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Navigating the media divide

Innovating and enabling new business models

Media and Entertainment

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Navigating the media divide

Innovating and enabling new business models

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The worlds of traditional and new media are already clashing, and it's a conflict that continues to expand. However, a second type of conflict is brewing – one that could cause major rifts among traditional partners. For media companies, it's time to pursue different and somewhat opposing business models…and navigate the media divide.

A new media world has arrived. Pioneered by teens and gadget-savvy professionals, it has quickly spread into virtually every consumer segment, and started to encroach on traditional media. The number of unique visitors to MySpace.com has now surpassed the 50 million mark – something akin to the number of U.S. households that tune into the Super Bowl.[1] Every day, consumers around the world watch about 100 million videos on YouTube – putting that number in context, the top 15 British primetime television shows combined attract about 100 million viewers, as do the top 4 U.S. shows.[2]

To examine the inherent tension between new and traditional media and explore future industry scenarios, we conducted a comprehensive study that included interviews with leaders of media companies and an in-depth analysis of the factors that are shaping the industry outlook.

Our findings highlight two trends as particularly disruptive to mainstream media: the rising popularity of user-created content and the move toward open distribution platforms. In fact, these two axes of change clearly delineate the old and new worlds of media. In the traditional world, content produced by professionals and distributed through proprietary platforms still dominates. But in the new world, content is often user-created and accessed through open platforms. These polarized tendencies mark the clear and present conflict between incumbents and new entrants.

But they also forebode another developing conflict that we call the media divide. This second conflict will emerge among existing players – between traditional *content owners* (such as studios, game publishers and music labels) and *media distributors* (television affiliates, retailers, motion picture exhibitors, cable and satellite providers and the like). It could pit partner against partner in a struggle for growth.

As content owners and media distributors begin to innovate in response to new entrants, we expect their strategies to diverge. Content owners will be increasingly interested in new open distribution channels that lead to greater licensing volume, brand extension and market disintermediation. Conversely, media distributors will want to bolster closed or walled communities, driving more subscriber loyalty and higher margins from interactive features, user-created content and niche experiences. As a result of these competitive struggles, we expect traditional media companies to seek growth in new business models. Our analysis suggests that four divergent business models will coexist at least through 2010:

Traditional media – This model relies on professionally made and branded content delivered through a "walled" conditional-access environment and with dedicated devices. This is where most content owners and distributors operate today.

Walled communities – This model is based on distribution of niche and user- and community-generated content within a conditional access environment through dedicated devices. Typically, these are traditional businesses that have expanded their "walls" to include nontraditional features and experiences.

Content hyper-syndication – This model makes professionally produced content available in open and portable channels, without proprietary access "walls" or dedicated devices.

New platform aggregation – This model relies on user-generated content and open distribution platforms. It is arguably the most disruptive model, as neither incumbent content owners nor distributors have legacy advantages here.

Although we've described each of these models distinctly, in its purest form, we believe these models will blur over time, as media companies experiment with multiple models at the same time. All sorts of combinations will undoubtedly emerge over the next three to five years. But as incumbents move further away from business-as-usual, we believe that media distributors and content owners will primarily head in opposing directions: distributors toward *Walled communities* (rather than just walled branded content) and content owners toward *Content hyper-syndication*.

This divergence in goals and strategies will put tremendous strain on traditional partnerships. Yet, while tension is certain, the end-game is not. Where there is conflict, you'll also find winners. The outcome for any individual company will be determined by how it responds to the opportunity presented by this impending divide. And even though the upheaval in business models and partnerships brought about by this divide probably won't reach its peak for a few more years, media leaders cannot afford to watch and wait.

Industry incumbents – and new entrants as well – face significant strategic choices about business model innovation: which model(s) to pursue and where and how much to invest. As they weigh their options, media companies should not ignore the impact these choices may have on established businesses and business relationships. While industry incumbents are readying their companies for roles in media's new world order, they must also anticipate and attempt to mitigate points of contention with their partners. It's time to seize the opportunities that flow from this growing media divide.

Navigating the media divide

Innovating and enabling new business models

The catalysts of conflict

Though the current battle between traditional and new media is real, it remains lopsided – in terms of finances if not buzz. Based on our analysis of current forecasts, worldwide revenue from new media channels – such as Internet advertising, mobile music and online games – is expected to reach nearly US$55 billion in 2006.[3] But that pales in comparison to the US$455 billion in revenue that traditional channels are expected to yield in 2006.[4]

New media, however, is growing much faster than traditional media. Its revenue compound annual growth rate (CAGR) from 2006 to 2010 is 23 percent versus 6 percent for traditional revenue streams.[5]

Several drivers of change have created openings for these fast-growing new entrants and sparked conflict between traditional and new media. These include:

- Device and access rollout
- Multichannel content innovation
- New consumer behavior and roles
- Faster revenue-to-attention alignment.

As these change drivers take hold, industry power is starting to shift, as are business models.

Device and access rollout

Today's frenzied pace of innovation has placed unprecedented access and device capabilities in the hands of average consumers. For example, the adoption of broadband and new generations of multimedia devices is providing both a foundation and motivation for richer online and mobile experiences (see Figure 1).

Generally speaking, as broadband adoption has increased, so have consumers' appetites for ways to use that extra bandwidth. In South Korea, where broadband penetration was over 60 percent in 2005, 53 percent of users download music and 36 percent download films.[6] Along with its 56 million broadband households,[7] the United States is also seeing sharp increases in video streaming and social networking.[8] For instance, U.S. users streamed over 22 billion videos in 2005, and by May 2006, 50 million were using MySpace.com.[9]

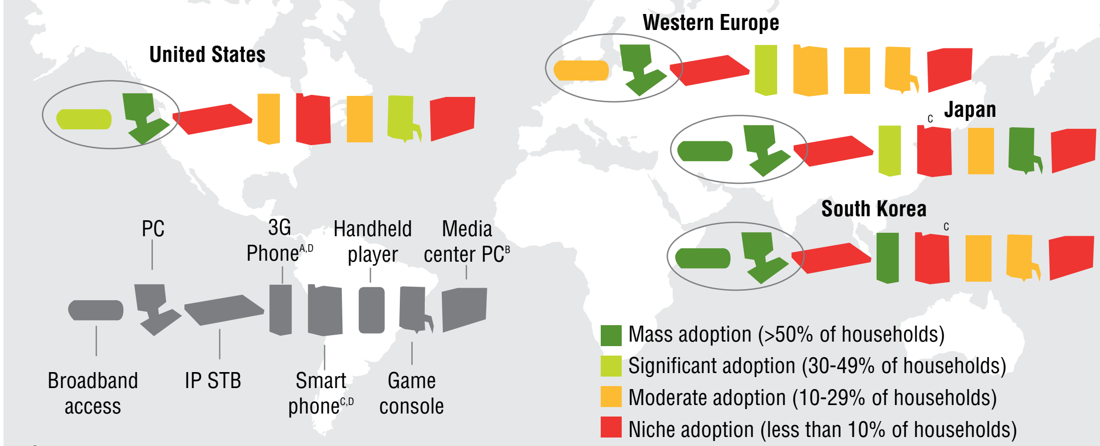
Study methodology

Our study consisted of primary research and analysis as well as supplementary secondary research. Specifically, we conducted in-person interviews with more than 75 senior media executives, industry analysts, economists and technology visionaries. We also worked with the Economist Intelligence Unit to survey another 125 executives from media, Internet portal and telecommunications companies.

Our analysis focused on multichannel media experiences. By multichannel, we are referring specifically to content that flows through: television sets; PCs; handheld devices such as music players or portable game players; mobile phones; and interactive content enabled by Internet protocol (IP) set-top boxes or broadband game consoles. In terms of type of content, we concentrated primarily on music and video (including games, films and television).

FIGURE 1.

Growing PC and broadband penetration is creating the foundation for online content experimentation.



Source: IBM Institute for Business Value analysis.

Notes: [A]Share of people having 3G Subscriptions in countries/regions. [B]Research and industry interviews indicate marginal take-up. Assumption for Japan handheld player. [C]Share of people with smartphone as calculated from sales. Japan/Korea only as Asia Pacific. [D]Phone penetration given by population, not households.

As high-speed access (both mobile and fixed) becomes less of an obstacle, media enablement hinges more on the device itself. Factors such as content transmission speed, battery life and screen size determine whether a device is actually suitable for media consumption.

Although having the right kind of access and device is clearly a *prerequisite* for new media experiences, and very often an *incentive* to try new experiences, it is in no way a *guarantee* of actual consumer uptake. When a device enters the market, consumers may initially ignore some of its advanced features or use it in surprising ways. If the device is not easy to use, has limited functionality or does not really fit the user's lifestyle, it will likely sit idle or underutilized.

Examples of hesitant adoption are plentiful. Of the 15 million U.S. households with high-definition television (HDTV) sets at year-end 2005, only 50 percent subscribed to HDTV content service plans.[10] Likewise, of the 270 million Internet-enabled mobile phone users in Western Europe, only 20 percent were using their phones' Internet capabilities.[11]

Even though it takes some time for consumers to discover and experience the full potential of new products or new means of access, the overall process of innovation and experimentation is crucial to accelerate consumer interest and demand. The perpetual stream of excitement – along with continuous improvements in usability and relevance – keeps leading-edge consumers engaged and, if the undercurrent is strong enough, eventually drags along the masses.

The Apple iPhone combines three products – a mobile phone, an MP3 player and an Internet communications device.

Divided industry views

"Korean infrastructure is so fully developed – 105 percent penetration in broadband cell phones... Cell phones are used to control both online and mobile environment."

– IBM interview with global music publishing executive

"People will only use [mobile screens] if they have no other choice (i.e., when in a plane)."

– IBM interview with North American motion picture exhibitor executive

Regulation's role in market expansion (or lack thereof)

Beyond volatile marketplace drivers, media executives must also contend with governmental regulation. Whether in China, France, the United States or practically any country in the world, government bodies dramatically impact service expansion and media adoption – spurring or stifling growth through their legislative actions or regulations. As an example, China's Ministry of Culture recently enacted rules requiring Internet companies to get ministry approval before posting music online. The regulations are intended to stem piracy by making companies prove ownership of distribution rights, but they could also prevent distribution of music the government deems indecent or improper.[12]

Government policy affects consumer pricing for access and content, piracy rules and their enforcement, network usage and competitive neutrality, business conditions for entrepreneurs, just to name a few areas. In addition, as telecommunications and media industry boundaries blur, companies are often subject to two sets of regulators, instead of one. For the foreseeable future, regulation remains a critical factor that can accelerate or derail new initiatives or strategies.

Multichannel content innovation

With media-capable devices in increasingly greater supply and consumers expressing increased interest in adopting those features, media companies are taking note. Attempting to capture their share of the new action, established content owners and media distributors are testing the waters – with mixed success.

Early trials have demonstrated both the upside and downside of multichannel media. Video on the Apple iPod, for example, demonstrated positive results at the outset. It was embraced enthusiastically by early adopters, with 8 million downloads in its first two months in the market.[13] It added to the industry's overall "revenue pie" by prompting users to spend money on a new type of product (viewing a TV episode on a handheld device, in this case). It also captured higher revenue per viewer, with higher returns to content owners: around US$1.40 per episode per download, versus the US$0.50 per viewer primetime television networks usually earn through advertising.[14]

However, the positive start was negated somewhat by downward trends from Apple iTunes. Between January and June of 2006, iTunes usage fell by 50 percent, acting as a reminder that enthusiasm can wane a bit as novelty fades.[15] Continual refreshment of the user experience is necessary to maintain a steady up-tick in usage.

The Microsoft® Zune™ hit stores in November 2006.[16]

Yet, we believe new screens are here to stay, even if their uptake is a bit uneven during introductory periods. Based on 2010 estimates, mobile revenues for advertising and content are unlikely to catch up with online PC comparable revenues in the near term (US$29 billion for mobile versus US$77 billion in online revenues).[17]

Media companies are actively experimenting with content that spans channels – but progress has been somewhat uneven.

A new "screen" – like an MP3 player or mobile phone – can provide newfound mobility and offer a sufficiently different experience for users. With its added benefits, some consumers – especially those who are heavy commuters or content addicts – will add to the time and money they spend on media. However, if the experience is too similar to established screens and devices, the gains could threaten current attention and revenues. For instance, a multi-player video game like *Blizzard Entertainment's World of Warcraft* played on the PC could substitute for time spent playing a console game.

In experimental stages, it is not always easy to gauge the attention and revenue cannibalization risk. As an example, in early trials by Vodafone SFR and Telefonica O2, 50 percent of the users watched mobile TV at home, not on the go.[18] This kind of behavior could be seen as a threat to traditional television viewership – and associated subscription and advertising revenues. In this case, it is likely a temporary aberration, attributable to the newness of the experience. But the story might be different for PCs and TV and their various combinations and manifestations in the years ahead.

On the down side as well, the industry is sensing that certain experiments – such as the recent proliferation of replay options – are negatively impacting historically profitable downstream revenue streams like television syndication. When *Desperate Housewives* was syndicated in 2006, it drew just half the price of *Sex and the City's* 2003 agreement.[19] Some industry experts blame the softening syndication market on new alternatives such as videos on demand, YouTube, iTunes and direct-to-consumer Web experiments such as those underway with abc.com and bbc.co.uk, which offer users almost immediate replay. Instead of trying to catch a television episode on a rerun, in syndication or wait 9 to 12 months for it to appear on DVD, consumers can access content practically whenever they want.

New media experiences are starting to call into question the established view of release windows. As a result, we anticipate some

Divided industry views

"The younger crowd has a stronger and faster influence today than the same age group did 10 to 15 years ago."

– IBM interview with a US multiple system operator executive

"Anytime you 'cross-collateralize,' or converge, devices, it remains in the realm of Gadgetiers. Portability is not key for Massive Passives." (see sidebar, *One size does not fit all*)

– IBM interview with Canadian broadcaster

cannibalization of mainstay revenues, though cataclysmic change is unlikely in the next three to five years.

One size does not fit all

We expect the pace of adoption of multichannel video, gaming and even music to continue at a staggered pace, relying heavily on the preferences and reactions of specific consumer segments. In a previous IBM study, *The end of television as we know it*, we segmented the video market into three categories: Massive Passives, who are generally content with traditional, "lean back" television experiences; Gadgetiers, who are drawn to the latest devices and are interested in participating and controlling the time and place of their media experiences; and Kool Kids, who also prefer interactive and mobile media experiences and rely heavily on content sharing and social interaction.[20] It is these last two groups of consumers – the Gadgetiers and Kool Kids – that will likely lead the way with multichannel entertainment consumption.

New consumer behavior and roles in media

Consumers want to play a bigger part in their new media experiences.

Encouraged by available bandwidth and interactive multimedia possibilities, consumers are now clamoring for new roles. Those Gadgetiers and Kool Kids that we just mentioned are not only interested in *consuming* content in new ways – they also want to *create, manipulate and mash* it. Between July 2005 and July 2006, five of the ten fastest growing Web sites were portals for user-generated content: imageShack.com, Heavy, Flickr, MySpace.com and Wikipedia.[21] Consumers are clearly passionate about being editors, producers and directors. The falling prices of sophisticated media editing and recording equipment and software have put the tools of the trade within reach of almost any aspiring talent or wannabee. The result is a blurring and merging of the roles of producer and consumer, or a "prosumer," as coined by Alvin Toffler.[22]

With the rising popularity of professional and social networking on the Internet, producing content is seldom a solitary endeavor. Communities – gathered at wikis, blogs and social networking sites – create, experiment with and refine content collaboratively.

Poor resolution and uneven editorial quality have not detracted from the frenetic enthusiasm for user- and community-generated content. With its meteoric rise, YouTube – a Web site where users from around the world can upload, watch and exchange video clips – is a prime example. The site came out of nowhere, and in less than two years, catapulted to 8.5 percent of all pages viewed, according to alexa.com (that's more than 40 times that of mtv.com, a Web site that competes for the same core audience of Kool Kids).[23]

Although YouTube and MySpace.com may have garnered more press of late, they are just part of a menagerie of user-submitted content sites. The trend crosses all genres of content – from sites dedicated to startup bands (such as NetMusicMakers) to amateur humorists (DailyLOL) to international communities (German site XING and mixi from Japan).

"Urban Ninja" – created by the EMC Monkeys and posted by "mrWoot" – is one of the most watched YouTube videos to date, viewed over 10 million times.[24]

"[Based on our business model research,] when advertising time went up 10 percent, the audience declined by 15-35 percent..."

– IBM interview with Professor Kenneth Wilbur, University of Southern California Marshall School of Business

"…but when the audience goes up 10 percent, ad prices go up 68 percent."

– same interview with Professor Wilbur

Faster revenue-to-attention alignment

Buyers and advertisers are watching all of these changes closely. And despite some initial skepticism about emerging channels, they now seem to be believers. According to a recent study, if advertisers had an additional US$1 million for marketing, 50 percent of them said they'd spend it on Internet search, 42 percent chose other forms of Internet advertising, but only 19 percent mentioned television.[25]

The new generation of chief marketing officers (CMOs) is steeped in Internet metrics. They've grown accustomed to the precision, granularity and realtime nature of those measurements and are carrying those same expectations over into television, radio and other traditional media, where metrics have historically been nonspecific, extrapolated and even dated. We can see evidence of this new attitude in the controversy surrounding Nielsen Media Research's Live Plus 7, which facilitates new TV advertising measurements and prices based on digital video recording playback.[26]

CMOs are also becoming more attuned to fast-moving audience changes. Although spending adjustments traditionally lagged far behind attention shifts, we think they are going to be much more closely synchronized going forward.

Power shifts

The flood of different delivery channel alternatives and experiences – film on your PC, music through your mobile phone or TV on your MP3 player – is commoditizing the value of pure bandwidth. As distribution platforms proliferate and new players drive access prices down, power is moving further away from those who own the pipes and toward the companies that control the consumer's media experience. Even in the case where the aggregation or programming function is associated with the pipes owner through corporate structure, it is almost always the experience that drives consumer loyalty. Driving this point home, the recent cash flow improvements of U.S. cable distributors are mainly attributed to on demand features, triple-play bundles and interactive devices like digital video recorders, *not* more network capacity.

How we define the players

In the context of this paper, we use the following role-related terms to represent different groups of media industry participants:

- *Content owner:* An entity that holds the rights to content for reuse, whether video, music, games or other types of digital content; sometimes also the original producer of the content
- *Distributor:* The middleman that owns the means of transmission for content (e.g., fiber, satellite, terrestrial) or distributes physical products like DVDs or CDs
- *Aggregator:* An entity that creates a user relationship (e.g., in store, online or through another channel) and attracts an audience through aggregated content, services and features.

Power is no longer found in the pipes; it's now about who can deliver the best experience.

While this trend has generally benefited content owners, more recently, it has started favoring *aggregators*, those who create a compelling forum for consumers and content. We can see this in the revenue-sharing schemes associated with new forms of pay-per-view (PPV), video-on-demand (VOD) and subscription services. For instance, the typical revenue split between studios and cable companies for traditional PPV is 60-40 (see Figure 2). But with mobile television subscriptions delivered through an intermediary like MobiTV, industry executives indicate that the mix is moving closer to thirds for content owners, distributors and content aggregators, taking into account, of course, contractual minimums.[27] And, in some models based on user- or community-generated content (such as YouTube), amateur or prosumer content owners do not (yet) participate in revenue sharing; the platform aggregator takes all.

This trend probably won't last forever, but, for now, the edge definitely goes to the aggregator and those that can consistently deliver valued experiences.

New battle lines produce new business models

As we examined these changing industry conditions and ensuing conflicts, our analysis led us to:

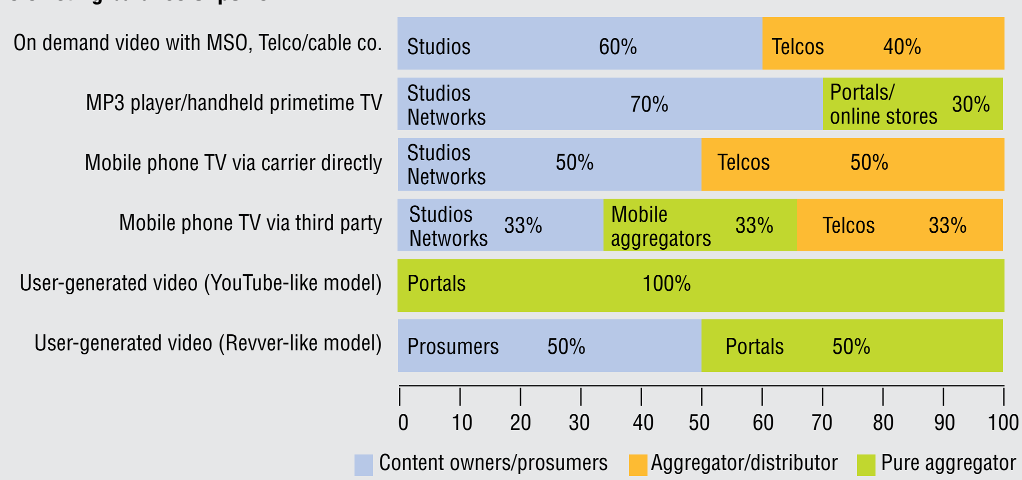
- Frame the industry in terms of its most disruptive trends
- Compare four alternative business models
- Investigate possible winning models.

Framing disruption

As we analyzed our research results, we isolated two variables that appear most disruptive to industry incumbents: the degree of user-generated content and the openness

FIGURE 2.

New entrants are introducing different pay-per-view and subscription revenue-sharing schemes, challenging the existing balance of power.



Note: 1) Content owners responsible for distribution of payments to artists, publishers. 2) 60/40 revenue split favoring studios is based on current VOD movie deals.
Source: IBM Institute of Business Value analysis.

of device/distribution platforms. While this analysis hones in on the options open to current players, the same framework can be useful to newcomers.

On the y-axis of Figure 3, the content source continuum refers to the proportion of media that is produced by professionals versus that which is contributed or generated by users. Content produced by professionals is typically vetted, developed and edited by studios, publishers or labels and can be of any type (video, games or music).

Two trends are shaking up the media industry structure: the move toward user-generated content and open distribution platforms.

User- or community-contributed content, on the other hand, refers to digital content that has been generated by individual users or communities of interest. It could be something someone created from scratch. Or, it might be a modification of professional content, like an overlay for a sound track or a digital mashup that combines several pieces of third-party content. The content could also be the result of community collaboration – like the online encyclopedia Wikipedia. Because of the broad range of skills involved, the quality of user- or community-generated content varies from obviously amateur to professional-grade.

The x-axis in Figure 3 represents the degree of openness of content distribution. On the left side, proprietary distribution is a situation where devices and/or networks lock in consumer access and control the user experience. Here, users can only consume purchased content via a particular device or access provider (such as cable television programming through a set-top box over the cable company's network).

Conversely, open distribution describes a condition in which open standards like Internet protocol or MP3 are used for both transmission and playback of content. Open platforms mean that a user is not tied to any one service provider and can access content using standard devices from a variety of manufacturers. It is important, however, not to confuse *open* with *unprotected*. Films, games, music and other types of content can be safe-guarded through digital rights management, while still moving fluidly through open, easily accessible channels.

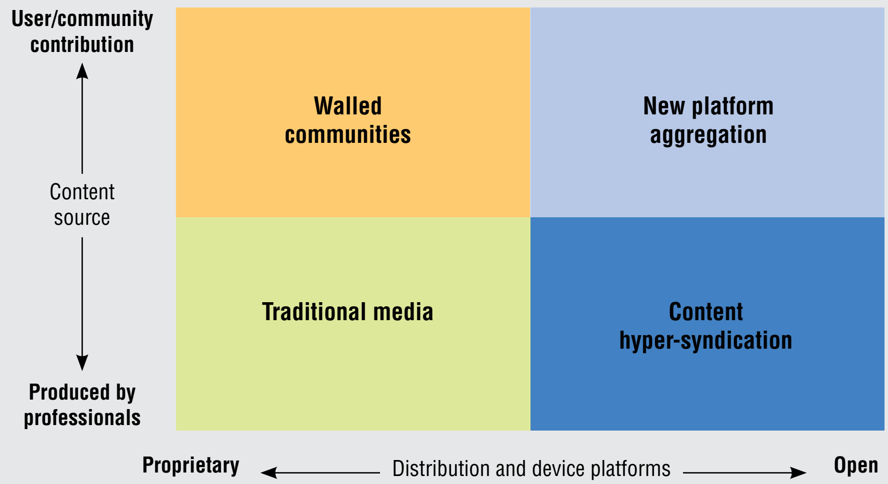
User-created online encyclopedia rivals traditional publishers

For many consumers, Wikipedia has become a viable online alternative to traditional encyclopedias. As a body of work, it contains nearly four million entries.[28] Beyond the fact that it is free, online and big, Wikipedia is also user-generated. Instead of using professional editors to create and maintain entries, the encyclopedia relies on enthusiasts and the occasional expert for its content.

Despite some recently publicized rogue entries, community collaboration and policing have helped the encyclopedia maintain a reasonable degree of quality. Some would even argue the quality approximates that of Encyclopaedia Britannica.[29] In any case, the debates over accuracy have not dampened enthusiasm for this source of information: Wikipedia is one of the top 20 most frequently visited sites on the Web.[30] Evidently, for many consumers, free and easy access outweighs perfection.

With educational and community-building (not necessarily revenue) goals at its core, Wikipedia has forced competitors to reconsider their historic licensing and retail business models. This endeavor illustrates how new entrants can pull attention and dollars away from traditionalists, without necessarily replacing the revenue withdrawn from the overall "industry pie."

FIGURE 3.
The conflict between traditional and new media has resulted in four business models that will likely coexist for the mid term.



Source: IBM Institute for Business Value.

Business models through 2010

When we examine the industry along these two continuums, we see four primary business models (as plotted in Figure 3).

- *Traditional media* – This model relies on branded content created by professionals that is delivered through a "walled," conditional-access environment and dedicated devices. This is where most established media companies operate today. Think Paramount Pictures, Canal+ or The Walt Disney Company.
- *Walled communities* – This model is based on distribution of user- and community-generated content within a "walled" or conditional access environment through dedicated devices. Typically, these are traditional businesses that have expanded their "walled gardens" to include user contributions and nontraditional features. For instance NTT DoCoMo has over 95,000 user and special interest communities, all accessible via their service on their devices.[31] And Comcast just announced an agreement with Facebook.com to produce a television series from user-generated videos.[32]
- *Content hyper-syndication* – This model makes professionally produced content available in open channels, without dedicated access providers or devices. Examples here include the BBC with its My BBC interactive media service, Lucasfilm Entertainment Company and Sony Online Entertainment Star Wars Galaxies massively multiplayer online role-playing game as well as the myriad broadcast networks in the U.S. that are making content available from their own Web sites.
- *New platform aggregation* – This more extreme model relies on both user-generated content and open distribution platforms. It is arguably the most disruptive, as neither incumbent studios nor distributors have legacy advantages here. This is where you'll find predominantly user-driven aggregators like YouTube, MySpace.com and Second Life, as well as a host of less-publicized players, such as LiveJournal, XING, mixi, DailyLOL and NetMusicMakers.

Media companies will have a palette of four different business models that they can combine as they redesign their own businesses.

We expect these four business models to coexist for at least the next three to five years, if not longer. And although we've described each in its purest form for comparative purposes, the marketplace, in reality, will be full of combinations. Some companies will have models with more "pure play" tendencies found in the extreme corners of this framework. Others will operate closer to the intersecting lines with more of a mixed model, whereby they might blend user and branded content or combine open channels with other proprietary services. For example, companies that began as user-generated content engines now include legal, branded, professional content, bringing the two models *New platform aggregation* and *Content hyper-syndication* closer together.

Once a company chooses a particular path, a whole new set of critical questions comes to the fore: is our new business model best forged alone or in collaboration with partners or competitors? Should we own the means of production or outsource it or something in between? How do we redesign and retrain our organization to support new models?

NTT DoCoMo offers its subscribers access to premium content on the go.

Where do telcos fit?

In terms of media, telecommunications companies (telcos) have been involved behind the scenes for years because of their network assets, but they are only beginning to assert themselves as part of mainstream media distribution.

A flurry of recent activity has centered on Internet protocol television (IPTV) and delivery of television programming to mobile phones. Telcos around the world are joining in, including PCCW-HKT Limited and Telstra Corporation Limited in Asia; AT&T Inc. and Verizon in the United States; and Belgacom, France Telecom and Deutsche Telekom in Europe. These types of content services initiatives are expected to help fill gaps left by wireline losses.

Due to telcos' historical strengths and their relative newcomer status in media, we believe these companies require an additional set of considerations outside of those we provide to media distributor incumbents in this paper.

Telcos have an opportunity to leap-frog beyond "me too" traditional media distribution and move quickly to the on demand, experiential niche and community features that excite consumers. The first hurdle will be delivering traditional programming and premium subscriptions – not a small feat, yet insufficient on its own. To compete, they will have to be willing to undertake more dramatic business model innovation than their incumbent media peers – and implement it much faster. For a more in-depth discussion of this opportunity, please see the IBM Institute for Business Value telecommunications industry paper, *A future in content(ion)*.[33]

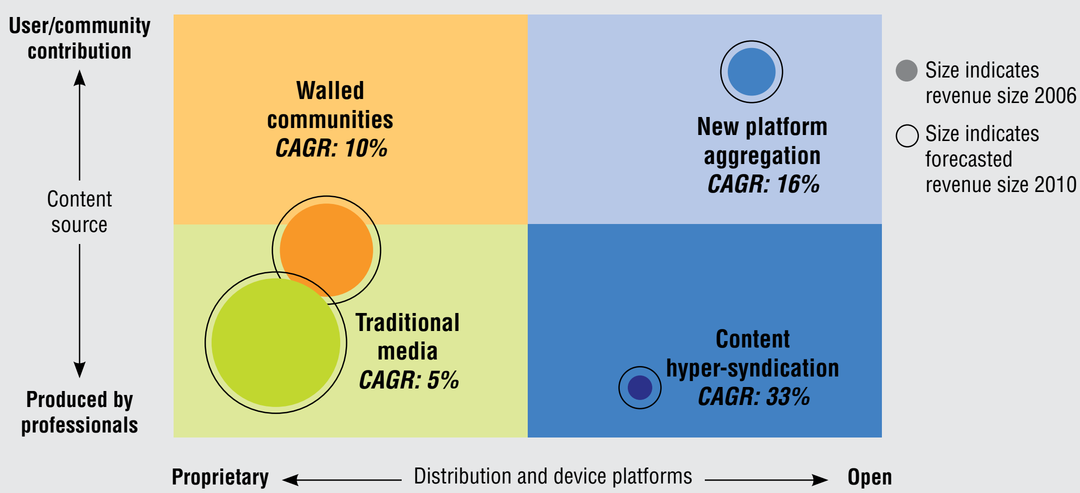
Which one wins?

For the next three to five years at least, we see no clear winner among these four business models. Instead, we expect different companies to pursue divergent models and unique combinations that leverage their historical strengths and assets – and as a result, the market overall will look extremely varied, even chaotic at times.

Traditional media and other types of walled environments will remain the dominant revenue producers in the near term, while the other business models grow their smaller bases at a much faster pace (see Figure 4). Our analysis suggests that, by 2010, annual revenues for Traditional media will reach US$340 billion, for Walled communities US$240 billion, for Content hyper-syndication US$25 billion and for New platform aggregation US$50 billion. That means revenue CAGRs from 2006 to 2010 of 5 percent for Traditional media, 10 percent for Walled communities, 33 percent for Content hyper-syndication and 16 percent for New platform aggregation. (Note: Revenues associated with the Walled communities model would historically have been part of the Traditional media category. However, as we believe the nature of distribution bundles will change by 2010, we have included in Walled communities the revenues from community features, along with conditional access subscriptions, advertising and gated mobile content fees.)

These numbers are a consensus forecast derived from a variety of research sources. However, since the original forecasts tend to be predicated on little or no cannibalization of traditional channels, we are somewhat skeptical that the categories of revenues within the lower left quadrant of Figure 4 will reach such auspicious levels. We believe these estimates should be tempered by the realization that spending on new channels will eliminate some of the revenue forecasted for traditional media.

FIGURE 4.
Size and position of bubbles indicates business model progression by 2010.



Note: Size and position of bubbles indicates business model progression by 2010. Traditional media *includes revenue from theatrical, video sell-through and rental, physical music, TV advertising, syndication and licensing, retail video games and VOD/PPV via MSO/Telco/Direct Broadcast Satellite;* Walled communities *includes revenue from basic and premium TV subscriptions as well as mobile music, television, ringtones/back, games and other content;* Content hyper-syndication *includes revenue from digital music, film rentals and streaming, interactive TV promotions, and online games;* New platform aggregation *includes revenue from online advertising.*
Source: IBM Institute for Business Value analysis.

Divided industry views

"Replacement revenues (digital revenues to replace lost CD sales) are not 1:1, far from it."

– IBM interview with global music publishing executive

"The new screens add to time of consumption. Period."

– IBM interview with North American media company CEO

As the positions of the circles in Figure 4 depict, during the next three to five years, we expect distributors to make moves to blend user contributions and community features with popular branded content. However, as the straddled position of the Walled community bubble suggests, we expect that the majority of revenues in 2010 will still be associated with branded (versus user) content. In contrast, content owners will likely move further along the continuum toward open platforms, hence the position of the Content hyper-syndication bubble. Even though many traditional media incumbents will be experimenting with other models, they will still be counting on the annuities provided by their Traditional media businesses. While platform aggregators themselves will likely be testing the waters in other areas, they will also continue to push the envelope in terms of openness and user involvement.

Given growth pressures and the challenge of new entrants, it is quite probable that individual companies will operate more than one of these business models to hedge their bets and develop new strongholds. But as companies move from traditional media in either direction in search of new incremental revenue, the risk of cannibalization and substitution increases. For the foreseeable future, incumbents will have an incredible optimization challenge: finding the right mix between sustaining their current cash generators and pursuing new – risky but necessary – growth paths.

The great divide

So, given these emerging business models and the competitive threat from new platform aggregators, what are the options for incumbent content owners and distributors? Staying the course? All-out pursuit of platform aggregation? Or something between the two extremes?

Nothing a no-go

First of all, we need to stress that doing nothing is not a viable option. For content owners, we only need to mention the music or newspaper industries as examples. In fact, the recent upheaval in digital music provides useful lessons for content owners of any stripe. Because the music industry largely ignored pricing problems, format issues and distribution innovations, mounting consumer dissension eventually found an escape valve in peer-to-peer networks.

To put a price tag on the losses associated with the music industry's inertia, we compared potential revenue – based on the industry's pre-1999 compound annual growth rate – to sales growth after the 1999 launch of the original Napster peer-to-peer service. Our analysis suggests that the industry will lose between US$90 billion and US$160 billion in revenue (cumulatively from 1999 through 2010) due to the tumultuous transition to online distribution.

Many traditional media companies will experiment with the new platform aggregation model in some way.

For distributors, the picture is best painted through a television example. Freeview is a digital television company in the United Kingdom. It retails a set-top box that is priced around US$70 and allows access to 30 free digital channels. Freeview's growth has been phenomenal – boasting well over 10 million units sold as of 2006.[34] In contrast, cable subscriptions have been declining by mid to high single-digit percentages.[35]

With this example in mind, it does not take much to imagine the fate of distributors that fail to innovate and grow. For instance, if distributors do not update their bundles, consumers may opt to make choices based on price alone. If so, global television distribution's expected revenue growth (from premium and basic multichannel subscriptions) could end up much lower. If the CAGR to 2010 were to drop by around 2 percent, for example, the television industry will have missed out on tens of billions in revenue.[36]

First option: Moving headlong into disruption

Of course, incumbents could (and probably will) choose to participate in new platform aggregation in some way. Here's why:

- *To exploit attention and revenue potential* – Simply put, the emergent business models represent attention and revenue up for grabs. As newer channels reach critical mass, media companies will want to be full-fledged participants and take advantage of emerging attention shifts – and the revenue that follows. They will want their brands present at new consumer touchpoints, especially those that reach increasingly attractive audiences.
- *To benefit from first-hand learning and greater user intimacy* – By participating, instead of simply observing, incumbents get a chance to learn more about the consumers attracted to these emergent business models. Rapid pilot programs can offer a stream of fresh market insights that can benefit both new and traditional businesses. More direct interaction also allows media companies to build more personal relationships with consumers.
- *To freshen brand* – Adopting some of the characteristics of the new business models can help incumbents refresh brands and keep them relevant. For content owners, this might mean wrapping community features around core branded content to increase enthusiasm, stickiness and loyalty. For media distributors, it could involve integrating community features or user-generated content to keep consumers interested in their walled gardens.
- *To capitalize on buzz (literally)* – Owning the "next big thing" could potentially increase the market valuation of an incumbent's business. This improved valuation could be used to fund growth initiatives.

The pursuit of this "white space" is what we've outlined in Figure 5 as option one (moving into *New platform aggregation*). Most incumbent media companies seeking entry will probably need to "buy in" for speed, as recent combinations illustrate: Sony Pictures Entertainment with Grouper Networks, Viacom International's MTV with Atom Entertainment, and News Corporation with Intermix Media (MySpace.com). Building a consumer portal, with partners or competitors, is a viable alternative, but one that can come with time delays.

Divided industry views

"Content creators are currently not fully using the community's creativity – there are great fan communities that can write and even produce new episodes of favorite shows. They know the whole history of the content by heart."

– IBM interview with European media professor

"We will never rely on user content – we are never going to be YouTube… never be in the upper right at all."

– IBM interview with global media studio executive

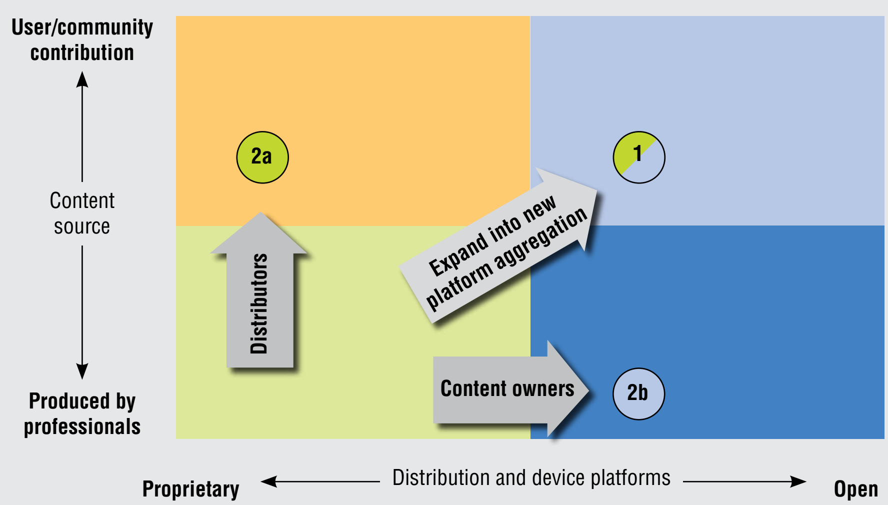
New platform aggregation, however, may dilute the value of current media assets; with this model, traditional distribution capabilities and branded content tend to be much less important. Therefore, we believe that, even if traditional media incumbents move here, they should do so carefully and not as their sole focus.

Second option: Assets dictate direction

Traditional media companies should – and presumably will – play primarily to their strengths. And that is what we have mapped out as option two. However, option two is not the same for both *content owners* and *media distributors* (see Figure 5).

We believe these two groups of incumbents – driven by the need for growth – will begin to adopt divergent strategies and veer in different directions. Content owners will be increasingly interested in new open distribution channels that lead to greater licensing volume and potential disintermediation. Media distributors will want to incorporate community content experiences to strengthen subscriber loyalty, lower content acquisition cost and combat competition from new platform aggregator entrants.

FIGURE 5.
We expect incumbents to experiment with option one, then diverge as they focus on option two.



Source: IBM Institute for Business Value.

Traditional media companies are even more likely to pursue options that leverage current assets in new ways, which may drive content owners and media distributors in opposite directions.

We anticipate a fair amount of conflict as formerly symbiotic partners pursue these divergent paths. Each group's actions clearly affect the other. If media distributors reinvent their walled gardens by incorporating more nontraditional niche or long-tail content and adding user and community contributions, it could launch a downward cycle for content owners. Traditional branded and blockbuster content could lose viewers as audiences shift further toward new sources of content and community features. Reduced viewership could lead to price pressure on content licensing and reduced advertiser spending on professionally produced content. Lower prices would mean more margin pressure, making it difficult to maintain current levels of spending on production. Any associated decrease in content quality puts viewer loyalty at even greater risk, starting the cycle again.

A similar story could unfold for walled-garden distributors. If content owners go "open" and viewers can obtain premium content from other sources in basically the same window of time, users may become more price-sensitive or opt to cancel their traditional subscriptions entirely. Declining subscriber volumes could erode deal-making leverage, which, in turn, would make it increasingly difficult to maintain an attractive value proposition for subscribers. Subscription, VOD and PPV prices may eventually succumb to pressure from viable competitive alternatives.

The actions each party takes, in some way, injure the others' business over time. In the near term, we don't anticipate a worst case scenario – where partners totally part ways – but we do think the strategies set in motion today could eventually reshuffle established alliances and shake up the entire industry structure. Given the conservative tendencies of dominant traditional players as well as Massive Passive consumers, the conflict is unlikely to peak by 2010, but the wedge is definitely in place.

Divided industry views

[On content owners supplying all portals and channels] "There is no downside to doing that right now; in doing so, they are forcing all the risk on network operators."

– IBM interview with US multiple system operator executive

[On commoditization of pipes] "Users do not care whether it is wireless or IPTV…the only thing they care about is the content quality."

– IBM interview with Japanese mobile operator executive

Preparing for the future – divergence and all

We have ten specific recommendations for incumbent media companies as they face the immediate threat from new entrants and eventual collisions with traditional partners:

- Put consumers at the center of your business and boardroom.
- Convert consumer data into competitive advantage.
- Give control to get share.
- Deliver experiences, not just content.
- Leverage virtual worlds.
- Innovate business models.
- Invest in interactive, measurable advertising services and platforms
- Redefine partnerships, while mitigating fallout.
- Shift investment from traditional business to new models.
- Create a flexible business design.

1. Put consumers at the center of your business and boardroom.

Firms must be fanatical about consumers – investing in a new corporate consumer-centric mantra along with advanced segmentation analytics and personalization tools.

New tools to collect insights and strengthen relationships are just the beginning. We think consumer centricity may need to be formalized by appointing a Chief Consumer Officer (CCO). Putting the consumer front and center – even in the boardroom – must be the *modus operandi* going forward. The CCO and his or her team will need to understand consumers – what they need today and what they might use in the future – and act as a vocal and powerful advocate.

The more companies know about consumers, the more relevant and personal their offerings can be. If we look, for example, at the three consumer segments discussed earlier – Massive Passives, Kool Kids and Gadgetiers – each group has different motivations, values and preferences. The Massive Passive segment puts a premium on simplicity and ease-of-use. If a device or service seems difficult to learn or use, they simply won't bother.

Gadgetiers, on the other hand, see the leading-edge devices and services they use as signs of prestige and *savoir faire*. They are attracted to offers that confer some sort of exclusivity or first-on-the-block benefits. Generally, they are willing to invest more time in learning to use a more sophisticated device or service because their ability to master the product places them in a more elite user group. Kool Kids think and act much differently than the other two segments. To them, devices and services are all about fashion and making a statement. Form matters more than function. However, they're young – and their wallets are much skinnier than those of Gadgetiers, making price an issue. Their social networks tend to be faddish, rising and falling out of favor quickly.

Media companies must replace assumption and guesswork with a data-driven understanding of consumers and an organization designed to act on that knowledge.

Packages customized for specific segments and microsegments will be key to retaining enthusiasm, relevance and, ultimately, brand equity for today's players. This tailoring should encompass the full experience, including personalized content, advertising, bundling, pricing and interactive features. Since many of these individualized offerings will require user opt-in or sign-up, providers will also need to educate consumers on why they should participate.

The new media world also introduces new ways of obtaining content – actively utilizing the creativity of consumers and "the wisdom of crowds." In a book by that name, James Surowiecki highlights the surprising accuracy of large groups of independent decision makers.[37] This group wisdom has led to several trends in the digital arena, such as the host of reputation and trust systems that now recommend doctors, toys and books, and self-police online marketplaces. As it pertains to media, it is certainly worth paying attention to the intuition of crowds and understanding taste inferences that can be deduced from all the buzz.

2. Convert consumer data into competitive advantage.

Media companies must recognize and act on what makes each consumer segment special. They must have first-hand knowledge about their customers – and use those insights to develop offerings that suit specific, targeted consumer segments. This means media companies need to build a foundation of data, information and customer relationship management. They will have to effectively profile and create predictive models for delivering the right products, bundles, brands and pricing to diverse consumer segments.

Content owners, often new to this game, will have to learn fast about data mining, profile building and predictive analytics. Historically, they have been one or two steps removed from actual transactions with consumers. To get access to the information they need, content owners will have to either invest in more direct consumer interaction or structure distribution deal terms to include information-sharing components. Some companies are already adopting creative ways of gathering consumer data: Viacom International's The N network created a research panel of 10,000 teens who use their mobile phones to provide ongoing feedback on pop culture, advertising, events and more.[38] Other companies are adopting more experiential and qualitative consumer research: they actually observe consumers as they use new or prototype products and services, rather than simply asking consumers to project how they might theoretically respond.

Major media distributors currently have a very critical competitive advantage: direct relationships with millions of consumers. Through retail point of sale systems, online checkout applications, and subscription and billing databases, media distributors typically have the source data for sophisticated analysis. However, in many distributors' businesses, this data simply sits in databases and is never synthesized or mined to gain usable insights for cross-channel experiences. Media distributors have a tremendous opportunity to turn their direct relationships with consumers – and the historical data they possess – into learning opportunities. The resulting insights can then be used to design meaningful experiences that engage consumers and engender loyalty across touchpoints. These data analysis services and/or the consumer insights they generate could possibly become an additional revenue stream for media distributors.

Behind the scenes, infrastructure will assist in creating new advantages. Customer relationship management systems, for example, can help to integrate and make sense of myriad data sources that span devices, screens and channels. By gaining fuller insight into historical and ongoing behavior patterns, companies can better target and personalize their products and services.

3. Give control to get share.

Though it may sound heretical, media companies need to give consumers more leeway and allow them to control their media experiences.

To maintain attention share, incumbents may very well need to relinquish some control of their content and walled gardens. Users – particularly the tech-savvy consumers that we've called Gadgetiers and Kool Kids – want to be in charge. They want schedule control, access to cool content, contribution opportunities and the ability to share content easily, just to name a few expectations. Content owners and distributors must loosen their hold on some of these areas in order to create new opportunities – or consumers may look for alternatives. For many incumbents, this is as much a mental shift, as a legal one.

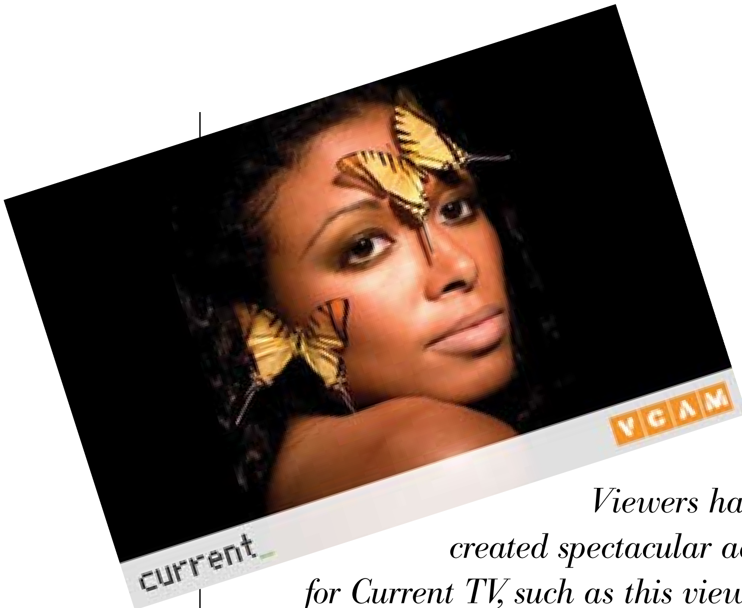
Content owners and media distributors should work together to facilitate legal reuse of content. It should be easy for fans to develop mash-ups, overdubs and other types of creations that celebrate their favorite branded content in new and creative ways. Some companies already are beginning to tap users as contributors. Companies like Revver or Current TV are financially compensating users who create compelling video or advertising clips, ready for rebroadcast across the Web (Revver, Current TV) or through television (Current TV).[39]

More specifically, leaders need to spearhead development of new licensing models that allow user editing and contribution of new content. Content owners should also simplify licensing for users, both as media consumers and as contributors.

TV – Current style

Launched in August 2005, Current TV is an independent media network that relies heavily on viewer-created content. Consumers can submit video clips ranging from 5 seconds to 15 minutes in length. Viewers vote on their favorite videos at Current TV's Web site. Then, the network integrates the most popular viewer-created content with its own programming and puts it on the air. The network is distributed through DIRECTV, Comcast, Time Warner Cable, Charter Communications and Cox Communications. It also has a channel on Yahoo!. Currently, the network retains exclusive rights to the submitted content for three months, and about 30 percent of its content is user-created.[40]

Buying a five-minute segment of user-created video costs Current TV around US$250 to US$1,000, while just one minute of traditional television programming typically averages somewhere between US$1,000 and US$10,000. Current also accepts user-generated ads that feature any of its corporate sponsors. Creators of ads selected for Current TV receive US$1,000. And if the sponsor likes the ad enough to distribute it through other channels, the submitter could earn tens of thousands more.[41] Even at the top end of the payment scheme, these user-created spots set sponsors back far less than the traditional 30-second ad, which normally costs hundreds of thousands, if not millions, of dollars when produced by a large advertising agency.



Viewers have created spectacular ads for Current TV, such as this viewer-created advertising message (VCAM) for L'Oréal.

4. Deliver experiences, not just content.

Media companies must also get serious about the overall consumer experience. It is not enough to migrate old models and content into new channels. Building a new-world experience will likely require new content, a new way of consuming it, and new tools to make the experience easy.

For today's consumer, content is an expectation; the experience itself is the differentiator.

The video game industry provides an illustration of this evolution in content and format. Video game publishers have launched new content experiences by moving beyond traditional licensing and console relationships to online subscriptions (such as with the popular Sony Online Entertainment Everquest I and II games), context-appropriate marketing and genre-specific product placement. As experimentation in games has shown, engaging media experiences easily cross channels, from one screen to another, and switch between "real life" and online play.

Divided industry views

"If content is king, distribution is King Kong."

– IBM interview with North American media company CEO

"Open standards are seen as winning in the end, but companies try to keep walled gardens as long as possible to monetize on this advantage."

– IBM interview with a Director of an international economic forum

In the digital world, some of the most pivotal factors influencing the consumer experience relate to technology tools, particularly those that handle authorization and authentication. Solutions for digital rights management and security must not put the company's rights and requirements ahead of the consumer's. Media companies must take the initiative in this legal tug-of-war and enable positive, legal experiences across devices – both to spur new revenues and provide alternatives to piracy.

When the consumer experience is the top priority, authentication of content experiences will happen at the user level, not based on the network or device he or she happens to be using. In other words, users, if they desire to, should be able to use authorized content on any device and also buy permissions from any of their devices.

If media companies are obsessed with the consumer, they also won't bother users with form-factor issues. This may involve investment in transcoding so that the music or video is playable on various devices without user intervention.

Clearly, the consumer's media experience will also be influenced by a media company's relationships with partners, from retailers to distributors to back-end providers. So in addition to working within an organization, fluidity for the user will hinge on a media company's ability to influence others for coordinated execution. Delivering convenient and seamless experiences takes a Herculean effort – but the return on that effort could be huge.

5. Leverage virtual worlds.

Another important expansion that media distributors should be thinking about is how best to venture into the virtual world for brand and service extensions. Here, we're not using "virtual world" as slang for the Internet in general; we literally are referring to virtual *worlds*. Tech-savvy and fashion-forward consumers (or in our parlance, Gadgetiers and Kool Kids) are flocking to these *avant-garde* virtual communities where they can assume new personas and carry out everyday activities, such as shopping, chatting with friends at a crowded restaurant or attending a "live" concert. Linden Research's Second Life, one of the most popular virtual world sites, now has over one million "residents" – with a median age of 36, half of which are female.[42]

For their part, content owners can use virtual worlds for content, loyalty, character and storyline extensions to entice those users that require advanced interactivity. Because virtual worlds allow self-styled experiences, virtual world inhabitants control if, when and how they interact with various brands.

IBM is already entertaining prospective clients in Second Life.

Media distributors can also link to these virtual worlds and enable services that blend the "real" and "virtual" across multiple devices. Another possibility might be for media distributors to establish (through acquisition or with the help of partners) their own virtual world that offers consumers the safety and privacy of their traditional walled gardens.

Companies like Reuters, BBC, Starwood Hotels and Resorts, Audi AG, American Apparel and Circuit City Stores have already extended brands into Second Life, among other places, to reach the tech-fluent, fashion-forward set. These companies, and others, are experimenting with avatar and virtual marketing, from in-world concerts and product education to virtual discounts redeemable in the real world. With all the virtual commerce already taking place in these worlds, we expect companies will soon be blending transactions across both worlds with purchases initiated in the virtual world that are fulfilled in real life (e.g., buying a book or DVD in a virtual store and having it physically delivered to your home).

6. Innovate business models.

New kinds of media experiences necessitate new business models, as well as a revived spirit of invention and faster way to test emerging ideas.

As companies enter emerging channels, they must be willing to cannibalize a bit of their current business to grow a new one. In other words, media incumbents must aggressively experiment with the revenue model, the industry value chain and the enterprise

Navigating the media divide will require significant innovation across the business – even fundamental changes to the company's business model.

model, including the use of partnerships and acquisitions. This also involves rapid innovation in content windows and their underlying economics (ad-subsidized, subscription, pay-per-use, licensing) – before an outsider chips away at their traditional businesses. Some experiments are already underway, such as the music industry's digital single pre-CD release date, as well as near realtime television on demand from North American broadcasters like CBS, ABC or FOX to international ones, from Alsat in Albania to Meridiano in Venezuala.[43] The revenue from these new channels can be significant, as has been the case with recording artists, Green Day, 50 Cent and Beyoncé, who have all received the Recording Industry Association of America Digital Gold Sales Award (for significant digital downloads in six digits).[44]

As they begin experimenting with new business models, media companies need to have a specific set of business goals in mind – and a strategy for how they will accomplish these goals. For instance, as content owners move toward more "open" Internet-based strategies, they must articulate what they specifically want to achieve – from brand extensions to incremental revenue to user stickiness. They need to decide whether to proceed with open strategies directly, or through licensing to a partner or via a consortium of competitors (see Figure 6). Since each alternative carries different risks and requires different skills, management attention and capital resources, content owners will need to assess carefully which option fits best with their own assets, capabilities and risk tolerance levels.

FIGURE 6.
Pros and cons of "open" content entry strategies: going direct versus through a digital portal or intermediary.

Direct to consumer	
Pros	**Cons**
• Content owner has larger upside potential. • Content owner manages the customer relationship, branding and pricing. • Content owner manages user data and user experience.	• Content owner takes on greater level of risk and has unpredictable cash flow. • Content owner is responsible for build-out and capital investment. • Content owner is responsible for billing and customer service, which probably is not a core skill.
Through partner	
Pros	**Cons**
• Partner (versus content owner) is responsible for build-out and capital investment. • Partner is responsible for billing and customer service. • Licensing agreement assures a minimum return, which makes cash flow more predictable for content owner.	• Partner takes larger share of upside, as compensation for greater risk. • Partner manages customer relationship, pricing and branding. • Partner owns user data and user experience.

Source: IBM Institute for Business Value analysis.

Once the entry strategy is determined, next steps include deciding on the operating model (for example, whether to own or outsource the supply chain) and an organizational design with new roles, skills and capabilities.

Similarly, as distributors identify new business opportunities, we suggest being explicit about the goals, identifying optimal entry strategies as well as operating models and requisite organizational designs. For all initiatives, we recommend scenario-planning exercises that test assumptions about possible cannibalization or additive affects of new *windows* and *channels*. Along these same lines, media companies can learn valuable insights about planned obsolescence and organized disruption from other industries such as electronics and consumer products.

We also suggest using rapid pilot programs to test new business models and garner "real life" data on consumer interest. Other considerations for accelerating the innovation process include: sharing risk and investment with partners (or even competitors) and establishing an incubation program office with dedicated funding and defined success criteria.

Generally speaking, corporate cultures must cultivate an ongoing spirit of innovation; even failures must be applauded. While we don't purport to know which disruptive services or technologies will find traction with consumers and the industry, we are confident that progress, and thus disruption itself, will continue and most likely accelerate.

7. Invest in interactive, measurable advertising services and platforms.

As alluded to earlier, we are in the middle of an attention defection. Progressive users, Kool Kids and Gadgetiers in our lexicon, are leaving traditional advertising outlets and giving more time, attention and "impressions" to new media and information devices. Even with traditional channels, increasingly popular services like DVRs and on demand viewing impact how, when and if advertisements are viewed at all. In the next three to five years, we do not see traditional channels, like television, sliding into *cataclysmic* decline, given their resilience among Massive Passives, strong emotional draw and current reach (even if diminishing). But, we do expect palpable change nonetheless. For media companies to exploit, not succumb to, inexorable change, new thinking and systems will be required.

First, the industry needs to move beyond any argument that advertising dollars are inelastic in traditional channels. While there is a historical reallocation lag, budget-to-attention alignment will prevail, with new breeds of CMOs requiring more and more for their dollars spent. This means multichannel innovation, experimentation and new packaging from all media touchpoints, even those not traditionally in the game. Media companies have an opportunity to lead the industry in investment incubators, experiential consumer research and the development of new metrics. This may also involve moving to behavioral measurements, and away from impressions.

Media companies should be testing various advertising alternatives now, so that they are ready to backfill traditional channel advertising when necessary.

Clearly, it's important for media companies to be proactive participants in the evolution of their revenue streams. If not, others will try to dictate. The recent controversy over DVR-adjusted TV ratings illustrates how other parties can effectively push a different agenda and set of interests, given a chance. Further, some advertisers are going "over the top" and bypassing broadcasters and other traditional channels altogether. For example, Anheuser-Busch announced in September 2006 its intention to launch a direct-to-consumer network, Bud.TV, on the Internet. Bud.TV plans to offer advertising, programming and branded entertainment content directly to computers, MP3 players and other devices. The network also plans to include a loyalty program called a "season pass." Upon sign-in, the site will (undetected) download content to users' hard drives so that it is available when the users are ready to view it.[45]

Now is clearly the time for the media industry to unleash its creativity for new business and advertising models. For media companies, this means assessing and updating systems and processes to underpin a more effective, personal and emotional brand experience.

Today, the affected processes and systems are currently disparate, without end-to-end transparency and management. Examples range from ad trafficking and audience addressability to dynamic advertising insertion, interactive formats, audience/individual measurements and agency management. Most of these processes are executed without linkage to each other and overall visibility of all the moving parts. To overcome the process gaps, companies will need to make a concerted effort to move to fluid, customer-focused processes and infrastructure. When these integrated processes are combined with customer relationship systems and databases – which offer the ability to do predictive modeling by consumer microsegment – media companies have a chance to substantially improve their brand impact.

8. Redefine partnerships, while mitigating fallout.

As content owners look to new, more open channels and media distributors seek out niche, user and prosumer content, both groups will need to establish decision criteria for evaluating new potential partners and acquisitions. They will also need to assess and address chess moves made by others.

Evaluation criteria for partnerships and acquisitions will often include a target's brand alignment, customer reach, management talent, financial stability and proprietary technologies, among other assets. For example, media distributors may be focused on partnerships or acquisitions that offer quality long-tail content, user communities or regional exclusivity rights for branded content. Content owners, conversely, may be interested in those companies that offer enabling Internet technologies or recognizable online brands.

As the interests and strategies of traditional content owners and media distributors diverge, it will be critical to assess and plan for the impact these actions have on existing partners. If, for instance, a content owner makes previously exclusive content available across multiple open channels, it needs to understand the short- and long-term effects on traditional distributors. When distributors bring user-contributed content inside their walled gardens, they should attempt to understand – and quantify – the cost to existing content providers in terms of lost attention.

Existing partnerships and investment patterns will need to be reevaluated as companies pursue new business models.

It is also important for incumbents to anticipate and mitigate partners' defensive posture and potential retaliatory moves – and how those might impact their businesses. In response to more competition for attention, for example, studios, publishers and labels could make pricing adjustments, modify exclusivity rights or even decide to withhold branded content entirely. If distributors are forced to rely less on exclusivity of branded content, they are more likely to focus their promotional capabilities and investments on other sources of content, namely niche and user contributions. As part of this analysis, we recommend sensitivity-testing of possible extreme scenarios to ascertain the probable magnitude of impact.

9. Shift investment from traditional business to new models.

New growth initiatives will need to be funded from significant cost savings carved from traditional business areas. It's also quite likely that the products and services of new entrants will increase pricing pressure, which, in turn, would reduce revenue in some corners of the business. Incumbents must find ways to substantially lower current costs to both fund growth and maintain competitive advantage.

To do so, we recommend that companies conduct a full assessment to identify potential areas for consolidation, scale efficiencies and even structural changes to the business. By examining the business in terms of its fundamental components – or groups of like activities – a company can more easily discern which areas of the business are ripe for outsourcing or converting into shared services.

For content owners, process efficiency assessments may lead to insights on how to reduce production costs or highlight additional shared services opportunities beyond the typical areas of accounting and procurement. For media distributors, these assessments may prompt streamlining of investment in wireless, wireline and high-speed businesses to fund innovation in features and new experience enablers.

Based on our client and industry observations, we estimate that several major music labels have already cut approximately 20 to 30 percent of the cost base from their traditional businesses. These savings have allowed those companies to reconfigure their businesses for the digital age. Such moves are now slowly being mirrored by broadcasters and studios.

It is important to set – and begin working toward – efficiency and effectiveness targets now, before external factors force a company into a corner and elicit an ill-prepared reaction. Companies must hold the management of traditional businesses accountable for freeing up dollars for new investment. Companies should incorporate these new goals into their key performance indicators and track progress systematically.

10. Create a flexible business design.

As incumbents reinvent their businesses for the new media world, the watch word should be flexibility. They need the ability to sense and respond rapidly. They must anticipate and move quickly to stay in sync with consumer behavior shifts. This will involve tackling head-on the issues of internal silos, vertical infrastructure and fragmented content exploitation companywide.

Internal silos – and the inertia they cause – can be one of the biggest barriers to flexibility and speed. In particular, media companies must examine their go-to-market capabilities and purge them of any ingrained organizational conflicts. Incumbents will have to overcome other substantial obstacles, such as legacy thinking, unaligned performance measurements and insufficient resources (see Figure 7).

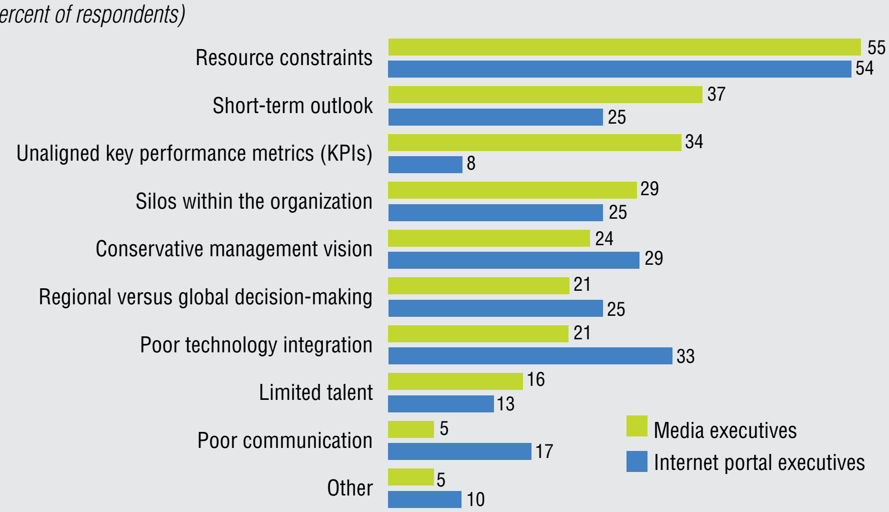
To operate in the new world, media incumbents will have to "horizontalize" their business silos. More specifically, they will need a sideways and complete view of their consumers that spans content types and channels and a common customer relationship management system. This will help media companies deliver an end-to-end experience for the consumer, without timing, pricing or brand experience breakages or conflicts.

Making the company more horizontal has its challenges, not least of which is that today there is an "illusion" associated with the new media parts of the organization: that they require little management infrastructure (because creativity, speed and flexibility might be hampered). Although their informality may seem "dot.com" like, these teams have immense linkages with other parts of the business (especially since their content often originates in a traditional channel where a mass medium helps build a substantial following). Even partial integration of digital and traditional lines of business will necessitate solid, appropriate and horizontal management infrastructure that facilitates communications, joint planning and effective execution. The absence of these horizontal management processes will likely cause havoc and a lack of basic coordination necessary to deliver on commitments.

FIGURE 7.

Executives report a variety of impediments that are hampering new content and distribution strategies.

(Percent of respondents)



Source: IBM Institute for Business Value survey conducted by Economist Intelligence Unit, May 2006

As channels continue to multiply, it is more important than ever to break down line of business silos; success depends on optimizing the business as a whole.

Siloed or *ad hoc* infrastructure also will need redress. This could include media archiving, data hierarchies, licensing databases, digital rights management infrastructure, service-oriented architecture and much more.

As an example, consider service-oriented architecture (SOA) and its potential impact. Media companies clearly need to establish not only new, but *integrated* business workflows and processes. The industry is also recognizing the need to accelerate its shift to open, flexible and interoperable infrastructures and horizontal workflows in order to be more competitive. On both counts, SOA can contribute. Ultimately, SOA is about creating the means to innovate more rapidly – having the flexibility to introduce new products and services, enter or create new markets and revamp business processes… as soon as opportunities appear, or as soon as they are envisioned. Using an SOA approach, enterprises can more easily manage the complexity of multidepartment systems and facilitate collaboration among multiple companies (partners and customers).

Rights management is another horizontal enabler. An appropriate approach to rights management and content enablement can allow flexibility even with complex content models. Yet, to fully activate its potential, companies will need to establish better internal coordination and hierarchical taxonomies, as well as gain buy-in externally from industry partners. Firms will need to understand the implications and architectural control points that rights management systems introduce. The technology platform's ability or inability to support various business models may help or hinder marketplace flexibility overall.

How will you navigate the divide?

Our ten recommendations are designed to guide your firm as it addresses the challenge of reinvention for the new media world. But they're also meant to help you navigate the media divide that could send you in a totally different direction than where your traditional partners are headed. The following questions are designed to stimulate your thinking about the strategic and practical issues associated with these challenges and opportunities:

Innovation for consumers

- What do you offer leading-edge users to keep them engaged with your brand?
- How can you improve your access to direct consumer, "real life" data? How can you make your consumer segment profiles more granular and substantive? How can research be done on actual, not theoretical, cross-channel, cross-device experiences?
- Where can you give consumers more control? What type of limits and constraints are you imposing (intentionally or otherwise) on the media experience? What obstacles prevent you from turning over control? Where policy and regulation is required, how are you minimizing disruption and inconvenience for the consumer?
- For leading-edge users, what virtual communities are most compelling? How can you extend your brand into virtual worlds?

Innovation with business models

- What is your company's current level of innovation? Who manages incubation of ideas and are they properly empowered and staffed? Would you describe your culture as appreciating risks and tolerating failures?

- What are the most radical business models imaginable to you? How can your company prepare to do pilots on different variations of market models? Which partners might share the cost of these pilots?
- If you were to pursue new business models, who in the industry might be affected negatively? What leverage or influence do they hold? What preemptive or retaliatory measures are open to them? Which are likely?

Innovation in business design and infrastructure

- If you had to take 20 percent of the cost out of your traditional businesses, where might you start? What internal or external groups should be engaged to confirm your hypotheses?
- Where do silos impede proactive research and development or content rollout across devices and channels? What key performance indicators are needed to drive cross-business unit collaboration?
- As a content owner, what percentage of funding will you invest in taking content to consumers directly versus through digital intermediaries and/or portals? What new information do you need to determine the bottom-line benefit of each avenue? How and where is it plausible to cooperate with competitors in developing new consumer channels?
- As a media distributor, which community and user interactivity features can be integrated technologically within a two-year time frame? What kind of research would allow you to assess the real demand for these features?
- What is your company's data strategy? What new investments or partner agreements are required to improve data gathering and modeling capabilities? How can you become a premier purveyor of consumer insight?

Conclusion

Over decades, long-time media incumbents have finely tuned their ability to create and protect branded content and distribute it to consumers who access it through a particular device or network. But leading-edge consumers – bolstered by a stream of constant technological innovation – no longer want to play by those rules. They want to create content themselves. And they want to access whatever content they seek from any suitable device, unfettered by distributors' conditional access controls.

The current clash between traditional and new media is reaching a fevered pitch. Industry incumbents are responding – but perhaps not quickly or completely enough. While they fight an escalating competitive battle on this front, traditional media cannot ignore the possible division in its own ranks. Content owners and media distributors need a strategy for turning conflict into opportunity and growth as they navigate this media divide.

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