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British Broadcasting Corporation

Market Impact Assessment of BBC's
Online Service
Final Report
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KPMG LLP

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Executive Summary

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Introduction

KPMG has been requested by the BBC to undertake an assessment of the market impact to date of the BBC's Online Service (branded "BBCi"), in the context of an impending review of the service against its Approval by the Department for Culture, Media and Sport. This report is the output from the study and is an independent, authoritative report produced for the BBC by KPMG.

Since its launch, BBCi has been subject to a number of external challenges. In particular, it has been claimed that the BBC's online presence damages the ability of commercial providers to gain users, which adversely impacts on their ability to generate commercial revenue. It has also been argued that BBCi crowds out commercial online services through cross-promotion, access to valuable brands and its ability to make predatory announcements.

Assessing the impact of BBCi is a difficult and complex task. The relevant markets in which BBCi operates are not easy to define, data are sparse and online markets are still relatively immature. This constrains the type and depth of analysis that can be undertaken. Despite these limitations, we consider that this report clearly sets out our view of the range of likely market impacts of BBCi.

BBCi and the UK online environment

BBCi is regularly visited by one third of Internet users, and is consistently within the top 10 of the UK's most visited websites. Its share of page views by UK Internet users is approximately 3%.

BBCi provides a wide range of content, some message boards, limited chat services and an Internet search facility.

Internet access, e-commerce and email services can also be obtained from the commercial arm of the BBC. However these services are not provided by BBCi and do not form part of the scope of this review.

The UK "online market" generated approximately £7.6 billion of revenues in 2002 (£6.1 billion from e-commerce, £1.3 billion from Internet access charges, £0.2 billion from advertising and just £12 million from paid-for content). A key question for this study was to determine BBCi's potential impact on these revenues.

Market impact of BBCi

Our analysis suggests that BBCi has sufficient market presence to make an impact in certain genres: News, in particular; to a lesser extent, Sport; and narrower parts of Food and Music.

However, despite BBCi's evident popularity, we consider that it has had relatively little commercial impact to date.

- *Paid-for content.* Content is generally free and widespread. Some companies have now introduced paid-for content models (with some success, e.g. ft.com) but this market is small to date and is being met by resistance from consumers. However, there may be some impacts at the margin, particularly in News. In BBCi's absence, some News sites may have experimented sooner with paid-for content or invested to increase consumers' willingness to pay.
- *Advertising.* The indirect impact of BBCi on the online advertising market is small, although some individual sites may be affected to a greater extent than the average. We estimate BBCi's current impact on the UK online advertising market is up to £5 million per annum (2% of the total).
- *Other revenue streams.* In Sport, Food and Music, major growth is coming from revenue streams on which BBCi does not impact (e.g. online gambling, food shopping and paid downloads).
- *Investment.* BBCi has not had a significant impact on past investment decisions of commercial operators; external economic factors have been the driving force. However, investment decisions are now more likely to be based on normal competitive pressures rather than the unrealistic expectations of the past. We consider it possible that planned investment of some sites would be marginally greater if BBCi did not exist, given its annual spend of £100 million.

The fragmented nature of the markets in other genres, combined with the content of BBCi's proposition and its position in those markets, suggests that it is unlikely that BBCi has a significant market impact in those genres.

In all genres, however, some competing sites may already be only marginally viable such that even a small BBCi impact could affect them.

Wider impacts of BBCi

BBCi has encouraged access to the Internet. The existence of BBCi was one of the main reasons why more than 1.5 million people first accessed the Internet. It also encourages exploration of the Internet. Two thirds of BBCi users use external links within BBCi to visit other (non-BBC) websites (although these are not normally to competitors).

BBCi ensures that a range of high quality content is available to UK users by setting high standards that act as a benchmark for the industry. It also acts as a test bed for online innovation and helps to develop the UK's multimedia skills base.

This report

This report is our view, taken at this time, of the main BBCi impacts to date. It should be acknowledged that online markets are in their infancy and are developing fast. New sites will enter the markets and new business models will develop. If the market for paid-for content expands then BBCi's continued provision of free content might have a more significant impact. Of course, in such an innovative and fast-moving market, it is difficult to make firm predictions about the future.

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Synopsis

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1.1 Introduction

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Assessing the impact of BBCi is a difficult and complex task. The relevant markets in which BBCi operates are not easy to define, data are sparse and online markets are still relatively immature. This constrains the type and depth of analysis that can be undertaken. Despite these limitations, we consider that this report clearly sets out our view of the range of likely market impacts of BBCi.

1.2 BBCi

BBCi has a strong presence on the Internet in the UK. BBCi is regularly visited by one third of Internet users, and it is consistently within the top 10 of the UK's most visited websites. Its share of page views by UK Internet users is approximately 3%.

BBCi provides a wide range of content, some message boards, limited chat services and an Internet search facility. The vast majority of BBCi investment is on Content (around £75 million per annum). Examples of content categories include Business & Money, Children's, Education & Learning, Entertainment, Health, History, Lifestyle, Music, News, Science & Nature, Society & Culture and Sport. The categories of News, Sport and Children are particularly popular.

Internet access, E-commerce and Email services can also be obtained under the wider umbrella of the BBC brand through a number of commercial ventures undertaken by the BBC. These services are not provided by BBCi and do not form part of the scope of this review.

1.3 The market context

Although the Internet has existed for decades, it came to prominence in the 1990s. The latter part of the decade saw a global explosion in the number of players online, many eager to exploit the enormous perceived revenue-earning potential of the new medium. Investment by established offline names and new entrants spiralled, as did share values. However, revenue models were soon exposed as over-optimistic. Advertising, sponsorship and e-commerce did not grow at the rates expected and users appeared to be unwilling to pay for content outside of niche areas and the business-to-business and

academic arena. Reliance on advertising alone proved to be an unsustainable business model. As a result, many businesses did not survive – there were many high profile casualties. Share prices collapsed, investment was reined back, and costs were scaled down to match more realistic revenue expectations.

Despite this, the Internet has still had a major impact on the global economy, on businesses and on individuals' personal and working lives. Some of the strongest online companies which survived the dot.com crash (e.g. Yahoo!, Amazon, lastminute.com) are now moving into profit. Complex business models continue to evolve, particularly in the transition to the delivery of content to wireless devices. Although most commercial Internet businesses have relied on multiple revenue sources, there was a habit of reporting or focusing on one main revenue stream only; first it was subscription, then the focus moved onto online advertising as this grew, and then onto e-commerce as this too was used to sell a growth story. Most Internet businesses now rely and focus on multiple revenue streams. Non-adult content generally remains free across the Internet. Paid-for content charging models are starting to gain more prominence.

The UK "online market" generated approximately £7.6 billion of revenues in 2002 (£6.1 billion from e-commerce, £1.3 billion from Internet access charges, £0.2 billion from advertising and just £12 million from paid-for content).

It is in this context that the BBC has developed its online services. Funded as it is by the licence fee, the BBC has, in contrast to its commercial competitors, been largely insulated from the market turbulence of the last few years. It has been able to continue to increase its expenditure on online services despite the downturn in the sector.

1.4 Defining the markets

An assessment of the market impact to date of BBCi requires identification of the relevant economic markets and analysis of BBCi's position within those markets. Market impact will depend on market share and many other factors such as barriers to entry. Our approach is based on economics within the standard competition policy framework. While there are a number of alternative approaches to assessing market impact, the standard competition framework is the most widely used and accepted, containing well established principles for identifying a market in competition cases.

The first stage in the assessment of the market impact of BBCi is to define the relevant economic market(s). Standard economic techniques are usually price-based. However, BBCi is free at the point of consumption, as are much of the content and other services available online. Consequently, we need to rely more on qualitative evidence of substitutability based on user characteristics and behaviour, the actual structure of the online market and the Internet functions offered to the user.

Online user behaviour is complex and consumer needs are wide ranging. User behaviour is generally task based, although it is also multi-dimensional and more analogous to a journey. The low levels of substitution between tasks suggest that the online market cannot be defined as one broad market, but rather a collection of separate markets. However, there is not enough evidence to suggest that the relevant market(s) should be defined entirely by a collection of very small tasks.

We therefore turned our attention to Internet functionality. Internet use can be separated by functionality into Access, Commerce, Chat, Content, Email and Search. Demand and supply-side substitution were then considered to establish whether the relevant markets are narrower (or indeed broader) than these Internet functions. Based on this analysis we concluded that Email, Search, Access and Chat should be defined as separate markets.

In the Content market, Internet sites generally structure their offerings in terms of genre (i.e. news, sport, music, etc). Many niche sites set up entirely within one specific genre and Internet rating companies such as Nielsen/NetRatings and Hitwise commonly report indicators by genre. Internet sites (niche and mass) have structured their offerings by genre because this reflects what users want and how consumers use websites. This evidence implies weak substitution between genres and, therefore, that the relevant Content markets are likely to be genre-based. On the supply side, access to appropriate content is also likely to be a barrier which makes it more difficult for suppliers to substitute across different genres. We therefore concluded that it is most sensible to define Content markets by genre.

However, we also considered that a reasonable case could be made for even narrower markets than genre (e.g. in Sport there may be narrower markets such as football or cricket). As robust empirical evidence is not available to make a definite conclusion either way, we have examined BBCi's position and market shares in both genre-based and narrower markets. This should indicate the upper bounds of BBCi's impact and we therefore consider this to be a conservative approach to the issue.

We concluded that the Commerce market should be defined by genre in a similar way to the Content market (e.g. music, travel, food). Evidence is inconclusive on whether Commerce markets should be regarded as separate to Content markets; this issue needs to be considered on a case-by-case basis.

To summarise, we consider the relevant online economic market(s) are:

- Internet access;
- Chat (and message boards);
- Email;
- Search;
- Commerce (various markets);
- Content (various genres, some defined more narrowly than genre).

Finally, while it is not a user function, Internet advertising represents a separate market, albeit one with recognisable segments (e.g. banner advertising, sponsorship).

1.5 **Barriers to entry**

Barriers to entry for commercial organisations seeking to create viable online businesses are now considered to be quite significant in the online market. Access to capital is likely to be one of the most significant barriers.

BBCi's current online investment is in the region of £100 million per annum, of which around £75 million is spent on Content. While this is a significant sum, we concluded

that past investment decisions have been largely unaffected by BBCi – investment has generally been driven by external factors.

However, the Internet boom and resultant bust has, effectively, been a one-off adjustment. The online market is now a very different one from the past with lower revenues and much lower expected profitability. The higher than average investment by BBCi is therefore relatively more important now than it was in the past. There is therefore the possibility that planned investment of some sites would be marginally greater now if BBCi did not exist.

There are many other entry barriers. Economies of scale and scope mean that smaller new entrants find it difficult to compete with the incumbents. Advertisers also generally want to be where the mass audiences are, e.g. large portals. Creating an online business also usually requires heavy investment to build up a brand (unless it has been spawned from an offline business with an existing strong brand). Again, BBCi is insulated in these respects. The BBC has a strong offline brand which appears to translate well into the online world. MORI research suggests that, among the UK's top websites, only Google inspires trust in more people than BBCi as an online brand. However, the success of Google also shows that heavy investment in marketing is not necessarily required to build up a credible new brand.

Cross-promotion of online services is important for all companies which operate across more than one medium, including the BBC (one third of UK Internet users have visited BBCi as a result of cross-promotion). However, it is a normal marketing activity of many businesses and its effectiveness should not be over-estimated, especially in the long term. Almost half of UK Internet users have proved resistant to offline cross-promotion from any media outlet in the last three months.

1.6 BBCi's market position and impact

BBCi has a presence in Content (defined by genre), Search and Chat/Message boards. In evaluating BBCi's impact, we considered BBCi's market position, market share and structure and the barriers to entry for each of the relevant markets. Taking all of these into account, we then examined BBCi's impact on the market in terms of revenues, costs, investment, users and market structure.

The number of genres of Content on the Internet is vast, and it is not practical within the scope of this study to examine all of the genres in which BBCi has a presence. Therefore, we selected six content genres to examine in more detail: News, Sport, Film, Food, Health and Music. Together these six genres comprise 54% of total traffic to the BBCi site. Around 73% of all Internet users regularly visit one or more of these genres.

Genres were selected based on their relative importance in terms of numbers of users or time spent online, their association with the BBC brand and the financial potential of those genres to commercial operators. Attention was also paid to the degree to which competitors had complained about the BBC.

Within these genres, we also considered which narrower markets may exist (e.g. film reviews within the film genre) and performed additional analysis based on these narrower market definitions.

1.7 News

1.7.1 Overview of BBCi's position in the online News market

News is one of the most popular genres of content on the Internet (one in four users read news on the Internet) and BBCi is the most popular site in the UK for users wanting to access news.

BBCi's market share in the News genre is in the region of 40% and it is BBCi's most popular genre. The News genre is dominated by a few successful sites, amongst others BBCi, Telegraph, Guardian and Freeserve. The UK market is more concentrated than other European countries.

A significant proportion (35%) of users of News on BBCi do not visit any other site for news. This is high compared to its competitors, with the exception of portals (which focus on a "walled garden" strategy, providing few external links).

The News genre is dominated by sites which have a presence in the traditional marketplace. This is partly because pan-media organisations have established businesses and recognised brands, and partly because they have advantages in re-purposing and repackaging their content for online delivery.

Although the majority of news content remains free to users, a number of websites have started to charge subscription for access to premium content or archive articles. The extent of charging is likely to increase for access via wireless devices and "push" services, where customised news is sent directly to the user.

1.7.2 Impact of BBCi on the online News market

If BBCi did not contain News, it is likely that a large proportion of its users would swell the user bases of major commercial news sites. BBCi's presence and success is making the market structure more concentrated.

Given that general news sites are not as attractive to advertisers as portals and advertising alone has proved to be an unsustainable business model for websites, it is unlikely that BBCi is having a significant impact upon the market for Internet advertising on news sites.

We consider it unlikely that BBCi is having a significant impact on the paid-for content market at present, given the abundance of free material available, and the resistance of consumers to paying for content. The widespread provision of free content has not constrained some companies from experimenting with paid-for content (e.g. FT.com have recently demonstrated that there is a willingness to pay for niche premium content). It is possible that these moves towards paid-for content may have been quicker in the absence of News on BBCi. We also consider it possible that commercial news providers might increase investment to overcome consumer resistance or reduce the amount of free content available if BBCi did not carry News.

We do not consider that BBCi's presence alone is a barrier to new entrants – all pan-media groups with established businesses, journalistic resources and recognised brands contribute to this barrier.

The difficult financial environment and the collapse in market confidence in dot.com businesses have been the driving forces behind the scaling back of investment in online news services in recent years. Some companies (e.g. FT.com) have continued to invest. BBCi is, therefore, unlikely to have had a significant impact on investment decisions.

1.8 Sport

1.8.1 Overview of BBCi's position in the online Sports market

Sport is also a popular genre of content on the Internet (one in five users read sports content on the Internet). The most popular sites are those which have a generic offering (i.e. covering a wide range of sports), like BBCi. Niche sites are common but relatively less popular. Sport is the second most popular genre on BBCi, with a market share of around 20%. Sport on BBCi is the most popular sport site in the UK, reaching more than one third of online sports content consumers each month. The market structure is very fragmented.

Around 43% of users of Sport on BBCi do not visit anywhere else for sports content. The second-largest player, Sky Sports, has a slightly higher proportion of users who use Sky as their sole source of sports content.

Principal revenue streams in this genre are e-commerce/transactions (mainly online betting), sale of content to third parties and advertising. Provision of online betting is a core strategy for many commercial sites; it is forecast to continue its strong growth. Many commercial operators intend to increase revenues from paid-for content – premium content, push services and wireless-accessed content. Sport has been the most successful genre at generating revenues from SMS push services to wireless devices.

1.8.2 Impact of BBCi on the online Sports market

There is no direct impact on betting as BBCi does not compete for gambling revenues. It does not provide comprehensive analysis of form or betting odds, so it does not impact on businesses which charge for this content. BBCi does not offer an e-commerce facility so there is no direct impact on e-commerce revenues.

BBCi is unlikely to be having a significant effect on advertising revenues. Advertising alone has not proved to be a sustainable revenue model for sports websites. Those advertisers wishing to target a “sports” audience demographic are still likely to place advertising with commercial sports websites – the presence of BBCi is unlikely to influence that decision. Some displacement from the Internet to other media may occur, but this is likely to be small in magnitude.

BBCi has had little impact upon investment since this has mainly been in sports sites with gambling capability. Similar to the News genre, BBCi's presence alone also is not a barrier to new entrants.

We understand that it is not BBC policy to bid for exclusive online sports rights. The associated impact on this aspect of content costs for commercial operators is therefore likely to be limited.

1.9 Food and Music

BBCi's share in the overall Food content market is approximately 10 to 15%, and as high as 20% in the online recipe market. However, the main revenue source in this market is online food shopping, and BBCi does not have any direct negative impact on this market. The market for paid recipes is as yet unproven.

BBCi's portfolio of music sites attract a relatively large combined market share (7.5% in the music market as a whole, or as high as 10 to 20% in narrower markets such as gig listings and charts). The most popular site in the portfolio is Radio 1; it is the UK's most popular music website. However, the market is much more fragmented than, for example, the News market, and Radio 1's share of the overall music market is under 5%.

As audio content on BBCi music sites is streamed (it cannot be stored) and much of it is time-limited or unique BBC content (e.g. sessions), we consider it unlikely that BBCi is having a significant impact on the developing market for paid downloads. Transaction revenues (e.g. CDs) are unlikely to be affected significantly as impulse purchases are rare; there could even be some positive effect – around 15% of BBCi users have made an online purchase from a commercial site as a result of learning about the product or service from BBCi.

It is likely that investment decisions in Food and Music have been largely unaffected by BBCi – investment has generally been driven by external factors. However, there is a perception within the online industry that BBCi's offering is very strong within these genres. It is possible, therefore, that at the margin some individual sites may have modified their investment plans.

Similarly to Sport, there is unlikely to be a significant impact on the advertising revenues associated with either of these genres.

1.10 Film and Health

BBCi's position in the other genres is much weaker. The market structure and the content offerings are much more diverse, particularly in Health. The markets are highly fragmented and BBCi has a relatively low market share.

Users tend to get information from many sites. Thus users do go to other websites for similar content and/or services, although the proportion that uses single websites for certain genres varies. Given this, together with the other market characteristics identified, the implications are that BBCi does not have a strong market position, or consequently impact, in these niche markets.

1.11 Chat and Message Boards

1.11.1 BBCi's position

BBCi provides both synchronous chat and asynchronous message board services. However, all chats and message boards on the BBCi website are moderated, and synchronous chat is only available between certain scheduled times ("live chat events"). It is almost always framed around a BBC TV or radio programme or strand (e.g. BBC3's

Liquid News or Radio 2's Terry Wogan Show). BBCi hosts between 10 and 15 of these live chat events per week, with average participation of around 450 users.

Large portals such as MSN and AOL provide 24-hour chat without some of the constraints of BBCi – this is an attractive proposition to many customers. A Nielsen/NetRatings survey suggests that a significant proportion of Internet users (16%) participate in chat rooms. In the UK, that represents approximately 4 million users. It is clear, therefore, that BBCi (with just a few thousand users) is very much on the fringes of this market. Indeed, its chat is restrictive enough in subject matter that it could be seen as an aspect of the BBC's standard content (e.g. programme support).

BBCi's message boards are largely an extension of its standard content – they are user-generated content which has been moderated by BBCi. They can be sub-divided into genres as with standard content. The BBCi's position within the message board market in a particular genre will therefore be closely connected to its overall position in content in that genre.

1.11.2 **Impact of BBCi**

It is unlikely that advertising and subscription revenues associated with Chat and Message Board services would be affected by BBCi's presence. The majority of Internet Chat is free. Subscription services are generally to adult Chat or highly niche subject areas – BBCi is not competing against these. The BBCi's low market share means it is not diverting significant numbers of users away from competitors' sites and therefore it is not impacting advertising revenues.

1.12 **Search**

BBCi Search was launched in May 2002. As would be expected given its late arrival into the Search market, it is well behind all the significant players such as Google, Yahoo! and MSN. It is too early to determine what position BBCi Search will ultimately claim. It has no significant impact on the market at present.

1.13 **Advertising**

It could be argued that, while impacts on advertising revenues within individual genres are not significant, BBCi is impacting upon the UK Internet advertising market as a whole. We estimated the quantum of this impact, based on the BBCi's share of time online among UK users. If BBCi did not exist, and all that time was spent on UK commercial sites, advertising revenues would increase.

However, evidence from the UK television advertising market suggests that the proportionate increase in revenues would be approximately a quarter to one-half of the increase in the number of advertisements seen by users/viewers. On this basis, the overall impact of BBCi on the UK online advertising market is likely to be quite marginal, currently in the region of £5 million per annum (2.4% of the total). This is likely to be an overestimate – particularly as there is some evidence that BBCi encourages people onto the Internet.

While the impact of BBCi on the overall advertising market as well as specific genres is marginal, there could be differential impacts. Some sites may have an elasticity which is

significantly different to the market average and therefore may be impacted on by BBCi to a greater extent.

1.14 **Wider impacts of BBCi**

BBCi has also had a number of wider impacts:

- Encouraging people online. The existence of the BBCi website was one of the main reasons why 7% of UK users (1.5 to 2 million people) first accessed the Internet.
- Encouraging exploration of the Internet. The BBCi site has at least 70,000 external links to other sites, although these are not normally to competitors. However, these links have still encouraged further exploration of the Internet. Two thirds of BBCi users use these links to visit other (non-BBC) websites.
- Ensuring that a range of high quality content is available to UK users by setting high standards that act as a benchmark for the industry.
- Acting as a test bed for innovation for all of the UK's online businesses. BBCi, which is not subject to commercial pressures, continues to innovate through investment and experimentation.
- Helping to develop the UK's multimedia skills base through training staff in multimedia skills and support of industry training organisations.

BBCi also has limited impact in its support of the UK's independent multimedia sector through external spending on online services (although the proportion of total spend is low).

1.15 Overall conclusion

BBCi has significant market presence to make an impact in certain genres: News, in particular; to a lesser extent, Sport; and narrower parts of Food and Music.

The market impact to date is limited. Content is generally free and widespread. Some companies have begun to test paid-for content models but this market is quite small to date and is being met by resistance from consumers.

There may be some impacts at the margin. Some News sites may have experimented sooner with paid-for content if BBCi did not carry News. There is also the possibility that commercial providers might have reduced free content available or invested to increase consumers' willingness to pay in the absence of News on BBCi.

The market impact is less in Sport, Food and Music. In these genres, major growth is coming from revenue streams on which BBCi does not impact (e.g. online gambling, food shopping and paid downloads).

The fragmented nature of the markets in other genres, combined with the content of the BBCi's proposition and its position in those markets, suggests that it is unlikely that BBCi has a significant market impact in those genres.

In all genres, however, some individual sites may already be only marginally viable such that even a small BBCi impact could affect them.

BBCi has not had a significant impact on past investment decisions of commercial operators; external economic factors have been the driving force. However, the online market has now realigned. Current investment decisions are now more likely to be based on normal competitive pressures in the current market rather than the high expectations of the past. BBCi invests around £100 million per annum (around three quarters on content). This is a significant sum and we therefore consider it possible that planned investment of some sites would be marginally greater now if BBCi did not exist.

The indirect impact of BBCi on the overall online advertising market as well as each genre-based market is small, although some individual sites may be affected to a greater extent than the average.

This report is our view, taken at this time, of the BBCi impacts to date. It should be acknowledged that online markets are in their infancy and are developing fast. New sites will enter the markets and new business models will develop. If the paid-for content market expands then BBCi's continued provision of free content might have a more significant impact. Of course, in such an innovative and fast moving market it is difficult to make firm predictions about the future.