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Winning the Broadband TV Game

The holy grail of Internet TV is closer to becoming a reality, and the players who are making it happen are not cable TV providers or telecoms

by [Gary Morgenthaler and Herve Utheza](#)

The dream of watching both Internet video and regular TV programs on the same television is not as distant [as many observers fear](#) (*BusinessWeek*, 11/19/07). Despite the dust and confusion from the maneuverings of the major players in telecommunications—primarily content providers, cable and phone companies, television makers, and console producers—the outlook for Internet TV is getting clearer.

Within three years, it now appears likely that a full 40% of U.S. consumers will have some way of connecting their TV displays directly or indirectly to the Internet. Within five years, the percentage of such viewers will reach 70%, laying the foundation for a true mass market. Ironically, the prime beneficiaries of this shift won't be cable TV companies like Comcast ([CMCS.A](#)) or phone companies like AT&T ([T](#))—even though they're the ones pouring billions of dollars into building the high-speed bandwidth infrastructure that's makes this upheaval so unstoppable.

Cable's traditional business model, a "take-what-we-offer-you" approach to customers, is being undermined by consumer demand for an à la carte, "give-me-what-I-want-when-I-want-it" model. Meanwhile, the new subscription television services from the phone companies—even AT&T's, which is being delivered with Internet technology—are largely "me-too" products that compete with cable on cost more than on features. Moreover, phone company TV will require too much time to roll out on a broad scale to capitalize on the melding of Internet video with television.

We see a strong analogy between the present era and 1993. Back then, the phone carriers were talking loudly about the inevitable coming of the "information superhighway," with the speedier pipes they planned to lay playing the central role by linking everyone and everything. Little did they realize that the superhighway was already arriving over their slow-poke pipes, courtesy of Netscape, whose novel Web browser was helping people make sense of the Internet and creating a whole new marketplace.

PROGRESS ARRIVES FROM UNEXPECTED QUARTERS

Similarly, the drivers of the today's Internet TV revolution are coming from a direction the carriers have failed to foresee. They are arriving by stealth in the form of three Trojan horses.

First, Internet connectivity is quietly appearing on most high-end TV sets with the addition of Ethernet jacks by manufacturers such as [Matsushita](#), Sony ([SNE](#)), [Samsung](#) Hewlett-Packard ([HWP](#)), and [Philips](#). Initial uses of these jacks, for viewing family photos and home videos stored on a personal computer, are effectively opening a pathway between the TV and the Internet via the PC's broadband connection. From there, new uses will emerge. Exciting new TV features typically migrate over time to lower-cost models, so we expect the number of homes with Ethernet jacks on their TVs to reach at least several million over the next few years.

The second Trojan horse is the emerging hybrid delivery model: free, over-the-air, digital broadcasts combined with on-demand delivery of premium content over a home broadband Internet connection. This model, pioneered in Britain by [Freeview](#), connects TV and computer via a set-top box. It has won over nearly 13 million British households during the past three years, outpacing both satellite and cable providers. U.S. startups are working to offer a similar service that should prove at least as popular in this country.

However, it is the third Trojan horse—the video game console—that promises to make the biggest inroad of all. The latest generation of consoles already offers consumers both Internet access and the ability to display digital content on their TVs. At today's rapid rate of adoption, we expect there will be 35 million TV-compatible gaming consoles in American homes by 2010, representing about one-third of all households. That is a market!

Our conversations with gaming providers indicate that they are beginning to grasp the broader opportunity of becoming the prime intermediaries between all consumers (not just game players), the Internet, and their TVs. Gaming, after all, connects players not only to online communities but to in-game advertising and all kinds of commercial and entertainment possibilities.

CONSUMER CUSTOMIZATION WILL RULE

Taken together, broad-scale Internet access, new hybrid delivery systems, and gaming platforms will provide the foundational tools needed for widespread Internet-TV connectivity. The resulting incentives for content aggregators, their distributors, and new entrants to help consumers connect the few remaining dots will be overwhelming. If not Comcast, then Google ([GOOG](#)). If not Verizon ([VZ](#)), then Apple ([AAPL](#)). Or maybe Sony, [Nintendo](#) (companyid=), or Microsoft ([MSFT](#)).

And consumers will find themselves in a position to do what they do best. Consumers have proven time and again that they are highly skilled at arbitrating one service opportunity against another on the basis of pricing, ease of use, and the richness of content. In a few years, the typical Internet TV consumer will pay for a core palette of 10 to 12 channels drawn from a far wider range of both commoditized and customized content, both broadcast and narrowcast. The mixes will be infinitely varied and highly personal: NFL football, commodity news, bass fishing, physics lectures, home decorating tips, Jimmy Cagney movies—whatever.

Meanwhile, traditional everything-for-everyone content aggregation—the proverbial 500 channels with nothing to watch, packaged in two or three service tiers—won't do the trick anymore. That business model—still pursued by cable providers and even a surprising number of Silicon Valley startups—will suffer from both a lack of customer enthusiasm and an ever-tighter squeeze on profit margins by Hollywood content providers.

Indeed, Hollywood is now blessed with a plethora of ways to reach the audience, from traditional distribution channels like cable to online video streams and downloads. And by pitting those channels against one another, content providers may gain enough negotiating leverage to boost their share of distribution revenues from 60% to as high as 85%.

That's the future as we see it. The barriers that have long inhibited Internet-based TV are beginning to crumble. The TV manufacturers will win; the gaming companies will win; the best new platforms blending personalized and branded content will win; Hollywood will win; and consumers will win. And, unless they find ways to adapt very quickly, telecoms and cable companies will lose. Messy? Absolutely. The process will, we predict, prove to be another example of long technological gestation followed by abrupt, even breathtaking, change. This is "creative destruction" at its best.

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