Retailers and Over-the-Top Video Services – Missed Opportunity?

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In the fight for video service supremacy – a battleground where TV shows and movies are available on-demand; in which an open broadband connection is a more powerful conduit than a cable TV connection; where new technologies are commoditizing the ability to deliver content; and where virtually any device connected to the TV can become the set-top box (if not the TV itself) – the very definition of a "service provider" is being altered. In this new world, to whom does a consumer turn for home video services? When we set up new home video services, most of us still turn to the incumbent cable, satellite, or phone companies. But does that exhaust the number of video "service providers" we use? Not at all. Most consumers purchase or rent DVDs from their local video store, others subscribe to an online DVD mail service, and a growing number are turning to Over-the-Top (OTT) video "service providers" such as VUDU, Apple TV, or Netflix.

> ***Such is the crux of the horizontal media world – tectonic market shifts which create new partnerships, new business models, and new market players (the most successful of which will leverage "old" brands).***

The definition of a "video service provider" has changed and will continue to morph as new services and providers emerge. There is little doubt, then, that our once-unitary understanding of the concept (e.g., the local cable TV provider) is set to be deconstructed, replaced by a plethora of new business and delivery models.

It is my opinion that, in the end, OTT service providers will be nothing more than an existing brand name that extends into the OTT space. Yes, it could be an emerging brand such as VUDU, but most upstarts are looking to be acquired by a larger company with true brand cache. It is more likely that strong consumer brands with which we're all familiar will dominate the OTT space – whether prima facie media brands or not. In fact, any dominant consumer brand can play in this space. Imagine for example, Starbucks TV, the Live Nation Network, the Sony Network (to the TV itself, not to just the Playstation Network via the PS3), and the Virgin Video Network. These are not only possible but probable entrants into the OTT market. Even media retailers – both online and brick-and-mortar – are beginning to offer OTT video services (Amazon and Blockbuster come to mind).

While many of these new OTT offerings will be limited to niche content (genre-focused, in many cases), it is this last category – the retailers – that may be best positioned to become legitimate competitors to incumbent Pay TV operators (virtual cable companies, if you will).

I offer two arguments as to why this will be the case.

(1) <u>Short-Circuit City</u>

In case you haven't heard – in which case you should be flogged – mega-CE retailer Circuit City is closing its doors: done, gone, toast, kaput, and a host of other adjectives. So what does this mean? Besides the temporary boost to U.S. employment due to scores of folks being hired to hold "40% Off" signs on street corners, it is a persuasive indicator that the retail media distribution market is undergoing permanent changes. In poor economic times, bankruptcy and consolidation is inevitable. Retailers who survive this economic downturn will emerge as very powerful media gatekeepers with more control over CE manufacturers and capable of competing directly with traditional media distributors. Such media control may offer insight into Blockbuster's original interest in purchasing Circuit City.

During several CES conversations, platform vendors were talking about retailers' growing frustration with having to sell physical products that simply refer on-going content sales to other companies. For example, why should Best Buy sell an LG Blu-ray player that connects the consumer to Netflix instead of a Best Buy-sponsored video distribution service? Retailers are looking to keep as much of the platform-associated service revenue in house as they can. Who can blame them?

(2) <u>Let's Get Physical… NOT!</u>

The days of physical media are numbered. I'm not suggesting it will completely disappear (or am I?). This is not about whether Blu-ray will diffuse as widely as DVD; however, Blu-ray may very well be the last new physical media platform, ever. Now I've got your attention!

Today's CE and mass-market discount retailers continue to rely heavily on sales of physical media. CDs and DVDs drive traffic, if not always profit (they are in many cases loss leaders which generate impulse purchases, thereby driving sales and profits). However, take away physical media from this mix and the retailer loses significant traffic and sales. This is a truth with which retailers are quite familiar. As media shifts away from the physical and toward the digital, retailers must find ways to make up for the anticipated shortfalls. And media services are squarely in their purview.

These arguments do not, however, imply that all such retailers will necessarily be successful as media service providers. We've already seen several retailers try and fail with house-branded media services. Wal-Mart's initial efforts in movie downloads was shuttered in late '07 when HP discontinued its platform. Hailed as "the game changer" that would introduce the DVD masses to digital downloads (that would be viewed on the PC), the platform failed to deliver the results HP expected. But something was overlooked. Consumers prefer watch video on their television, not their PCs. As readers of these opinion pieces are constantly reminded, consumers overwhelmingly choose the TV as the viewing platform of choice (84%) with the PC as the "if I must" solution. Getting alternative video distribution services to the TV is the key, as TDG has argued since the day we were founded.

At the 2009 CES, CE vendors made it clear that new video platforms will be armed with an Internet connection of some kind. Sir Howard of Sony recently boasted that 90% of Sony's devices will be Internet-enabled by 2011, each built around a Sony-branded TV delivery service intended to bypass incumbent video distributors. It is this (predicted) explosion in device connectivity which (finally) allows an alternative video distributor to reach the living room TV – something before only possible with complicated adapters well beyond the limits of the ordinary consumers. Times have changed since Wal-Mart's downloadable video service effort. The stage is better set: broadband connectivity is in place, solutions are more consumer-friendly, and dissatisfaction with incumbent video services (and prices) is palpable with 60% of consumers complaining about the value of their pay TV service.

As a shopping destination – either in-person or online – the big-box retailer provides vast product and content choices, to which have been added installation and maintenance services as well as affinity programs such as Reward Zone. But the reach of the retailer's brand has traditionally stopped once the product hits the living room. At that point, the CE manufacturer (Sony) or video service provider (Comcast) is front and center, not Best Buy or Wal-Mart. This is set to change (and soon).

Within the next two years, retailers can be expected to push their own OTT video services, pairing them with most any consumer electronic platform that is (a) enabled with an open broadband connection, and (b) destined to be connected to a video display. Imagine a Best Buy digital video store that is instantly enabled when a consumer connects a new TV, game console, Blu-ray player, or network-enabled digital video receiver; putting digital movie purchases and rentals – not to mention other retailer-affiliated commerce opportunities – directly at the fingertips of consumers.

So the next time you go to shop for a new TV or video platform, don't be surprised if Best Buy throws in a free 30-day trial of its new OTT video service. Sure beats those magazine offers…..

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TDG is a market planning and research firm dedicated to keeping our clients In Front of the Curve™. Since 2004, TDG has helped more than 250 technology leaders, media companies, and service providers to understand and manage the quantum shifts now impacting how consumers access, navigate, distribute and consume media – whenever and wherever they may be.

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