood majors: Sony Pictures, Universal Studios, Paramount Pictures, MGM and Warner Brothers. Disney and Twentieth Century Fox have a content licensing deal. Fox was the final major studio to provide content to the service when it agreed a deal towards the end of 2005. The inclusion of Fox content added around 1,200 titles. However, the complexity of online distribution rights prevents the inclusion of all of its titles.

In August 2007, the five studios sold MovieLink to Blockbuster. The deal was originally reported to be worth in the just under US\$20 million, although later reports suggested that Blockbuster paid just US\$6.6 million, with a further US\$7 million paid to rival Netflix to settle a patent dispute.

The relatively low sum paid for MovieLink represents a poor return for its five previous owners, which, according to estimates, pumped between US\$100 million and US\$150 million into a venture that in five years under their stewardship gained little traction. Differences of opinion over anti-trust concerns have hampered its growth. The studios have also been criticised for being too cautious, especially with their reluctance to allow users to burn downloaded titles to DVD. MovieLink looked set to launch such a service in early 2007 when it agreed a deal to licence the technology from Sonic Solutions, in January 2007. However, as of early 2008, it had still not implemented the service.

Following the acquisition of MovieLink, Blockbuster has been considering merging its Blockbuster.com destination with MovieLink in order to boost its digital-distribution channel. The company has also looked at trial video download kiosks for portable players and Sony PlayStation 3 consoles in its stores in an attempt to reverse revenue declines in its retail outlets.