

EMERGING STRATEGIC TRENDS IN THE MEDIA & COMMUNICATIONS SECTORS: ISSUES & IMPLICATIONS FOR TRADITIONAL MEDIA FIRMS

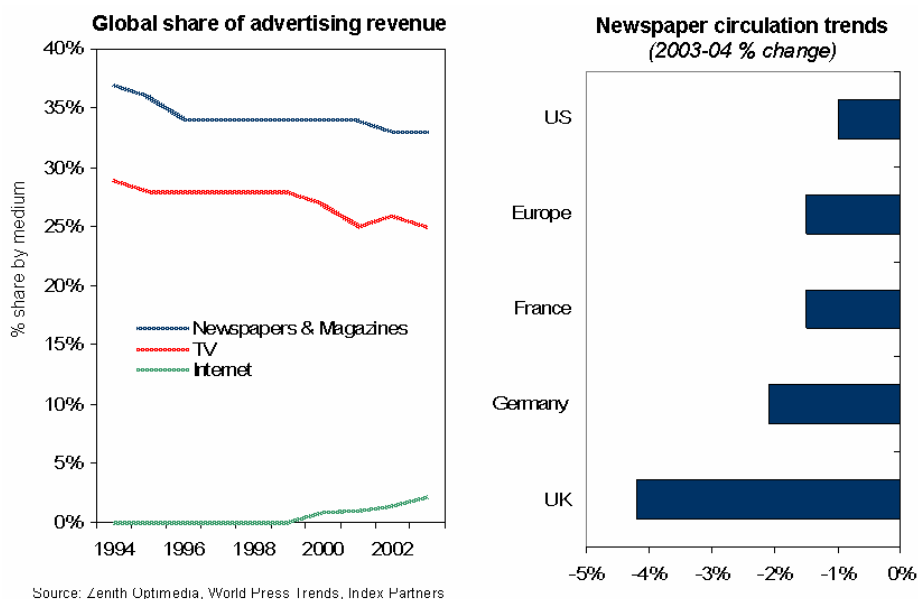
Technology development and evolving consumer choices in the media and communication sectors are significantly reshaping the revenue models and distribution economics of the traditional media industry¹. These changes are triggering significant strategic rethink in boardrooms of all incumbent and potential participants in the broader media and communications sector.

1. The revenue challenge from emerging media platforms

The traditional media sector as a whole is losing audience share and advertising revenue dollars to emerging media platforms² and other non-media entertainment forms. Consumers are spending increasing amounts of time on “competing” forms and channels of infotainment such as video-games, online services and (increasingly) mobile services. The consequent decay in audience share is eroding subscription revenues and driving advertising revenues to emerging media. The migration of advertising dollars is further accentuated by the ability of these new platforms to offer more “informed” targeting of consumers as well as better “impact assessment” of the ad-spend relative to traditional media. The increasing import of the matter is evident in the recent (April 2005) comments from acknowledged business leaders in the industry; Rupert Murdoch and John Malone warned of the challenge posed by the internet’s cannibalisation of advertising revenues (20% year-on-year growth in 2004 to \$9.3 billion³) while Andrew Robertson (CEO of Omnicom’s BBDO advertising agency) projected the emergence of mobile telephones and other wireless communication devices as “the most important medium” for advertisers to reach technology-savvy consumers.

"Subscription and advertising revenues are shrinking..."

The growing penetration of devices such as TiVo is likely to further undermine the effectiveness of advertising spend in traditional media platforms, thereby potentially accelerating the migration of advertising revenue dollars from traditional to emerging media, and potentially to content generators. Many leading consumer product firms are already examining the case for “embedding” their brands and products in the content itself (e.g. use of Coca-Cola brand in relevant movie scenes).



¹ Defined as collection of old or legacy media businesses including press, television and direct marketing businesses

² Defined as a collection of new and potential media platforms including online and mobile platforms

³ Internet advertising revenues in the UK outstripped radio advertising revenues for the first time in 2004

2. The challenge of audience fragmentation

The decade of the 1990s saw the fragmentation of traditional media channels into a bouquet of specialised “theme” channels targeted at defined consumer segments. Consequently, the number of channels on the digital satellite platform alone increased from 300 in 2001 to 450 in 2005, and is projected to exceed 500 by 2007. This trend has been reinforced by a proliferation of distribution platforms and capacity, particularly the growth of pay-TV and DTT. The growth in advertising budgets (3.5% during 2002-04) however significantly lagged the increased in distribution capacity. Furthermore, the channel fragmentation is increasing the competitive intensity – and consequently the cost – of securing “preferred access” to the select killer content categories (e.g. sports).

"... and more channels are vying for the smaller revenue pie"

3. Implications for business and revenue models

In summary, the above trends are eroding advertising revenues per channel and increasing content cost, thereby exerting severe margin pressures. Consequently, the industry is going through a period of “restructuring” with players embracing innovative models to survive and win in the face of declining advertising revenues. For example, UK pay-TV segments have successfully increased subscription revenue streams (ARPU grew from ~£40 in 2002 to ~£42 in 2004) by designing innovative pricing packages with differentiated content and service bundles. This impact is further accentuated by the growth in subscriber base⁴. Consequently, subscription revenues (\$6.5 B) in UK pay-TV exceeded advertising revenues (\$ 6.4 B) for the first time in 2003. Similar innovative models are emerging in the print media too. A notable example is “Metro” that, as a free newspaper, is penetrating mass audience of young, urban, workers that is highly coveted by advertisers and remains free from the threat of dwindling subscription revenues (*in contrast to traditional newspapers that derive 30-50% of revenues from subscription*).

However, these trends – coupled with the initial strategic response of a few large firms (as discussed above) - are significantly increasing the intensity of *change* and *uncertainty* in the industry. This raises the premium for timely insights to define (and refine) the strategic agenda of current and potential future participants in the media and communications sectors, notably in the following areas:

- What are the expected revenue, cost and profit structures in the evolving segments in the industry?
- What is the optimal composition of the business portfolio (online vs broadcast vs print businesses)?
- What are the value and risk profiles of alternative growth models (e.g. acquisition, JV, organic growth, etc.)?
- Who are the best strategic and financial partners for the growth of a specific business?
- What is the estimated present and future value of a given business (financial and strategic)?

"Change and uncertainty demands re-evaluation of strategic options"

Answering these questions require rigorous, independent, timely and insightful analyses of relevant issues within the media as well as related communication and technology industries. Index Partners leverages its insights across these converging sectors to evaluate the collective intensity and impact of these forces on client’s specific businesses.

⁴ In Europe, pay-TV is projected to penetrate 94.4m households by 2008, up from 82.4m households in 2003

Notes:

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