

Main Report

2.1 Background

The BBC's Online Service received approval from the Secretary of State for Culture, Media and Sport on 28 October 1998. In its application for approval, the BBC stated that the service's objectives were:

- to act as an essential resource offering wide-ranging unique content;
- to use the Internet to forge a new relationship with licence fee payers and strengthen accountability;
- to provide a home for licence fee payers on the Internet and act as a trusted guide to the new media environment.

The Department for Culture, Media and Sport (DCMS) announced on 14th April 2003¹ that it intends to undertake an independent review of the BBC's Online Service against the terms of its approval.

Since the launch of the BBC's Online Service, it 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.

2.2 This report

This report and the information contained in it have been prepared by KPMG LLP ("KPMG"), a member firm of KPMG International, in accordance with specific terms of reference agreed between the BBC and KPMG at the time and for the benefit and information of the BBC. This report will be presented to the DCMS as a report for the BBC.

The BBC has appointed KPMG to conduct a study to assess the market impact to date of the BBC's Online Service (branded "BBCi"). This report is the output from the study and is an independent, authoritative report produced for the BBC by KPMG. The report reflects the information available to KPMG and KPMG's views held in good faith on the basis of that information. The information contained within the report has not been verified except to the extent expressly stated therein.

KPMG has produced this report with key inputs from Nielsen//NetRatings and MORI². Nielsen//NetRatings provided data on Internet user behaviour while MORI provided market research analysis. Throughout this study KPMG has reviewed the suitability and quality of the data produced by Nielsen//NetRatings and MORI. However, we have not verified the systems and process in which the preliminary survey data has been collected and validated and therefore offer no opinion on its overall quality and accuracy.

¹ 'Independent review of BBC Online Service'. Written statement by Secretary of State for Culture, Media and Sport (Tessa Jowell) on 14th April 2003.

² MORI Survey (May 2003). See Appendix B.

The report will form part of the BBC's submission to the DCMS review of its Online Service. However, KPMG expressly excludes any duty to parties in respect of the report other than the BBC. Should any party other than the BBC choose to rely on the report, or any portion of it, it does so entirely at its own risk.

KPMG will accordingly accept no responsibility or liability in respect of the report or any part of it to persons other than the BBC. Neither the whole nor any part of this report, nor any reference hereto may be included in any published document, circular or statement, nor published in any way, without KPMG's prior written approval of the form and context of such publication or disclosure.

2.3 Study objectives

The key objective for the study is to produce a market impact assessment of BBCi to date, which is economics based and founded upon standard competition policy techniques.

The requirements of the study are set out in the BBC's Invitation to Tender Reference CP109, dated 24 June 2002. A summary of the terms of reference for this study is set out in Appendix C. In short the study is to cover the following key aspects of BBCi:

- relevant economic markets – define the relevant product and geographical markets affected by BBCi;
- the market position – of BBCi and other players within the relevant markets, and other potential players;
- market power – examine whether BBCi has market power and whether other players have equal opportunities;
- market impact – what is the market impact of BBCi on other players and users to date.

In conducting the study, therefore, we have aimed to answer the following broad questions:

- does BBCi damage the ability of commercial providers to gain users?
- does BBCi crowd out commercial provision of online services through cross-promotional opportunities?
- does BBCi have a strong market position?
- does BBCi act as a trusted guide to the new media environment?
- does BBCi educate users on the Internet or boost the market in any way?

2.4 Study scope

The study is focused on the impact of BBCi using standard techniques employed in competition investigations. We were asked to focus on the public service remit of the BBC's Online Service (branded "BBCi") rather than any services provided by BBC Worldwide, the commercial arm of the BBC.

We have not been asked to assess in detail Chapter I and Chapter II issues as defined in the relevant legislation, the UK Competition Act (1998). Chapter I centres on the prohibition of 'agreements between undertakings, decisions by associations of undertakings or concerted practices which have the object or effect of preventing, restricting or distorting competition in the UK (or a part of it) and which may affect trade within the UK or (any part of it)'. Chapter II prohibits conduct by one or more undertakings which amounts to the abuse of a dominant position in a market which may affect trade within the UK (or any part of it).

In terms of our approach, we were requested not to undertake any direct research into competitors' views of BBCi. Instead we researched and reviewed comments made on BBCi, which are well documented and in the public domain. This secondary research was supplemented by primary research into competitors' general Internet strategies, such as why they are on the Internet and how they see their marketplace.

The scope of this study did not include the likely future impact of BBCi on the marketplace. We were also not asked to consider whether the services offered provided by BBCi were appropriate public services. This is a separate exercise to be undertaken by the BBC and will form an integral part of its submission to the DCMS review of its Online Service.

2.5 Our approach

2.5.1 Introduction

Our approach to the study entailed a combination of primary and secondary research, economic analysis and brainstorming. It is composed of the following five closely related work packages:

- review of BBCi and preliminary market definition. This involved examination of the key elements of BBCi, the key complaints made against the service and formulation of the key hypotheses to be tested. Economic techniques were used to define the relevant market;
- analysis of the position of BBCi in the relevant economic markets. Markets were examined by genre³ and by Internet functionality. Key historical trends and future developments in the marketplace were also assessed. Primary data on Internet user behaviour was collected by Nielsen/NetRatings;
- analysis of the competitive landscape. Key areas studied included the structure of the market, investment, the strategies of online players, the various revenue or business models and supply side constraints such as barriers to market entry. This work package is predominantly based on secondary information sources available in the public domain;
- market research questionnaire undertaken by MORI. The survey examined user behaviour in more detail, testing economic hypothesis where data and evidence was limited. Particular issues examined by the survey include cross-promotion, brand and whether BBCi increases or inhibits the market. The survey took place in May 2003.

³ Categories or topics of information (e.g. News, Sport and Music) analogous to how books are indexed in a library by subject.

- market impact assessment. This final work package brought together all of the analysis and primary research to assess the impact of BBCi on the market using economics tools with the standard competition analytical framework.

2.5.2 **Key hypotheses to be tested**

The foundation of our work has been hypotheses led. At the start of the study we set out a number of hypotheses relating to market definition, market conduct and market impact. In conducting the study we re-visited the hypotheses as we gathered information with a view to reaching a conclusion. Hypotheses included:

Market definition:

- is there a broad online market or are there a number of narrower genre specific markets?
- is BBCi predominantly used for its niche content or range / depth of content?
- is BBCi a portal?
- is the relevant geographic market international and English language based?

Crowding out competitors and inhibiting or increasing market growth:

- does BBCi encourage growth in the overall Internet market by, for example, encouraging consumers to use the Internet initially or on an ongoing basis?
- does BBCi drive the market by educating the audience about the opportunities that the web offers?
- does BBCi attract users to the web and then, by providing direct links or content guides, encourage them to explore other offerings?
- does the BBC's online presence damage the ability of commercial providers to gain users? Are users displaced from other Internet sites to BBCi or is the BBCi site purely additional?
- does BBCi have a negative impact on the online advertising market?
- is the BBCi search engine likely to inhibit the growth of other search engines or facilities?
- does BBCi have easy or privileged access to financial resources compared to the competition?
- do users go to other websites for similar content and/or services?

Cross-promotion and brand:

- does BBCi promote its Internet site via television and radio advertising more than its competitors do?
- does BBCi crowd out commercial provision of online services through cross-promotional activities?
- does BBCi use the power of the BBC brand to drive users to its sites?

Generic market power hypotheses:

- does BBCi have a strong market position in UK 'Internet' markets?
- does BBCi have a strong market position in UK 'niche' markets?

2.5.3 **Nielsen//NetRatings and Hitwise**

KPMG worked in conjunction with Nielsen//NetRatings to study the different online markets in which BBCi operates, primarily to assess BBCi's market share, usage and position compared to its competitors.

Nielsen//NetRatings has a syndicated Internet audience measurement service which collects real-time user data from nearly 230,000 individuals with access to the Internet around the world from both the home and workplace. Nielsen//NetRatings measurement technology allows very specific user behaviour to be monitored, such as visits down to page level, site and advertising demographics, and time spent online. Crucially, the methodology captures what users do on the Internet as well as the size and shape of different online markets.

The output from Nielsen//NetRatings was supplemented with data from Hitwise, which is the only other significant company in the business of monitoring and reporting demand for different Internet sites.

Hitwise reports demand for different sites by genre with each genre is made up of thousands of individual sites. For example, News & Media genre is currently made up from measuring 'hits' to around 3,300 sites.

Hitwise is therefore very useful for calculating market share as each genre is based on analysis of thousands of sites. Nielsen//NetRatings on the other hand is most useful for benchmarking BBC's relative performance against other sites as more detailed user demand indicators are available.

2.5.4 **MORI**

KPMG worked with MORI to aid further understanding of BBCi consumers, their attitudes and behaviour online, through the development of a custom survey. The following are some examples of the specific hypotheses or issues we set out to test:

- the effectiveness of cross-promotion, and the degree to which it is used at the BBC compared to its competitors;
- the extent to which BBCi is trusted compared to its competitors;
- whether BBCi encourages Internet use by helping people onto the Internet or alternatively whether BBCi inhibits growth;
- whether BBCi is a trusted guide to the Internet by helping people find their way around;
- the appropriateness of the market definition, in terms of the link between commerce and content, and the role of genre.

MORI undertook interviews with around 2,000 interviewees as part of MORI's general public monthly Omnibus Series. This sample is nationally representative by age, sex, social class, working status and region and interviews are conducted face-to-face within the home environment. Of the total sample, around 1,000 were Internet users. The survey took place in May 2003.

2.5.5 **Additional sources of information**

In addition to Nielsen//NetRatings and MORI, we have assembled general information on the market for online services from several sources, including:

- information on Internet user behaviour from industry analysts and published surveys;
- information on how stakeholders – industry analysts, investors and participants – perceive the general online market and its constituent parts or segments;
- evidence on a number of market definition models available from industry analysts relating to products and Internet functionality.

The sources of information presented in the text are referred to as appropriate throughout the document.

3 Overview of the online market

This section appraises the structure of the online (business to consumer) market, the revenue models, the investment environment, the role of advertising and the key economic features of the online marketplace. Key findings include:

- The market structure is complex and can be analysed on a number of levels. The most important distinctions are between types of Internet functionality such as 'Access', 'Chat', 'Commerce', 'Content', 'Email' and 'Search' and types of player such as Portals, Search Engines / Directories, Content Aggregators, Special Packagers, Single brand sites and Destination sites.
- The Internet landscape can be viewed as one with multiple playing fields or levels, each with its own participants offering services and Internet tools, which they consider best serve the needs of their target market. The form of this landscape partly reflects users' 'online journeys' as well as the participants' deliberate commercial strategies.
- The role of genre is of particular importance in the provision of Content. Mass market Internet sites structure their offerings by genre to better reflect what users want and how consumers use websites. Smaller Internet organisations have established themselves as providers of highly focused niche sites by genre.
- There are a number of revenue sources, most notably access charges, advertising, subscriptions and transactions/commissions, which combine to yield a UK online (business to consumer) market worth around £7.6 billion in 2002. Many early business plans relied on over-optimistic revenue assumptions and have since failed. In particular, advertising revenues have not met expectations and generally only go to the most popular websites (around 80% of advertising revenues go to the top 10 sites).
- Companies now rely on streams of revenue from a variety of sources rather than just one. However, it is still not clear whether the vast majority of existing Internet companies will reach profitability. Non-adult content generally remains free across the Internet although paid-for content charging models have started to gain more prominence. It is currently unclear whether these revenue models will be successful.
- Changes in the investment environment have been striking. With financial markets now no longer interested in backing online retailers and other consumer websites, many new Internet businesses have abandoned their plans to expand, have significantly cut costs or had to close down completely.
- Revenues have been growing, but not as expected and are insufficient to support the number of businesses. Consolidation is occurring and there is the search for profitability and commercial sustainability.

3.1 Introduction

This section describes the characteristics of the Internet, its size and shape and the services offered to the user. We consider:

- the development of the Internet over recent years and what it offers to users;
- the structure of the (business to consumer⁴) online market, the different player types and the industry characteristics;
- the financial characteristics, such as the different types of revenues, the business models and the overall value of the UK online market;
- the investment environment, with reference to public and private investment in online companies.

3.2 Key definitions

The Internet is a global network of computers. It is a powerful medium as it combines the advantages of publishing with the advantages of telecommunications (instant communication and interactivity). Perhaps the best definition of the Internet is by reference to how it relates to another widely used term – the World Wide Web (Web):

"The Internet ... is a network of networks. Basically it is made from computers and cables. ... The Web is an abstract (imaginary) space of information. On the Net, you find computers - on the Web, you find document, sounds, videos, ... information. On the Net, the connections are cables between computers; on the Web, connections are hypertext links" Tim Berners Lee (the inventor of the Web)⁵.

There are a number of principal services that users can access from the Internet. Broadly, these can be grouped into the following:

- 'Chat' – a website, part of a website, or a venue where users with a common interest can communicate in real time. Chat sites can be generic or focused on specific subjects;
- 'Commerce' – the buying and selling of goods and services on the Internet. Examples of specific online e-commerce markets are software, books, music, videos and toys;
- 'Content' – the actual information contained on Internet sites, usually structured by genre. There are a large number of different genres on the Internet such as News, Sport and Music⁶;
- 'Email' – electronic mail exchange between users;
- 'Search' – the provision of tools (search engines/directories) which help the user choose where they go next.

⁴ This report focuses on the Business-to-Consumer (B2C) market rather than the Business-to-Business market (B2B).

⁵ Quote replicated from 'The Economics and Regulation of the Internet', Martin Cave and Robin Mason, 10 April 2001.

⁶ Other examples include Finance, Education, Career, Children's, Women's, Health, Beauty, Food and Drink, Movies, Weather, Travel, Holidays, Motoring, Gardening, Games, Adult, What's on and Local.

'Access' to the Internet itself is also required to use these services. This is defined as the provision of a connection to the Internet through an access provider or an Internet Service Provider (ISP) such as AOL.

This segmentation of services is not completely clear-cut, e.g. many commerce sites will contain a great deal of content, and many message boards effectively constitute content. These six services constitute our definition of the 'Online market' which is the basic starting point for defining the relevant economic markets. The term 'market' is loosely used in this section. Section 6 examines the relevant economic markets in more detail.

A key theme running through this study is the importance of genre within the Content market. Where content (whether educational, entertainment or informational) is the main draw for users, the type of content (the 'genre') has become important to users. As a result, many sites structure their information by genre. Internet rating companies such as Nielsen/NetRatings and Hitwise also commonly report market performance indicators by genre to reflect how suppliers are segmenting their online offerings. Content arranged and structured according to genre and its implications for the definition of the relevant economic markets is defined in greater detail in Section 6.

3.3 Market structure

The online market is a mass of websites offering a vast range of information, goods and services. To describe this complex environment we have defined a number of different types of websites based loosely on market structure, the size of the website and the objectives of the site for being online.

The categories used are Portals, Search Engines and Directories, Content Aggregators, Special packagers, Single brand sites and Destination sites. Figure 3-1 summaries this landscape with its various levels and some principal participants.

Portals are one of the most popular and important websites. These are online service providers (i.e. they compete with pure ISPs in the provision of access) which aggregate large numbers of Internet users (some may be subscribers) around a suite of online services and Internet tools. The best known leaders in this field are AOL, MSN, Freeserve, and Yahoo! which are in one sense unfocused because of the variety, range and depth of online content and Internet functionality they offer.

There is no standard definition of a portal. Although the term is widely used across the Internet, there is no consistency in its use, particularly as it is often used to market a site. A very loose definition generally accepted is that a portal is some kind of gateway through which a wide range of online services can be accessed. However, this definition is too qualitative and therefore is not appropriate for the purpose of this study. We have therefore used a rigid definition defining a portal as an organisation which offers all six types of Internet functionality⁷ and therefore is essentially a 'one-stop' Internet service – analogous to a supermarket in the retail market.

The main purpose of the provision of a 'one-stop' service by portals is to attract Internet users and retain them with all the possible services and tools users may need, thereby locking out any other competing offering. Although it is one of the principal aims of all

⁷ The six types of Internet functions are Access, Chat, Commerce, Content, Email and Search.

operators of websites to attract and retain users, most online commercial players and BBCi are not portals⁸ and do not compete by being all things to the largest possible mass audience. However, portals do compete in the markets or segments that other online players serve. For example, AOL, MSN, Freeserve and Yahoo! operate as portals, search engines, content aggregators and ISPs. Some of these companies are also now part of larger companies with other telecommunications (e.g. Freeserve) or media interests (e.g. AOL Time Warner). Overall, portals have been amongst the most innovative and successful at exploiting new revenue models on the Internet (including access, advertising, e-commerce, and subscription). The scale and scope of their operations has helped many of these survive the downturn. They maintain their Internet presence with a view to reaching profitability. Increasingly, this is as part of a pan-media strategy.

Search Engines and Directories are another fundamental part of the online market. The purpose of these sites is to help users choose where to go next during their connection to the Internet. As directories, they attract mass audiences 'searching' and identifying websites that may serve their needs. Search engines are, almost by definition, less successful at retaining users on their site for long durations. As a result, one of the first and most successful companies, which started off as a Directory - Yahoo! - is now a fully fledged portal.

Content Aggregators are analogous to national newspapers, as they provide a mix of content covering information as well as entertainment. The content available on the websites of these participants is typically by channel, based on specific genres. Such content may be produced in-house by content aggregators or acquired from agencies such as Reuters and The Press Association, or from other content producers. Popular genres include news, sports information, music, health and food. The most successful content aggregators tend to be established publishers and broadcasters.

Pan-media companies such as The Guardian, Emap and News International (e.g. The Times and BSkyB) largely fall within this category (although some smaller pan-media companies could be defined as special packagers or even destination sites, but this is less common). The majority of these companies have had significant media operations in the UK prior to the Internet age. The original objectives for going online included exploiting their greatest asset – offline content – in an online environment and brand extension (seeking to promote the offline brands through an online presence). For some there was an element of defensive positioning. If established media brands did not establish themselves on this new medium, they could be eclipsed by rivals or new entrants if/when the new medium overtook the old. In the early days, many of the pan-media companies considered that online services could become profitable through advertising and transaction revenue, although by now many have tentatively experimented with various revenue models. Some have reigned back their investment or reintegrated their online operations into their core businesses.

On a smaller scale to content aggregators are **Special packagers**. These sites are analogous to specialist magazine titles and cover interests based on a certain social demographic – for example, ivillage for women – or cover a particular need – for example, fish4 for job hunters. In this respect, they differ from the content aggregators because they do not offer a variety of content, but in-depth content in one particular subject area or genre.

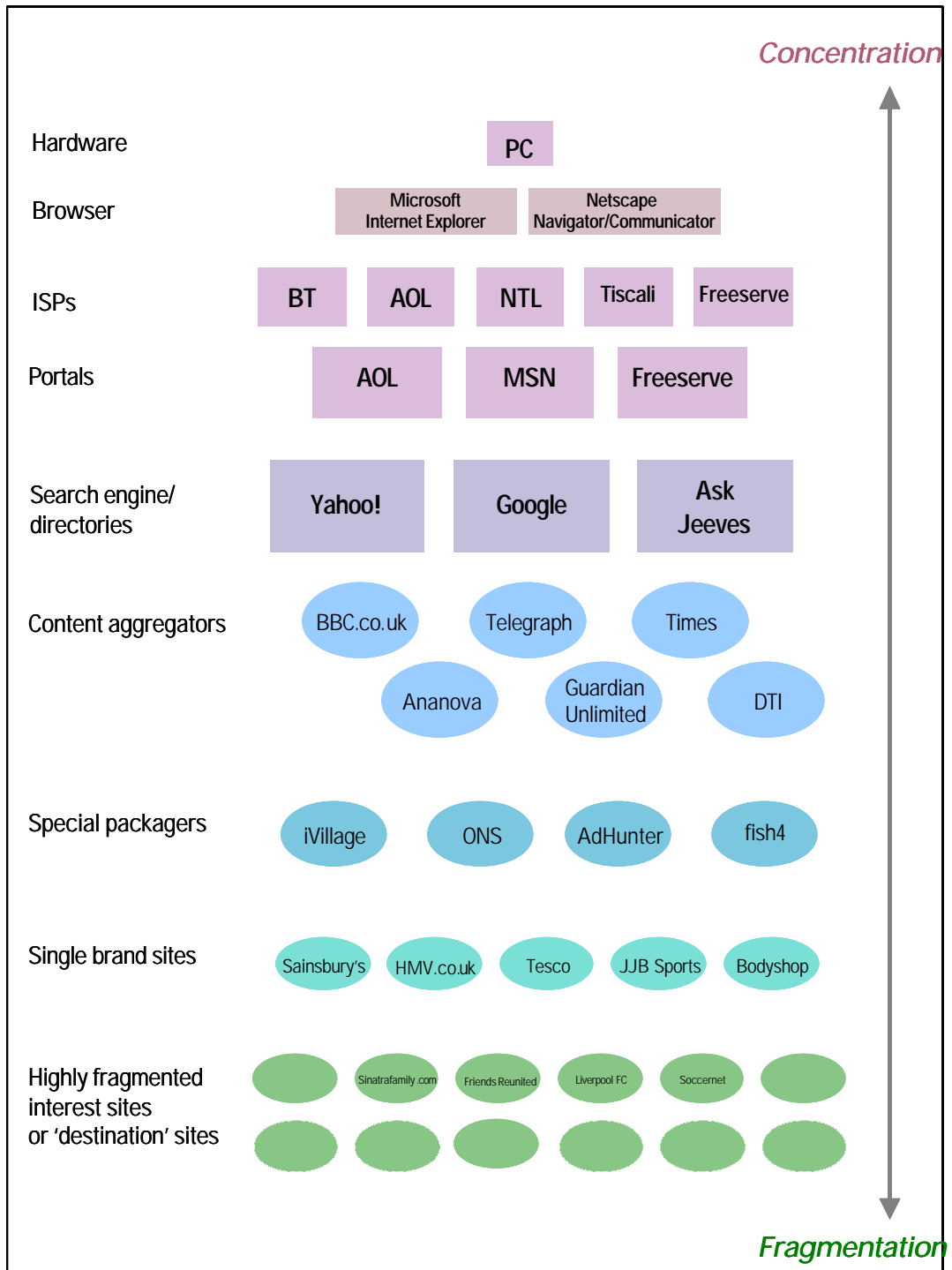
⁸ A more detailed discussion of whether BBCi is a portal is given in Appendix C.

Single brand sites are similar in many respects to special packagers but exploit heavily a well established brand and its core values by offering ancillary, related, or supporting services. Typically, the site is focused around a specific genre. 'Clicks and mortar' companies tend to fall within this category. These companies tend to be large and established in the traditional marketplace and include mainly consumer-focussed retailers or manufacturers such as Tesco, Sainsbury's, Boots and JJB Sports (e.g. the Food, Health and Sport genres).

Initial reasons for establishing presences online were similar to the media companies – brand extension/support, land grab, defensive moves – although many of these companies established themselves on the Internet later than the pan-media companies described above. However, companies with parents or head offices in the USA often forged ahead of their British counterparts due to the difference in maturity between the online market in the two countries. Over time many developed e-commerce propositions to accompany their existing content, but it has become clear that most will not be profitable in the short to medium term. Presences (including e-commerce operations) are being maintained to promote brand awareness, provide additional customer service and foster customer loyalty.

Destination sites are highly focused websites that deal with a single genre or consumer interest such as a football team or a famous person. Pure play dot.coms such as single media commercial players, e.g. Soccer.net, largely fall within this category. These sites have typically been highly innovative companies, entering a niche or genre. Originally eBay and Amazon started out in this category but their well recognised brand means that they are more likely to fit in the single brand classification. There have been some spectacular failures in this category (e.g. boo.com, clickmango). Those which have survived have been those which concentrated on financial controls, user needs and customer service. Those which failed over-promised in their expensive marketing campaigns and under-delivered.

Figure 3-1: Illustration of the Market Structure



3.4 Revenues

3.4.1 Overview of the key revenue streams

During the past five years Internet and online services companies have been highly innovative in establishing business models to exploit commercially the new digital interactive medium. Some clear revenue sources rapidly evolved, even before the onset of the downturn in technology, media and telecommunications industries. The four principal revenue sources which emerged are:

- Access charges – Businesses commonly referred to as ISPs provide a connection to the Internet through a metered dial-up or through an always-on telecommunications service. Some of these providers of access also provide a fuller suite of online services (such as AOL and Freeserve for example) and would therefore also actively develop advertising, revenue sharing and commerce driven revenue streams;
- Advertising (direct marketing) revenues – Website owners derive income from organisations wishing to pay a fee for exposure on the website. Advertisers aim to reach their potential customers through awareness or sales generating advertising campaigns and are attracted by the size and/or profile of audiences that websites are able to deliver;
- Subscription charges – There are organisations that have begun to charge users for their online content offering. Apart from websites offering adult content for a fee on the Internet, there are a number of well-established publishers such as the FT, The Economist and the Wall Street Journal which charge for certain content. However, the subscription market is at a very early stage of development;
- Transaction revenues – There are businesses that trade goods, services, or information online. There are two variants of these:
 - E-commerce businesses – this is where an online business has replaced or competes directly with, a physical store with its own website. The best known example is Amazon.com which still owns stock and is responsible for the fulfilment of product;
 - Commerce Facilitators – this is where an online business does not own stock or get involved in fulfilment and shipping. The business earns a commission for enabling the transaction. Lastminute.com is a good example. Market makers, such as eBay are also facilitators earning commissions for bringing buyers and sellers together and enabling transactions.

In addition, there are websites that do not aim to attract revenue *per se*, nor are they required to be self-financing. These are websites either funded by corporate marketing expenditure e.g. Esso, and their presence is a pure brand extension/awareness exercise, or 'public' websites provided by local and national government e.g. town councils or The Department of Trade and Industry (DTI), which are primarily providers of public information.

3.4.2 Value of the online market

The outlook for Internet revenues has changed over the past few years. Industry analysts are now less bullish about future revenues than they were at the height of the boom. The total value of the UK online market in 2002 is now estimated to be around £7.6 billion as shown in Figure 3-2 overleaf (as compared to around £9.3 billion that was forecast in 1999 at the height of the boom).

The vast proportion of this revenue accrues from e-commerce transactions (£6.1 billion) and Internet access (£1.25 billion). These e-commerce transaction revenues are gross figures. Although no published figures on net revenues are available, they are likely to be significantly less than the gross figures – many online companies will only receive revenues on a commission basis.

Access revenues include revenues from dial-up (metered and un-metered) and broadband Internet access charges. Access revenues are expected to grow by 7.6% per annum reaching a value of £2.6 billion by 2006⁹.

The online advertising market is relatively small, accounting for only 2.6% of the total online market in revenue terms in 2002. The figure of £197 million represents about 1.4% of the total advertising market in the UK and is 18.7% higher than the previous year. However, online advertising is expected to grow substantially, forecast to be worth £800 million in the UK by 2006¹⁰.

The western European paid-for content market is estimated to be £226 million in 2002¹¹. Of this, £166 million (74%) was spent on adult content, with the rest (£60 million) being generated mainly from games, finance, and business news. The non-adult content segment is expected to increase significantly to around £1.2 billion by 2007.

⁹ 'UK ISP Market Profile', Datamonitor, 2002.

¹⁰ 'UK Online Advertising Spend', Interactive Advertising Bureau, November 2001.

¹¹ 'Paid Content Revenues in Western Europe', Jupiter MMXI, January 2003.

Figure 3-2: Illustration of the size of the online market in the UK

	Revenues in 2002 - £ million, % share of total		
	Projected at the peak of the boom in 1999	2002 (or latest estimates)	% change
Internet Access Charges ¹²	£ 1,620 m ¹³ (17.4%)	£ 1,250 m ¹⁴ (16.5%)	- 22.8%
E-commerce (gross figures)	£ 7,206 m ¹⁵ (77.4%)	£ 6,100 m ¹⁶ (80.7%)	- 15.3%
Paid-for content ¹⁷	Negligible (0%)	£ 12 m ¹⁸ (0.2%)	N/a
Advertising	£ 479 m ¹⁹ (5.2%)	£ 197 m ²⁰ (2.6%)	- 49.4%
Total	£ 9,305 m	£ 7,559 m	- 18.8%

Source: Various sources (Jupiter MMXI; Office of National Statistics; Interactive Advertising Bureau; Datamonitor; Fletcher Research).

3.4.3 The business models

As the Internet began to be exploited by commercial Internet businesses from the mid 1990s, a number of different business models emerged. Some came and went. Others became the main focus of attention for a time until industry participants, analysts and investors realised that one particular source of revenue was not going to be the mainstay of the Industry. There has been a habit of concentrating attention on one source of revenue; first it was subscription, then the focus moved onto online advertising as this grew at faster rates, and then onto e-commerce as this too was used to sell a growth story.

As a result of the shake out in the Internet sector since early 2000, online businesses realised that focusing on one single source of revenue at the expense of others was not a viable commercial strategy. Companies have begun to rely on streams of revenue from a variety of sources – syndication, online advertising, e-commerce, and consumer payments for content – to increase viability. The main business models are:

- Content and e-commerce. This business model set out that online content would be used as a lure to draw customers to a website where business could be transacted. Such websites regard the provision of information as only one aspect of their activities, rather than their core purpose. They would gain revenues not from users' subscriptions, but from a combination of advertising and, predominantly, transaction fees.

¹² Includes subscriptions and call charges.

¹³ Inteco forecast that there would be 9 million households that would access the Internet, each paying an average charge of £15 per month.

¹⁴ 'UK ISP Market Profile', Datamonitor, 2002. The total ISP market in UK for 2001 was \$1.8bn.

¹⁵ IDC 1999 forecast revenues in UK of \$10.8bn (£7.2bn).

¹⁶ 'UK Online Annual Report 2002', Office of the e-Envoy. Business to Consumer online spending for 2001.

¹⁷ Excluding adult content.

¹⁸ 'Paid Content Revenues in Western Europe', Jupiter MMXI, January 2003. According to Jupiter, £59 million was spent on (non-adult) content by Western European Internet users in 2002. UK Internet users account for around 20% of the total in Western Europe.

¹⁹ 'UK Banners Survey 1998', Fletcher Research, December 1999.

²⁰ 'UK Online Advertising Spend', Interactive Advertising Bureau (News Release), 16 April 2003.

- Paid-for content. Free content on the Internet has become well established. However, in the past year or so, more and more websites are beginning to adopt fully paid-for or a combination of free and paid-for content.
- Advertising and marketing revenue. It appears that advertisers have begun to recognise the value of advertising as a branding (rather than customer acquisition) tool. As agencies build more data on what works, advertisers should become more comfortable with spending on the Internet. The Internet is a fairly task-orientated medium, so advertisers want to reach consumers when they are engaged in something related to the product or service they are marketing.

Most of the commercial advantages of the Internet are derived from the ability of online players to attract and arbitrate audiences. As Thomas Middelhoff, former CEO of Bertelsmann, said, "We're all competing for the most precious and least replaceable asset the consumer has – time. To win that battle, we need superb content, attractive brands, and increasingly, a direct pipeline to the customer."²¹

Because the overall supply of online services is highly fragmented with hundreds of sites to choose from in any given genre, the websites which have been able to make most commercial gain have been those which pre-empt the need for the user to choose between hundreds of alternative websites. These sites have become commonly known as portals and content aggregators.

Portals and content aggregators have achieved this by making sure that they are more visible on the Internet than their competitors. Strategies to achieve this have included:

- exploitation of established brands;
- cross-promotion from established distribution channels;
- positioning themselves so that they achieve first screen advantage - that is positioning their site so that it is seen by the largest number of Internet users as frequently and as early as possible in a user's Internet journey.

²¹ Bertelsmann Annual Report, 1998.

3.5 The paid-for content market

Many website operators have realised that persuading users to pay for online content or services is fundamental to their sites' long-term survival. As BBCi provides content free, a detailed understanding of this market is crucial to examining BBCi's impact. This section therefore explores in greater detail the market for paid-for content.

The resulting moves towards paid-for content have thus been driven by businesses rather than consumers. In fact, surveys of consumer opinion have repeatedly demonstrated that a large proportion of Internet users are unwilling to pay for online content. However, increasingly, some businesses are achieving degrees of success in their attempts to generate revenues through charging for content. Consumer resistance appears to be weakening; the latest Jupiter survey indicates that 41% of European Internet users still refuse to pay for online content, but this is down from 47% a year ago.

Despite the recent downturn in the US economy, the market for paid online content has increased significantly. In the second and third quarters of 2002, US consumer spending on online content was more than double the corresponding periods in 2001²². If these growth rates continue in the fourth quarter, the total US spend for 2002 is likely to be in the range of \$1.2 to \$1.5 billion²³, excluding adult content²⁴. For the first time, more than one in ten US users paid-for content in the third quarter of 2002. Europe lags significantly in the paid-for content market; it is estimated that European spending on online content in 2002 was around £226 million, of which three-quarters was on adult content²⁵.

American success stories include classmates.com (similar to the UK-based Friends Reunited site) which has approximately 1.75 million subscribers paying \$36 per year, Consumer-Reports.org with one million subscribers paying \$24 to \$48 per year and the Wall Street Journal with 664,000 subscribers paying \$79 per year²⁶. Most categories of content have shown growth, but by far the strongest is the Personals/Dating category. It has overtaken Business/Investment and Entertainment/Lifestyle to become the most popular category. These top three categories accounted for 62% of all paid-for content revenues in the US in the third quarter of 2003. Research and Community-Made Directories complete the top five, although they trail the top three categories quite significantly. Although they continue to demonstrate growth, categories such as General News and Sport do not feature amongst the top five categories.

²² 'Online Paid Content, US Market Spending Report, Q2 and Q3 2002', Online Publishers' Association, December 2002.

²³ KPMG analysis of comScore Networks/Online Publishers' Association data suggests a market close to \$1.5 billion. eMarketer's mid-range estimate for 2002 is \$1.2 billion.

²⁴ Excluded content categories are Pornographic sites, Gambling sites, Software purchases, Illegal drug-related sites, Get-rich-quick sites and scams, Internet Service Providers, Business Services, including electronic faxing and Web-based email applications, and Games for which subscriptions are purchased and are played through a proprietary (non-web browser-based) software interface.

²⁵ 'Paid Content Revenues in Western Europe', Jupiter MMXI, January 2003.

²⁶ 'The Online Content Report', eMarketer, December 2002.

eMarketer's analysis of the leading consumer online content properties suggests that consumers are most willing to pay for online content if it:

- is unique;
- saves or makes you money;
- enables you to build and maintain personal relationships within communities of like-interest;
- helps improve health and well-being;
- is of a passionate personal interest;
- is tied to the user's career²⁷.

Recent developments in Europe have also indicated a movement towards paid-for content. In June 2002, ireland.com, the online version of the Irish Times, began charging users 79 euros per year for access to the full range of its online content. The Irish Times has claimed that its introduction of the subscription model has been successful, although it has not released subscriber numbers. In November, Spain's El Pais also began to charge users an annual subscription of 80 euros for full access. The Economist website was a pioneer in developing the subscription model, and ft.com now charges up to £200 per year for full access. ft.com has gained around 40,000 paying customers in the first seven months of charging for content²⁸ (it had 2.8 million regular users when its site was free²⁹). Other UK newspapers' websites have begun charging for selected content and services (e.g. archive searches, crosswords). The site which accompanied Channel 4's Big Brother was a notable success, attracting 25,000 users paying £10 each³⁰. While subscriber numbers and the overall revenues generated from paid-for content are still relatively low, it appears that there is a growing trend towards charging for content in Europe.

²⁷ 'The Online Content Report', eMarketer, December 2002.

²⁸ Zach Leonard, COO of ft.com, quoted on www.paidcontent.org, January 2003.

²⁹ Media Guardian, 29 July 2002.

³⁰ 'No more free rides on the net', Sunday Times, 1 September 2002.

3.6 Advertising

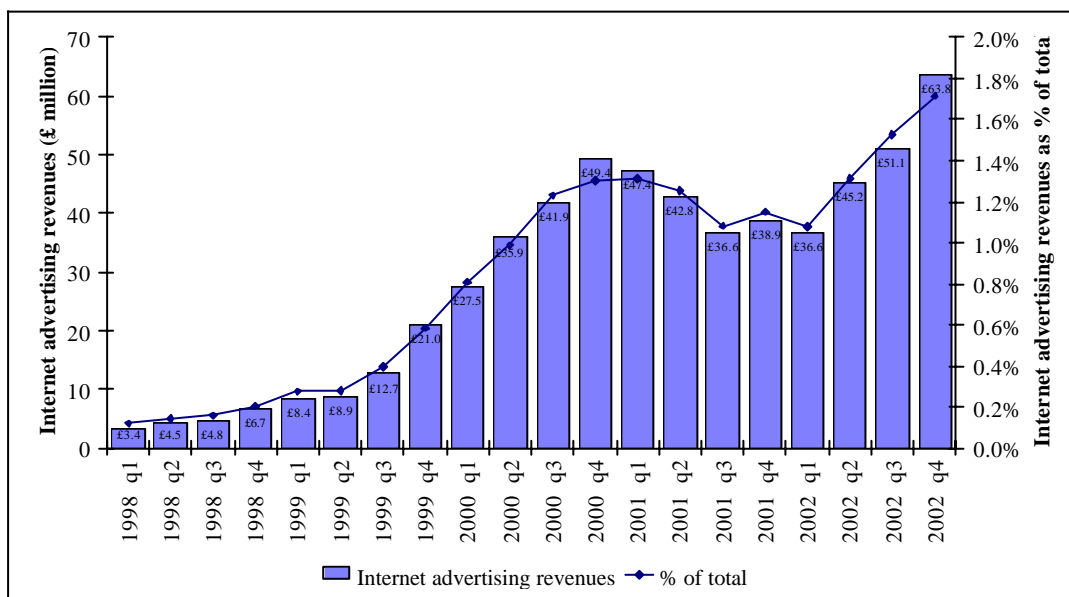
3.6.1 Key trends in the online advertising market

UK online advertising revenues were around £197 million in 2002 (up 19% from the previous year) compared to total UK advertising revenues of £13.9 billion³¹. The online advertising market grew in line with the dot.com boom and really took off around the second quarter of 1999 as shown in Figure 3-3.

Revenues peaked at the end of 2000 at nearly £50 million in the final quarter and then declined over the next few quarters in a similar pattern to that experienced by other media. The bottom of the cycle occurred in the 1st quarter of 2002. Since then, growth has returned. Current revenues (quarter 4, 2002) are at an all time high of £63.8 million.

Relative to other advertising media, Internet advertising has increased from 0.2% of the total market in 1998 to 1.1% in 2000 and 1.7% by the end of 2002 (quarter 4, 2002). Online advertising revenues exceeded cinema advertising revenue in the UK by the end of 2000.

Figure 3-3: Internet advertising revenues



Source: UK Online Advertising Spend, Interactive Advertising Bureau (News Release 16 April 2003).

According to Forrester, the online advertising market for Europe is expected to be worth £4bn by 2007, and the UK will account for approximately one-quarter of this.

As a result of the downturn in advertising revenues, there have been a number of casualties. Many sites were simply unable to generate enough revenue from advertising sales alone leading to consolidation in the market. Most importantly, the advertising only business model ceased to be a relevant strategy.

³¹ The Advertising Association (Press Release), 7th March 2003.

3.6.2 Destination of Internet advertising expenditure

Despite the wide range of Internet sites available, over 80% of online advertising is spent on the top 10 sites³². A similar picture occurs in the US, with 71% and 83% of dot.com advertising going to the top 10 sites and top 25 sites respectively³³.

One of the main reasons for such concentration of advertising is that there are likely to be significant economies of scale in the selling of advertising to Internet sites. Companies interested in advertising on the Internet are likely to want to place advertising on one or two sites with large numbers of visitors rather than a number of websites with smaller audiences³⁴.

It appears that advertisers simply want to be where the mass audiences are, which overwhelmingly means the large portal sites. Sites that attract the most users get the most advertising revenues, which in turn means these sites can offer more services and attract even larger audiences. So economies of scale and scope are a large barrier to entry. And scale, once established, is difficult to overthrow.

3.7 Investment

3.7.1 Background

The emergence of the Internet fuelled an investment phenomenon that reached its peak in the brief period between early 1998 and April 2000. Aided by investors, who tapped public markets with a number of IPOs, entrepreneurs generated a host of new business Internet ideas.

These new e-businesses generated much market enthusiasm. As Henry Blodget from Merrill Lynch said in mid 2000: "Five years ago, there was only one Internet company and that was America Online (the pioneering Internet service provider); it was worth \$1bn and that was seen as egregious. Five years later - after the bursting of the "bubble" - there were 400 companies with a combined market capitalisation of a trillion and that is awesome value creation".

Old economy rules were discarded as investors channelled money into new dot.com companies. According to Mr Shaheen of Sequoia Capital: "... that time was an anomaly. There was at that time an unbridled optimism that any Internet company would be valued highly. There was unlimited upside."

However, funding began to recede in April 2000 leading to many corporate failures. Since then, the investment and commercial climate has become more difficult and Internet companies have been in search of profitability and survival. The rest of this section describes the investment trends in more detail and, in particular, the difference between the investment environment during and after the dot.com boom. The analysis is structured into the following:

³² Internet Advertising, MSN & Net Imperitive, September 2002.

³³ 'Dotcoms: how long will the rout continue?', R Tomkins, October 2000.

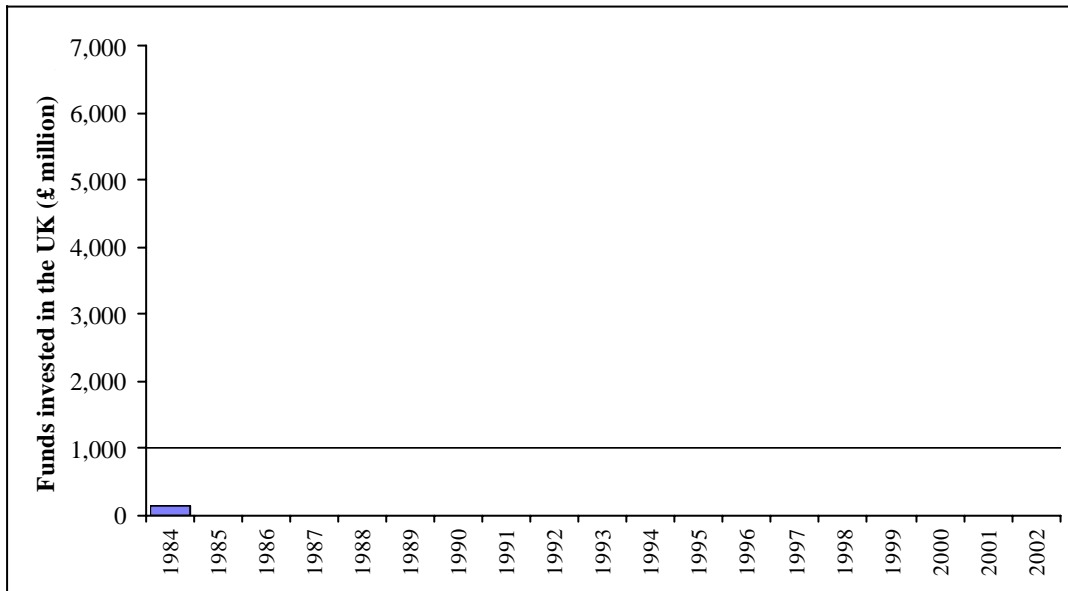
³⁴ 'Will the Internet Lead to Perfect Competition', G M Peter Swann (Manchester Business School), The Business Economist Vol 32 No 2.

- private equity or venture capital;
- stock market initial public offerings (IPOs);
- investment by public companies.

3.7.2 Private equity

In the past five years there has been a structural change in the private equity community. The rise in venture capital has made it far easier for entrepreneurs to create valuable new businesses as shown in Figure 3-4, which illustrates funds invested by members of the British Venture Capital Association (BVCA).

Figure 3-4: Funds invested by BVCA members in the UK (1984 to 2002)

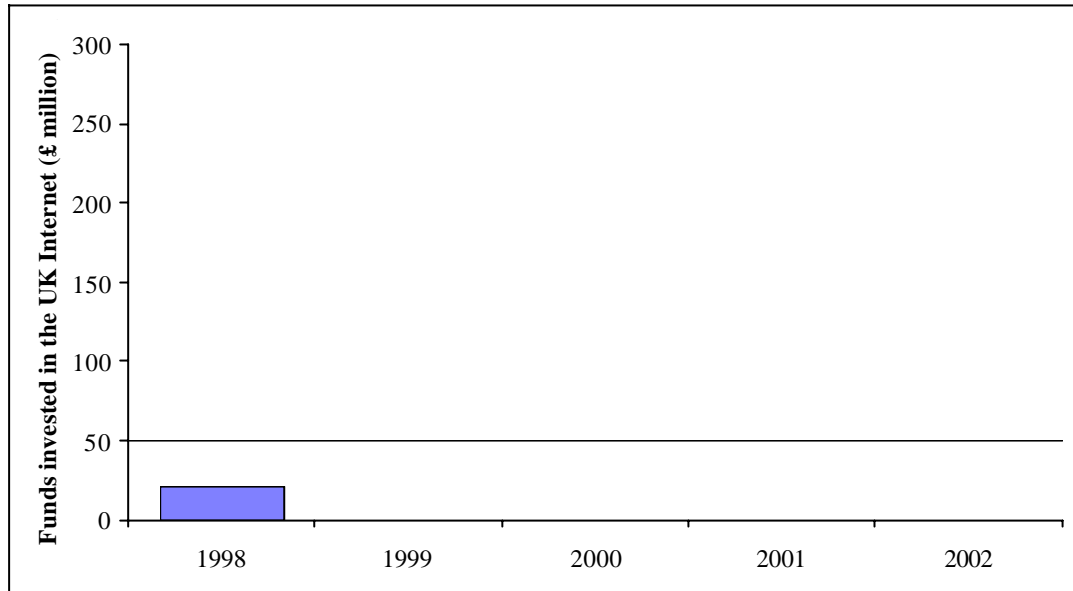


Source: BVCA Report on Investment Activity 2002 (published June 2003).

Traditional venture capital funds in Europe also started to wade into Internet investment in the late 90s, lured by the promise of extraordinary returns that their American counterparts had already begun to realise.

There was an over-capacity of money for online start-ups with a total investment in the Internet sector of £254 million in 2000 (around 4% of total funds). However, the amount invested in the sector has fallen dramatically since then to only £73 million in 2001 (1.5% of funds) and £15 million (0.3%) in 2002 as shown in Figure 3-5.

Figure 3-5: Funds invested by BVCA members in the UK Internet sector (1998 to 2002)



Source: Source: BVCA Report on Investment Activity 2002 (published June 2003).

Note: Internet sector is defined by BVCA as dot.coms, ISPs, B2Bs or Internet-incubators.

It is highly unlikely that PE houses will invest in online start-ups in the near future³⁵. Some of the reasons given for PE houses not investing in UK Internet businesses are related to structural reasons within the venture capital industry. For example, some of the investment funds that were raised three to five years ago are becoming more mature and approaching their exit date. This is when the PE house has to liquidate its investment fund. The investment window has shrunk and therefore the PE house will not invest in start-ups that require more time to reach profitability.

Other reasons for not investing are related to the perceptions and the realities of Internet businesses. A common theme was that online businesses are simply too risky. We have paraphrased other key points made by individuals within the PE community as follows:

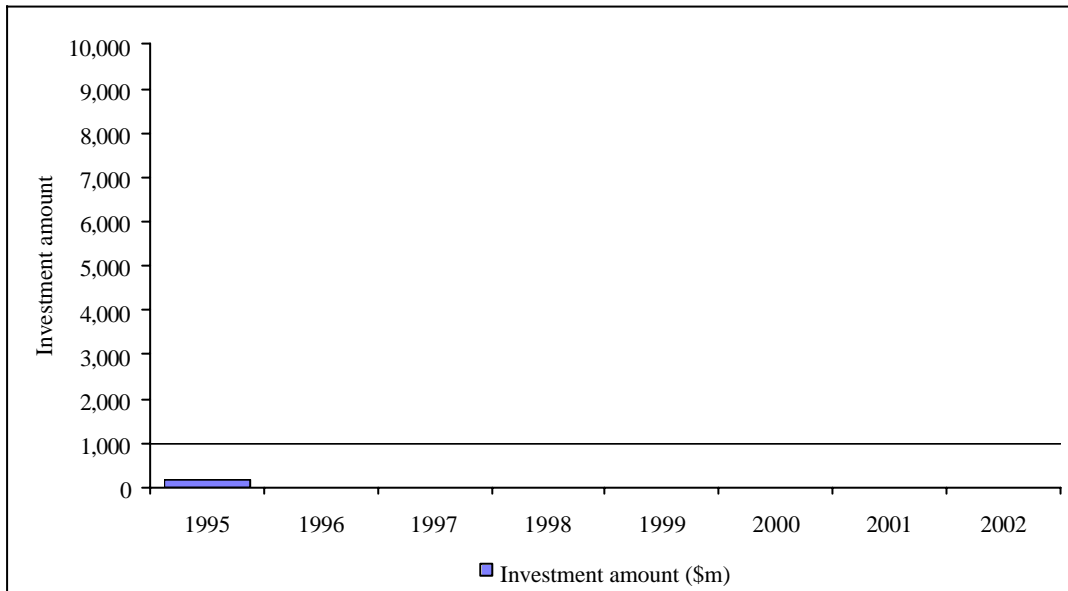
- “there is no validation of the market...”
- “...market demand has not come to fruition...”
- “it will be the death for 99% of them...”
- “for some online businesses to succeed, consumer behavioural change needs to occur and that takes time. If these online businesses have raised funds, then the money will run out before there is a market.”
- “market has not proven that that there is enough online advertising, e-commerce and subscription revenues...”

³⁵ KPMG interviews with selected private equity houses.

The US venture capital market has experienced a similar boom-and-bust cycle to the UK. Funds invested in American IT services³⁶ companies reached a peak in 2000 of \$8.8bn, but then significantly decreased to \$2.8bn in 2001 and \$1.1bn in 2002 (see Figure 3-6). More than half the dot com companies present at the NASDAQ peak in the first quarter of 2000 have either been acquired or have disappeared³⁷.

Hopes of recovery are, however, beginning to surface. According to Pegasus Research, 40% of America's 209 publicly quoted dotcom companies traded profitably in the last quarter of 2002, more than double the number in the same quarter in 2001.³⁸ In 2003 there has also been a steady resurgence of Internet stocks in the US, typified by improving results at Amazon, Yahoo and Ebay, who have seen share price improvements of 35%, 57% and 39% respectively since the beginning of the year³⁹.

Figure 3-6: US venture capital investment in IT services companies (1995 – 2002)



Source: *The MoneyTree - a quarterly study of venture capital investment activity in the US (Quarter 1, 2003)*

3.7.3 Public investments and IPOs

The total value of UK IPOs peaked in 2000 when £10.6 billion was raised through 119 issues. The value fell back to £4.8 billion in 2002 from 36 issues with the majority of funds raised in the first half of the year (£3.2 billion). In the first quarter of 2003 there have only been two flotations raising a mere £15 million⁴⁰.

³⁶ 'IT services' is defined as 'Providers of computer and internet-related services to businesses and consumers'

³⁷ Source: Webmergers, quoted in article 'Dotcom shares are soaring, but it's not a bubble' The Sunday Telegraph, 27 April 2003.

³⁸ 'From dot bomb to dot profit' The Sunday Times, 23 March 2003

³⁹ 'Dotcom shares are soaring, but it's not a bubble' The Sunday Telegraph, 27 April 2003.

⁴⁰ KPMG Corporate Finance.

A drop in funding of Internet ventures has also occurred. There have been no new UK listings of Internet-related businesses on the London Stock Exchange since 2000. Money raised on the Alternative Investment Market has also fallen significantly from £467 million in 2000 to only £3 million in 2003. Figure 3-7 summarises the key figures from 1998 to April 2003.

Figure 3-7: Internet related investment on the London Stock Exchange and the Alternative Investment Market (1998 to 2003)

	London Stock Exchange		Alternative Investment Market	
	Number of listings	Money Raised £m	Number of admissions	Money Raised £m
1998	-	-	1	13
1999	4	371	26	195
2000	9	508	68	467
2001	0	0	5	30
2002	0	0	3	3
2003 (to April)	0	0	0	0

Source: London Stock Exchange

The overall stock market investment environment is summed up by Gary Rieschel, who ran Softbank's venture capital fund in the US, who believed that: "there were too many me-too companies. There were effectively no barriers to entry. The public markets finally said, enough." With hindsight, one could say that the Internet industry was going through what every emerging industry goes through. An emerging industry tends to have an explosion of opportunity at the beginning and over the course of anything from two to five years, the amount of capital allocated to that industry exceeds the amount of opportunity. For a brief period between the end of 1998 and mid-2000, the phenomenon created a stock market bubble.

3.7.4 Public listed companies

The amount of investment by public companies has also been scaled back significantly in 2001 and 2002 as shown in Figure 3-8. This picture of investment has been generated by examining the press announcements of key companies over the past two years. Note that the numbers are only a sample of investment as many companies do not release details to the public.

The strategy and plans of the EMAP and Telegraph Group illustrate how companies have viewed the Internet sector. EMAP slashed its online digital plans most dramatically after announcing in April 2000 that it planned to spend £250m in its digital division. It announced only seven months later that the budget for its digital division would be £120m. The budget was finally reduced to £25m within a year of the first announcement.

A similar story existed in relation to the Telegraph Group, which launched a number of online businesses during the dot.com boom, namely:

- an online student magazine (launched in 1997);
- the electronic Telegraph (which won the e-newspaper of the year in 1999);
- a women's special interest website (Handbag.com);

- an online property magazine.

At the height of the dot.com boom Hollinger International, parent company of the Telegraph Group, had invested millions into many online ventures similar to those mentioned above. The investments are believed to top \$200 million. By 2000, Hollinger's Internet investments showed a net loss of \$20.5 million. In March 2001, it named only three of its many Internet investments as successful. In 2001 third quarter results announcement there was no mention of Internet investments. A press release said "investments in digital enterprises had virtually ceased"⁴¹. Similar to EMAP and most other online businesses, it scaled back its investment plans.

Figure 3-8: Investment plans by public companies

	Internet Investment plans announced	
	During the boom (1997-2000)	After the fall of dot.com (2001 onwards)
EMAP	Announced in April 2000 plan to spend £250m on digital division	Reduced this budget to £120 million (after 7 months) and then to £25m (after 12 months)
BSkyB	£250m plus acquisitions - Sports Internet and Letsbuyit (£10m)	Announced 300 job cuts and write down of £250m million, followed by a further write down of £25m
Guardian	£34m in September 2001	Around £30m to September 2002
Reuters	Announced £100m in 1996 Announced a further £12m in 1998 and a overall budget of £500m	Announced plans were to be 'scaled down dramatically'. Write downs of £245m in e-investments
Pearson	Planned £120m spend Revised plan announced of £250m Actually reported spending £196m in 2000	Only plans announced relate to a plan to spend £300m in the business-to-business online education market
Channel 4	Announced a plan to spend around £15m in 2000 and a further £250m in 2001 on various Internet ventures	Announced plans were to be 'scaled down dramatically'

Source: KPMG, various press articles⁴²

Although the analysis illustrates that investment has been cut back, there is some positive but typically small investment occurring in some niches, most typically gambling sports and online grocery shopping.

In the online sports sector for example, new money has been raised on the Alternative Investment Market (AIM) to support consolidation strategies. Ukbetting floated on AIM in August 2001, raising £5.7 million of new money for the Group. At the time of this public fund raising, Ukbetting acquired ukbetting.com (the online bookmaker) from ENIC plc; PA Sporting Life (an online sports content operation) from the Press Association and Trinity Mirror; and subsequently two other online sports organisations.

⁴¹ The Express on Sunday, 25 November 2001.

⁴² EMAP: The Times (17 March 2000). BSkyB: FT (10 February 2000, 7 February 2001, 10 May 2001). Telegraph: Coventry Evening Telegraph (15 March 2001). Guardian: The Independent (7 September 2000, 3 August 2002), Media Week (9 August 2002). Reuters: Computer Weekly (30 April 1998), Dow Jones Business News (8 February 2000), Daily Telegraph (8 June 2001, 13 February 2002). Pearson: The Times (3 August 1999, 27 January 2000), Daily Telegraph (31 July 2001). Channel 4: Marketing Week (31 May 2001), The Times (14 January 2000).

As a result Ukbetting has spent some of its capital reserves in putting together a business with critical mass in both digital sports betting and sports content. It has invested in growth via acquisition so as to benefit from economies of scale and scope. This is contrast to the strategies of online organisations during the dot.com boom of two to three years ago which invested their capital in advertising to create and build up a brand name.

It seems that this has become an established pattern across a number of other online segments: Listed online organisations which raised funds from public markets have adopted growth strategies based on acquisitions of companies in the same markets.

The largest and best known example of an online company that has implemented this strategy has been Lastminute.com which received net proceeds of approximately £125 million when it floated in April 2000. Lastminute has subsequently invested this capital on expanding its business through product development and acquisitions. Its acquisitions have included: Degriktour (£59m), Travelselect.com (£9m), The Destinations Holdings Group (£12m), Travelprice.com (£32m) and Holiday Autos (£39m). Lastminute.com has now emerged from four years of losses and achieved an EBITDA⁴³ profit of £2.5 million in 2002.⁴⁴

⁴³ Earnings Before Interest Depreciation and Amortisation.

⁴⁴ 'Labourer cashes in on Lastminute's £39.7 million buy', Independent, 27th March 2003.

4 Internet user characteristics

This section examines some of the research into user behaviour. It is important to gain a good understanding of user behaviour to aid our later market definition work on the demand side. As we are dealing with a service that is free, the standard economic approach (e.g. “hypothetical monopolist” test) cannot be readily applied and we have to rely more on inferences based on observed consumer behaviour independent of price. To this end we need to understand the size of the market – how many consumers go online, what users typically do online, whether this varies with experience and whether what users do online can be readily categorised and translated into market definition.

The Internet is a powerful medium as it enables users to satisfy a number of user needs, electronically – obtain information (or consume ‘content’), communicate (via e-mail or ‘chat rooms’) and make purchases (via e-commerce sites). Consequently, the analysis of user characteristics demonstrates the complexity of the ‘online market’, that it is a wide-ranging market and that it satisfies a number of consumer needs.

The key conclusions are that online behaviour is complex and consumer needs are wide ranging. Some of the key findings are as follows:

- User behaviour is generally task-based. An AOL study defines user behaviour specifically in terms of task or needs, while Booz-Allen & Hamilton identify many different session types, most of which are identified by the user’s task. Some behaviour is exploratory such as surfing, but this only represents around one-quarter of user online sessions.
- User behaviour varies extensively with experience. In particular, a recent ONS survey of behaviour and spending patterns online found that the more experienced a user is, the more likely they are to purchase products online.
- Demographics appears to be a much weaker guide of user behaviour than experience online. In fact, the Booz-Allen & Hamilton report found little predictive power in the demographic typology.
- Users may on some occasions satisfy all or a substantial part of their Internet requirements together on one site and during one visit, and on other occasions satisfy each need from a number of different websites or during different web visits.

The demand for Internet services is a sizeable and growing market, with around 45% of households having Internet access. There is no typical user nor usage pattern.

Overall, user behaviour is multi-dimensional and more analogous to a journey. However, behaviour is typically task-based e.g. users conduct searches, go online to purchase or go online to communicate. Such tasks appear distinct, with limited substitutability. This implies that the online market can not really be defined as one broad market, but rather a collection of separate markets. We extend these ideas further in Section 6 where we consider market definition.

4.1 Market context

This section examines key indicators of Internet use such as the number of Internet users, penetration and the number of users together with a comparison of the UK market within Europe and how it has grown over time.

4.1.1 The UK market within Europe

The UK has been a relatively early adopter of the Internet technology and culture, and is therefore considerably advanced compared to many other countries. According to the ITU⁴⁵, the UK has above average penetration of the European Union countries at 40.6% (2002)⁴⁶. The UK lags behind the US where around 54% of individuals go online and other smaller populated Nordic countries such as Sweden (57%), Finland (51%) and Denmark (47%).

The UK has the second biggest number of users in Europe, just behind the German market. The number of users for 2002 in the UK was around 24 million⁴⁷ which equates to 17.8% of the European market. Active Internet users in the month of March 2003 in the UK numbered around 17.7 million⁴⁸. More detailed statistics for each European country as well as other key global markets are presented in Appendix D.

4.1.2 Trends in UK Internet penetration

Oftel's residential survey of consumers' use of the Internet conducted in March 2003 found that 45% of UK homes or around 11.25 million homes are connected to the Internet⁴⁹. The penetration rate rises to 50% when measured in terms of individuals' access to the Internet across a variety of locations⁵⁰ such as offices, homes and educational establishments. PC ownership is currently around 54% of UK households⁵¹. In terms of lifetime access, a total of 62% of adults in Great Britain have accessed the Internet at "some time"⁵². The rise in penetration of the residential Internet sector is illustrated in Figure 4-1.

⁴⁵ International Telecommunication Union.

⁴⁶ Note the difference in estimates of penetration which are predominantly due to time period. The ITU figure of 40.6% is an annual figure while Oftel's and Nielsen//NetRatings figures are based on monthly data.

⁴⁷ International Telecommunication Union.

⁴⁸ Nielsen//NetRatings (Home Panel, month of March 2003). This rises to 22.8 million when both Home and Work are considered.

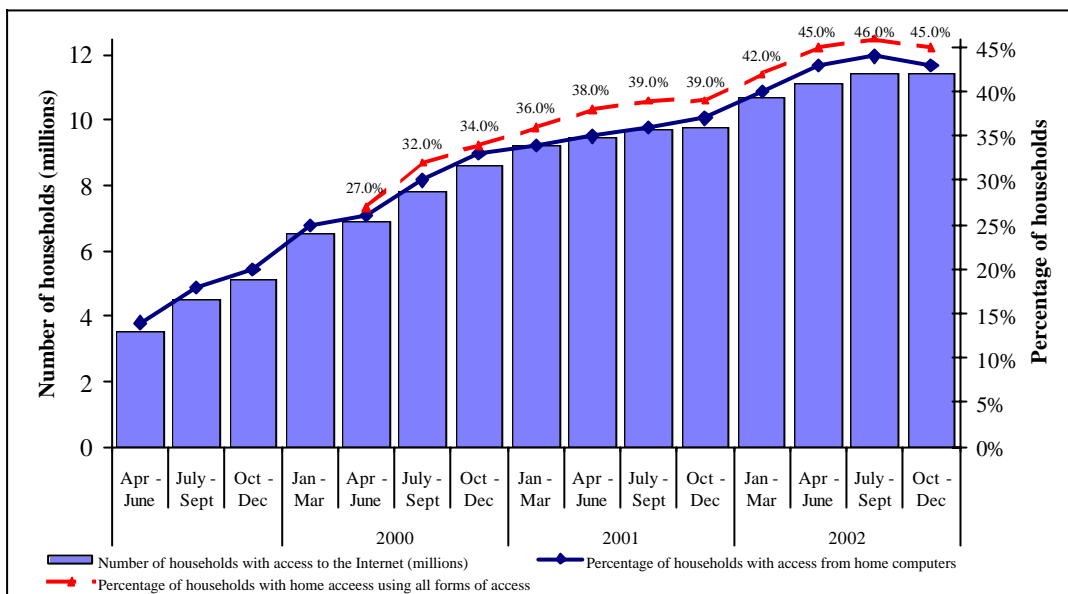
⁴⁹ Oftel Consumers' use of the Internet, residential survey (Feb 2003) – published May 2003.

⁵⁰ Oftel Consumers' use of the Internet, residential survey (Nov 2002) – published Jan 2003.

⁵¹ Oftel Consumers' use of the Internet, residential survey (Feb 2003) – published May 2003.

⁵² 'Internet Access – Households and Individuals', Office of National Statistics, 29 April 2003. Figures include all methods of access to the Internet.

Figure 4-1: Growth in the UK Internet market (1999-2002 by quarter)



Source: *Internet Access Households and Individuals*, Office of National Statistics, April 2003.

4.1.3 Wider Internet indicators

Increasingly, more people are accessing the Internet at work, which is the most common way to access the Internet outside the home. A total of 15% of UK adults access the Internet in the work place⁵³.

Other key indicators of the nature of the Internet market within the UK are as follows:

- access to the Internet is generally by the personal computer with 96% of UK homes with Internet access using this device. Other key devices are mobile phones (5%), digital television (5%), games consoles (2%) and personal organisers (1%)⁵⁴;
- unmetered packages have risen in popularity of the past few years, from 16% in (May 2000) to around 63% (November 2002), with around a total of 54% of homes using a narrowband unmetered package. Other packages are 7% (subscription and calls) and 30% (no subscription and calls)⁵⁵;
- the most popular ISPs used by the UK residential market are Freeserve (21%), BT (20%), AOL (17%), NTL (13%), Tiscali (6%), Virgin Net (4%) and others (18%). The market is therefore extremely concentrated with the four biggest players accounting for around 71% of the market⁵⁶;
- on average 10 hours per week are spent online per household⁵⁷;

⁵³ Ofcom Consumers' use of the Internet, residential survey (Nov 2002) – published Jan 2003.

⁵⁴ Ofcom Consumers' use of the Internet, residential survey (August 2002) – published Oct 2002.

⁵⁵ Ofcom Consumers' use of the Internet, residential survey (Nov 2002) – published Jan 2003.

⁵⁶ Ofcom Consumers' use of the Internet, residential survey (Feb 2003) – published May 2003.

⁵⁷ Ofcom Consumers' use of the Internet, residential survey (Feb 2003) – published May 2003.

- the average online spend per online buyer in the UK in 2002 was 600 euros (around £415) compared with a European average of 430 euros (around £297)⁵⁸;
- around 65% of all SMEs have Internet access. For medium-sized businesses (101-250 employees) Internet penetration rises to 94%⁵⁹.

4.2 Online users' choice of Internet content and functionality

Online demand can be expressed in terms of demand for a bundle of services, as well as for specific single elements of the Internet, such as e-mail communication, or real-time information on the latest score of a football match. However, online users typically have varying needs for content on the Internet and for Internet tools, resulting in different forms of website visits and duration of time spent online.

The complex nature of online user behaviour stems from, *inter alia*, the multiple needs that consumers have, as shown in Figure 4-2. This demonstrates consumers' needs in terms of the wide range and depth of services and Internet functions the user expects. These wide ranging needs include conducting research, communicating with business associates, purchasing goods, banking, playing games and downloading music.

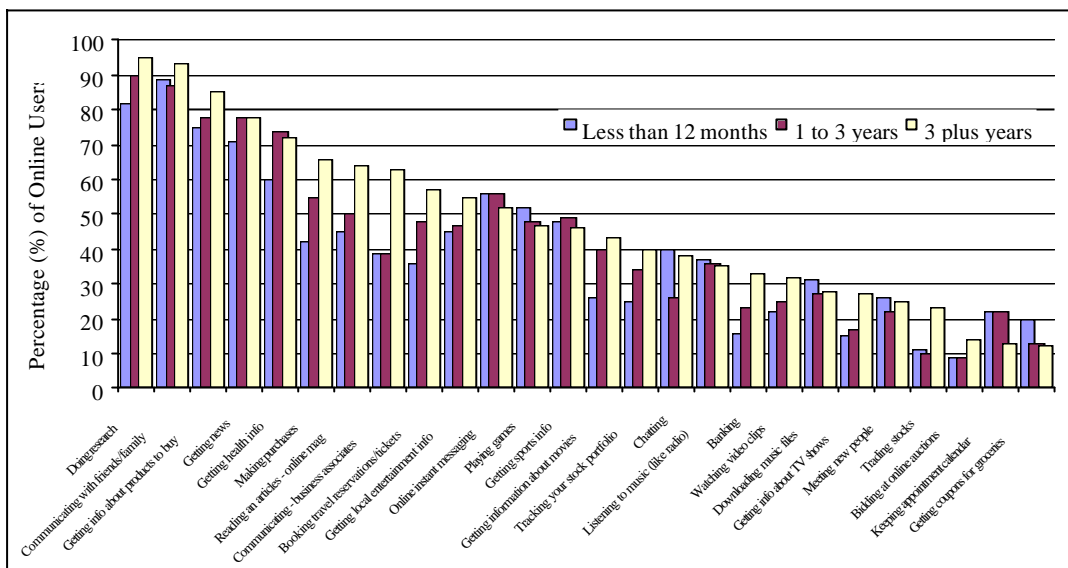
Needs also change over time. The chart demonstrates a few key differences between user behaviour depending on how long users have been using the Internet (up to 12 months, one to three years or three plus years):

- relatively new users, for example, are more likely to engage in chatting, online messaging and playing games than established users;
- established users are more likely than novice users to undertake most of the tasks listed but, in particular, they are more likely to use the Internet for making purchases, communicating with business associates, banking and booking travel reservations/tickets.

⁵⁸ 'Vital Statistics', Revolution Magazine, 1 April 2003.

⁵⁹ Oftel Business use of Internet (Feb 2003) – published May 2003.

Figure 4-2 Internet needs and how they change over time



Source: AOL Europe / Roper Starch Cyberstudy 2001

While many of the needs shown can be grouped into broad categories (e.g. communications, purchasing etc), the figure is useful in demonstrating the plethora of needs that consumers have when using the Internet. This is important for the definition of the relevant economic markets. Individual users' behaviour online will be influenced by their specific needs during that online session. Users generally go online for a specific purpose or task and substitution between these different tasks or needs is therefore weak. This implies that there is unlikely to be one overall online market, but rather a collection of specific separate markets (see Section 6 for a more detailed discussion).

A key point is that an individual user's behaviour online is influenced by their specific needs during that online session. Traditional attempts at user segmentation by demographics fail to recognise this. A detailed study by Booz-Allen & Hamilton and Nielsen/NetRatings⁶⁰ found that while many types of people use the Internet, there is no demographic typology which is predictive. The study was unable to identify groups of people who routinely engaged in one form of activity over another. The report concluded that "Internet market segmentation must take account initially of the wide behavioural variations exhibited by the same consumers during different sessions on the Net."

The Office of National Statistics has recently undertaken some research on activities on the Internet. The research identified four main types of activities, namely communication, searching for information, purchasing goods, services (e.g. banking) and interaction with public authorities, as shown in Figure 4-3. The most popular activities identified are 'finding information about goods and services' and 'using e-mail', where 79% and 72% of adults engaged in these activities.

⁶⁰ 'Seize the Occasion: Usage-based Segmentation for Internet Marketers', 2001.

Figure 4-3: Adults who have accessed the Internet by purpose of Internet use (personal use only) – February 2003

Category	Activities	Activity - % of all adults
Communication	Using e-mail	72%
	Using chat rooms or sites	18%
Information search and online services	Finding information about goods / services	79%
	Finding information related to education	40%
	Reading or downloading online news	26%
	Playing or downloading music	23%
	Playing or downloading games	14%
Purchasing goods, services and banking	Buying or ordering tickets / goods / services	48%
	Personal banking / financial / investment activities	29%
Interaction with public authorities	Using or accessing government / official sites	17%
Others	General browsing or surfing	53%
	Looking for work	24%
	Other things	4%

Source: *Internet Access Households and Individuals*, Office of National Statistics, April 2003.

The ONS survey (February 2003)⁶¹ also researched the spending patterns and behaviour online. The key finding was that the more experience an individual has with the Internet, the more likely they are to use it to purchase goods and services, namely for Internet users:

- with three years or more experience – 57% purchased products online;
- with between one and three years Internet experience – 41% purchased products online;
- with less than 12 months Internet experience – 25% purchased products online.

Clearly the more Internet “savvy” an individual is, the more inclined they are to engage in e-commerce. In terms of the actual amount spent online, the figures are still relatively small as shown in Figure 4-4.

Figure 4-4: Amount spent by respondents who had purchased goods or services on the Internet in the three months prior to interview (personal use only) – February 2003

Total value of goods bought on the Internet (in three months prior to interview)	Activity - % of all adults
Less than £100	39%
£101 to £200	17%
£201 to £500	24%
£500+	19%
Don't know	1%

Source: *Internet Access Households and Individuals*, Office of National Statistics, April 2003.

⁶¹ ‘Internet Access Households and Individuals’, Office of National Statistics, 29 April 2003.

4.3 Online User Behaviour

When a user enters the Internet, he or she is faced with a very wide range of options and is likely to have a wide range of needs to be fulfilled. In a sense, the user experience is analogous to a journey. The journeys themselves are wide ranging from a simple and direct “A to B” to a “mystery tour” where even the user is unsure of the next destination and final outcome.

This journey-based use of the Internet is expressed in a study by Booz-Allen & Hamilton and Nielsen//NetRatings (the BAH/NNR study). User behaviour during a given session online was broadly segmented into the following four main characteristics:

- session length, defined as the duration of a user session measured in minutes;
- time per page, defined as the length of time a user spends on each page before clicking to the next page;
- category concentration, defined as the maximum percentage of total time spent at sites that are classified in the same category (sports vs news vs entertainment, for example);
- site familiarity, defined as the percentage of total session time spent at familiar sites, or sites previously visited four or more times.

The way in which these characteristics blended together led to the identification of seven online session⁶² types, set out below in terms of increasing order of frequency:

- ‘Quickies’ (8% of sessions) – very short visits (around one minute) centred around one or two familiar sites.
- ‘Just the Facts’ (15% of sessions) – users seeking specific pieces of information from known sites. Often involves quickly visiting and comparing related sites.
- ‘Single Mission’ (7% of sessions) – users want to complete a specific task or gather specific information and then leave the Internet. Often using unknown sites within the same category (e.g. sports), identified from a search engine.
- ‘Do it Again’ (14% of sessions) – users know exactly where they want to go and spend a reasonable amount of time there (e.g. online banking).
- ‘Loitering’ (16% of sessions) – leisurely visits to familiar sites (e.g. entertainment).
- ‘Information-Please’ (17% of sessions) – used to build in-depth knowledge of a topic, gathering broad information from a range of sites.
- ‘Surfing’ (23% of sessions) – by far the longest type of session (averaging 70 minutes) with very wide (many sites) but not deep (not very long per page) explorations.

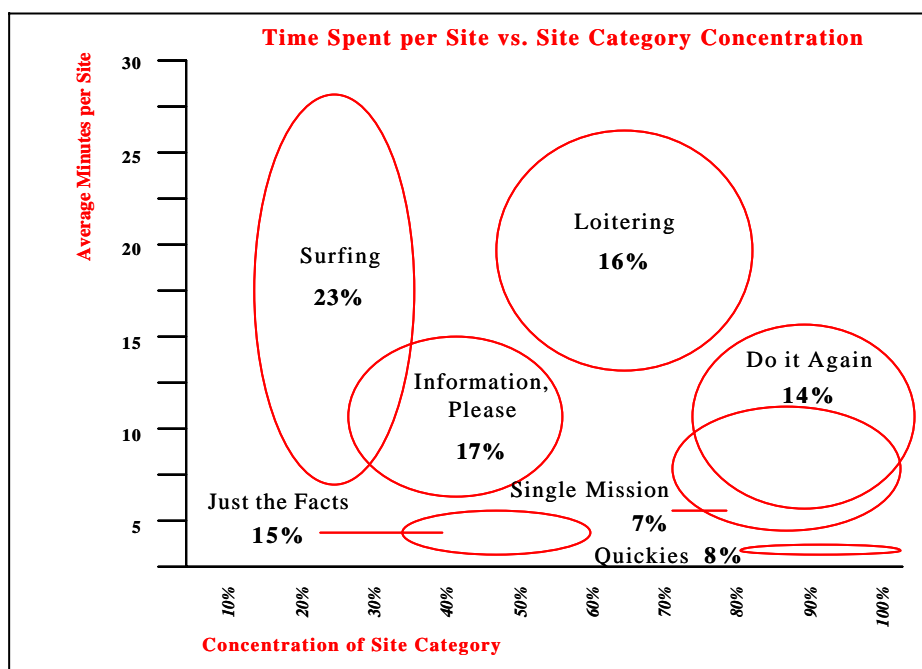
The researchers found that the majority of users (two-thirds) engage in five or more session types and that there are very few differences in the demographic makeup of consumers engaging in different types of sessions. In short, behaviour is not dependent

⁶² A session is formally defined as the “total time between a user’s sign-on to and log-off from the Internet”.

on user categorisation. At one stage a user may just engage in surfing while at another time, the user may have a specific task in mind.

Figure 4-5 shows how these different behavioural characteristics differ according to session length and category concentration.

Figure 4-5: How people use the Internet



Source: Booz-Allen & Hamilton analysis of Nielsen/NetRatings click-stream data (2001)

This categorisation is important because the likelihood of substitution (an important factor in defining the relevant economic markets) is affected by the type of session. For example, in a 'Surfing' session, substitution by sites in a different category is likely (note the low category concentration in Figure 4-5). By contrast, in a 'Loitering' session, 'Single mission' and 'Do it again', users tend to stick with their favourite sites within the same category.

Three types of session ('Loitering', 'Information-Please' and Surfing) have shown a higher likelihood to involve shopping. Users engaged in 'Quickies' and 'Just the Facts' sessions are unlikely to be influenced by Internet advertising. By contrast users who are 'Loitering', 'Surfing' or 'Information-Please' will visit sites with lots to read and do, exposing themselves to advertising/sponsorship messages for longer periods. Users on a 'Single Mission' will most likely only be influenced by highly targeted advertising (e.g. resulting from entering a specific term into a search engine).

A key challenge for industry participants and analysts is which conceptual model of market segments best represents the complex patterns of online user behaviour and multiple user needs.

In summary, the level of substitution between different categories of sites depends on the way the person is actually using the Internet at any specific point in time rather than the

user. Overall the key theme to emerge from the BAH/NNR study is that online user behaviour is complex and therefore it is more useful to analyse Internet usage patterns during individual sessions.

5 **BBC's Online Service**

This section describes the key offerings of BBCi and its position within the UK online environment.

The BBC's Online Service is an important and popular part of the BBC's public service offering. It is within the top 10 of the UK's most visited websites and offers a great range of content, an Internet search facility, message boards and limited chat services. The site is branded "BBCi". (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.)

BBCi is a very popular site with around 8.2 million unique users each quarter and a reach of 40.5%. On average each BBCi user spends three-quarters of an hour on the site each quarter. Both the number of users of the site and the amount of traffic have increased considerably over the past few years (page impressions have quadrupled in the past three years).

The structure of the Internet is very fragmented with thousands, if not millions of different sites available to the user. Out of the top 500 sites, BBCi secures a share of total page impressions of around 3.0%. BBCi's impact on the overall online environment at this aggregate level is therefore likely to be marginal (although we conclude in the next section that BBCi actually competes in a number of narrower and distinct markets based around Internet functionality).

Within BBCi the most popular genres are News and Sport. These two genres have been consistently popular, accounting for 46% of the total page impressions to the BBCi site over the year to March 2003.

5.1 Overview of BBCi

5.1.1 History of BBCi

The BBC has had a presence on the Internet since the mid-1990s, although this was not widespread and mainly concentrated on programme support in specific areas (e.g. Tomorrow's World, Blue Peter and Election 97). It was only in the late 1990s that a process was started to clarify the role and objectives of BBCi and for the Government to formally approve its overall remit.

The BBC initially requested approval from the Secretary of State for its online service in October 1997. The BBC's proposal stated that its current service was limited to programme support and helplines for educational and social action broadcast programmes. The proposal set out plans for the first stage of the development of a full online service to stand alongside radio and television output as a third medium. The BBC stated that "the proposal is in response to the rapid convergence of telecommunications broadcasting and computer technologies and to the fact that the BBC will need to ensure that its public services continue to serve the public in the most appropriate way in this new environment".

Implementation of BBCi was planned over two phases. Phase 1 concentrated on improvements to existing websites and developing selected new services particularly in News and Education. Phase 2 focused on the introduction of further enhancements and new services including interactive services and new platform support.

5.1.2 Objectives of BBCi

After consultation, the Secretary of State gave approval for the go ahead of Phase 1 in November 1997. The approval of Phase 2 was to be decided after a detailed review of Phase 1 and widespread public consultation. This consultation took place in mid-1998 and focused on:

- licence fee payers' attitudes towards the BBC's role on the Internet;
- the effectiveness of current BBCi services, the range and balance of current sites and services;
- the way in which BBCi might develop in future.

The consultation process was carried out through postal distribution of the consultation document, an online questionnaire and public meetings. As a result of the review and the consultation, the BBC clarified its online public service objectives:

- to act as an essential resource offering wide-ranging, unique content;
- to use the Internet to forge a new relationship with licence fee payers and strengthen accountability;
- to provide a home for licence fee payers on the Internet and act as a trusted guide to the new media environment.

Further to this, the Secretary of State granted approval for the BBC's proposal (28 October 1998).

5.1.3 **BBCi funding**

The main costs of BBCi are for content, staff, freelancers and the technology infrastructure. In 2001, the total expenditure on BBCi was in the region of £100 million, of which £75 million was spent on Content⁶³.

5.2 **BBCi Service offerings**

Services on the Internet can be divided (as described in Section 3.2) into six categories based on functionality, namely 'Access', 'Chat', 'Commerce', 'Content', 'Email' and 'Search'.

BBCi focuses on Content, Chat and Search:

- **Content.** This is the core basic service of BBCi and is currently divided into major areas of interest defined as categories. There are currently ten main category areas – Children, Drama and Entertainment, Factual and Learning, Nations & Regions, New Media, News, Radio & Music, Sport, Weather and World Service.
- **Chat and message boards.** BBCi offers message boards and limited real time chat including discussion groups on TV programmes, opportunities to speak with celebrities and other discussion topics.
- **Search.** The Search function was introduced by BBCi in May 2002 and is available through the BBCi site. It allows simple searching of the BBCi site, or the Internet. The Internet can be searched completely or with a UK only or BBCi only focus. There is no advertising involved so that the search results are editorially independent and are based solely on the search words provided. The results are, however, filtered for obscene content. A number of external websites are "BBCi Recommended" which means that they are considered to have useful content and are technically sound. A more limited form of search (WebGuide) has been part of BBCi for several years. This provides a guide to the best non-BBC websites and includes hundreds of external links.

It should be acknowledged that Access, Commerce and Email can be obtained under the wider umbrella of the BBC brand (see Section 5.6). These are not BBCi services and do not form part of the scope of this study. They are undertaken on a commercial basis in contrast to Chat, Content and Search which are largely licence fee funded.

5.3 **BBCi's position in the UK online environment**

As the Internet is a complex market, the demand for BBCi needs to be analysed on a number of levels such as audience size, reach, page impressions and time online.

In the UK online market, many of the top 10 players are portal companies, such as MSN, Yahoo! and AOL, which dominate the market across all indicators such as audience size, reach, page views and time online.

The BBC is consistently ranked as one of the more popular destinations. It generally features as one of the top 10 players as illustrated in Figure 5-1 according to demand by

⁶³ Source: BBC.

'Property'. We use property as it is the most aggregate measure, capturing more relevant traffic than 'Domain' or 'Site'. Intuitively, it also best represents the size of any one company operating in the online arena. Property is an aggregation of domain name (e.g. www.msn.co.uk, www.msn.com and www.hotmail.msn.com are all part of the MSN property)⁶⁴.

In the quarter ending March 2003, MSN is the top property with around 12.1 million (home) visitors and a reach of the active Internet universe⁶⁵ of around 60%. This compares to BBC, ranked 6th in the list which has (home) visitors of 8.2 million and (home) reach of 40.5%. Minutes of use are around 44 minutes per person (42 minutes in quarter to February 2003). The BBC's demand over the quarter to March is slightly higher than usual, predominantly as a result of the war in Iraq. In the quarter to February 2003, unique users (audience)⁶⁶ were 7.7 million.

Figure 5-1: Top 10 players visited by UK Internet users by Property (Nielsen//NetRatings UK Home Panel, Quarter ending March 2003)

Property	Audience (000)	Reach % (Active)	Page Views (000)	Visits Per Person	Pages Per Person	Time Per Person
MSN	12,166	60.0%	2,490,168	17.61	205	1:32:22
Yahoo!	10,245	50.5%	1,650,117	11.86	161	1:16:23
Google	10,157	50.1%	939,505	11.51	92	0:29:19
Microsoft	9,482	46.7%	190,915	3.71	20	0:14:01
AOL Time Warner	8,364	41.2%	484,490	9.63	58	0:32:07
BBC	8,221	40.5%	656,449	6.85	80	0:44:10
Wanadoo	7,858	38.7%	382,018	9.61	49	0:29:31
Ebay	7,589	37.4%	2,293,186	9.61	302	2:00:53
Amazon	7,032	34.7%	500,345	4.37	71	0:30:45
British Telecom	6,959	34.3%	472,115	11.49	68	0:35:35
Ask Jeeves	6,265	30.9%	250,018	4.19	40	0:21:00
Lycos Network	5,780	28.5%	239,753	4.73	41	0:17:30

Source: Nielsen//NetRatings UK Home Panel (Quarter to March 2003).

Using the concept of Property slightly overestimates the relevant demand for BBC as it includes demand to both commercial and public sector parts of BBC. This impact is, however, marginal. The BBC's audience size falls to 8.1 million in terms of 'Domain' and to 7.4 million for the 'Site' over the quarter to March 2003. Demand is also smaller

⁶⁴ The exact definition of Property, Domain and Site as provided by Nielsen//NetRatings is as follows. A 'Property' is owned by a company, corporation, organisation, government agency, private group, or other institution that has a controlling interest in each domain and URL within the consolidation. In some cases, the Property is the highest level of aggregation. A 'Domain' is a group of unique sites and pages that end with "domain-name.*", where "domain-name" is the name of the domain and "*" is for example com, net, edu, etc. This includes all the Web pages that are under that domain. A 'Site' is the consolidation of multiple URLs associated with a domain name. That is, a single .com, .net, or .edu that consolidates all of the information after the /. Examples of unique sites are www.xyz.com, and 123.zxy.yahoo.com.

⁶⁵ 'Active' users are those people who used the Internet at least one time during the specified time period. Current users are those people that have access to the Internet, but have not necessarily accessed the Internet during the specified time period. We have generally used Active users as the appropriate measure.

⁶⁶ Unique users (audience) is the number of unique people that have gone to the website at least once in the defined time period. If a person goes to the same website more than one time they are only counted once. Definition provided by Nielsen//NetRatings.

in terms of monthly data rather than quarterly data. A more detailed discussion of the impact of measuring the BBC according to Domain and Site, as well as for monthly data, is presented in Appendix D.

Out of the top 500 sites, the top 10 sites account for 45.7% of the market in terms of page views. BBCi's share of page views is 3.0% of the market (defined by the 500 top sites)⁶⁷. As the number of sites used by UK residents is likely to be much larger than this 500, BBCi's actual share of the overall market is likely to be considerably smaller than this. Clearly then, while BBCi is a popular site, it has a small share of the overall UK market⁶⁸.

5.4 Trends in BBCi visitors and reach

Trends in number of BBCi users over time can be examined with reference to a monthly survey undertaken by BMRB. This survey estimated a total of 8.3 million users visited BBCi during the month of March 2003 (7.7 million users in February 2003). This corresponds to reach of 42.8% in terms of percentage of all UK adult Internet users who accessed BBCi (39.3% in February 2003). Note the BMRB figures presented in this section are monthly and therefore different to the quarterly numbers presented by Nielsen//NetRatings above⁶⁹. The average number of users and reach for the whole of 2002 were 6.4 million and 35.7% respectively.

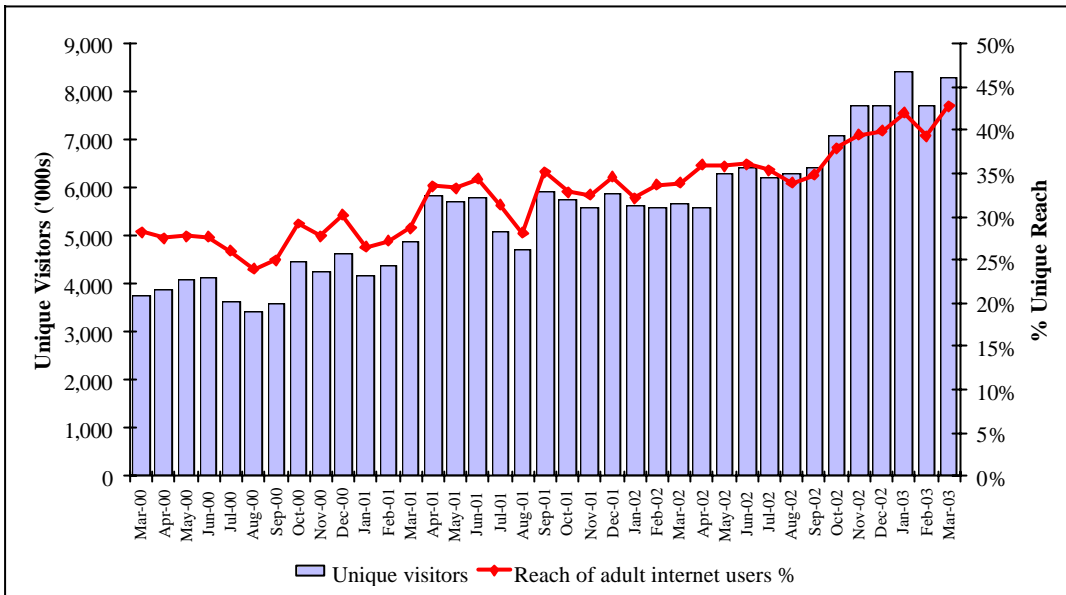
Over time there has been a gradual increase in the popularity of BBCi. There was a step increase in demand from May 2002 likely to be as a result of Sporting events (e.g. World Cup, Wimbledon and the Commonwealth Games). A further step change occurred from October 2002, likely to be as a result of International issues (the war in Iraq and events at the United Nations). Figure 5-2 shows the longer term trends from a starting point in March 2000 of 3.8 million users and a reach of 28.2%.

⁶⁷ Nielsen//NetRatings, Property, Home Panel, Quarter to March 2003.

⁶⁸ Note that we conclude in the analysis of market definition (Section 6) that there is no broad online market as such. Instead, there is a number of narrower and distinct markets based around Internet functionality.

⁶⁹ As well as BMRB being a monthly survey compared to Nielsen//NetRatings quarterly count, the BMRB survey is of "claimed usage" at home, work and any other locations. Claimed use is generally higher as people tend to over report use when prompted. This is particularly significant for top sites (e.g. BBC or portal sites) as they have high brand visibility.

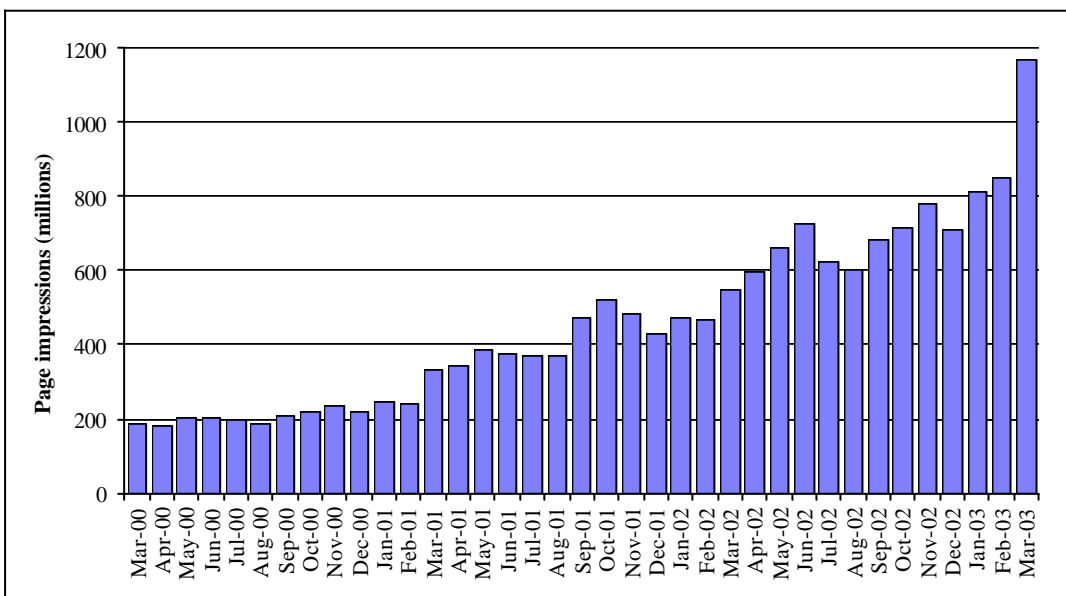
Figure 5-2: BBCi visitors and reach (March 2000 to March 2003)



Source: BRMB from BBCi (March 2003)

Growth in the use of BBCi has been even more significant using page impressions as the indicator of demand. Page impressions have more than quadrupled from 244 million in March 2000 to 1,170 million in March 2003 (850 million in February 2003) as shown in Figure 5-3. Sporting events are again likely to have caused higher figures in May and June 2002 and the war in Iraq in March 2003.

Figure 5-3: BBCi page impressions (March 2000 to March 2003)



Source: BBCi Server Logs (March 2000 to March 2003).

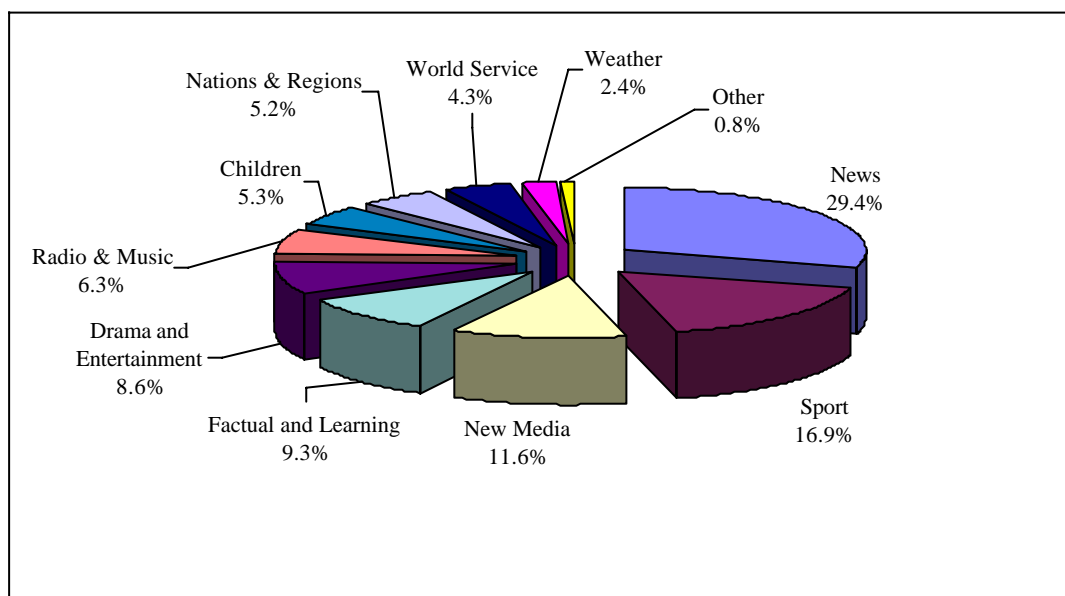
5.5 Demand by category

A breakdown of the demand for each of BBCi's ten categories of content, using page impressions, is set out in Figure 5-4.

The most popular category is News which accounts for 29.4% of total page impressions (year to March 2003). This is to be expected as News is one of the core offerings of the BBC, both offline and online. BBCi offers an extensive range of current News items as well as past articles and by sub-sections for Regional News and some major themes (e.g. Business, Technology, Politics).

Other popular categories are Sport which accounts for 16.9%, New Media (11.6%) and Factual and Learning (9.3%). Note that the BBCi home page is included within the New Media category. If this traffic is excluded, New Media's market share falls to 6.2%. Market shares for other categories are also shown.

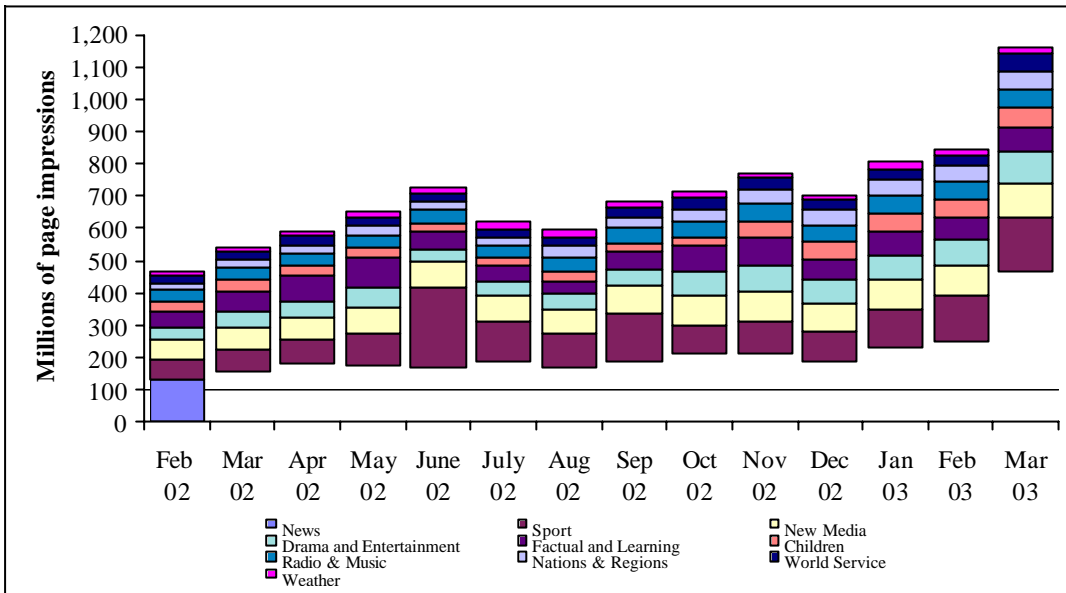
Figure 5-4: BBCi page impressions by category (Year to March 2003)



Source: BBCi Server Logs (April 2002 to March 2003).

News and Sport genres have been consistently popular over the past year as illustrated in Figure 5-5. The combined News and Sport traffic accounted for 46.2% of the total over the year to March 2003. News had largest demand in March 2003 with a 39.7% share of total traffic due to reporting on the war in Iraq. Sport, on the other hand, was most popular in June with a 34% share of traffic due to the coverage of the World Cup. Maximum combined Sport and News measured 57.3% of the total in June 2002 and 53.9% in March 2003.

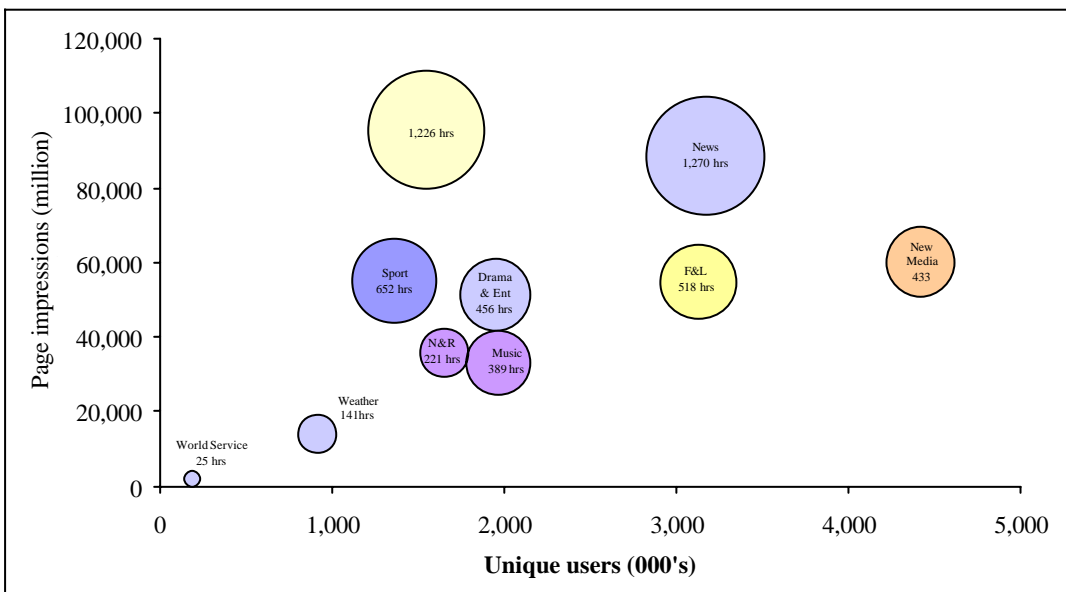
Figure 5-5: BBCi traffic breakdown by category over time Feb 2002 to March 2003



Source: BBCi Server Logs (February 2002 to March 2003).

Figure 5-6 shows a selection of BBCi categories by time spent online, reach and visitors. This figure demonstrates that the News category is the most popular genre as measured by all of the three main demand indicators, visitors and time online.

Figure 5-6: BBCi Genres by Reach, Visitors and Time Online (UK Home Panel Quarter to March 2003)



Source: Nielsen/NetRatings UK Home Panel, Quarter to March 2003.
 Note: F&L (Factual and Learning); N&R (Nations & Regions)

A key question to address is whether people use BBCi predominantly for its niche content or range / depth of content. This will help with understanding how BBCi competes in the online marketplace. This is a difficult question to answer, but an indication is provided in Figure 5-7, which shows a significant overlap of users between the main 10 categories – on average a user visits 2.5 of the main categories over the quarter.

Figure 5-7: Unique UK users by BBCi category (Quarter to March 2003)

BBCi category	Audience (000)
World Service	190
Weather	913
Sport	1,357
Childrens	1,548
Nations and Regions	1,648
Drama and Entertainment	1,953
Radio and Music	1,970
Factual & Learning	3,130
News	3,169
New Media	4,474
Total audience	8,119
Total (added separately)	20,352
Average number of categories visited per person	2.51

Source: BBCi Petal analysis by Nielsen/NetRatings UK Home Panel (Quarter to March 2003).

5.6 Services offered under the wider BBC brand (not BBCi)

BBCi focuses on Content, Chat and Search. However, it is important to acknowledge that Access, Email and Commerce can also be obtained under the umbrella of the generic 'BBC' brand rather than the 'BBCi' brand. These wider services are provided on a commercial basis and outside the scope of this study. These are described below:

- Access. An ISP service is provided by a different branded organisation (beeb.net). It has a similar business model to the initial Freeserve offering in 1999 and is owned by Beeb Ventures Ltd. Beeb.net currently has around 200,000 subscribers which represents less than 2% of the market⁷⁰.
- Email. There is the facility within the Beeb.net site to log on and to check personal email. This is similar in functionality to the usual online email accounts such as Hotmail or MSN.
- Commerce. This can be undertaken within the BBC Shop (bbcshop.com), which sells BBC branded products such as books, CDs and DVDs. Although a much more focused and narrow offering than most e-commerce sites, the site is prominent as the journey to the shop can be undertaken immediately and directly from the BBCi Home Page via the 'buy BBC Products' link⁷¹.

⁷⁰ 'BBC's ISP redesigned and relaunched' M2 Presswire, 3 March 2003.

⁷¹ BBC Shop should not be confused with the recent BBC venture into e-commerce (beeb.com) which was terminated in April 2002. Although there are remnants of this structure remaining, the home page address beeb.com now re-directs users to BBCshop.com.

To date, Access, Email and Commerce have not been very successful commercial ventures. However, we have identified and noted any knock on BBCi impacts on the market from this wider provision.

6 Market definition

Before any assessment of BBCi's market impact can be made, it is necessary to define the relevant economic market(s) and BBCi's position in those markets. There are well established economic principles for identifying a market in competition cases. The aim of these principles is to assemble evidence to define the relevant economic market(s) so that the necessary subsequent analysis of market power, of any abuse of that power and of its effects on competition can be properly conducted.

The approach to defining a market is economics based and founded upon the standard competition policy framework. Whether different products or services are in the same or separate relevant markets depends on the degree of substitutability on both the demand and supply side.

We conclude that the relevant online economic market(s) are:

- Content (various genres);
- Commerce (various markets);
- Chat (and Message Boards);
- Email;
- Search;
- Internet access (both dial-up and always on);
- Internet advertising.

The evidence and arguments for the Content and Commerce markets are complex. On the supply side, Internet sites generally structure their offerings in terms of genre, 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. This evidence implies weak substitution between genres and, therefore, that the relevant Content markets are likely to be genre-based. Access to appropriate content is likely to be a barrier which makes it more difficult for suppliers to substitute across different genres.

A similar argument exists on the demand side; substitution is likely to be weak across different genres (e.g. between sport and music), but stronger within a particular genre. There are also some valid arguments for markets narrower than genre in genres such as Sport. However, for many other genres such as Film the arguments are less persuasive and a genre-based market is more appropriate. Whether the market is narrower than genre is therefore likely to be dependent on the genre studied.

On balance, we conclude that the Content market should *generally* be defined by genre but for some specific genres an even narrower market definition may be more appropriate. As robust empirical evidence is not available to make a definite conclusion we have analysed data (where possible) in terms of both genre-based markets as well as narrower versions.

The key geographic characteristics, which are important in defining the relevant economic markets, are low transaction (search) costs, the limited effects of physical boundaries and national borders and the importance of language and culture. Geographically, online content markets transcend traditional boundaries, although the geographic market definition really depends on the type of content.

For Search, Email, Chat/Message Boards and Access:

- The very limited demand substitutability from Search and Email to other Internet functions imply that those represent separate markets. Email is an international market, and Search is international and language-based.
- The unique characteristics of Chat (alternatively termed 'synchronous chat' or 'real time chat'), namely its speed, accessibility to groups and transitory nature, make it a separate market. Chat may be genre-based, but is not always so, and markets are largely national in nature. Asynchronous communication (by message boards) is slightly more permanent than Chat and has more of an overlap with Content. It can be moderated *ex ante*, but its interactive nature distinguishes it from standard content. Therefore, there is a market in asynchronous communication, although there is likely to be significant overlap with synchronous Chat and Content.
- Access is a prerequisite for other services. The major markets for Access are dial-up narrowband, broadband and leased-line (corporate). Other methods (WAP, PDA, TV, payphone) represent growing markets. All markets appear to be nationally based.

On the supply side, it is unlikely that Email, Search, Access or Chat/Message Boards are easily substitutable with each other by suppliers. The technology required for each function is very different and the services are generally 'bundled' making them complementary rather than substitutes.

6.1 The economic theory

6.1.1 Overview of economic principles

The approach to defining the market is economics based and founded upon the standard competition policy framework. The key concepts and procedures are set out in two reports published by the Office of Fair Trading, namely:

- Market Definition, The Competition Act 1998, The Office of Fair Trading (403, March 1999);
- Assessment of Market Power, The Office of Fair Trading (415).

Whether different products or services are in the same or separate relevant markets depends on the degree of substitutability. This is undertaken formally through the use of the hypothetical monopolist test sometimes referred to as the 'small, significant non-transitory increase in price' test (i.e. the SSNIP test). This test examines whether a hypothetical monopolist (i.e. the only supplier in the market) can increase profits by charging significantly higher prices in the marketplace than it would otherwise charge when faced with competition. A 5% to 10% increase in prices is normally considered as the small, significant non-transitory increase in price.

One reason why a monopolist could not increase prices above competitive levels is the possibility that consumers would substitute to other products. If this is the case, then these other products should be brought into the definition of the market, and the test applied again. This process is continued until no further substitution is possible – this is then taken as the definition of the relevant market.

The relevant economic market(s) usually have both a product and a geographical dimension. There is also a demand and supply-side dimension. The overall procedure on the product side is to determine whether customers consider the product or services as substitutes (demand-side substitution) and how easily a supplier of one product or service could switch to supplying another (supply-side substitution⁷²). Demand-side and supply-side substitution is discussed in greater detail below, together with the geographic issues.

6.1.2 The product market: Demand-side substitution

The test of whether one good or service is within the same market as another good/service is the degree of substitutability between the two goods or services. If they are substitutes then they should be regarded as being part of the same market.

Typically the starting point is a very narrow definition of the market. The extent of substitution between other related products is considered and the market widened (or not) as appropriate. The extent to which goods or services are good substitutes is governed by the behaviour of customers. The degree of demand type substitutability will depend on the following factors:

- product characteristics;
- relative price, quality and performance;

⁷² Supply-side substitution is strongly related to barriers to entry.

- switching costs (costs associated with changing suppliers/changing products);

A price test to establish the degree of substitutability of goods considers the impact of an increase in the price of a product of 5%-10% above the competitive level. If a significant number of customers switch to other products due to this price rise, then the products concerned should be viewed as being in the same market. The significance of the test is that the availability of substitutes strongly limits the ability of a firm to set prices at a level that generates supra-normal profits. If it tries to do so, customers will switch to the substitutes.

6.1.3 **The product market: Supply-side substitution**

Another type of substitution that is relevant for market definition is supply-side substitution. This arises where other suppliers can easily begin dealing in the relevant product. Supply-side substitution means that new competitors for the relevant product will enter the market. The key factor on whether supply-side substitution takes place is timing. Supply-side substitution is only assumed to take place if substitution takes place within one year.

As set out in the OFT guidelines, some approaches adopted by competition authorities only use demand-side substitution and characteristics to define the market⁷³. Supply-side issues are taken up through the analysis of whether there are barriers to entry in a particular market. We have combined both these approaches in this report by concentrating first on the demand side to define the market and analysing the supply-side evidence to see if this conclusion is contradicted. However, the supply-side issues in the form of barriers to entry are also dealt with separately.

6.1.4 **The geographic market**

As with product substitutability, the approach to determining the relevant geographic market aims to assess whether a firm can independently raise prices in a particular area without losing a (significant) market share.

Under the hypothetical monopolist test, the economic market is defined as that minimum number of products and that smallest geographical area in respect of which a hypothetical profit-maximising firm that was the only present and future seller of those products (i.e. a hypothetical monopolist) could profitably impose a small but significant and non-transitory increase in price on these products.

Usually, an important factor which helps to determine the geographic market is level of transport costs. Where these are high, the geographic market is normally much narrower. However, online markets are virtual with low transportation (and search) costs and therefore this is likely to lead to a much broader market definition.

⁷³ For specific issues and the approach to market definition for media markets (including the Internet), see 'Market Definition in the Media Sector - Economic Issues', Europe Economics for the European Commission, DG Competition, November 2002, which argues that the standard market definition framework should be adopted.

6.1.5 Summary

The above economic techniques used to define economic markets within the demand and supply-side substitution framework are largely price based and rely on robust data on price movements, price elasticities⁷⁴, the hypothetical monopolist test etc.

However when considering BBCi, which is free at the point of consumption (as indeed is much of the content and other services available online), we need to rely more on qualitative evidence and user characteristics. The assessment, albeit more intuitive than if it were a price study, is still conducted using the economic concepts of demand and supply-side substitution together with the relevant geographic market.

6.2 Overall analysis of online market characteristics

6.2.1 Our approach

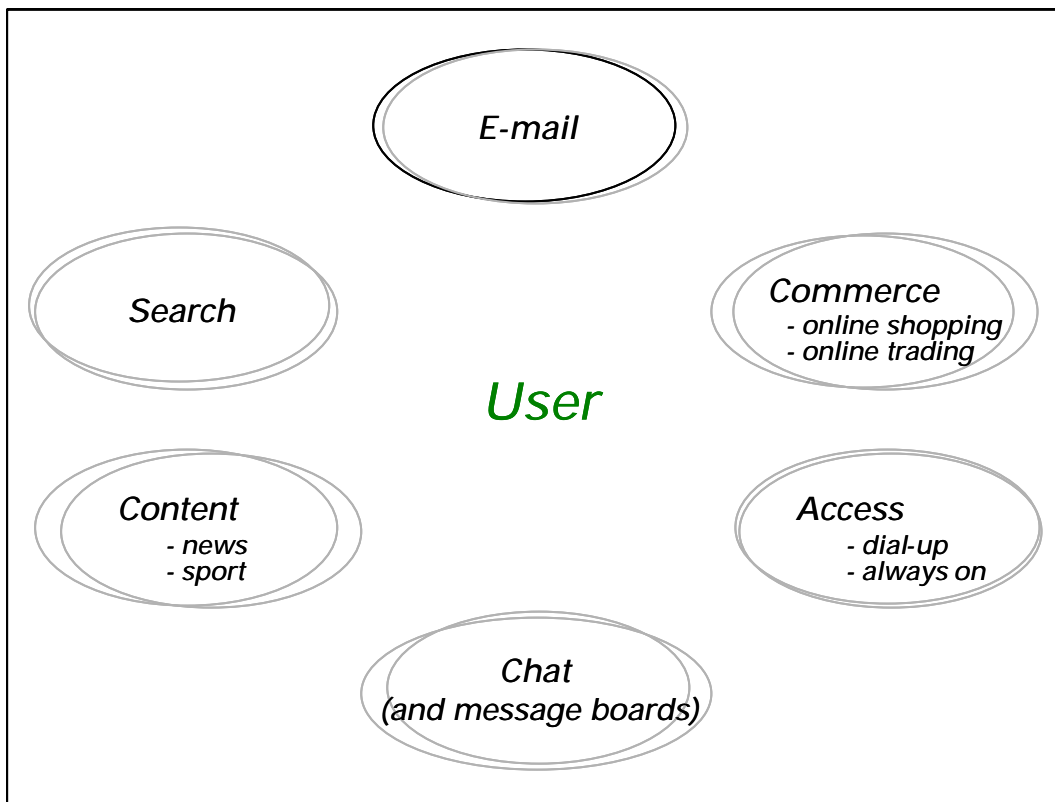
As discussed in the theoretical framework, the process of defining the relevant product market is to start by looking at a relatively narrow definition or area. A number of closely related or neighbouring areas are then examined to consider whether consumers or suppliers would substitute into them, if there was a reduction in supply. The presence of substitution would imply that the initial narrow market definition should be widened.

We have followed this approach starting from the narrowest market definition available: specifically, that markets could be defined by very small tasks (based on the analysis of user characteristics). It is clear from the user research (see Section 4.3) that the low levels of substitution between tasks suggests that the online market cannot be defined as one broad market, but rather a collection of separate markets. However, the actual manner in which the user characteristics research classifies different tasks is often general or in subjective terms. This makes it difficult to use as a way of defining the market and as a result is not appropriate as a formal economic definition.

We therefore re-started the market definition from the next most narrow level available, namely the different generic services offered to the consumer (as shown in Figure 6-1). Demand and supply-side substitution were then analysed to consider whether the preliminary definition is correct.

⁷⁴ Price elasticity is the percentage change in sales of a good caused by a change in the price of that good.

Figure 6-1 Segmentation of the market by Internet functionality



There are likely to be a number of alternative approaches to assessing market impact, but the standard competition framework is more widely used and accepted, containing well established principles for identifying a market in competition cases.

An alternative valid analytical approach to measuring BBCi's impact would be a bottom-up approach, which focuses on identifying and examining the overlap between competitive sites and BBCi. The main problem with this alternative approach is data availability. This approach and its strengths and weaknesses are discussed in greater detail in Section 8.6.

Market share estimates using Nielsen//NetRatings are therefore a slight over-estimate or upper bound. This is in contrast to the market share estimates based on Hitwise data where an adjustment assumption has been made to capture the whole News universe.

8.6 A bottom-up approach to market definition

8.6.1 Overview

The above approach is the standard competition policy method. We define the relevant online market and then describe the impact according to the size of the market share (as well as a whole host of other factors such as barriers to entry). This is essentially a top-down analysis.

An alternative valid analytical approach to measuring BBCi's impact could be a bottom-up approach. This approach would focus on the overlap between competitive sites and BBCi. Although the approach is significantly different to the standard competition policy approach, it should in principle produce the same results.

This rest of the section therefore describes this approach in more detail as well as its disadvantages, using the Film genre as an example.

8.6.2 Illustrative example: Film genre

The first step in the approach is to identify the generic categories that are typically offered by sites in the genre. These categories should be fairly broad and should correspond to aspects of the sites that are functionally distinct.

The implication is that sites are only likely to experience a significant loss of traffic if BBCi is a very good alternative to other sites in certain areas and if these overlap areas are a core part of the non-BBCi sites' offer that attracts a high proportion of its traffic.

Seven generic categories were identified during this step. These are 'information on films', 'local cinema search facility', 'message boards', 'e-commerce', 'information on film industry celebrities', 'audio visual content and listings'.

The next step is to identify the overlap between BBCi sites and other sites at this broad level. Where an overlap is identified a more detailed analysis is required. The result of this analysis is summarised in Figure 8-4.

Figure 8-4: Overlap analysis in the Film genre for BBCi, IMDb and Guardian

Category	BBCi Films	IMDb	Guardian Unlimited
Film Information	✓	✓	✓
Celebrity information	✓	✓	✓
AV Content	✓	✓	✓
Listing			✓
Cinema Search	✓		✓
Message Search	✓	✓	✓
E-Commerce		✓	✓

The above table shows the extent of overall overlap between BBCi Films and IMDb and Guardian Unlimited in many of the categories apart from Listings and E-commerce. More analysis was therefore undertaken in each of the overlap categories.

This further analysis is shown in Figure 8-5. It shows that the offering of BBCi Films differs from IMDb for those users who are seeking film information (e.g. BBCi offers original reviews while IMDb offers film synopses). There is more overlap in the celebrity information area, which may suggest that BBCi Films competes more directly with IMDb in this aspect.

Figure 8-5: More detailed analysis of overlap between BBCi and IMDb

Category	BBCi Films	IMDb
Film Information		
Film synopses		✓
Original reviews of UK releases	✓	
Original reviews of US releases	✓	
User-generated reviews		✓
Links to external reviews		✓
Film database		✓
Celebrity Information		
Star bios and filmographies		✓
Interviews and articles	✓	✓

8.6.3 Key findings

The analysis suggests that the overlap of BBCi Films with IMDb is unlikely to lead to significant loss of traffic for IMDb if the celebrity interviews and articles are differentiated and appeal to different audiences and that the celebrity interviews and articles offered by IMDb attract only a small proportion of IMDb hits.

A similar detailed overlap analysis has been undertaken between BBCi Films and Guardian Unlimited. This analysis indicated that BBCi Films is active in all of the areas covered by the Guardian Unlimited, with the exception of e-commerce.

This implies therefore that BBCi Films has an impact on Guardian Unlimited. Although it may be possible to argue that BBCi does not have a significant impact on the Guardian's visitors: if the Guardian appeals to a loyal base of Guardian readers; if BBCi gets relatively few hits in those areas where the Guardian is relatively strong; if visitors to BBCi Film also make use of Guardian online; if a significant number of visitors are attracted to the Guardian's site for e-commerce reasons.

A key problem with the bottom-up approach applied generally to all BBCi activity would be data availability. In practice there is insufficient data to undertake such an intensive detailed analytical approach. It is just not practical to analyse hundreds of competing sites as well as the hundreds of pages within each site. It does, however, provide a means of cross-checking the more general approach and (as described above) this has been done for film.

9 **BBCi's position and impact in the Content market**

This section examines BBCi's position and impact within the content market. We have undertaken case studies of News, Sport, Food, Film, Health and Music. To assess the impact we:

- examine BBCi's position and market share in the relevant markets, together with the positions of the leading players;
- consider relevant parameters such as barriers to entry, revenue models and online strategies.

News and Sport

The News market is the largest part of BBCi accounting for around 29% of BBCi's total traffic in page impressions. BBCi's market share in the News genre is in the region of 40%. There are high barriers to entry, most notably access to capital and economies of scope and having a strong brand in news. Pan-media firms generally enjoy these advantages, although funding for online ventures has fallen significantly in recent years.

BBCi appears to have a significant proportion of loyal users. The proportion of solus users of News on BBCi is around 35%. This is high compared to its competitors, with the exception of portals which focus on a "walled garden" strategy, providing few external links. In contrast to portals, BBCi has many links to external sites which encourage people to explore further the Internet, although these links are generally not to commercial competitors.

High market share, customer loyalty and high levels of solus use mean that BBCi potentially has a significant impact in the online News market. However, 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. However, there is the possibility that, without BBCi, commercial news providers may offer less free content or invest to overcome this resistance.

We consider the possible indirect impact on advertising revenues in more detail in section 10. BBCi may be contributing to making the news market in the UK more concentrated, but we do not consider that its presence alone is a barrier to new entrants.

Sport on BBCi is the most popular sport site in the UK. BBCi's market share in the Sport genre is in the region of 20% and reaches more than one third of online sports content consumers each month. Sport on BBCi has many links to other sites, although like News these are not to commercial competitors. The percentage of solus users in Sport at 43% is above average when compared to other popular sites.

However, the market impact is less than in News. BBCi is not in the market for betting/gambling and does not offer e-commerce. The market is fragmented and BBCi is not involved in the market for push services.

Food and Music

BBCi's share in the overall Food content market is approximately 10%–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, and 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's 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 from the 15% of BBCi users who have made an online purchase from a commercial site as a result of learning about the product or service from BBCi.

There is a perception within the online industry that BBCi's offering is very strong within these genres. At the margin, some individual sites may have modified their investment plans as a result.

Film and Health

BBCi's position in these 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.

The implications are that BBCi does not have a strong market position, or consequently impact, in these niche markets.

Investment

Overall, the primary driver of past investment decisions has been the wider economic environment, rather than the presence of BBCi. However, the importance and effect of the economic climate is now much less important – the Internet boom and resultant bust has, effectively, been a one-off adjustment. Current investment decisions are now much more likely to be based on normal competitive pressures in the current market rather than the high expectations of the past.

The BBC's current expenditure on its online services is £100 million per annum, of which £75 million is spent on content. At present, this is a significant sum in a market where little investment is taking place. We therefore consider that there is a possibility that investment decisions taken now by some individual sites may be affected.

Competitors are likely to invest in those areas where revenue models yield positive returns (e.g. investment is taking place in some niches such as online grocery shopping within the Food genre and gambling in the Sport genre.) BBCi may have a presence in these markets but, as it does not compete directly for revenues, its presence is unlikely to deter the competitors, considerably mitigating this impact. Also, arguably, BBCi has a positive impact as it continues to invest while the private sector has cut back.

Paid-for content

The extent of the impact will also depend on the paid-for content markets. A number of websites operated by publishers are however charging for certain types of content, be it premium content or archive articles. These content owners are deploying what some industry analysts call a "free and fee" model – i.e. some content is free at the point of use, whilst other content is available to subscribers only.

That BBCi's content is free may constrain new entrants into the paid-for content market. However, the existence of an abundance of free content from many other companies has the same effect. If existing or new players are to make the paid-for content model a success, they will need to invest in innovative new services to alleviate consumer resistance. BSkyB has managed this successfully in the pay TV market, albeit after many years of free provision followed by many years without profits.

The widespread provision of free content has not constrained some companies from launching paid-for content (e.g. ft.com, which has enjoyed some degree of success). There is, however, the possibility in News that moves towards paid-for content may have been quicker in the absence of News on BBCi.

Although BBCi is likely to slow the speed of adoption of the new charging models, the high level of aversion by consumers to paying for content is likely to be the major constraint. It is difficult to disentangle the impact of BBCi versus consumer resistance. We therefore conclude that it is possible that, without News on BBCi, commercial news providers might have increased investment to overcome consumer resistance or reduced the amount of free content available.

Overall

BBCi has a strong market position in News and Sport. In both these genres it has a high market share and a high proportion of solus users. These factors together with the barriers to entry identified indicate that BBCi's market position is strong. While this strong position does not have a significant impact on advertising revenues, it does act as a constraint on the speed of adoption of the new charging models employed by some of the players.

However, another constraint on this is the high level of aversion by consumers to pay for content. It is difficult to disentangle the impact of BBCi versus consumer resistance. BBCi does not impact some of the other new revenue models such as gaming and betting.

The BBC's online investment is £100 million per annum (of which £75 million is spent on content) is significant in the current marketplace. At the margin there is therefore the possibility that some individual sites may currently have different investment plans if BBCi did not exist. But this is a marginal impact – past investment decisions have been largely unaffected being dependent predominantly on external economic factors.

BBCi has a relatively strong position in Food and Music. However, the key revenue streams (online food shopping, paid music downloads, CD sales) are unlikely to be adversely affected by BBCi's presence due to the nature of the BBC's offering.

In the other genres studied (Film and Health), BBCi does not have a strong market position. The markets are highly fragmented and BBCi has a relatively low market share.

In all genres, there could be a negative impact on competitors' subscription revenues in the future if the paid-for content models become more commonplace and sophisticated. However, there is always some doubt about the future. To date, the BBCi impact has been limited.

9.1 News

9.1.1 Overview

The News genre has been analysed as it ranks highly in our key criteria for selection. It is the most popular part of BBCi accounting for 29% of page impressions and is the most popular genre on the Internet. News is consumed by around 41% of Internet users¹⁰⁷. The News genre appears to have reasonable revenue potential as some News sites have started to charge for content.

News on BBCi has a similar style and reputation to BBC News, which has a very strong brand and a world-renowned reputation. UK viewers and listeners consistently turn to BBC News in times of crisis and for major national events. Its BBC1 bulletins regularly achieve higher ratings than their counterparts on ITV1, and Radio 4 and 5 Live have strong reputations for radio news. All these criteria suggest that it is imperative to analyse the News genre.

Some common offerings within the News genre are:

- current affairs and political analysis;
- financial and business news;
- geographic based news (e.g. international, national, regional and local);
- archived news, search and database services;
- paid-for content models for premium content and services.

In terms of organisations and companies which offer news, they can be broadly grouped into the following:

- broadcasters which include a significant amount of News on their respective sites such as the BBC, ITV and CNN;
- newspaper groups which re-version their newspaper articles for electronic publication such as timesonline.co.uk or independent.co.uk;
- niche sites, which only have an online presence or just focus on small parts of the market (e.g. local or regional news);
- portals such as AOL or Freeserve, which provide News content;

News sites do not typically focus on selling products. Indeed, e-commerce is often limited in the category of News. However, charging for content is becoming an increasing part of content owners' strategies. News sites which have started to charge for content include Wall Street Journal, Financial Times and Independent while others have started to charge for archive searches such as the Times¹⁰⁸.

Over the long term the key issue is whether these companies can succeed in charging consumers without losing the majority of their users, especially as Internet users are used

¹⁰⁷ MORI Survey (May 2003): "Which of the following types of website (Film, Food, Health, Music, News, Sport) have you visited in the last 4 weeks?"

¹⁰⁸ Additional analysis of revenues models is given in Appendix A.

to most content on the Internet being provided free. Once a content provider has decided to charge for some or all of its content, it faces the problem of whether the paid-for content model will displease the customer and damage its reputation. Another key issue is establishing which content users are willing to pay for.

9.1.2 **News: Market definition and BBCi's position**

The News offering on BBCi provides up-to-date local, regional domestic and international news similar in scope to other news providers.

The first step to understanding BBCi's impact is to consider the BBC's share in the overall News genre. However, neither Hitwise nor Nielsen//NetRatings 'standard' News definitions are applicable. Both include sites which are not relevant to our definition¹⁰⁹ or apportion demand incorrectly to economic market¹¹⁰. It is important to note that we are not criticising Hitwise's or Nielsen//NetRatings' data and methodology – this clearly satisfies the needs of the Internet industry – it is just that their genre definitions do not conform to the relevant economic market(s) as we have defined them.

We have therefore calculated BBCi's position in the overall News genre by analysing and modifying Hitwise and Nielsen//NetRatings data to make it more relevant to the economic market. Hitwise is a better measure of a market share as each genre sample is based on thousands of sites, whereas the KPMG/Nielsen//NetRatings sample is more useful for benchmarking BBC's performance against other sites as more detailed volume indicators are available.

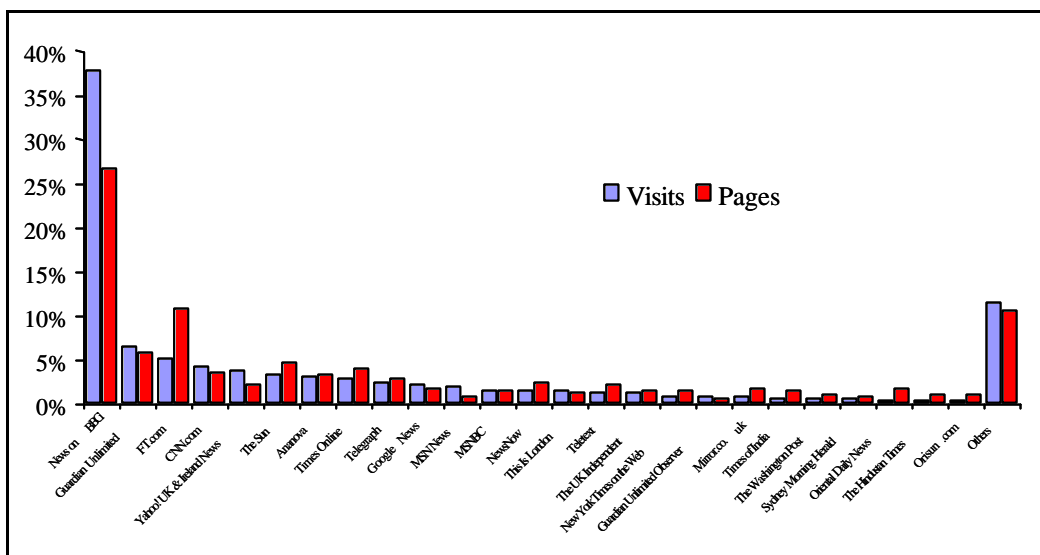
The results of the analysis of Hitwise data in terms of market share are illustrated in Figure 9-1. On average BBCi's share is 38% in terms of number of visits and 27% in terms of pages.¹¹¹

¹⁰⁹ The most relevant Hitwise category is "News and Media". However, it includes many sites which are not relevant such as Music sites (nme.com) or consumer information sites (which.net). An alternative category 'News and Media - Print' is also unsuitable as BBC and other niche players are not included.

¹¹⁰ For example, the whole of demand to portals (e.g. freeserve) is included as demand for News. This is different to our relevant economic market which separates content by genre.

¹¹¹ Monthly average taken from November 2002, February 2003 and March 2003.

Figure 9-1: BBCi's market share of key competitors within the online News genre case study



Source: KPMG estimates based on Hitwise data (November 2002, February 2003 and March 2003)

The above analysis has been validated with data from the KPMG/Nielsen/NetRatings custom sample of competitive sites and reveals a similar picture. BBCi reaches 50.7% of the users in the overall News market of 7.1 million users in the overall News genre followed by Guardian Unlimited with a reach of 22.3%. The time spent by an average user on News on BBCi is 29:42 minutes of use compared to the next most popular sites of Electronic Telegraph (24:18 minutes) and FT.com (21:43 minutes).

Figure 9-2: Benchmarking demand for News on BBCi against key competitors (UK Home Panel, Quarter to March 2003)

	Total time online (millions minutes)	Reach (%)	Total page views (million)	Page views per person	Visits per person	Minutes of use
News on BBCi	107.41	50.7%	139.2	38.5	4.71	0:29:42
Guardian Unlimited	17.55	22.3%	26.6	16.7	2.71	0:11:02
Electronic Telegraph	17.54	10.1%	18.5	25.6	4.14	0:24:18
Yahoo! News	7.72	7.0%	7.6	15.2	4.87	0:15:24
Freemove News	7.16	17.1%	6.5	5.4	2.53	0:05:53
CNN.com	7.38	12.3%	10.7	12.2	2.62	0:08:24
The Sun	6.80	5.3%	12.9	34.2	4.76	0:17:59
FT.com	6.80	4.4%	9.2	29.5	3.77	0:21:43
Times Online	6.69	7.5%	9.4	17.7	2.48	0:12:34
Ananova	4.43	7.0%	6.3	12.6	2.45	0:08:48
Genre sample total (39 sites)	213.87	100.0%	290.2	40.7	5.38	0:29:58

Source: Nielsen/NetRatings Custom Analysis (UK Home Panel, quarter to March 2003).

Out of this Nielsen/NetRatings/KPMG sample of 39 sites, BBCi accounts for 48.0% and 50.2% (for the Home Panel) and 67.8% and 73.3% (for the combined Home-Work

panel)¹¹² of page views and share of time respectively. Note that only 39 popular sites are included in the custom KPMG/Nielsen/NetRatings custom News sample. It does not cover all News sites (particularly the hundreds of many small sites), and therefore the market share figure is an overestimate.

Based on the above analysis, the different indicators and sources, a sensible composite figure for BBCi's market share in the overall News market is that it is very approximately 40%. A market share of this magnitude implies that BBCi therefore has sufficient market presence to have an impact. More detailed demand analysis of indicators is given in Appendix A.

9.1.3 News: BBCi's position in narrower markets

An important market definition issue is whether the News genre should be defined more narrowly; in particular, whether there should be separate online markets by geography (e.g. international, national, regional and local), for business/finance news or for current affairs and political analysis. Clearly, this is a difficult question to answer without any detailed empirical evidence (which is not available). However, the current structure of the market does provides some useful indicators.

Most of the major news sites we examined provide both international and national news alongside each other. Only foreign based sites provided international news and not UK national news. But there are very few popular non-UK News sites used by UK residents to make this significant – CNN being the only exception in the top 20.

In terms of other narrower markets. It is difficult to distinguish current affairs and political analysis from the other News categories of national or international news. Substitution between these categories is also likely to be high. We therefore consider it is reasonable to treat all these categories (international, national, current affairs, political comment) as being in the same economic market.

In any case, the impact is small. Excluding non-UK news sites and regional niche sites results in estimates for BBCi's market share which are slightly above the whole News market, as shown below.

Figure 9-3: BBCi's share within the UK News genre

Category	Indicator	BBCi market share
News (UK focus)	Visits	43.2%
	Pages	32.4%

Source: KPMG estimates based on Hitwise data (November 2002, February 2003 and March 2003)

The arguments are stronger for separate markets in terms of regional and local issues and for business news.

¹¹² One reason why Home-Work figures for the BBC are higher than for the Home panel is that users tend to use more "conventional" sites at work. Possible reasons are work environment, company policy and/or IT systems.

Demand for local news from one part of the country is clearly not substitutable for News from another part of the country. Note that as News specific to one local/regional area are separate markets, there cannot be an overall market for local news.

To some extent the above discussion is theoretical. There are likely to be thousands of sites which provide local and regional news and, similarly, thousands of separate markets. Sufficient analysis of BBCi's position in each of these markets to be able to make conclusions is just not practical. Another problem is that these are very small markets. Scottish News is one of the biggest local/regional markets, yet this represents less than 1% of traffic to the overall News site on BBCi. Apart from BBCi, the level of demand for each News site associated with each regional/local market is not available. We have therefore not presented any quantitative evidence on BBCi's market share in these smaller niche markets, which could therefore be higher or lower than the overall market share.

Business (Financial) News is also likely to be a separate market. News offered by Business News orientated websites, such as FT.com and Wall Street Journal, will appeal to a specific user type requiring a distinct style and quality of content. General News from sites such as the 'The Sun' is unlikely to be a valid substitute and therefore should not be in the same market.

There is therefore a valid case for a separate Business News market. However, we have not been able to identify the relevant proportion of Internet traffic to general News sites which is specifically for Business News – although it is relatively easy to identify particular sites which focus wholly on business news. We have, therefore, not calculated any market shares for this narrower market.

9.1.4 **Barriers to entry: Economies of scope, brand and access to capital**

A few successful sites dominate the market. Sites that have a presence in the traditional marketplace dominate the News genre (apart from Ananova.com). Internet pure-plays are less common in this genre owing to a combination of high barriers to entry and the fact that while the revenue potential of News may be large, it is difficult to realise.

A key reason for this dominance is the presence of economies of scope realised by the pan-media companies, as newspaper groups and broadcasters use the Internet as another distribution channel to reach their audience. In particular:

- pan-media organisations have established businesses and recognised brands;
- they also have advantages in re-purposing and packaging their content for online delivery;
- the ability to cross-promote online services may also be a contributory factor, but this is likely to be less significant than the overall brand strength;
- the costs of distribution are lower for online enterprises, although this advantage is largely offset by the heavy marketing costs of establishing and/or maintaining an online brand.

In addition, funding for online ventures has almost completely dried up in the UK. Access to private capital is very difficult, as venture capitalists are currently unprepared to back new online start-ups. Also, established businesses have announced actual or

planned cuts in the amounts they are investing in online businesses in the future. Access to funding is therefore a high entry barrier in the News genre.

Key barriers to entry in the News genre are therefore economies of scope, having a strong brand in news, and the ability to differentiate the service. Most, if not all, of the pan-media firms enjoy these advantages. These barriers may deter new entrants and established players from investing further.

9.1.5 **Barriers to entry: A 'walled-garden'**

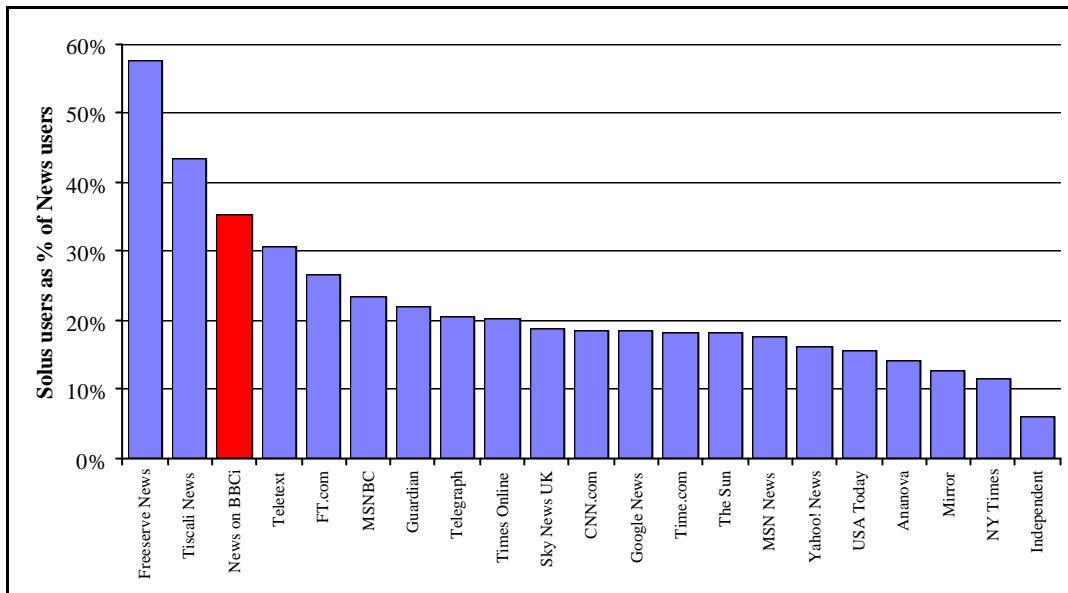
The strategy of online news sites is to maximise the online time that users spend on their website and to lock out the competition. The consumption of online news can be extended through chat and interactive functionality such as straw polls. More importantly, online news publishers have found that they need to provide attractive non-news content that will retain browsers within their site. Hence a number of websites offer a variety of other "channels": e.g. personal finance (The Times), a travel guide (Telegraph), a film guide (The Guardian).

An indication of the success which the different news sites have in retaining users is given in Figure 9-4. Over the quarter to March 2003 (UK Home Panel) around 1.3 million people are solus¹¹³ users of News on BBCi or 35% of the total users of News on BBCi¹¹⁴. The position of BBCi on this indication compared to its competitors is high. It is only the portals such as Freeserve which have a greater proportion of solus users. This is not surprising as a key strategy of portals is the focus on the 'walled garden' strategy, which is to keep users within their site by providing few external links.

¹¹³ A solus user of News is an individual who accessed only one News site over the specified period.

¹¹⁴ In the Home Work panel over the same period, there were 1.6 million solus users of News on BBCi compared to total users of News on BBCi of 5.9 million (i.e. 27.0%).

Figure 9-4: Proportion of solus users of News (UK Home Panel – Quarter to March 2003)



Source: Nielsen//NetRatings Custom Analysis (UK Home Panel, Quarter to March 2003).

BBCi has a very different strategy to portals and has thousands of external links throughout its site, encouraging people to move on and explore other parts of the Internet. However, links from BBCi are generally to official websites (government departments, public sector agencies, trade associations etc.) rather than competitors (e.g. The Telegraph). MORI research indicates that two-thirds of BBCi users visit non-BBC websites following links from BBCi¹¹⁵.

From analysis of origin and destination data, most people do not go on to explore other News sites. They generally stay within BBCi or leave to go onto other non-News content.

Differentiation of service is another barrier to entry. New entrants and incumbents need to guarantee access to content. Agencies such as the Press Association, Reuters, and Associated Press all make their content available to third parties for a fee and on a non-exclusive basis. However, the pan-media companies benefit from economies of scope, as they are able to use their content many times over for different media. The marginal cost to established publishers and broadcasters of re-purposing their news and information services for the online medium is relatively low. New entrants and organisations that are single-media do not benefit from these economies of scale and scope.

The differentiation of service through high quality reporting and the reflection of this through a well recognised and respected brand is a barrier to entry in News. Consumers are aware of established brands and will have affinities to one or more of these established brands, making it difficult for new entrants and single-media incumbents to overcome such loyalties. This is borne out by the above data.

¹¹⁵ See Appendix B.

9.1.6 News: Impact of BBCi on revenues

If News on BBCi did not exist, a large proportion of its solus users would swell the user bases of major commercial news sites. In such a scenario, they might attract some additional advertising (diverted from other genres). However, general news domains are not as attractive to advertisers as portals and advertising alone has proved to be an unsustainable business model for websites. Therefore, it is unlikely that BBCi is having a significant impact upon the market in terms of advertising revenues.

Conversely, it is possible that the News genre's low share of the advertising market is a consequence of BBCi's strong presence. The overall impact of BBCi on Internet advertising is discussed in Section 10.3.

Given the current abundance of free news on the Internet, it is unlikely that BBCi is having a significant impact at present, especially if one considers that more than two-thirds of consumers¹¹⁶ have stated that they are unwilling to pay for content and that online content has largely been free. It is, however, possible that without BBCi, commercial news providers would invest more in news content (advertising and marketing) to overcome consumer resistance to paying. Providers might also make less free content available. In these circumstances the BBCi impact could be more significant.

It is also possible that BBCi continuing to provide current and archive news free of charge may be slowing down moves towards paid-for content. However, the fact that some sites are attempting to charge both in the UK and the rest of the world means that BBCi has not stopped the UK market developing.

Payment for wireless-accessed online content on the other hand has become accepted practice¹¹⁷. Revenues are currently small but the advent of broadband and wireless technologies should extend the move towards paid-for content – there is a lot of potential from certain content such as 'live pictures' of a major news event. The revenue potential is clearly dependent on the success of 3G technology. If 3G is a success and accessing content via wireless devices becomes more commonplace (and charging models become more sophisticated) then BBCi's impact could increase.

9.1.7 News: Other impacts of BBCi

There are significant barriers to entry in the News genre. Economies of scope mean that pan-media organisations with established businesses, journalistic resources and recognised brands would continue to lead the market. BBCi's presence alone is not a barrier to new entrants – all existing pan-media groups contribute to this barrier. A market without BBCi would still have similar barriers to entry.

Other impacts are summarised below:

- Costs – the high quality of BBCi's offering means that competitors will have to invest highly in journalism to be able to compete.

¹¹⁶ 'Paid Consumer Services: Assessing Market Opportunities', Jupiter Media Metrix, March 2002.

¹¹⁷ Orange charges mobile users to read or listen to news from Ananova on the mobile telephone. Virgin Mobile also has audio news. See Appendix A for more examples of planned charging models.

- Investment / Innovation – the difficult business models coupled with the dot.com crash, not BBCi's presence, have been the driving forces behind the scaling back of investment in recent years. Some (e.g. FT.com) are continuing to invest.
- Consumers – they have access to a further source of high quality comprehensive UK and international news. The large proportion of solus users and other BBC research confirms that consumers trust the BBC brand and display strong loyalty.
- Market structure – The market structure in the UK market is more concentrated than other European countries. Reach of the strongest player in News markets in Italy, Germany and France are 11.1%, 15.3% and 8.5% respectively, compared to 19.1% in the UK (measures used are reach of the total online market rather than specific News genre). BBCi with its high market share could be one reason for this higher concentration. Therefore, without BBCi, the market structure would be likely to be less concentrated, as BBCi's market presence would be shared around a number of pan-media groups, rather than one specific alternative company.

9.2 Sport

9.2.1 Overview of the online Sport market

Sport is another popular genre on the Internet and accounts for a significant proportion of the traffic and time on BBCi. It is the second most popular visited genre on BBCi site accounting for 16.9% of page impressions¹¹⁸. In terms of financial potential, it could prove to be one of the most lucrative genres on the web, largely because of betting. Like News, Sport is also widely associated with the BBC brand. All of these factors suggest that it is imperative to include an assessment of BBCi's impact on the Sport genre.

The Sport website on BBCi provides information on Football, Cricket, Rugby, Tennis, Golf, Motorsport and lots more. The BBC did lose some sports TV rights in the 1990s, but it has recently succeeded in regaining some of the lost ground. 5 Live has also grown the radio audience for sport. BBC TV still has many flagship events, and BBC Sport's popularity was demonstrated by its ratings success in the World Cup 2002.

Some of the common features within the Sport genre are:

- generic sites which provide content on a range of different sports;
- niche sites which focus on one or two specific sub-genres (Football, Rugby, Cricket, etc.) or more narrowly, on one team within a sub-genre (e.g. Manutd.com);
- e-commerce facilities, predominantly sports retailers;
- betting revenues becoming a crucial part of many business plans in the sector. These revenues have grown strongly and are projected to continue to grow in the near future;
- infrequent/seasonal events or one-off sporting event sites (e.g. World Cup, Wimbledon).

Niche and one-off sites are commonplace within the Sport genre. The market therefore is much more fragmented than News.

Revenue models already being exploited include gambling, merchandise sales, pay-per-view, and charging for premium content/services. The most interesting strategy is the use of sporting information and other content to attract online users and then extending the user relationship with the provision of online betting. For some companies betting has become the core strategy.

That aside, most commercial Sport sites generally exploit many sources of revenue. Some supplement core revenues from e-commerce or betting with the selling of content to third parties and the generation of revenues from online advertisers. Others focus on content generation using in-house skilled reporters to attract users and generate online betting revenues (and advertising), but also selling this content wholesale to third parties.

Clearly, the pursuit of revenues from a variety of sources exists. What is reasonably certain from our research is that Sport sites which rely on online advertising revenue alone are unlikely to succeed in the long term. The betting model, on the other hand, is

¹¹⁸ BBC Petal analysis, average of year to July 2002.

likely to be increasingly lucrative. This may have implications for BBCi's impact which is discussed below.

9.2.2 Sport: Market definition and BBCi's position

The online Sport genre covers many different topics from e-commerce to betting and from general sports content to niche supporters sites. One feature which distinguishes BBCi from many sites within this genre is that it does not provide gambling related services or e-commerce.

As BBCi does not compete in these areas and the Commerce market is considered to be separate to Content, the relevant market definition within the Sport genre is much narrower. It is, however, important to analyse developments in the wider Sport genre, namely betting and commerce, as there could be indirect impacts and often there is not a clear distinction between Commerce and Content. Developments in betting and e-commerce within this genre are therefore covered briefly in this section with more detailed analysis presented in Appendix A.

With the market defined to exclude pure Commerce sites (both e-commerce and betting sites) BBCi's market share increases to 10.8% (measured by visits) from the figure of 7.1% under the standard Hitwise Sport genre definition. Figure 9-5 summarises these figures identifying the key top five sites in each Sport definition.

Figure 9-5: BBCi's share within the overall Sport genre

Category	Indicator	BBCi market share	Top sites
Standard Sport genre (Hitwise)	Visits	7.1%	Sport on BBCi Ladbrokes.com Sky Sports Football365.com
Sport (excluding commerce and betting)	Visits	10.8%	Sport on BBCi Sky Sports Football365.com Rivals.net

Source: KPMG estimates based on Hitwise data (February 2003)

9.2.3 Sport: BBCi's position in narrower markets

In this genre the case for a narrower market is more persuasive than the other genres considered, as discussed in 6.2.2. However, similar to the News genre, there are significant data constraints. Detailed data are limited and as a result we have only been able to estimate BBCi's market share in Football and non-Football sub-genres. The market calculations in these markets are likely to provide a reasonable indication of BBCi's general position and market share. However, due to the data limitations in the narrower markets we have placed most weight on BBCi's position in the overall sports market.

The analysis is summarised in Figure 9-6. It shows that with Hitwise data the estimates of BBCi's market share in narrower Sport genre ranges from 9.5% to 15.5%. BBCi accounts for 19.1% and 25.0% of page views and share of time respectively within the KPMG/Nielsen/NetRatings custom sample of 75 popular Sport sites.

Similar to the News genre, the equivalent figures from Nielsen//NetRatings' Home-Work panel are much higher – ranging from 30.7% to 37.9% for page views and share of time respectively. More detailed Nielsen//NetRatings demand indicators for popular sites are provided in Appendix A.

Figure 9-6: BBCi's share within narrower Sport genres

Category	Indicator	BBCi market share	Top sites
Football ¹	Visits	9.5%	Sport on BBCi Sky Sports Football365.com Rivals.net
Sport (not Football) ¹	Visits	15.5%	Sport on BBCi Sky Sports CricInfo Sporting Life
KPMG/Nielsen//NetRatings Sport sample (around 75 most popular sports content sites)	Page views	19.1%	Sport on BBCi Sky Sports
	Time	25.0%	Football365.com Sporting Life

Source: KPMG estimates based on Hitwise data (February 2003) and Nielsen//NetRatings (UK Home Panel, Quarter to March 2003)

Note: ¹ Proportion of Sport on BBCi attributable to football estimated from BBCi server logs.

Based on all of the above figures and analysis, a sensible composite figure for BBCi's market share is approximately 20%. Detailed demand indicators for popular sites are given in Appendix A.

9.2.4 Sport: Barriers to entry

Economies of scope are a high barrier to entry. Many of the most popular sites within this genre have generic sports offerings, covering many different types of sports. A new entrant to compete in this market will need to have access to this diverse range of content, or otherwise carve out a very well-defined niche for itself.

As with most segments of the online market, access to funding for sports websites is difficult, creating an entry barrier. This is particularly significant in the wider online Sport market of betting and e-commerce.

Product differentiation is another barrier. In the sports online segment a number of websites have spent substantial amounts of money in the past to create a brand name and a strong presence in the online sports market. These websites have combined sports content with technology to provide users with the ability to bet online. Any new entrant would have to invest heavily to overcome this established user loyalty.

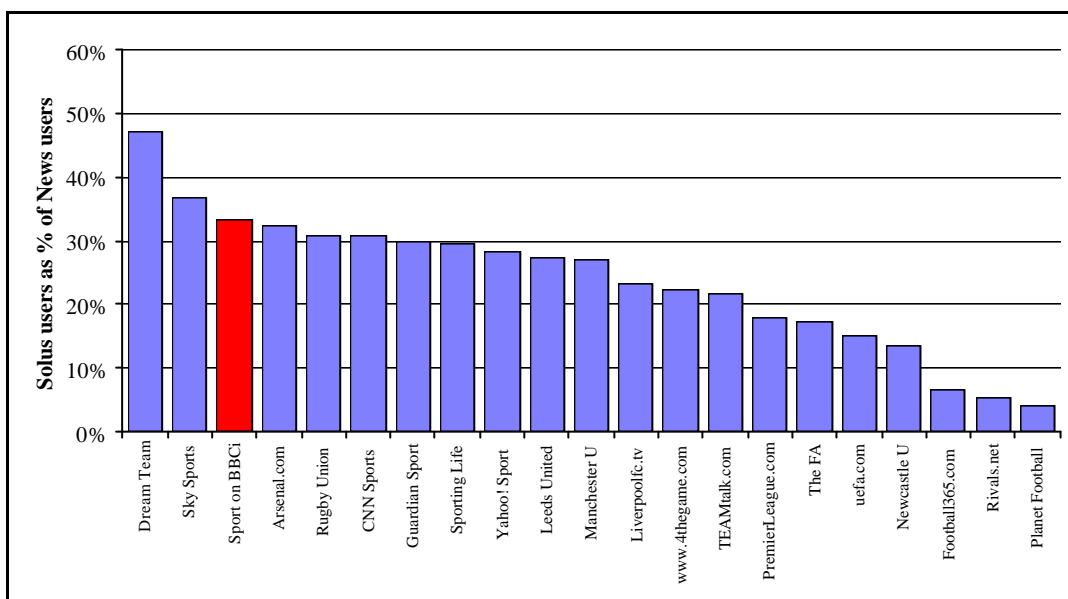
How successful different players are in fulfilling users needs is shown in Figure 9-7. Around 33%¹¹⁹ of users of Sport on BBCi are solus users (i.e. did not visit any competitors' sites to supplement the sports content they had consumed on BBCi). This is above average for the sample, despite the fact that Sport on BBCi (similar to News) has

¹¹⁹ KPMG/Nielsen//NetRatings Custom Sport panel, Quarter to March 2003.

hundreds of links to external sites encouraging exploration of the Internet, albeit these links are generally not to competitors.

The second largest player in the market, Sky Sports, has a slightly higher proportion of solus users. In addition, most of the portal sites had higher proportions of solus users. However, apart from Yahoo! we have not reported individual figures for portals as demand is below statistical significance of Nielsen/NetRatings' sample.

Figure 9-7: Proportion of solus users of Sport (UK Home Panel – quarter to March 2003)



Source: Nielsen/NetRatings Custom Analysis (UK Home Panel, quarter to March 2003).

9.2.5 Sport: Impact of BBCi on Revenues

Determining the market impact of BBCi in the Sport genre is complex. The principal revenue streams in the wider Sport genre are betting, e-commerce revenues, the sale of content to third parties and advertising revenues.

However, BBCi does not offer any e-commerce facility so there is no direct impact on such revenues. The only potential impact would be on an impulse purchase which does not occur due to the user choosing BBCi sites as opposed to a commercial one which offers e-commerce in addition to its content. Evidence from MORI suggests impulse buying is relatively low (see Appendix B).

BBCi does not provide comprehensive analysis of form or betting odds, so it does not impact on businesses which charge for this content.

Advertising alone has not proved to be a sustainable revenue model for sports websites. BBCi's impact in taking market share may be to divert some advertising spend from sport to other genres. However, sport sites do not receive a significant amount of advertising.

Also, those advertisers wishing to reach a “sports” audience demographic will still place advertising with commercial sports websites – the presence of BBCi is unlikely to influence that decision. Therefore BBCi is unlikely to be having a significant effect on advertising revenues.

Push services which provide compelling content to users are becoming an increasingly more important part of the Sport online market. The demand for customised personal content is particularly strong in this genre due to the requirement for live reporting of sporting events and consumers affinity to specific teams. As a consequence of this relatively higher demand, charging models for these services are now more common. At present, BBCi is not involved in the provision of such push services. There is, therefore, no direct impact on this market.

Overall, there are unlikely to be many direct impacts on revenues in terms of e-commerce, betting, advertising and push services.

9.2.6 **Sport: Other impacts of BBCi**

Other impacts are summarised below:

- Costs – 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.
- Investment – Access to funding for sports websites is again an issue, as is product differentiation, where many sports sites have spent a great deal of money to build up a reputable and specific brand. Like most genres there have been many dot.com casualties. But the general investment climate has been the main cause of these failures rather than BBCi. That said, the investment picture is not entirely negative in the wider sports genre. Major investment has been taking place in sites with online gambling capability and some new money has been raised (e.g. Ukbetting). Again, BBCi has not impacted upon this investment.
- Consumers – They have access to a comprehensive range of news on all sports, not just the most commercially attractive ones.
- Market structure – Niche sites have a contrasting offering to generic sports sites in this genre, generally concentrating on one sport only. This is entirely different to the generic sports sites such as BBCi. In the absence of BBCi, users are more likely to visit one of the established content owners with a relatively strong brand. As a result, BBCi is likely to be withholding market share from the larger, rather than smaller players.

9.3 Food

9.3.1 Overview of the online Food market

The Food genre on the Internet has a much lower profile than News or Sport. However, there are a number of reasons why the genre is a good case study. Food is widely seen as a strong part of the BBC brand. There has been a long tradition of popular cookery programmes on the BBC from Fanny Craddock to Delia Smith to Jamie Oliver. There also seems to be a growing potential for e-commerce in the sector.

BBCi provides information on recipes, features, profiles of favourite chefs, information on healthy eating and links to food programmes. The genre is widely associated with the wider BBC brand (e.g. television cookery programmes). BBCi Food is most active in the provision of online recipes.

Some of the common features within the Food genre are:

- sites which focus on Food content, predominantly recipe sites;
- food and drink shopping sites;
- sites on nutrition and healthy eating;
- corporate (or promotional) food sites;
- restaurant and pub guides, bookings and listings;
- drink “culture” sites .

A key revenue stream in the wider Food genre is online shopping. Most of the major supermarkets (e.g. Tesco, Sainsbury’s, Waitrose) have an online presence offering delivery of groceries¹²⁰.

Another source of revenue is paid-for content. A branded food website may consider it has exclusive rights to attractive unique content and is therefore able to charge users for this.

Sites such as deliaonline.com have also demonstrated that there is a wide range of potential opportunities for generating revenue from the food genre, including food, wine, homeware, gardening, books, video and gift sales.

9.3.2 Food: Market definition and BBCi’s position

The standard Hitwise and Nielsen/NetRatings Food genre definition cover a diverse set of Food sites which do not quite fit our economic market definition. The biggest problem is that many pure Commerce sites are included.

Our market definition is clear. All sites which offer Food content should be included in the relevant market and any site which just offers e-commerce only should be excluded.

This issue is less clear in the case of bundled sites offering both Content and Commerce. Although we concluded (Section 6) that bundled sites should be included, we have

¹²⁰ Some have diversified into other services such as online banking.

examined individual sites on a case-by-case basis to take into account the extent to which a significant amount of Content is provided. For example, if the Content part is a very small part of a site (such as in Tesco.com) we have excluded the site from the genre.

With these adjustments to the raw data an estimate of BBCi's market share in the overall Food Content genre is given in Figure 9-8. Data over a number of periods and indicators are presented as the position of BBCi Food, more so than other genres, has fluctuated quite considerably over the past year.

Figure 9-8: BBCi's share within the overall Food genre

Indicator (Period)	BBCi Food (% share of total)	BBCi Food ranking	Top sites (excl BBCi)
Visits (April 2003)	9.9%	1	Waitrose.com Atkins Nutritionals Coca-Cola UK
Visits (February 2003)	14.1%	1	Waitrose.com Delia Online UK Food
Visits (August 2002)	8.7%	1	Waitrose.com Kellogg's UK Delia Online
Pages (April 2003)	12.7%	1	Atkins Nutritionals Food n Drink Sainsbury's Recipes
Pages (February 2003)	19.2%	1	UK Food Sainsbury's Recipes Food n Drink
Pages (August 2002)	10.4%	1	Kellogg's UK Food n Drink Delia Online
Average of above	12.5%	1	

Source: KPMG estimates based on Hitwise data (August 2002, February 2003 and April 2003)

9.3.3 Food: BBCi's position in narrower markets

The above analysis is based on a definition of the market which includes a diverse range of Food content sites from corporate sites to drinks sites and from listings sites to recipe sites. The key question which arises, therefore, is whether all of these should actually be included in the same market as BBCi or whether the market should be narrower.

The first category is Corporate Food sites. We consider that these should be excluded from the Food Content market definition as they are not really in competition with BBCi. They are using the Internet to promote single products or the wider company, predominantly for marketing purposes.

Another popular type within the Food genre are sites which provide a guide to restaurants and bars in certain areas, listings of restaurants or the facility to book tables (e.g. search.5pm.co.uk). These are not considered to be in the same market as BBCi Food, being more akin to travel and leisure genres. Finally, we have also excluded all pure Beverage sites from the market definition (although most of these are already excluded being commerce, corporate or listings sites).

The result of narrowing down the genre, by excluding Food promotional sites, Food Commerce sites and pure Beverage sites is a market share for BBCi of approximately 17.3%.

Another alternative way of defining this narrow market is to consider sites which have similar offerings to BBCi. As the BBCi site is structured around the provision of online recipes we have used this to define the market. Under this definition, the market share of BBCi rises slightly to 21.2% as shown in Figure 9-9.

The table also summarises BBCi's market share when estimates are made using the alternative Nielsen//NetRatings dataset. Out of 47 popular Food sites in the KPMG/Nielsen//NetRatings custom sample, BBCi accounts for 24.7% and 21.0% of page views and time spent respectively.

Figure 9-9: BBCi's share within narrower Food genres

Market definition of Food genre	Indicator	BBCi market share	BBCi ranking
Food only (excluding Beverage, Corporate and Booking/Listing sites)	Visits ¹	17.3%	1
Food only (recipes sites only)	Visits ¹	21.2%	1
KPMG/Nielsen//NetRatings Food sample (47 of the most popular recipe focused sites)	Page views	24.7%	1
	Time	21.0%	1

Source: KPMG estimates based on Hitwise data and Nielsen//NetRatings (UK Home Panel, Quarter to March 2003)

Note: ¹ Average of 3 months (Aug 2002, Feb 2003 and April 2003). Demand for BBCi Food has fluctuated significantly from month to month.

The above analysis does not include shopping sites as they are within the Commerce market definition. However, some e-commerce shopping sites have recently started to provide recipes (e.g. Sainsbury). As this is evidence of supply-side substitution, it could be argued that these should also be included in the market. There is also a close link between Commerce and Content as users drawn to the supermarket sites can be direct or indirect via food content sites such as Delia Online.

The impact of including these sites is a significant decline in BBCi's market share to around 3% for share of time and page views respectively¹²¹. However, we consider that home shopping sites should not be included when estimating market share for the following two reasons.

Firstly, Content is only one small aspect of the activities of most food Commerce sites, rather than their core purpose. Secondly, from the Hitwise and Nielsen//NetRatings data it is not possible to disaggregate user demand between the Content and Commerce parts of the site.

¹²¹ Nielsen//NetRatings Home Panel, Quarter to August 2002.

As demand to the Commerce parts of these sites is very much higher than the Content part, inclusion of these sites tends to distort the figures making the market appear very much more highly concentrated than it actually is. We have, however, analysed the developments in e-shopping to ensure that all BBCi's impacts, both direct and indirect, are examined thoroughly.

To summarise, BBCi's market share in the overall Food content market is approximately in the range of 10%–15%. BBCi also competes in a narrower Food content market which revolves around the provision of online recipes. When the market is defined in this way the market share is just over 20%.

9.3.4 **Food: Barriers to entry**

Most of the significant barriers to entry in the Food genre occur in the Commerce arena. In this part of the online food genre, the major food supermarkets have invested heavily in online technology and fulfilment capabilities, which has created a high barrier to entry. Any new entrant or incumbent in this genre would also have to invest heavily in these areas to adequately compete.

Part of the reason for major food supermarkets being in the online market is to enhance brand. However, as food supermarkets already have well-established brand names and a high reputation as retailers of food, this imposes a significant barrier on pure (greenfield) new entrants, who will need to spend significant amount of time and money to break into the market.

Other commercial players in this market have used the popularity and fame of an existing chef to build an online business not reliant on home shopping revenues. Once again this has created a barrier to entry to new entrants as there are a limited number of 'branded' personalities that could be exploited.

9.3.5 **Food: Impact of BBCi**

The main revenue source in the Food genre is online food shopping. BBCi does not have any direct negative impact on this market. There is some anecdotal evidence from other websites that some users actually use food content websites to gather information and then go onto the supermarket websites to undertake online shopping.

BBCi publishing food recipes online could potentially have an indirect impact on sites attempting to charge for recipes, if its free content is the same or very similar. However, since there is an abundance of recipes available free of charge on the Internet, a site would only be able to charge if it could sufficiently differentiate itself (e.g. for new exclusive recipes from a famous chef).

For instance, Delia Online has differentiated itself against other food websites by providing its 'Christmas Countdown' promotion in December 2002 and, more recently, 'Family Feasts', where users pay to view new Delia Smith recipes¹²². We have not identified other significant examples; the market therefore seems to be unproven, so it is not clear whether BBCi has an impact. That Delia Online has introduced paid-for content means that BBCi has not stopped the market developing.

¹²² The website charges £4.95 for access to this exclusive content, with payments being collected via BT's Click&Buy secure micropayments site.

BBCi also provides some external links to competitors within this genre, which may reduce BBCi's impact on the marketplace.

Other impacts are described below:

- Costs – No specific impact is noted on costs.
- Investment/innovation – Major investment and innovation is in online food shopping. BBCi does not impact upon this investment.
- Consumers – Food content websites provide consumers with more information to plan their eating habits, in preparing food and so on. BBCi has a positive impact in educating consumers on food matters. Consumers are then free to buy their foods from commercial firms.
- Market structure – The market (outside online shopping) is fairly fragmented, and would probably remain so without BBCi.

9.4 Health

9.4.1 Overview of the online Health market

Online Health is a broad genre which includes health and medical information, diagnostic tools, physician consultations, retail pharmaceuticals, insurance as well as fitness and beauty information and products. The most accessed health resources online are those for general health information¹²³.

There are two main reasons for considering the Health genre as a case study. First, television and radio programmes about health (issues, dramas or documentaries) are quite popular. The BBC received very positive feedback from its NHS-themed day of programming in 2002. Second, the Health market has financial potential now, but also more so in the future due to an ageing affluent population. Users seeking health information online will be attractive to healthcare industry retailers, advertisers, and sponsors.

BBCi provides information on various diseases, patient resources, health and medicine in the news. It also offers interactive content and community features such as a life expectancy quiz, message boards, moderated chats, and tools (including a calorie counter and body mass index calculator). Some of the common features within this genre are:

- consumer health information: reference information, advice on illness, health support groups and databases on diseases;
- consumer health lifestyle: Slimming, fitness, body-building, diet and nutrition;
- business – medical information: sites run for medical and health-care practitioners by medical institutions, professional bodies and public and private sector agencies in areas such as clinical governance, clinical trials and medical bibliographies;
- business – policy and administration: sites targeted at running the health service (e.g. public bodies focused on health policy, professional bodies, corporate sites, job vacancies and careers sites).

The commercial side of the Health genre generally focuses on consumer health information and consumer health lifestyle. The sub-genre of diet and slimming is a particularly significant component. Most portal sites focus on general health information.

The key revenue stream in this area is e-commerce. Popular products sold are health and beauty goods, fitness products and health related travel packages (spa holidays, for example).

There are examples of subscription revenue models, such as that offered by Internet pure-play edietsuk.co.uk. Other less common revenue streams are advertising and sponsorship, licensing and pay-per-use/pay-per-download/micro-payments (although this is becoming more commonplace for professional medical information).

¹²³ On average, 54% of online healthcare consumers use general health information websites. The second most popular sites are hospitals/doctor/medical institution websites. Source: 'Online Healthcare Communities: Opportunities for Accessing Consumers', Datamonitor, September 2001.

Public sector provision such as nhs.uk or doh.gov.uk is also strong within this genre. Some public sector sites offer health information and advice to the consumer, while others centre on medical practitioners and health care professionals. A significant proportion supply information to both consumers and the business sector.

9.4.2 **Health: Market definition and BBCi's position**

According to the standard Hitwise Health genre, BBCi's market share ranges from 1.4% to 1.9% depending on indicator (page views, visits) and month of survey (Feb 2003, April 2003). Key figures are summarised in the table below.

Figure 9-10: BBCi's share within the overall Health genre

Indicator / Period	BBCi Health (% share of total)	BBCi Health ranking	Top sites
Visits (April 2003)	1.9%	7	eDiets UK Wellbeing UKBabyworld
Visits (February 2003)	1.8%	9	eDiets UK Wellbeing UK Babyworld
Pages (April 2003)	1.4%	13	Babyworld Weight Watchers UK Wellbeing UK
Pages (February 2003)	1.4%	12	Weight Watchers UK Wellbeing UK Babyworld

Source: KPMG estimates based on Hitwise data (February 2003 and April 2003)

9.4.3 **Health: BBCi's position in narrower markets**

The health market is a very fragmented and diverse market, appealing to both the consumer and the health-care professional and administrator. The health market could therefore be classified in a number of narrower ways than the above rather broad classification.

In particular, the content appears to divide into consumer health and business health. There are also further distinctions (albeit less clear) within these categories. Within consumer health there seems to be the separation between health information and health lifestyle. The business sector divides into sites designed for the practice of medicine and sites designed with the running of the health service. These all could be viewed as separate markets, and so as a precaution we have treated them as such.

BBCi's Health content is focused on medical information for the consumer rather than health lifestyle or appealing to medical practitioners and/or administrators. We have therefore calculated BBCi Health share under this narrow definition, which results in a market share of 3.6%. This compares to 2.9% under the wider definition of consumer health (i.e. including health lifestyle) as shown below.

The table also shows the results of analysis of the Nielsen/NetRatings survey data used for validation purposes. Out of the 60 popular Health sites in the KPMG/Nielsen/NetRatings custom sample, BBCi accounts for 4.9% and 4.7% of the

page views and time spent respectively. BBCi Health therefore has a relatively low market share.

Figure 9-11: BBCi's share within narrower Health genres

Market definition of health genre	Indicator	BBCi market share	BBCi ranking
Health: Consumer information	Visits	2.9%	6
Health: Consumer information (excluding diet and fitness sites)	Visits	3.6%	4
KPMG/Nielsen/NetRatings Health sample (around 60 most popular consumer health focused sites)	Page views	4.9%	6
	Time	4.7%	4

Source: KPMG estimates based on Hitwise data (February 2003 and April 2003) and Nielsen/NetRatings (UK Home Panel, Quarter to March 2003)

BBCi Health reaches 5.3% (page views) and 3.6% (time) in terms of the Nielsen/NetRatings Home-Work panel. Detailed demand indicators for popular sites are given in Appendix A.

9.4.4 Health: Barriers to entry

Barriers to entry vary depending on the type of health site. The sub-segments which have higher barriers are the professional medical information sites, which require very specific and scientific content, and the online pharmacies, which operate under inconsistent and evolving regulatory guidelines.

Brand plays an important role for many online strategies. Consumers view this as crucial, as high quality and reliable information is essential in this genre. In some ways, this is why many successful providers of health information are public sector sites or organisations with strong reputations (e.g. NHS). These sites provide a certain level of assurance and are highly trusted. Brand is a tremendous strength for BBCi Health, as filtering the plethora of information is a concern for consumers. They want assurance that information is accurate. The BBC brand gives them a level of confidence.

Other key barriers for players who want to enter this market include:

- access to content. In particular, the ability to manage large amounts of content as the Internet now offers an unparalleled amount of medical information to the average person. Previously, much of this information was difficult to find and often only accessible to healthcare professionals or through specialised medical libraries.
- quality of content. In response to the rapid rise in popularity of health-related websites, and concerns over the quality of online health-related information, the European Commission recently released a new set of quality criteria for websites providing such information¹²⁴. The standards were developed as a consensus among healthcare specialists, governments, international organisations and website users, and may go on to form the basis of codes of conduct within Member States.

¹²⁴ 'New EU guidelines for e-health websites', Europemedia, 17 December 2002.

- the regulatory environment. The number of policies and laws regulating this genre is quite large and currently in a state of flux. Awareness of these regulations and associated management and implementation of appropriate procedures is therefore a barrier to new entrants.

Although these final four issues impact on both incumbents and new entrants, they are particularly significant for smaller and niche sites. Smaller sites typically do not have the economies of scale to manage large amounts of content or to respond efficiently to changing regulations.

9.4.5 **Health: Impact of BBCi**

BBCi's health site is consumer focused and as such, its content is significantly different to that of professionally oriented sites which often charge for content through subscription, pay-per-use, and licensing. The sites which are making money directly from paid-for content are the niche-oriented such as eDiets.com which offer greater depth of content and services within that niche. BBCi does not currently compete in these niche sub-segments.

BBCi does, however, compete directly in the consumer health information category. But it still has a relatively low market share ranging from 2% to 5% depending on whether the genre is defined in a broad sense (all of health information) or more narrowly (excluding health lifestyle). As a consequence, there is unlikely to be any significant impact on advertising revenues, which in any case are small in this genre, predominantly accruing to portal and/or top 10 sites.

While BBCi Health provides many external links to agencies and organisations within the health sector, there are no links to commercial sites such as wellbeing.com. Therefore BBCi is unlikely to have a significant positive impact on the commercial market.

Other impacts are described below:

- Costs – No specific impact is noted on costs.
- Investment/innovation – BBCi has minimal impact on investment and innovation within the genre. The primary changes occurring in online health are in the medical profession sub-segment (Business-to-Business) within which BBCi does not operate. BBCi offers general health content for informational purposes to Internet consumers not for medical purposes. The Government (NHS) is investing, developing, and expanding its online offerings and we can assume that it will continue to do so. In addition, pharmaceuticals and other companies looking to sell medical products online will continue to explore and develop their web presence as a cost of doing business in the modern age, at a minimum, or as an actively targeted new sales channel. These activities will not be deterred by BBCi.
- Consumers – With respect to consumers, BBCi provides trusted information which is relied upon for currency and accuracy but it tends to be only one of many online sources for consumers.
- Market structure – The market is very fragmented with many different types of players, and BBCi does not impact upon the market structure.

9.5 **Film**

9.5.1 **Overview of the online Film market**

The Film genre on the Internet appeals to a wide cross-section of consumers in parallel with film and cinema in the traditional marketplace. Total users for the Film genre during the quarter to March 2003 were 4.0 million (one in five users). Page impressions were 232 million¹²⁵.

Revenue sources are wide and growing with sales of cinema tickets, DVDs, videos, magazine subscriptions and movie merchandise all currently possible from some film websites (e.g. Empire Online). As technology and connection speeds continue to improve, pay-per-view and downloading content are becoming more prevalent – new business models are evolving.

In the traditional marketplace the BBC brand in the Film sector is strong. For many years the BBC has broadcast the UK's most popular film review programme.

For all of these reasons, we have selected Film as one of our genre case studies.

Some of the most common features of websites in the film genre are:

- general film information including film/celebrity news;
- film reviews (user-generated, original and reproduced/digested);
- trailer downloads;
- cinema listings/search facility;
- e-commerce facilities (mainly DVD sales).

Many of the most popular sites are American, reflecting Hollywood's dominance of the global movie industry. Single film websites attached to blockbusters such as Lord of the Rings or Harry Potter are also popular. The websites of commercial cinema chains offer a range of content, and often provide the opportunity to purchase tickets online. Most newspapers or broadcasters with a significant online presence cover the film genre, as do most portals.

The market is relatively fragmented. The top ten sites in the genre comprise around one third of visits to film genre sites¹²⁶.

9.5.2 **Film: Market definition and BBCi's position**

The BBCi Films website includes reviews of theatrical films and DVDs, film news, celebrity interviews, a cinema search facility, a message board and an opportunity to view trailers.

The standard Hitwise Film genre definition includes a diverse set of Film sites including cinemas, official (single) film sites, sites providing downloadable short films, audiovisual hardware reviews and others. While many of the sites include an opportunity for e-

¹²⁵ Nielsen//NetRatings case study, Home Panel, quarter to March 2003.

¹²⁶ Hitwise/KPMG, February 2003.

commerce (e.g. to purchase DVDs), pure ecommerce sites such as Amazon are not included in the analysis.

We consider that all sites which offer Film content should be included in the relevant market and any site which offers ecommerce only should be excluded. Whether to include cinema websites, which sell cinema tickets as one of their primary purposes, is a difficult issue. Such sites are very popular, and most of them contain content on the films (e.g. synopses) together with film listing times (also a feature of other film sites such as BBCi and Guardian). However, their cinema listing information is not comprehensive – it only contains listings for cinemas within their chain. They also offer the opportunity to purchase cinema tickets. Research by MORI (see Appendix B) suggests that the two types of content users are most likely to expect to find on film websites are film information/reviews and cinema details/listings. Therefore we have not excluded cinema websites from our overall analysis.

Sites containing downloadable short films and hardware review sites have not been excluded from the initial overall analysis as their impact is negligible. They have been excluded from the more detailed analysis of BBCi's position in narrower markets in the next section.

Therefore, an initial estimate of BBCi's market share in the overall Film Content genre is given in Figure 9-12. BBCi's position and share were relatively stable over the period. The most popular sites are also relatively consistent (although the popularity of certain specific sites such as Harry Potter will fluctuate depending on film releases).

Figure 9-12: BBCi's share within the overall Film genre

Indicator (Period)	BBCi Films (% share of total)	BBCi Films ranking	Top sites
Pages (April 2003)	0.7%	28	IMDB Harry Potter UK Odeon
Pages (February 2003)	1.0%	21	IMDB Odeon Harry Potter UK
Visits (April 2003)	1.0%	20	IMDB Harry Potter UK Warner Village Online
Visits (February 2003)	1.2%	17	IMDB Warner Village Odeon
Average of above	1.0%	22	

Source: KPMG estimates based on Hitwise data (February 2003 and April 2003)

9.5.3 **Film: BBCi's position in narrower markets**

Recognising the diverse demands of users, we have conducted further analysis of the film genre market in several ways. This enables us to estimate BBCi's market share¹²⁷ within the following categories:

- total film genre (adjusted to exclude sites such as hardware reviews and those which only offer the opportunity to view short films);
- general film information;
- theatrical reviews;
- theatrical reviews written for a UK audience;
- UK cinema listings/search facility.

Note that there are inherent difficulties in estimating market share in these narrower categories. We are unable to disaggregate the use of BBCi Film into the various categories. Therefore, for example, a user who has visited BBCi Film to find out which cinemas are showing a particular film will also be included in our market share analysis of sites which carry film reviews. However, this is also true of any site which contains different types of film content (e.g. Empire Online).

With these limitations in mind, our analysis gives BBCi a market share of between 1.4% (in all of the film genre, adjusted as described) and 17.3% (amongst sites which carry theatrical reviews written for a UK audience) as shown in Figure 9-13 (overleaf). In the latter category, BBCi comes second only to Empire Online. (Note that this does not take account of the many sites attached to UK newspapers which carry film reviews, but do not have dedicated websites for Film.) US-based sites which carry theatrical reviews and which attract more visits than BBCi include Yahoo! Movies and Rotten Tomatoes. It should be noted that while some users prefer to read reviews written for a UK audience, the release schedules for major films and the US-dominated nature of the film industry mean that US-based film review sites provide strong competition to UK-based sites (the US sites will often review films before their UK counterparts).

In cinema listings/search, many of the cinema chains' websites attract more users than BBCi Films, as does Cinemas Online. Guardian Film and Film Four also provide this facility, although their share is not as high as BBCi Film.

In the overall film genre (adjusted as described), BBCi's site is outside the top ten. The most popular film website is The Internet Movie Database, although it has limited overlap with BBCi Films. BBCi's position in the Film market is explored in greater detail in Appendix A.

¹²⁷ In terms of visits as measured by Hitwise, February 2003. The analysis was not repeated using pages or in a different period as the results were relatively stable over the period reviewed. The BBC has a slightly larger share of visits than of pages viewed, so this analysis should determine the largest possible measurement of the BBC's market share.

Figure 9-13: BBCi's share within the Film market

Category	BBCi Films (share of visits)	BBCi Films ranking	Top three sites
Hitwise genre definitions:			
All film websites (adjusted)	1.4%	14	Internet Movie Database Warner Village Online Odeon Cinemas
Narrower market definitions:			
General film information	2.6%	6	Internet Movie Database Yahoo! Movies Cinemas Online
Theatrical reviews	6.6%	4	Yahoo! Movies Rotten Tomatoes Empire Online
Theatrical reviews written for a UK audience	17.3%	2	Empire Online BBCi Films Guardian Film
Cinema listings/search facility	4.6%	7	Warner Village Online Odeon Cinemas Cinemas Online

Source: KPMG estimates based on Hitwise data (February 2003)

9.5.4 **Film: Barriers to entry**

Many small scale and amateur sites feature among the top 100 film sites, indicating relatively low barriers to entry. However, a review of the most popular sites indicates common characteristics which suggest that there are barriers to attaining significant market share.

Most have extensive compelling content (e.g. Internet Movie Database, Cinemas Online, Empire Online) – the scale of content required to attract users is a significant barrier. Others are offshoots of popular film or cinema brands (e.g. Odeon, The Matrix) – the brands, the marketing expenditure and access to exclusive content (e.g. clips of forthcoming films/interviews) all constitute barriers to entry.

9.5.5 **Film: Impact of BBCi**

In terms of revenues, we consider that an adverse impact on advertising revenues as a result of BBCi's presence in the Film genre is unlikely. It is a fragmented market, and BBCi (with its relatively low market share) is not taking significant numbers of users away from any particular website.

However, BBCi is one of few significant players with dedicated Film websites that provide theatrical reviews targeted at a UK audience. Within this "sub-market", assuming that there is a demand from UK users for reviews from a UK perspective, then BBCi is likely to be diverting users from using Empire, Guardian Film and Film Four.

While BBCi does not take advertising, these additional users could potentially generate some additional advertising revenue for the commercial UK sites. However, given the

low levels of advertising revenue directed at niche sites (i.e. compared to the major portals), we consider that there is unlikely to be a significant impact on the revenues of the commercial sites.

Advertising alone is not a sustainable business model, hence all of the UK commercial film sites also offer (at least) the facility to purchase DVDs (either directly or through a partner). BBCi does not offer this facility and we do not consider that there is an adverse impact on transaction revenues of competitors – if users wish to purchase a DVD online after reading about films on BBCi, they will visit one of the commercial sites. MORI research (see Appendix B) indicates that 80% of all users have not made an impulse purchase online in the last year, indicating that BBCi is unlikely to have a significant adverse impact on e-commerce revenues as a result of diverting potential users of commercial sites to the BBCi website. Any potential adverse impact would also be mitigated by the 15% of bbc.co.uk users who, within the past year, have purchased a product or service from a non-BBC website after reading about it on BBCi's website.

Other impacts are described below:

- Costs – No specific impacts are noted on costs.
- Investment/innovation – The main aim of commercial players is to build a platform from which to exploit commerce opportunities – cinema tickets, video and DVD sales and merchandising in the near term, VOD and PPV in the medium to long term. BBCi commands a small market share in this relatively fragmented genre and does not have the compelling and extensive access to content to compete with larger commercial players; investment and innovation by competitors, based on these current and potential revenue-generating opportunities, is unlikely to be affected by BBCi.
- Consumers – BBCi is not restricting choice for consumers. Film is a popular genre and it will continue to be covered by the majority of generalist websites (such as portals and newspapers). As discussed above, the revenue streams of specialist film websites are not significantly affected by BBCi's presence – therefore BBCi is unlikely to have any adverse impact on the decisions of commercial operators to start or continue film websites. BBCi potentially adds to consumer choice by providing a UK-based, non-commercially-focussed alternative to existing sites, especially in a genre where so many of the popular sites are US-based.
- Market structure – The Film market as a whole is fragmented – BBCi has a limited impact on the market structure. If BBCi was not present, the market structure would not change.

9.6 Music

9.6.1 Overview of the online Music market

The Music genre has been analysed as it is one of the most popular revenue earners on the Internet. It is also an area where the BBC has a strong presence in the TV and radio markets. The music genre has been the subject of frenetic activity in recent years, as major record companies have struggled to gain control over the exploitation of their intellectual property on the Internet. The genre is extremely wide as it encompasses:

- physical music retail (e.g. CDs);
- digital music downloads (free and paid-for);
- music/radio/video streaming (free and paid-for);
- music news/non-audio content.

Ancillary businesses such as concert ticket and merchandise sales are also connected. As already discussed, some sites offer more than one of these services. Therefore a site which contains both music news and the facility to purchase CDs will be competing against a news-only site and also a commerce-only site. However, the news-only site is not competing against the commerce-only site, as consumers would not regard one as a ready substitute for the other.

Within the music genre, there are a number of sites which provide a broad range of features, and others (more numerous but usually less popular) which concentrate on a particular niche (e.g. information on a particular band). Within some of these niches, particular sites have attained relatively high levels of popularity through the depth of their content, even if they do not provide a broad range of features (e.g. mp3.com or A-Z Lyrics Universe). Those providing a broad range of features are often linked to offline brands such as MTV or NME. Many generalist sites (such as online newspapers or portals) on the Internet also contain a music section.

The most frenetic activity has been in the area of downloads – there have been increasing moves to begin charging for music downloads (further detail is given in Appendix A). Many sites which offer downloads also offer the opportunity to listen to streamed music online. Streamed music is perishable; it cannot be stored and replayed later. For this reason, streamed music is generally much cheaper than downloadable music (much of it is free). It may be time-limited in order to encourage purchase of the music. Many radio stations stream their entire output live on the Internet, also free of charge.

Music news represents a further segment of the music genre. This includes pictures, reviews and archive information. There is a plethora of music news available on the Internet from many sources; the most popular music news websites in the UK tend to be UK-based, reflecting linguistic and cultural differences with other countries. Official single-band/artist websites can reach levels of popularity equal with or greater than the major music websites. Websites providing music news largely derive revenues from advertising, sponsorship, commission on CD or concert ticket sales (they will often provide links to online retailers) and ancillary services such as mobile ringtone sales.

The music genre market is highly fragmented compared to other genres on the Internet. The top 10 sites in the genre comprise less than one fifth of visits to music genre sites¹²⁸.

9.6.2 Music: Market definition and BBCi's position

BBCi has a number of music properties including BBCi Music, sites which accompany its national music radio stations and Top of the Pops. BBCi provides a range of music news and streamed audio content, including specialised music shows and some concerts and sessions (generally available for the week following broadcast), a selection of archive sessions and samples of songs (e.g. Top 40). There are no downloads available via BBCi (only streamed content) and it does not sell any music. There are many links to external sites. Therefore, BBCi provides a broad range of musical content across its portfolio of music sites.

We have defined the market as excluding pure e-commerce sites, such as 101cd.com. Hitwise excludes such sites from its music category. Content sites such as nme.com which have an e-commerce aspect (it includes the facility to purchase CDs) are included. Hitwise calculates BBCi's combined share of the music genre as follows:

Figure 9-14: BBCi's share within the overall Music genre

Indicator / Period	All BBCi music sites combined share (share of pages, visits)	All BBCi music sites combined ranking	Top sites
Pages (April 2003)	3.9%	1	Mxtabs.net BBCi Radio 1 MTV Online
Pages (February 2003)	4.4%	1	Mxtabs.net BBCi Radio 1 MTV Online
Visits (April 2003)	6.0%	1	BBCi Radio 1 NME Mxtabs.net
Visits (February 2003)	6.1%	1	BBCi Radio 1 MP3.com NME

Source: KPMG estimates based on Hitwise data (February 2003 and April 2003)

BBCi has a larger share of visits than of pages viewed, but the shares are broadly consistent over the period reviewed. The Hitwise definition of the music genre includes a broad variety of music sites such as mxtabs.net (aimed at guitar players), cdcomplete.com (which allows online indexing of CDs) and audioreview.com (reviews of hi-fi equipment). For the period and method which gave BBCi the largest market share (February 2003, share of visits), we carried out further analysis, described in the next section.

¹²⁸ Hitwise/KPMG, February 2003.

9.6.3 Music: BBCi's position in narrower markets

From the Hitwise share analysis, we excluded sites aimed purely at musicians (e.g. mxtabs.net) and other sites which are more peripheral to the music genre such as hardware reviews. This gives an estimate of BBCi's combined share in the overall music genre (as adjusted) of 7.5%. The most popular BBCi site, Radio 1, has a share of 3.6%.

Also, recognising the diverse demands of users, we have analysed the music genre market in several more ways. This enables us to estimate BBCi's market share¹²⁹ within the following (narrower) categories:

- music news/information;
- charts;
- databases of music/artists;
- gig listings;
- song lyrics.

As we noted in Section 9.5.3, there are inherent difficulties in estimating market share in these narrower categories; data measurement techniques do not provide for the disaggregation of usage statistics into the various categories. Therefore, for example, a user who has visited BBCi's Top of the Pops site to read song lyrics will also be included in our market share analysis of sites which carry charts. The problem is common to all sites which contain different types of music content.

This gives BBCi's sites a combined share of between 6.4% (amongst sites which contain song lyrics) and 18.3% (amongst sites which carry gig listings). The most popular music site overall is BBCi Radio 1. Other notable players in the market who offer a similarly broad offering to BBCi include nme.com, Launch Yahoo! and MTV Online.

¹²⁹ In terms of visits as measured by Hitwise, February 2003.

Figure 9-15: BBCi's share within the Music market

Category <i>Sites which contain...</i>	All BBCi music sites share of visits <i>(Top BBCi music site & share of visits)</i>	All BBCi music sites combined ranking <i>(Top BBCi music site ranking)</i>	Top three sites
All music websites (adjusted)	7.5% <i>(BBCi Radio 1: 3.6%)</i>	1 <i>(1)</i>	BBCi Radio 1 mp3.com nme.com
Narrower market definitions:			
Music news/interviews	14.4% <i>(BBCi Radio 1: 9.2%)</i>	1 <i>(1)</i>	BBCi Radio 1 nme.com Launch Yahoo!
Charts	15.7% <i>(BBCi Radio 1: 10.8%)</i>	1 <i>(1)</i>	BBCi Radio 1 mp3.com nme.com
A database of music/artists	15.8% <i>(BBCi Radio 1: 10.9%)</i>	1 <i>(1)</i>	BBCi Radio 1 nme.com Launch Yahoo!
Music reviews	16.3% <i>(BBCi Radio 1: 14.4%)</i>	1 <i>(1)</i>	BBCi Radio 1 nme.com Launch Yahoo!
Gig listings	18.3% <i>(BBCi Radio 1: 16.1%)</i>	1 <i>(1)</i>	BBCi Radio 1 nme.com MTV Online
Song lyrics	6.43% <i>(Top of the Pops: 6.43%)</i>	4 <i>(4)</i>	A-Z Lyrics Universe Launch Yahoo! Lyrics.com

Source: KPMG estimates based on Hitwise data (February 2003)

BBCi's position in the Music market is explored in greater detail in the Appendix.

9.6.4 **Music: Barriers to entry**

The presence of sites such as A-Z Lyrics Universe among the top ten music websites indicates that a site does not need to be backed by big business, linked to an offline brand or have the benefit of a large marketing budget in order to attain significant market share. However, as in other genres, the key to the popularity of such sites is the depth of content they provide (A-Z Lyrics Universe has the lyrics of more than 40,000 songs) – attaining this scale of content may be a barrier in itself.

An additional barrier to entry in the online Music market may be the access to attractive content. Major record companies have begun to reassert control over the exploitation of their intellectual property online. The power of the major record companies and the sites that they control (or endorse) is likely to increase at the expense of smaller sites in the highly fragmented music genre market.

9.6.5 **Music: Impact of BBCi**

There is no direct impact on advertising revenue as BBCi does not accept advertising. Its low market share also makes an indirect effect unlikely (BBCi is not taking significant share from any individual website). It is also worth noting that advertising revenue is not significant in this market – as a sole source of revenue, it has proved to be an unsustainable model.

Paid-for content in this market is mostly subscription-based, giving users the right to download a particular volume of music. It is unlikely that BBCi is impacting upon these subscriptions as it does not provide any downloads which can be stored and replayed, only streamed music. Most streamed music on the Internet is available free of charge at the moment; that which is paid for is much cheaper than music which can be downloaded and stored. In addition, much of BBCi's streamed content is time-limited. That which isn't is BBC-recorded material (e.g. archive sessions) which is unavailable elsewhere. Therefore there would appear to be no impact on the revenue of competitors. If, in the future, streamed music stops being generally free of charge, and BBCi continues to offer a similar range and quality of streamed music free, there could be an impact on those businesses attempting to charge for it.

BBCi does not offer a music purchase facility so there is no direct impact on transaction revenues (e.g. sale of CDs). The only potential adverse impact would be on an impulse purchase that does not occur due to the user browsing a BBCi music site as opposed to a commercial one that offers e-commerce in addition to its content. BBCi's low market share and the fragmented nature of the market would make the impact on an individual site negligible. In addition, as described in Section 9.5.5, MORI research (see Appendix B) indicates that 80% of all users have not made an impulse purchase online in the last year. BBCi could even be encouraging sales; users who visit BBCi to read about or listen to music have no choice but to visit a commercial site if they wish to purchase that music. The MORI research also indicates that 15% of bbc.co.uk users have, within the past year, purchased a product or service from a non-BBC website after reading about it on the BBCi website.

Other impacts are described below:

- **Costs** – BBCi has not sought to purchase exclusive online rights to concerts to webcast them (although there may be occasions where BBCi was already broadcasting the material on free-to-air television or radio and it has sought to simulcast them online). Where online rights are purchased as part of a package of rights including broadcast rights, the value which could be attributed to the online rights would be minimal (if consumers already have free access via radio or television, there is not a great deal of value in the online rights). Therefore it is unlikely that BBCi is having an inflationary impact on the cost of the rights to online music.
- **Investment/innovation** – BBCi's lack of impact on the revenue streams and costs associated with music websites makes it unlikely that its presence has influenced commercial investment decisions.
- **Consumers** – Consumers may benefit from the additional choice provided by BBCi's music websites. Their enjoyment of music on BBC radio and television may be enhanced by the additional content available via BBCi's websites.
- **Market structure** – The market structure is largely unaffected by BBCi's presence. Without BBCi, it would remain fragmented.

10 **BBCi's position and impact in other relevant markets: Search, Chat and Advertising**

This section examines BBCi's position and impact within other relevant markets. We consider Search, Chat and the Advertising market.

Search

BBCi Search currently has a small market share. After 10 months of operation, it has a reach of 5%, compared to the market leader Google with 66%. It is too early to determine what position BBCi Search will ultimately claim, particularly given Google's rapid rise from obscurity to the top in little over two years. To date, BBCi Search is unlikely to have had any significant impact upon the market.

Chat

BBCi has a low market share and is therefore not attracting users away from competitors' sites. Advertising and subscription revenues are unlikely to be affected by BBCi's presence as Internet Chat is generally free. Where subscription services exist, these are generally to adult or highly niche subject areas – where BBCi does not compete.

Advertising

BBCi both stimulates Internet usage by directing users to other parts of the Internet and takes market share from other sites, especially in the News and Sport genres. The key question is whether the BBC's presence on the Internet impacts online advertising revenues.

Our research has suggested that Internet advertising expenditure (in total) is based on fixed budgets rather than "eyeballs". However, it is possible that, as for other media, "eyeballs" may be a key driver (i.e. if more users are viewing websites which carry advertising, then companies will increase their online advertising budgets). We have not identified an Internet advertising elasticity with respect to "eyeballs", so have estimated the impact using the television equivalent.

Therefore, BBCi is expected to reduce the online advertising market by up to £5 million per annum, around 2.4% of the total. This is an upper bound estimate as there are a number of non-quantifiable factors which are likely to reduce this impact considerably. The TV market is a well developed, widely researched and highly sophisticated medium. The Internet equivalent eyeball elasticity is likely to be much less than the TV elasticity and possibly zero. BBCi also encourages people onto the Internet more generally which could even turn the negative impact into a positive one.

10.1 Search

10.1.1 Introduction

Once online, search is a crucial tool to aide the user's journey. It allows the user to access information available on the Internet in the most efficient way. The functions of a search engine differ from company to company. Some act as a walled garden, some are directories where websites pay for a listing. Others have added paid-for services such as dedicated researchers to answer specific questions. The term "search engine" is often used generically to describe both crawler-based¹³⁰ search engines and human-powered directories¹³¹.

The creation of value in search is in the introduction of the consumer making the search, and the ultimate destination site(s) that fulfils that consumer's needs. The intermediary search engine websites (and the companies which supply software and technology to support the search) extract value from making this connection.

10.1.2 Overview of the online Search market

Search is a significant part of the online business environment and is notable because it is profitable and continues to grow. It is also dynamic with the relative market shares changing significantly – Google has come from nowhere to be the market leader in the past two to three years, taking share from the major portals along the way. A recent report demonstrated the popularity of search among Internet users – it suggested that approximately 90% of the US online audience use Internet search services each month, conducting about 6 billion searches¹³². Furthermore, a recent study in the UK showed that three quarters of Internet users rely solely on search engines to find information on the web¹³³.

Increasing profitability has come from the growth of paid placement, following on from paid inclusion. Paid inclusion ensures that a website is simply included within the search engine's database; paid placement allows websites to pay for placement or priority within the search results rankings. Payment methods vary between companies – they may be a flat annual fee or on a per-click basis. Often the payment is made by the websites to an intermediary company (e.g. Overture Services, Espotting) which then supplies these listings to the search website (passing on a share of the revenue).

In addition to listings, search results pages also include other promotional messages e.g. banner ads, links along the side. These are additional revenue streams for the search website. However, if a search website's results are deemed to be so commercially

¹³⁰ Crawler-based search engines, such as Google, create their listings automatically; they "crawl" or "spider" the web. Page titles, body copy and other elements all play a role in how a site is listed. These search engines generate revenues from licensing their search technology or selling their search results and from accepting paid advertising.

¹³¹ A human-powered directory, such as Yahoo!, depends on manual input for its listings. Content providers submit a short description to the directory for their site, or directory editors write one for sites they review. A search looks for matches only in these descriptions. Changing web pages has no effect on their listing if the description remains unchanged. Directories generate revenues from charging for listings and advertisements.

¹³² 'The Internet Search Market', Salomon Smith Barney, 1 October 2002.

¹³³ 'BBC prepares UK Plc for e-commerce explosion,' M2 Presswire, 29 April 2003.

corrupted that the website loses its integrity or reputation for quality and relevance, consumers will 'vote with their mouse' and change their choice of search website.

The rest of the world is slightly behind the USA in terms of search revenues. However, given the recent growth in revenue and profitability in search in the USA, international investment in search is expected to continue in the expectation that international search revenues will follow the USA's example.

The largest players in the search market in the UK are American companies with significant international operations. Key players in search in the UK include Google, Ask Jeeves, AOL, MSN and Yahoo!. Google, the market leader, offers a targeted search engine that indexes and ranks websites according to the number of links leading to that site. Google also licenses its technology to more than 100 companies (including its competitors Yahoo! and AOL). The company continues to innovate, having recently launched Google News which compiles news automatically from thousands of news sources. It has also entered the paid listings market with AdWords Select.

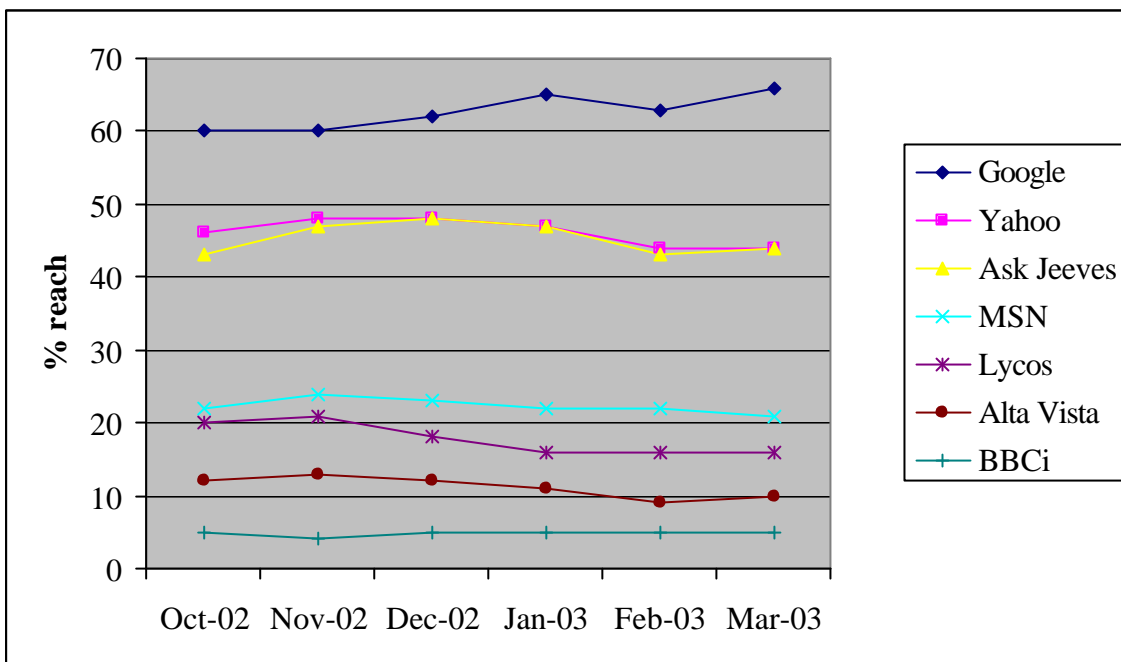
Prior to the arrival of Google, Yahoo! was the market leader in the UK. It operates primarily as a directory, but also allows a full search of the Internet using Google technology and editorial content. Yahoo! is one of the longest-established Internet brands. Over the years, it has expanded its business from a search engine/directory into a portal and ISP. AOL and MSN both provide a search facility as part of their overall portal/ISP offering. Ask Jeeves is not a portal, but its innovative natural language search query functionality has allowed it to attain a reasonable position in the search market. It also licenses this technology to other companies.

10.1.3 **Search: Market definition and BBCi's position**

BBCi Search was launched in May 2002. It can be accessed from the BBCi homepage, and most pages on the BBCi website. It enables simple searching of the BBCi site, or the Internet. The Internet can be searched completely or with a UK focus. There is no advertising involved so that the search results are editorially independent and are based solely on the search words provided. However, the results are filtered for obscene content. A number of external websites are "BBCi Recommended" which means that they are considered to have useful content and are technically sound.

Given its recent launch, it is unsurprising that BBCi Search is behind all the major players in terms of reach among UK home Internet users. After 10 months of operation, BBCi Search has a reach of 5%, compared to the market leader Google with 66%. It is too early to determine what position BBCi Search will ultimately claim, particularly given Google's rapid rise from obscurity to the top in little over two years.

Figure 10-1: Reach of search engines among UK Internet users aged 15+



Source: BMRB Access/BBC, March 2003.

10.1.4 Search: Barriers to entry

Companies that provide the technology and the editorial content which underpin Internet searches are willing to license their expertise and their services to third parties. Therefore there is no inherent barrier to entering the online search market, other than access to capital. The rise of Google suggests that brand is not a barrier to entry – Google has done very little traditional marketing. However, in order to achieve significant market share in an already crowded market among powerful players such as AOL and MSN (which can already rely on significant portal traffic) a new entrant would need significant differentiation in terms of its offering (as Google did with its website ranking technology, or Ask Jeeves with its natural language search query technology).

Search engines continue to try to differentiate themselves from each other in order to gain customer loyalty. The ease of switching means that investment and innovation must be continued for a leading search engine to maintain its position. Google’s addition of its news service, automatically generated several times an hour by searching thousands of news sources, is a good example of this. This also demonstrates one of the eternal dilemmas for search engines – the better and more efficient they are, the sooner users will leave the search engine for the destination site.

A continuing trend is the desire to achieve credibility and a reputation for quality in the consumer’s mind. Google’s extremely strong reputation for the efficiency and quality of its editorial results has encouraged others such as Yahoo! and AOL to license Google’s technology and database. An issue for these companies is that by doing this, they have further enhanced the reputation of Google’s brand. This increases the risk that users will bypass Yahoo! or AOL completely to go direct to google.co.uk.

10.1.5 **Search: Impact of BBCi**

Search revenues are primarily through advertising (and associated revenues such as paid listings/placement, which are effectively forms of advertising). Should BBCi Search obtain significant market share it is possible that search engines (and associated companies) that lose share to BBCi would see decreased revenues.

BBCi Search is unlikely to have any impact at present, being such a relatively small player.

Other impacts are described below:

- Costs – No specific impact was identified on costs in this market.
- Investment/innovation – Competition is intense and switching is very easy for users. Therefore, search engines need to continue to invest and innovate to maintain their position. BBCi's relatively novel proposition (family-friendly, UK-focussed, independent) may encourage others to invest and innovate to maintain or strengthen their position.
- Consumers – Consumers have a genuinely new choice in search engines with the knowledge that BBCi Search listings are independent of advertising, UK-focussed and filtered to exclude offensive content.
- Market structure – The market is already relatively concentrated. BBCi, with its small market share, has not had any impact on the market structure to date.

10.2 Chat and message boards

10.2.1 Introduction

Chat and message boards are an important aspect of the online market. These services are ideally suited to the Internet in their rapid, interactive nature. Chat, with its real-time connection, is particularly distinctive, whereas message boards have a closer relationship to standard content.

10.2.2 Overview of the online Chat and Message Board markets

It is difficult to gauge the size of the chat market in the UK, but a 2001 study¹³⁴ estimated the number of “chat room” facilities available to users in the UK to be over 100,000. Message boards are a ubiquitous feature of the Internet, with boards appearing on sites of all types and genres.

The major players in the chat and message board markets are the portals such as Yahoo!, MSN and AOL. Broadcasters and content aggregators such as Guardian Unlimited and Channel 4 is also experimenting with chat and message boards. A number of niche chat-only sites also play in this relatively fragmented market.

Chats and message boards from broadcasters and content aggregators are often themed, e.g. “live chat events” round a particular issue, article, programme or personality. Those from major portals are often much more general in nature, and are often described as “chat rooms”.

A Nielsen//NetRatings survey suggests that a significant proportion of Internet users (16%) participate in chat rooms¹³⁵. In the UK, this represents approximately 4 million users.

Chat and message board services are not usually seen as revenue generation opportunities in themselves. However, by increasing the time users spend on the site and their level of engagement, this may increase advertising revenue on the site. Chat and message board services may also be part of a larger proposition for which subscription is charged, e.g. AOL. Some adult chat sites also charge subscription.

10.2.3 Chat and Message Boards: Market definition and BBCi's position

BBCi provides both synchronous chat and asynchronous message board services but 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 users¹³⁶.

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 consumers.

¹³⁴ ‘ChatWise – Children and Internet Chat Services’, Internet Crime Forum, March 2001.

¹³⁵ ‘Nielsen NetRatings survey shows e-mail still most popular online application’, Internet Business News, 10 May 2002

¹³⁶ BBC, May 2003.

Given that millions of people are regularly participating in Chat on the Internet, and BBCi has just hundreds of users, it is clear that BBCi 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).

Message boards themselves bear a stronger resemblance to standard content. They are available for all to see and they are preserved (in contrast to the transitory nature of synchronous chat). On BBCi, message boards are effectively user-generated content that has been moderated by the BBC. They can be subdivided into genres, as with standard content. In fact, usage of BBCi message boards within a particular genre (such as News) will be reported and recorded as usage of that particular part of the BBCi site (i.e. news.bbc.co.uk). BBCi's position within the message board market in a particular genre is therefore likely to be closely connected to its overall position in content in that genre. We have considered BBCi's overall position in various genres and the market impact of BBCi's presence in those genres elsewhere in this report.

10.2.4 **Chat and Message Boards: Barriers to entry**

Chat and Message Board services are relatively easy to set up, as demonstrated by the very large number of websites offering such services. However, without additional content to attract users to a particular site, it may prove difficult for a stand-alone chat site to generate a significant user base (and therefore any meaningful revenue streams). In contrast, the major portals have a lot of compelling content and other attractive services such as Search and Email.

Chat and Message Board services are also seen as vital ways for a website to interact with its audience, distinguishing the Internet from other media. They increase 'stickiness' (by engaging users in this interactive manner, sites can retain users for longer periods of time) and loyalty, fostering a community feeling around the website.

10.2.5 **Chat and Message Boards: Impact of BBCi**

We consider BBCi's impact is as follows:

- Revenues – It is unlikely that advertising and subscription revenues associated with chat services and message boards are affected by BBCi's presence. The majority of Internet chat services and message boards are free. BBCi's operations on the fringe of the chat market mean it is not diverting significant numbers of eyeballs away from competitors' sites and therefore is unlikely to be impacting advertising revenues. Subscription services are generally to adult chat or highly niche subject areas – BBCi is not competing against these.
- Costs – No specific impact was identified on costs in these markets.
- Investment/innovation – As BBCi's low user base and niche offering in chat makes it unlikely to be affecting revenue streams, it is also unlikely that BBCi is affecting investment.
- Consumers – Consumers may benefit from BBCi's chat and message board services. They may welcome the constant presence of a moderator to expel disruptive participants from live chat or censor offensive postings to bulletin boards. BBCi is

also offering users an opportunity to extend and enhance their enjoyment of the BBC's offline services.

- Market structure – BBCi's low market share means that the market structure is unlikely to be affected by BBCi's presence.

10.3 Advertising

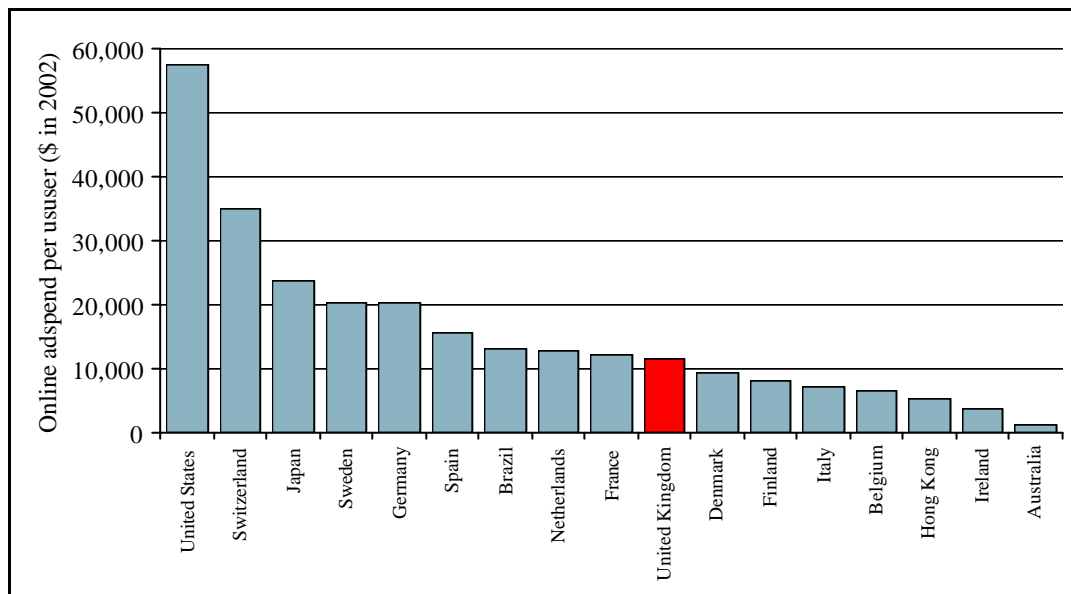
10.3.1 Overview

This section discusses in more detail the potential impact which BBCi has on the advertising market. While we do not have direct evidence of the impact we have the following statistics as a starting point:

- the total UK advertising market is approximately £197 million. Of this around 80% goes to the top 10 players (i.e. approximately £158 million)
- out of the top 10 players only BBCi accounts for 7.6% of time online and 6.4% of page views¹³⁷ (i.e. and average of 7.0% based on these two indicators).

The question which follows is whether the UK market is smaller as a result of BBCi. The chart below shows that advertising expenditure per user is considerably smaller than the US, but closer to the average for the sample of countries.

Figure 10-2: Comparison of online advertising expenditure per Internet user by key countries (2002)



Source: Zenith Media, "Advertising Expenditure Forecasts" July 2001 (forecasts of 2002); International Telecommunications Union

The above graphical analysis shows that the UK advertising market per capita (Internet user) is much smaller than the US and slightly smaller than other European countries. However, it is not possible to determine whether this smaller market is as a direct result of the presence of BBCi or other factors. We therefore turned our attention to estimating the impact through the use of elasticities.

¹³⁷ Nielsen//NetRatings, Quarter to February 2003 – see Figure 5-1.

10.3.2 Estimating BBCi's impact on the Internet advertising market

If a simple assumption is made, that all of BBCi's 7% share of the top 10 market is lost advertising to the online market, or at least displaced to other offline media, then BBCi's impact on the advertising market is to reduce it by approximately £16 million.

However, this is too simplistic a view of the relationship between eyeballs and advertising. A more sophisticated estimate can be made with reference to the estimates of the elasticity of demand for advertising with respect to eyeballs.

We have not identified a direct Internet advertising elasticity with respect to eyeballs. However, elasticities in the television advertising market are widely reported, and so we have employed this elasticity to estimate the impact BBCi could have on the Internet advertising market. The next section sets out the likely relationship between the television and Internet advertising elasticities.

10.3.3 Internet advertising versus television advertising

The demand for television advertising is the most responsive advertising medium to changes in audiences (compared to radio, print, outdoor, Internet etc) owing to its stage of development and established buying and selling process. It is bought and sold on the basis of commercial impacts or "eyeballs". To this end, a sophisticated measurement system has been developed and provided by suppliers to BARB. While there are acknowledged shortcomings of the system¹³⁸, commercial impacts represent the currency in which television advertising is traded.

Internet advertising on the other hand is a relatively new medium and therefore does not have a track record commensurate with television nor such a sophisticated and tried and tested measurement system. Indeed, there are a number of key characteristics of Internet advertising which strongly indicate that the demand responsiveness to "viewers" is likely to be undeveloped at this stage:

- Internet advertising is often sold based on the number of 'click-throughs'. However, the number of advertising page impressions (the number of times the advertisement is shown) is irrelevant as the media owner will have to show as many ad impressions as necessary in order to meet the agreed number of 'clicks' or 'sales'.
- although it is true that buyers also often buy on a cost per thousand page impression basis this no guarantee of a certain number of viewers. The number of unique users that it takes to generate a thousand page impressions depends on the nature of the website. For example, some websites are click-heavy and require the user to pass through a number of pages before reaching their destination - thus generating a large number of page impressions. Other websites present the user with the required content on the first or second page.
- there are currently no universally accepted audience measurement systems for the Internet. Where online advertising is bought on a cpm basis it is often based on the media owners own measurement. There are various tools used to measure impressions and subtle differences exist between the methodology used. There is

¹³⁸ For example, some viewers leave the room during commercial breaks without informing the monitoring technology.

currently no BARB equivalent and so it is very difficult to determine how a particular site's audience is made up. Many sites conduct audience profile research in order to create a picture of who their viewers are (age, demographics, preferences etc), but again methodologies vary so comparison is impossible.

Intuitively therefore, Internet advertising is likely to be much less responsive to impacts (or eyeballs) than is television. Consequently therefore, we would expect the demand for Internet advertising to have a smaller "eyeball" elasticity than television¹³⁹.

10.3.4 Elasticity of demand for television advertising

The television elasticity most widely used is that estimated by Professor David Hendry¹⁴⁰. While this study is over 10 years old, the ITC considers that compared to other estimates (e.g. studies referred to by the Competition Commission in its assessment of the proposed mergers of Carlton, Granada and United¹⁴¹, such as those commissioned by ITV and advertising agencies) it is both impartial and the most econometrically robust. Indeed, in its assessment of the likely impact of BBC3 on the television advertising market¹⁴², the ITC employed the Hendry elasticity. The Competition Commission also adopted the Hendry analysis in its report on the Carlton/Granada/UNM mergers.

In terms of the range of estimates:

- the *price* elasticity of demand estimated by Hendry ranges from -2.4 (long-run) to -4.3 (short-run)¹⁴³. This translates into an advertising revenue elasticity in response to changes in the supply of impacts in the range of 0.42 to 0.23¹⁴⁴ (i.e. if impacts fall by 10%, television advertising revenues fall by 4.2% to 2.3%, respectively);
- if the BBC's view of the price elasticity is adopted, then the resulting revenue elasticity with respect to impacts is 0.5.

10.3.5 Impact of BBCi in the Internet advertising market

Based on the above range of television elasticities (0.23 to 0.50), the estimate of BBCi's impact on the advertising industry ranges from around £2 to £6 million. The calculation steps are summarised below.

We consider Hendry's long run elasticity to be the most suitable overall estimate. This gives an impact of around £4.6 million (2.4% of the total online advertising market). This means that BBCi does have a small, negative impact on the advertising market.

¹³⁹ We have not been able to identify estimates of the elasticity within the public domain.

¹⁴⁰ 'An econometric analysis of TV advertising expenditure in the United Kingdom', DF Hendry, 1992.

¹⁴¹ 'Carlton Communications Plc and Granada Group Plc and United News and Media Plc.', Competition Commission, 2000.

¹⁴² Independent Television Commission (ITC).

¹⁴³ The BBC in its submission on the commercial impact of BBC3 stated that it considers that the long-run price elasticity should not exceed -2.

¹⁴⁴ The advertising revenue elasticity with respect to impacts is the reciprocal of the price elasticity.

Figure 10-3: Estimates of the impact of BBCi on the online advertising market

Step	Description	Impact		
		Low	Medium	High
Input	Revenues to top 10 online companies	£ 158 m	£ 158 m	£ 158 m
Assumption	Estimated increase in size of 'commercial' top 10 market if BBCi did not exist	6.4% (page views)	7.0% (average)	7.6% (time online)
Assumption	Advertising elasticity	0.23	0.42	0.50
Calculation	Resulting BBCi impact (%) on advertising revenues (to top 10 online companies only)	1.6%	3.0%	4.0%
Calculation	Resulting BBCi impact (£) on advertising revenues (% impact on total advertising market)	£2.4 m (1.2%)	£4.6 m (2.4%)	£6.0 m (3.0%)

This above estimate is likely to be an upper bound for two reasons. First, the Internet equivalent eyeball elasticity is likely to be much less than the television elasticity and possibly zero.

Second, and more importantly, BBCi actually encourages people onto the Internet more generally, thereby increasing the overall number of Internet users. This latter effect is perhaps the most significant of all factors. Our MORI survey suggested that for 7% of UK users (1.5 to 2 million people) the existence of the BBCi website was one of the main reasons why they first accessed the Internet. Taking this factor into account turns the above negative impact into a positive impact. However, we have taken a cautious view of this latter effect and excluded this factor from the estimate.

11 Positive impacts of BBCi

BBCi has a number of wider impacts:

- Ensuring that a range of high quality content is available to UK users by setting high standards which act as a benchmark for the industry.
- Acting as a test-bed for innovation for all of the UK's online businesses. The BBC, not subject to commercial pressures, continues to innovate through continued investment and experimentation.
- Supporting the UK's independent multimedia sector through external spending on online services by BBCi (although the proportion of total spend is small).
- Helping to develop the UK's multimedia skills base through training staff in multimedia skills and support of industry training organizations.
- Encouraging millions of people online and providing tools to assist people in negotiating the online landscape.

11.1 Setting high standards

BBCi has set a benchmark for quality in the UK, ensuring that UK users have access to a range of high quality content. Setting high standards ensures that the competition will strive to innovate and exceed these. The result is more choice and a better quality experience for UK Internet users.

An article in the Guardian considered that “even the most rabidly commercial site owner would acknowledge that the UK new media scene would look very different were it not for BBCi. Without it, the UK would have few sites that could rival US behemoths such as MSN, AOL and Yahoo! in range, scope and ambition.”¹⁴⁵ While expressing concern about the scale of the BBC’s digital operations, the Daily Telegraph agreed that “the BBC site is superb. Smartly designed and easy to navigate.” It also commented that “much of the (BBC’s) online output is aimed at specific geographic or ethnic groups which might otherwise be overlooked, and there is certainly a strong public service aspect to many of the features.” As an example, the article highlighted Ouch!, the BBC’s website for people with disabilities. The article considered that Ouch! “manages to be informative and challenging without being overly patronising.”¹⁴⁶

The quality of BBCi is confirmed by the recognition the BBC has received in awards ceremonies in recent years. The US-based Webby Award winners are selected by members of the International Academy of Digital Arts and Sciences, and there is also a People’s Voice Voting section. These are the most high profile and prestigious international Internet awards. In 2002, the sixth year of the awards, the BBC picked up the award for the best news website in the world. Its Radio 4 website also triumphed in the radio category, being voted the winner both by the Academy and also the People’s Voice. The BBC was the only British winner at the 2002 Webby Awards¹⁴⁷.

This built on the BBC’s success at the Webby Awards in earlier years:

- BBC World Service won in the radio category in 2001;
- BBC News Online was also nominated in the news category in 2001;
- in 2000, Radio 1 Online won the People’s Voice radio award.

In the UK, the BAFTA¹⁴⁸ Interactive Entertainment Awards have been in existence for five years. Every year since its inception, BBC News Online has won the award for News. On its fifth consecutive victory, BAFTA commented:

“The depth of content that the BBC provides on its website is excellent and yet it is very easy to find whatever it is you’re looking for. There is a good combination of facilities with feedback areas and discussion groups. The multi-language support was felt to be a good thing as the site is accessed throughout the world. There is a good balance between written reports and use of other media – audio and visual.”

¹⁴⁵ The Guardian, 22 July 2002.

¹⁴⁶ Daily Telegraph, 25 October 2002.

¹⁴⁷ The BBC is also nominated in the Community, News and Spirituality categories of the 2003 Webby Awards.

¹⁴⁸ British Academy of Film and Television Arts.

The BBC's innovation and success was also recognised by nomination in several other categories in 2002:

- factual for its "Painting the Weather" website;
- online entertainment for Radio 1 Online;
- online learning for How to be a Gardener nominated;
- accessibility for Ouch!, the BBC website for people with disabilities;
- enhancement of linear media for Test the Nation;
- sports and leisure for RHS Chelsea Flower Show and World Cup Interactive.

When BBC History won the Factual award in 2000, BAFTA commented that the site was "a treasure trove bursting with interesting information, attractively presented and full of surprises. It is a teacher's dream and will bring the subject alive for many students, but it is also tailored to a wide range of audiences and capable of continually growing and expanding. It has a remarkable depth of content presented in a range of interesting and innovative ways".

BAFTA also awarded BBC Online the special award for Best UK Developer 2000 "in recognition of its work over the last five years. Starting with the pioneering endeavours of the BBC Networking Club and the Multimedia Centre... With its richness of well designed, educational content BBC Online is well deserving of the BAFTA Award."

11.2 Innovation and investing in people

"New technologies trigger rampant experimentation, by both companies and customers, and the experimentation is often economically unsustainable." This comment, by the renowned business strategy theorist Michael Porter¹⁴⁹, demonstrates the benefit of public organisations investing in innovative online services using public funding – experimentation is not always economically sustainable in the private sector. New Media Age commented in August 2002 that, "free from commercial pressures, the BBCi music and radio team has been able to be creative in an almost unfettered way."¹⁵⁰

The BBC also helps to support the independent multimedia sector in the UK. At a time when most businesses were cutting back their online spending, the BBC spent £4.8 million externally in the financial year 2001/2002. However, this represents a small proportion of total budget (less than 5%)¹⁵¹. There is no quota for the use of independents as there is, for example, in the television production sector.

The BBC provides training for its staff – it budgeted £600,000 for training across the BBCi division in the financial year 2002/2003. The BBC also recruits trainees via its New Media Training Scheme (four recruited in 2000/2001) and the Production Training Scheme, which includes multimedia placements (33 trainees are currently in multimedia placements). The BBC is also a major contributor to Skillset, the industry training organisation for the production sector.

¹⁴⁹ 'Strategy and the Internet', Michael Porter, Harvard University, March 2001.

¹⁵⁰ New Media Age, 15 August 2002.

¹⁵¹ Proportion of budget excluding central overhead apportionment is 6.6% (Source: BBC).

11.3 Encouraging people online

In the BBC's application for approval of its online services from the Secretary of State for Culture Media and Sport in 1998, the BBC stated that the service's objectives were:

- to act as an essential resource offering wide-ranging unique content;
- to use the Internet to forge a new relationship with licence fee payers and strengthen accountability;
- to provide a home for licence fee payers on the Internet and act as a trusted guide to the new media environment.

The BBC is encouraging the UK population online. 500,000 people visited the BBC Test the Nation website on the day the Test the Nation programme was broadcast on BBC1. 300,000 of those had never visited the BBC website before. Given the BBC's presence in the UK market, the presumption is that many of those users were Internet novices, encouraged to try the test and come online by the BBC promotion.

However, research suggests that, while the BBC does fulfil a role in bringing new users online, it is doing this for a relatively small proportion of the Internet population. MORI research¹⁵² indicates that the existence of the BBC's website was one of the main reasons why 7% of UK users first accessed the Internet. While this is a relatively small proportion of the Internet population, this still means that the BBC was a significant factor in bringing between 1.5 and 2 million individuals in the UK online¹⁵³.

An article in the Guardian in September 2002 portrayed BBCi as "the latest instalment in the BBC's 20-year-old effort to create a digital Britain. Twenty years ago, the launch of the BBC's computer literacy project and, with it, the BBC microcomputer, started the technological revolution in the UK... Two generations of schoolchildren have been introduced to the wonders of the digital age, inspired directly or indirectly by the BBC's original efforts."¹⁵⁴

While cautioning that the BBC must "start knowing where to draw the line", the Guardian stated in July 2002 that "the BBC has done more to get the UK population online than any other new media publisher in the country. Its one million-plus pages of content are rarely anything less than innovative and entertaining, and the fact that it regularly reaches one-third of the UK online population tells its own story."¹⁵⁵

The BBC is encouraging people to go and explore the Internet. A site survey of BBCi found links to at least 70,000 distinct domains¹⁵⁶, including at least one external link on most BBC News and BBC Sport pages. These links are usually to relevant official sites (e.g. to the website of a company which is in the news, to public bodies/organisations such as UEFA or to governmental sites). Apart from Food, there are not normally links to commercial competitors, e.g. to The Telegraph to read an alternative view of a story. However, these links are still encouraging further exploration of the Internet. MORI

¹⁵² See Appendix B.

¹⁵³ Based on UK Internet population of approximately 24 million.

¹⁵⁴ The Guardian, 19 September 2002.

¹⁵⁵ The Guardian, 22 July 2002.

¹⁵⁶ BBC.

research¹⁵⁷ suggests that two-thirds of BBCi users use these links within BBCi to visit other (non-BBC) websites.

BBCi provides facilities to assist Internet novices and inexperienced users. The BBCi WebGuide - a guide to "the best non-BBC websites" - includes hundreds of links to external websites, including many which are competing with BBCi (e.g. in the Film section, it includes links to IMDb and Guardian Unlimited Film). BBCi's WebWise site is "the Internet made simple by the BBC" - it includes a glossary of terms, answers to Frequently Asked Questions, guides to basics such as using email and an eight-stage online course for Internet beginners. However, WebGuide is not currently well used by BBC users. It only recorded 60,000 users out of a total of 6.6 million in the quarter to June 2002.

BBCi Search, by its nature, will lead users to other Internet sites (although there is an option to search only BBC sites). Although BBCi Search has not yet had a large uptake, its family-friendly nature may yet prove attractive for parents and children. The BBC's moderated chat and message board services may also give parents more confidence in allowing their children to surf the Internet.

The combination of all of these BBC initiatives to encourage people online and explore the Internet is bearing some fruit. MORI research¹⁵⁸ suggests that more than one in five UK Internet users (i.e. approximately five million people¹⁵⁹) consider that the BBC's website has introduced them to some of the different opportunities offered by the Internet.

Encouraging more British people online grows the universe of Internet users. This is good news for all companies operating websites aimed at the UK market. It increases potential e-commerce and transactional revenues. As the Internet becomes a mass market medium, it is likely that advertisers will switch more of their spend online from other media. Ancillary revenues arising from connection charges and consumer investment in hardware and software will also rise.

¹⁵⁷ See Appendix B.

¹⁵⁸ See Appendix B.

¹⁵⁹ Based on a UK Internet population of approximately 24 million users.