Opportunities for Action in Consumer Markets

Thriving in a World of Consumer Control

THE BOSTON CONSULTING GROUP

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The media sector—where consumer markets, communications, and technology intersect—has always been particularly susceptible to technological change: witness the impact of television, VCRs, DVDs, MP3s, and the Internet. Now, thanks to the most recent wave of innovations, consumers are taking increasing control of what they read, watch, and listen to, as well as when, where, and how they pay for it.

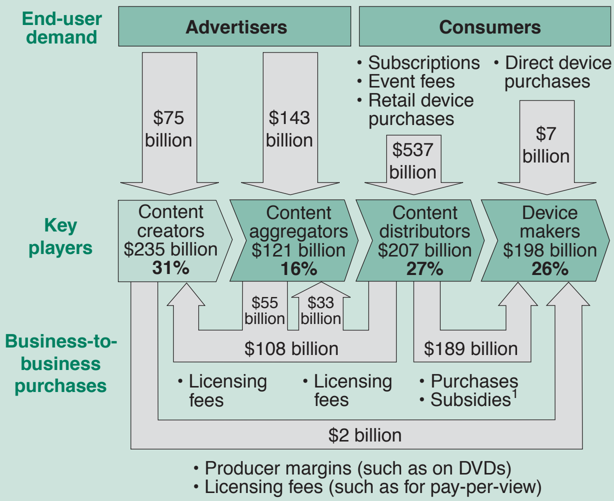
These changes in consumer behavior are expected to reverberate throughout the media industry for years to come, eventually altering the competitive dynamics for content creators, aggregators, and distributors, as well as device makers. Flexible new entrants will introduce fresh business models. Attackers, following the path blazed by Apple's iPod, will seize new opportunities. Although these developments will affect different businesses in different ways, media organizations—as well as other players along the value chain—will have to respond to the complex needs of a fragmenting mass market. That said, there is as much upside for nimble companies as there is downside for sluggish ones.

On the Brink of Upheaval

Although new technologies invariably elicit hand-wringing, the media sector appears to be quite healthy, with more than $750 billion in major market revenues, attractive margins in several parts of the value chain, and growth rates higher than the GDP in many subsectors. (See Exhibit 1.) Significantly, more than $200 billion comes from advertisers, which increasingly are seeking better ways to get their messages to consumers. Yet, despite those numbers, leading media players have delivered below-average shareholder returns over the past three years, partly because the expectation premium embedded in the stock price has declined considerably. As innovation continues to accelerate and long-anticipated technologies reach critical mass, expectations of an industry shakeup—with winners and losers—are escalating.

If the outlook is uncertain for business, it seems quite promising for consumers—so far. The amount of

Exhibit 1. The Media Industry Is Alive and Well Around the World



SOURCES: Veronis Suhler Stevenson; PricewaterhouseCoopers; eMarketer; Reed Electronics Research; BCG analysis.

NOTE: This exhibit excludes revenues associated with Internet access and advertising ($51 billion in 2003) and with public television. All numbers have been rounded.

[1]Does not include mobile phone subsidies.

bandwidth, storage, and processing power available has increased exponentially over the past five years, while costs have dropped below the threshold for mass-market adoption. Although only 10 percent of the population in most developed countries (except South Korea) currently uses broadband, that number is growing rapidly. Today more than half of the Internet users in the United States connect through broadband.

Libraries of digital content, rich with "metadata," will provide for sophisticated content management and navigation, while standards for format and connectivity—already established in a variety of situations—will improve access. The growing support for interoperable digital-rights-management platforms will remove the barriers now discouraging suppliers from increasing investments in digitizing and from sharing "premium" content. Meanwhile, the richness of the supply side will continue to outstrip the growth in demand, increasing value for consumers while raising the bar on ease of navigation.

How Will Consumers Respond?

Taken together, these trends are expected to produce new consumer behaviors, many of which can already be observed among early adopters of the new media technologies.

Increasing Media Consumption and Multitasking. Consumers will spend more time (and money) on media than ever before, often while engaged in other activities, such as riding the bus or studying. In South Korea, for example, time spent on the Internet is taking away from the time people spend interacting with their families and sleeping. Although monetization is problematic in some sectors, the trend of increasing consumption is good news for many businesses.

Trading Up and Down. Consumers will spend more on media with greater functional, technical, or emotional benefits. For example, sports fans will trade up to live pay-per-view coverage. But in other areas, such as newspaper subscriptions, consumers may trade down to local “free sheets” or to an Internet portal. On the whole, spending will continue to increase, although demographic segmentation will become less relevant as the behavior of “identical households” varies with different media.

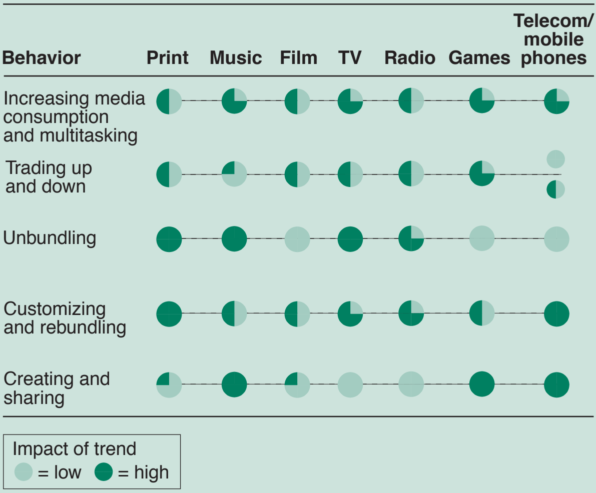
Unbundling. Consumers will disaggregate media bundles—stripping out the articles, programs, and songs they desire and skipping the parts they don’t want, such as commercials. This is already happening with network television, thanks to DVRs. In the newspaper sector, Web sites—such as Monster.com and eBay—are displacing classified ads, which in the past have subsidized editorial content. Radio will be next as automakers offer the option of satellite radio. Overall, the cross-subsidies embedded in media bundles will become increasingly transparent and vulnerable.

Customizing and Rebundling. Consumers are creating their own bundles, such as music playlists and personalized portals. But with consumers doing the aggregating, advertising revenues will be at risk and cross-subsidies will be further exposed.

Creating and Sharing. Whether consumers play games or exchange photos online, content sharing is altering how they interact with each other both locally and globally.

Predicting how each of these behaviors will play out in specific consumer segments won't be easy, and evidence from early adopters can be misleading. For instance, approximately 70 percent of the first wave of DVR owners skipped TV ads, but that is unlikely to hold true for consumers who enjoy sporting events or other real-time programming (for which ad-skipping rates are closer to 30 percent). Experience with other technologies suggests that different segments of the market—professionals, working moms, students, and retired people, for example—will interact differently with different technologies. That's why media businesses must be careful to "de-average" the market. Will mass-market moms, for instance, start downloading music to an iPod? And if they do, how will that affect their spending on music media? (See Exhibit 2.)

Exhibit 2. The Impact of the Trend Toward Greater Consumer Control Will Vary by Media Subsector



SOURCE: BCG analysis.

How Will Consumer Behavior Affect the Industry?

If the mass market assumes even some of the behaviors of the early adopters, revenues from advertising will shift as the effectiveness of mass advertising and the ability to cross-subsidize within traditional bundles erode. New chokepoints in the value chain, such as platforms to control technology and intellectual property, will appear. New entrants and business models will alter the landscape. The following are some patterns we expect to emerge in the near future.

Content creators (such as film studios, music labels, and newspapers) and consumers could both win, thanks to low-cost virtual-distribution models. Creators of valued, or targeted, content will benefit from consumers' trading-up behavior, increased spending on media, and access to a greater variety of content distribution channels. But the unbundling of traditional formats, such as music albums, and the availability of free content pose a threat to current revenues. As the costs of content rise and revenues shrink, players must consider new business models with different product offerings and distribution strategies.

Content aggregators (such as TV networks and radio stations) could see their existing business models erode as consumers gain more control. With self-programming, time shifting, and ad skipping, revenues from mass advertising are likely to decrease. In some cases, content creators, content distributors, and device makers will become new players in the aggregation space and will target the ad dollars directly.

Content distributors (such as DSL, cable, and satellite) could leverage their current relationships with

customers—and the influence they have over the customer interface—to take on orchestration roles. They could, for example, provide detailed customer data (with the appropriate privacy protections in place) to advertisers interested in targeting. On the downside, multiple distribution channels could erode profitability, and redundant platforms could result in the unbundling of distribution services and subsequent price wars.

The device sector will benefit from growing demand as different modes of accessing content proliferate. Meanwhile, standardization and low-cost manufacturing will lower barriers to entry. But intense competition and brand-driven differentiation could present a challenge to players whose businesses are rooted in technology.

Although no one knows for sure how these changes will play out, one thing is certain: incumbents can't continue with business as usual. If the popularity of DVRs and ad skipping increases, growth projections for television could be halved, costing the industry an estimated $20 billion over the next few years. Meanwhile, newspapers will have to rely more than ever on syndication to counteract declining circulation and advertising revenues. Not to respond quickly, as the music industry proved, is to flirt with disaster.

Serving More Powerful Consumers

Survival in a world of increasing consumer control will depend on employing the deep consumer insights and segmentation strategies that have kept consumer goods companies thriving. It will mean shifting from a *push* model, which forces "averaged" media bundles onto the market, to a *pull* model, which attracts consumers with differentiated offerings. Developing such a strategy involves three steps:

- *Discovering Your Core Customers.* This is no simple task. It means anticipating how your most valuable customers will react to as-yet-unavailable offerings. You may even need to reconsider the "heresy" of shrinking to increase profits.

- *Reconceptualizing the Product.* It's crucial to link consumer insights and segmentation to product development and to manage a portfolio of differentiated offerings supported by channel and pricing strategies. The hourlong scripted drama, for example, may also need to be sliced into three-minute vignettes that can be downloaded to a mobile phone and consumed during niche time slots.

- *Rethinking Your Role in the Value Chain.* Decide how and where you'll play for the long term and what alliances you'll need. Many competing players are targeting the media value chain, so establishing the right alliances will be critical.

Here are some strategic questions that media and technology companies can ask themselves as they pursue these goals:

- Regarding consumer behavior:

  —How quickly will the new technologies be available and at what cost to consumers?

  —How quickly will consumers adopt new technologies in *our* sector?

—What factors—technical, functional, and emotional—will drive demand?

—How will consumer behavior change as a result?

—How will different consumer segments respond over time?

—What can we do to speed up or slow down the pace of change?

- Regarding business impact:

—How will changes in consumer behavior affect our business model?

—How will revenues and profitability change?

—What is the cost of delaying?

—To what extent will changes in behavior alter demand for current and future products?

- Regarding strategic options:

—How should we alter our strategy and product offerings?

—Should we rethink our product offerings and/or bundle them differently?

—Should we revamp our pricing and/or use new distribution channels?

—What alliances or bets should we make today to position ourselves for the future?

—What metrics should we use?

The future for the media sector is ripe with potential. To benefit from the greater control that consumers will gain and to minimize the risks, you must act decisively. That means figuring out how new behaviors will likely affect your business and your most profitable customer segments.

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