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ANALISI

TV 2.0

CONNECTED TV AND AUDIOVISUAL MEDIA SERVICES IN THE EUROPEAN CONTEXT

Current trends and new challenges

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Current trends and new challenges

New technologies have dramatically changed television and the TV consuming experience. Users are more and more consuming audiovisual content through connectable devices such as PC and laptops, set-top-boxes, smartphones, tablets, game consoles, but also through the new generation of TV sets. The Connected TV plays a pivotal role, as it combines the traditional viewers' habit in watching audiovisual content with the interactivity of the content delivered via IP platforms. The European Commission has submitted to a public consultation a Green Paper addressing the fully converged audiovisual world, as well as national authorities (i.e. AgCom in Italy, CSA in France) have also launched studies and consultations on this topic. But in the meanwhile the industry is rapidly moving, at any stage, providing the audience with new services and new technologies to deliver them.

Between 2006 and 2011, TV consumption increased in many of the EU member states, and this happened especially in mature TV markets, such as France (+11.3%) or the UK (+12.0%), due to the enlargement of the TV offer, driven by DTT, but also, more recently, to the use of connectable devices. In fact TV-connectivity in Europe is taking off rapidly, even though it is happening at different rates from country to country. According to the European Audiovisual Observatory, there were around 20 million connectable TV households in the EU27, or 10% of the total number of TV households. Nordic European countries, such as the UK, Germany or Denmark, show higher penetration rates than Latin European countries, such as Italy or Spain, where connectable TV households account for just 6%. Sales of connectable TV devices are therefore increasing. If we particularly consider Smart TVs, there were around 66 million sets sold globally in 2011, and this figure is expected to climb to 173 million in 2016, when Smart TVs will account for two thirds of the total sales of TV sets.

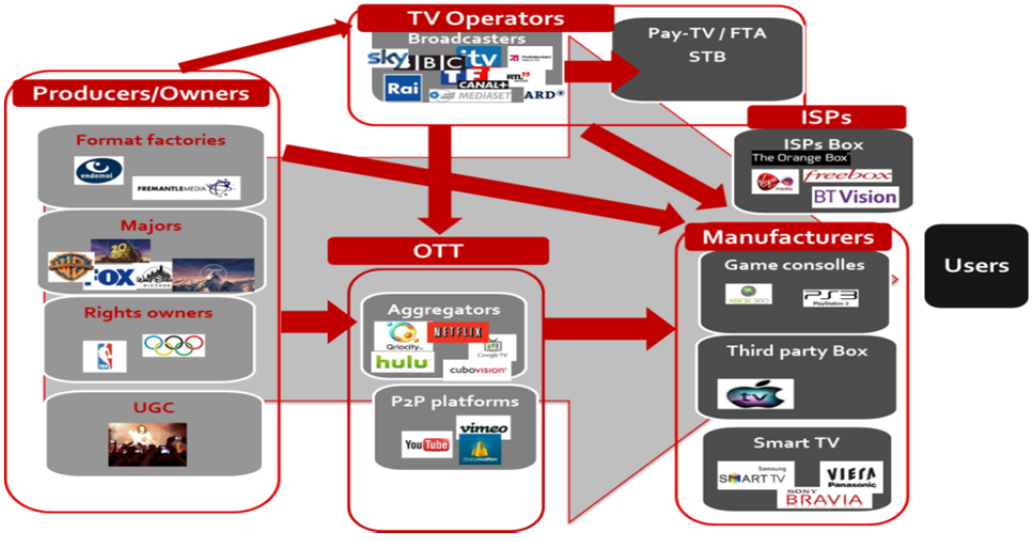
However, despite these promising figures, there are still some questions that need to be tackled.

Firstly, there is the question of awareness. Not every connected device is indeed plugged into the broadband network.

Ofcom has pointed out, in one of its latest reports (*Communications Market Report 2012*), that connectivity is not always the reason for purchasing a new TV set. Usually, consumers seem to be more interested in buying the last model of TV, irrespective of its connectivity features, and they discover later the potentialities that such devices can provide through online services. Secondly, there is the question of digital literacy. Many consumers are still not very familiar with interactivity and with the searching and browsing functions that are available with Smart TVs.

A third question is related to broadband connection penetration. The average broadband penetration in the EU27 is around 70%, although many countries show penetration rates up to almost 90%. In many other EU Member States, such as Italy, penetration is much lower. Many point out that these figures should be adjusted, considering mobile broadband devices and in particular "mobile keys" (mobile sticks through which to connect to the internet) which had reached around 8.6 million units in Italy in 2012,

The new value chain



although it might be underlined that these devices are not the best ones for the consumption of online videos, because of their higher tariffs and their lower speed when compared to the fixed broadband network services.

Speed is a key issue when we talk about the supply of audiovisual content and the interactivity that the internet brings to the viewer. The broadband penetration *per se* is not a sufficient indicator for an understanding of the readiness of a market for connected TV services. Broadband speed is indeed another crucial factor in guaranteeing an adequate level of quality in the supply of internet audiovisual services. Actually, only 10% of all households in the European Union have a broadband connection above 30 Mbps, and nearly half of the households have a connection speed lower than 10Mbps. This will be an increasingly important aspect, as content will be more and more bandwidth hungry, and also because of the technological development that comes with new formats, such as HD or 3D.

This topic is also related to the development of the new generation networks. All European markets are facing a trade-off between the fully fiber service (FTTH) and the hybrid solutions that mix copper technology and fiber to reach the office, buildings, or premises (FTTC, FTTB, FTTP). Fiber-to-the-home solutions have always been regarded as – and probably are - the best in terms of performance, but the costs of a full implementation of this technology are very high and thus FTTH is not always profitable, especially in rural areas. In such conditions, only urban, highly populated areas would be cabled, with a potential risk of increasing the digital divide. More recently, hybrid solutions, such as vectoring or virtual unbundling (VULA) seem to allow high speeds using the copper infrastructure in the local loop, thus dramatically reducing the costs.

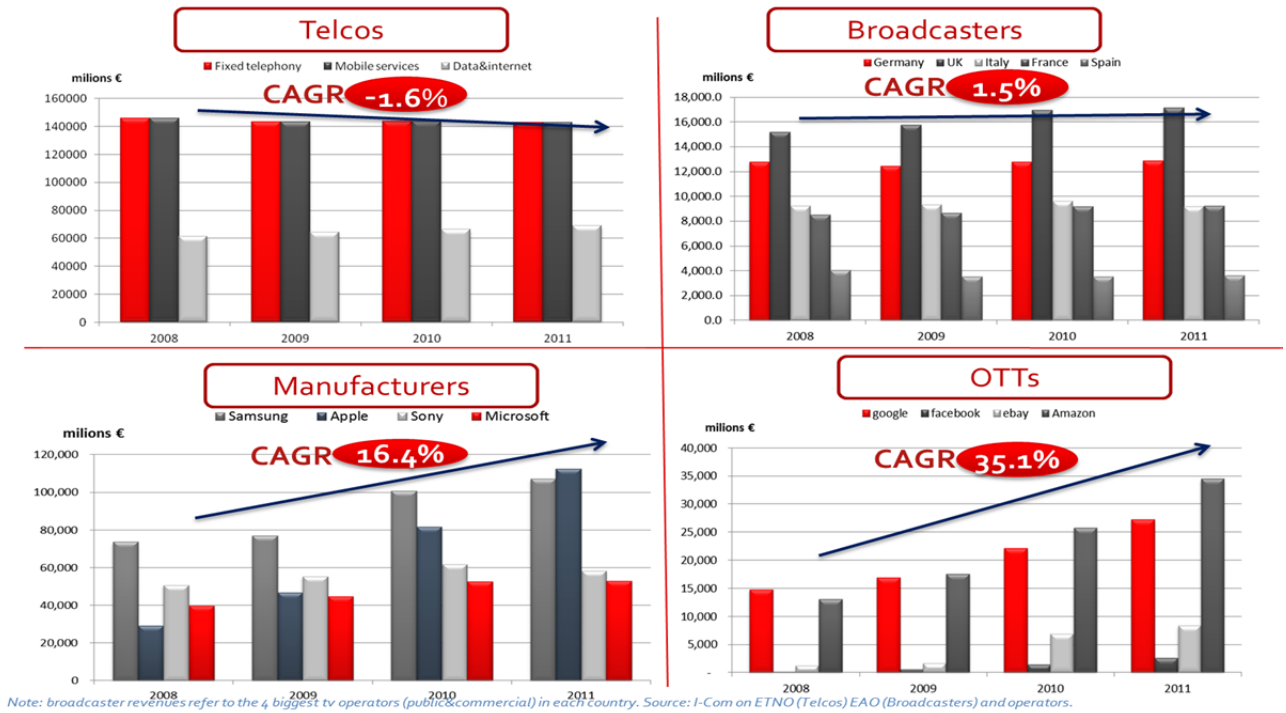
However, such a solution requires a clear separation between the network and the service, in order to avoid asymmetries that could favour the incumbent operators.

The delivery of audiovisual services through connected devices based on the broadband network is completely reshuffling the value chain. When compared to the traditional landscape, the new one is completely disintermediated: broadcasters lose their centrality and there are two new and unprecedented kinds of players: the Over-the-top players (OTT) - that is, all the aggregators, P2P platforms - and the manufacturers. Traditional players who were used to dealing only with content providers now have also to deal with other players. If we include the Telcos as well, we can say that there are now 4 different categories of players who are somehow competing to deliver content to TV users. These players show different levels of revenue and investment. In terms of revenue, while Telcos and broadcasters see their turnovers either decreasing or only slightly increasing, the manufacturers and the OTTs are boosting their revenues. In terms of investments, on the one hand, traditional players have invested the most: the Telcos, in relation to the networking side, the broadcaster in relation to content and the product side. On the other hand, there are new operators who are becoming the most innovative part of the industry, but who are still investing very little or nothing at all into the market.

The most debated issues around the economy of the online media are their profitability and the lack of viable business models.

However, some of the best practices worldwide are showing some possibly winning business strategies. Hulu, the co-petition video platform backed by 3 majors - Disney-ABC, FOX and NBC - is based on a hybrid business model combining the basic free-to-view service with the advertising-supported Hulu+,

Trends in the media economy: revenues



Note: broadcaster revenues refer to the 4 biggest tv operators (public&commercial) in each country. Source: I-Com on ETNO (Telcos) EAO (Broadcasters) and operators.

demonstrating the key role that traditional TV networks continue to play. Hulu recorded almost US$700 million in revenue in 2011 (80% coming from advertising and 20% coming from subscription), with a base of 3 million subscribers. Netflix shows the success of the business model for subscription video-on-demand, with around 30 million subscribers worldwide, generating US$3.2 billion in revenue. YouTube works with a completely different business model, free-to-view and based on the advertising, with 140 million unique viewers and a turnover of US$1.3 billion.

Of course, behind these success stories, some big questions still linger. Firstly, it should be noted that all of them have a very low ARPU/power ratio, when compared to traditional TV services or linear broadcasters.

This means that in order to generate considerable profits, they tend to expand geographically, so as to enlarge their customer base and benefit from economies of scale. However, this makes it harder for local industries to either duplicate this success or to compete with such economies of scale. Secondly, it should be observed that these services all originated in the USA, none of them comes from Europe.

If we look at the European industry, many services have been launched by broadcasters and this shows that the industry is highly responsive.

The business models, though, are less clear and there is also a significant challenge in regard to interoperability.

Not every service is available on any platform and it should be considered that broadcasters either opt for walled-garden services, delivering their content through their own set-top boxes,

Broadcasters internet TV services in the EU

Service	Main features	STB	IPTV	Game Consolle	Smart TV
BBC iPlayer	Over 200 million videos per month consumed	Freesat Sky	Virgin Media Talk Talk	Xbox 360 PSP3	Samsung Sony
CANAL PLAY INFINITY	9,000 titles, both VoD and SvoD (Infinity). Catch-up TV from around 40 channels	Canalsat	Free	Xbox 360	Samsung LG Panasonic
4OD on demand	Channel 4 programs available the day of transmission. Around 500 million programmes views per year (420M in 2011)	Freesat Sky	Virgin Media Talk Talk	Xbox 360 PSP3	Samsung
francetv pluzz	1,200 videos any moment (57,000 in 2011). Preroll spot. Not supporting Flash		Orange Free SFR		
itv PLAYER	ITV programs available 30 days after the broadcast, with restrictions due to rights.	Freesat Sky	Virgin Media Talk Talk BT Vision	PSP3	Samsung
4oD REPLAY	New version launched in 2012 with new socal networks functionalities		Orange FreeSFR	Xbox 360	Sony
myTF1	4.000 TV programs. "En direct USA", US TV series the day after they brodcast in the US. Strongly engaged with social TV		Orange SFR	Xbox 360	Samsung
PREMIUM PLAY	3.000 TV programs (1.000 movies).New window: TVOD (extra-pay).			Xbox 360	Samsung
RAI REPLAY Rai.tv	Catch-up TV service (Rai Replay) and on demand				Samsung
Sky On Demand	Over 2,000 TV programs and movies available	MySky HD			

or need to make deals with manufacturers and the technological industry in order to be distributed on different platforms. This can cause broadcasters to make exclusivity deals, especially with Smart TV producers, such as the one agreed by TF1 with Samsung, or that signed by M6 with Sony. This is, however, an ongoing process, as many of these deals were completed in the first months of 2013 (i.e., the deal between ITV and Samsung). On the other hand, there is interoperability. The difference in the business models of the US and EU services helps also to explain the gap between the US and the EU online video industry in terms of revenue. Despite the EU having a higher GDP and a larger internal market, the American online video industry is 4 or 5 times bigger than the European one.

The interesting thing is that the whole US audiovisual media industry is 3 times larger than the EU one. This means that in the online video market the difference between these two economies is even larger than it is in the audiovisual media industry as a whole, and according to *Screen Digest* forecasts, this gap is not going to be narrowed by European players in the near future.

Some more mature markets, such as the UK's or France's, are somehow growing, while there are other countries, like Italy, that are suffering from some problems in making their online video economy grow. It is worth noting that in the US subscription video-on-demand is definitely taking off and it represents around 40% of total revenues, even more than advertising.

This is not the case for the EU, where advertising accounts for two thirds of the total revenues. In some countries, such as the UK, the paradigm is, however, changing, probably

because players like Netflix have come into the marketplace.

How is it possible to overcome this situation and make the European industry more able to generate its players in the globalised media economy?

Indubitably, some of the answers are expected to come from the regulatory framework.

It is fundamental to understand what kind of regulation should be undertaken in order to give the market more possibilities for growth. There are many regulatory issues on the ground and, of course, the starting point is the 2007 *Audiovisual Media Services Directive* that provided a regulatory framework which extended the regulation of linear services to the non-linear services. However, in recent years the market has changed dramatically and there are several services that did not exist, or which just played a marginal role, at that time and which were then excluded from the scope of the directive. A good example is the audiovisual content provided by newspaper websites, which was considered to be an ancillary part of those sites. Other examples are social networks or user generated content sites that were excluded since they were not considered to have any editorial responsibility.

It is fundamental to understand whether the definition of 'audiovisual media service' that is provided by the directive is still adequate, or whether it should be re-considered in order to better respond to the new audiovisual media services landscape.

This also comes together with the definition of the relevant media markets. The substitutability criteria, both on the supply and demand side, for audiovisual media services will be key in better addressing regulation, and also in better assessing pluralism, in particular, external pluralism, in order to understand whether the markets are becoming more or less concentrated. The internet is lowering entry barriers, but with high economies of scale, new entrants risk soon becoming marginalised. The most innovative part of the industry is also probably the least regulated and, on the other hand, the traditional part of the industry is the section that has been subjected to the most regulation. An excess of regulation risks weakening the European industry in the globalized economy. On the other hand, the lack of regulation can also mean that all the purposes of the legal framework that have been set so far risk being no longer able to compete, to defend its interests and to protect work.