CMS NewsLine

May 2003 | Interpreting Technology and New Media | ISSN: 1540-5087

TV Revenue Models

Greater Revenue for Greater Profit

By Leo B. Willner, Ph.D. and R. Gregory Kalsow

Are there any new ways to rapidly grow revenues at cable, satellite and other broadband providers? We have an idea or two to share with you that may help! Herein, we analyze the nature of new and old revenue models and provide some prototype models for you to consider and perhaps even try out. These revenue models are not limited to ORCA™ forms, — Open Revenue Channel Access — although open access may ultimately be a good way to go. While the ORCA concept we reviewed in this column last month offers one way to open up the broadband pipe to greater traffic and revenue to services and applications providers, there are other avenues to exploit as well. What is needed is a combination of greater choice, utility and value for the TV viewers along with new revenue opportunities for cable companies and other broadband providers. Due to the need to be realistic (and modest) when tackling a topic as complex as revenue models, this article only seeks to open up the dialogue to further analysis and discussion by getting down to the guts of the matter. As your perspective may be the one that provides a key element or insight, we invite you to please share your point of view with the editors: (831) 427–3833.

"What is needed is a combination of greater choice, utility and value for the TV viewers…"

Herein we describe how to generate attractive new revenue sources by utilizing three simple to understand and easy to use guidelines:

1. Elect to open up broadband access to many more providers of goods and services, i.e., avoid the

Don't Miss the Last Word

CMS NewsLine offers items of interest for everyone.

Kalsow's Back-Channel (expanded in this issue) offers candid comments from the publisher.

Each month you will enjoy commentary on the state of the industry, new media and technology.

CMS NewsLine accepts no advertising, so expect our point of view to be no-nonsense, and maybe even a little controversial. See for yourself on page ten.

CMS NewsLine

"Validating the Middle Ground"

CMS NewsLine
Alvairi-Derfler Associates
Lake Forest, CA 92630
Tel: +1.949.584.0989
www.ad-assoc.com
newsline@alvairi.com

walled garden semi–closed system; instead seek to broaden access opportunities to new providers and new customers.

2. Innovate with hybrid revenue models that mix and match subscription, transactional, promotional and other forms and allow them to be changed on the fly as needed — even by end users.

3. Utilize ITV technology to provide the ability to vary the form and nature of e–transactions on an as–you–need basis and even in real time if need be. This flexibility gives the customer more choice, more ways to view and to buy.

> *"…few among us would even lay claim to a far–reaching understanding of how to optimize the revenue model…"*

These three forms of empowerment are available due to a number of important advances made in critical technologies over the past few years. Such progress was underway even while the high tech world was convulsing in a financial agony resulting from such things as a loss of perspective as to consumer wants and needs, a lack of sufficient focus on basic market economics and perhaps even a shenanigan or two by financial analysts, brokers, politicians, public accountants and systems operators. All the while, technology continued to move forward deriving better, faster, more flexible and more economic forms that can enable improved revenue models and more flexible pricing schemes to be tested, modified and perhaps ultimately institutionalized.

If you doubt that such possibilities exist, give a moment's reflection to the luxury automobile market just prior to the miraculous rise of the Lexus. Who would have imagined that such a luxury product would have any chance in a world already overpopulated by the likes of Mercedes Benz, BMW, Jaguar and Lincoln? Nonetheless, a combination of new technology, better engineering, improved manufacturing and innovative marketing turned the locked–in–step world of the luxury automobile upside down. To observe a similarly narrow worldview in the TV, entertainment and telecommunications sectors — you do not have to look far. For most of us gadget and technology worshippers are still bumping along starry eyed from one capital–intensive new product or service play to another, often while somewhat disregarding business and marketing realities. Just reflect on the actions of the likes of AOL Time Warner, AT&T, Vivendi–Universal, Lucent or Cisco in recent years. They and many others do seem lost in their cyberspace adventures, with many ill–advised customers and shareholders still in tow, and a blank–eyed FCC, as marshal, following closely behind.

IN TURBULENCE…MISUNDERSTANDING

It has often been said that a fool and his money will soon be parted. If such a person is also inept at revenue sources and effective pricing, then he or she will also generate less revenue — to lose. Let's face it; a great deal of difficulty, misunderstanding and uncertainty is commonplace when it comes to revenue models and pricing. Thus, few among us would even lay claim to a far–reaching understanding of how to optimize the revenue model or pricing of the very goods and services with which we are most familiar. Take as an example the pricing of PPV championship boxing on HBO and Showtime. It does seem hard to understand. Why charge $49.95 for a single viewing when this extraordinary amount limits long run viewership to the existing aficionados of boxing? Why not grow an audience of boxing sports fans, who by their repeated viewing at more modest pricing — say $29.95 — learn to appreciate and support PPV championship boxing matches on cable? The folks at HBO will tell you that they already 'prime the pump' by offering regularly scheduled boxing as part of their premium channel subscription service – as though what they put on for 'free' will attract anyone to pay $49.95 for the real thing. PPV is the model and $49.95 is the average price today, but why?

"Such pricing difficulties have recently helped undermine quite a few major enterprises…"

Such pricing difficulties have recently helped undermine quite a few major enterprises including some leading US airlines and a few large retail chains. These and similar disasters have led some 'injured' parties to demand price protection from the government, or to seek protection within a cartel, oligopoly and the like. The prescription drug business in the Americas may already be nearing such slippery slopes, as indicated by the drastically different prices charged for some ethical drugs when they are sold in Mexico, the US and Canada. After all, it is unit price times volume that yields total revenue, so you need both to be high enough and low enough to make a perfect blend.

Yet some initial pricing must be in place before consumers by their behavior can impact business traffic and thereby weigh–in and influence a next round of pricing adjustments. In large part, unless a more–or–less free market is allowed to prevail, pricing can easily be soiled by manipulation, collusion and the like. Senator Feinstein during her last election campaign pledged that she would do something about the excessively high gasoline prices in California. Either she got cold feet, was somehow redirected to turn the other cheek or came to realize that the business model and the pricing of gasoline is not as easy to comprehend or control as she might first have imagined. Perhaps she discovered that even in a free market it does not necessarily follow that prices can be stabilized for very long.

After all, high profit, even for a relatively modest period of time, often leads to further investment and greater competition, adjustments that tend to drive prices down and lead to lower profits and even business failures in the long run. In this manner the business cycle repeats itself without any apparent necessity for long–term price stability. All that, apparently without cause, stop–and–go and up–and–down pricing can, in part, be attributed to so called economic stickiness, meaning that markets do not necessary behave as those supposedly wise, entertaining and well remunerated economists profess.

With regard to the telecommunications, computing and electronic entertainment industries, the pricing issues and revenue models can get very complex. The circumstances in these markets are constantly changing due to rapidly evolving technologies, often to such a degree that any revenue model is likely to be effective for no more than a brief period of time at best. Have you paid attention to revenue models and pricing schemes in the cell phone business of late, or to the vast loses and layoffs at Nokia, Eriksson and the like? Can games, photo opportunities or broadband access save the major cell phone makers? We shall see.

New technology constantly leads to new products, new services and new applications entering the market. As the consumer has only a limited amount of time, money and attention, these new 'things' must compete within the maze of existing goods and services for a place in the market. It all begins with an initial revenue model, and the game in the marketplace is off and running. With the current level of complexity and with the high state of flux in products and services now in place, as many equivalent products compete with one another, the pricing compass can spin wildly so that 'true north' is difficult to find and follow. One of the economic fallacies perpetrated on an unwitting public — say since the time of the economists David Ricardo and John Stuart Mills in the early 19th century — is the idea that free markets tend to stabilize and come to equilibrium. In the high tech sector that unfortunately is usually poppycock.

"It all begins with an initial revenue model, and the game in the marketplace is off and running."

TARGETING 'CONSEX' TRANSACTIONS

Before we can hope to select a suitable revenue model or pricing scheme for a given product or service, we must consider the reasons WHY a given person or population would AGREE to buy in the first place. In that regard, it is important to note that such schemes and models cannot be understood in isolation. Instead, as there are numerous competing products and services, the motivation for a specific purchase and the willingness to actually transact and buy are both absolute and relative. Furthermore, these aspects must be incorporated in context with existing circumstances and such things as:

- Advertising, promotion and knowledge of the product or service.
- Prior experience with similar products and services.
- Knowledge of alternative products and services and of the market.
- The demographics of particular persons or groups.
- Need, ability to pay, authority to buy and willingness to act.
- A sense that what is offered is a good, fair or at least acceptable 'deal'.
- A sense that the 'shoe' fits, etc.

Together, these factors and conditions make it possible for the individual or the group to engage in a 'CONSEX' or CONtext Sensitive EXecution of a purchase. When everything fits, or when emotions or social pressures override these factors and sensitivities, a purchase transaction is possible and may, or may not, occur. It is within the multi–faceted, multi–tasked, multi–purposed framework of real human behavior that each revenue models is tested for real — and survives or fails.

> *"…it is the reality of actual human behavior that determines the practicality and efficacy of a particular scheme."*

REASONS FOR BUYING

Yet even the fact that a particular CONSEX action makes sense is not always nearly enough. Think of the many attractive things you never get around to doing or buying. In part this is due to the fact that the psychologically motivated and driven individual may at times be impulsive, emotional and even somewhat irrational, especially when a purchase is near. He or she is also subject to the whims, impulses and impact of group psychology and group behavior. That is, to the need to feel accepted, in the know as to what is appealing, avant–garde or required within the social setting and milieu. For these reasons a revenue model that may appear solid and a proper fit or a 'good deal' may not fare well in the bubbling cauldron of actual human behavior. The revenue model and pricing scheme problem is simply harder than that.

A specific revenue model or pricing scheme may by design be tailored or focused on this or that aspect or attribute of a given sub–population. It is in this targeted sense that each revenue model can best be examined, analyzed and tested. In the end, it is the reality of actual human behavior that determines the practicality and efficacy of a particular scheme. That is to say, only a pragmatic field test can validate a particular model and allow us to say yea or nay as to its validity and usefulness. Such is a truth we must learn to face if we are to devise valid revenue models and truly effective pricing schemes.

When it comes to motivating the prospective buyer to agree to acquire or transact for a specific product or service, one approach is to target a particular aspect or motivation for buying, including such things as:

- A perceived need, value, benefit or requirement.
- Habitual or compulsive behavior.
- Curiosity, impulse, convenience or laziness.
- Social pressure or a need for approval.
- Anxiety about an upcoming shortage or price increase.
- A sense of empowerment, enrichment or celebrity.
- Fear, Uncertainty and Doubt — in technology, the famous FUD–factor.

It is only by contrasting one revenue model or pricing scheme against another that one can begin to see the advantageous and disadvantageous aspects of any given approach. Of course, as the market must ultimately clear at some price, there is a best scheme for us to use — but we may not know what it is. The challenge is to find a revenue model or approach that is close to this idyllic best.

"As its colorful history illustrates there are lots of ways to make or lose money in television."

BUILDING BLOCKS FOR NEW–AGE REVENUE MODELS

1. Provide the ability to change the revenue model at any point in time via ITV.

2. Mix subscription, transactional, and promotional revenue choices on the same content — and let the user change on the fly, at a price.

3. Set PPV and VOD movies and other content at varying prices depending of the attractiveness of each piece of content.

4. Use a value–over–time approach to help determine the pricing of individual content within the PPV and VOD revenue models to reflect their dependence on such things as initial value, number of weeks available on VOD, etc.

5. Provide ad hoc pricing choices, including ITV bidding in certain circumstances, as opportunistic pricing — to meet local or transient demand conditions.

6. Run specials, discounts and promos to energize PPV & VOD that adopt a CONtext Sensitive EXecution approach in tune with real time real life conditions in the individual TV rooms; i.e. an approach that is based on a CONSEX ITV model.

7. Employ a la carte menus in attractive GUIs to make it easy and convenient for consumers to buy more shows, more often — one click where possible is best.

8. Offer a mix of purchase, single–use rental, multi–use rental and long–term lease options in a mosaic to give consumers a breath of buying choices.

9. Give ORCA revenue models a chance to grow new markets and attract new services, applications and

merchandizing schemes to the cable business.

PROTOTYPE NEW–AGE REVENUE MODELS

These building blocks listed above and others can be combined in various ways to create many varieties of revenue models for further analysis and where appropriate virtual and actual field–testing. Herein, we outline but a few such prototype models to illustrate the variety of possibilities.

"…allow consumers and operators to easily switch from one revenue mode to another…"

PROTOTYPE I — ITV VOD

ITV VOD is a revenue model utilizing head–end (or client–based DVR) VOD along with ITV technology to allow a viewer to choose the degree of advertising interruption he or she is willing to abide at a price point. Operating at several fee levels for VOD service the viewer can alter his or her TV mode in real time and on the fly starting with standard TV intermixed with full advertising interruptions, to fewer ads and finally to VOD devoid of advertising. Trick–play capabilities such as fast–forward and ad skipping are altered as needed to make the process sensible. For example, a viewer watching a movie in standard mode with lots of ads can at some point in real time elect to pay a fee to switch to a no advertising mode. ITV technology makes this possible.

PROTOTYPE II — PPV PROMO MOVIE VIEWING

Promo Movie Viewing allows a subscriber to view the first X minutes for free, the next Y minutes at a partial fee and then pay the balance of the full PPV fee or be disconnected. This feature is especially attractive for features that are not well known or were not highly promoted to the general public such as many foreign films and entertainment videos. While this model is not suitable for all content, it may gain traction for a sub–class of entertainment products.

PROTOTYPE III – VOD WITH A DVD PURCHASE OPTION

'VOD Plus' (VOD+) with a Purchase DVD Option is a way to increase the total revenue generated from a VOD transaction. The viewer is rewarded by being granted a now–or–never choice during the viewing of the movie or video – hopefully with one click — to buy the DVD movie or CD soundtrack at a significant discount. This choice has the attraction of enabling in–hot–blood impulse buying.

PROTOTYPE IV — CHANGING REVENUE MODELS ON THE FLY

Changing Revenue Models On the Fly is a method by which a viewer can alter his Cable Tier at will, or, on an a la carte basis add or delete premium channels such as STARZ on Demand, HBO and the like. Due to its convenience and ease of use this mode is likely to help reduce large–scale cable churn and lead to an overall higher per–subscriber revenue level.

PROTOTYPE V — VIEWING WINDOW CONTROLS

Viewing Window Controls can be utilized to give the viewer an option to give up a portion of his viewing window — to advertising and promotion — in return for a reduced subscription fee. This could apply to all of the channels or just to a limited number of channels. The advertising space can be a frame or border, an L–shaped edge or a window. It also may remain in use all the time, or be sporadic. The great advantage here is that no DVR, VCR or other methodology can allow advertising and promotional materials to be fast–forwarded or skipped. As a test case, a $5.95 per–month reduction in cable subscription fees might be a place to begin. A fully tiered approach with multiple levels of fee reductions may ultimately prove best.

> *"…revenue models and pricing schemes must emphasize convenience, be easy to understand and self–evident to employ."*

PROTOTYPE VI — A LA CARTE VOD PRICING

A La Carte VOD Pricing is a way to allow market–based reality to impact the price–to–volume of transactions curve in a manner that is favorable to the content provider and the MSO. Herein, the price of a VOD, PPV or SVOD is variable over time based on such things as product age, weeks out on VOD, attractiveness of the content, level of current network or VOD traffic, time of day or day of the week, seasonal factors and the like. The advantages here include the ability to smooth out traffic on the system and thereby reduce the level of capital expenditures for head–end and network equipment. Think of such things as matinee tickets at the theater.

PROTOTYPE VII — ORCA ACCESS TO CONTENT HOUSES

ORCA Access to Content Houses is a way to make Open Revenue Channel Access available to more content people while maintaining a profitable business model for service providers including MSOs and other Broadband systems. Herein the service provider rents out a portion of his system to a content house on a fixed or tiered level–of–use basis. Disney, for example, gets to use a portion of an MSO's head end VOD system on his own with full control over conditional access, revenue model, choice of content and the like. The MSO is freed from most managerial considerations and costs beyond running his head–ends in the usual way. This method with a few modifications can also enable application providers, e–marketers and others to develop ORCA revenue streams on private segments of Broadband.

INDUSTRY GUIDELINES

1. The cable industry, among others, has witnessed the phenomenon that maximizing short or even medium term taxable profit is not necessarily an optimal approach in highly capital–intensive, rapidly

changing enterprises. The impact of depreciation and amortization on a company's books can lead MSOs astray when product and technology horizons are undergoing drastic change. Book value and true market value can greatly diverge at such times thereby leaving the business investor in a lurch holding the bag.

2. Charging good accountants with the additional burden of attempting to use accounting records to support pricing policy — just because they are skilled at after–the–fact accounting of past performance — is a common practice that may in some cases be inherently flawed.

3. Evolutionary operations, or EVOP, is one of the better ways of establishing an understanding of what is possible and workable when it comes to revenue models and specific pricing in the face of a fickle public and so much uncertainty.

4. Revenue models that base the pricing of content on its value over time, time of day and the like can help balance the PPV and VOD network traffic. That is, reduce the need for extra head–end equipment to cover peak hours of operation, first releases etc. It utilizes the marginal utility of a given piece of content over time to various segments of the viewing population.

5. When local competition is limited, revenue models should seek to drive long–term viewer behavior in a manner that grows overall revenues.

6. Pricing tactics cannot be isolated from other marketing schemes, promotions and considerations; instead they should be integrated into an overall approach.

7. Consumers buy convenience so revenue models and pricing schemes must emphasize convenience, be easy to understand and self–evident to employ.

8. Existing locked–in–step revenue models now prevalent in the entertainment industry can be pensioned out by demonstrating that new models can raise revenues.

9. Opportunistic revenue models and pricing tactics that reflect a sense of urgency and timing can be of help.

10. There is limited price elasticity on some entertainment products. That is to say that playing the price–volume curve to gain traffic will not always yield good results.

IN CONCLUSION

As its colorful history illustrates there are lots of ways to make or lose money in television. This applies to the various sources of television revenue: sponsorship, subscription and transactions. For revenue results can be unstable as new technologies such as DTV, Broadband, DVD–R, VOD and PVR change the dynamics of the game and allow new combinations to come to the fore. One powerful new ITV approach is to allow consumers and operators to easily switch from one revenue mode to another, even on the fly. That may be of value to consumers and to service providers alike and is made possible by interactivity. In this article we have examined aspects of the TV business from the prospective of new, old and changed revenue sources and what they offer the industry. It appears that there are real opportunities for viewers to improve the quality of their TV experience and for the commercial interests to enhance their top and bottom lines.

###

KALSOW'S BACK–CHANNEL: *"Validating the Middle Ground"*

■ The favorable impression made by the MXF file format as initially employed by Sony and others is good news. MXF apparently had a good coming out at the NAB Show in Las Vegas last month as a new standard by which to enable multimedia interoperability among media devices. The ability to employ this type of file wrapper around audio, video, metadata and other data — all at once — could herald in an improved ability to use IP to transmit news, entertainment and sports among all sorts of electronic gadgets. It sounds like progress.

■ If Toshiba and others are right that Texas Instrument's new TurboDOX software really works well, then cable DOCSIS modems may soon be able to increase their downloading speeds many fold. The apparent trick is to reduce the excessive and essentially redundant 'handshaking' systems interruptions, which disrupt the so–called TCP/IP transmission down the server-to-client channel. Skipping the gobbledygook, if TI is right then HSD transmission will go much faster on existing cable modem equipment and greatly benefit operators and end users alike. It sounds like progress.

■ While we haven't seen much of Sony's Passage system in the field yet, if it works as promised we can expect MSOs to learn to mix and match set top boxes from different manufacturers within the same cable head end systems. That is to say that with the Passage system different conditional access cable entry control systems can operate out of the same head end equipment to enable set top boxes of different types, modes and access controls to coexist with little or no difficulty. If so, what some have called the tyranny of the Motorola/Scientific Atlanta duopoly may be coming to an end. Hello Pace, Pioneer and Sony. It also means that some basic cable boxes may enjoy an extended life at a few cable systems. It sounds like progress.

■ Early indications from Time Warner Cable suggest that their new DVR and VOD systems are likely to raise earnings, lower digital churn and help fend off those tough DBS competitors DirecTV and EchoStar. In fact, the Scientific Atlanta Explorer 8000 which contains a DVR is reputed to work well and have sufficient functionality to usher in a new era of advanced set–top boxes that indeed address the principal concerns of the cable operators for greater revenue, lower churn rates and more success against the satellite service providers. The same applies to TWC's VOD systems. The natural duality of VOD — offering non–linear TV from the head end — and DVR providing the same on the client side portends good things for the future. It sounds like progress.

■ Could Ted Turner be anywhere near the mark when he suggests that Rupert Murdoch — via his Fox News, BskyB and other news outlets — is making excessive 'reality TV' entertainment hay out of war mongering? It is surely a cynical point of view to suggest such a thing about the world's leading media tycoon. But could Ted be right? Is it possible that the (apparently) unstoppable confrontation between the Christian West and the Muslim East — with all the terror it portends — is being energized by the drumbeat of Murdoch's worldwide news empire. If so, this does not sound like progress.

■ With the battle still joined and a re–examination of the classification of cable broadband categories by the 9th Circuit Court of Appeals underway, MSOs may find it more advantageous to adopt the negotiated revenue streams style made possible within an ORCA system — rather than capitulate to regulated, federally mandated, fixes to common carrier tariffs and other aspects of their revenue models. ORCA and other adaptive revenue models represent (a whale of) a far better idea than more regulation of broadband and its commerce — an approach that portends a more open and rapidly growing e–market.

[Your mileage may vary. —RGK]

About CMS NewsLine

CMS NewsLine is published monthly by Alvairi-Derfler Associates, a Market Development company, which specializes in assisting corporations with:

- Full Life Cycle Marketing Support
- Product Development and Product Strategy
- Branding and Positioning
- Business Development and Strategic Alliances
- Communications, Launch and Deployment Plans

Leo B. Willner, Ph.D., Editor, CMS NewsLine
Senior Partner, Alvairi-Derfler Associates
leo@ad-assoc.com or +1.831.427.3833

Alvairi™—Derfler Associates

Better Marketing Execution

Alvairi-Derfler Associates is a MARKET DEVELOPMENT company situated to help your company navigate through its most challenging marketing problems. It is also there to assist you sort through and exploit the marketing opportunities your company now faces. Alvairi-Derfler partners, each with twenty or more years of direct field experience, can help prepare broad-based, professional, time-tested alternatives for action by you and your team.

Working hand-in-glove with your in-house corporate team, Alvairi-Derfler partners can:

- Assess New Product Opportunities
- Gauge Competitive Threats to Products and Markets
- Refine Specific Pricing Tactics
- Determine How to Reposition Products and Services
- Provide Comprehensive Support for Your Trade Shows
- Optimize Advertising Campaigns and Promotional Programs

Better Marketing Tools

Clients of Alvairi-Derfler Associates enjoy the confidence gained from thorough analysis, meticulous preparation and crisp execution leading to:

- Better Targeting of Products
- More Effective Branding
- Sharper Pricing
- Improved Sales Promotions
- Better Communications
- Upgraded Advertising
- Better Distribution Systems
- Improved Command and Control

Alvairi-Derfler partners also participate in business development activities involving new marketing relationships with third parties to help create advantageous alliances, organize licensing and joint development agreements and the like. When needed, its senior staff can help facilitate a client's outside business relationships in new markets at home or abroad.

Please contact Alvairi-Derfler today for an informal chat, to discuss a business situation, or to get advice on a new product or a changing market.

Silicon Valley: +1.831.427.3833

So. California: +1.949.584.0989

CMS NewsLine
Alvairi-Derfler Associates
Lake Forest, CA 92630
Tel: +1.949.584.0989
www.ad-assoc.com
newsline@alvairi.com

Subscribe to CMS NewsLine

CMS NewsLine is available only by subscription, and is e-mailed to our subscribers at no additional charge. To subscribe using your credit card, please visit: http://www.ad-assoc.com/news.htm

Every month you will enjoy thought-provoking analysis of the significant issues driving the growth of new media, technology and entertainment.

R. Gregory Kalsow, Editor-in-Chief
Publisher, CMS NewsLine
Managing Partner, Alvairi-Derfler Associates