



## **BSAC Business Briefing**

### **Video-On-Demand Services in the UK: The state of play**

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Video-On-Demand (VOD) has now been a reality in the UK for over 20 years, with BT having launched commercial trials with 2,000 Colchester households in 1995. Even back then, the telco managed to sign up over 100 content and service provider partners – including a range of major and independent movie studios who had been eager to exploit the most advanced means of offering video convenience and choice to the consumer. The BT service, following 1993's pioneering Time Warner 'Full Service Network' trial in Orlando, employed a specialist set-top box connected to BT's network to deliver On-Demand video services to the TV set. In the interim 20 years, the biggest change has been the dramatic development of broadband Internet that is able to carry high quality video services 'over-the-top' (OTT) of, or more accurately 'around', conventional pay TV deployments.

After a slow start, the growing array of different On-Demand services in the UK has now begun to have a significant impact on traditional linear TV viewing. Today, more than 25% of all British TV viewing is done on an On-Demand basis. Most of this is consumption of time-shifted programmes that have been recorded by the user on a Digital Video Recorder (DVR) built into the set-top box, but genuine On-Demand services delivered over the Internet or via the pay TV network account for a growing share of non-linear viewing.

By the end of 2015, almost 60% of British TV households were equipped to receive an On-Demand video service of some kind via one of the TV platforms in this country. Over 6.5 million homes are able to access a true VOD service via cable TV (Virgin Media) or IPTV (primarily BT Vision and TalkTalk), while over 9 million homes can receive On-Demand services via Sky's satellite platform. The latter is made possible by the connection of the Sky set-top box to the Internet. In parallel, the roll-out of broadband has enabled more and more OTT video services to flourish via a proliferating range of Internet-connected devices (including smartphones, tablets, game consoles and smart TVs, OTT boxes, amongst others). By the end of 2015, broadband penetration of UK households had reached 84% – or just over 23 million households.

In revenue terms, the VOD market was worth just over £1.5 billion last year and is set to exceed £2.5 billion by 2018. There are three core VOD business models: 'subscription', as exemplified by Netflix; 'transactional', which includes rental and retail – and is exemplified by Apple iTunes; and 'advertising-supported' online video services – a market pioneered by YouTube.

By value, transactional VOD accounts for less than one third of the total On-Demand market and the rental business model continues to account for the majority of those transactions by both volume and total value. Indeed, the retail business model – widely referred to as Electronic Sell Through (EST) or download-to-own – has not taken off to the extent that many in the industry had hoped. This had been a disappointment for the Studios, which had hoped that this sector would develop into a replacement for the physical market, helping to replace the high-margin retail transactions generated by the DVD business.

The EST business model has been relatively more successful in the US than in other territories, largely due to the entry of more players into the market who offer consumers an easy means of viewing their purchased digital content on the TV set. Comcast, the cable TV giant, is a case in point; it has grown the overall market – and its own share – after helping customers to buy movies through their cable set-top boxes. Sky and BT have had some success pursuing a similar strategy in the UK, but globally, pay TV companies have been slow to exploit this EST business model alongside their core subscription business.

Overall, the two biggest players in the UK transactional VOD market are Apple, through iTunes, and Sky, through the Sky Store – which now offers both rental and EST offerings, with Virgin being in third place (and yet to offer EST). However, despite growth in these digital transactions, the overall trend for revenues from the total traditional post-theatrical home entertainment window for movies and TV shows is in decline. Revenues from sales and rental of DVD and Blu-ray Discs still account for the majority of the market, and IHS forecasts that the value of all transactions from this window – physical and digital – will be worth half as much in 2019 as it had generated in 2008.

The advertising-funded free-to-view segment of the On-Demand market in the UK is growing faster than the transaction business, driven mainly by YouTube and Facebook.

Last year, close to 8 billion hours of free-to-view video content containing commercials were viewed by British consumers. While commercial British broadcasters have been improving the volumes of ‘catch-up’ TV monetized by ads, that growth is being eclipsed by the explosion of video distributed by major Internet players. By 2019, IHS forecasts that over 50% of revenues from this market segment will be captured by YouTube and Facebook alone.

With the growth of these online giants comes an underlying and profound shift in the way that video advertising is bought and sold. The rise of so-called ‘programmatic advertising’ involves the application of data within sophisticated analytics tools to auction and trade advertising spots with the fraction of a second that it takes for a web page to load. By 2019, we estimate that over half of the UK online video advertising market will effectively be sold by algorithmically-driven robots rather than by human beings.

The third VOD business model – subscription – has probably received the most attention in recent years thanks to the dramatic rise of Netflix. In the style of Steve Jobs’ legendary ‘one more thing’, Netflix CEO Reed Hastings ‘dropped a bomb’ at the end of his recent Consumer Electronics Show keynote when, during his 60-minute presentation, he announced that the pioneering Subscription Video-On-Demand (SVOD) service had launched simultaneously in an additional 130 countries – making its global footprint roughly 190 different markets. In one fell swoop, this had almost fulfilled the company’s long-stated ambition to be active in 200 countries by the end of 2017. The most important market that Netflix is not yet active in is China, because regulatory, political and commercial factors dictate that a local partner will be critical to any successful launch there – and a suitable partnership has yet to be concluded.

Within the UK market context, we believe that Netflix has now overtaken Virgin Media in terms of absolute number of subscribers. Amazon’s Prime Video service – the successor to LOVEFiLM, which it acquired, has also grown well. Another strong performer has been NOW TV, which Sky created to be a separately branded stand-alone competitor to Netflix and other OTT challengers.

Analysing the growth of SVOD services within the overall pay TV market, it is clear that the overall appetite amongst British consumers to subscribe to a premium video service has expanded dramatically. Since 2010, the number of video subscriptions sold has increased by a staggering 73%, although this does of course include a number of people who pay for multiple subscriptions – e.g. Netflix as well as Sky. The total value of the subscription video market has increased by 21% over the same period – the smaller increment is due to the lower pricing of the OTT video entrants. This means that Sky and Virgin – with their higher monthly ARPUs (average revenue per user) – still capture the majority by far of the subscription video spending ‘cake’.

When it comes to content rights spend per viewer or subscriber, Netflix’s acquisition and origination spend is approximately in line with the typical spend per viewer or subscriber for other services. However, Netflix’s’ global scale means that its total spend on entertainment rights is now higher than the BBC’s or Sky’s in the UK, or that of HBO

or Discovery globally. By comparison, Amazon spends slightly more per subscriber than the industry mean, but on a global basis now spends more than ITV. Moreover, SVOD services are actively shifting their content spend away from movies and towards TV programming, particularly high profile original content commissions that can be used to market their service to potential new subscribers.

The proliferation of SVOD services has had a strong positive impact on the total UK 'downstream' market for film and TV – i.e. all revenues derived from post-theatrical and post-broadcast paid-for in-home viewing. This has stabilised and begun to reverse the negative trend precipitated by the decline of the packaged home video market. In fact, spending on SVOD subscriptions last year pushed this total downstream market to the highest level seen since 2010 – just over £1.7 billion.

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