New business models for emerging media and entertainment revenue opportunities

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As consumers continue to enhance and replace traditional media consumption with digital experiences, established media and entertainment companies – such as newspapers, broadcasters, music labels and movie studios – face both a potential revenue challenge and an opportunity. As a growing share of consumer value shifts to new industry entrants, long-time leaders in many media and entertainment (M&E) market segments must find a way to replace declining traditional revenue with equivalent value from digital media. To capitalize on new revenue opportunities, M&E companies should focus on enhancing the consumer experience, embracing new distribution platforms and expanding revenue models.

Consumers of all ages are trading printed books for e-readers, traditional television sets for Internet-connected TVs and mobile phones for smart phones. They are adding new device categories – like tablets – to their portfolio of electronics, and they are using established devices like game consoles to access more types of content. While these new devices present opportunities to further engage consumers, they also trigger disruption in the established M&E ecosystem as new entrants compete for consumer loyalty.

Three key drivers are underscoring this reality:

Value shifts. The balance of power has shifted, as device manufacturers and distributors/aggregators continue to innovate and deliver superior experiences for the consumer, capturing greater revenue share.

Substitution. Once merely a threat, the mainstream adoption of digital devices and content across all age groups continues to drive fragmentation and declines in traditional media consumption.

Weaker digital revenue models. Current digital revenue models tend to be weaker than traditional revenue models, whether due to lower unit value, lower inventory or the move toward à la carte offerings. Consumers have been trained to expect ‘‘free to them’’ content delivery and companies now struggle to gain acceptance for consumer paid models.

In addition, M&E companies face competition from aggregators, device manufacturers and other new entrants – all vying for consumer mind and wallet share. Today's M&E companies must determine how they can overcome these challenges to reclaim revenue. To tackle these issues and chart a course toward growth and prosperity M&E businesses should look beyond content, and concentrate on three key principles:

- **Focus on the experience.** Media companies need to ‘‘rethink’’ their business models and seek innovative ways to enhance the consumer experience and connect with consumers.
- **Embrace new distribution platforms.** Media companies can leverage connected platforms to engage consumers in an ongoing relationship while optimizing value across distribution channels. But it's now time to think strategically about how to optimize across distribution platforms.

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- Expand revenue models. New marketing, consumer-paid and packaged revenue models must be flexible and tailored, offering relevancy, choice, integration and packaging options for consumers.

To successfully address the revenue challenge by delivering a better consumer experience, M&E companies will require the capabilities to build analytics and insights, develop consumer-centric models and enable multiplatform delivery.

Today’s digital reality

Consumption of digital content is now mainstream among younger segments, and older audiences are catching up rapidly. This move to digital has created challenges for M&E companies, primarily caused by three key drivers: value shifts, substitution and weaker online revenue models.

Value shifts. As the options for consuming media have continued to grow and connected multimedia devices have been introduced, the overall experience has become more and more important. Consumers are making choices based on simplicity of use, integration and convenience. To meet consumers’ growing needs, a new set of industry participants stepped in to deliver novel and superior experiences.

Device manufacturers and distributors/aggregators have led in consumer experience innovations – and consumers have gladly responded by allocating a greater portion of their budgets to offerings that enhance their experience. As a result, the balance of power and resulting value have shifted and, in many cases, device manufacturers and distributors/aggregators are capturing greater revenue share.

The music industry serves as a prime example. The industry’s traditional players are on track to lose more than 40 percent of value between 2003 and 2012 due largely to digital migration.[1] At the same time, new players in the broader music ecosystem have captured value by focusing on the consumer experience. In fact, if you define the industry more broadly and include the new players, the industry actually grew by 3 percent year-over-year between 2003 and 2008.[2]

Apple, for example, profited by charging a premium for its iPod devices but charged a low, standard price for songs. The model defined value in a new way and provided consumer convenience.[3] Other nontraditional players also saw revenue opportunities, including concert promoters and some retailers like Best Buy, which helped consumers enjoy their connected devices through in-home networking services from its Geek Squad subsidiary.

Background and research methodology

This analysis contains insights from an online survey conducted by the IBM Institute for Business Value. The questionnaire generated more than 3,300 responses from consumers in five countries: Australia, Germany, Japan, the United Kingdom and the United States. In addition, a series of one-on-one interviews were conducted with business executives across the globe spanning relevant industries, including traditional content owners, media distributors, software/analytics providers, advertising agencies, consumer electronics providers and telecommunication providers. Also included were relevant outside parties (including industry analysts and associations).

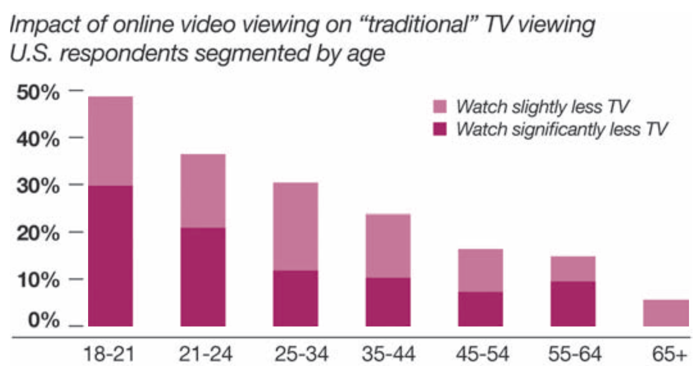
Substitution. The substitution threat to traditional media is real. For television, substitution is most apparent with the coveted younger audiences (see Exhibit 1). Fifty percent of the US consumers IBM surveyed in the 18 to 21 age group indicate they regularly watch online television, and close to 50 percent watch less television overall as a result of online viewing.

Substitution has been an intractable issue for newspapers. Believing newspapers would retain their aging print readers, many in the industry focused digital strategies on attracting younger audiences.[4] However, recent research indicates the bulk of online newspaper growth is within the 55 and older segment, with simultaneous erosion in the 18 to 24 segment, implying there might not be a ''safe'' print segment.

Even more alarming is the possibility that older audiences will continue to shift from print to online, while younger audiences will migrate away from the newspaper as a destination altogether. In a recent survey, 57 percent of respondents indicate they prefer digital over print news – and they indicate that the online newspaper is their preferred destination only 8 percent of the time. Underscoring another value shift, they instead turn to aggregators like Google and Yahoo or other sites (see Exhibit 2).[5]

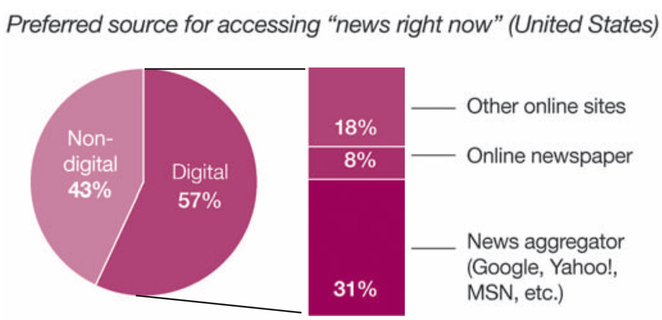
Weaker revenue models. Substitution is a critical issue given the heavy reliance on online ad-supported models that have yielded a substantially lower unit return. For example, a print

Exhibit 1 For television, substitution is more apparent with younger audiences



Source: 2008 IBM Digital Consumer Survey

Exhibit 2 For ''right now'' news, consumers prefer digital over print

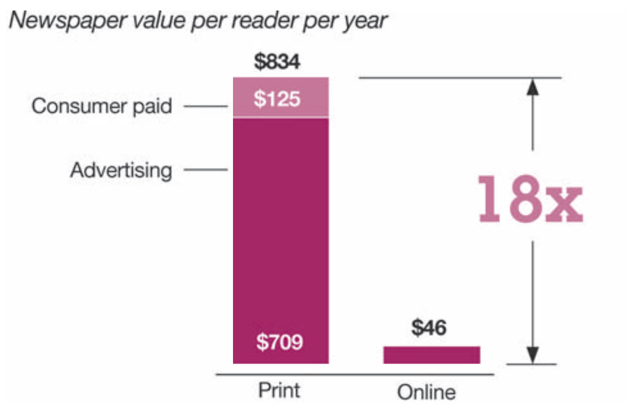


Sources: "Outsell Report Shows Nearly Half of News Users Bypass Newspaper Sites in Favor of Google." Outsell press release. January 19, 2010. http://www.outsellinc.com/press/press/press_releases/news_uers_2009 newspaper reader today is estimated to bring in 18 times the value of an online reader (see Exhibit 3).[6]

A value discrepancy also exists in the world of broadcast, with a broadcast TV viewer estimated to bring in three times the value of an online viewer (see Exhibit 4).[7]

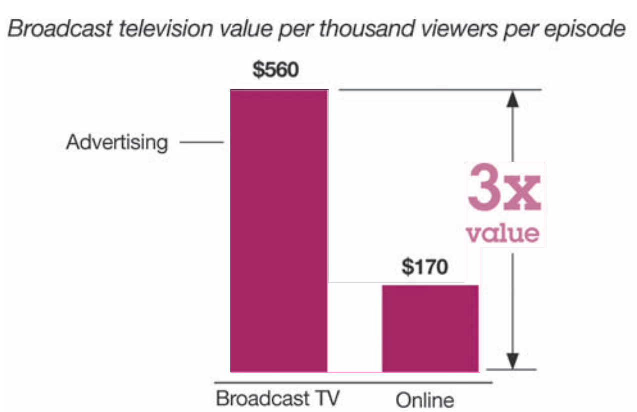
However, the reasons differ from those for newspapers. Online ads can often match or surpass broadcast price points due to the ability to target. However, the number of ads shown during programs on the most popular online video sites is approximately only 20 to 25 percent of what is shown on broadcast TV. Many industry experts believe Internet audiences simply will not tolerate as many commercials as there are on TV.[8] IBM research also shows that consumer willingness to pay for online content continues to decrease, and one-third of heavy Internet users admit to regularly pirating music and video content. These findings make it all the more clear that M&E companies need to provide an easy, valuable and appropriately priced consumer experience – or risk piracy.

Exhibit 3 Value of print versus online reader



Sources: IBM analysis of publicly available information. For list sources used for analysis, please see page 16, Reference 6

Exhibit 4 Value of broadcast versus online reader



Sources: “Can Pay TV Benefit from Online Video?” UBS Investment Research. June 22, 2009: IBM Institute for Business Value analysis

Reclaiming and growing industry revenue

The shift to digital provides a potentially expanding problem – or a huge opportunity to develop more strategic and tailored relationships with consumers by focusing on the overall experience, embracing new distribution platforms and expanding revenue models (see Exhibit 5).

Focusing on the experience. The M&E ecosystem has already become more complex, and once-defined roles have blurred – creating shifts across the value chain. Companies throughout the M&E space are vying to capture value and revenue share. To be successful in this endeavor, M&E companies will need to take risks and evolve their business models to more closely engage customers through superior innovative experiences.

We suggest three practices to help traditional M&E companies in this pursuit:

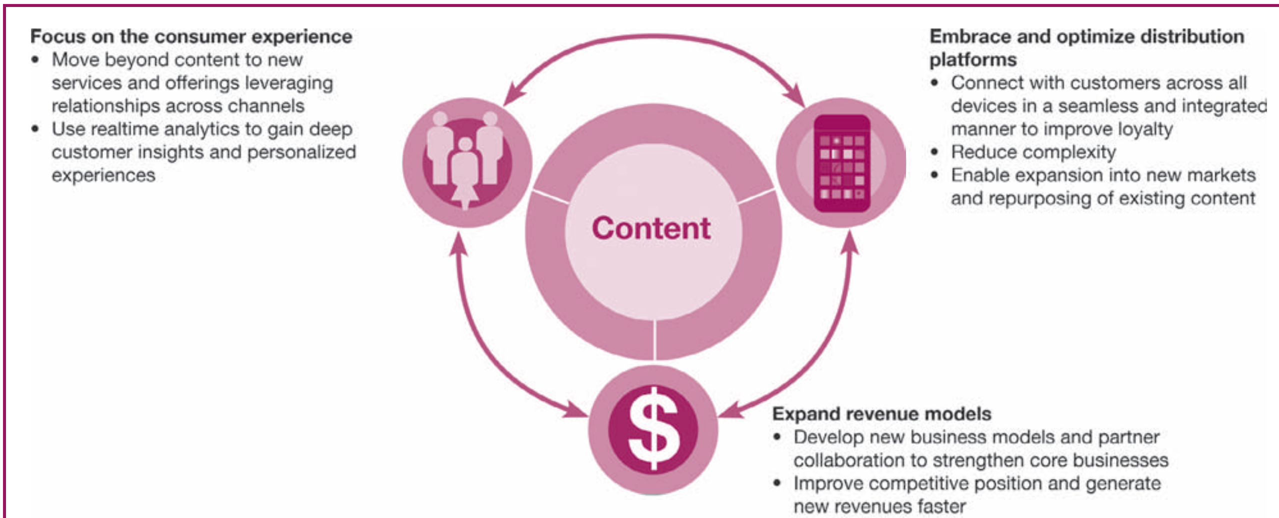
- Extend to other elements in the value chain to enhance the consumer experience and capture revenue share. Create strong partnerships to capture a greater share of value chain revenues.
- Deliver the social experience. Seek to both enhance the consumer experience and capture loyalty through value extensions that deliver directly to the consumer.
- Use data to provide more value. Offer incentives to gain consumer insights and then offer value in exchange. Leverage the knowledge of consumer preferences and behavior patterns through analytics offerings and additional revenue models focused on targeted advertising and pricing opportunities.

These three practices can be adopted and tailored to fit the specific scenarios faced by various M&E industries (see ''Case study: music industry'').

Embracing new distribution platforms. To successfully drive the connected consumer experience, M&E companies must embrace and optimize new distribution platforms to deliver content wherever, whenever and in whatever format consumers desire. With new platforms continuously emerging, they certainly have no shortage of choices: smartphones, gaming consoles, mobile music players, PCs, tablets, e-readers, netbooks, e-toys and in-vehicle entertainment devices – just to name a few.

The opportunities across new platforms are large and growing. For example, Netflix's new streaming application on the Nintendo Wii was adopted by over 1 million users in its first

Exhibit 5 Media's revenue challenge – strategic area for focus



Source: IBM Institute for Business Value

Case study: music industry

What could the music industry have done differently to mitigate the value shifts and loss of share it experienced with the shift to digital?

1. Extend to other elements in the value chain to enhance the consumer experience and capture revenue share.
If record labels had partnered with device manufacturers early on, they might have been able to create an agreement where they captured a portion of revenues generated on the devices themselves. This would have allowed the labels to profit from the popularity of digital music. They also could have advocated more strongly for variable-based pricing to better reflect the value of individual songs. Their efforts in these areas, such as Total Music in 2007 (the industry's attempt to create its own digital distribution business) were generally unsuccessful.

2. Deliver the social experience.
If record labels had more closely tied themselves to consumers' social experiences, such as live or online concerts, they could have captured a portion of revenues generated off the concerts and marketing deals as opposed to the narrower arrangements that were structured only around song sales.

The social music experience has been mostly in the hands of small digital innovators, including Spotify (which offers music streaming services and the ability to create and share playlists) and Jelli (which allows radio listeners to listen to songs simultaneously with others and determine which songs are played by live online voting).[11] These companies offer the kind of online social experience the record labels could have provided – and owned – much sooner.

3. Use data to provide more value.
Music record labels could have culled the data and knowledge of consumers' preferences and behavior patterns related to music to offer targeted services, enhance the listening experience and help audiences discover and share new songs. For example, they could have created a service like the one offered by Pandora, which uses algorithms to suggest similar songs based on structure.

Behind the scenes, record labels could monetize consumer insights through analytics offerings and/or additional revenue models focused on targeted advertising and pricing opportunities. For example, they could have taken the lead in enabling artists to market directly to consumers based on their tastes and preferences. They also could have provided insights about consumers' music preferences to marketers and captured an additional revenue stream through advertising.

month, Apple sold more than 3.3 million iPads during the first quarter it was available and the e-Reader market is expected to double in 2010 – and double again by 2012.[9]

At the same time, more and more consumers are using multiple devices concurrently. For example, NBC, an American television network, found that during its coverage of the Olympics, a significant number of viewers used two screens simultaneously, such as a PC and TV, or a mobile device and a TV. When this occurred, ad recall went up, presumably because NBC was able to create a more engaging and interactive experience across the devices.[10]

A key benefit of new distribution platforms such as mobile media devices is the opportunity to engage the consumer with targeted content. Though the ability to target ads online certainly exists, only about 10 percent of online ads are targeted and relevant.[12]

Consumers surveyed also indicate a willingness to pay for services on mobile and other new devices, presenting an opportunity for more balanced revenue models. This opens up a multitude of possibilities in terms of what mobile marketing includes and how a marketer can engage with a consumer. Mobile couponing, shopper applications and social crowdsourcing tools are paving the way for an integrated shopping experience.

As an example of this integrated shopping experience, Foursquare, which provides a location-based social network mobile application, is enabling businesses to offer hyper-local targeted marketing messages to consumers based on proximity and frequency. In addition, users offer peer reviews of locations and services, adding a layer of user-generated content. In exchange for loyalty, more and more businesses – from local retailers to larger organizations like Bravo TV, Starbucks and The History Channel – are offering coupons, discounts, free goods and marketing materials.[13]

While the opportunities available through new distribution platforms are plentiful and potentially very profitable, there are a number of costs and strategic decisions to make. For example, media companies need to decide whether they will favor an open or closed ecosystem approach, as well as assess the real costs of working with a plethora of device manufacturers with different technology and metrics requirements.

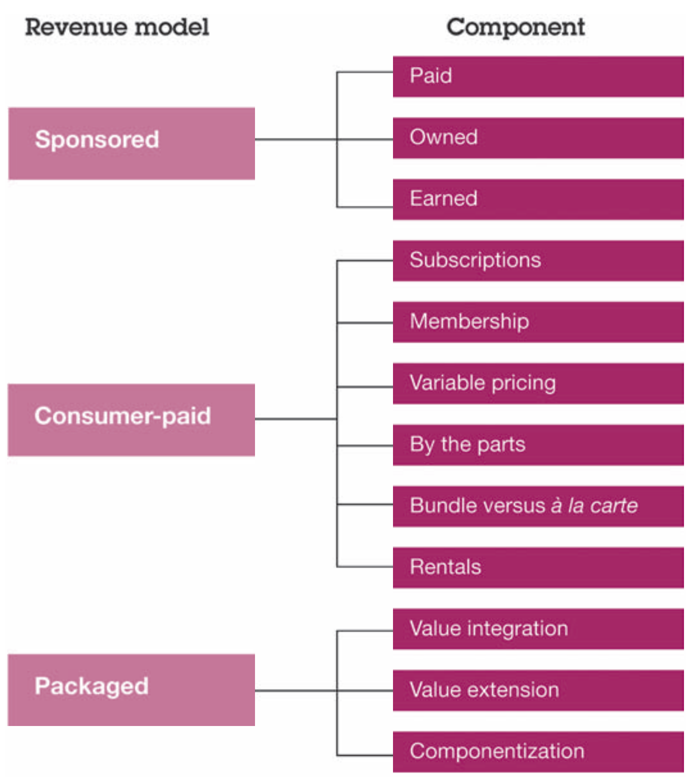
Expanding revenue models

The survey indicates that consumers today want relevant messaging, pricing models that provide choice and flexibility, and a seamless experience across their devices. As a result, new revenue models need to evolve beyond a ''one size fits all'' mold and offer the relevancy, choice, integration and packaging options consumers demand. We have identified three key types of revenue models that media companies should innovate to meet consumers' needs (see Exhibit 6).

Sponsored: marketing innovation. Sponsored – or indirect – revenue models separate the end customer from the person who actually pays, so that there are three parties to every transaction instead of two. Advertising sales is a classic source of indirect revenue, and other third-party revenue sources include fee-based product placement and sponsorship.

Today's M&E companies need to find innovative ways to ''upgrade'' traditional sponsored revenue models so they appeal to the digital consumer. They need to move from the ''one-to-many'' approach and take advantage of digital platforms to target and interact with

Exhibit 6 Media companies can develop innovative sponsored, consumer-paid and packaged revenue models



Source: IBM Institute for Business Value

“ Mainstream adoption of digital devices and content across all age groups continues to drive fragmentation and declines in traditional media consumption. ”

consumers in a segmented or individualized way. They need to go ‘‘beyond advertising’’ and focus on consumer-centric marketing tactics. Examples of such consumer-centric marketing can be seen across paid, owned and earned categories:

- Contextual marketing through paid media. This involves making messages and content more relevant for the consumer, with new advertising formats, new methods for reaching segmented consumers, and deeper integration between the content and the advertising messages.
- Branded applications through owned media. These applications, primarily for mobile devices, are designed to enhance the value of a brand through immersive experiences and relationships directly with the consumer.
- Social networking through earned media. This strategy focuses on profiling audiences, targeting social influencers and becoming a topic of conversation for social groups of consumers who are connected to one another.

Some companies pursuing such strategies have already seen incremental revenues. Meredith Corporation, for example, has evolved beyond traditional magazine publishing to offer full-service interactive marketing. Its Meredith Integrated Marketing division has created custom publishing, e-mail, social media and mobile campaigns for major companies. When the company’s magazine ad revenue plunged 15 percent in one year, revenue tied to the interactive marketing business rose 13 percent.[14]

Consumer-paid: pricing innovation. Media companies employing consumer-paid revenue models also must embrace innovation to offer more choice and flexibility to consumers. Our recent research reveals that pricing preferences are extremely heterogeneous. Some consumers prefer not to pay at all and are more than willing to view advertising in exchange. Others place a high value on their time and, as a result, are willing to pay for content, often through a subscription. Still others prefer to ‘‘design’’ their experience, paying for a specific content category (such as sports) à la carte, while some prefer to pay on a one-time or transactional basis for content.

Effectively pricing innovative models involves rethinking both the amount of money charged and the point(s) where and when the customer pays. For instance, ‘‘pricing by the parts’’ allows products previously sold as one unit to be cut into component parts that are priced and sold according to perceived value – giving the consumer a choice. As an example, consumers can buy a single song versus an album via Apple’s iTunes, an online digital media store. Another pricing model involves applying rental or subscription models to industries that were traditionally priced on a transactional basis.[15]

Packaged value innovation. Consumers are increasingly interested in having consistent experiences across their various devices. Successful M&E organizations will embrace innovative packaged revenue models to deliver this consistency in experience across devices.

There are three packaged model practices currently being pursued to capitalize on integration across platforms: value integration, value extension and componentization:

- Value integration – Introducing new platforms as additional opportunities for consumers, with incremental charges. The company generates revenue by charging incrementally on each distribution platform to drive more revenues. Companies pursuing this model include *Wired Magazine*, *The Wall Street Journal* and the *Financial Times*.

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- Value extension – Introducing new platforms in an existing bundle, with no incremental charge. Instead of an incremental charge, a company extends the subscription to include new distribution platforms within an existing price point as added value to drive retention. Examples of companies pursuing this strategy include TV Everywhere and Netflix.
- Componentization – Splitting products or in-house resources into component parts and monetizing them in a different form for a different customer or use. Pricing by the parts, as Amazon does with songs, ringtones and albums, is an example of componentization.

Regardless of strategy, M&E companies must recognize that today’s digital world ‘‘one size fits all’’ mindset will no longer suffice. Consumers desire – and expect – revenue models that offer relevancy, choice and integration.

Are you ready for the challenge?

Three strategies will likely help M&E leaders overcome the revenue issues they face– focusing on the consumer experience, embracing new distribution platforms and expanding revenue models. Media and entertainment leaders should work now to build the capabilities necessary to take action and overcome the revenue challenge they face.

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