# Connected Life

## Assessing the Threat of Video Disruption: Strategies for Service Providers

**Cisco Internet Business Solutions Group**
**November 2010**

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# Connected Life Market Watch Program
## Transitions in Consumer Video

| Market Watch Program | | |
|---|---|---|
| Trend Monitoring | | |
| The Mobile Consumer | **Disruption in Video** | Service Delivery Experience |
| Opportunistic: Timely Customer Touchpoint | | |
| IBSG Research Platform | | |

### Approach

**Market Watch Program**

- Cisco IBSG's recurring primary research program
- Monitors changing consumer behavior to identify key market transitions

**Methodology**

- Broadband consumers
- 20-minute online survey
- 5,500 total respondents
- December 2009 – January 2010

**Segmentation**

- Used proprietary scoring methodologies to identify consumer "technology" segments

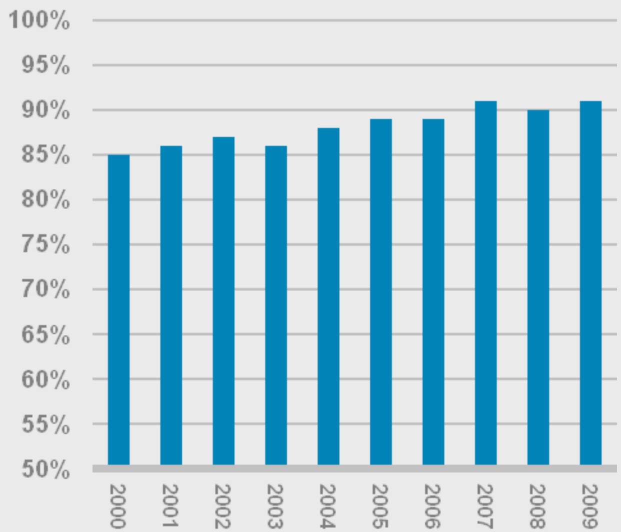
Source: Cisco IBSG Connected Life Market Watch, 2010

# Video Entertainment Today

## Situation

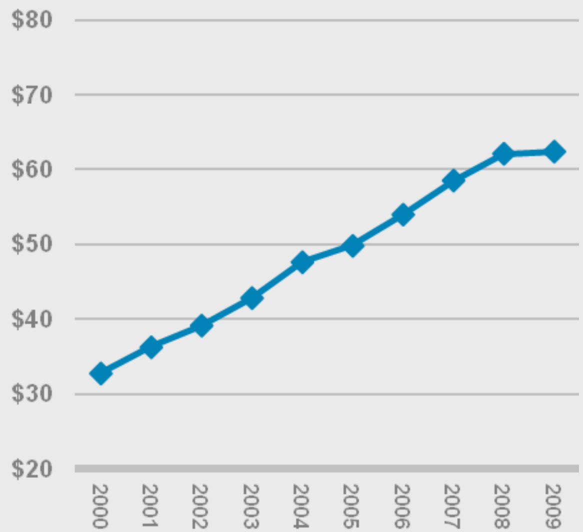
# Mature, Mostly Saturated Pay-TV Market

## U.S. Pay-TV Households
**as Percentage of Total**



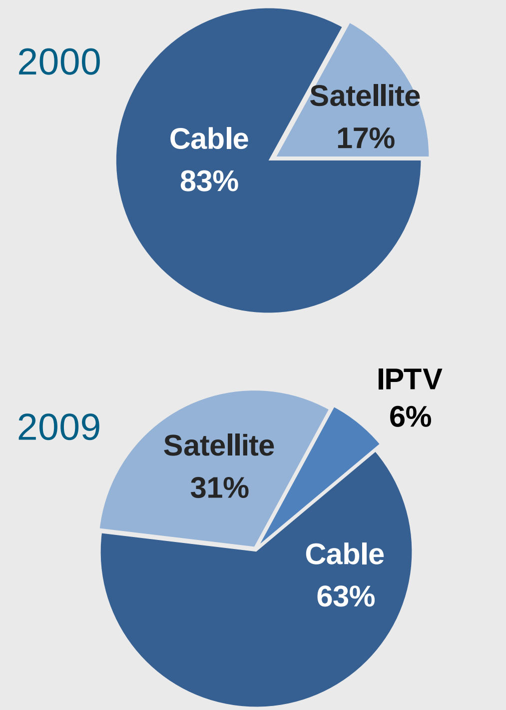

At 90% of households,
U.S. pay-TV market is saturated.

## Monthly Pay-TV ARPU
**US $**




With average monthly spending of $62, consumer market for advanced pay-TV services may be tapped out.

## U.S. Pay-TV Market Share

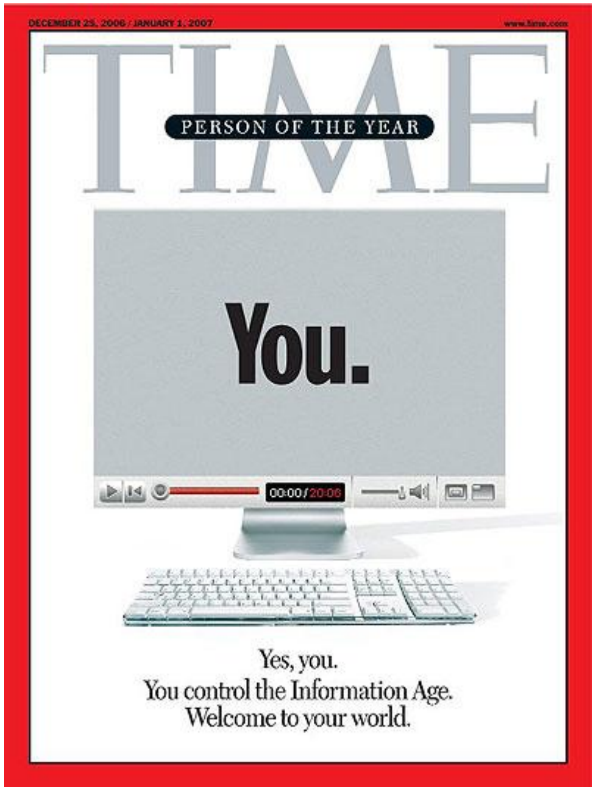



In addition to increasing competition from traditional players, new players (Apple TV, Hulu) are entering market.

Source: Screen Digest, 2010

# Consumers Are Taking Control of Video Entertainment Experience

**2006 *TIME* Magazine Person of the Year**




**Consumers got the message**

- DVRs taught users they could take control of video experience
- This increased user control is driving four interrelated trends:
  1. Time shifting
  2. Device shifting
  3. Increased video sourcing options (e.g., Internet)
  4. Increased spending control
- Together, these are part of larger, viewer-controlled trend

Source: *TIME* Magazine, 2006; Cisco IBSG Connected Life Market Watch, 2010

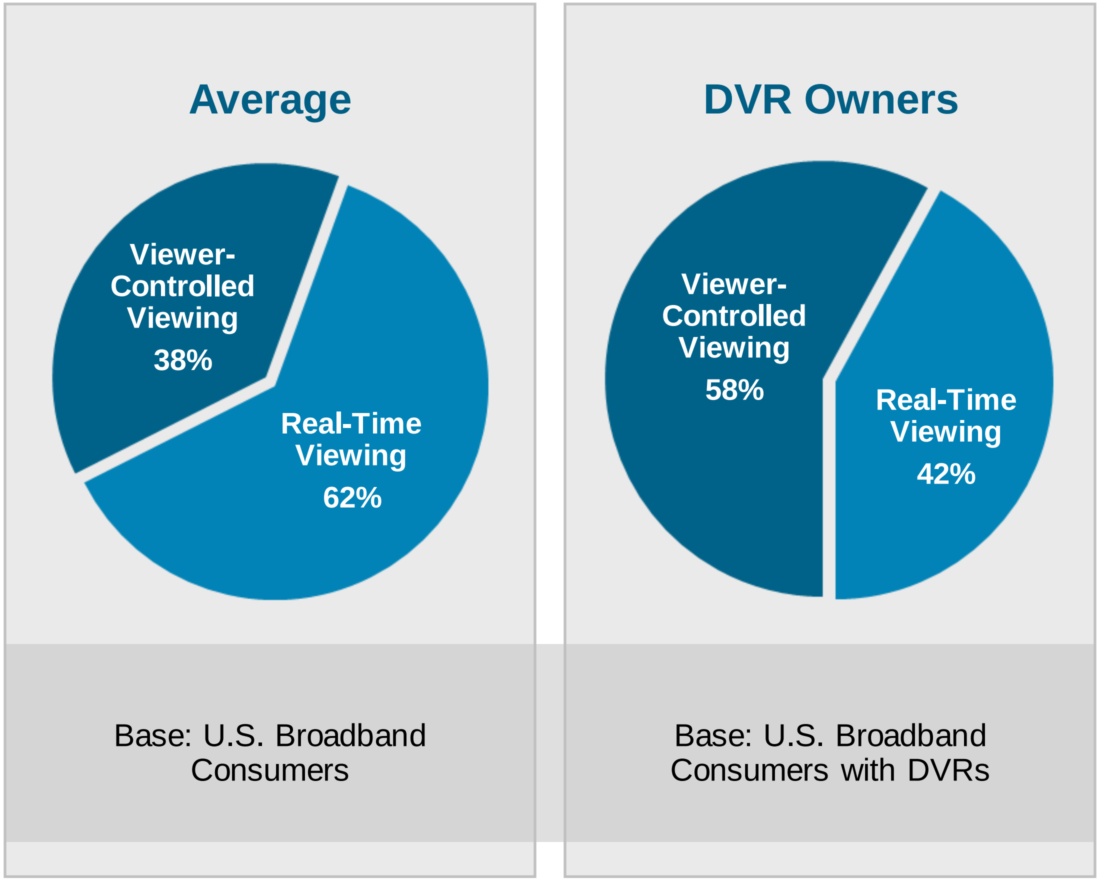
# Traditional TV Experience Is Changing

Time Shifting

## Consumers Are No Longer Making Appointments with Their TVs

- Consumers are changing their usage patterns
- They are no longer making appointments with their TVs
- They want to watch video entertainment at the time they choose

**Real-Time vs. Controlled Viewing**
**(Percentage of Time Spent)**




Source: Cisco IBSG Connected Life Market Watch, 2010

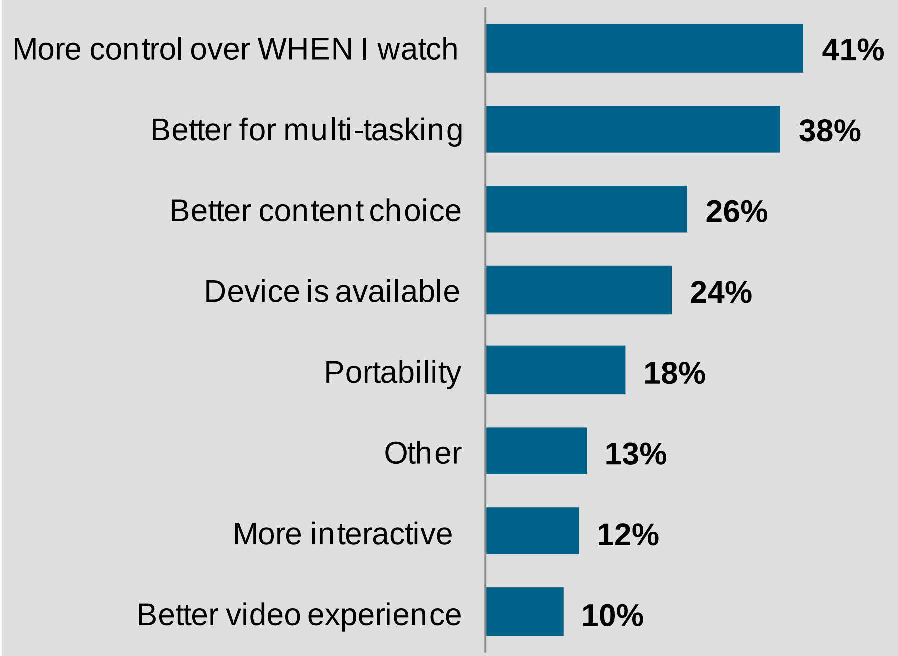
# Consumers Choose Alternative Devices, Even When TV Is Available

Device Shifting

- 75% of respondents watch video on computers
  - Each week, they watch about 1 hour, 45 minutes of video on computer
  - They watch at home 63% of time
  - 93% of 18- to 24-year-olds watch video on a computer, averaging 2 hours, 45 minutes per session
- 40% of respondents watch video using portable devices
  - Each week, they watch about 54 minutes of video on portable devices
  - 39% of this time, they are at home

Source: Cisco IBSG Connected Life Market Watch, 2010

## Reasons for Watching Computer Video When at Home




Base: Watch Video on the Computer at Home

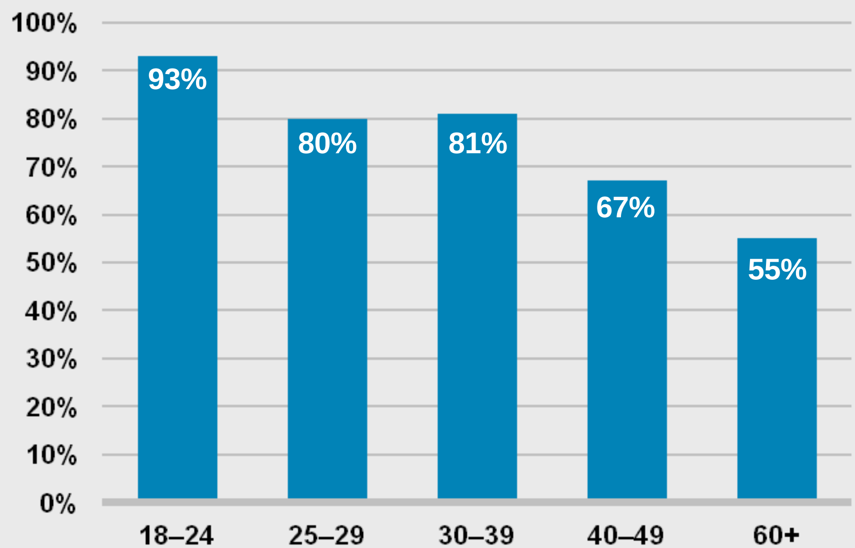
**Consumers Watch Video on Their Computers To Time-Shift and Multi-Task**

# Consumers of All Ages Watch All Types of Internet Video Content

New Sources

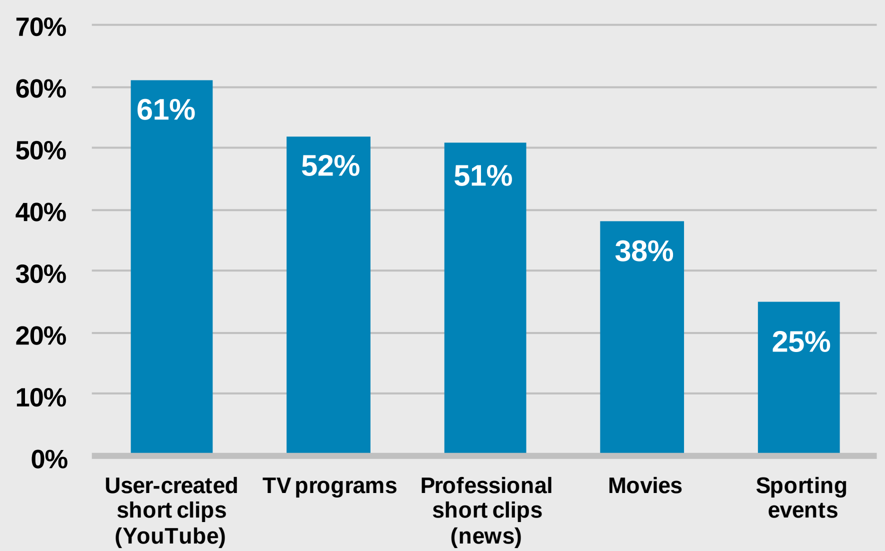
## Internet Video Is No Longer Defined Only by Young People Watching YouTube

### Watching Internet Video (by Age)




| Time per week | 2.6 hours | 1.7 hours | 1.1 hours | 47 min | 43 min |
|---|---|---|---|---|---|

### Watching Internet Video (by Content)




Source: Cisco IBSG Connected Life Market Watch, 2010

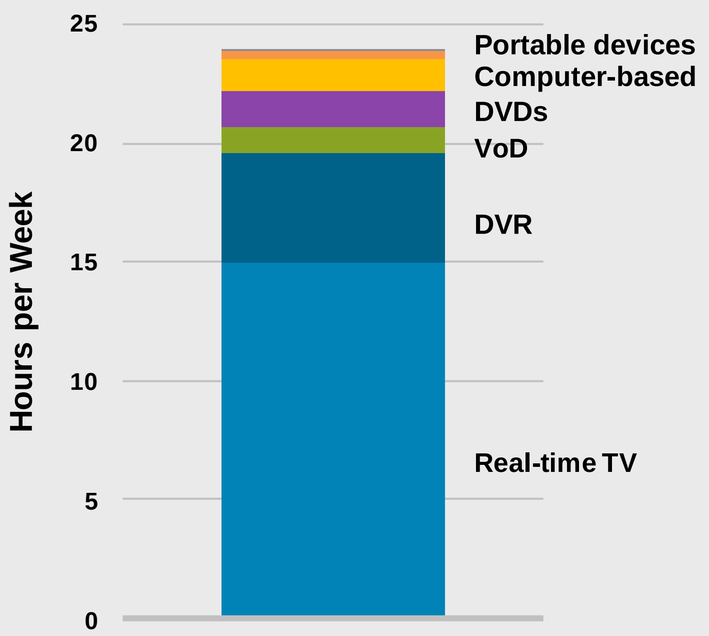
Base: U.S. Broadband Consumers

# The TV-Content "Walled Garden" Is Cracking

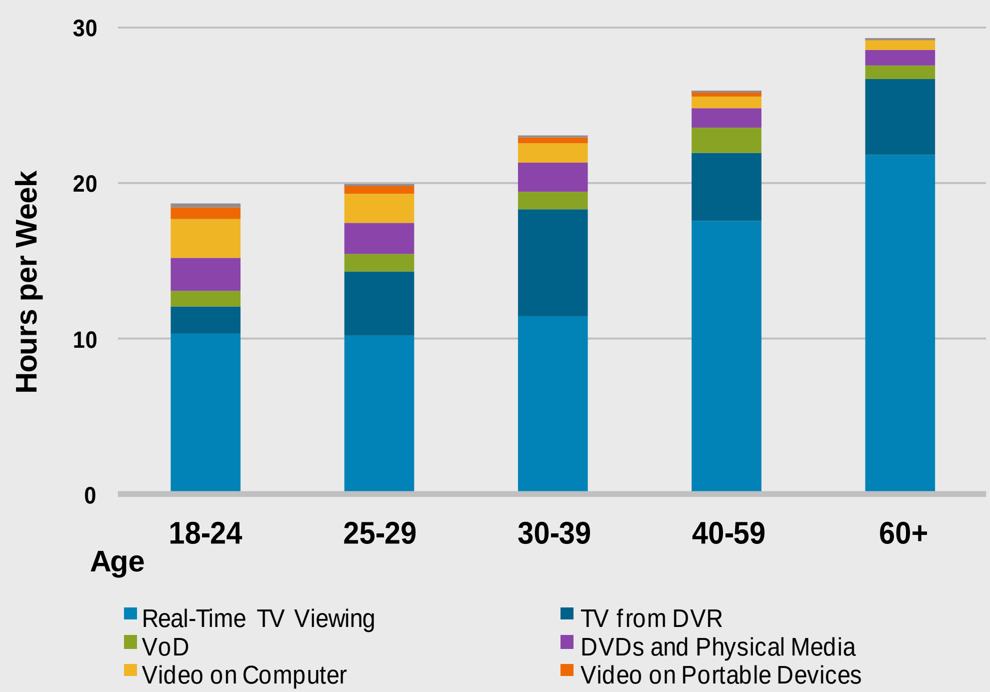
New Sources

## Consumers Are Supplementing TV with Other Video

### Weekly Time Spent on Video Entertainment




### Weekly Time Spent on Video Entertainment by Age




Source: Cisco IBSG Connected Life Market Watch, 2010

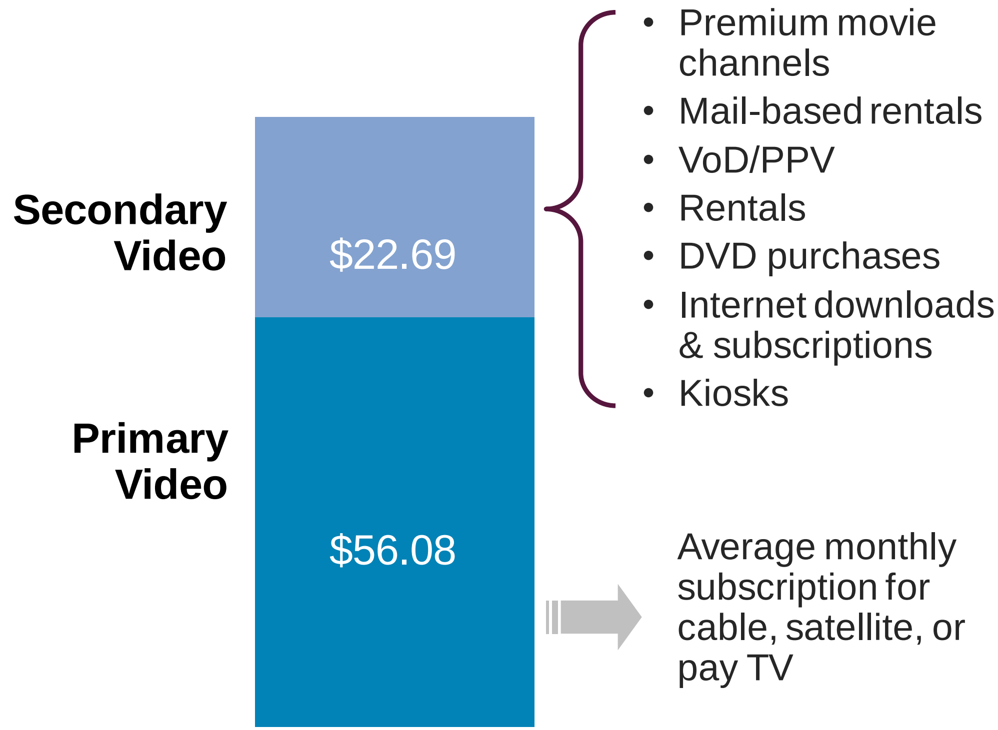
Base: U.S. Broadband Consumers

# Nearly 30% of Consumer Video Spending Is for Secondary Video

Spending Control

- Consumers supplement their basic TV experience with as many as 7 other sources of video
- Consumers can exert more immediate control over these a la carte options
  - –Flexibility, selection choice
  - –Can adjust spending incrementally without entirely abandoning the service

U.S. Broadband Consumers' Monthly Video Spending



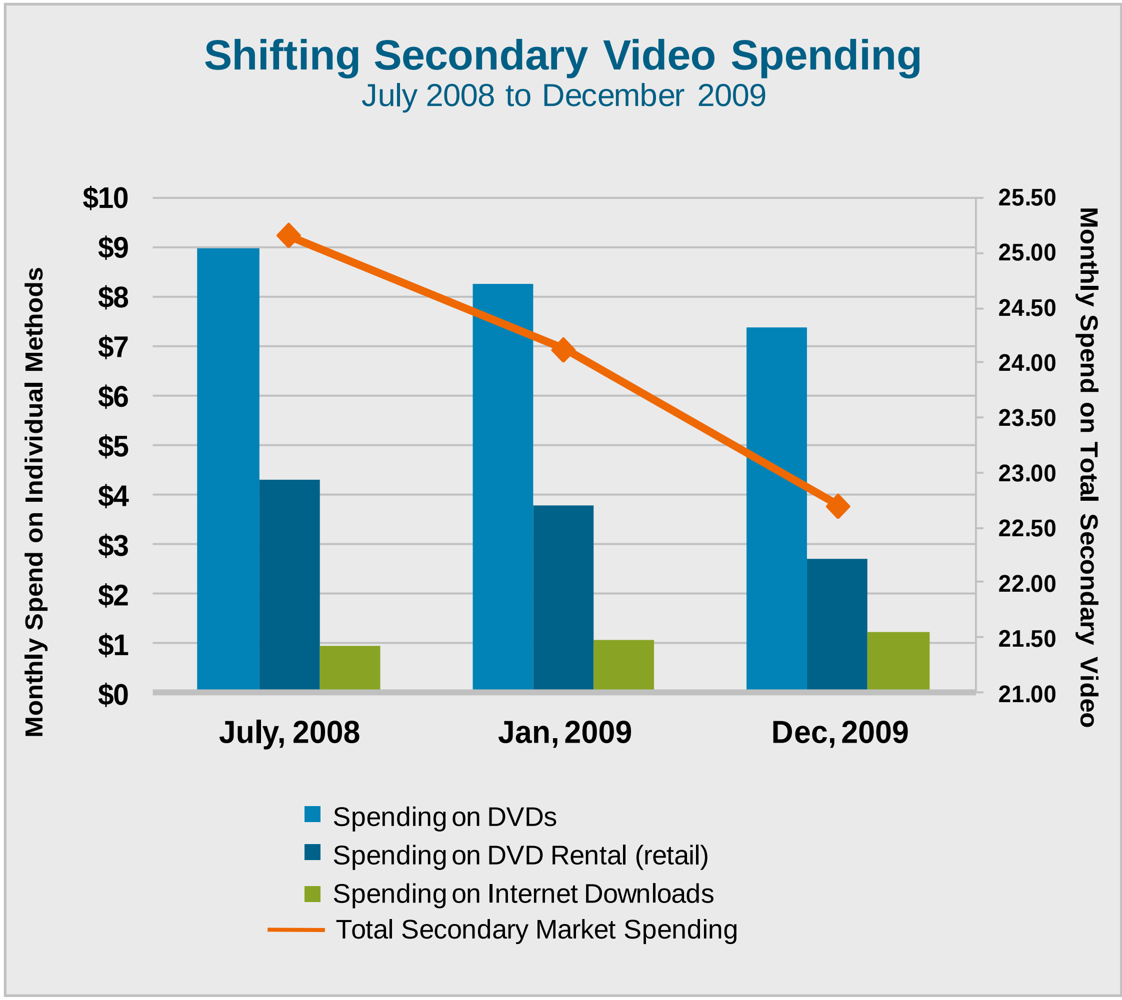

Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Broadband Consumers

# Secondary Video Spend Is Shifting from Traditional Media

Spending Control

- Total secondary video market declined 10% in 18 months
- Trend led by DVD purchase and rental declines; at same time, Internet movie downloads increased by nearly 30%
- In 2010, 22% of respondents expect to spend less on DVDs; these reductions may not be fully reallocated to other video options, but instead to savings and non-video expenses



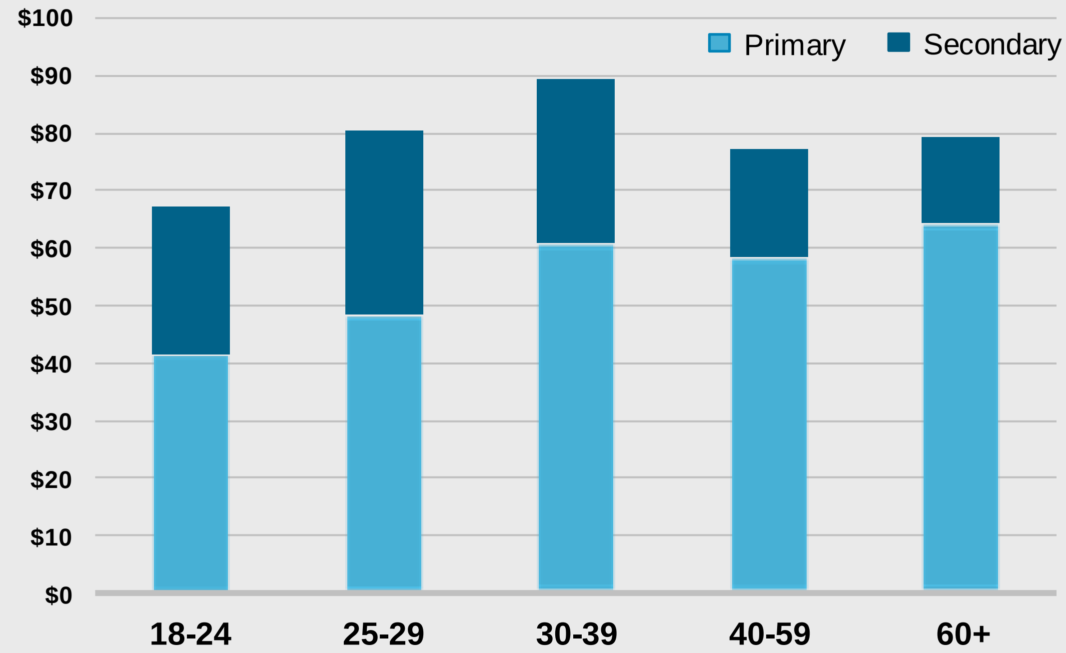

Source: Cisco IBSG Connected Life Market Watch, 2010

# Younger Consumers Allocate More Spending to Secondary Video

Spending Control

- Greater reliance on secondary video among younger consumers could support rapid shifts in spending
- On average, consumers between 25 and 29 spend more than $5 per month on Internet video

**Monthly Video Spending**
**by Age**




| | 18-24 | 25-29 | 30-39 | 40-59 | 60+ |
|---|---|---|---|---|---|
| % Spent on Secondary | 38% | 39% | 32% | 24% | 12% |

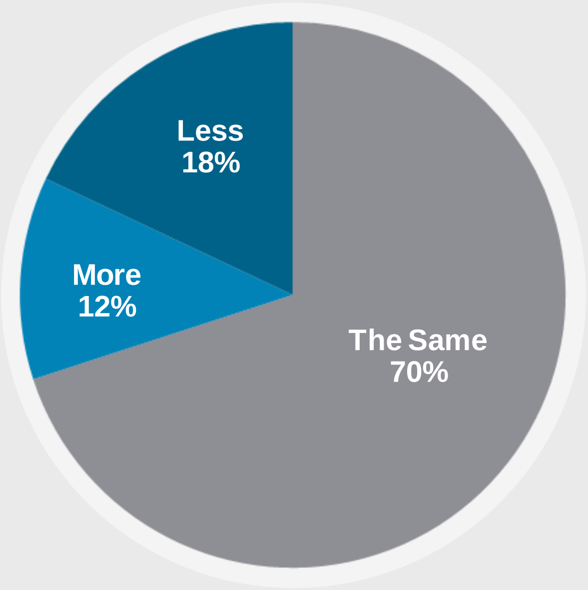
Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Broadband Consumers

# Impact of Transitions in Consumer Video

# For Some Consumers, Internet TV Is Cannibalizing Traditional Linear TV

**Change in Time Spent Watching TV After Beginning To Watch Internet TV**




**Question:**
Since you began watching TV programs on the Internet, do you spend more, less, or the same time watching TV programs on a television?

- For 70% of consumers, Internet TV viewing has not impacted time spent watching TV
  - 18% watch less on TV since they began watching Internet TV
  - 12% watch more TV on television now, supporting theory that Internet can find new user bases and/or help keep users loyal
- There is more cannibalization effect in younger consumers
  - 31% of Internet TV viewers aged 18-24 say they watch less TV on television since they began watching Internet TV

Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Internet TV Viewers

# Traditional TV Viewing Is Also Growing

## What Is Impact of Online Video?

In-home TV viewing is at all-time high

5.13 hours per person 2010

~4 hours in 1991

8+ hours per household 2010

~7 hours in 1991

"We seem to have an almost insatiable appetite for media, with online and mobile programming only adding to it." **– The Nielsen Company**

Online video is growing

Traditional TV viewing continues to grow, too

Supplemental?

Even Complementary?

Or Disruptive?

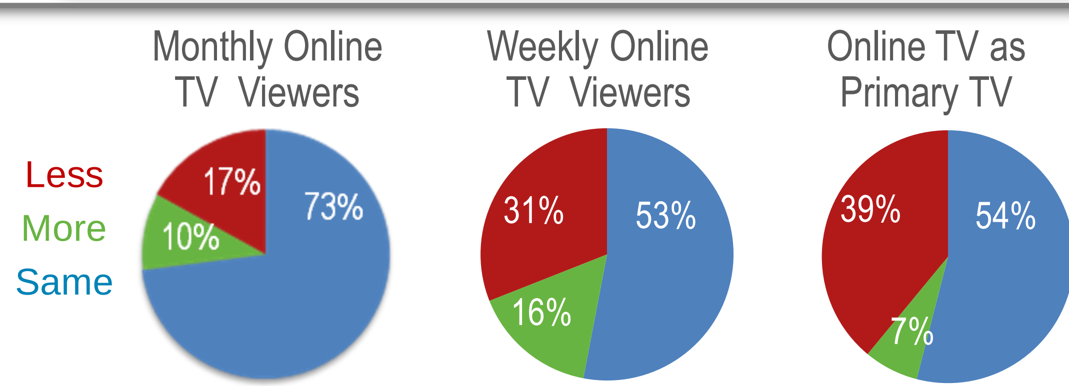
Source: The Nielsen Company, 2010; Cisco IBSG, 2010

# Impact of Internet Video?
# It All Depends on Who You Are

| | All TV Viewers (Broadband Users) | Internet Video Viewers | Internet TV Viewers | Internet TV as Primary TV |
|---|---|---|---|---|
| Percentage of Base | 100% | 68% | 53% | 10% |
| Effect on Traditional TV | **Supplement**<br>"More television sets in the home, more channels and content to choose from, and using their DVRs more than ever." –Nielsen | **Complement**<br>"(Online) content creates more interest, more buzz, and more awareness...drives more people to TV." –NBC.com | **Substitution**<br>Increase in online TV usage takes some viewership away from traditional TV | **Replacement**<br>Full adoption of online TV replaces need for traditional TV |

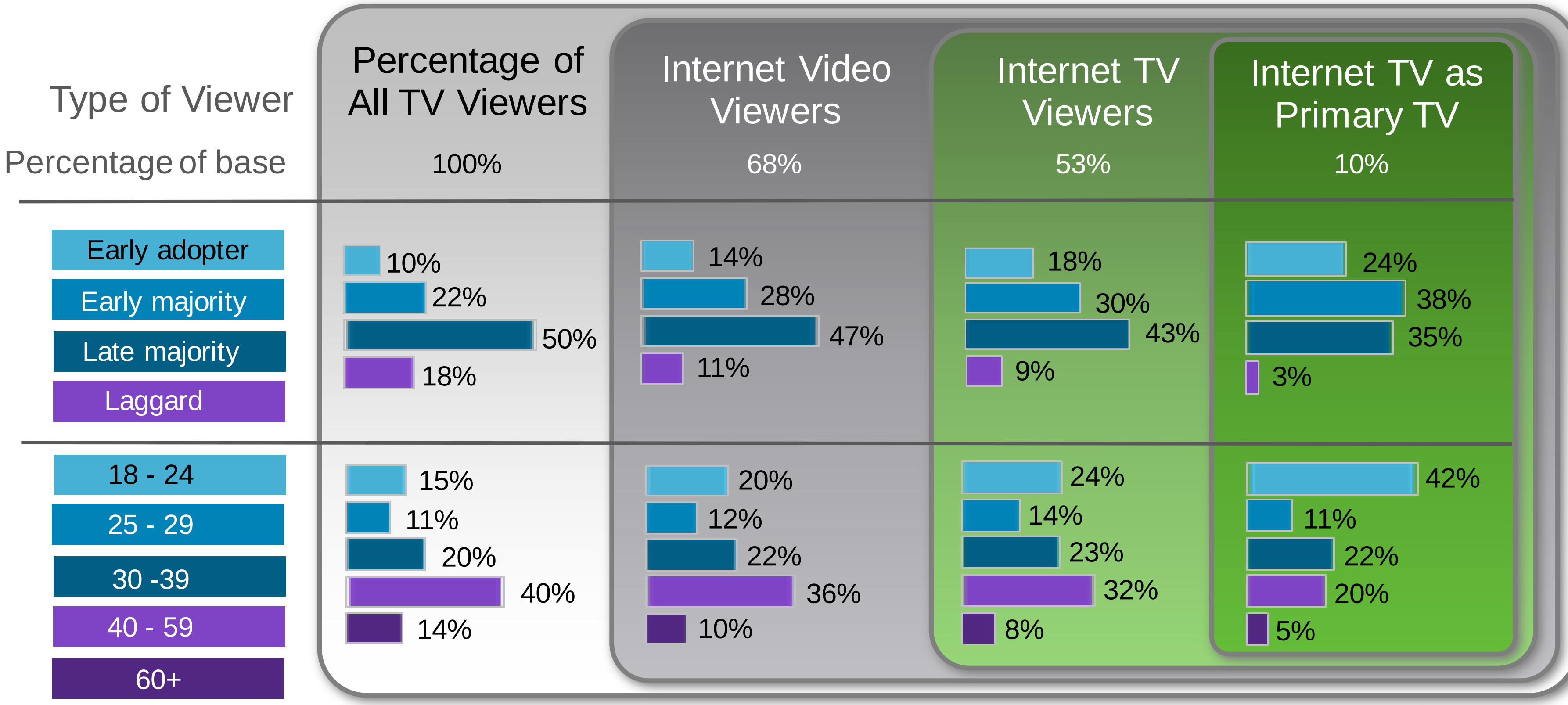
Traditional TV viewing since starting to watch online TV

Base: U.S. Online TV Viewers




Source: Cisco IBSG Connected Life Market Watch, 2010; The Nielson Company, 2010; NBC.com, 2010

# Profiles of Internet TV Viewers Suggest Future Trends Toward Substitution

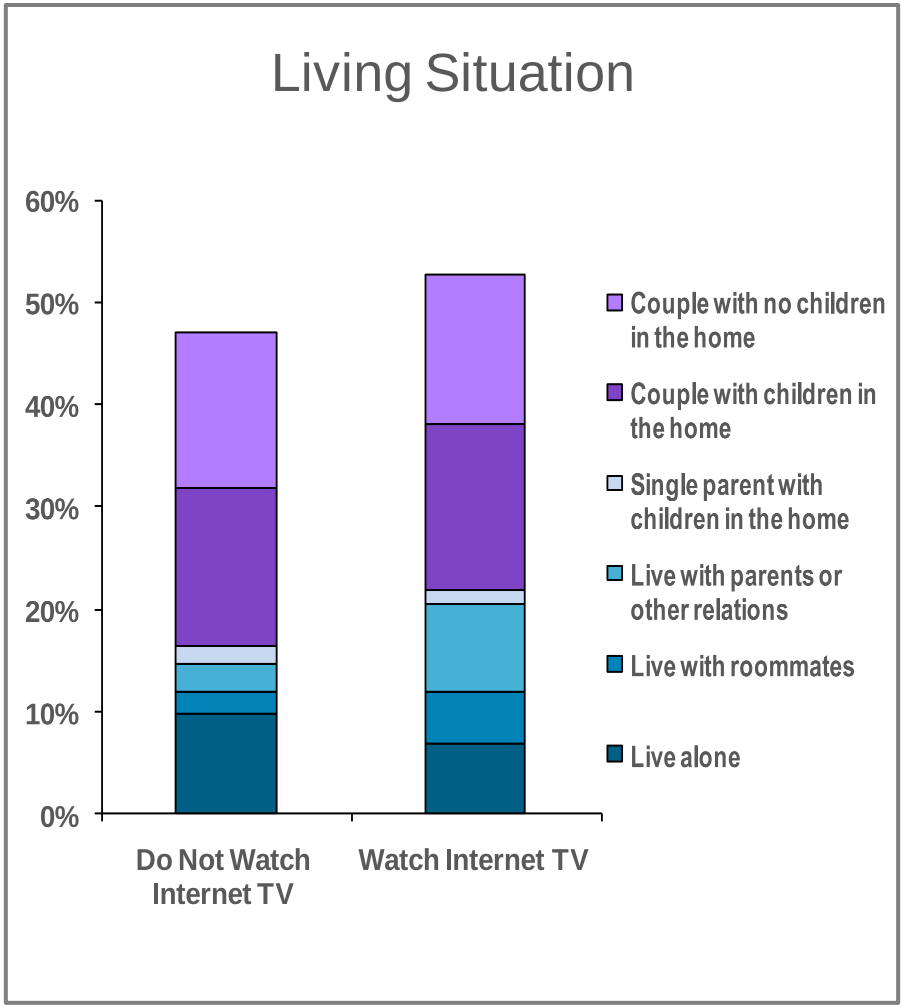


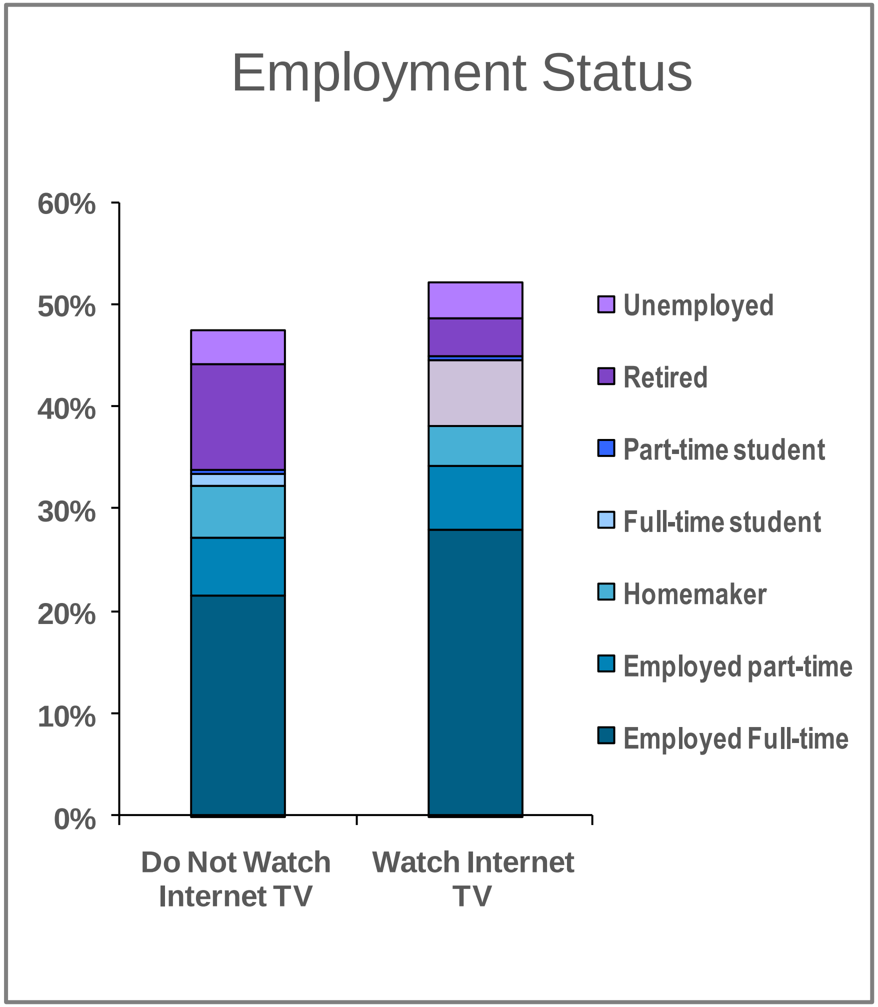

Skewed toward younger and earlier adopters

Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Broadband Users

# Adoption of Internet TV Is Not Isolated to Certain Life Stage or Demographic




Source: Cisco IBSG U.S. Connected Life Market Watch, 2010

Base: U.S. Broadband Consumers

# With Increasing Substitution, Internet Video Could Threaten Pay-TV Business

| Online Video | Drivers (US$ Impact in 3-5 Years) | Traditional Pay TV |
|---|---|---|
| Combination of online video and other video options meeting customers' video needs | Cord-Cutting / Downgrade ($5.3B) | Replacement of pay-TV service or downgrade premium channel, paid VoD, and/or DVR/HD |
| Cheaper alternative; more competition | Price Erosion ($1.3B) | Perceived value of and demand for pay TV decreases |
| Increasing viewership and interactive capability | Ad Revenue Decline ($0.5B) | Advertising revenue decline from ad money shifting to online |
| Per-use "a la carte" pricing model | Pricing Model Disruption ($0.9B) | Consumer demand, regulation, and/or competitive pressure impose "a la carte" model on pay TV |

Source: Cisco IBSG, 2010

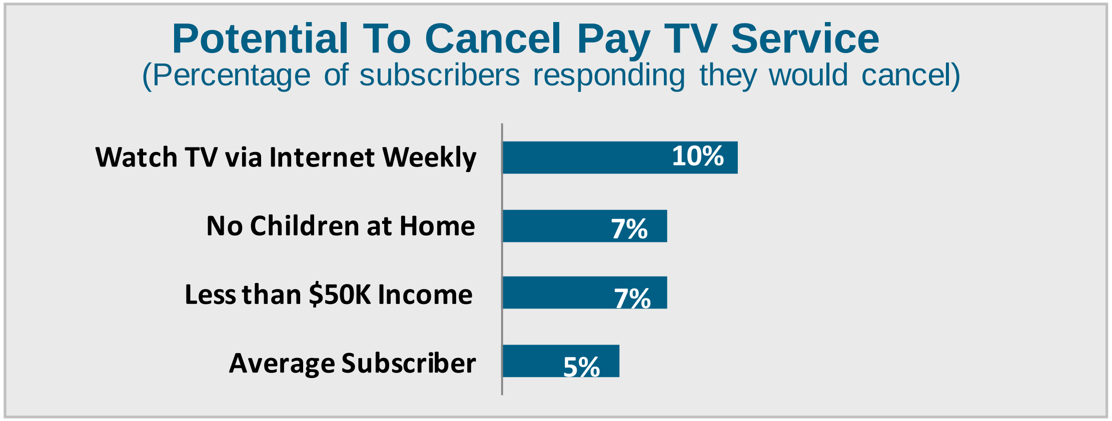
# Internet Video Could Threaten Core SP Businesses

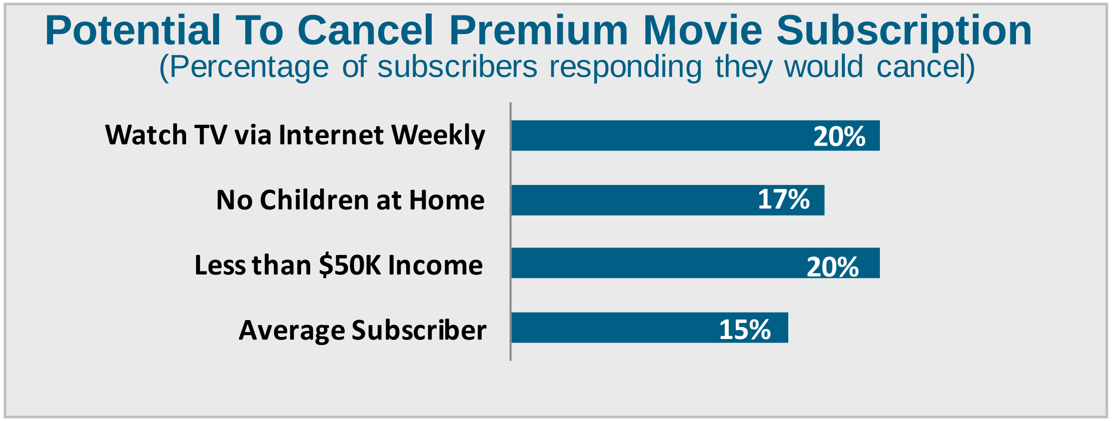
## Greatest Threat Is in Secondary Video, but New Alternative Services Could Touch Core SP Markets

If you had…

- Free access to *web video to TV*
- Easy ability to watch all Internet video content on your TV
- On-demand access to prime-time TV shows, but not your regular TV service or your TV lineup as it airs . . .

…would you make any changes to your current TV service package?



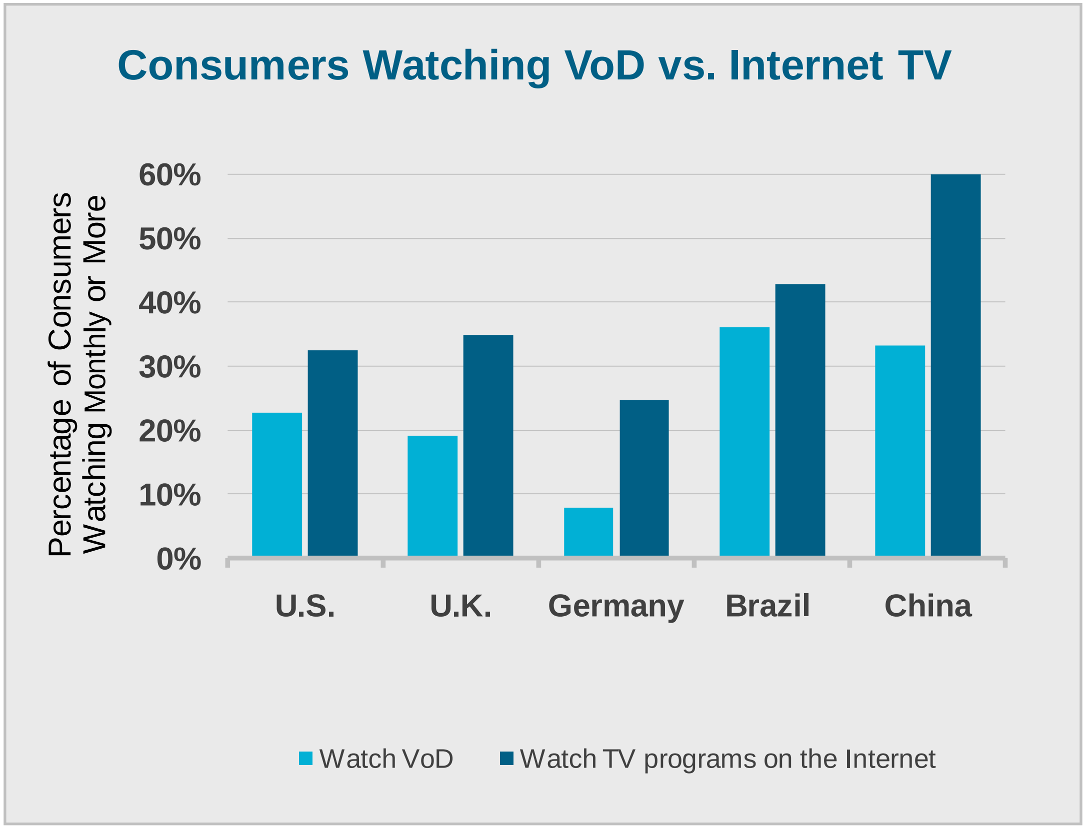




Source: Cisco IBSG Connected Life Market Watch, 2010

# Internet TV Is Already More Popular than Video on Demand

## Consumers Are Turning to Internet for On-Demand Viewing

- In U.S., U.K., Germany, Brazil, and China, more consumers watch TV on the Internet than watch VoD each month

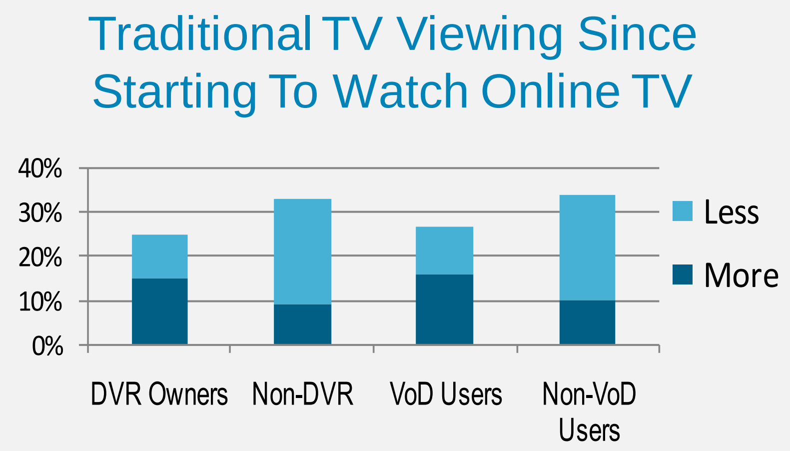


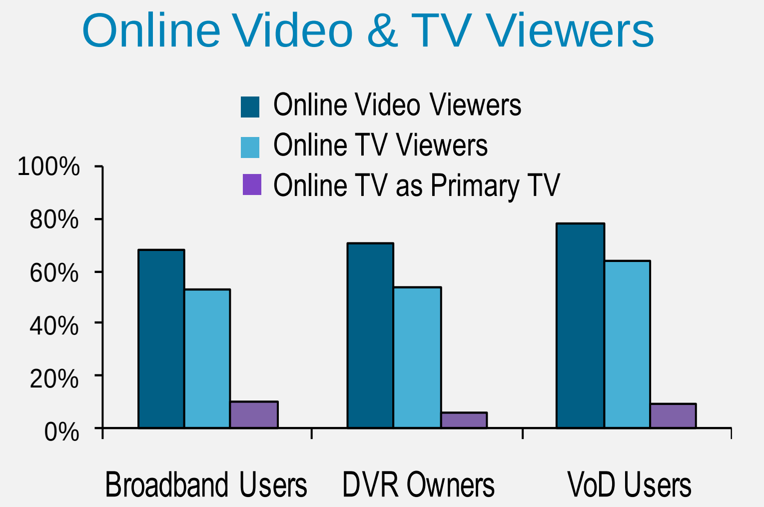

Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Broadband Consumers

# Providing Consumers More Control May Blunt Impact, but Threat Remains

- **Less substitution by DVR owners and VoD users . . .**
  - –DVR owners and VoD users watch traditional TV more, even after starting to watch online TV
  - –Level of online substitution is much higher for non-DVR owners and non-VoD users
- **. . . But not enough to deter online video use**
  - –Number of online video & TV viewers does not decline for DVR owners or VoD users
  - –Online video usage is not just about control (time shifting)
    - User interface, portable device, UGC, etc.



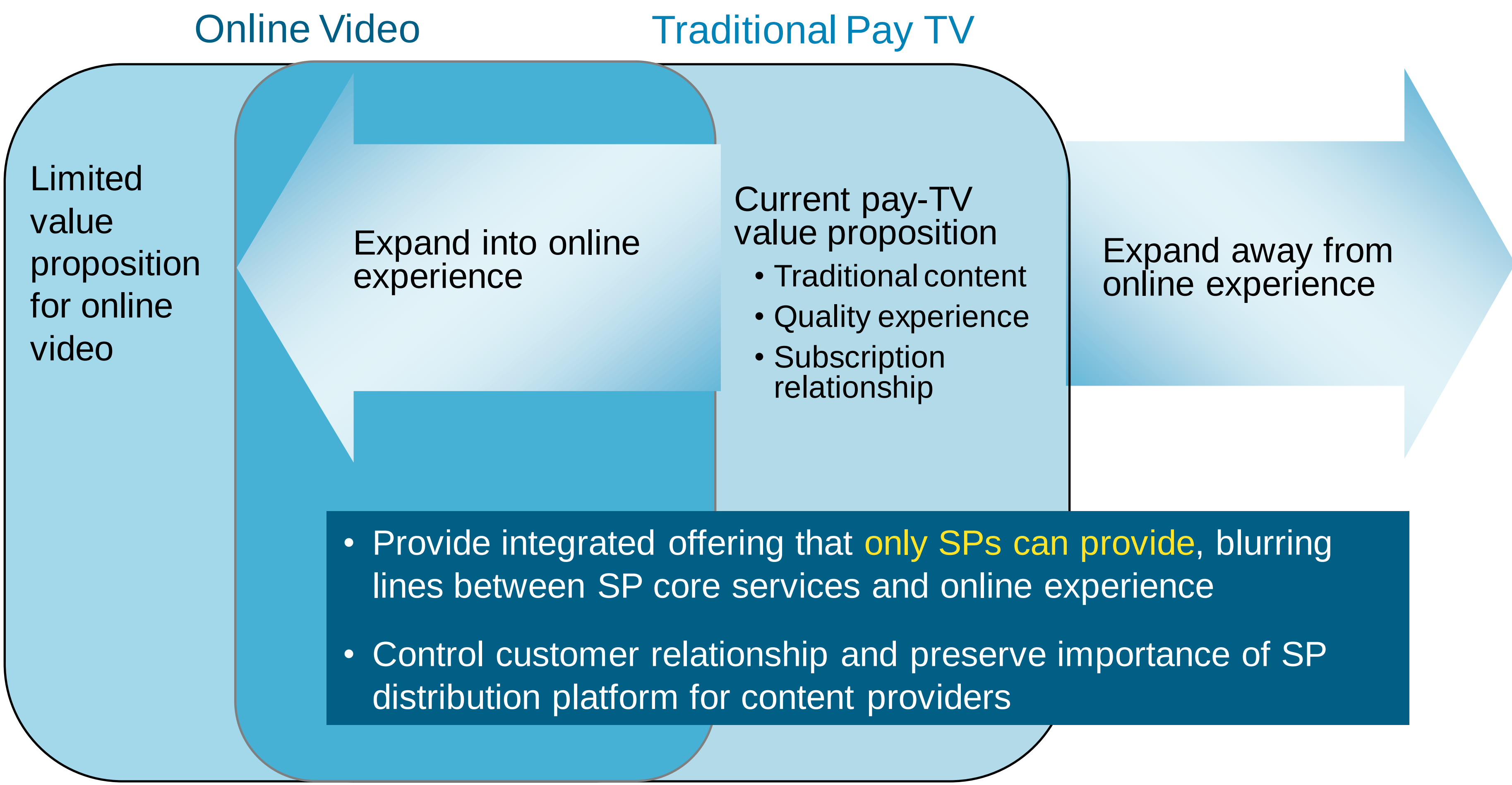




Source: Multichannel News (Data from Rentrak and Magid Associates), 2009;
Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Online TV Viewers

# Integrate and Expand User Experience Both *Into* and *Away* from Online Video

## Wining SP Strategy




Source: Cisco IBSG, 2010

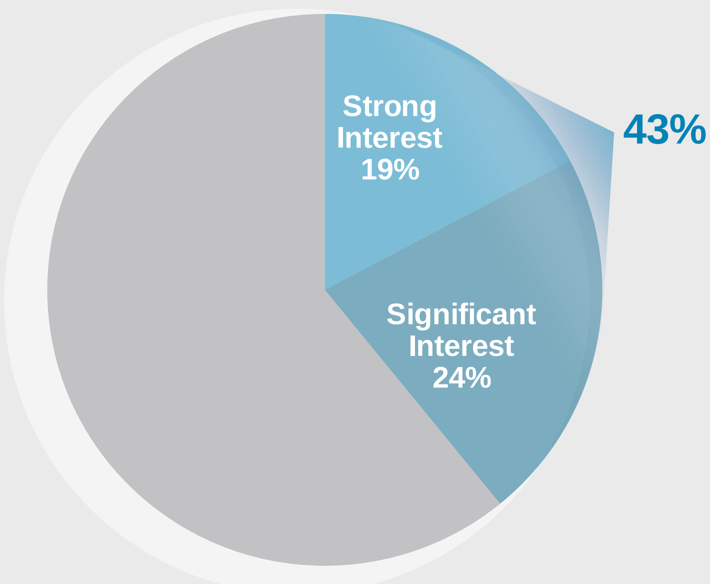
# SPs Have Key Advantages in Providing End-to-End, Integrated Video Experience

| | Pay TV Service Providers | OTT Online Video Providers |
|---|---|---|
| **Device** (cost and installation) | ▪ STB or cable model/gateway to enable TV-to-web and web-to-TV experience<br>– No up-front cost and installation support | ▪ Require additional device for web-to-TV<br>– Up-front cost & installation complexity |
| **Content** | ▪ Can use existing content distribution relationships and level of scale<br>▪ Own networks for some SPs<br>▪ Web-to-TV enables all non-TV content to be viewed | ▪ Require new content relationships or own content only |
| **Subscriber Relationship** | ▪ Relationship with pay TV, data, and voice customers with high level of involvement<br>– Confidence includes future improvements | ▪ Loose relationship with web visitors<br>– Uncertainty about what to buy<br>– Less confidence about getting it to work |
| **Quality** | ▪ Own network<br>▪ Dedicated bandwidth for video | ▪ Over-the-top of other networks<br>▪ Bandwidth limited to broadband |
| **Service** | ▪ Field force and remote service | ▪ Remote services only |
| **Monetization** | ▪ Existing billing relationship<br>▪ Can use video/data subscription<br>▪ Advanced advertising (subscriber data) | ▪ Need to develop more profitable business model |

Source: Cisco IBSG Connected Life Market Watch, 2008

# Consumers Are Ready for New TV Services, Such as *Web Video to TV*

### Consumer Interest in Service that Simply and Easily Enables Internet Video on TV




**Question:**
How interested would you be in this offering if it were priced at a level you consider reasonable?

**Service Concept: *Web Video to TV***

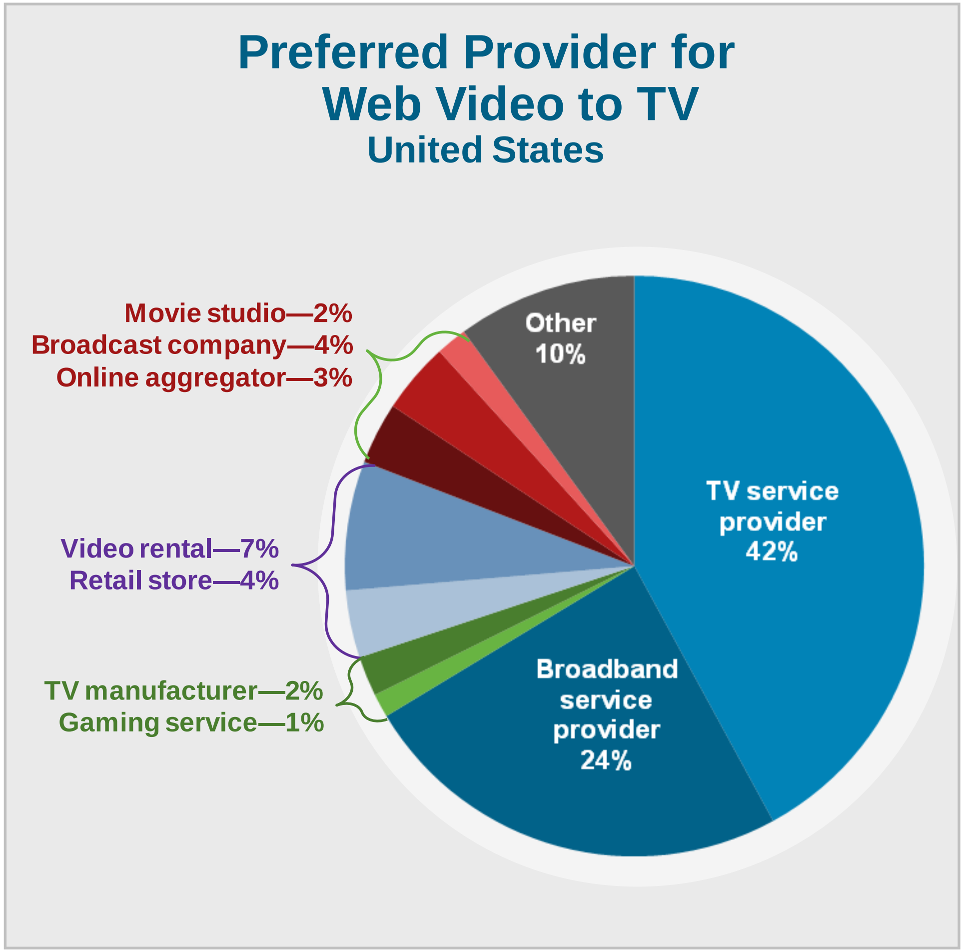
- Simple and easy to watch different types of Internet video on your TV instead of on your computer
- Use TV's remote control to find and select program, movie, or clip from an Internet site and watch it directly on your TV
- Enabled through device attached to TV; separate from your TV service
- Still need TV service to access television channels, video on demand, and other services offered by TV service provider

Source: Cisco IBSG Connected Life Market Watch, 2010

Base: U.S. Broadband Consumers

# Consumers Would Prefer SPs To Provide Such Full Video Service

## Service Providers Are Strongly Positioned To Deliver Online Video




Source: Cisco IBSG Connected Life Market Watch, 2010

- 66% of consumers choose SP to deliver web video-to-TV service
- SPs can address consumers' concerns, including up-front cost and quality
- This preferred position reflects lack of activity in market by any player. It could change quickly if any consumer electronics manufacturer, retailer, or aggregator launches aggressively

# Key Trend to Watch: Internet Video Moving to the TV

Migration to TV

## Consumer TV Behavior Could Shift Rapidly When Internet Video Becomes Easily Accessible Through the TV

TV has been the preferred viewing device for video entertainment

- 93% of U.S. video entertainment is viewed on a TV today
- #1 reason consumers don't watch more Internet video today is because they'd rather not watch video on a computer

CE manufacturers are bringing Internet video to the TV

- 28% of TVs sold in January 2010 in U.S. were Internet-connected
- By 2014, 54% of flat-panel TVs sold globally will be Internet-enabled
- TV manufacturers are building video content portals
- New devices are making it easier to access Internet video directly from the TV


**In next 2-4 years, consumers will establish their TV-to-Internet behavior and usage patterns**

# Key Trend To Watch: Importance of Quality

Impact of Quality

## Quality Can Have Powerful Impact on TV Preference

- Internet TV is better than traditional TV in 7 out of 8 experience categories, according to younger consumers
- Areas most important to overall TV experience are:
  1. Content
  2. Timing control
  3. Quality
  4. Ease of use
- While traditional TV surpasses Internet TV only in quality, it delivers better "overall experience"

Internal Survey of Younger Consumers:

**When comparing traditional and Internet TV, which option is better for the following factors?**

| | Traditional | Internet |
|---|---|---|
| **Content** | 7% | **79%** |
| **Timing Control** | 7% | **83%** |
| **Quality** | **80%** | 16% |
| **Ease of Use** | 23% | **52%** |
| Control (FF, etc.) | 9% | **77%** |
| Portability | 4% | **92%** |
| Interactivity | 31% | **52%** |
| Sharing | 33% | **56%** |
| **Overall Experience** | **53%** | **33%** |

Source: Cisco IBSG Youth Survey, Cisco IBSG Youth Focus Group Sessions, 2010

# Winning SP Strategies: Cutting Through the Noise

## Growing Customer Revenue Amid Video Disruption

- Consumers are taking control of their video entertainment experiences
- Internet TV use is impacting a small portion of viewers' traditional TV behavior today
- From a revenue standpoint, Internet video usage will threaten pay-TV providers in the secondary video spending areas (e.g., movie channel and VoD)
- Pay-TV providers are well-positioned to compete by offering consumers an integrated video experience that expands both *into* and *away* from online video

Source: Cisco IBSG Connected Life Market Watch, 2010

CISCO