

Media Predictions

TMT Trends 2007



About TMT

The Deloitte Touche Tohmatsu (DTT) Technology, Media & Telecommunications (TMT) Industry Group consists of the TMT practices organized in the various member firms of DTT and includes more than 5,000 member firm partners, directors and senior managers supported by thousands of other professionals dedicated to helping their clients evaluate complex issues, develop fresh approaches to problems and implement practical solutions. There are dedicated TMT member firm practices in 45 countries and centers of excellence in the Americas, EMEA and Asia Pacific. DTT's member firms serve over 90 percent of the TMT companies in the Fortune Global 500. Clients of Deloitte's member firms' TMT practices include some of the world's top software companies, computer manufacturers, wireless operators, satellite broadcasters, advertising agencies and semiconductor foundries – as well as leaders in publishing, telecommunications and peripheral equipment manufacturing.

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Foreword

Welcome to the 2007 edition of the DTT TMT Industry Group's Media Predictions.

The media sector has again had a vibrant year. As forecast last year, digital music's popularity has continued growing, helped by the increasing range of online retailers and MP3 players. The television industry has also experienced much change, with the launch of ever larger television sets, a spurt in the uptake of high-definition equipment and huge excitement, though little revenue, from IPTV. The falling price of memory and processors has enabled further digitization of the media production process. The video-game market has seen considerable progress online, with rapid growth, albeit from low levels, of participation in virtual worlds. Radio has continued its reinvention, both in the expansion of digital services and the launch of new digital sets. Both audience fragmentation and convergence have offered challenges as well as opportunities for all media players. Meanwhile, consumers themselves have had a hand in changing the media landscape – the number of blogs worldwide now exceeds 60 million¹ and user-generated video content has become headline news.

The outlook for the media sector in 2007 is similarly interesting. 2007's Predictions cover: the commercialization of social networks and user-generated content; the disparity in metrics used to quantify new media and traditional media; opportunities in China's media sector; the growth of real economies within virtual worlds; the long tail's alternative forms; the immediacy of VOD to PCs; public participation in television programs; the growing symbiosis between online publications and paper sources and finally the cost of free media.

I am often asked how the DTT TMT Industry Group's Predictions differ from the many similarly titled reports produced by other organizations. I believe Predictions has a unique combination of objectives and methodology.

The Predictions series has been designed to provide a diverse selection of views and thoughts that challenge, inform and engage industry leaders and executives. It neither aims, nor claims to be, a comprehensive forecast of every anticipated event.

The methodology used to generate the Predictions series is revisited every year. The 2007 series of Predictions has included inputs from conversations with member firm clients, contributions from DTT member firms' 5,000 partners and managers specializing in TMT, and discussions with industry analysts.

This series of Predictions has incorporated two additional sources.

The first is a series of 36 interviews with leading executives from around the world on the key industry theme of convergence. This global primary research exercise, spanning the TMT sectors, produced a wealth of insight, much of which is reflected in many of this year's Predictions. The interviews, collectively published by DTT as a book, *Convergence Conversations*, are available from www.deloitte.com/tmt.

The second source is a column, *Drowning by Numbers*, that the Financial Times invited Deloitte & Touche LLP in the United Kingdom to write on a fortnightly basis. Some of the ideas for Predictions have been tested in this column.

I hope that the result of our endeavors provides you with plenty of food for thought for the year ahead. On behalf of DTT's TMT Industry Group, may I take this opportunity to wish you all the best for an enjoyable 2007.



Igal Brightman
Global Managing Partner
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Executive summary

In 2007 user-generated content could increasingly complement established media output², perhaps to an unprecedented extent. Digital user-generated content is often cast as the conqueror of established media. Blogs, citizen journalists and amateur film makers have all been portrayed as threats to publishers, professional columnists and established media empires. However in 2007, as in years to come, owning a professional-quality video camera, a PC or a mobile phone is unlikely magically to imbue the majority of people with talent. Indeed, some user-generated content may increasingly be seen as a vindication of, rather than an assault on, the professional media industry. Nonetheless, some digital user-generated content is likely to have a role in the professional media world. Much as readers' letters, listeners' phone calls and children's drawings are expected to continue feeding into newspapers, radio shows and television programs respectively, their digital equivalents are likely to be used in a similar way. Additionally, media companies could well find that the online channels that serve up user-generated content could become not only a powerful new promotional vehicle, but also an efficient and effective medium for scouting new talent.

Public participation in television has come a long way since producers first used studio audiences to create a sense of excitement for programs. Now millions of viewers participate in programs, directly influencing their outcomes. A key driver for the growth in participation has been technological advance in the forms of: rising broadband penetration, ubiquitous ownership of mobile phones and the development of platforms capable of handling thousands of simultaneous calls or text messages. Participation's role in television is also likely to be driven by sharp declines in advertising, one of the major sources of revenue for the television sector. In 2007, the key forms of participation, voting, competition television and television shopping, all of which are based around a call to action from the television show to its audience, are likely to generate increasing revenues. However, the television industry should be careful not to let participation become regarded as a panacea. All formats of participation should be subject to constant reinvention; for example voting should not be regarded as solely relevant to light entertainment. In addition, companies offering television shopping should ensure they have two core skills: CRM and logistics. Broadcasters using competitions within programs should monitor regulations carefully.

China is likely to remain one of the most tantalizing media sector opportunities in 2007. China's 1.3 billion inhabitants would suggest massive potential, but this is likely to remain frustratingly hard to tap into during 2007 and possibly beyond. While China's GDP is expected to continue growing strongly, only a minority of Chinese citizens are likely to have sufficient income to consume similar amounts of media to citizens in developed countries. Media companies targeting the Chinese market should have a realistic view of opportunities in 2007. China is a unique market, blending opportunity and challenge like no other country. Entering the Chinese market is likely to be quite different to any other in terms of scale, approach and timeliness.

A copy and paste approach to targeting China, based on attempting the same business model as in a media company's home country, is unlikely to succeed. A blend of precision and patience will likely be required, with companies taking a long-term strategic approach enjoying the greatest likelihood of success.

During the course of the year, the print media may increasingly realize that the relationship between paper and pixels may not always be about one versus the other, but more about a symbiotic, profitable coexistence. Both digital and physical publishing should enjoy strong success in 2007. Internet advertising should continue on its way to becoming a \$20 billion industry. But 439 million people may still buy a newspaper every day. Digital and paper will retain their distinct strengths and may often be able to promote each other. Profit from both paper and pixels should be possible if publishing companies always seek to reinvent traditional formats and develop new products and services that use the unique characteristics of both online and printed text. Online-only publishers may turn to paper to raise profitability. Some blogs, for example, may generate more revenue as analog books than in their original online format.

The Internet has given rise to the online store, which in turn has revealed the long tail: the potential to yield value from media companies' back catalogs. Many in the media sector may hail the long tail as a panacea. However media companies should not rely on the long tail to rekindle spontaneously the appeal of every title in their archive. Vast repositories of content available for sale over the Internet may struggle to sell even a tiny fraction of the volume generated by blockbusters, due to the still rather rudimentary nature of search and recommendation tools. Indeed the Internet may even serve to increase the dominance of the blockbuster. Websites selling all forms of content, from music to movies, are likely to list the most popular content prominently. Thus in 2007, while the potential of the long tail may grow longer still, it may be the thick, short start of the tail that is worked hardest and is most productive.

In 2007, the need for metrics that provide like-for-like comparisons between traditional and new media performance is likely to become more obvious. This should replace the old approach of using different sets of metrics that may flatter new media's performance, underestimating the true impact of traditional media as a result. Comparing unique users or downloads for social networks to viewing figures for television stations, for example, may paint an unrealistically rosy picture of the former. Balanced, comparable statistics that clearly show the relative performance of all types of media, both old and new, should be used to ensure that investors' expectations are properly managed, advertisers' budgets appropriately allocated, and acquisitions are accurately priced.

The public's readiness to pay for content varies between geographies, changes over time and is influenced by a growing range of factors, from technology to disposable income. The challenge for media companies in 2007 is to second guess how the public's perception of value may change, on a market-by-market and even segment-by-segment basis.

A benefit of this fluidity is that a reduction in the price paid for one format, in one market, is likely to be balanced by an increase in another. The year should see much experimentation with pricing for all types of media. For example television programs that were broadcast free may become available for purchase via Internet downloads.

Social networks enjoyed massive success in recruiting users in 2006. Their key challenge in 2007 is likely to be to monetize their massive user bases. Social networks are best known for offering 15 megabytes of fame to all for free. One of social networks' revenue opportunities may be to offer gigabytes of privacy for a fee. Proud parents enjoy distributing photographs of their children to friends and family via the Internet. But they might feel more at ease if they could control exactly who was viewing those pictures. Friends may want to share videos of their weddings, including entertaining but indecorous escapades. But they may be prepared to pay to ensure that only their intimate circle, not prospective employers or existing peers, can see their uninhibited moments.

2007 should see substantial growth in the number of movies that are made available simultaneously on DVD in the shops and for download via VOD over the Internet to PCs. VOD's allure is that it has the potential to exploit the 21st-Century consumer's passion for instant gratification. But the addressable market for VOD is likely to remain very small. While close to 300 million consumer broadband connections are forecast for the start of 2007, fewer than five percent of these may be fast enough to support high-quality VOD. As a result, media companies should not see VOD as a panacea, but rather as one of a growing number of routes to market. Differentiation is likely to be essential, as VOD will have to compete with well-established and inexpensive alternatives, such as rental by post. For most DSL subscribers wanting instant access to blockbusters, a swift walk to the local video rental store may be the most immediate route to satisfaction.

The real world value of transactions taking place in virtual worlds is likely to rise through 2007. Second Life's overall GDP for 2007 could be close to \$700 million. Members of some virtual worlds may be able to withdraw cash from their virtual bank-accounts via real-world cash machines. A small handful of individuals are expected to make a healthy living from virtual worlds. But for the vast majority, particularly those in developed countries, virtual worlds are likely to remain little more than a recreational activity throughout 2007. If virtual worlds' economies were to grow by 10 percent per month, GDP per capita by the end of 2007 would still be under \$700 per annum. A sense of perspective is required. The games industry should question how large the addressable market for such fantasy games really is. The number of individuals with the desire and means to spend \$15 per month, 50 hours a month and some \$500 a year on their alternative life may be limited. Indeed the majority may already be customers. Governments should be alert to any attempts to exploit the mechanisms of virtual economies to undertake criminal activity. Money launderers may use trade in digital artefacts and virtual currencies as a new means of money laundering.



Making digital, user-generated content useful

Digital user-generated content has been cast as the eventual conqueror of the established media world. Blogs could batter established media empires. Citizen journalists may render the professional columnist redundant³. Amateur film-makers, armed with camera phones, could even topple Hollywood⁴.

This view has been gathering steam during 2006 and may become even more prevalent in 2007, as the volume of blogs grows, the specification of mobile phones improves and the number of websites supporting user-generated content rises.

Yet the majority of user-generated content is likely to remain mediocre, and thus of little interest or value to most. Essentially it is not likely to pose a major threat to the media industry.

In 2007, the majority of blogs and bloggers, while being available to the billion Internet users around the world⁵, may well find themselves ignored by most of that number. While a few thousand blogs may attract significant traffic, few of the estimated 60 million bloggers⁶, excepting those columnists who have just rebranded themselves as such, may be able to make a living from their weblogs alone⁷. By the end of the year there may still be just one example of a news site of any scale that is based solely on citizen journalists⁸. In 2007 the role of the individual with a camera phone may be recognized as being more like that of a digital eyewitness, providing a photographic or video-based comment on an emerging news story, rather than a journalist trained to analyze and interpret an unfolding event⁹. Websites whose original ethos was to collect user-generated content may find their most popular content is user selected rather than user created¹⁰.

Indeed, in 2007, as in years to come, owning a professional-quality video camera, a PC or a mobile phone is unlikely magically to imbue the majority of people with talent, much as it is improbable that a paintbrush could produce a budding Picasso. In many cases, user-generated content may increasingly be seen as a vindication of, rather than an assault on, the professional media industry.

However, this does not mean that digital, user-generated content has no role in the professional media world. Indeed in 2007, all forms of user-generated content should complement established media¹¹, perhaps to an extent that has never been seen before. As well as readers' letters, listeners' phone calls and children's drawings continuing to feed into newspapers, radio shows and television programs, respectively, their digital equivalents are also likely to be used in a similar way – to complement professional content.

Further, digital, user-generated views may well be used to provide informal feedback on a wide range of media, and websites featuring user-generated opinions and recommendations may also be used, subversively or openly, as an increasingly important research and marketing channel.

Bottom line

In 2007, digital, user-generated content may offer more of an opportunity than a threat to incumbent media companies. The more media companies take an opportunistic stance towards user-generated content, the more they are likely to be able to exploit its potential value. The industry should consider, for example, how such content can be incorporated into traditional media formats.

For user-generated content to be meaningful, clearly it has to generate revenue, directly or indirectly¹². While using the public's content for program and new concept creation can generate revenues¹³, that opportunity is likely to be limited.

More broadly however, the established media sector could grow its top line by using user-generated content channels to raise awareness of existing, forthcoming and archive material, grow market share, engender loyalty and, indeed, identify new talent.

A media company could publicize a new media property by creating a buzz in social networking sites and virtual worlds. Music companies have used social networks to raise the profile of emerging acts¹⁴; some established bands have attempted to maintain profile by playing concerts in virtual worlds¹⁵. They could also use user-generated content as a means of gauging reaction to established content, from television shows to newspaper columns. Companies could either analyze discussions on Internet forums¹⁶ or ask consumers directly to review new movies, plays and restaurants, rather than just rely on the opinions of professional journalists. This approach could create a more interactive and intimate relationship with customers¹⁷.

Digital, user-generated content could be used to enhance the loyalty of an established media format, such as a television show based on viewer's videos. The broadcast show could feature a selection of the producer's picks; the best of the rest could then be made available online for viewing and rating. The most popular of the Web-based videos could then be broadcast on the following week's show. This approach could both retain interest in the show and add viewing hours¹⁸, drawing the focus of eyeballs away from the PC and back to the television.

New media companies could also use digital, user-generated content as a means of establishing new content. Thus the A&R function of music companies, or the talent-scouting unit of a movie studio could partly move online. However media companies should recognize that online searches for talent can be just as arduous and painstaking as the physical quest.

Profiting from participation in television

Audience participation has contributed to the enduring popularity of television since its first days as a mass medium in the early 1950s. Producers used studio audiences to create a sense of excitement for programs. Wide, pan-shots of audiences emoting in response to shows helped engender loyalty to programs and made viewers feel like a part of them.

Since then, participation has come a long way, and now millions of viewers participate in programs, directly influencing the outcomes of some of the most popular shows in television¹⁹. This trend is likely to continue through 2007.

Use of participation is also being driven by technological advances, in the forms of rising broadband penetration, ubiquitous ownership of mobile phones and the availability of platforms capable of handling thousands of simultaneous calls and text messages. These advances have enabled new, instant ways for audiences to connect with television programs on a wide scale^{20,21}.

Participation's role in television is also likely to be driven by sharp declines in advertising, one of the major sources of revenue for the sector²².

In 2007, the key forms of participation, all of which are based around a call to action from the television show to its audience, are likely to generate increasing revenues.

Voting, whereby viewers communicate with a television program to influence its outcome, may generate hundreds of millions of dollars in revenue in 2007, particularly in countries where the use of premium-rate calling and messaging services is legalized²³. The United Kingdom has seen spending on voting via text messaging rise to \$458 million per year^{24,25}. In 2000, that spend was zero.

Competition television, where viewers call in to participate in competitions in a game-show format, is likely to become more popular among television networks worldwide as a means of boosting the bottom line. In European countries, competition television can generate up to tens of thousands of calls per hour, at rates of up to \$2 per minute²⁶.

Television shopping generates revenues by encouraging the audience to purchase products being demonstrated on the program. Viewers participate in the program by affecting the price and even by speaking live to the presenters. Revenues from television shopping may reach billions worldwide; in the United Kingdom alone they may reach close to \$1 billion in 2007, with strong growth predicted²⁷.

Other forms of participation may also emerge in 2007. Text-to-speech participation, in which viewers' text messages are read out on air by virtual hosts is likely to become a popular niche for late-night shows²⁸. MMS messages may also become a more popular form of participation, with viewers sending in photographs to be broadcast²⁹. Similarly, mobile and webcam video contributions are likely to become more commonly broadcast. Additionally, reverse auction programs, in which viewers use their mobile phones to bid, are likely to grow in popularity, after initial success in India and the United Kingdom³⁰.

Bottom line

The television industry should not regard participation as a panacea. However effective deployment of participation programming could have a significant impact on audiences, loyalty and revenue, even in developing economies³¹.

In considering voting, the television sector should ensure that it remains relevant for its audiences from year to year. As a marketing concept, it should not be allowed to stagnate, otherwise revenues from voting may well decline. For example while the audience for the UK series of Big Brother has remained constant, voting volumes have declined by 60 percent from their 2002 peak. Voting should also be diversified. It currently predominates in the light-entertainment sector, but could also be relevant in other genres, from politics to nature programs, and even interactive drama³². The information generated by voting, such as telephone numbers, could also be used for marketing and viewer research, legislation permitting. Similarly, callers to a program could be sent a reminder to view, just prior to the next installment, potentially boosting, or at least maintaining, viewing figures.

Television companies considering entering the home-shopping market should ensure that they have two of the core skills of any retailer: good CRM and robust logistics. Customers who have positive interactions with call centers and who receive goods promptly are more likely to become repeat customers.

Broadcasters offering play television programming should monitor regulations concerning this format carefully. A key recommendation is to ensure that competitions are genuinely competitive: questions should not be so simple such that regulators may redesignate the activity as a lottery, thus potentially changing its taxable status. Some shows' competitions were regarded as so simple that they prompted a public consultation³³.

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Cracking China's media sector

China's sheer size and growing importance in the world economy give it an almost irresistible allure to media companies around the world. Yet China is a market in transition, particularly in its media sector³⁴, which remains of strategic importance to the Chinese government, both in terms of its economic value and also because of its ability to influence³⁵.

China's population implies a massive potential market³⁶. But that potential may be hard to tap into. While China's GDP continues growing at a rapid pace³⁷, only a minority of Chinese citizens have the disposable income to consume content in a substantial way. The bulk of China's 1.3 billion inhabitants³⁸, some 800 million people, still live in relative poverty in rural China³⁹, with limited access to contemporary media⁴⁰.

Furthermore, government censorship and restrictions on foreign ownership and private enterprise have made China a challenging market for foreign media companies to develop. In 2006, the Chinese media market has appeared to tighten up, rather than open, to foreign media companies⁴¹.

Piracy is another big challenge for all types of media and is likely to remain a key issue in 2007. Illegal copies are likely to be available everywhere, in cafes, bars, major retailers and even in the workplace⁴².

Yet there should still be steady growth in the value of China's media sector in 2007⁴³. Broadcast and cable television are expected to grow steadily, with a forecast value of \$18.8 billion by 2009, a 66 percent increase over five years. China's film and entertainment business may be worth \$143 billion by 2009, compared to only \$46.4 billion five years earlier⁴⁴.

Thus the liberalization of the Chinese media sector is likely to remain slow and sporadic in 2007 and beyond, although opportunities are likely to tantalize both established and emerging media companies.

Bottom line

Media companies targeting the Chinese market should have a realistic view of opportunities in 2007. China is a unique market, blending opportunity and challenge like no other country. Entering the Chinese market is likely to be quite different to any other in terms of scale, approach and timeliness. A copy and paste approach to targeting China, based on attempting the same business model as in a media company's home country, is unlikely to succeed.

Media companies need a blend of precision and patience. Precision means identifying where China's biggest gaps are. One of the most immediate challenges China faces is the Beijing Olympics. China is likely to want to make a showpiece out of broadcasting the games⁴⁵. It is likely to need existing skills to help attain this aim⁴⁶. Over the longer term, the Shanghai World Expo in 2010 could also provide an opportunity, as China aims to show off its media skills.

Patience is likely to be a prerequisite⁴⁷, and businesses attempting to challenge the pace of change or idiosyncratic local rules may find themselves punished⁴⁸. Media companies should focus on laying a solid foundation for long-term success by increasing their market knowledge, building their brands, and forming positive relationships with Chinese business partners and government agencies, rather than trying to rush for market penetration.

Media companies should also consider the fact that China aspires to become a leading adopter of DTV. It is currently testing systems across the country⁴⁹ in preparation for nationwide accessibility before the Beijing 2008 Olympic Games. However, as of 2005 only 4.4 million households had DTV⁵⁰. Given the scale of deployment needed in such a short timescale, foreign companies may well find opportunity in assisting Chinese DTV operators.

One of China's key aims is also to establish its own companies as global powerhouses. China's government would like its media companies and also its major national brands, such as PC manufacturer Lenovo, to become leading multinationals. The opportunity for western media companies is to enable Chinese companies attain this aim, particularly with regard to establishing global brands⁵¹.

Finally, western media companies should take time to understand that the Chinese government's rationale for controlling the extent of the media sector's liberalization is not necessarily just about exerting strict control over its citizens. China remains a command economy whose transformation into a market economy is highly challenging.

Paper, pixels and profits

The pixel has often been portrayed as paper's long-term replacement; in the long-run, online may just be another channel to market for quality content.

Digital subscription and advertising revenues now comprise over 18 percent of business publishers' and 10 percent of consumer publishers' total revenues⁵². Internet advertising is on its way to becoming a \$20 billion industry⁵³. Online classified advertising generates more than \$2 billion in revenues⁵⁴. One forecast has predicted that 2043 may be the year in which the last newspaper is printed in the United States⁵⁵.

Yet, currently 439 million people in over 210 countries buy a newspaper every day⁵⁶. Over 1.4 billion magazines are sold each year and numbers are rising⁵⁷. Book sales exceed three billion annually⁵⁸.

The relationship between paper and pixels, it seems, may not always be about one versus the other, but more about a symbiotic, profitable coexistence.

In 2007, the print industry may therefore start making its future more certain by focusing on two areas: understanding and exploiting the unique characteristics of print, which cannot be replicated via other media, and turning the threat of the Internet into an opportunity. There may even be scope for the newspaper sector to reverse some of the declines it has suffered, particularly in more developed markets⁵⁹.

A key reason, in 2007 and beyond, for the enduring consumer appeal and commercial success of print is its practicality and its universality. Unlike its digital equivalents, print needs no power supply or network access. Print is portable, foldable, inexpensive, lightweight, legible in sunlight and accessible to anyone who can read.

The increasingly widespread and vibrant growth of free newspapers is evidence of continued demand for the printed word, even in markets such as the United States, where newspaper circulation has seen sharp decline⁶⁰. Free dailies can increase the total number of newspaper readers, without cannibalizing revenues from existing titles⁶¹. And most importantly, free papers tend to appeal to younger readers⁶², whose attention and loyalty should become a key strategic objective in 2007.

With just 285 million broadband connections⁶³ serving a global population of 6.5 billion, paper retains an unassailable lead as the best route to the mass market. Further, for any article greater than 800 words with photographs or graphics, print is typically preferable to most readers⁶⁴.

Nonetheless, in parallel, print media companies are likely in 2007 to continue making more active and profitable use of the Internet, to compensate for some of print's inherent weaknesses: its content cannot be updated in real time, and print-runs imply up-front risk. Newspapers are generating a growing proportion of their revenues from online advertising⁶⁵, magazines, particularly special-interest titles, are enjoying revenue growth from online subscriptions⁶⁶.

Conversely, online-only publishers may also start looking at the printed page as a means of boosting their revenues. Printing may be the best way of monetizing previously digital-only content.

During the course of 2007, print media companies are likely to make increasingly diverse and creative use of both paper and pixels, to support revenue growth, fuel innovation, defend their core business and expand their relationships with customers.

Bottom line

Publishers and other media companies should create a balance between paper and pixels. The sector should assume that it may take many years, or even decades, for the Internet to match the accessibility of paper. Even then, readers may often prefer to curl up with a good book, newspaper or magazine, rather than remain hunched in front of a monitor. In the meantime, profitability from both paper and pixels is possible if companies reinvent traditional formats, developing new products and services both online and in print.

Newspapers could complement printed versions of stories by using the Internet to distribute multimedia accompaniments to them. Podcasts, audio interviews, additional photographs and even articles that never made it onto the printed page could all both attract new readers and keep existing ones loyal.

The growing availability of free news on the Internet may be best addressed by a change in editorial approach. Rather than simply reporting the news, newspapers and current-affairs magazines may wish to focus more on opinion pieces, essays, editorials, in-depth analysis and features, all of which may be better suited to paper forms than the Internet⁶⁷.

Publishers should also consider reinventing formats where necessary. Free papers and magazines, with a deliberate youth-orientation, a strong visual identity and a substantial amount of readers' contributions could all add to a resurgence of the printed word⁶⁸.

Publishers should understand how and when online advertising will have its greatest impact. Classified advertising, such as recruitment and personal columns, is most critically at risk as it is moving rapidly online⁶⁹. Unless publishers move to use the power of the Internet in this area, either alone or in partnership⁷⁰, the classified advertising market, which represents up to one-third of revenues⁷¹, could soon be lost to specialized Internet players.

Online-only publishers may also want to consider turning to paper as a source of revenue, not least as a means of reaching customers who are not yet online. Their digital content may even be more profitable as analog. The recent success of titles such as "PostSecret: Extraordinary Confessions from Ordinary Lives"⁷² suggests that there is a growing market for books based on blogs and other content that was previously only found online.

The digital tail comes in many shapes and forms

The Internet has given rise to the online media stores, capable of selling both physical and digital products on almost endless virtual shelves. The largest online stores are able to offer their customers millions of products, all of which are readily accessible.

While customers of a physical store may get exhausted at the mere prospect of browsing through millions of goods, online customers are offered two tools that have the potential to accommodate a huge variety of choice: a search tool and a recommendations engine. The former allows the customer to pull information on any content in an instant. The latter pushes suggestions to the user. This combination of push and pull has the potential to revitalize the ever-growing back catalogs owned by media companies.

Previously forgotten content in theory becomes more accessible to the general public. So books that have long been out of print may suddenly discover another lease of life. Television programs, long since consigned to the archive, may find a new audience, decades after they were originally broadcast. This impact is known as the long tail⁷³.

To many in the media, the long-tail phenomenon has been embraced as a panacea. Even if new releases do not turn into blockbusters, the long tail means that the back catalog has the potential to become a more productive and potentially profitable line of business, less prone to the seasonal sales spikes and massive marketing costs of new releases.

However media companies should not rely on the long tail to rekindle the appeal of every title in their back catalog automatically. Even with search and recommendation engines, the vast repositories of content available for sale over the Internet may struggle to sell even a tiny fraction of the volume generated by blockbusters. In short therefore, the majority of sales may well always be generated by a minority of product⁷⁴.

As a means of exploiting the long tail, recommendation is not perfect, particularly if recommendations are driven purely by technology, and that technology is driven solely by historical purchasing behavior⁷⁵. While one customer's purchase may consist of a couple of CDs in the same genre, another customer may well be collecting gifts for a wide range of friends and family. So the purchase history for one may make little sense for anyone else with a different combination of friends and family (in other words, potentially everyone else in the world). Similarly, search is only a useful function if users have a good idea of what they are looking for, and more importantly, if the content has been tagged, or otherwise identified, correctly. For the vast majority of content produced before the digital age, which is by far the bulk of all professional media content in existence, and even some of the content created digitally, this is not yet the case.

Further, while technology may have the potential to enable the long tail, in many cases it also serves to promote a short list of blockbusters. Websites selling all forms of content, from music to movies, provide prominent lists of the most popular content.

The real estate of a website is clearly physically smaller than that of a shop display, favoring the display of a top 10, as opposed to a shop's top 20. As for content sold over a mobile phone, such as a ringtone or a song, a general inability to browse extensively means typically only a top five is possible. As a result, for content sold over a mobile phone, the tail is rather short indeed⁷⁶.

Thus in 2007, while the potential of the long tail may grow longer still, it may be the thick, short start of the tail that is most productive.

Bottom line

Media companies should embrace the long tail, while recognizing its limitations.

Historically the Pareto Principle, which implies that 20 percent of content generates 80 percent of revenues, has been a reliable rule of thumb. As such, a singular faith in the power of the long tail could be counterproductive. There is little evidence to suggest that the majority of customers have either remarkably eclectic tastes, or huge reserves of free time to spend searching through online archives. Media companies should therefore seek to balance the long tail against the Pareto Principle. In practice, this means selectively making available a wider range of material – but not necessarily all material. Certain types of content will, almost by default, have broader appeal. Hit television series are always likely to hold more appeal than local news that is years-old. Content which did not sell when first released may well have failed due to its mediocrity; in most cases the passage of time is unlikely to have enhanced its appeal. Not only is this a sensible approach from a consumer perspective, but it is also economically more tenable. While the cost of digitizing archive content is falling, in aggregate the cost can be substantial.

More importantly, sophisticated tools exist that can help media companies to analyze what types of content Internet users are interested in, by compiling and analyzing blogs, reviews, chat rooms and other forums⁷⁷. Such tools should become much more widely used as a means of informing the process of digitizing the back catalog and stimulating the long tail.

Better search and recommendation tools are also likely to be essential, as is accurate tagging of content. Media companies should be prepared to invest in the best solutions. But investment in technology may not be the only answer. In 2007, it is still likely to be the case that human beings, assisted by computers, will be able to provide better advice than any technology alone⁷⁸. Making more intelligent and active use of customers' experience and knowledge, as well as their passion for content generally may well be the most productive way of benefiting from the long tail in 2007.



Analog apples and digital oranges

Headlines about new media's near vertical rise abound. Analyses of the travails of old media are similarly plentiful. Yet terms of reference often differ and context is sadly lacking. This causes misunderstandings that are likely to linger throughout 2007.

The success of 2006's new media darling, social networking, is often expressed in terms of daily downloads and unique viewers. Though the numbers are enormous, they are perhaps deceptively impressive. YouTube, one of the largest social networking sites, has been positioned as a threat to the traditional television industry. YouTube's users both upload and download, in far greater numbers than watch television, short videos that some regard as a directly comparable alternative. YouTube enjoys over 100 million downloads every day and boasts 70 million monthly unique users. During the course of 2007, these numbers may well rise, perhaps significantly.

So how does YouTube fare, when compared with one traditional television broadcaster, the BBC, in the context of one nation, the United Kingdom? BBC's four terrestrial television stations now consider a prime-time, weekend audience of 10 million viewers, from a population of 60 million, a major success. But a television viewer is not directly comparable to a unique viewer on the Internet, and a television program is quite different to a video clip. The former is longer, and generally has higher production values. The average length of the 20 most viewed video clips to date on YouTube is a shade over three minutes; the overall limit is 10 minutes. A television program often lasts 30 minutes, sometimes more.

And if we compare total hours watched, a quite different picture emerges. The number of hours watched of the BBC's television output in the United Kingdom alone, far outstrips that of YouTube globally, by a ratio of 10 to one. And that does not include the growing number of hours of BBC television watched over the Internet.

Bottom line

Media companies, advertisers and even telecommunications operators have been keen to tap into new media's potential. In 2007 they should continue to do so, but ideally when informed by using only statistics that are directly comparable.

Balanced, comparable statistics that clearly show the relative performance of all types of media, both old and new should ensure that investors' expectations are properly managed, that advertisers' budgets are appropriately allocated, and that acquisitions are accurately priced.

Any company considering new media applications should always consider the total addressable market. For new media that is likely to be limited initially by the number of broadband-connected PCs and mobile phones. While over a billion PCs are forecast to be in use in 2007, only a quarter are expected to be connected via broadband⁷⁹. As for mobile, of over 2.1 billion mobile phones that are in use globally⁸⁰, only 285 million are capable of handling new media content and services, and an even smaller percentage are actually used to access them^{81 82}.

In contrast, penetration of television and radio is almost guaranteed to remain several orders of magnitude higher, both in 2007 and for several years to come⁸³. In 2007, there should be some 1.7 billion televisions in use⁸⁴, with sales running at over 160 million each year⁸⁵, and more than 2.2 billion radio sets in use⁸⁶.

Headlines about new media's near vertical rise abound. Analyses of the travails of old media are similarly plentiful. Yet terms of reference often differ and context is sadly lacking. This causes misunderstandings that are likely to linger throughout 2007.

Media's never-ending quest for value

The public's readiness to pay for content varies between geographic areas, changes over time and is influenced by a growing range of factors, from technology to disposable income. The challenge for media companies, in 2007 and beyond, is to second guess how the public's perception of value may change, on a market-by-market and even segment-by-segment basis.

The television market's many business models around the world are testament to the complexity of pricing. Historically the public's quid pro quo relationship with broadcasters has been to accept a regulated dose of advertising in exchange for free television. That model still predominates for the mass market in many developing countries around the world.

However, as incomes rise, the demand for choice, exclusivity and quality, and the willingness to pay for this, increases accordingly. Thus in more affluent markets, subscription television is steadily replacing the pure advertising model.

The perfect balance of subscription and free-to-air television is hard to achieve. In fact in some markets, a few channels, which were launched on a subscription basis, have since converted to free-to-air, on the assumption that advertising can generate more revenue than subscriptions⁸⁷. For some time slots, a few television channels have even opted for competition television, funded entirely by premium-rate call revenues. Competition television has no advertising, as this might cause viewers to switch to another channel.

Broadcasting the most popular television series for free can also promote high-value peripherals, from DVD box sets to magazines. Restricting these series to subscription channels, with smaller audiences, may limit the demand for licensed products associated with each program.

The public's perception of where value lies is also highly variable in the music industry.

For example, music broadcast by radio stations has typically been free to the consumer. One of the historical benefits of this was to generate demand for albums and singles, particularly among the 16-24 age group⁸⁸. However technology has changed buying behavior, in some markets to a profound extent. As a growing number of broadband-equipped households have the ability to download music illegally, at zero cost, the perceived value of all forms of music for this demographic has plummeted.

But music is still valued, albeit in other forms. For example the price of live performances, which are much harder to pirate, has risen above inflation, particularly for blockbuster acts⁸⁹. The face value of tickets for the hottest acts has risen to over \$300⁹⁰, while the cost of an album has barely changed over the past 20 years. The mobile-phone ringtone, another representation of music, has become a \$5 billion global market⁹¹. Music is even generating value in the dental-care market, courtesy of the \$10 MP3 toothbrush⁹².

In some markets where piracy is rife, pirated MP3 tracks may even encourage the sale of paid-for ringtones⁹³, offsetting some of the losses from more traditional music formats. Similarly, music radio is also becoming more valuable to some consumers. Some markets have already shown a readiness to subscribe to specialist radio stations, and new markets are likely to experiment with subscription radio.

Thus, 2007 should see much experimentation with pricing for all types of media. Television programs that were broadcast free may become available for purchase via Internet downloads. Some companies may offer, via the Internet, to rent out music for free, in exchange for advertising. The scope for delivering value and charging for content should get far more complex, challenging and lucrative in 2007.

Bottom line

Determining price in the media sector appears especially challenging. Pricing strategies may need to be tailored to each market, by demographic or by income level, as the price that each of these segments is prepared to pay is driven by a growing array of factors.

Media companies should always bear in mind that one of the benefits of this fluidity is that a reduction in the price paid for one content format is likely to be balanced by an increase in another. A reduction in the price paid for news stories, due to the availability of instant news on the Internet, may drive an increased demand for news analysis, which is harder to commoditize. A public that refuses to pay for a piece of content online may often be happy to pay for exactly the same content when published, as a newspaper or a book.

No area of the media sector should consider itself immune to this variability in pricing. One of the fastest growing areas, search-driven advertising, may also be subject to variability in pricing. If search results become less meaningful because of advertisers being able to influence the order of results, some consumers may consider this too high a price to pay, and demand paid-for, objective search-engines.

However one historical constant should remain true in the long-term. Consumers are always likely to gravitate to, and be willing to pay for, the best quality content, in whatever form it may be available.

15 Megabytes of fame; one gigabyte of privacy

Social networking, an online service that allows people from all over the world to meet in cyberspace and share views, experiences, knowledge and content, such as photographs and videos, has been one of the success stories of 2006. Its impact has spanned the consumer market, the business world and the entire technology sector.

Transformed from a niche activity for the technologically inclined into an increasingly popular and pervasive leisure pursuit, social networking is currently on a pedestal. If it is to stay there, it will need to show a sustainable business model that can appeal to consumers and advertisers with limited budgets⁹⁴.

While awareness of social networking is widespread, use actually remains relatively low by comparison to other media. Users in the United States typically spend less than half-an-hour per month visiting social networking sites⁹⁵. In contrast, the average North American spends four-and-a-half hours watching television each day⁹⁶.

Social networking's appeal has been stronger among younger demographic groups, particularly the 15-30s, many looking for their moment in the limelight, courtesy of their 15 megabytes of self-expression available for all to view on the Web. The activity has generally been less popular among older age groups. Indeed it may not appeal to this sector in its present form in 2007⁹⁷. While younger people generally opt for the broadest possible circle of friends, older people tend to be more guarded.

Indeed privacy typically commands a premium that may rise with age. Thus the private garden is preferred to the public park; the secluded beach commands a higher price than a resort; the private dining room incurs a higher bill than the open-plan section of the restaurant.

So far social networks have rarely charged their members. This is perhaps because the typical user, being relatively young, is averse to subscriptions. But social networks, in offering privacy, have a good chance of collecting a fee from the less attention-hungry, typically older and wealthier, mass market.

Proud parents enjoy distributing photographs of their children to friends and family via the Internet. But they might feel more at ease if they knew exactly who was viewing those pictures. Friends may want to share videos of wedding, including entertaining but indecorous escapades. But they may be prepared to pay to ensure that only their intimate circle, not prospective employers or existing peers, can see their uninhibited moments^{98,99}.

Indeed over our lifetimes, even those who frequently indulge in social networking today, may well value privacy over publicity, in both digital and physical domains.

Bottom line

Social networking companies should move rapidly to expand both the appeal and the revenue-generating capacity of their services. Advertising revenues may not suffice, not least because more established media are likely to continue to perform well, and attract the lion's share of advertising dollars¹⁰⁰. Moreover, advertisers are unlikely to be keen to associate their brands with the often questionable contents of unmoderated social networking sites, and some users may not care to have their social experience tainted by adjacent advertising messages.

As a result, subscription revenues may well have to become an increasingly important part of the revenue mix. Social networking companies should examine how such revenues can be generated, and from whom. While monetizing virtual social experiences may prove challenging, because they are essentially free in the real world, monetizing privacy may not.

Premium subscriptions, in addition to the guarantee of privacy, could also offer a range of value-added services, from voice messaging to group chat, from online storage to webpage design. As premium users are likely to be older and less technologically literate, technical support may also be in demand, ideally on a paying basis.

Social networking sites should also consider their services within the context of established and mature social groupings. Families, professionals, scientists and other tight-knit communities may have the most advanced social networking needs, and a greater-than-average propensity to pay for secure services that bring the benefits of the digital age to the process of social interaction.

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Video-on-demand may leave you waiting

2007 should see substantial growth in the number of movies that are made available simultaneously on DVD in the shops and for download via VOD over the Internet to PCs. VOD's allure is that it has the potential to exploit the 21st-Century consumer's passion for instant gratification.

VOD has had a chequered history. Just over 10 years ago, there were more than 50 VOD trials around the world, some of which were based on what was then regarded as a scorchingly fast two Mbit/s¹⁰¹. Almost all of these trials were eventually canceled.

But some ideas never die, they just get reinvented, reinvigorated and relaunched. Today, VOD to PCs is being offered by a growing number of companies, with two approaches: downloads and streaming.

Whereas streaming video appears to be working well, video downloads may encounter some challenges in 2007, particularly when downloaded to PCs. The key issue is most likely to relate to the meaning of 'on-demand'. In 2007, on a typical two Mbit/s DSL network, it can take one minute to download each minute of a movie¹⁰². Thus a three-hour thriller may take 180 minutes or more to arrive (see Figure 1). A high-definition video, on a one Mbit/s DSL connection could take the best part of a whole day to download. There may then be further delay as the PC writes the movie file to the hard drive. Even when this process is complete, the movie may still be unwatchable unless the DRM key arrives with the movie. If not, there is another potential delay.

Figure 1: Estimated download times for video files

	1Mbit/s	2Mbit/s	4Mbit/s	8Mbit/s
30-min SD TV show	34 mins	17 mins	14 mins	7 mins
90-min SD movie	1 hr 40 mins	50 mins	25 mins	13 mins
2-hour HD movie	17 hrs 8 mins	8 hrs 34 mins	4 hrs 17 mins	2 hrs 8 mins

Note – Assumes encoding rates of 800Kbit/s and 6Mbit/s respectively for SD and HD programs. Download times are based on 70 percent of potential download speed to account for bandwidth and contention issues.

Source: Enders Analysis, 2006

Download speeds would of course be faster with a higher speed broadband connection. Around the world, 24 Mbit/s DSL connections are now available, but attaining this speed tends only to be possible for those fortunate enough to be living close to the local telephone exchange¹⁰³. So this searing rate, and absolutely on-demand service, may remain an aspiration rather than a reality for the vast majority of consumers in 2007.

In addition, it is likely that in 2007 there will be a rise in the use of a number of Internet-based applications, from VoIP to email to massive, multimedia, online games. If several of these services are used simultaneously within a household, video download speeds could collapse¹⁰⁴.

Thus in 2007, it may be the case that for DSL subscribers wanting instant access to blockbusters, a swift walk to the local store may be the most immediate route to satisfaction.

Bottom line

Media companies should consider VOD to PCs as one of a growing number of distribution channels. It is not to be heralded as a panacea. The available market that could receive VOD, to any device, remains relatively small. While there were an estimated 285 million consumer broadband connections in the world by the end of 2006,¹⁰⁵ only 14 million were regarded as fast enough to support high-quality VOD¹⁰⁶.

Companies should also recognize that while the concept of VOD is likely to appeal in general, the majority of consumers may not need their supply to be instant on every occasion. The success of relatively slow video delivery solutions, such as rental by post, most famously Netflix, or purchase, most ubiquitously Amazon, suggest that consumers are quite prepared to wait before they watch¹⁰⁷.

VOD's success as a channel is likely to depend on its differentiation and its core advantage may not be its eventual ability to deliver content instantly. VOD may be best deployed for non-blockbuster content that video rental stores and retail outlets do not stock due to limited demand. VOD's optimal role may be the merchandising and distribution of back-catalog and more esoteric content, accessible via powerful search tools and marketed via a combination of customer rankings, purchasing history and archivists' suggestions. VOD's appeal could be bolstered by features such as conferring free ownership of a title once it has been downloaded more than three times.

Thus in the long-term, VOD's main competitive advantage may be far more than its ability to deliver content fast. And its main commercial benefit impact is likely to be felt in the value of the back catalog.

Virtuanomics

Real economies are emerging within digital online fantasy worlds. The largest virtual worlds, such as Second Life, collectively host millions of citizens, some spending many hours every day living their virtual lives¹⁰⁸.

Some aspects of these virtual worlds increasingly mirror real life, such as value creation, trade and even labor offshoring. Low-income workers in developing countries manufacture digital artefacts for sale, such as virtual clothing and weapons, to time-constrained players in the developed world. But other aspects still differ markedly from reality, such as the ability to fly unaided and the absence of any form of taxation.

The real-world value of transactions taking place in virtual worlds is rising steadily, and is likely to continue growing through 2007. One estimate of the value of commerce in Second Life is of \$265,000 per day, and it is estimated that average turnover is rising by up to 15 percent per month. If these trends were to continue, Second Life's overall GDP could be close to \$700 million in 2007. One analysis has suggested that Second Life's economic impact is equivalent to that of the South African nation of Namibia¹⁰⁹, whose GDP is \$14 billion.

Another virtual world, Project Entropia, has generated turnover of around \$160 million a year¹¹⁰ and one property alone in this virtual reality was sold for \$100,000 of real money¹¹¹. Members of this virtual world are able to withdraw cash from their virtual bank accounts via real-world cash machines.

A small handful of individuals are able to make a healthy living from virtual worlds. But for the vast majority, particularly those in developing countries, virtual worlds are likely to remain little more than a recreational activity throughout 2007. At the moment, turnover per person in virtual worlds averages under a dollar per day. If virtual worlds' economies were to grow by 10 percent per month, annual GDP by the end of 2007 would still be under \$700 per annum.

Bottom line

Virtual fantasy worlds have become a serious business in their own right. Consequently they are now attracting the interests of advertisers and even media companies¹¹².

There is a steady blurring of the line between fantasy and reality, which is leading real people to spend real money on entirely virtual goods and services, and real companies promoting or even offering virtual versions of their products for real money¹¹³. Clearly, at some point, the value of this trade may, based on recent growth, become large enough to also attract the attention of tax authorities.

However a sense of perspective is required.

The total available market for such fantasy games may be limited; only a small number of people want to, or have the time to, spend the majority of their spare time playing video games¹¹⁴. The leading online games may well be able to generate hundreds of millions of dollars in annual revenues from subscriptions. However, the number of individuals with the desire and means to spend \$15 per month, 50 hours a month and \$500 a year on their alternative life may be limited, and they have probably already subscribed. It may simply not be worth the while of tax authorities to identify transactions, some of which may be covert, particularly when crossing borders. Even if the real world value of virtual economies were to reach \$1 billion in 2007, this would still pale in comparison to global GDP, forecast at \$47 trillion in 2007¹¹⁵.

Governments may wish to focus more on identifying any attempts to exploit the mechanisms of virtual economies to undertake criminal activity. Money launderers may use trade in digital artefacts or the ability to withdraw cash from an ATM as a means of money laundering.

The real world value of transactions taking place in virtual worlds is rising steadily, and is likely to continue growing through 2007.

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Glossary of technical terms

3G	Third generation mobile network
ATM	Automated Teller Machine
CRM	Customer Relationship Management
DRM	Digital Rights Management
DSL	Digital Subscriber Line
DTV	Digital Television
GSM	General System for Mobile
HD	High Definition
IPTV	Internet Protocol Television
MMS	Multimedia Messaging Service
SD	Standard Definition
SMS	Short Message Service
TMT	Technology, Media and Telecommunications
VOD	Video-on-Demand
VoIP	Voice-over-Internet Protocol

Recent thought leadership

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- "Global trends in venture capital 2006 survey", Deloitte Touche Tohmatsu
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- "Be prepared: Imperatives for TMT executives, 2005-2010", Deloitte Touche Tohmatsu
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