

IPTV Monitor – Issue 1



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Business confidence in IPTV: few illusions, high hopes.

Written in co-operation with the Economist Intelligence Unit

Key points:

- Confidence is not high among industry executives that IPTV will deliver significant revenue over the next year. No wonder: subscription fees are high, and only 22% of survey respondents believe that firms in the industry have their marketing and pricing strategies in place.
- But there is longer term optimism: 34% of surveyed executives believe IPTV will be generating "significant revenue" three years from now, and another 57% are at least "somewhat confident" that this will be the case.

Fast broadband access means that telecoms operators can envisage selling content. Throw in IPTV technology, which makes programming interactive and allows the gathering of detailed information for advertisers about viewers' habits, and they have a cast-iron business model.

If only it were that simple. Broadcasters and content providers are not idle onlookers. UK satellite TV provider BSkyB bought the ISP EasyNet in October 2005 precisely because it wants to use the latter's broadband IP network to deliver entertainment. Meanwhile, operators serious about content distribution will have to make wrenching changes to their organisations. And the technology retains many areas to be ironed out, a process made problematic by the absence of agreed standards.

It is little surprise, then, that only 4% of 302 executives of telecoms, broadcasting and media firms surveyed by Accenture and the Economist Intelligence Unit are very confident that IPTV will generate significant revenue for their industry in the coming year. Confidence levels of early revenue windfalls are uniformly low across all regions, reflecting the nascent stage of development of the IPTV business.

Extend the time frame, however, and optimism rises significantly: 34% of surveyed executives strongly believe that IPTV will be generating significant revenue in three years time, and another 57% say they are at least somewhat confident that this will be the case. Around the world, North American respondents display the highest level of longer-term optimism for IPTV success. Among the different players in the IPTV value chain, it is equipment manufacturers, content providers and broadcasters who are the most optimistic.

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About the survey

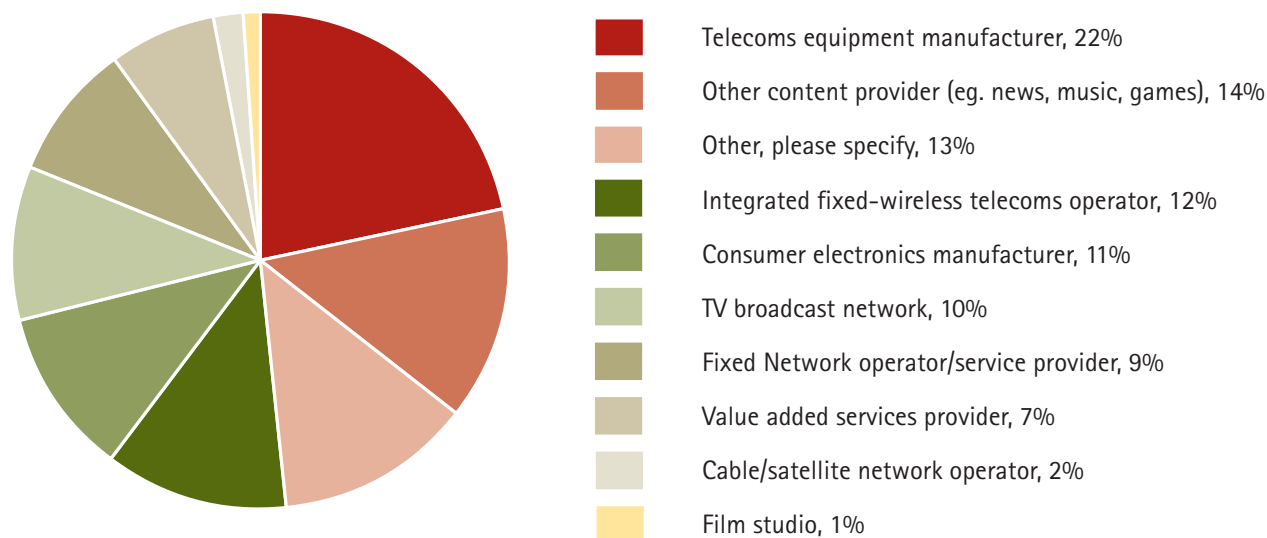
In April-May 2006, Accenture and the Economist Intelligence Unit conducted a wide-ranging survey of 302 executives of technology and media firms that are involved in or close to the IPTV business. The survey covered 40 countries in three regions; 35% of respondents were based in Europe, 33% in the Americas and 32% in Asia Pacific. The types of firms represented in the survey are detailed below

These results are reflected in the Accenture/Economist Intelligence Unit IPTV confidence index. Among executives of technology and media firms that are close to the IPTV business, confidence in short-term IPTV revenue generation is measured at 4.06 ('a little confident') on a scale of 1 to 10, but it rises to 7.55 ('fairly confident') when a three-year time horizon is brought into play. (We will update business confidence in IPTV in six months time.)

Among the various value-chain players, network operators' uncertainty about IPTV revenue prospects stands out. Not a single respondent from this group is very confident that IPTV will spur significant revenue growth within a year, and no more than half are fairly or very confident of substantial revenue generation in three years' time.

Yet Verizon, AT&T, Telecom Italia, France Telecom and China Netcom are all in various stages of trialling or offering IPTV; not to mention a multitude of other tier one, two and three operators across the globe, with over 300 trials or launches underway. Surely, not all the world's largest telecoms operators can be wrong about IPTV?

Types of companies represented in the survey

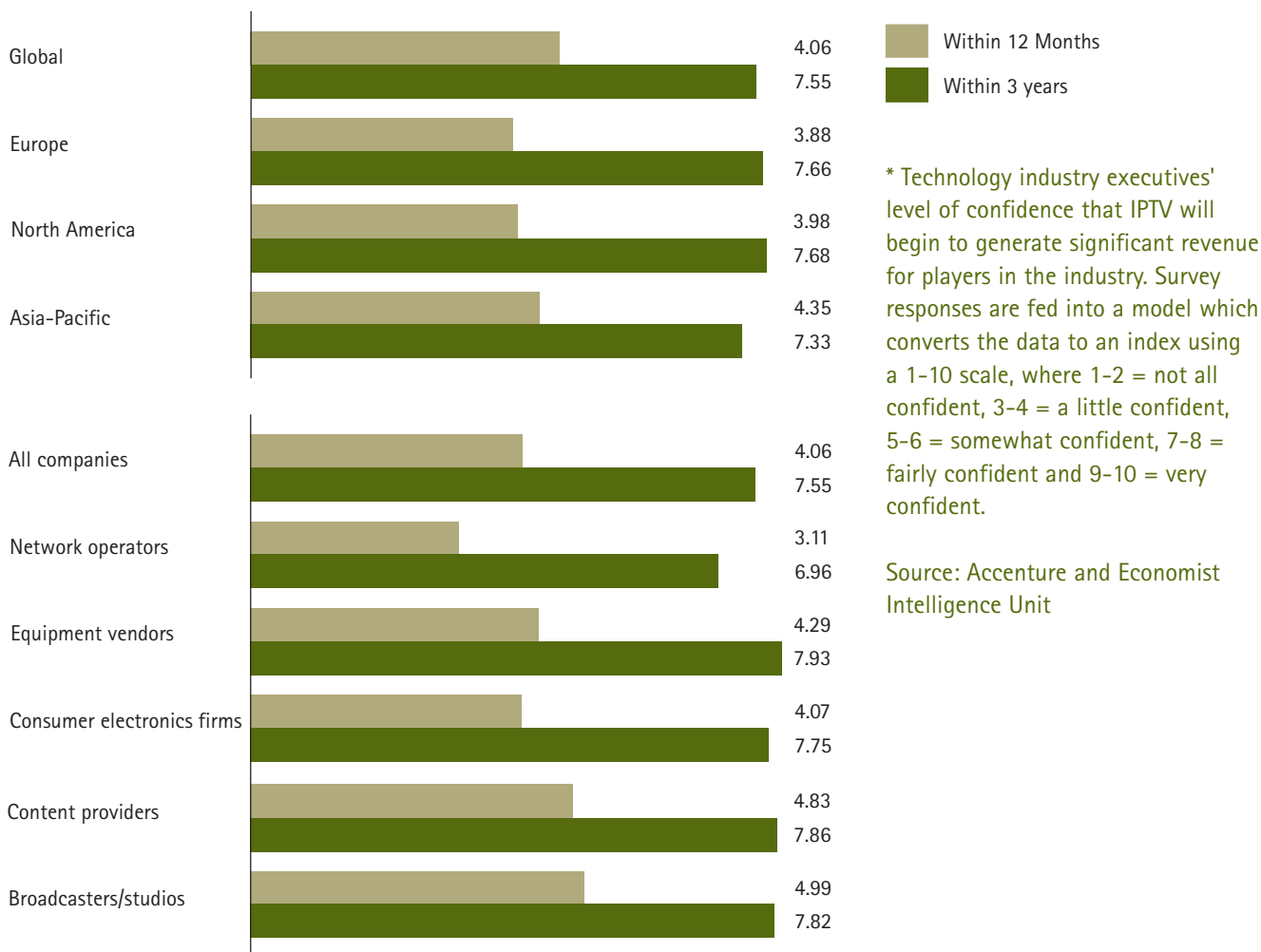


In addition to being cosmopolitan, our survey sample was very senior. Fully 53% of respondents were C-level executives such as CEOs, CIOs and CFOs, and the other half consisted of senior managers such as heads of business units

and directors of marketing or planning. Participants also came from a range of company sizes, with 54% reporting annual revenue of over US\$500m, and 28% over US\$5bn.

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IPTV Confidence Index*



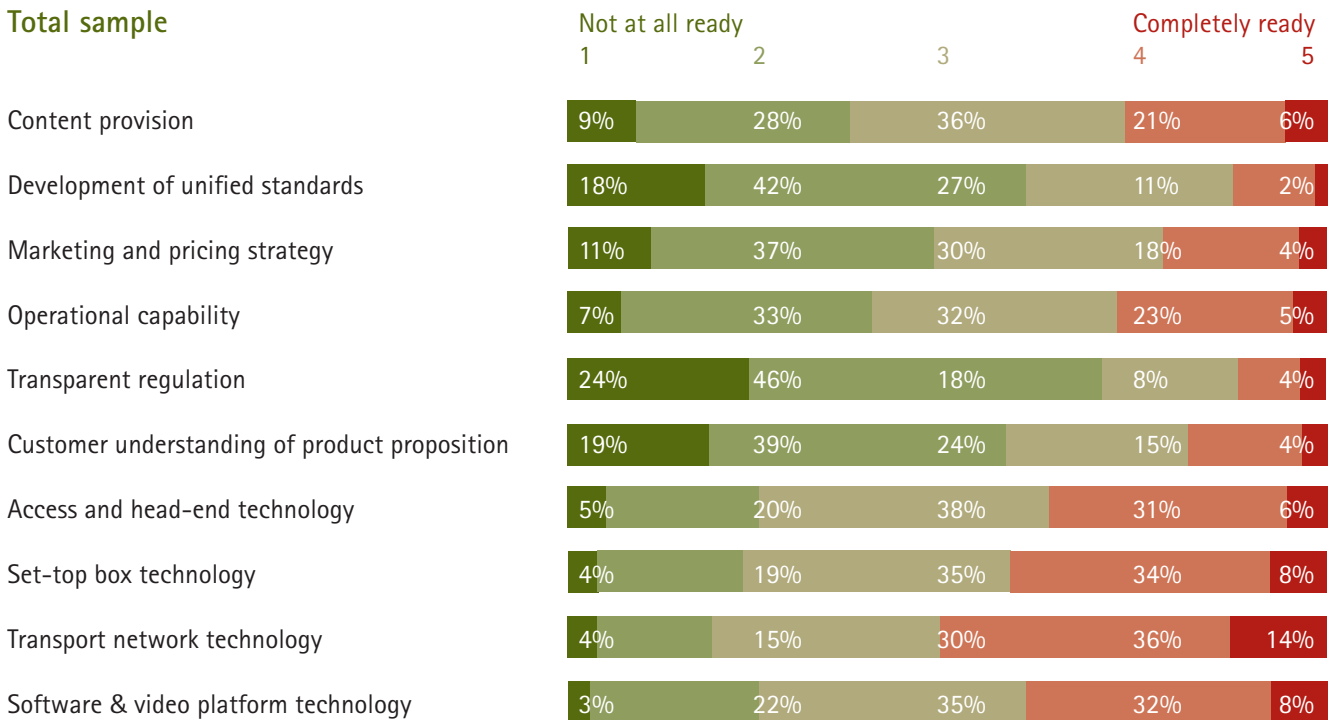
The answer depends on what they expect to get from it, and when. Tellingly, any service provider already offering IPTV services is keeping revenue details quiet. Furthermore, most IPTV launches are launched as part of a bundle, with key objectives being to reduce churn and increase broadband penetration.

Currently, IPTV is almost always sold as a package of services. Fully 85% of executives at network operators believe discounted prices, through service bundling, will play an important role in persuading consumers to spend on triple or quadruple play in the next 12 months.

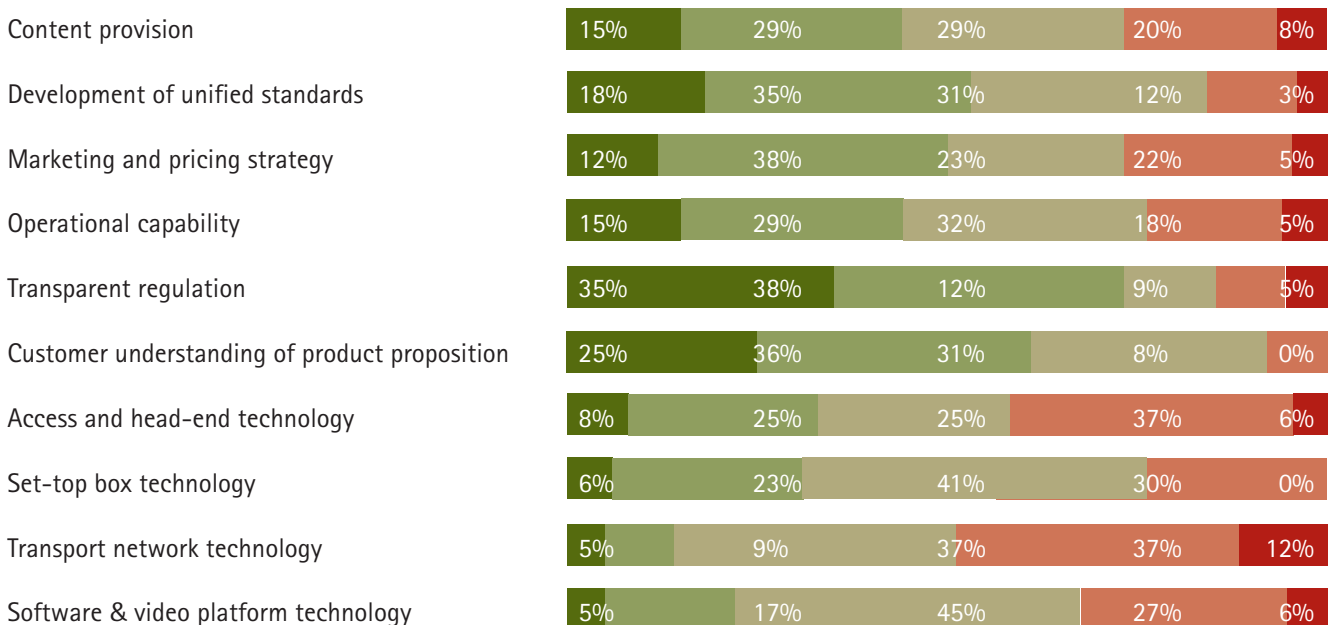
After all, voice and internet access prices are plummeting independently of IPTV launches, and 'get more, spend less' is an easy concept to sell. More importantly, plans for more innovative service bundles that add value rather than simply offer discounts are not yet fully developed. Only 22% of survey respondents believe that firms in the industry have their marketing and pricing strategies nearly or completely in place; 48% (and 50% of network operators) say they are not ready.

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To what extent are the following aspects of the IPTV business in place to enable the delivery of IPTV services by network operators?



Network operators



Source: Accenture/Economist Intelligence Unit survey, May 2006

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This should come as no surprise. IPTV propels telecoms operators from the familiar territory of selling per-minute or flat-rate voice and data services into a whole new business of managing and pricing content. Breaking into IPTV creates a dilemma for operators: they must keep prices low to lure subscribers, but equally they must secure a return on their investment in infrastructure and content.

This will be difficult to achieve in the short term. Survey respondents say that, over the next year, high subscription fees due to the cost of network access and/or equipment will be the greatest obstacle to IPTV adoption by households, along with quality of service issues.

These barriers to market growth will diminish over time. Equipment costs will fall, and quality hitches will ease as the technology improves. Three years from now, IPTV providers will also be bringing substantially more content to

customers than today, mainly through revenue-sharing or distribution agreements with content owners, and some also through content development of their own.

But content sourcing will increase costs; indeed, executives in our survey expect the high cost of content to keep subscription prices high, and that in three years this will be an important obstacle to household adoption.

By then, the competitive environment will be different. Not only will telcos be vying with alternative operators for IPTV customers, but cable and DTH (direct-to-home satellite) operators can be expected to respond aggressively. Executives in our survey say emphatically that the competitiveness of offers from cable and DTH providers will be the single greatest obstacle to IPTV adoption in three years' time.

The business case: lock the customer in.

Written in co-operation with the Economist Intelligence Unit

Key points:

- Few companies expect a substantial IPTV impact on their bottom line. Rather, most see the larger impact being on top-line growth; network operators also hope IPTV will drive the take-up of broadband access connections and help reduce customer churn.
- Content is critical to network operators' business model. They are currently acquiring it however they can, and the largest proportion of respondents say distribution without rights of ownership will be the primary means of sourcing IPTV content over the next year.

Three years ago, tens of thousands of landline customers of Hong Kong's incumbent operator PCCW were defecting to alternative service providers. Today PCCW not only claims to have stemmed the loss, it hopes to increase its fixed subscriber base this year, thanks to IPTV. As of April 2006 the company had 549,000 IPTV customers¹, making it the world's largest deployment.

But even if IPTV is a useful arm in the battle for subscribers, PCCW does not claim that it generates huge revenues. This is fairly typical. To date the business logic behind IPTV deployment has been defensive on behalf of incumbents and aggressive on behalf of alternative operators—or a mix of both.

¹ Source: PCCW

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IPTV subscribers, selected operators

IPTV provider	Customers
PCCW (Hong Kong)	549,000 (April 2006)
Telefónica (Spain)	206,000 (December 2005)
France Telecom (France)	200,000 (December 2005)
Free (France)	195,000 (December 2005)
Neuf (France)	90,000 (April 2006)
Belgacom (Belgium)	33,000 (December 2005)
Homechoice (UK)	34,000 (April 2006)

Source: operators

What are the principal business benefits that your company hopes to achieve through involvement in the IPTV business? (Top responses)

	Total sample	Network operators
Establish new revenue streams	50%	55%
Acquire new customers	30%	20%
Drive profit growth	20%	20%
Increase take-up of broadband access connections	16%	31%
Drive adoption of other services	16%	11%
Acquire/develop new competencies	12%	3%
Respond to competitor threat(s)	12%	18%
Not applicable (we have no plans to become involved in the IPTV business)	12%	8%
Reduce customer churn	11%	22%

Source: Accenture/Economist Intelligence Unit survey, May 2006

In France, competition for broadband customers had driven average revenue per user (ARPU) through the floor. Now, operator ARPUs are showing signs of stabilising. Neuf Telecom, for instance, which had 90,000 IPTV subscribers at the end of April 2006, has used bundled services to boost its residential ARPU from under €0 a year ago to €2 today². Neuf also claims that its customer churn rates have dropped dramatically, thanks to its triple-play offering of internet, telephony and video services.

IPTV may help secure customers to a service provider. What is missing from the IPTV business case for operators' is the promise of a major beneficial impact on the bottom line. When asked the primary benefits they hope to gain from the provision of IPTV, profit growth comes well down the list for network operator executives in our survey.

To be fair, the same is true of all surveyed executives: the establishment of new revenue streams is the dominant motivation of technology and media firms for entering the IPTV business. Most aim to achieve this through the acquisition of new customers, and network operators also hope that IPTV will help increase the take-up of broadband access connections. More than other players in the value chain, operators also hope that IPTV will help in reducing customer churn.

For operators, the business model currently consists largely of selling the best content they can get their hands on, for viewing via their dedicated set-top box. The largest proportion of respondents from both this group and the broader sample (29% and 30%, respectively) say distribution without rights of ownership will be the primary means of sourcing IPTV content over the next year.

However, both Disney and AOL Time Warner are testing PC-based IPTV services that bypass operators' set-top boxes and offer free content, which is tied to advertising that viewers cannot fast-forward. Three years from now, only 14% of operators expect to depend on simple content distribution. Instead, 41% expect to rely on a more complex blend of models that includes revenue sharing and distribution of content with or without rights of ownership.

² Source: Neuf Telecom

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Meanwhile, operators will have to pay content companies such as Disney to distribute premium content. In the US, for example, they are up against cable operators, who are already adept at managing content pricing. And cable can be cheap. In China, cable companies are reported to offer TV and video services for about US\$2 per month.

The business case for equipment manufacturers is slightly different. Vendors in North America and Europe count on IPTV to help make up for sales and margins lost to lower cost rivals from Asia, such as China's Huawei. The plan for vendors is to offer not only technology—head-end equipment and set-top boxes, not to mention broadband

access infrastructure—but also integration and consulting services. Certainly IPTV deployment is an area where operators are likely to need help.

The IPTV market is littered with competing technologies; only 12% of the survey group think that unified IPTV standards are close to being ready.

The business case of all companies in the value chain, of course, is predicated on the customer coming on board. As will be clear from the following article, the customer proposition may not turn out to be as today's IPTV players expect.

No accounting for customer taste.

Written in co-operation with the Economist Intelligence Unit

Key points:

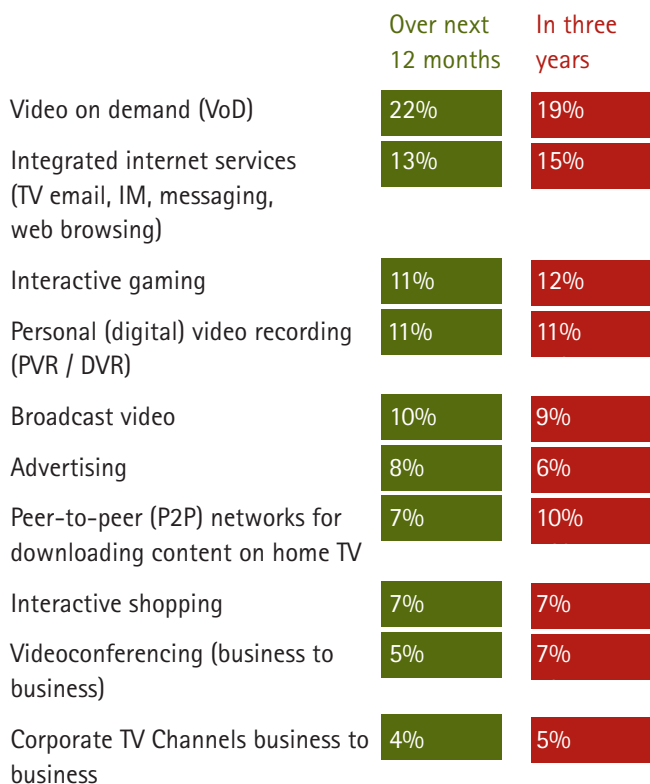
- Video-on-demand is expected to be the chief money-spinner among different IPTV services, both today and over the longer term. There is little consensus on other likely revenue sources. Advertising is conspicuously overlooked by respondents as a potential money-earner.
- A dearth of compelling content and lingering quality-of-service problems are viewed as the chief hurdles to IPTV adoption by consumer over the next year.

In the early 2000s in Europe, mobile operators observed the success of Japan's NTT DoCoMo in selling data content over mobile phones and began investing heavily in next-generation mobile data networks. But European customers ignored efforts to sell them weather reports and news updates, and plumped for SMS instead. They still do. Messaging traffic accounts for nearly two-thirds of Vodafone's revenues from data services.

Executives close to the IPTV business expect that IPTV customers really will buy content, given that the service is based on a large colour screen that people have been watching passively for decades. Survey respondents deem video-on-demand to be the application most likely to create revenue both in the coming year and three years out. Next come integrated internet services, which cover TV browsing, email and instant messaging, followed by gaming and personal video recording.

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Which of the following IPTV services offer the most significant opportunities for revenue growth over the next 12 months, and over the next three years?



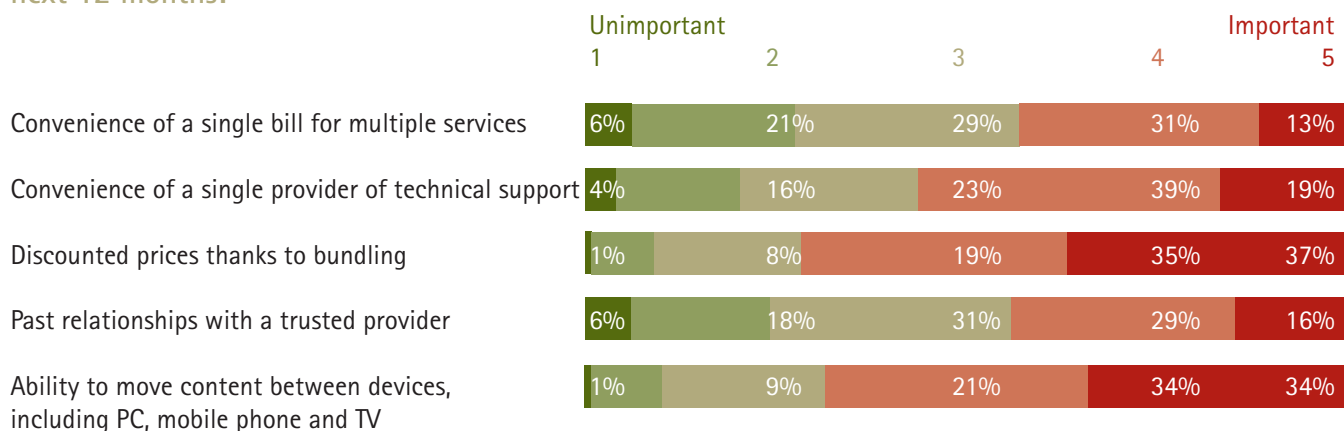
Advertising figures low on the list of possible money-spinners in three years' time, although broadcasters and content providers are slightly more optimistic about its potential than telecoms operators. This seems surprising, given the ability of IPTV platforms to combine the precision targeting and measurement of internet services with the impact of television. Advertising appears to be a potentially overlooked area in current network operator plans, and an opportunity for revenue growth.

Despite Telecom Italia's recent decision to trial corporate TV services, the survey group ranks corporate TV channels last on the list of potential revenue earners in both the short and longer terms, not far behind corporate video-conferencing.

Surveyed executives are also sceptical that peer-to-peer content downloads will generate significant revenue for their firms (although broadcasters and consumer electronics producers are more optimistic than the rest). An advantage of peer-to-peer content exchange, however, is that a significant proportion of younger customers understand it. This is a considerable boon, given that 58% of respondents say customer comprehension of IPTV is not well developed. The drawback of peer-to-peer content is that it is not obvious how to charge for it.

Source: Accenture/Economist Intelligence Unit survey, May 2006

What will most motivate consumers to spend on "triple" or "quadruple" play services over the next 12 months?



Source: Accenture/Economist Intelligence Unit survey, May 2006

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Operators around the world are developing their own user interfaces and interactive services that run on a set-top box which guides customers through operator-managed content. Yet, just like mobile operators, they may find that usage develops independently of their best-laid plans. The success of the video exchange site, YouTube, demonstrates that peer-to-peer video exchanges require neither IPTV, nor the guidance of a service provider armed with a set-top box, in order to thrive.

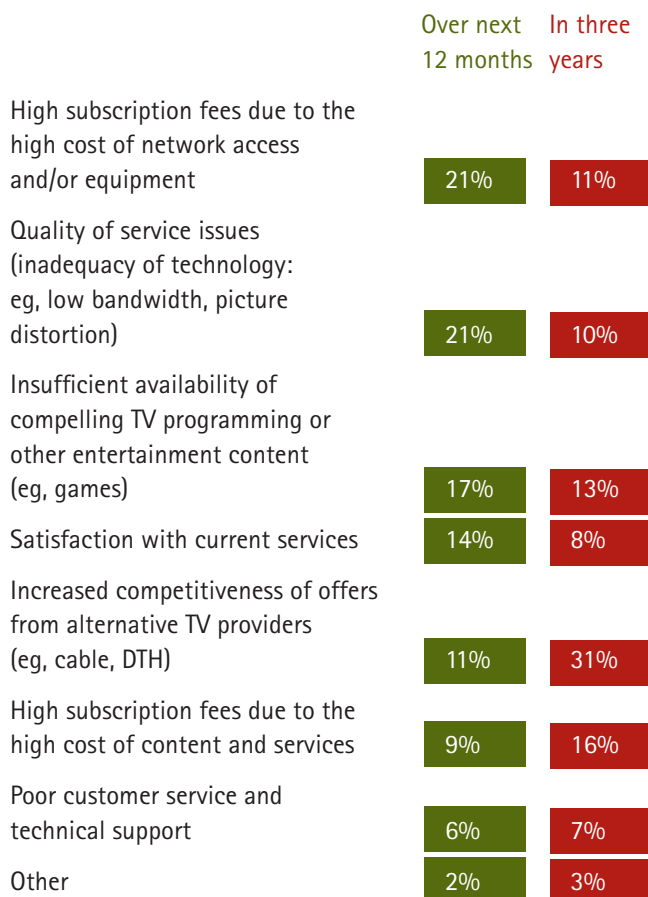
Given the wealth of free content on the internet, not to mention terrestrial television, IPTV will need to be of high quality if customers will pay for it. But quality-of-service issues are expected to be one of the two most serious obstacles to IPTV adoption over the next year (along with high subscription fees), according to the surveyed executives.

Access to content remains a large hurdle; only recently have the bigger IPTV providers started signing distribution deals with Hollywood studios. Respondents think that insufficient availability of compelling TV programming will be the third most important hurdle to IPTV adoption in the next year, although content availability should improve markedly in the longer term.

Operators can also charge for personal video recording (PVR) to store content. France Telecom already charges customers € a month to store 40 hours of recorded programming. But broadcasters and film companies can outdo PVR if they wish. The BBC, for example, intends to make available for download its previous seven days of television programming and is experimenting with making its full archives available online.

With competition like this, operators will need to be creative, and no more so than in pricing. In the short term at least, it is their ability to bundle voice, internet and video/TV services in discounted packages that offers the greatest appeal to customers. Once the flow of content begins, most are certain that video-on-demand will be the most attractive IPTV service to customers, and the paramount revenue generator. Maybe so, but industry experience suggests they should keep their minds open.

What is the single most important obstacle to the growth of IPTV adoption by households over the next 12 months, and what will it be in three years' time?



Source: Accenture/Economist Intelligence Unit survey, May 2006

About Accenture

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