

Digital Europe: Diversity and Opportunity

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Overview

This report on "Digital Europe: Diversity and Opportunity" by Enders Analysis (www.endersanalysis.com), has been commissioned for the "Let's Go Connected" (www.letsgoconnected.eu) event on 8-10 May 2012 in Brussels by Bertelsmann, NBC Universal and Vivendi. It contains only the opinions of Enders Analysis.

The report concerns digital music, video-on-demand (VOD) and ebooks in the European Union. It reports on demand and supply factors relevant to the advent of a Single Market in Digital Cultural Products, part of the EU's Digital Agenda. We conclude that the EU27 represent a diversity of opportunity for e-commerce in digital cultural products, but a more significant opportunity in the future, provided continued progress is made on the core enablers of e-commerce.

An extraordinary diversity and density of licensed digital film and music offers are available to purchase or consume in the EU27. Data from IFPI indicates 543 licensed interactive music services in the EU27, in addition to hundreds of ad-supported non-interactive webcasting services. Most music services are served on local storefronts to address the whole market and respect local linguistic and cultural preferences. For films, the European Audiovisual Observatory reports 264 licensed online VOD services in EU27, to which must be added the VOD services of pay-TV operators, free-to-air (FTA) broadcasters, VOD channels on iTunes, 612 channels serving professional content on YouTube (in February 2012) and those on other video-sharing sites. The population of the EU27 may access licensed online VOD services from any location except when non-local IP addresses are blocked by geo-localisation, along with hundreds of unlicensed online services and P2P networks serving films and music. The market for ebooks is nascent and closely tied to the adoption of tablets, which are platform-specific.

E-commerce enablers for digital cultural products

The hierarchy of core enablers for e-commerce in digital cultural products when supplied nationally are: disposable income/ability to spend on cultural products, the acquisition of internet skills and high-speed broadband connectivity, credit/debit cards and e-payment systems, licensing and anti-piracy activity.

Licensing by content owners is a necessary condition, but potential suppliers seek it more frequently for markets with an appropriate commercial opportunity. Consumer spend on cultural products, of which digital is a subset, is highest in absolute terms in the UK, Germany and France. Adding in Italy and Spain, the top five markets represent over 75% of expenditure on cultural products in the EU. These markets are amply supplied with offers of digital cultural products. Smaller markets have a reduced supply due to their smaller customer bases.

Licensed online content exploitation may be pay-for or free to the user. If pay-for, then an e-commerce transaction is required. Despite steady progress towards the Digital Agenda Scoreboard targets, the disparity amongst the EU27 in terms of the level of core e-commerce enablers is the principal barrier to the emergence of a Single Market in Digital Cultural Products.

Promoting national e-commerce is a route to cross-border e-commerce in digital cultural products. In the absence of EU-level convergence of the regulations concerning e-payments and consumer protection for cross-border transactions, a Single Market in Digital Cultural Products lacks an essential pillar.

The existence of 23 official and working languages in the EU segments the market for digital cultural products. As a result, suppliers adapt their exploitation strategies to local market conditions, including linguistic and cultural preferences. Consumption of books and films requires knowledge of the language of the product, and only those with strong cross-border commercial potential are translated. Music is more international because its enjoyment does not require knowledge of its language.

Piracy is the 'free' option

Digital piracy of music, films and increasingly books is widespread because it is 'free' to the user. In relation to e-commerce, piracy has fewer enablers: only a broadband connection is required. It is safe to assume that the vast majority of piracy concerns illegally obtained copies of works that are available to purchase or consume legally, rather than copies of works locked by licensing.

In the presence of a licensed offer, piracy by consumers reduces the demand for digital cultural products. Markets where anti-piracy action is undertaken therefore offer a greater commercial opportunity. For example, Spain is estimated to have one of the highest levels of music piracy in Europe, and the number of licensed interactive music services in Spain is lower than the Netherlands, Denmark and Sweden, despite the latter three markets being much smaller in terms of GDP.

Action to combat piracy will enable the market for digital cultural products to reach its fullest potential. France's HADOPI anti-piracy regime has been successful in curbing P2P activity. Content owners routinely issue take-down notices for pirated content hosted on sites, or may seek to take down sites entirely (e.g. cyberlocker Megaupload was closed in January 2012), or may litigate to require ISPs to block access to sites (e.g. The Pirate Bay). However, the supply of pirated content is virtually limitless.

Digital music

Music was the first digital cultural product to emerge, via piracy, in the early 1990s. Tracks were ripped from CDs to computer hard drives into MP3 format and shared online via email, instant messaging and P2P networks. The piracy of digital cultural products became a global phenomenon. True, in this early stage of digital music, there was a notable absence of licensed digital music services, but despite their subsequent advent, piracy remains entrenched, especially when impunity reigns.

Based on data from IFPI, we calculate there are currently 543 licensed interactive digital music services in the EU27, to which must be added hundreds of non-interactive licensed digital music services, such as sites serving webcasting or the online sites of radio broadcasters.

In terms of interactive digital music services, consumers in most markets have the choice of a download-to-own storefront (iTunes, served in English to 20 markets), an 'access' service, and a 'smart radio' service. However, the choice of service is wider and denser in the top three markets (UK, Germany and France) where consumers spend the most on recorded music. Smaller markets for recorded music such as Cyprus, Latvia, Lithuania and Malta are served by just a few services.

Subscription-based 'access' services like Spotify and Deezer operate multi-territory exploitation models, serving their European markets from a common technical platform, often with a local storefront.

The super reduced VAT rate applicable to digital cultural products (3%) supplied from Luxembourg makes this country the preferred choice for establishment, giving global suppliers a cost advantage over local suppliers. VAT divergences are also interfering in the cross-border e-commerce of goods. The Commission's plan to achieve VAT harmonisation by 2015 is key to achieving the EU's e-commerce potential in goods and services.

Video-on-demand

The licensing strategies adopted by film studios are territorial in nature and also adapted to local market conditions in order to maximise revenues. The usual sequence of release windows is: theatrical (cinema), packaged media (DVD/Blu-Ray) and transactional video-on-demand (VOD), pay-TV, FTA TV, subscription VOD. These release windows are negotiated between rights holders and distributors, with endorsement by legal instrument in France and Portugal, and a link between film subsidies and cinema release windows in Germany and Austria.¹

Cinemas in particular consider their exclusive window to be a core driver of their business model. There would be less reason to go to the cinema to view a new release if a copy was also available to buy. This exclusive window is a motive for piracy, which is well established for new releases. After the cinema window, a copy is available to rent or purchase.

Pay-TV operators similarly view premium content such as films (and other programming, notably live sports) to be a key differentiator in relation to FTA models, whether supplied on film channels or on their catch-up TV services. The agreements between pay-TV operators and rights holders protect this differentiation, subject to competition policy.

¹"Green paper on the online distribution of audiovisual works in the European Union: opportunities and challenges towards a digital single market", COM(2011) 427 final, http://ec.europa.eu/internal_market/consultations/docs/2011/audiovisual/green_paper_COM2011_427_en.pdf

On-demand video services are supplied through-the-middle (TTM) to TV sets by pay-TV operators using a dedicated connection, and over-the-top (OTT) to internet-connected computers, TVs and devices. Catch-up TV TTM VOD services are often bundled at no extra charge with the pay-TV package, while OTT services may be pay-for (e.g. Netflix's subscription model), or free to the user and supported by advertising (e.g. FTA catch-up TV services, YouTube).

TTM VOD film services have key advantages in relation to OTT VOD services:

- TTM VOD services are typically licensed along with the linear broadcast rights, and the content may not be made available to subscription VOD services
- Dedicated connections produce higher picture and sound quality than internet 'broadcasts' of content
- Delivery of TTM VOD services is to the TV, which is the centre of the home entertainment experience, although the adoption of internet-connected TVs will reduce this advantage over time
- Direct customer relationships for pay-TV that facilitate transactional and subscription VOD in relation to the e-commerce transactions required for pay-for OTT VOD services

Volume 2 of the European Audiovisual Observatory's 2011 Annual Report contains the first compendium of VOD services in the EU, and indicates that:

- The main cable, IPTV, satellite and DTT operators in Europe each offer catch-up TV VOD services
- iTunes and pay-TV operators offer transactional VOD services
- There are 264 licensed online VOD services
- Video-sharing sites serve channels of 'professional content' (e.g. YouTube)

It goes without saying that the European Audiovisual Observatory does not monitor unlicensed sites or the exchange of files on P2P networks, which are both commonplace means of accessing film content.

A number of VOD services (e.g. the OTT catch-up TV services of UK FTA broadcasters) are not accessible to computers connecting from outside the territory (geo-blocking). However, a Commission-sponsored report issued in 2012 has found a low level of potential cross-border demand for video services.² The principal customer base is the EU's 'migrant' population of 17.6 million people or 3.6% of the EU's total population of 490 million. Within this group, 85% already consume licensed programming cross-border, mainly via TV or online. Just six million migrants or 1.2% of the EU's population would be willing to consider paying €10/month for a cross-border offer of all premium channels.

While licensing is a constraint on the availability of films to OTT VOD services supplied on subscription, the exploitation strategies for films adopted by the content owners and their commercial partners are the source of the edifice of value worth about €86 billion to the EU in 2009: theatrical exhibition revenues of €6.5 billion, pay-TV revenues of €28.6 billion, television advertising spend of €27.3 billion and public income to television and radio of €23.3 billion. These revenues fund investment in film programming, including original production in the EU, along with thousands of jobs. They also fund investment in innovation by broadcasters.

² Plum Consulting (2012), "The economic potential of cross-border pay-to-view and listen audiovisual media services", http://ec.europa.eu/internal_market/media/docs/elecplum/plum_tns_summary_en.pdf

ebooks

The market for ebooks is nascent in relation to films or music. It has become significant in the UK, reaching 8% of the invoiced value of book sales in 2011 according to the Publishers Association, but has yet to rise above 1-2% of revenue in other European markets. This is partly due to the timetable by country established by the major platforms for the rollout of tablets, and the fact the consumer must purchase either an ebook reader or a general purpose device such as a tablet or smartphone, if they do not already have one, adding to the cost of the experience. Another factor accounting for the nascent state of the ebooks markets in the EU27 is the availability of titles to purchase in electronic format, which depends on local publisher decisions. There is possibly also a consumer preference for the printed format (e.g. Germany).

The ebooks market features integrated platforms, wherein a single company controls the end-to-end experience: the catalogue of ebooks, the purchase and payment and the reading experience. Hence, Amazon has its own dedicated ebook reader device for sale, and also makes dedicated apps for all the major mobile computing platforms: iOS, Android, Windows Phone and RIM. Apple has built its own parallel system, iBooks, which is available only on iOS devices (i.e. the iPhone, iPad and iPod Touch).

Each of these platforms uses its own proprietary digital rights management (DRM) system to encrypt ebooks (despite the existence of a notional industry standard), and no platform can read the DRM used by another. However, all of the major platforms will accept ebook files from third parties that do not use DRM. Publishers, with a few exceptions, apply DRM in order to try to reduce piracy.

The end effect is to make it impractical for consumers to switch between different ebook platforms. This is a small issue on tablets, which can run reading apps from different platforms, but means that ebook readers can only display books bought from the platform provider. For publishers, a higher degree of interoperability in the ebook market would permit readers of ebooks to access them on all sorts of devices no matter from where or whom they have bought them.

Each of the leading integrated platforms serves each European country through a local storefront. Typically, different platforms have different sized inventories in any given country, depending on their progress and investment in securing commercial deals with local publishers.

Conclusions

We recommend the Commission establish the following priorities for policy action to foster demand for digital cultural products:

- Develop the high-speed broadband networks that deliver digital cultural products to consumers
- Strengthening linguistic and cultural affinities
- Fostering national and cross-border e-commerce through e-payment systems and harmonised consumer protection regulations
- VAT harmonisation
- Anti-piracy action
- Greater interoperability of platforms and devices

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