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Television networks in the 21st century

Growing critical mass in a fragmenting world

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Contents

Foreword

The global broadcast television industry is in the midst of a fundamental transformation. Its business model is steadily and inexorably evolving from being mass-market, single-event, broadcast-oriented. It is transforming into a sector that is far more complex but potentially more valuable, with a base of smaller – but more numerous and lucrative – audiences.

The drivers of change include: new forms of content; new means of content delivery; new devices for consuming television; new consumption patterns; new routes to market. Inevitably, entirely new markets are emerging.

While the extent of transformation so far varies by national market, and a small number of television broadcasts are still able to attract massive, valuable audiences, the overall direction towards fragmentation is consistent on a near-global basis.

This Deloitte Touche Tohmatsu Global Technology, Media & Telecommunications Industry Group report: examines the evolution of the incumbent television network model; assesses where the industry currently is; examines the impact of consumer behaviour on the sector's transformation and offers a few ideas to help television companies grow a critical mass of viewers, advertisers and revenues in a market of fragmenting audiences.

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Introduction

Not so long ago, the business model for television networks around the world was simple: produce programs, broadcast them across a national network of owned and affiliated stations to a mass audience, and sell access to that audience to advertisers based on viewership.

Today however, the situation is much more complex, and is likely to become more complex still. What was previously considered "television content" is now being burned onto DVDs, time delayed by Personal Video Recorders (PVRs), broken into fragments, piped on demand over the Internet, downloaded to mobile devices and syndicated around the globe. Such changes are having a profound effect on the structure, dynamics and the future of the global broadcast television industry, both private and public.

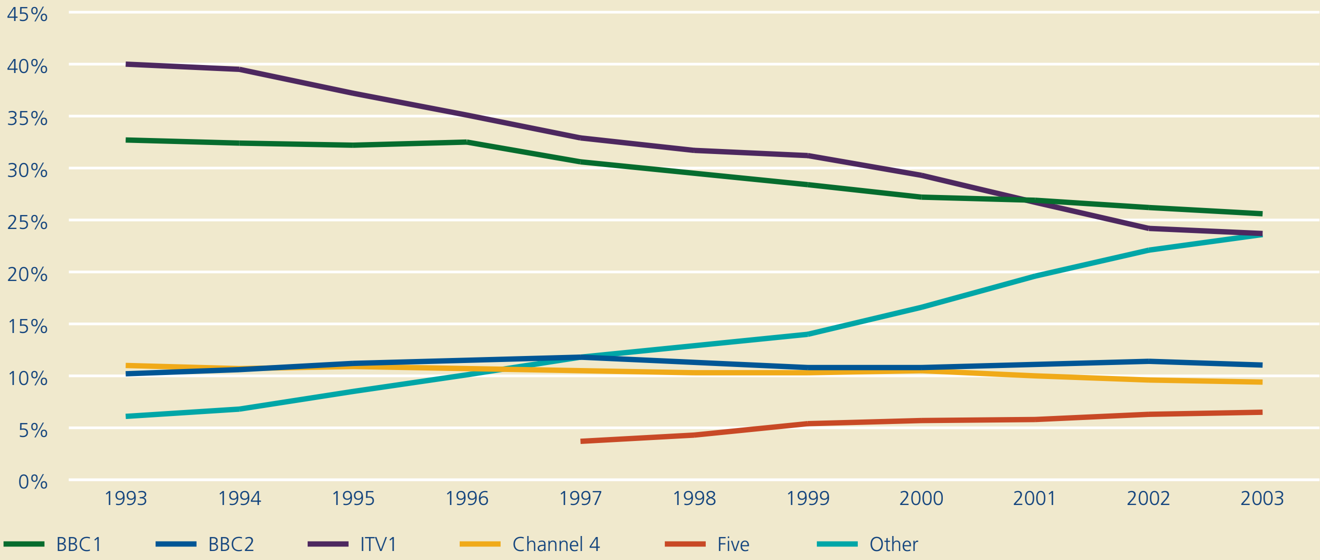
The most significant impact of this transformation is audience fragmentation. Content is being consumed across an expanding array of media, channels and devices. This, in turn, is steadily eroding the once dominant position of television broadcasters and major networks.

This is shown in Figure 1 which shows shifting market share for television broadcasters in the UK market, one of the countries most affected by fragmentation.

The mass audience that they once enjoyed is scattering along with content and as a result, the ability to charge premiums to advertisers is beginning to evaporate. This trend – even in countries that have undergone fragmentation for years – is expected to continue, and its impact will be felt across the entire broadcast television industry.

But every major shift creates opportunities as well as threats. In this case, the threat of audience fragmentation is the direct result of exploding demand for content and media in a growing variety of forms, creating a wealth of opportunities for companies that make the right moves. Agile broadcasters, content providers and any other form of television company that can redefine the scope, shape and scale of their "network" to capitalize on the changes will thrive. Those that remain chained to the past will not.

Figure 1: UK television channel shares: all homes 1992-2003



Source: Ofcom.

The aggravation of fragmentation

The traditional broadcast television network model is based on the idea of one-to-many communication (hence the term "broad-casting") with revenue primarily derived from the sale of time-advertising. At its heart is the notion of mass-market reach – the ability to deliver advertising messages to a substantial portion of the population (nationally, or even internationally) through a single broadcast. The network essentially provides the center of gravity around which the audience orbits.

That business model made perfect sense in what we now consider a technologically simple world, a market dominated by a small handful of major networks with broadcast television as the primary form of mass video communication. It made even more sense as globalization took hold, creating a truly mass market. But times change.

In recent years, the number of media formats and channels has exploded – changing the way people consume content and splintering the mass market into many smaller pieces. Major trends, which are manifest to different contents in each national market include:

- Proliferation of new media formats and distribution channels – with the value of content dispersed accordingly.
- Growth in the number of distribution networks: terrestrial (digital as well as analogue), satellite, cable, Internet Protocol television (IPTV).
- Fragmentation of audiences among those media formats – in some cases even leading to "broadcasts" with an audience of one.
- Trend toward pay-per-view or use down to the smallest fragment.
- Reduced market power for the major networks – curtailing their ability to dictate to the audience.
- More control for consumers over the content they consume.
- Growing demand for choice, delivery options and ultimately control.

For the broadcast television industry, that translates into a fragmented world of increasingly scattered audiences – with the possibility of increasingly frustrated advertisers. The ability to skip through commercials and break down content into fragments is a growing source of worry for advertisers.

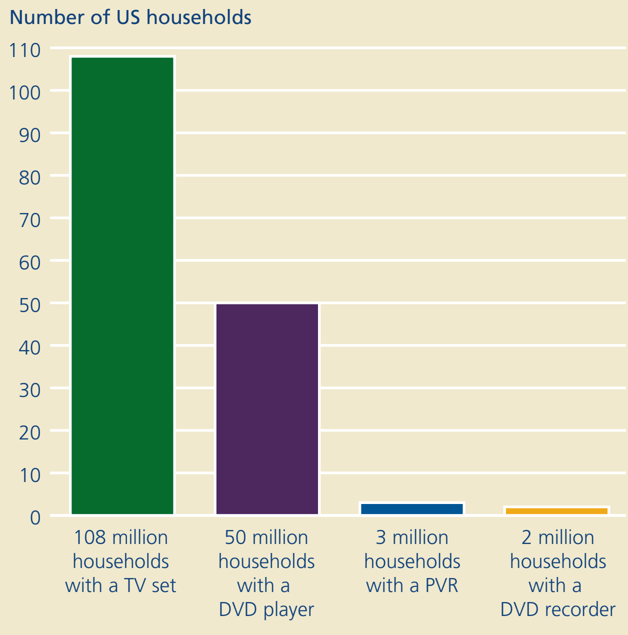
Doubtless some types of content – the Olympic Games, the soccer World Cup and Super Bowl, for example – will always attract some level of mass audience. And these events will still generate astounding advertising revenue – as high as $80,000 per second. But even in those cases, today's audience is being dispersed across a wide variety of media, content is being fragmented and in some cases, time-shifted.

As markets fragment, control shifts from suppliers to buyers – or in this case, from broadcast networks to viewers or consumers. That shift raises serious questions about the continued viability of the broadcast network business model.

Today, major television networks (public and private) and their affiliates still cling to a premium as the only media outlets with true mass-market reach. But as fragmentation continues, even the most optimistic advertisers have come to realize that no single channel can truly reach the masses. The mass-market is being re-defined.

Figure 2: Fragmentation in the US: setting the stage

Fragmentation is real and on-going, but it is a trend in progress and its total impact so far vary. Major networks still dominate in developing countries, where consumers have less disposable income and less market power – and therefore fewer choices. In more developed countries, market disaggregation is very real, but far from pervasive. The US market is a case in point.



Source: Deloitte Touch Tohmatsu, Plunkett Research Limited, 10000Watts, Yankee Group, Nielsen Media Research.

Although consumers are being presented with a wealth of options, emerging technologies like PVRs and DVD recorders remain on the fringe. Choice has proliferated, yet customers still flock to the fundamentals. Services that work. Brands that appeal and can be trusted. And quality over quantity.

That said, audience fragmentation is likely to accelerate over the long-term as young people who have grown up with diverse media such as cable television, mobile telephones, digital recording equipment and the internet – come to represent an increasingly large portion of the market.

Fast forward to the future

The television industry will continue to be shaped and enriched by a constant stream of new products and services. But with technology lifecycles getting shorter and shorter, there will never be another standard that dominates the market for decades the way broadcast VHF/UHF did. In order to thrive, companies must learn to generate quick profits from technologies that come and go – in relative terms – in the blink of an eye.

A rapidly changing market requires a very different approach to commercializing content. Instead of broadcasting a program once or twice, then eventually releasing it on video, television networks will have to develop digital content that can be quickly and easily packaged, marketed and sold across a wide range of media – including physical packages such as DVDs and memory cards, electronic downloads via wired and wireless networks, and services that are standalone or bundled with other products.

The good news is that demand for content in all forms of media is way up – with no end in sight. In fact, audience fragmentation has been a major contributor to the unprecedented growth in consumer spending. For instance, since 1997, cable subscription revenue has tripled, while DVD revenues have skyrocketed by a factor of 15. Internet Protocol Television (IP TV), whereby content can be provided on demand over cable or DSL networks, has the potential to drive video content revenues higher still.

The bottom line is that television networks will have plenty of opportunities for rapid growth. They'll just be different than the ones companies rely on today.

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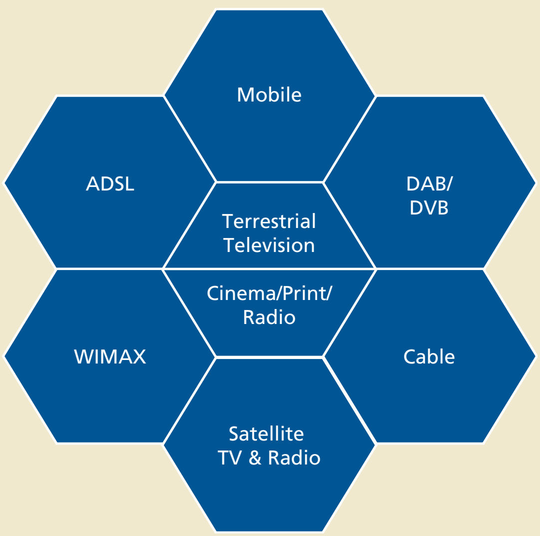
TV networks in 3-dimensions

In a fragmented market, the traditional network model will no longer be able to deliver the kind of growth investors have come to expect. Instead of relying primarily on advertising revenue and mass market reach, networks will need to extend their business models to produce greater value along three new dimensions:

- **Broadening** their reach to new media channels and formats.
- **Deepening** their relationships with customers by offering services, personalized to meet customer needs.
- **Lengthening** their content lifecycles through the creation of physical products.

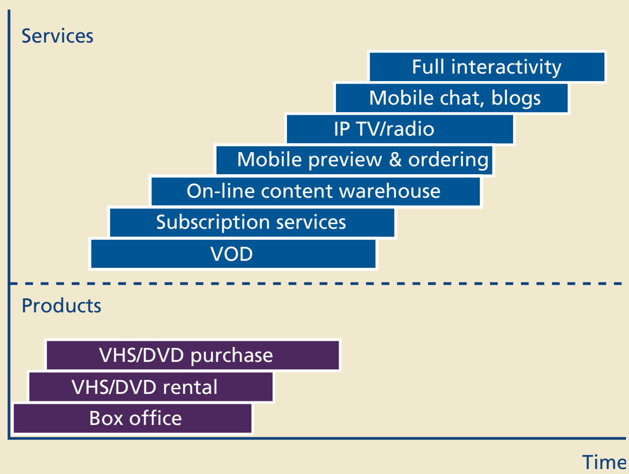
For each dimension, there are a few key principles for networks to consider when extending their business models.

Figure 3: Breadth



- Offer content and programming across a variety of media channels and formats, in both national and global markets, to offset falling revenue from traditional sources in home markets such as broadcast television.
- Position the company as technology agnostic – capable of serving customers on any popular and economically viable platform.
- Deliver content in a variety of formats as appropriate to the dynamics of each new medium.

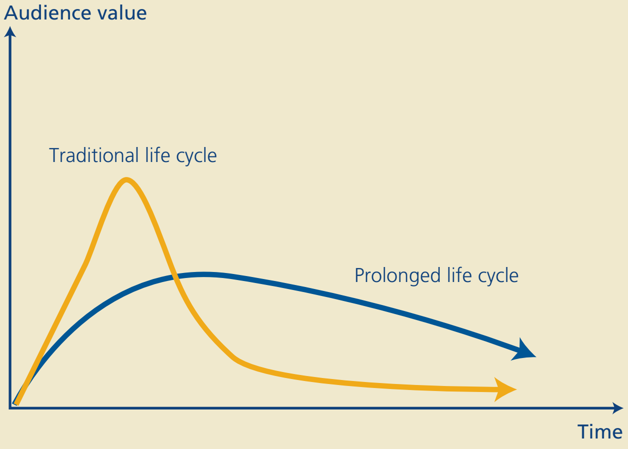
Figure 4: Depth



- Treat content as a core offering that can be re-packaged and marketed not just as products **but also services**.
- Focus on serving long-term customer needs, rather than stimulating audience numbers (which are likely to become increasingly irrelevant thereby changing the sales and revenue model).
- Structure the business in order to respect the fact that while customers may well be happy to consume the same content as one another, they will most likely wish to do so via many different means – some will continue to passively watch TV, others will want to order video on demand, and others still may want premium subscription services for networked home entertainment system viewing.

Some companies have begun to move down this path: for others it is a journey that needs to commence immediately.

Figure 5: Length



- Offer more content as a physical product (such as VHS or DVD for sale and rental) to significantly extend the content's lifespan.
- Evaluate the implications of offering content on video on demand, as well as broadcast. In trials, the BBC found that offering content on demand for seven days after initial broadcast raised audience size by 50%.
- String together diverse consumers by understanding swarm networks and sub-sub consumer groups and how to reach them.
- Use a formal, adaptive business planning approach to manage the lifecycle of products and services – maximizing ROI as a function of time, market demand, and competition.

By actively exploiting these three dimensions, television networks can simultaneously offset the fragmentation of their audiences, and generate income from entirely new activities. Some companies have begun to move down this path: for others it is a journey that needs to commence immediately.

Television content – the programming output of the network – becomes the raw material for many different potential offerings. It continues to be broadcast via traditional means; but it is also sold for syndication; burned onto physical media; and used to power content-driven services provided over the Internet, wireless and other media.

In this way, networks' reliance on advertising revenues can potentially be disrupted and reduced, their capacity to manifest direct relationships with consumers can be increased, and their revenues from product and service sales can be optimized.

Beyond the network model

As television networks expand along the three growth dimensions, they will need to develop new and quite different business models. The three models described below are a natural fit to extend a traditional network business. But they are just a few of the many options available.

Each of the following models incorporates elements from all three dimensions – breadth, depth and length. Individually, they can help a network capitalize on the many opportunities emerging from market fragmentation. Combined, they would give a network a massive presence and footprint in the media industry.

TV network as a gateway

One way for networks to leverage their existing market position and brand is to become a gateway to the media market at large. Companies like Yahoo and Google are already doing something similar in the Internet space, providing consumers with a familiar and trusted entry point to a confusing world of seemingly unlimited choices.

In the physical world, supermarkets and department stores serve that same function, acting as a central source for a wide variety of products and services. In fact, many of the techniques that supermarkets and department stores use to create incremental value would also apply to television networks. Building customer relationships and gathering customer data. Creating and packaging their own premium products for certain segments, while offering generic products or national brands for others. Building different types of stores for customers with diverse needs. And most importantly, establishing primary control of the billing relationship – a highly advantageous position in most value chains.

To succeed as gateways, the networks must expand their scope of business – just as supermarkets do. They must also carefully manage their brand, which is the primary means for attracting new customers. Those two factors are the keys to growth, ROI, and long-term customer loyalty.

As a media gateway that transcends media forms, channels, products and services, a network would be strategically positioned at the apex of the customer relationship – generating significant value at the point of inquiry, the point of decision and the point of purchase. The gateway needs to be available on every appropriate device, with the same brand in a similar form with optimal flexibility.

TV network as a service provider

The music industry made the mistake of regarding content as the beginning, middle and end of the story. The result was a lack of innovation and lost opportunities. Major industry players consistently failed to keep up with changes in consumer behaviour and the overall market.

Record companies have largely overlooked growth in the live concert business, which is now a significant revenue earner with the largest tours grossing hundreds of millions of dollars.

Over the past two decades, the public's valuation of a fair price for a concert ticket and souvenir T-shirt has risen; in many markets the cost of a CD has fallen. In other words, the physical product now promotes the event, rather than the converse.

Thus, the music industry lost countless revenue to piracy by not providing a viable alternative based on technological evolution. The result: illegal downloads. In short, it focused its efforts on selling a product – not selling music in the way that consumers were increasingly wanting to buy it.

A television network's core content provides the basis for both products and services. In a services model, the television network delivers content-driven services that are re-packaged for a wide range of devices, media and consumer groups. Those offerings can be further customized by brand, by segment, and by individual customer preferences.

- **On demand content** – creating a content warehouse and marketing slices of audio and video content for a wide range of uses. Potential consumer applications include web-casts, radio airplay, mobile phone downloads, and video on demand. Professional applications include charging other networks – particularly those overseas – for access to content archives.
- **Interactivity** – participation, voting, purchasing, news and information, on-line games, question and comment submission, and web-based chat.
- **Events** – generating revenue from tie-in events, such as the concerts based around the **Pop Idol** and **American Idol** series.

Offering a broader range of services directly to consumers is a powerful way for television networks to nurture customer relationships and stay abreast of changing market needs. It also has the potential to provide a reliable stream of subscription revenue and repeat business, helping to offset volatility in other areas of the business. Most importantly, a content-oriented service model would allow networks to give consumers more of the control they demand – the key to customer satisfaction and loyalty in a disaggregated market.

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TV network as a consumer products company

Consumers looking for maximum control and personalization of their media experience are driving demand for content as a physical product – or devices that can capture content as a physical product. Movies and TV shows on DVD and VHS. Screensavers and ring tones on mobile devices. DVD recorders. And a whole host of consumer products that have yet to be invented.

We don't expect the major networks to drop their existing broadcast business to focus solely on consumer products. But we do expect much of their future growth will come from the product side especially as traditional network viewership and revenues decrease. Traditional network operations will provide a foundation for the business – and the raw content – but retail consumer products will be an increasingly important source of fast growth and eventually content origination and formation. In this model, consumer goods competencies such as personalization, brand marketing and new product development are paramount. For a network moving in this direction, here are some important things to consider:

- **Adaptive Forecasting and Business Planning.** Advertising revenues are tightly correlated to general economic conditions and key broadcast events such as Grand Slam Tennis and Formula 1 Grand Prix. Consumer product revenues have similar dependencies, but they are also seasonal, regional and of course dependent on the performance of the selected retail outlets.

- **Innovation and New Product Development.** Television companies have deep experience developing new programming, but that's not the same as developing new products. DVDs are a hot growth segment today. Tomorrow there will mostly likely be other platforms, and networks will have to examine how new technologies can be used to keep their back catalogue alive. The television sector must stay aware of shifting opportunities in other sectors: the global mobile ring tone market is currently worth $4 billion per year; the electronic games market is worth $10 billion in the US alone.

- **Branding.** In the chaos and unlimited choice of the Internet, consumers gravitate toward brands they trust. This is a particularly difficult area for television networks, because there is a degree of tension between the network's brand, and the brand of individual shows and movies. Managing the hierarchy of brands in a manner that does not confuse consumers will require great agility. Brand management and acceptance is crucial to success. When brand is managed well, its impact can be lucrative: the **Apprentice**, **Who Wants to be a Millionaire** and **Survivor** have all benefited from video games tie-ins.

- **Segmentation.** In rapidly shifting markets, companies need to be expert at quickly identifying customer segments and sub-sub segments, then translating those fragments into attributes that advertisers understand and value. In the 'intangible' world of content and advertising, this is a very complex task.

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Looking ahead

The global broadcast television industry is undergoing fundamental, unstoppable change that is steadily rendering the traditional network business model obsolete. The age of a few dominant channels, funded by advertising, has long been disappearing, and may soon be turned off for good.

And fragmentation will continue for the foreseeable future. In recent years fragmentation has been driven by the emergence of new cable and satellite players. In the years to come, further fragmentation will be driven by the transmission of both broadcast and on demand television content – even in high definition format – over IP networks. The most powerful of these IP networks will reputedly support download speeds of up to 1 Gbit/s .

Yet those very same changes also create a wealth of new opportunities. All of the existing network players in the television sector have the potential to exploit these new opportunities. But to do so, if they have not already started, they must quickly evolve away from the comfortable legacy of the network model and move towards a multi-dimensional, highly adaptable, customer-focused model.

In fact, at the crux of the fragmentation problem is the distance that traditional network broadcasters now find themselves from their customers. In an age of interactivity, service provision and customer choice, the network operator not only has to deal with the declining power of its mass broadcast infrastructure – in terms of reach and capacity to attract advertising spend – but it also has to find ways of establishing and maintaining closer, broader, longer and more profitable relationships with the individuals who used to be part of their mass audiences.

And those individuals are presently drowning in choice. New programming output. New transmission media. New devices. New interactive platforms.

All of which means that consumer spending will be spread across – and fractured by – a wide range of options, as fragmentation tightens its grip.

To take control of the situation, the whole network ecosystem, from production through to consumption, will have to settle on a more measured, rational set of options, which customers can more readily understand, navigate and ultimately consume. How this process evolves depends largely on who leads it – and if network operators don't take that lead, they will be very lucky to yield substantial benefit.

This report highlights the general patterns and trends of market fragmentation, and suggests some possible directions that companies might pursue. Now it's time for all players in the broadcast network industry to take charge of the future. While no one knows exactly how things will turn out, one thing is certain – tomorrow will be different than today.

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