

Internet Protocol Television (IPTV): A Survival Strategy or Revenue Generator for Telcos?

A Parks Associates White Paper

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1.0 The Initial Traction for IPTV

Internet protocol television (IPTV) uses IP as the transport platform to send video signals to the television via high-speed Internet connections such as fiber-to-the-X connections (FTTx) and/or next-generation digital subscriber lines (xDSL). With this technology, consumers will be in complete control of what, when, and where they watch television programming. Moreover, given the versatility of the IP network, consumers will have the opportunity to embrace a plethora of services that go beyond video signals.

Although consumer may embrace IPTV services and applications for their richness, service providers, especially telecom operators, are venturing into this business purely as a survival strategy. Over the past few years, telecom operators have been losing a significant percentage of consumers to voice-over-IP services from cable operators and mobile services from wireless operators.¹ Telecom operators are seeking new avenues that will prevent their existing consumers from switching to other service providers. If “survival” is the underlying motivation for telecom operators, then telecom operators may lose sight of the possible revenue-generating streams that can emerge from IPTV.

As a first step, telecom operators have to change gears from a “traditional fixed-line provider” to an “entertainment provider” if they want to be successful in the video business. They have to offer sophisticated programming packages that will entice consumers to keep their fixed lines in order to experience the advanced TV offerings. Moreover, telecom operators have to strategize their approach such that their initial survival strategy eventually turns into a revenue-generating model. To realize this model, telecom operators have to form strong partnerships with various network infrastructure, software, and other solution providers to build a network that supports the current offerings and is future-proof.

2.0 What are the Potential Market Drivers?

For many decades, telecom operators have maintained their “5-9s” standard (i.e., 99.999% reliability assurance) for their fixed lines. Now as are expanding their services beyond voice and

data, the question is whether they can maintain their “reliability” image as they did for their phone.

Although it is too early to answer this question, telecom operators have to watch for specific market drivers that will help them maneuver in the right direction. The obvious drivers are price of the bundle package and speed of the broadband service, while the not-so-obvious one is creating a compelling customer experience.

2.1 Playing the Pricing Game

In the current market scenario, service providers, including, cable, satellite, and telecom operators, are getting very aggressive about the pricing game.² In their quest to increase their customer base, service providers are offering triple-play packages with a very thin profit margin. Although this strategy may be successful in gaining initial customer traction, it will not be profitable in a long run. If telecom operators want to emerge as leaders in the video market, they have to identify compelling drivers for consumers to acquire their services beyond the “price” of the basic triple-play package.

2.2 Quest for Delivering High-Speed Connections

Cable providers offer video services and high-speed Internet connections using a hybrid fiber coax (HFC) network. Although HFC promises huge bandwidth for the downstream (400 Mbps), its performance on upstream transmission is notably slower (128 Kbps). This limitation hinders the opportunity for service providers who want to offer more interactive advanced TV services and applications.

Telecom operators have addressed this limitation by spending huge dollars for the infrastructure that promises high-speed connections for delivering video signals through FTTx and/or xDSL lines.³ Although major Regional Bell Operating Companies (RBOCs) in the U.S., SBC and Verizon Communications, vary in their initiatives regarding access infrastructure, both seem to

¹ <http://www.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21750>

² http://www.comcastoffers.com/1/?cid=51993&affid=comcast_high_speed_internet
<http://promo.yahoo.com/sbc/?refer=ds10>

³ http://news.com.com/Verizons+fiber+race+is+on/2100-1034_3-5275171.html
http://news.com.com/SBC+plans+billions+on+high-speed+fiber/2100-1037_3-5243514.html

have established good positions for supporting more interactive advanced TV services and applications. In a competitive environment where broadband speed no longer acts as a differentiator, telecom operators have to search for other options that will help them to distinguish themselves in the market.

2.3 Building Customer Experience

As telecom operators gear up to position themselves as “entertainment providers,” they have to be creative in bundling services that really excite consumers. Customer experience creates a sense of bonding between the service operator and consumers and is critical for building long-term relationships with consumers.

In order to create a compelling customer experience, telecom operators have to partner with content providers such as DAVETV⁴ and Akimbo Systems⁵ that are working aggressively in aggregating content specifically targeted to IPTV. These partnerships will help telecom operators offer a wide range of video-on-demand content that is better or at least matches the offerings by cable operators. Moreover, telecom operators have to be responsible for deploying and managing an end-to-end IPTV backbone infrastructure that supports the advanced TV services and applications. As there is no definite standard established for the end-to-end IPTV backbone infrastructure, telecom operators have to partner with experienced providers for video head-end, middleware, system integration, and other value-added services. The mantra for a successful end-to-end IPTV backbone is to ensure that the IPTV system is flexible and scalable under any market environment.

3.0 Where is IPTV Market Likely to Find Early Success?

Sometimes consumers find it difficult to comprehend the benefits offered by a new technology. If telecom operators have to make the grade among consumers with their IPTV offerings, they have to educate consumers about the richness of the technology. In their quest to educate consumers, telecom operators have to understand their consumers’ preferences for advanced TV services and applications.

⁴ http://www.marketwire.com/mw/release_html_b1?release_id=93340

⁵ http://www.businessweek.com/magazine/content/05_24/b3937028_mz006.htm

3.1 Know Your Consumers

Parks Associates has identified four key segments in the U.S. based on consumers' specific preferences for advanced TV services and applications. These segments are "Converge Me", "TV on My Terms", "Interact with Me", and "Don't Bother Me." As an example, consumers interested in personalization services such as personalized recommendations from a service provider, one-button access to recording favorite TV programming, and one-button access to important information like news and weather are grouped into the segment called "TV on My Terms." The U.S. market has a good mix of consumers with different preferences, indicating that a "retail" video model may not be suitable.

Since IPTV is all about giving consumers full control over what they consume, the telecom operators in the U.S. have to build models that realize this concept. This approach can cause significant strain on telecom operators' resources and revenue as they have to offer customized services to all their consumers. Telecom operators therefore have to identify the customer segment of the four specified that is most willing to pay for advanced TV services and applications.

Parks Associates has identified the consumer segment "Interact with Me" as willing to spend 20% more than average for advanced TV services. This segment, which represents 27% of all U.S. households, is highly interested in interactive services such as voting for game shows, targeted advertising, and gaming over the television.

This finding opens new opportunities for telecom operators to generate more revenue. Since this segment is the most receptive to advanced services, telecom operators have to cater their product offerings and marketing efforts to these consumers.

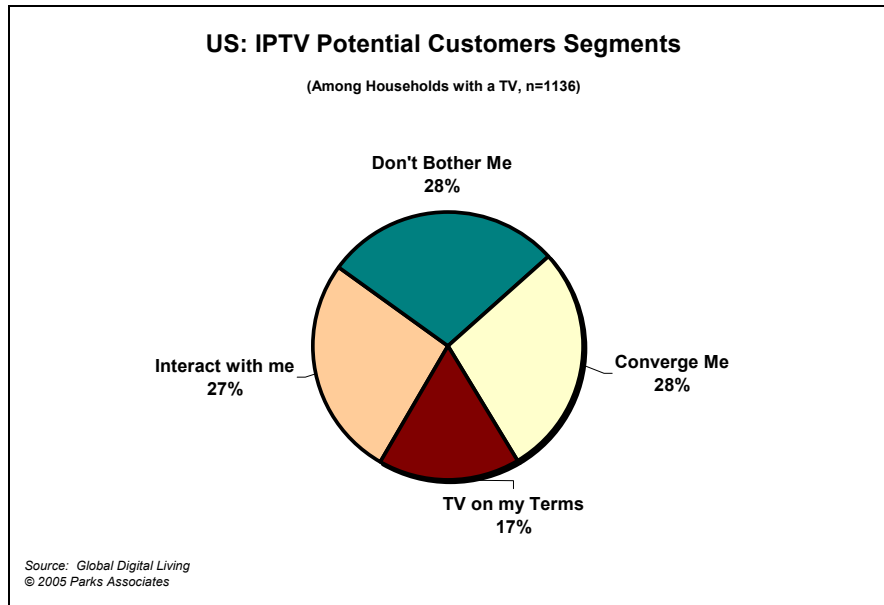


Figure 1 U.S. IPTV Potential Customer Segments

3.2 Analyze Consumers' Switching Behavior

Consumers typically associate triple-play packages (which include voice, data, and video) with a cable operator. Consumers are largely unaware that telecom operators can provide video in addition to the voice and data.

Telecom operators have to overcome the initial branding issue. According to the current market dynamics, only 4.1 million subscribers are likely to select a telecom operator for a basic triple-play package. Telecom operators have to change consumers' mindset, and thus capture more market share, and by offering compelling programming and attractive services that could draw consumers away from the cable operators.

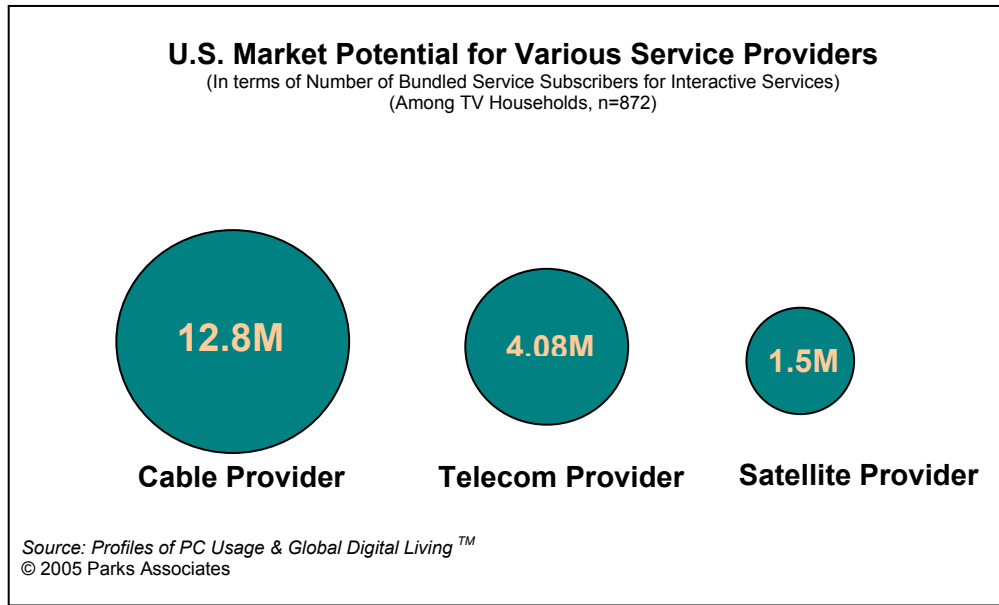


Figure 2 U.S. Market Potential for Various Service Providers

Steep discounts play an important role in driving consumers’ decision to select a service provider. Nearly 33% of the respondents are willing to switch to a telecom operator for video services if they are offered \$20 or more in discounts. This finding raises an interesting question – “Can telecom operators monetize by offering steep discounts?”

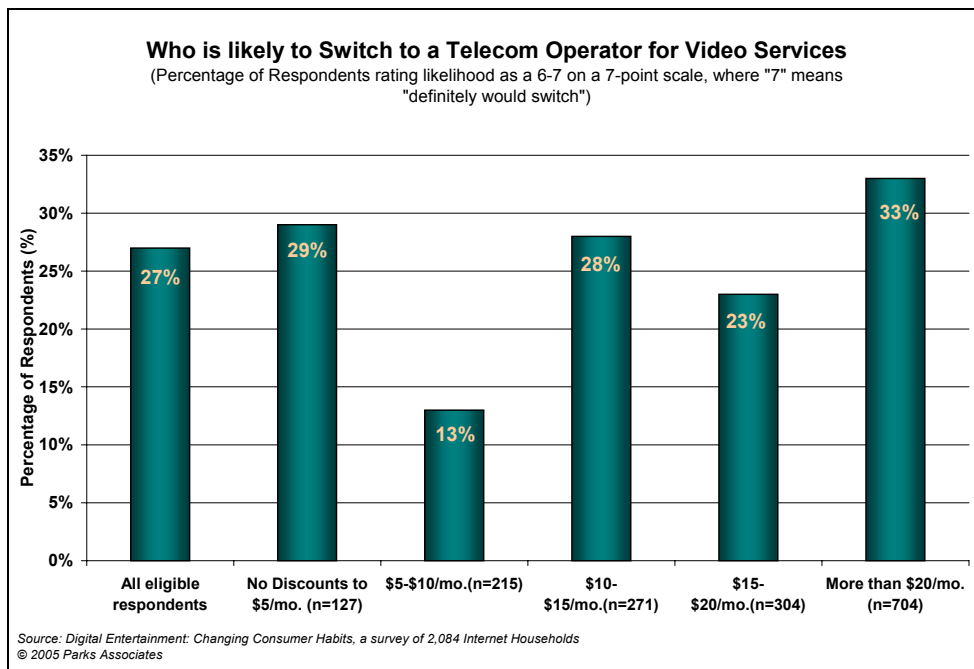


Figure 3 Percentage of Respondents likely to switch to a Telecom Operator

Although offering steep discounts may be an ideal short-term solution, telecom operators have to consider their long-term goals. One possible strategy that may favor telecom operators is their old “reliability” image. Telecom operators can garnish their basic quad-play services with additional services such as computer security software and other related services that have high profit margins.

4.0 Conclusions

IPTV has the potential to cause a paradigm shift in telecommunications services, and service providers, especially telecom operators, have a great opportunity to increase customer ARPU. Over the years, telecom operators have found success from their “one bill” approach for triple-play service (which includes voice, data, and wireless). But with the addition of video into the package, things become more complicated. Consumers attach more value when it comes to video. Quality and quantity of video content are important issues that drive consumer preferences.

Although it is quite early to define an “ideal” market model, telecom operators have to follow a strategic approach by mapping out the key components necessary for the efficient operation of the IPTV infrastructure. Strong partnerships with experienced vendors and efficient delivery of compelling services, such as video-on-demand and other interactive service applications like targeting advertising, gaming, and entertainment-relating voting, will significantly improve their ability to compete for subscribers and revenue.

About the Author: Deepa Iyer is a research analyst for Parks Associates and studies emerging technologies for delivering quad-play services in the broadband market. Her most recent focus is on studying IPTV market and consumer dynamics. Her forthcoming reports include High-Definition Television and Bundled Services.

About Parks Associates: Parks Associates is a market research and consulting firm focused on all product and service segments that are “digital” or provide connectivity within the home. The company’s expertise includes home networks, digital entertainment, consumer electronics, broadband and Internet services, and home systems.

Founded in 1986, Parks Associates creates research capital for companies ranging from Fortune 500 to small start-ups through market reports, multiclient studies, consumer research, workshops, and custom-tailored client solutions. Parks Associates also hosts two executive seminars, both part of the Fall Focus series, and co-hosts CONNECTIONS™ (in partnership with the Consumer Electronics Association) each year. www.parksassociates.com.