Prime Time No More: The Television Industry Struggles Against Digital Distribution Upstarts

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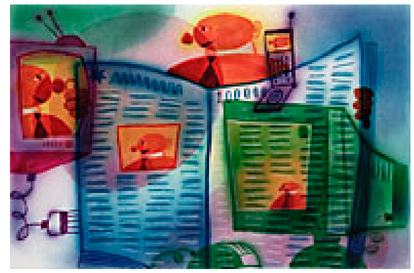

It's open season on the television industry's business model. In recent years, the three pillars of the industry's profits -- advertising, regional programming and syndication deals -- have come under fire from a band of technology companies, including Sling Media, TiVo, Orb Networks and Apple Computer, that are rewriting the content distribution rules. As Wharton legal studies and business ethics professor Kevin Werbach notes, TV won't necessarily be viewed via TV anymore.

"Over the next decade, the idea of video content being limited to a single time and device will become quaint," says Werbach. "Broadcasting, as we know it, is an artifact of historical limitations on distribution, which are increasingly irrelevant in the digital broadband age." The only real question for Werbach is how quickly the transition will occur as technology shifts the place and time that television is viewed.

Other experts at Wharton agree with Werbach's thesis. Dan Hunter, legal studies and business ethics professor, sees television as a slow growth industry that will struggle to capture Internet-savvy generations now spending more time with web sites like MySpace than with their remote controls. Nelson Gayton, a Wharton adjunct professor who studies media and entertainment, suggests that technology will forever redefine viewing habits. Kendall Whitehouse, senior director of information technology at Wharton, acknowledges that media giants such as CBS, Disney's ABC and General Electric's NBC will have to change, but says that the TV giants seem to be willing to adapt to new technologies. "The TV industry realizes that the recording industry didn't handle the digital era well, so it's very aware of the dangers and the opportunities [of digital distribution]."

Indeed, the major television networks have cut deals to distribute shows for a small charge through Apple's iTunes or have launched on-demand viewing from Comcast or DirecTV Pay Per View. But what remains to be seen is how television giants adapt to a shifting landscape. TiVo, with its digital video recording technology, allows consumers to "time shift," or view programs whenever they want and skip commercials. Apple has shifted both the time and place viewers can watch TV by selling shows that can be downloaded to iPods. Sling Media, a San Mateo, Calif., company that in January secured $46.6 million in venture capital funding, has created the Slingbox, a device shaped like a gold brick that allows you to "placeshift" and watch your TV live from a laptop PC. On March 23, Sling Media announced software that allows a viewer to channel surf his home TV from any network-enabled mobile phone or handheld computer (PDA) powered by Windows Mobile. Sony also has a device, called Location Free TV, that lets viewers watch shows streamed from a home TV set to a PC anywhere, much like the Slingbox.

Individually, these technology companies aren't going to upend broadcasters anytime soon. Collectively, however, they could undermine the business model that media companies have relied on for years. Television operates under a complex set of arrangements that cuts deals with local affiliates based on geography, syndicates reruns and relies on ratings to sell advertising. But gadgets like Slingbox do away with geography. TiVo redefines the definition of prime time. iTunes puts on-demand reruns in the palm of the viewer's hand. Sites like YouTube (www.youtube.com), a Menlo Park, Calif.-based consumer media company, allows amateurs to share and distribute video clips and could someday threaten TV networks. Meanwhile, the audience becomes more fragmented, a fact that undercuts the ad rates TV can charge.

Wharton's Hunter may be a sign of the future: He canceled his cable subscription because he doesn't watch much TV anymore. Tim Bajarin, an analyst at Creative Strategies, a Campbell, Calif.-based research firm, is another. Bajarin, a frequent traveler, recently caught an NCAA [National Collegiate Athletic Association] tournament game in Singapore using his Slingbox. "TV in Singapore wasn't the greatest so I watched the GMU [George Mason University] game," he says. "If you are traveler and want access to your TV, it makes sense."

According to Bajarin, gadgets are beginning to define the entertainment business. "How I access my media is hardware driven," says Bajarin. "There are challenges -- such as digital rights management [DRM] and whether [TV over the Internet] will work -- but the bigger theme is time shifting. Consumers can access content whenever they want." TiVo had 4.4 million subscribers as of January 31, 2006. Cable had 66 million subscribers as of 2004 and the estimated TV audience that year was 200 million.

What makes these developments more interesting is that there are no clear winners. Broadcasters may muddle through the changes, but many of the companies that now seem so innovative soon could hit roadblocks, says Werbach. For instance, TiVo is being threatened by cable-box makers that are embedding digital video recording technology. Slingbox has first mover advantage, but could stumble as other players enter the market. "The challenge for Sling Media, and companies like it, is that eventually what they do will become a standard feature of the television experience, rather than something you pay for in a separate device," says Werbach. "Like TiVo, Sling runs the risk of being a true innovator that struggles to reap the full economic benefits of the innovation it unleashes."

For Gayton, the main questions are where technology will lead entertainment in terms of how it will be viewed and distributed. "From a business model perspective, technology is clearly redefining entertainment," says Gayton. "Technology is allowing you to bring your living room on the road."

Shifting the Business Model

Gayton argues that gadgets such as the Slingbox give consumers more control than ever over what entertainment they choose, what devices they use to view it and what they can do with it. That fact fundamentally changes TV's relationship to viewers. "Broadcast TV has been telling you what to see, when you see it and how you see it," says Gayton. "Technology has changed all that forever."

The big unanswered question is how the television business model will respond to the changes. Gayton argues that the television industry is used to adapting. Indeed, broadcast TV has had to fend off encroachment from VHS video tape recorders, cable networks and new entertainment forms over the last 30 years. Cable TV splintered audiences and VHS recording allowed consumers to time shift programs. Through it all, TV giants have survived, and in some cases, thrived.

But the real wildcard is whether typical TV broadcasting can withstand online and other new forms of distribution. The networks' major thrust in digital television has been toward HDTV (high definition television) which, while it offers significantly better quality, still follows essentially the same distribution model. To the TV industry, geography still matters, says Whitehouse. But Internet-connected devices change the equation dramatically. "TV has built a whole business model around geographic segmentation, but the Internet blows that away." Indeed, digital distribution could affect everything from local advertising rates to what stations pay to rerun hits such as "Lost" and "CSI." "How much can [the networks] charge for a program in syndication once a large segment of the audience already carries around all the episodes on their iPods?" asks Whitehouse. On the other hand, he notes that digital distribution also creates markets for programs that may not work well as reruns. "A show like 'Lost' has a lot of buzz on its first run on TV. But once the [show's] mystery is revealed, it may not be as valuable a commodity for syndication. ABC may make more money selling it now through alternate venues while it's still a hot program [than it will selling it in syndication]."

Gayton acknowledges the threats, but also notes that the true effect on the business model will take years to unfold. "The TV model is about control, and it is clear that broadcast attributes are a part of the past," says Gayton. "But it is still one of the best ways to get a mass audience."

However, attracting a mass audience may lose some of its value as consumers become increasingly fragmented. New devices from TiVo and Sling Media can potentially give advertisers smaller, but more lucrative, audiences due to better viewer tracking. By focusing on actual audience behavior instead of Nielsen ratings -- which may not be able to capture how and when content is viewed over alternative devices -- advertising could become more efficient, Wharton experts say.

The changes aren't lost on the television industry. It is experimenting through its iPod deals and could team up with a company like Sling Media, which streams TV content from anywhere but doesn't allow consumers to skip ads. To Gayton, it's way too early to count out media giants. "Technology will change the way we receive information, but you don't have to look too far back in history to see television reinvent itself." Hunter isn't as sure about television's future. "These devices represent transition points for media. Television can't expand that much as an industry. It will keep the generations that now watch it, but the current generation doesn't care about TV. Over time, [broadcast television] will be a declining market."

Searching for Content

While the television industry is in flux, it remains to be seen if current leaders such as ABC, CBS and NBC will remain in front. In the future, a broadcast network may look a lot more like Google and Yahoo than NBC. "The broadcast network could be in a different medium entirely," says Gayton. Why? As the Internet increasingly becomes the key distribution mechanism for entertainment, the need for search becomes significant. Consumers will increasingly go out to find the content they want because "they don't want to be told what to see," says Gayton. "The ability to search is a phenomenon you can't deny."

Bajarin agrees. The next frontier for media will be creating a portal where a consumer can get all of his or her entertainment needs met in one place. This portal would allow someone to manage, distribute and mix and match media as it is loaded onto a device of choice. "I have Google video, iTunes, Slingbox and more," says Bajarin. "Right now, I have to manage seven or eight devices. Google, MSN and Yahoo seem to be in the best position to help with that."

What would it take to create a new digital entertainment powerhouse? According to Werbach, "the next key development will be when the first hit show, on the scale of 'The Sopranos,' is primarily distributed not through broadcast or cable TV, but through the Internet and mobile devices. It's only a matter of time."

What's unclear is who will create that hit and navigate digital distribution models. Could it be someone like Apple CEO Steve Jobs? Experts at Wharton point to the fact that Jobs, who is also Pixar's CEO, will become one of Disney's largest shareholders once the acquisition of Pixar by Disney is completed -- a sign of how technology and entertainment are converging.

What won't be changed by technological advances is entertainment's effect on personal experience, says Gayton. For instance, each individual has a unique reaction to content. When two people watch a comedy or a drama, each takes away something different. "Technology will never change that emotional thread and can't alter human imagination and story telling," says Gayton. "Technology won't fundamentally change creativity." In that respect, the entertainment production companies are still in the driver's seat even though their distribution models are in flux, he argues. It is still uncertain, however, whether "content will [remain] king," a mantra that was touted in the late 1990s. These days, he adds, "functionality will be a key part of it. Technology brings the functionality."

According to Whitehouse, the key for the media industry is blending the technology with the entertainment content. "What remains to be seen is how the TV networks will construct a business model that works in the digital age. They can put a finger in the dam for awhile, but eventually the floodgates will open up. They need to be ready."