



## Satellite Radio: Wave of the Future or Niche Play?

Published : November 03, 2004 in [Knowledge@Wharton](#)

When Sirius Satellite Radio brought the controversial disk jockey Howard Stern to its network earlier this month in what the company described - without a trace of humor - as "the most important deal in radio history," it may have moved satellite radio a step closer to going mainstream. Experts at Wharton and elsewhere say there's little doubt that satellite radio will eventually become big business. The question, though, is when.

Satellite radio offers a nearly unlimited selection of largely commercial-free music channels - 80s hair bands, underground garage rock, bluegrass, jazz, classical music and even Broadway show tunes - for monthly fees ranging from \$9.99 to \$12.95. The radio signal is sent from satellites to receivers that primarily reside in new automobiles for now, but increasingly are becoming portable. The two providers on the market - XM Satellite Radio and Sirius - have deals that include their receivers as options on new GM, Ford, Honda and Chrysler cars.



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XM launched nationwide in Nov. 2001 a year ahead of Sirius, which was late getting its receivers on the market. As a result, XM had 2.5 million subscribers as of Sept. 30 and is targeting 3.1 million by the end of 2004. In contrast Sirius has 700,000 subscribers in October and is targeting 1 million by the end of the year. "I'm a fan of the technology and the subscription model," says Wharton marketing professor [Peter S. Fader](#). "There's a bright future for them, but it may be a long time before that future manifests itself."

Meanwhile, neither satellite radio provider is profitable; both companies burn through cash and frequently raise capital on Wall Street. For the second quarter ending June 30, Sirius reported a net loss of \$136.8 million on revenues of \$13.2 million. For the same quarter, XM lost \$166 million on revenues of \$52.9 million.

At this stage, both XM and Sirius are building out their programming. XM has deals to broadcast college football games and recently signed Stern rivals "Opie and Anthony," whose broadcast is positioned against the so-called "shock jock" during morning drive time and resides on a premium XM channel.

Sirius plans to pay Stern \$100 million a year for five years and share revenues as the company grows its subscriber rolls. Sirius CEO Joe Clayton says Stern, whose audience is estimated to be around 10 million listeners, "is capable of changing the face of satellite radio and generating huge numbers of subscribers for Sirius." The company also notes that if Stern were to attract 1 million more subscribers, the deal would pay for itself. Sirius has also paid heavily to broadcast all National Football League games.

XM has been working on striking its own massive deals to retain its competitive lead over Sirius. On Oct. 20, for example, the company announced an 11-year, \$650 million deal with Major League Baseball. The company said this agreement would enable XM to broadcast games of every Major League Baseball (MLB) team from the 2005 season. "This is the crown jewel - the deal that we've been waiting for," said Hugh Panero, CEO of XM Satellite Radio, in a press release. "Major League Baseball is America's national pastime and a natural fit with XM. MLB has the broadest appeal of any major sport. Baseball is also a sport ideally suited for radio, given its natural pace and the ability to vividly describe each play."

According to Wharton professor [Kevin Werbach](#), signing such blockbuster content deals makes sense since each additional subscriber will cost both companies less as they expand. "There's nothing wrong per se about neither company making money right now," he says. "The issue is whether satellite radio is a niche play or the future of radio."

Wall Street analysts have voted that satellite radio is the future, especially since a popular (some might say notorious) disk jockey like Stern has jumped onto the bandwagon. "[The Stern deal] reinforces our belief that satellite radio will become ubiquitous, and that investors should start to think of the duopoly of XM Radio and Sirius as Coke and Pepsi," wrote Bear Stearns analyst Robert Peck in a research report. According to SG Cowen International's Thomas Watts, Stern's move shows that satellite radio "is no longer a gimmick."

## Marketing a Movement

According to Fader, many customers would come around to satellite radio even without big name programming moves such as Stern's. Still, such deals get Sirius - and the satellite radio industry - free publicity and can lead to more users.

There are hurdles, however. The main one is the idea of paying for radio, suggests Fader. "The idea of paying for radio is a psychological barrier. It's a generational thing. People were appalled when cable companies asked them to pay for TV. Now, 20 years later, we laugh about it."

So how do you convince consumers to pay for radio? "There are two ways to entice customers - you either bring in new buyers or accelerate adoption by consumers who were going to do it anyway," says Fader. The Stern deal may act as an accelerator for people who were on the fence about satellite radio. "It's important to know that the early adopter is very different than the new buyer."

Watts estimates Stern could bring 2 million more subscribers to Sirius and 4 million in all. Like Fader, Watts distinguishes between Stern loyalists who wouldn't have signed up for satellite radio if he hadn't moved (2 million) and early adopters who would have adopted Sirius (2 million).

XM and Sirius have developed a mixed approach that targets both types of users. According to Fader, companies generally use two methods of marketing in such situations: a "skim" approach and a "penetration" one. In the skim method, the goal is to pick off likely users who are willing to pay a higher price. In the case of satellite radio, this may include consumers who buy new cars and opt for satellite radio as an option.

In contrast, the penetration approach focuses on signing up as many consumers as possible. (Example: America Online carpet-bombing the U.S. with sign-up disks and special introductory offers.) Both XM and Sirius are focused on signing up consumers rapidly - Wall Street closely watches subscriber rolls. Sirius offers a lifetime subscription for those willing to fork over \$499.99 through Dec. 31. "XM and Sirius have a mish-mash of both approaches," says Fader. "It's unclear whether getting a subscriber at any cost is better than building a small, solid base. In the long run, though, it's difficult to do both."

XM and Sirius, both of which are focused on signing up new customers, will also have to change their business models to minimize churn and retain customers. "I think [subscriber growth] will be a much slower ascent," says Fader. "The growth curve may still look like a hockey stick, but satellite radio has to get beyond the early adopters."

"The challenge for both these companies is that they have to know when to step on the accelerator and when to lay off," notes Werbach. "Step on it too soon, and you flame out. Wait too long, and you never hit escape velocity. The risk is that satellite radio could become like TiVo [the company that developed the

first digital video recorder]. Whoever has TiVo raves about it. Whoever doesn't have it doesn't see why he needs it."

### **Uncertain Business Models**

If XM and Sirius are successful signing up consumers - and so far, that is still a big if - their businesses could be highly profitable. "I think the technology and the model will be profitable," says Fader. "Down the road, subscriptions will be common in radio."

According to Werbach, the network effect - where the costs of serving an additional customer are low once infrastructure has been built - is likely to work in favor of satellite radio. Both Sirius and XM have already launched their satellites, built networks and signed deals with leading content providers. In addition, satellite radio will gain subscribers as consumers buy new cars. "By installing the receivers in automobiles, it takes much of the decision out of the consumer's hands," says Werbach. "All the consumer has to do is decide whether to subscribe or not."

The automobile strategy should give satellite radio a captive audience and grab new customers. According to Peck, XM has projected that it could reach 20 million subscribers by 2010, largely because of its deals with GM and Honda, which churn out 6 million cars a year. Sirius has deals with Ford and Chrysler, which account for 6 million to 7 million cars a year.

But ultimately, Fader says XM and Sirius will have to get by without depending on automakers to market their receivers. "Right now the model depends on people buying new cars, but ultimately the businesses will have to stand on their own. In a couple of years, I see satellite radio growth divorced from the auto market."

Selling satellite radio services in the absence of collaboration with automakers will require the industry to transition to new, smaller devices. Today satellite radio receivers are bulky when compared to the Sony Walkman or Apple Computer's iPod. While the receivers may be fine when fitted into cars, XM and Sirius have cumbersome products that aren't easily lugged around when running, walking and other activities. Peck has speculated in research notes that XM is planning to introduce a Walkman-sized device. "Mainstream acceptance does depend on new devices," says Fader. "As technology improves, it won't be surprising to see MP3 players in the future function also as satellite radio receivers."

### **Target: iPod?**

The potential success of satellite radio is likely to have bigger implications than whether it will supplant free radio - Fader and Werbach say both types of radio will coexist much like skis and snowboards. However, satellite radio could wind up being a major competitor to Apple's iPod as services and devices converge, suggests Fader.

For now, consumers choose to download music and carry it around via devices like the iPod. Satellite radio, however, can in theory carry more songs. With technology improvements, devices will be able to sort songs played over satellite. It could be the ultimate subscription music service, says Fader, who believes that subscription music services will ultimately win out over downloading. Toss in real-time data and local information, and satellite radio could be a big rival to downloading devices. "There's so much selection, it's easy to imagine you could have a real-time playlist."

Werbach says the iPod vs. satellite radio will offer an interesting contrast. Apple's business model revolves around its iPod players, while services such as iTunes are used to boost hardware sales. XM and Sirius, in contrast, aim to sell their satellite radio content as a service and the hardware devices are secondary.

Are XM and Sirius gearing up for the inevitable iPod battle? "I doubt they are thinking that far ahead, but they need to think that way," says Fader. "It's important if they want to bridge the chasm between early adopters and the mass market."

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