Video-on-Demand

The future of media networks – strategic lessons from the US experience

Second Edition

screendigest

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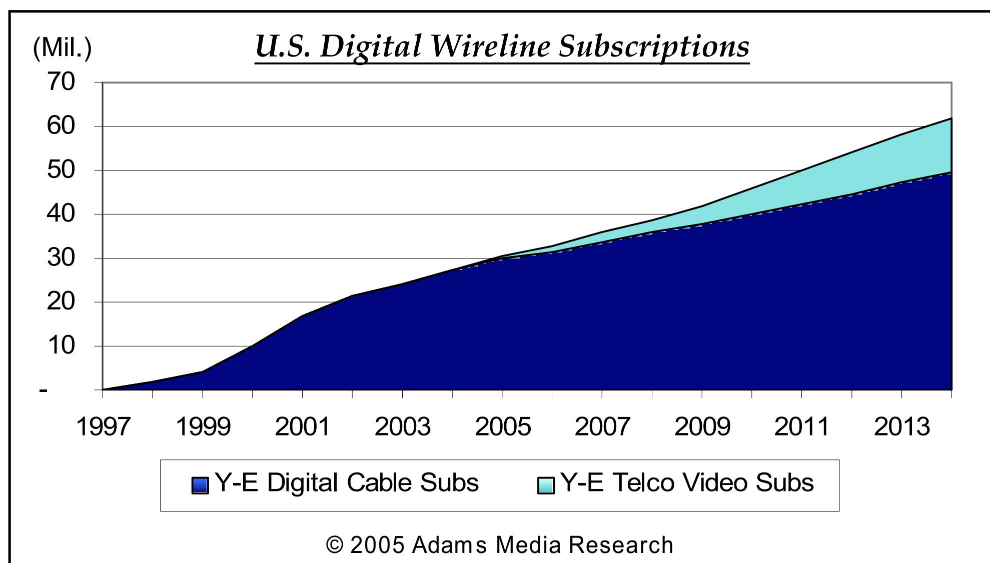


In contrast, as the telcos announced their first programming deals in the second quarter of 2005 it became apparent that in their hurry to get into the field they will be offering—at least initially—a programming line-up and set of features that are essentially the same as digital cable and DBS.

That suggests to us the cautious view that telcos will not be able to match DBS' early numbers—12.3 million subscribers, not 20 million, 11% of nationwide subscriptions, not 22%. But from the studio point-of-view, the three-way competition to come will be good news in many ways, finally lighting a fire under ALC spending on proprietary networks that has climbed slowly to $938 million over nearly 20 years, pushing it to $3.4 billion by 2014.

First of all, the competitive marketing and price cutting should drive the combined digital cable and telco penetration to about 75% of total wired network basic subscribers a decade from now (see graph above). The remaining 25% will be made up of homes that cable's digital churn problem today shows are out there: folks to whom more TV choice simply isn't worth an extra $120 per year.

Although telcos will undoubtedly be cannibalizing both cable and DBS customers, we expect that over the next ten years digital cable-telco penetration of TV homes will grow from 25% to 48%. With 99% of digital wireline homes VOD-enabled at that point, cable-telco VOD-enabled homes will total 61.1 million in 2014 (see Appendix, P. 98).

That is more than double the 24.2 million VOD-enabled proprietary network subscribers we expect to see hooked up to servers by year-end 2005. However, those 61.1 million potential VOD renters still represent less than half of U.S. television homes.

This view of the potential growth for wired VOD homes is based on several factors:

1) Basic cable subscriber counts have declined in four of the last six years.

2) Even DBS' continued growth has only managed to keep overall proprietary network subscription penetration about flat, at 81%-82%, since 2000.

3) Digital cable subscription churn (the percentage of homes giving up the service monthly) remains stubbornly high—above 5%—despite cable's aggressive marketing of the service in 2004.

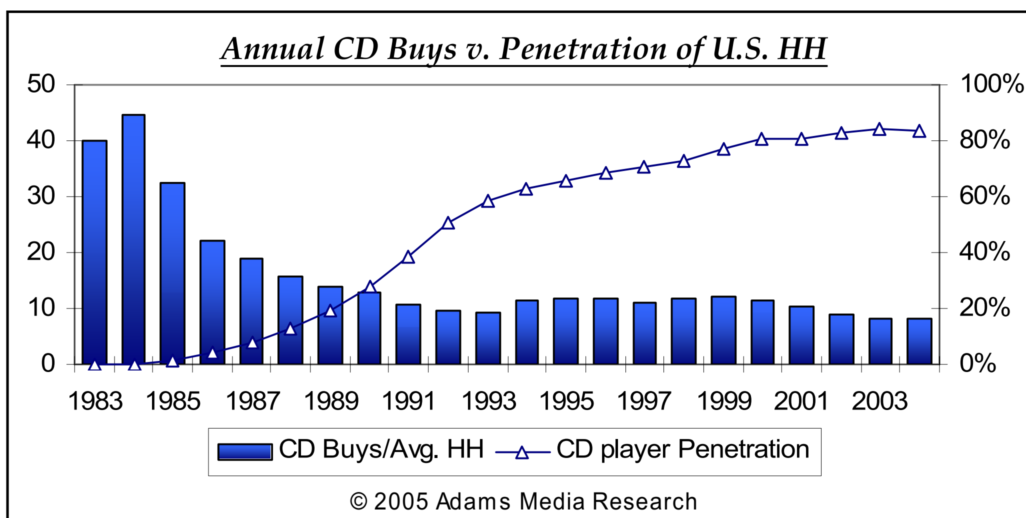
4) Nationwide digital cable household growth rates fell to 12% in 2004 despite ubiquitous availability (90%-plus of homes passed), suggesting that cable companies are running up against the limit in the percentage of homes willing to pay a premium for the digital tier.

Another limit to the digital upside for networks owners that could turn into a plus for studios: a third competitor with cheaper pricing should limit the ability of all networks to raise basic and digital subscription rates. That could pay off in more marketing money being spent on VOD. With subscriber growth limited and pricing constraints in place, network operators will have little choice but to pursue revenue growth through more aggressive marketing of "add-on sales" such as VOD rentals.

In addition, since the actual consumer proposition that the telcos will have to offer their customers will be very similar to cable and DBS, they will likely emphasize any differences in their marketing pitch. What is likely to be different, given the fact that they will be using Internet protocol (IP) standards, is the on-demand "look and feel" of their services. Latency—the lag time between when a button on the remote is clicked and something happens on screen—should be much better than on cable. Cable customers who stumble across the VOD channel are often greeted with a screen saying something like "Browser loading, please wait." It's not the kind of message that gets people in a lather to consume.

Finally, IP standards should allow telcos to offer a much more compelling VOD interface than cable has fielded to date. Scrolling through lists of file names and clicking on one is a lot like what many people do at work. To the sophisticated analysts and industry executives that have long thought VOD would replace tape/disc rentals, going out to the video store may not seem like quality entertainment. But to most people it's shopping, and shopping is widely acknowledged (or at least secretly admitted) to be fun. And so is browsing the Internet, at least compared to wrestling with cable's cramped interface.

For all those reasons, we think the disappointing buy rates of the early cable VOD roll-out do not spell doom for proprietary network electronic rentals. Admittedly, the typical trend is that as enabling technologies spread to more households, per-household consumption of the related content tends to decline (see history of audio CD, below).



There are a few exceptions to that "law of media consumption"—video sell-through being the closest relative to VOD that has seen per-HH consumption increase even as hardware penetration rises—as we think will happen with proprietary network VOD rentals (see graph, P. 47).

Video purchases per VCR home grew from around 2 per year in the late 1980s to about 6 per year in the mid-1990s because of a unique set of circumstances. Studios dramatically brought down prices, first on catalog fare, then on an increasingly wide variety of new releases. Meanwhile, consumers started finding the product available everywhere they looked, especially along the aisles of high-traffic mass merchant outlets, who