McKinsey&Company

Telecommunications, Media, and Technology

iConsumers: Life online

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Contents

Why iConsumers matter

Consumers around the globe have rapidly adopted new digital technologies and incorporated them into their everyday lives. You only need to ride the Tube in London, walk the streets of New York, or sit in a café in Rio, to observe how quickly – and completely – so many people have put their mobile phones at the center of their day-to-day lives. And of course it doesn't stop with phones – as our global research shows, consumers the world over own and use a wide array of digital, Internet-connected devices and applications at home and on the go, and they're using them in ways that will shift hundreds of billions of dollars in economic value. For many complex, multinational organizations, recognizing and responding to these consumer behavior changes remains both a critical challenge and a competitive opportunity.

Through our global iConsumer research program, we have surveyed well over 200,000 consumers over the past few years to understand and quantify how their behavior and spending is changing across platforms (e.g., from PC to mobile to tablet), over time, and between key geographies. We have deep insight into how these consumers are communicating, consuming video in new ways, using social networks, playing games, and shopping both on- and offline.

In this compendium, we present a number of our recent findings and recommendations. We begin by exploring the opportunities in digital marketing and the role that digital and mobile tools play in the consumer's decision process. The implications for "brick-and-mortar" retailers are particularly acute, and we propose some of the strategies they can employ to win these mobile shoppers. For communications service providers, the value proposition is rapidly shifting from a voice-led offering to all-data, and we discuss the implications and opportunities for telcos. Moreover, as the next piece shows, online channels represent a substantial opportunity for telcos to both serve and sell to valuable segments.

The changes for traditional media players are equally profound: we investigate how they can operate in today's digital environment. Understanding the demographic and segment-level differences and how much more rapidly the youngest cohorts have integrated digital technologies into their communication and entertainment lives is the focus of our next article. We then review some of the major global changes – the emergence of a substantial African Internet class, the rise of the Brazilian digital consumer, and the complex usage of social networks by Chinese consumers. Such phenomena could shape the next generation of global consumer opportunities. Finally, we look into the upcoming changes for the video industry from OTT and other IP-delivered video to multiple different screens.

We hope you join us as we explore these sweeping changes and consider the sales, marketing, organizational, and operational challenges your business will need to address. We look forward to the conversations that will follow.

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1 Purchase portal: The Internet as the shopper's tool

By Eric Hazan and Nicola Wagener

Research confirms that the online channel is expanding in all product categories, particularly for consumer electronics and digital/mobile products. Companies – including telecoms providers – should address this new online buyer segment to tap a strategic source of growth and savings.

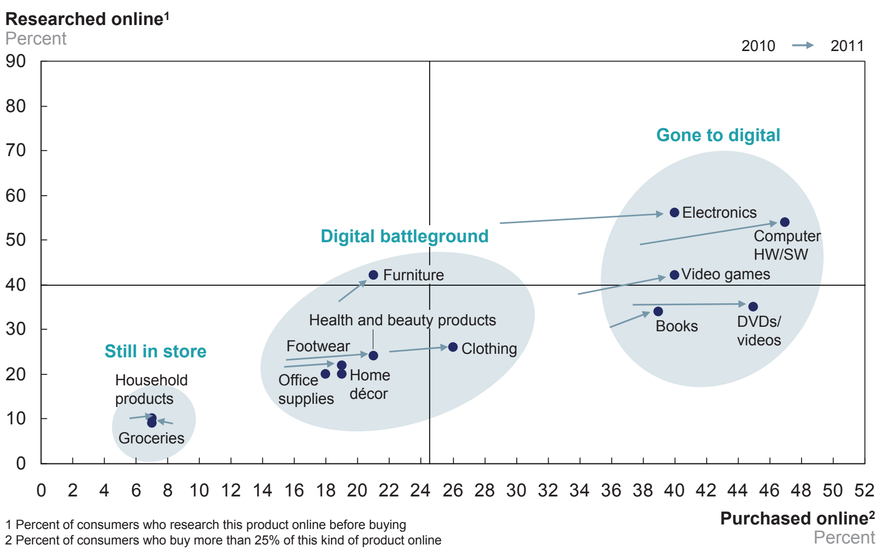
Increasingly, consumers research products online via computers and mobile devices prior to making any purchase decisions – especially when on the market for a mobile phone. To capture opportunities like these, companies require a comprehensive understanding of digital research and purchasing behavior – which is complex, involving a multitude of touch points. Once this is established, they should align their digital marketing strategies with these emerging usage patterns.

Digital marketing presents an open opportunity

The digital research and purchasing trend continues. Consumers have already gone digital when shopping for products in categories such as consumer electronics and mobile/digital goods. Some 60 percent of consumers report that they research these products online before buying them – and nearly half make more than 25 percent of their purchases online.

But product categories such as furniture, clothing, and footwear – once classic offline domains – are now also being researched and purchased in the digital space. This trend is expected to continue (Exhibit 1).

"Digital window shopping" is growing across all categories EUROPEAN AVERAGE



1 Percent of consumers who research this product online before buying
2 Percent of consumers who buy more than 25% of this kind of product online
SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 1

The number of consumers who use their computers to conduct online research within certain purchase categories has already seen a significant rise from 41 percent in 2010 to 50 percent in 2012. Over that same period, the number of consumers using mobile devices for product research has nearly doubled – from 12 to 21 percent. Both means of information retrieval are especially popular among consumers shopping for mobile phones. Nearly every second consumer searches for information online. Approximately one-third of them conduct mobile-device-based research before purchasing a new mobile phone.

Great differences, however, still remain between individual countries in Europe. The Netherlands leads the pack with 55 percent of Dutch consumers conducting computer-based research for a mobile phone and 43 percent using mobile devices to gather pre-purchase information. At the other end of the spectrum, only 33 percent of Polish consumers perform computer-based research for a mobile phone and only 9 percent of French shoppers use their mobile device for that purpose.

One new major disruption for retailers is the combination of traditional and digital research – the in-store use of mobile devices. More than 20 percent of consumers already use mobile phones for product research across all categories, and 40 percent of them do it right in the store – primarily to consult professional reviews and price comparison sites (Exhibit 2).

Consequently, companies across all industries hoping to capture the resulting growth opportunity will need to ensure that they offer their goods via the right channels – and that consumers can easily and quickly find what they are looking for. But this is easier said than done.

Mobile devices will be major new disruption for retailers

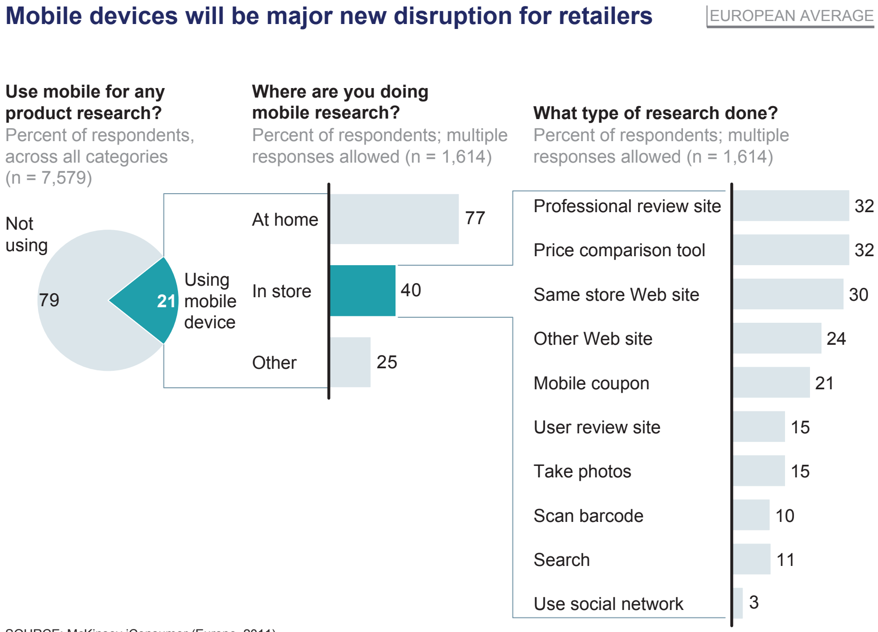


Exhibit 2

SOURCE: McKinsey iConsumer (Europe, 2011)

Consumers' digital purchasing journeys are becoming more complex

It's no news that the digital world is highly complex. Consumers are accessing multiple information sources (four on average) in their digital research. These range from search engines and commercial Web shops or retailer sites to user-generated videos and social content (Exhibit 3).

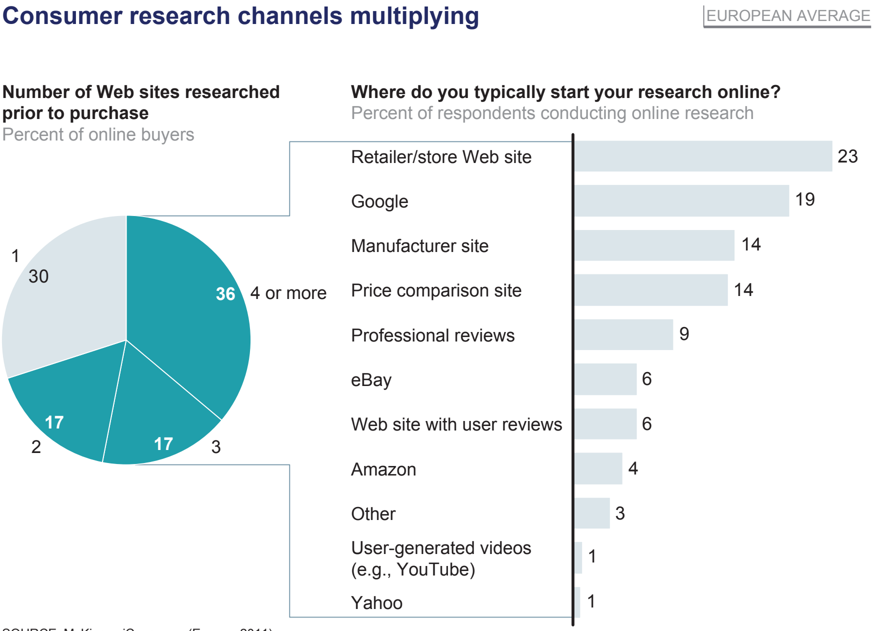
Adding to the complexity, consumer online journeys differ by customer segment, product category, and geography. For instance: the majority of British consumers (57 percent) use Amazon when searching for books, whereas the typical Spanish user would first conduct a search using Google. For footwear and household products, on the other hand, half of British consumers prefer to gather information from the retailer's Web site, while Spanish shoppers visit price comparison sites for their shoes. By and large, they perform no research at all on household products.

Once again, it is important that companies understand their customers well – not only to be able to provide the right information, but also to make it accessible in the right digital spots.

Capturing the opportunity: Aligning digital marketing strategies to current trends

Companies should develop a consistent strategy for addressing all of these fragmented new touch points – e.g., mobile- and computer-based online research, social networks, word of mouth, etc. – by investing in the most efficient ones and aligning messages across all platforms.

Consumer research channels multiplying



SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 3

The first element of this alignment is to invest marketing resources in the arenas where consumers spend their time. This means shifting investments from channels owned by other companies, such as print or online newspapers (paid channels), to those the brand controls, such as its own Web sites (owned channels), and customer-created channels, such as communities of brand enthusiasts (earned channels). Stores themselves are also among the owned channels that should not be neglected in a digital strategy (see text box, page 13).

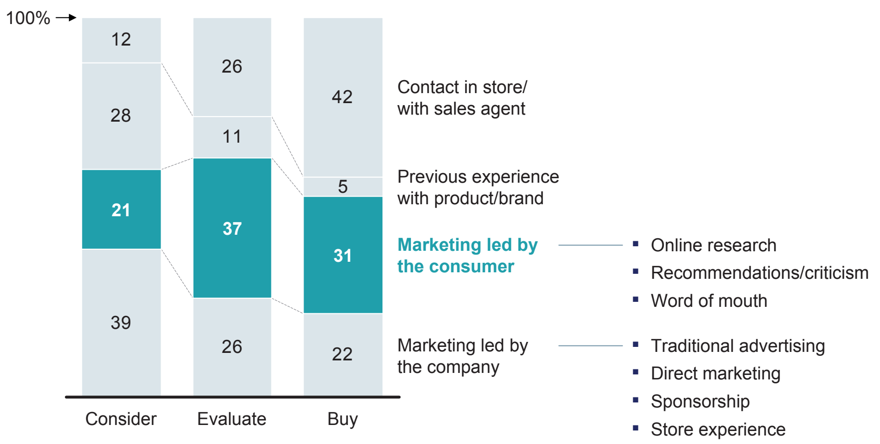
The second element is more internal and involves the coordination of messaging across all channels to ensure that they reinforce and do not contradict one another. Third, companies that develop direct, opt-in channels will increase their ability to deliver information to consumers. Some 20 percent of Facebook users now use the site to follow retailers in Europe (compared with 34 percent in the United States) and 23 percent of Twitter users rely on the service to follow brands or retailers or both. In particular, followers value the opportunity to stay up to date on promotions and to receive coupons. Companies should reinforce their presence on these channels, create fan pages or groups, and promote their products accordingly. Another strategic move would be to develop smartphone- or tablet-native applications, since 13 percent of customers now use their mobile devices as purchasing tools. The growing number of sites in the "earned channel" category is a rich source of information. By mining the content created by users and experts, companies can gain insights into consumers and brands, and use the data collected to create engaging content (Exhibit 4).

The final digital marketing element leverages targeted online marketing. Consumers are demonstrating an increasing preference for targeted advertising – and many view it as a service. For instance, 35 percent of online buyers are willing to share personal information in order to receive promotional coupons (Exhibit 5). Companies that invest in this channel have the opportunity to package and deliver marketing as a service valued by their customers and boost their sales at the same time.

Exhibit 4

Consumer-driven content is critical in creating high-impact marketing campaigns

The most influential touch points along key consumer decisions[1]
Percent



1 Consider: cars, insurance, mobile phone devices, and operators in the US; evaluate: insurance and mobile phone devices in the US; buy: insurance, cars, TVs in Japan, mobile phone devices and operators in the US

SOURCE: McKinsey

Mobile multiplier: The marriage of in-store and on-the-go shopping

The presence of mobile in the shopping experience is powerful and growing. Some retailers are reluctant to give way to its use, feeling the need to defend the turf of their brick-and-mortar stores. The reality, however, is that multichannel marketing is not a zero-sum game. Retailers can make six commitments to actually attract on-the-go shoppers to their stores and keep them buying once they are there.

- *Emphasize in-store value.* Mobile shopping has mass appeal, but retailers shouldn't lose sight of the unique advantages of in-store shopping. Mobile shoppers value the speed and efficiency of the digital channel, so retailers might promote the value of "same-day enjoyment" over "next-day delivery." The "buy local" movement is also growing, and the neighborhood store may have the advantage here over a faceless fulfillment center in the nether reaches of the Internet.

- *Make mobile core.* Brands need to optimize all channels that matter to their customers. Sephora-to-Go, for example, makes mobile shopping almost as fun as the in-store experience with an app that delivers special offers. Floor personnel actually encourage shoppers to download the mobile app and then explain its best features.

- *Offer unique products.* Nordstrom, Target, and Walmart offer one-of-a-kind items as well as private label merchandise and commodity products in distinctive packages. Introducing a unique product or brand can shield a retailer from the impact of price transparency that mobile creates.

- *Use digital as entry point.* Some large grocery chains and big box chains like IKEA and Target encourage customers to download digital coupons from their Web sites or Facebook pages for in-store redemption. This satisfies mobile users' inclination to use their smartphones in search of good deals.

- *Make mobile simple.* Brands' mobile sites should be just as easy to use as – if not easier than – their Web-based sites. Shoppers should be able to quickly find the product they're looking for and buy it with a simple click.

- *Think and act local.* A brand's prominence on national search engines like Google and Bing is only half of the strategy. Companies might consider having a real presence on Yelp or sponsoring local blogs popular among members of their target market. Walmart, for example, is building loyalty at the local level by managing Facebook pages for each of its 3,500 stores.

Mobile shopping is here to stay. It's time for retailers to mobilize to capture growth and profits, or risk being shut out for good. Strategies such as factoring mobile and social media into store design not only facilitate multichannel communication, but they renew stores' relevance and keep traffic flowing.

Online users are typically more interested in targeted marketing, which they consider a service

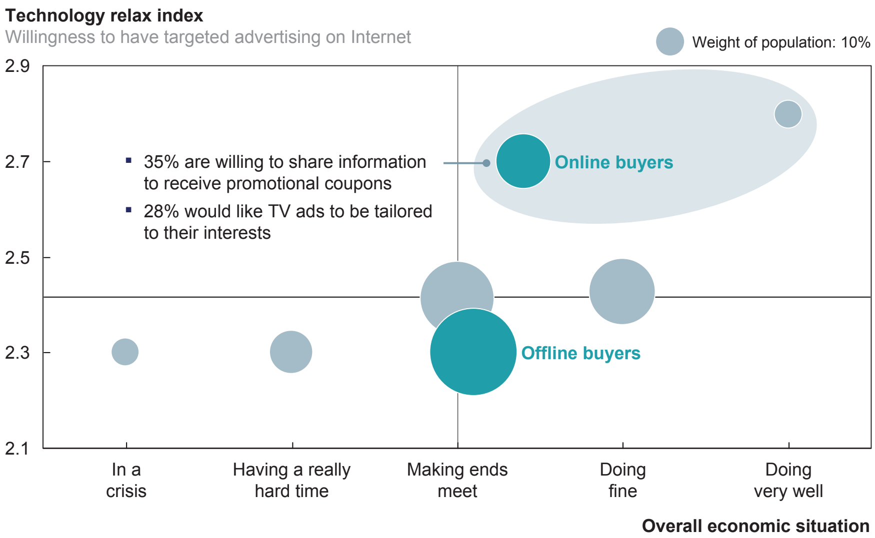


Exhibit 5

SOURCE: McKinsey

By specifying the right digital strategy and aiming it at the right customers, companies will surely find new sources from which to generate growth as well as new opportunities to serve current and potential customers. Some companies – including telecommunications players and retail giants – have already adopted these strategies and are well prepared to capture the digital marketing opportunity.

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It is clear that consumers are increasingly opting to "go digital" in their purchasing habits. Increased online and mobile-device-based retail research as well as social network usage have made it easier to access the latest product information. Companies have an opportunity to address new customer segments by refining their digital marketing strategy and taking advantage of new trends. Those that invest their marketing resources and align their messages accordingly will reach and connect with the most consumers possible.

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2 Profit paradox: Growing value and shrinking margins

By Eric Hazan and Piero Trivellato

Consumer communication patterns are evolving rapidly, driven by the combination of new devices and Internet heavyweights increasingly moving into the mobile arena. Although these shifts endanger mobile operators' monetization models to an ever greater extent, they are also opening up new opportunities.

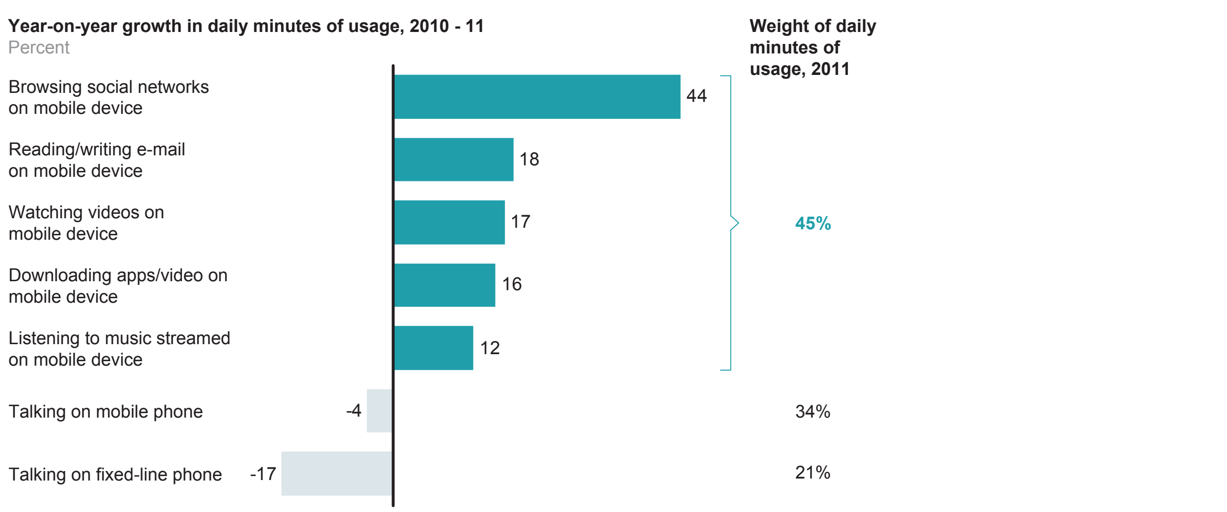
The last two years have brought major shifts in the ways Europeans use their communications devices (Exhibit 1). The average iConsumer admits to spending roughly half of his or her total (mobile and fixed) communication time on non-voice activities (social networking, e-mail, video/music, etc.) using mobile devices. Some of those activities have massively grown over the past year alone – social networking on smartphones and tablets, for instance, climbed a staggering 44 percent from a baseline that was already significant.

All evidence supports the assertion that people are communicating now more than ever. The difference lies in their medium of choice. As on-the-go e-mail, texting, and social network messaging gain popularity, live voice conversations on the phone are taking up less and less time. We have seen a reduction of 4 percent over the past year in time spent on mobile calls – for fixed, this was already a widely known trend.

While the growing reliance on smartphones is apparent, all devices aren't created equal. When it comes to monthly spend, the amount users shell out greatly depends on the operating system that drives their device. The category of usage also varies by operating system. Watching downloaded or streaming video and downloading apps, for example, is largely the domain of Apple's operating system (i.e., the iPhone). On the other side of

Consumers are more and more engaged with their mobile devices, but they're talking less

EUROPEAN AVERAGE



SOURCE: McKinsey iConsumer (Europe, 2010 - 11)

Exhibit 1

the coin, BlackBerry and Apple users are browsing social networking sites at rates disproportionately higher than their Android and Windows counterparts. Voice calling is – as could be expected – unrelated to the operating system.

User trends impact operators' ability to monetize

This evolution of consumer usage has significant implications for the ways telcos monetize their services.

Let's take a closer look at social media on smartphones. We have seen that social media usage is booming. This holds true in general, but even more so for mobile (Exhibit 2). One consequence of this rise is that people are using other communication tools much less. The problem for telcos is that they don't monetize this form of communication. The bytes required to send a message through a social media platform are a negligible share of the 0.5 or 1 GB per month that the average data plan allows. That same message sent via SMS – which is virtually all margin for an operator – would have been a profitable transaction. With Facebook as the interface, operators lose. And obviously, the threat to monetization can become much worse if Facebook and the other over-the-top players start to implement VoIP capabilities.

As countermeasures, operators are exploring at least three options.

Regulation. Operators are discussing with regulators the idea of having OTT players contribute to data network investments. Today, OTT players are able to monetize thanks to operators, but with no investment of their own.

Charging on top. A monthly fee for unlimited Facebook on top of a given data plan, for example, may be an attractive proposition for consumers who value the ability to send unlimited messages and have unlimited browsing privileges – especially when their perception of the amount of data required for this activity is unclear.

Bundling. The most effective (long-term) strategy is to migrate as many subscribers as possible into large voice+data+SMS bundles. This lets operators "anchor" ARPU and protect it against usage shifts inside the bundle. Proactively accelerating and pushing this, however, might come at a cost in the short term.

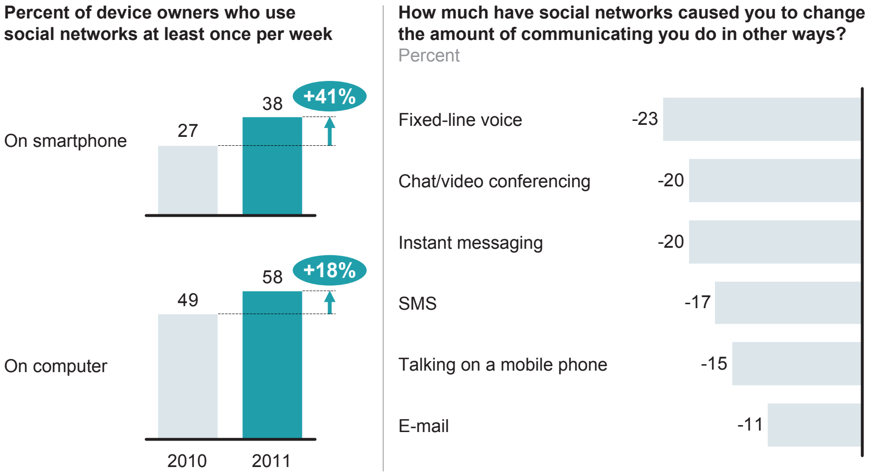
Smart data pricing

Apart from shielding traditional voice and SMS revenues from the data-driven threat, another challenge operators face is protecting the value of pure mobile data connectivity. Looking at the recent evolution of consumer price preferences, it appears that consumers are becoming increasingly polarized. When McKinsey evaluated the output of different conjoint analyses over time in one Western European market, for instance, such polarization became apparent.

At one end of the spectrum, it is confirmed that consumers are ready to pay more to have unlimited mobile data. At the other end, however, are the users who prefer a light usage package (0.5 to 1 GB) and are not prepared to pay more for data overages. In other words, it is tough to convince people to pay more for additional gigabytes beyond the

iConsumers' use of social networking has resulted in a decline in their use of other communication forms

EUROPEAN AVERAGE



SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 2

first. The good news: the same conjoint analysis shows that users would be willing to pay a premium for higher speed – a clear opportunity in markets where LTE/4G is on the way. One response to this may indeed be an attempt to monetize selected services on top of pure data connectivity. For example, while the idea of paying for additional bytes in general was met with resistance, conjoint analysis indicates a willingness to pay for specific data-driven services, e.g., Facebook, news, or maps.

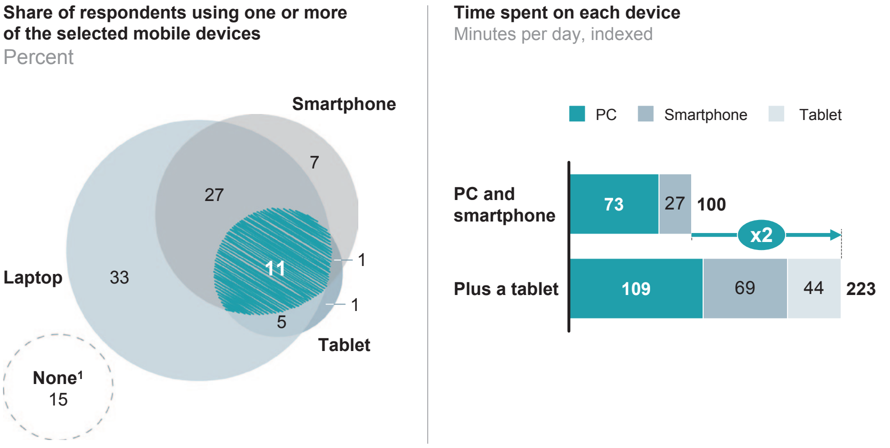
Practically speaking, this willingness to pay can be the basis for add-ons to a consumer's current data plan. One operator in the Netherlands, for example, has marketed the possibility for subscribers to access a leading OTT music distributor for an additional fee on top of their data plan. The partnership combines the billing relationship and commercial presence of the operator with the brand strength and the music library of the OTT player. Another example: Vodafone Italy includes one year of access to the digital edition of *Corriere della Sera* (Italy's top newspaper) in its tablet data plan.

The multi-device/multi-screen opportunity

The boom in tablet penetration – which has joined the smartphone as a mass-selling device – opens up new opportunities for pricing differentiation. An already substantial number of consumers have multiple devices with different configurations (Exhibit 3). Research shows a correlation between ownership of multiple devices and higher total time spent online. When a consumer adds another mobile device to his or her collection, instead of splitting the same amount of time across devices, usage actually increases.

Offers specifically targeting owners of multiple devices – for example, a large monthly data allowance that can be utilized across devices – can enhance ARPU and reduce churn by increasing stickiness. Matching data connectivity with content through partnerships can be a powerful proposition. We asked iConsumers if they would be willing to pay

A growing number of users have multiple devices, and more devices mean more time spent online



1 They access the Internet through a desktop

SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 3

more on top of their bill to be able to watch the same video content on different screens (TV, PC/laptop, smartphone, tablet, etc.): 32 percent are prepared to pay 10 to 20 percent more. An additional 22 percent would be willing to add 30 to 50 percent more to their current bill for the privilege of watching a single downloaded file on all of their mobile devices.

On the other hand, the technical capabilities required for multi-device billing are not trivial. Operators will need to develop the capacity to accommodate the complexity created by including multiple devices under a single data plan.

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Consumers of mobile technology are more socially connected than ever, but their modes of communication are shifting. What used to require a live voice call – an operator's bread and butter – is now being accomplished via messaging on social media sites, yielding almost nothing for operators in terms of revenues. To recapture profitability, operators can look to regulation, partnership, and pricing strategies that capitalize on the high degree to which users value data and their growing family of mobile devices.

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3 New news: Content providers and mobile media consumption

By Eric Hazan and Michael Lamb

Traditional media companies are fighting an uphill battle as they confront a new breed of online consumers with their own news perspective. That's why the hottest news story today is the media's own struggle to reinvent itself online.

To access the opportunities presented by the significant shift in consumer behavior, traditional news media organizations must first address four digital challenges.

The device challenge. As consumers worldwide increasingly integrate smartphones into their daily lives, news media players will need to understand more and more how the shift from traditional online access to mobile devices will affect the ways people obtain, buy, and consume their offerings. Mobile devices continue to capture a larger share of consumer time. In the US, for example, mobile phone use grew 14 percent each year from 2008 to 2011, while the use of other major electronics platforms such as TV and personal computers has largely remained flat. Ironically, mobile phone use is growing, but the amount of time consumers spend "just talking" on them has shrunk – from over 60 percent in 2008 to 27 percent in 2011. Why? The smartphone has opened up new usage options, including social networking (14 percent of time), Internet browsing, listening to music and messaging (10 percent each), and gaming (8 percent).

What's more, the smartphone may be the first truly personal reading device. A full 55 percent of smartphone users in Europe consider their devices to be theirs alone, while far fewer say the same about their e-readers, laptops, tablets, or PCs. Another finding is that US smartphone users watch videos (66 percent) and surf the Internet (60 percent) at home – not on the move – indicating that in the majority of use cases, the mobile phone is fundamentally neither "mobile" nor a "phone." Tablets are also showing strong uptake. Europe experienced a surge in tablet use from 2010 to 2011, when their coverage of online users grew from 3 to 11 percent in France, 5 to 18 percent in Germany, 3 to 22 percent in Spain, and 2 to 14 percent in Poland.

McKinsey's research also shows that consumers will pay for digital content with the right value proposition. For instance, 25 and 32 percent of iPhone and iPad users respectively have purchased games in the past six months, while only 8 percent of the overall population has done the same. Similar findings are apparent regarding music and other content, illustrating the potential for increased digital content revenues with the right go-to-market approach. Furthermore, the more devices users own, the more time they spend reading (Exhibit 1). Compared with smartphone owners, tablet owners spend 1.25x more time reading, while e-reader owners spend 2.1x more time. Those who own both an e-reader and a tablet spend 2.3x as much time reading.

This whirlwind of mobile market dynamics presents both challenges and opportunities for media players. We believe successful companies need to invest in mobile solutions for the long run because handheld screens and touch interfaces are here to stay. Leaders should focus on content version controls, dedicating resources to different platforms and devices strategically and not reactively. They should also explore innovative business models, since new devices could open the door to new possibilities in areas such as subscriptions, short-form content, and new sponsorships.

Adding a device increases reading – not a zero-sum game

US MARKET

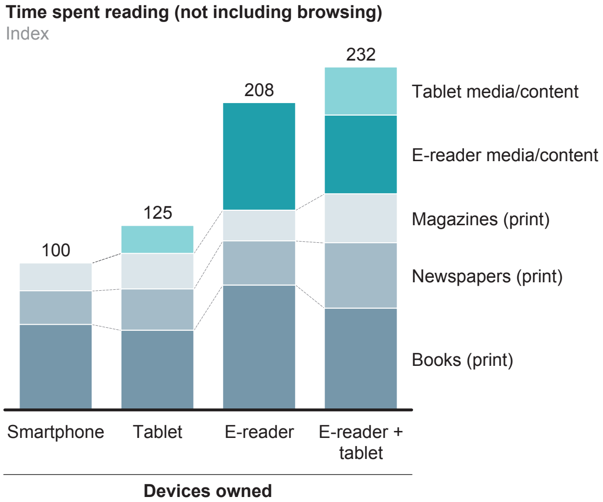


Exhibit 1

SOURCE: McKinsey iConsumer (US, 2011)

The social gateway challenge. Social networks have become important points of entry to news consumption. More and more, they are the first places users log into on the computer; they serve as content starting points and video discovery tools. Likewise, consumers increasingly use social networks to stay up to date on news and general trends. They rely on them to take advantage of deals and learn about products and services.

Online communities have therefore become a highly effective but perhaps underutilized marketing channel. Advertisers, for example, have begun to balance overall online audience attention levels and ad spending; at the same time, many remain woefully behind in taking advantage of the social networking revolution. While 27 percent of the time US consumers spend online is devoted to social media, advertisers currently focus only 6 percent of their online spending on this area.

Against this backdrop, media companies need to address several issues. As with search engines, social networks are both a huge potential source of new customers and direct rivals, so they need to be engaged with caution. Likewise, new social tools should be viewed as part of a media company's established arsenal of marketing strategies. Social networks will continue to be a gateway to content consumption; it is, therefore, an obligation for media companies to optimize their presence on them. Also – in this new world – media companies need to understand that they are delivering a distinctive content consumption experience through multiple gates, then position their offerings accordingly.

The digital migration challenge. News media companies face new challenges as consumer migration to digital increases. Most adults still read newspapers at some point, but the writing is on the wall regarding print media's decline. In 2011, for instance, 56 percent of the UK population still read daily newspapers at least once a week, but digital alternatives have become dominant in European markets in terms of time spent reading. Further, a massive generation gap is apparent (Exhibit 2). Around 55 percent of those 25 to 34 years old see the Internet as the most useful news source; only 16 percent of 55- to 64-year-olds agree.

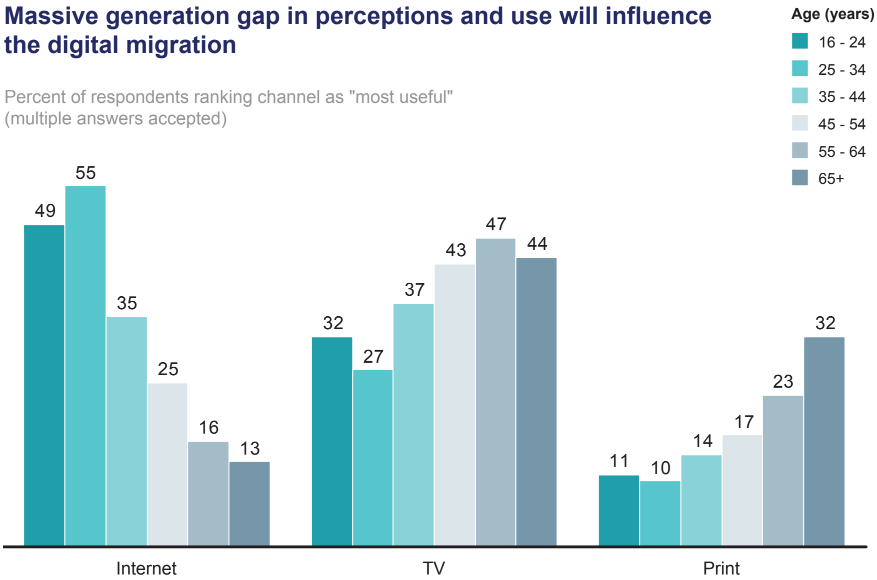
Conversely, 23 percent of people between 55 and 64 say print media is most useful, while only 10 percent of those 25 to 34 years old say the same. The paradox is that younger readers trust the general news Web sites less and less, especially compared with print newspapers. The percentage of those who believe that the news sections of general Web sites are as trustworthy as newspapers dropped from 46 to 38 percent between 2006 and 2011.

To survive in a media landscape that is shifting to digital faster than before, media players need to understand and build on their strengths, focusing on what makes their brands and media distinctive from the consumer perspective. They should also move to a clearly digital stance and work to build or rebuild trust among consumers by pursuing transparency in terms of processes, motives, and editorial opinion.

The advertising challenge. The world has changed not just for how consumers gather their news, but how they research and buy all sorts of goods and services as well. Flipping through pages of classified ads to find a used car or a home for sale would now seem totally out of date to most of us, but less than a generation ago it was practically the default way to do business – and a multibillion dollar profit stream for media players. Retail is now under similar pressure. Consumers are using online tools to research as well as to purchase, and activity on both fronts has been increasing. This shift clearly hasn't taken place at the same rate across all retail categories. In the US, for instance, some categories such as groceries or household goods remain firmly in local brick-and-mortar stores. Others, such as furniture or footwear, are still in the "digital battleground," while consumer electronics, computer hardware and software, and video games have "gone digital" and are primarily shopped online. As more traditional retail products make this jump, it poses challenges for offline media and their marketing partners to reach the right customers with the right marketing messages at the right time. As a consequence, there is a paradigm shift in advertising, and this affects traditional but also digital media, especially on revenue generation strategies. This trend has a huge impact on how advertisers advertise.

Massive generation gap in perceptions and use will influence the digital migration

Percent of respondents ranking channel as "most useful"
(multiple answers accepted)



SOURCE: McKinsey Media & Entertainment Practice

Exhibit 2

Further complicating this issue is the emerging mobile retailing phenomenon, which provides users with an even more immediate way to buy online. Increasingly, goods will be purchased on a mobile device and a rise in mobile advertising will follow – and it is even more complicated for advertisers to progressively adjust their media investment strategies on mobile platforms.

McKinsey's research also makes clear that a single Internet user segment no longer exists – instead, an array of very different profiles is emerging. Both media players and advertisers need, for example, to establish a different strategy for people who consume four times more online videos than the others. In the US and in Europe, a number of established segments, such as traditionalists, on-the-go workers, professionals, and gamers are already losing share to newer clusters that range from digital media junkies to digital communicators.

Media companies would benefit by understanding their audiences intimately, which means going far beyond basic demographics and identifying the segments most attuned to their offerings. They don't, however, have to go it alone. Creating true marketing partnerships with retailers and advertisers – who are also still adapting to this new digital experience – can be a mutually beneficial endeavor.

Opportunities for media players

News providers face the current digital challenges – which have direct implications regarding the future of the entire media industry – while the echoes of past missteps still resonate. How different might the media industry be if there had been a better alternative to the commoditized banner ad or the hated pop-up ad? What if the industry had avoided the overemphasis on ineffective "click-counting" performance metrics or the early rush to make all content accessible and free all the time to everyone? All of that, as they say, is the past. Now content providers must determine how best to build for the future with the Internet we have, rather than the one we'd like to see.

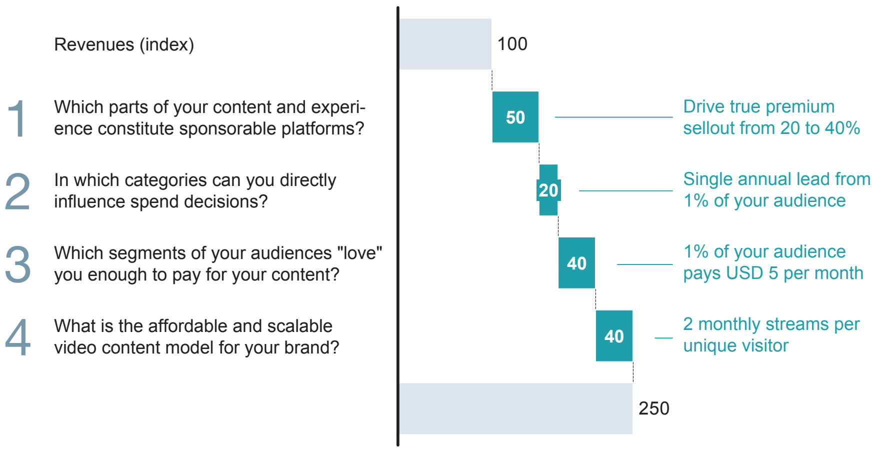
In addition to investing in mobile for the long term, engaging intelligently with social media, and developing a deeper understanding of the nuanced segments of the customer base, media players would be well advised to explore innovative new revenue models based on four pillars (Exhibit 3).

1 **Sponsorship at scale.** Run-of-site advertising (targeting only at the broadest site level, not the audience level) and exchange or backfill networks (with much lower yields than direct sales) are important parts of the revenue mix but cannot be the foundation for the next phase of big digital media business building. Executives need to look hard at their businesses and determine which parts of their content and experience could become "sponsorable" platforms and which parts are truly unique, attractive, and monetizable.

2 **Proprietary lead generation.** Move beyond "keeping an eye out" for leads and toward active, focused lead generation. Leaders of media organizations might ask themselves how much a partner might be willing to pay for just one qualified lead per year from each member of their audience. They might also make decisions on which categories can directly influence advertising and consumer spending decisions and which partners can help them build their scale.

Carefully identifying opportunities in four areas can more than double online revenues for media players

ILLUSTRATIVE



SOURCE: McKinsey analysis

Exhibit 3

3 **Consumer-paid content.** Rebuild the consumer-paid leg of the revenue stool by running real numbers. How much money would be at stake if only 1 percent of a media player's monthly audience paid USD 5 a month for the content they "love"? What if the organization drove that to 5 percent and USD 10? Executives might seriously consider this model and work hard to identify which members of their audiences "love" them enough to pay for content and then spend some time determining what they can offer these customers beyond products – e.g., access, recognition, rewards, or intangibles – that might change their spending patterns.

4 **Digital video content options.** Video is no longer a premium or niche feature on the Web but a fundamental part of the offering. Publishers and brands of all shapes and sizes need to establish a role in the video value chain – whether producing, distributing, selling, or otherwise. Publishers in particular need to create an affordable and scalable video content model that fits their brand and determine which ecosystem partners are critical to their success.

Building on these four pillars, media players can turn the challenge of rapidly-evolving consumer behavior into a major opportunity. Reimaging business and product models has the potential to more than double their online revenues.

□ □ □

News media companies had to catch up with the online phenomenon, and now they are finding themselves having to take their shows on the road – or the data highway. The mobile nature of the digital world, the growing importance of social networking sites, and other shifts in consumer online behavior are compelling media companies to take their accessibility strategies – thus their revenue strategies – to the next level. By rethinking their business and content platforms, media managers will be able to build scalable, sustainable media businesses online for generations to come.

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4 The digital youth: A glimpse into future market evolution

By Bertil Chappuis, Ewan Duncan, and Naomi Neruda

While many commentators note the swift uptake of all things digital by younger consumers, new insights from McKinsey's iConsumer research quantify the distinct differences in digital device usage and digital content consumption – many surprising.

How well do companies understand young consumers – those under 35? Can they describe fairly accurately how these consumers communicate, with what devices, and why? Important questions to be able to answer – particularly for high-tech, telecoms, and media companies. Half-trillion dollar questions, actually, since that is McKinsey's estimate of the aggregate market that will be affected by this cohort. Differences abound between US consumers aged 13 to 34 (youths) and consumers aged 35 to 64 – and the implications these differences raise could be strategically decisive for telecoms, media and entertainment, and high-tech companies.

McKinsey's research revealed that American youths lead digital lives distinct from older consumers: they don't and won't buy PCs or laptops, preferring smartphones or tablets. Landlines are a curious waste to them, as are CDs and most hard-copy media – newspapers, magazines, and books. Not surprisingly, they are almost twice as likely to own portable digital devices as older consumers, and they lead in adopting new services such as video chat, social media for many types of communication, and on-demand video.

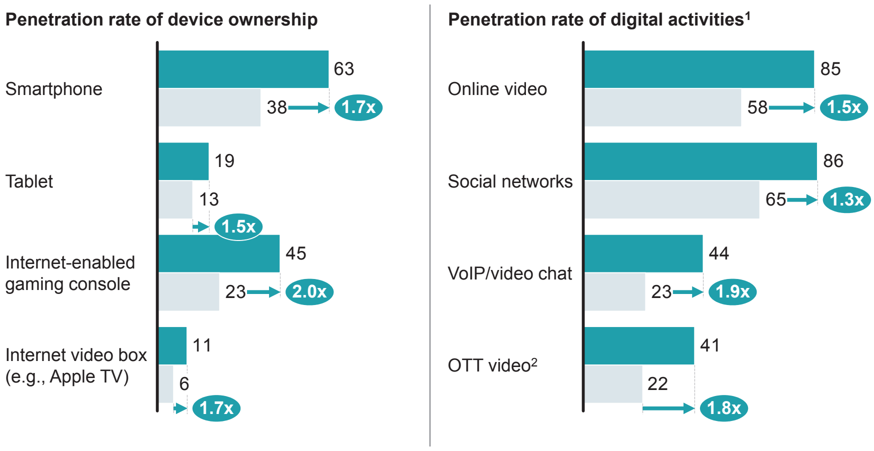
But it's not only their current behavior and preferences that present a challenge to many companies, or even the greatest challenge. It's what it portends for the future. Based on current penetration and usage among youths, projected cumulative revenue from youths in emerging digital streams over the next three years tops USD 15 billion across mobile advertising, mobile apps, on-demand digital video, and social network advertising. However, device and content provider choices among the youth will affect USD 500 billion in annual estimated spend across PCs, mobile/landline voice, and pay-TV. As the digitization of life continues, brands that ushered in the digital age such as Microsoft, Sony, and Yahoo don't resonate with youths as much as Apple or Google. Is losing this market a foregone conclusion for more mature companies? No. But it will require some new thinking. Companies will need to invest in capabilities, services, partnerships, and business models that reach and retain this critical segment. In short, action must be taken to bridge the divide before it becomes an abyss.

The youth segment drives current and future digital consumption

"Early adopters" may be an understatement – at least in some categories of activity. During the past five years, new platforms and digital offerings proliferated rapidly, and youths drove adoption of many of these devices and services. Compared with consumers aged 35 to 64, youths are 1.5 to 2 times more likely to own a smartphone, tablet, Internet-enabled gaming console, or Internet video box. Similarly, youths are 30 to 50 percent more likely to go online to communicate via social networks and VoIP/video chat or access entertainment such as online and over-the-top video (Exhibit 1).

Youths have 1.5 - 2.0 times the penetration for connected devices and online digital activities compared with older users

Percent, 2011



1 Penetration rate based on users with activity at least once a month across any device (PC, mobile, tablet)
2 OTT is defined as consumption of Internet-based video on TV via connected devices

SOURCE: McKinsey iConsumer (US, 2011)

Exhibit 1

Surprisingly, when further segmenting youths into the most common life stages – teens (13 to 17), college-aged (18 to 21), and young adults (22 to 34) – there are minimal differences in the penetration rates of devices and activities. The two exceptions are online gaming – which skews slightly toward teens – and VoIP/video chat – which is favored by more in the college-aged segment. The most dramatic drop-off in usage occurs after consumers “age out” of their youth in their mid- to late-30s.

The most probable explanation is that this post-youth stage of life is when many consumers have young children and career demands that combine to limit the amount of time available for device usage or quick adoption. The high level of familiarity with digital devices and channels and the consistency of digital behavior before consumers reach 35, however, suggest an opportunity and challenge for device makers and content providers alike. Companies will need to work harder to create offerings that would maintain usage by the 35- to 44-year-old cohort, and adopt different customer management approaches for this time-starved group.

Even more compelling than device adoption is the higher willingness of youths to pay for digital content. Across the content menu (Exhibit 2), McKinsey found that youths are 1.5 to 2.3 times more likely to purchase premium content subscriptions and apps. Many use their mobile device as the predominant gateway to news, entertainment, and communication. Unlike older consumers, youths may not have any non-digital subscriptions to magazines and newspapers, or even a landline phone or pay-TV service. Thus, they are not duplicating channels or costs by paying for digital content. The relative portability also drives consumption of digital content.

The implications of this are significant for content owners looking to drive more revenue from subscription services. Combining subscription/transaction services of youth-oriented content optimized for digital platforms could habituate more consumers to turn to digital channels exclusively – and this could extend into later life stages.

Penetration of digital content spending by activity/product by age segment

	Content type	Youths (13 - 34)	Other (35 - 64)	Difference
Paid subscriptions	Subscription for premium video content on your PC	20%	12%	1.6x
	Online newspaper subscription (e.g., Wall Street Journal Online)	11%	5%	2.3x
	Digital reader newspaper subscription (e.g., New York Times on Kindle)	31%	18%	1.7x
	Online magazine subscription (e.g., The Economist)	12%	6%	2.0x
	PC2Phone (e.g., SkypeOut)	20%	13%	1.5x
Mobile or tablet app purchases (users who spent more than USD 0)	Purchasing a game app	31%	19%	1.6x
	Purchasing an app version of a magazine or newspaper	16%	10%	1.7x

SOURCE: McKinsey iConsumer (US, 2011)

Exhibit 2

Mobile devices – preferred communication and entertainment vehicle

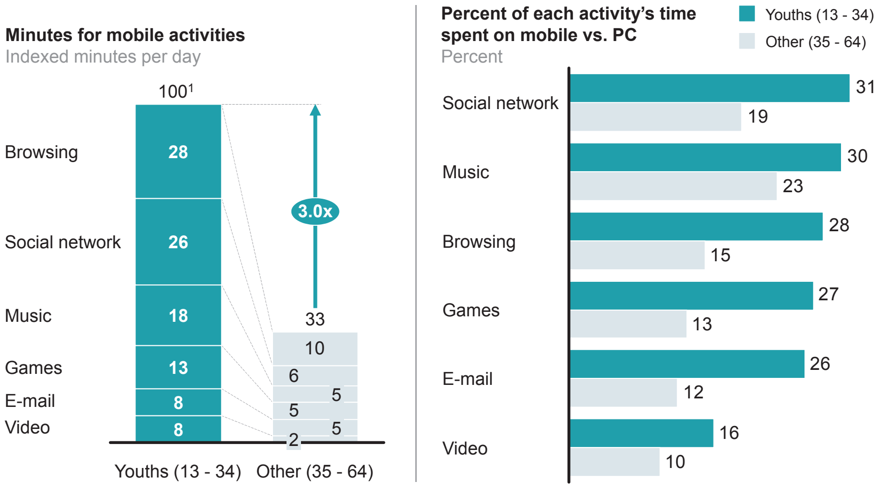
With the rapid proliferation of smartphones, mobile is quickly becoming the device of choice for online activities. This trend is particularly noticeable among youths, who spend over three times the number of minutes on their mobile devices for common online activities than those over 35. Both youths and the 35+ age group spend more time on e-mail on their PCs than on mobile phones – but putting things into proportion, youths spend 26 percent of total e-mail time on their mobile versus only 12 percent for the older age group (Exhibit 3). The preference for mobile among younger consumers is also evident in the time they spend browsing the Web and logged on to social networks. The McKinsey survey shows that even when they are near a PC or laptop, youths often prefer to use their smartphones to access and consume content, since they consider this more convenient and personal.

A further factor: while mobile voice has long been cannibalizing landline usage, traditional telecoms players are now seeing the next wave of greater competition from VoIP/video chat (e.g., Skype, Facetime). Especially among youths, minutes devoted to this medium are starting to reach that of mobile phones and have overtaken landlines. Older demographic groups are still heavily reliant on traditional forms of communication (Exhibit 4).

Social networks as communication central

With the continued demand for real-time communication with and among multiple people, social networks – and Facebook in particular – are emerging as a core online activity. For youths, social networks have displaced e-mail based on proportional use

Youths (13 - 34) spend over 3x the time on their mobile than those aged 35 - 64; in addition, youths spend a greater proportion of each activity's time on mobile than on PC



1 Sum does not add up to 100 due to rounding

Exhibit 3

SOURCE: McKinsey iConsumer (US, 2011)

Older audiences rely more on traditional talk and landline while younger ones prefer video chat over landline

Voice activity usage by age; percent of total minutes by platform, 2011

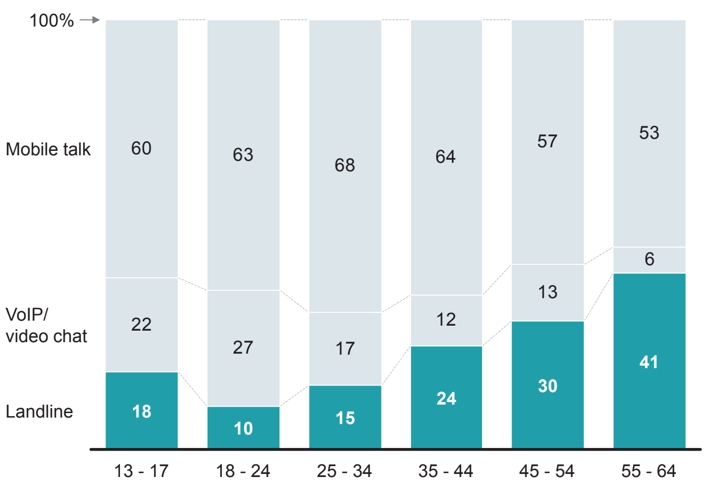


Exhibit 4

SOURCE: McKinsey iConsumer (US, 2011)

in minutes per day on both PCs and mobile phones (Exhibit 5). Among smartphone owners, 75 percent of youths use mobile social networks at least once a month versus 48 percent of older smartphone owners.

Social networks are also becoming information and entertainment portals since many young consumers see them as the most convenient way to share videos, photos, and other content among friends and family. As a result, marketers should be adapting their digital strategies to incorporate social networks as an increasingly important communication channel to drive word-of-mouth marketing.

Video on demand continues to gain traction

With digital platforms multiplying, consumer video viewing habits have changed as well. Overall, TV viewing time has increased slightly across all age groups, but youths are displacing regular (linear) TV with more on-demand Internet-enabled video. Over-the-top has traction with 41 percent of youths, who watch OTT video at least once a month versus only 22 percent of consumers aged 35 to 64. This could, in part, be driven by the proliferation of Internet-enabled gaming consoles owned or at least controlled by youths, since many are already integrated with leading OTT video service providers (e.g., Netflix).

Across non-TV devices – PCs, mobile devices, and tablets – online video adoption among young consumers is 46 percent higher than for older users with twice the viewing time (Exhibit 6). This demand for anytime, anywhere video is driving opportunities for new areas of competition and innovation across multiple platforms for both traditional and emerging video players.

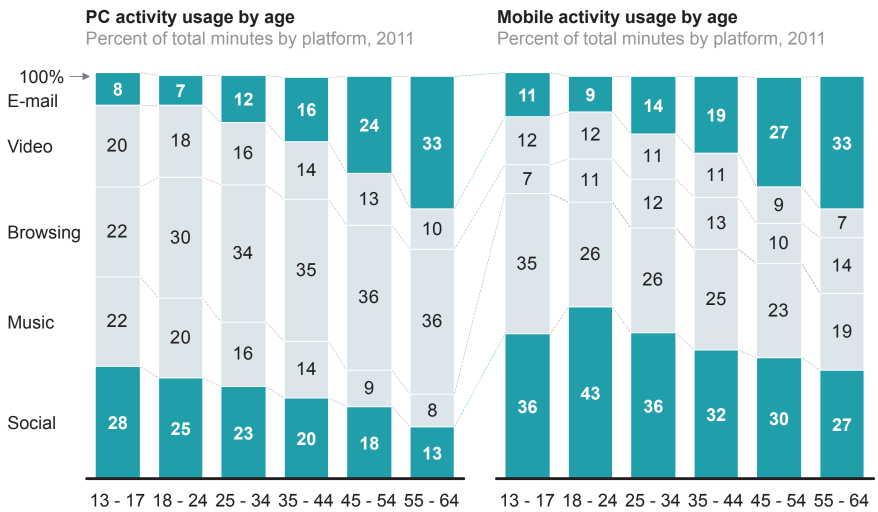
Advertisers must refine their marketing plans so that these reflect this new video viewing behavior. They will also need to get creative about targeting youths, who are time-shifting and consuming video-on-demand across devices.

Distinctive youth brand affiliation and online preferences

Beyond the differences in digital behavior between youths and older consumers, what is also apparent is that some brands and platforms hold particular appeal for younger consumers. Given youths' reliance on mobile devices, coupled with their general interests and digital behavior, it comes as no surprise to find Facebook, VEVO, Apple, and Viacom Digital among the top online properties for youths. The challenge for companies seeking to serve more of the youth segment themselves is to learn from these sites and find out how to leverage them, affiliate with them, or adopt their attributes to generate more interest among young consumers. Companies may need to rethink their creative ad content and placement, for example, and experiment with combinations of content and ads to determine what actually drives higher penetration in the youth segment.

The youth segment is the leading indicator of future digital demand. Devices such as smartphones and tablets, online offerings in social networks, online and OTT video, and VoIP/video chat are but a few examples of changes emerging in the digital world. Today's younger generation will mature into an older generation of relatively tech-savvy adults

Youths focus on social networking, while older audiences spend significantly more time on e-mail



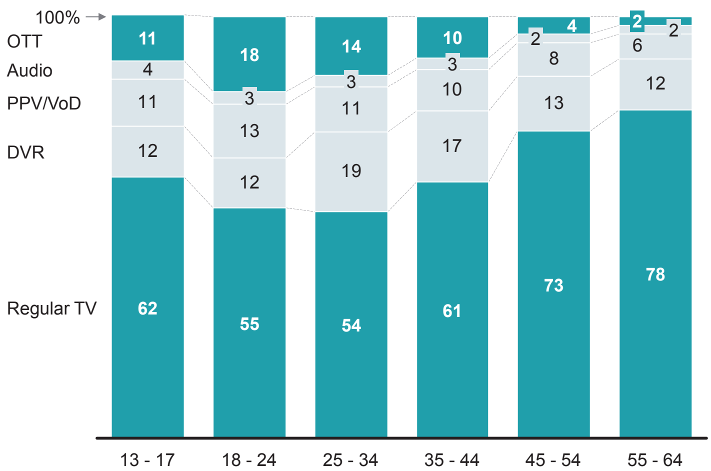
Note: Sums may not add up to 100 due to rounding

Exhibit 5

SOURCE: McKinsey iConsumer (US, 2011)

Older audiences watch more live TV; younger ones watch OTT video

Percent



Note: Sums may not add up to 100 due to rounding

Exhibit 6

SOURCE: McKinsey iConsumer (US, 2011)

compared with those currently over 35 – but youths as an age group will likely continue to drive adoption of cutting-edge devices, content, and digital services still on the horizon.

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The future – one worth USD 500 billion – that young consumers will drive has actually begun. Still, their current impact is unevenly distributed. But as the young segment matures, youth preferences will increasingly shape the digital world as young consumers gravitate to and integrate certain brands, platforms, and activities into all facets of their personal and professional lives. Companies that fail to gain the attention of the young segment risk creating the next digital-age flop – a business that will wither as this influential group turns its back to it. Many brands and content providers have already taken steps to become or remain relevant to youths. Some have not. The latter will pay the price, either in terms of lost share or missed opportunities. Vigilance is critical for companies to remain agile and adjust their approaches as quickly as young consumers change their digital behavior.

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5 Altering the approach: Mobile operators and online consumers

By Eric Hazan, Florent Illat, and Piero Trivellato

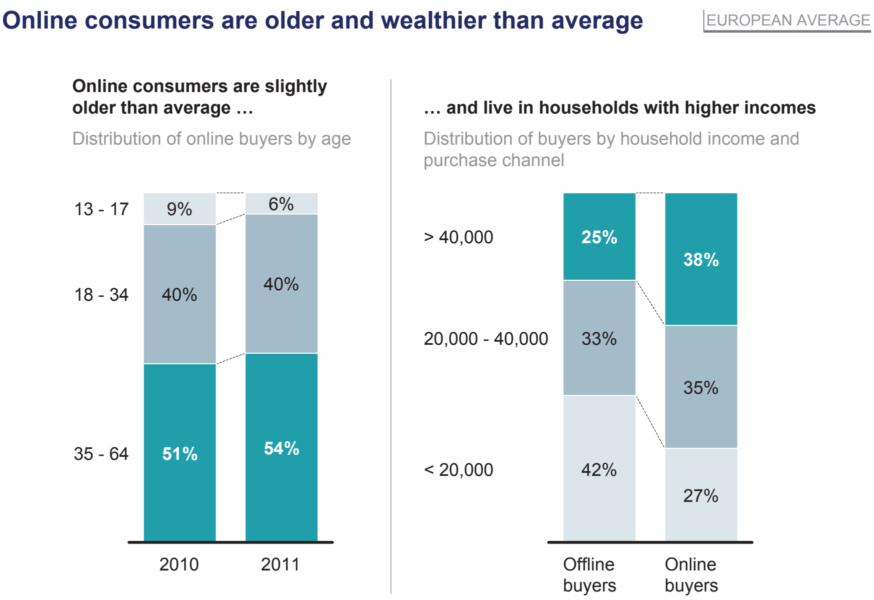
Mobile network operators now have an excellent opportunity to draw on an expanding segment of online buyers as a source of growth and savings. Capitalizing on this trend, however, will require operators to provide dedicated – but not necessarily less expensive – offers, while utilizing a market approach based on differentiation.

Consumers increasingly go online to research and buy mobile products such as service subscriptions, accessories, and devices. Online sales in this area have grown by 33 percent each year over the past five years. More than 25 percent of Europe's online consumers surveyed buy mobile products online, and there is potential for this figure to rapidly reach 30 to 40 percent – similar to other, more mature consumer electronics categories.

An attractive and affluent target market

For mobile operators, online consumers are an attractive demographic: in addition to being slightly older than the rest of the population, they have higher average household incomes (Exhibit 1). And they are willing to spend money on telecommunications devices and mobile communications plans. According to response data, online consumers spend 11 percent more on monthly mobile phone bills and 28 percent more on mobile devices than offline buyers. Furthermore, online consumers are more likely to be "digital addicts" – about 30 percent own a tablet computer, double the level for offline buyers. Smartphone ownership is also more common, and about two-thirds of these online consumers use such devices – compared with just 57 percent of those in the offline community.

Online consumers are older and wealthier than average



SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 1

Online consumers also spend more time surfing the Internet and using data-related applications on their mobile phones; some 61 percent use these services often, while only 37 percent of offline buyers do the same. Data-related applications are increasing in number to support digital activities such as reading e-mail, listening to music, browsing social networks, video chatting, and online gaming.

Finally, online consumers are interested in new forms of technology such as augmented reality, cloud storage, and HD video. More than half of the online consumers in the study claim that they would consider using these data applications, while only 38 percent of offline consumers stated the same.

Adapting offers to new consumers

Online consumers have generally been perceived as a low-end segment that should be served via low-cost channels. Consequently, they have been targeted with the lowest-priced plans. As the online channel grows and gains appeal with a broader and more prosperous customer base, mobile operators should emphasize products rather than price.

Online buyers are consuming more and more data – and doing so using a variety of applications. Accordingly, they are looking for features such as unlimited SMS bundles, multi-device bundles, faster speeds, and other data-related products. In Europe, mobile-data-related offers hold significant sales and growth potential for operators. While 54 percent of mobile phone users in the United States already have a limited or unlimited data plan, the same is true for only 36 percent of Europeans (Exhibit 2). At the same time, Europeans place greater value on data access than Americans.

With access to data, additional possibilities for cross- and up-selling open up. For example: nearly 20 percent of smartphone users indicated that they would be willing to pay a

In Europe, unlimited mobile data plans carry unlocked potential, and data accessibility is highly valued

EUROPEAN AVERAGE

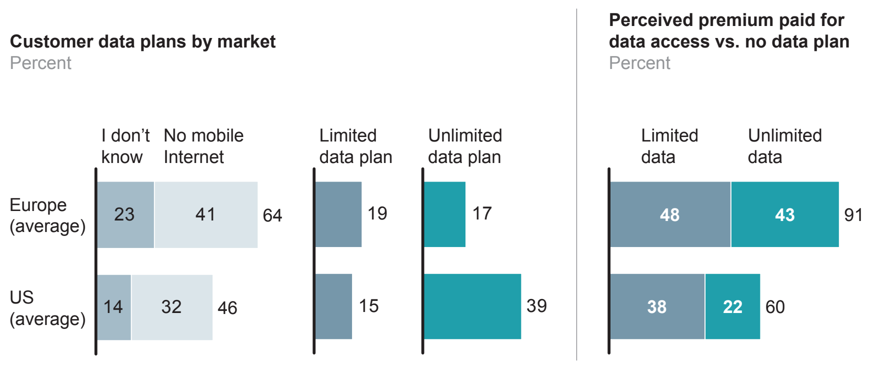


Exhibit 2

SOURCE: McKinsey iConsumer (Europe, 2011) premium for advanced security options, and approximately 10 percent would do so for services such as remote medical consultations, cloud-based storage, augmented reality, and high-quality premium video or music streaming.

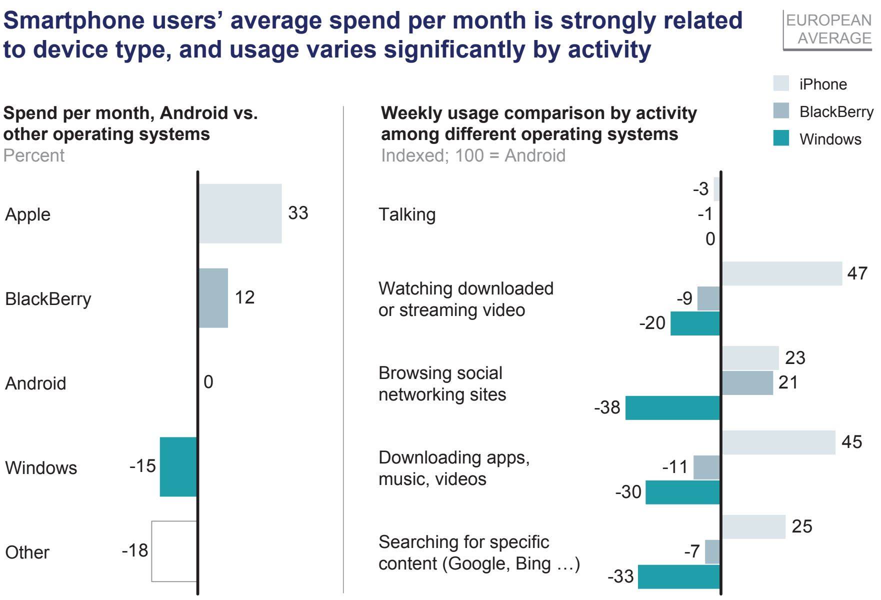
Flexible offers to match consumption profiles

It seems that one size may not fit all in the diverse digital world, and different devices require individualized mobile service packages. Even within the smartphone user group, average spend per month differs significantly. Compared with Android users, Apple iPhone owners spend 33 percent more on average on their monthly service bill, while Windows users spend 15 percent less. Usage patterns – with the exception of those for voice services – also differ considerably according to smartphone type. Again, Apple users spend significantly more time engaged in data-heavy activities – such as watching videos, browsing social networks, and downloading apps – than Android users. On the other end, Windows device owners consume less mobile data. Thus, mobile operators should offer mobile phone plans tailored to the different phones available (Exhibit 3).

Companies can also make the most of the opportunity to target "digital addicts" who use multiple devices. Fifty-four percent of the online buyers surveyed said they would pay more for a multiple-screen subscription that would include PC and smartphone Internet access as well as real-time TV in a bundle. Surprisingly, 12 percent of respondents stated they would probably be willing to pay 50 percent more to enjoy this multi-screen feature.

From a tactical standpoint, operators should also consider additional segments when thinking about new product offerings for online consumers. The video game console segment, for example, holds great potential. Fifty percent of console owners indicated that access to advanced TV features was a key driver for their online console subscription – in 2010, only 28 percent said the same. Furthermore, 37 percent view access to

Smartphone users' average spend per month is strongly related to device type, and usage varies significantly by activity



SOURCE: McKinsey iConsumer (Europe, 2011)

Exhibit 3

social networking sites an important feature, compared with 29 percent in 2010. By providing tailored offers for various smartphones, offering subscription models for multi-device users, and creating new product offers for non-traditional customer segments, mobile service providers can meet the needs and expectations of online consumers.

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For mobile network operators, the online customer segment is sizable, attractive, and sophisticated – making it well-suited for customized offers and marketing approaches. The development of such offers and advertising is critical for operators who want to be successful in this cost-efficient channel as well as capture a customer segment vital to an industry that is increasingly dependent on data consumption.

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6 Market in the making: Profiling Africa’s digital consumers

By Lohini Moodley, Suraj Moraje, Marie Nielsen, and Ade Sun-Basorun

As Africa joins the global digital fold, understanding the attitudes and needs of the continent’s consumers can help operators boost Internet penetration and usage.

Urban Africans have embraced the Internet, driven by the need to connect with friends and family and the increasing affordability of Internet-capable phones. One indication that consumers have gone online in a meaningful way is that over half access the Internet at least once a month (Exhibit 1). McKinsey’s Africa Consumer Insights Center survey of 15,000 individuals from 19 cities in 12 countries across Africa reveals that Africans generally embrace all things Internet despite low incomes and limited infrastructure. The survey focused on the largest African cities because they generate disproportionately large amounts of Internet traffic. These cities account for over 80 million consumers (15 percent of the respective countries’ national populations) and nearly 25 percent of their countries’ national consumption (USD 350 billion).

Cities generate robust Internet demand

Of the 25 percent of consumers who access the Internet daily, most do so using mobile phones (Exhibit 2). The survey reveals that 54 percent of consumers have either smart-phones or other types of Internet-capable mobile handsets, although percentages vary widely from country to country. In Kenya, for example, 95 percent of those surveyed had such devices.

Social networking is the number-one online activity, followed by e-mail and music videos (Exhibit 3). To date, online commercial activities such as shopping, banking, and travel

In Africa's major cities …

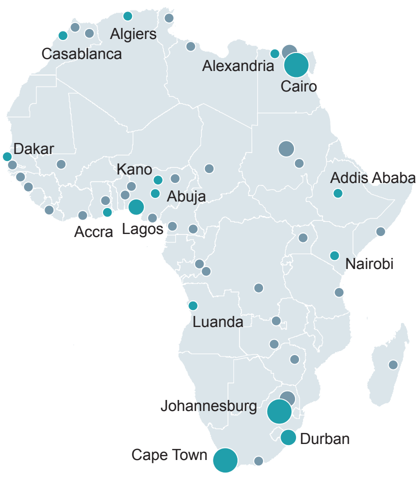
51% have accessed the Internet in the last month

25% are online daily

21% spend more than 10 hours per week online

54% own Internet-capable devices

57% of Internet users are frequently on social networking sites



SOURCE: McKinsey Africa Consumer Insights Center

Exhibit 1

25% of consumers access the Internet daily and ~ 20% go online for more than 10 hours a week

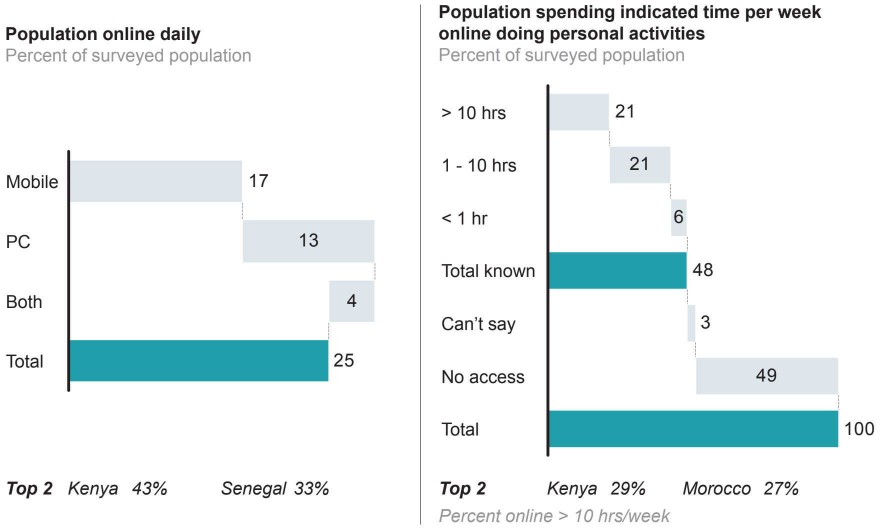


Exhibit 2

SOURCE: McKinsey Africa Consumer Insights Center

have low penetration levels in Africa: only 10 to 13 percent pursue online shopping, for example, and similarly few go online to bank or book travel arrangements.

Many segments, many uses

Not all consumers are using the Internet in the same way. McKinsey research identified six main urban consumer segments (Exhibit 4):

- *Early adopters* focus on the novelty of the new online products and services available without regard to brand and are willing to spend more to buy new gadgets. That's one reason they generate the highest average revenue per user per hour spent online. They comprise about a quarter of urban telecoms spending and are heavy Internet users.

- *Image conscious* consumers view their mobile devices as a critical element of their self-image, assess mobile devices in aesthetic (not functional) terms, and have a revenue market share of 15 percent.

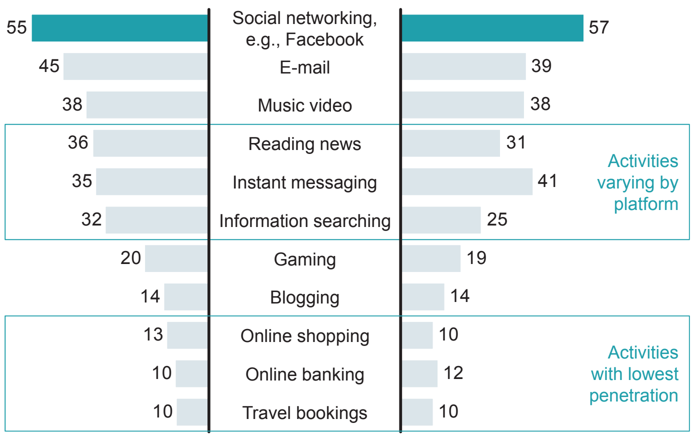
- *Brand loyals* only purchase well-known brands, are willing to pay a premium for specific brands, do not think of their mobile phones as a major part of their self-image, and represent another approximately 15 percent of Africa's telecoms spend.

- *Pragmatic users* contribute 15 percent of urban African telecommunications spending and they place their focus on product functionality. As a consequence, they tend to be brand and aesthetics "agnostics," they do not view mobile devices as part of their self-image, and they are usually unwilling to be early adopters of new and unknown products and technologies.

Social networking is the leading use of the Internet, with ~ 57% of users viewing networking sites often

How often do you do the following activities on a PC/laptop/tablet
Percent of Internet users responding with "often"

How often do you do the following activities on a mobile phone
Percent of Internet users responding with "often"

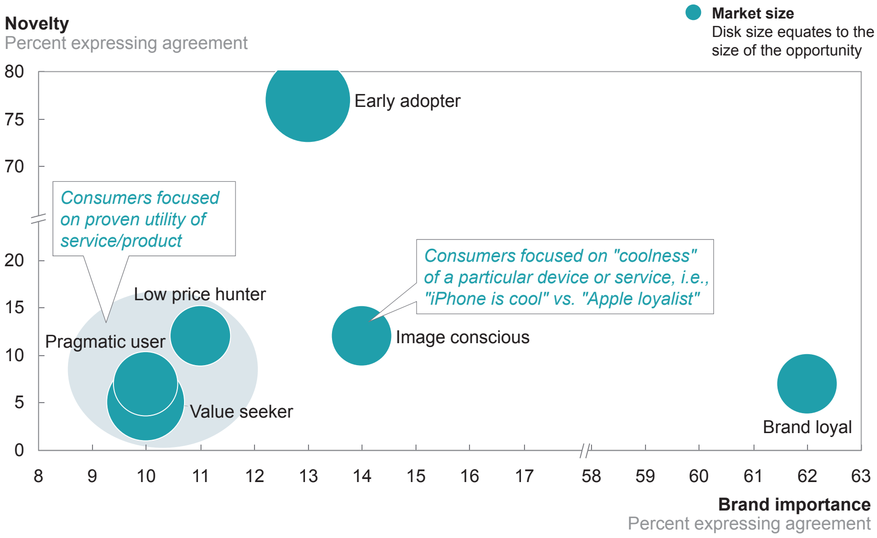


- African consumers have generally been able to use mobile phones to do what users in developed markets would normally do on the Internet on a PC/laptop
- Commercial activities – e.g., shopping, banking, travel – have a particularly low penetration in Africa

SOURCE: McKinsey Africa Consumer Insights Center

Exhibit 3

Brand loyal consumers are willing to pay a premium for brands



SOURCE: McKinsey Africa Consumer Insights Center

Exhibit 4

- *Value seekers* contribute 20 percent of total annual telecoms spending and rigorously compare products and prices of telecoms products and services before buying. They seek advice before making a purchase and are unlikely to pay a premium for a product or service.

- *Low price hunters* are extremely promotion-sensitive and spend a lot of time looking for the best deals. They tend to be brand-agnostic, are willing to sacrifice customer service for price discounts, and will travel to get the best price. As a result, they typically pay the least of all six segments for each hour they spend online. They make up 13 percent of the annual urban market share in terms of spending.

Learning from regional frontrunners

Viewing Africa's Internet penetration across major cities reveals some unexpected differences. Kenya and Senegal, for example, have achieved the highest urban Internet penetration rates in Africa – 72 and 68 percent of their populations respectively accessed the Internet.

Interestingly, Kenya and Senegal have used different platforms to advance Internet penetration levels among their urban populations. Senegal's online presence is largely PC-based, while mobile devices dominate Kenya's.

Kenya. Both the government and operators have played critical roles in shaping demand in the country. Affordability has been a key factor for Kenya – per gigabyte, Kenya is 80 percent cheaper than the average African country. In addition, the government removed the value-added tax and import duties on handsets in 2009, which contributed to a 200 percent increase in phone sales. And the introduction of the m-Pesa mobile money platform arguably drove technological literacy and openness to new technologies. Other initiatives include lower-cost smartphones, reduced broadband pricing, and improved network quality.

Senegal. Senegal grew its Internet penetration through the introduction of enabling government policies, Internet cafés (which drove access), and local content (which drove interest). Key government interventions included the removal of taxes and duties on imported computers, the privatization of communications companies, and the encouragement of downstream competition among Internet service providers.

The first African nation to establish an Internet café (in 1992), by 2007 Senegal had 18,500 "telecenters," many of which offer Internet access for as little as 65 US cents an hour. The service achieved content relevance because local media players quickly adopted the Internet as a key communication platform, with numerous local newspapers establishing online presences. Also, Senegal's large expatriate populations have demanded cost-effective ways to stay in touch internationally, thus supporting the Internet explosion.

Boosting Internet adoption and use

African operators can take a number of concrete actions to profitably drive Internet usage and adoption even further:

Improve the network experience. Across Africa, research shows that faster browsing is the most requested change among Internet users (as opposed to cheaper access). To deliver this, operators have several options, including optimizing network allocation between voice and data, making selected investments to remove bottlenecks in the highest-potential regions, and encouraging the use of data compression and buffering technology to promote higher speeds.

Reduce price anxiety. In a number of African countries, from 20 to nearly 25 percent of consumers who do not currently access the Internet mentioned price and a lack of control over monthly expenses as key reasons. To attract these potential customers, operators need to offer clear and predictive pricing. They can tailor pricing to specific customer segment needs and reduce price anxiety in a number of ways:

- *"All you can eat" price plans* allow unlimited usage for a fixed fee (with appropriate fair usage policies attached).
- *"Tiered" pricing* with short messaging service (SMS) notification plans can bundle Internet service with an SMS to alert customers when their allotted access is exhausted. This makes it possible for them to buy a refill, thus avoiding more expensive out-of-bundle rates.
- *Speed reduction* after the usage bundle is exhausted enables operators to prevent "sticker shock" at billing time.
- *Time-based options* such as pay-as-you-go plans or bundles can allow customers to pay on an hourly basis or buy unlimited plans for fixed monthly fees.
- *Protocol-based pricing* provides options such as differentiated pricing by type of use (e.g., unlimited fixed broadband for a set fee).

Increase affordability. Telecommunications operators can lower consumer barriers to entry by introducing new rate plans and lower-cost devices while supporting the propagation of Internet cafés. Operators could make a number of pricing adjustments such as lowering basic data bundle sizes and prices to drive uptake or by introducing small time-based bundles to attract new users. Sourcing low-cost, higher-tech Internet devices could help MNOs cultivate increased levels of sophistication among users. Establishing Internet cafés is another way to democratize online access. Operators can pursue this channel via direct ownership, through partnerships, or by offering support to small and medium-sized enterprises that could be interested in establishing cafés to boost consumer traffic.

Increase ease of connection. McKinsey research shows that the number-one reason African consumers do not use the mobile Internet is fundamental – they don't know how. To boost consumer confidence, telecoms players can launch above- and below-the-line (ATL/BTL) advertising campaigns to educate non-users. They can also reduce the "hassle factor" of setting up online access by pre-installing Internet apps on phones and providing in-store support.

Demonstrate need. Simple indifference was also a key reason for not accessing the Internet: consumers do not feel the need to use it. To "make the case" for the Internet, operators can demonstrate popular Internet uses in ATL/BTL campaigns, strike partnerships with respected content providers, and entice consumers with free offers such as a no-cost gigabyte of text-based social network access.

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McKinsey's survey reveals that urban Africans across the continent are gaining significant levels of sophistication when it comes to using the Internet, but telecoms players could capture a lot more value by helping more of them overcome the real and perceived barriers to going online. While stakeholders across the Internet value chain have roles to play in making Internet ubiquity a reality, telecoms players have a broad array of options to improve Internet penetration in both urban and rural areas alike.

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7 Brazil's e-psyche: Grasping trends in an elusive market

By Julia Broide, Fernanda Hoefel, and Daniel Swift

Brazil matters. And it is getting noticed for the best possible reason: its success. As the world's sixth-largest, Brazil's economy continues to emerge, and this is mirrored by its digital world. For companies to better understand this country, McKinsey provides insights to sharpen the focus on Brazil's online consumers.

As Latin America's largest country with a population of 195 million generating USD 2.5 trillion in GDP, Brazil's economy has been growing with vigor and breadth since 2004. Even during the exceptional but inevitable blip in 2009 when its economy shrank, it did so only by a comparatively enviable 0.2 percent.

Since global interest in this market has never been stronger, companies are increasingly looking for more depth in understanding the digital aspects of this fast-growing economy with dynamic industries. This is why McKinsey included this country in its survey on digital behavior to shed light on two key questions: Who are Brazil's iConsumers? And how do they use the Internet?

Brazil's iConsumers

Given dynamics in Brazil's digital world, crystal clarity in the situation would be too much to expect. What can be said, however, is that all indicators are pointing up. Taking a step back, let's first set Brazil's iConsumer scene.

Over half of Brazilians over the age of 13 are potential iConsumers – in other words, these users have the prerequisite of Internet access in place. This percentage is well ahead of fellow BRIC countries China and India. Broadband in particular has shown rapid growth, now available in almost every city. One interesting phenomenon: Brazil is currently leapfrogging past fixed broadband – which shows a modest coverage of 30 percent coupled with slow growth – and skipping right to mobile broadband instead.

In Brazil, the digital economy has penetrated every social class and every age group. Almost half of users belong to the 61 percent of households with income levels between USD 12,000 and USD 50,000 a year. But less affluent Brazilians also play into the picture, accounting for 12 percent of iConsumers.

One trend in Brazil is also apparent around the globe. Young people are particularly well connected: 79 percent of Brazilians between 18 and 29, and 88 percent of teenagers see themselves as iConsumers; as do 31 percent of those over 50. Thus, the Internet economy is a significant force in Brazil, making strides in every region.

One important factor applies across all segments: Brazilians really, really like the Internet. They spend more than twice as much time online as the British, French, or Spanish – and only slightly less than Russians.

To sharpen the distinction between groups of digital consumers, McKinsey has identified seven different behavior-based iConsumer segments (Exhibit 1).

How Brazil's iConsumers use the Internet

The stereotypical Brazilian is fun-loving and social – and Internet behavior bears this out. Specifically, Brazilians spend much more time on social networks than US Americans – the "digital communicators" segment reflects this – and on posting and viewing online videos ("video digerati").

Generally speaking, Brazilians enjoy using the Internet to connect with each other and to play. Social networking sites and games are by far the most commonly installed apps on their mobile phones. More than 80 percent of Brazilians have visited a social network over the past six months – more than every other country surveyed with the exception of Russia. And they don't just drop in: spending almost 60 percent of online time on social networks, the typical Brazilian iConsumer also uses more than one site – most often Facebook and Orkut, a local player that is particularly popular outside the upper class.

The love of social networks is widespread, and the deeper dynamics underlying it are intriguing (Exhibit 2). The first generation of iConsumers – those who had Internet access early on – is roughly characterized by those over 30 and/or belonging to the upper economic classes. They are heavy e-mail users but light social network users. Those who joined the Internet world later – the young and the less affluent – use it very differently. Instead of e-mail, they see social networks as their primary communication gateway.

"Gamification" is another key trend. At an average of eight, Brazilians download twice as many games as people in Germany, France, or Britain. But enthusiasm should not be mistaken for loyalty: 58 percent of respondents say they change games "all the time."

Mobile devices account for about one-fifth of the time Brazilians spend on gaming activities, but mobile gaming sessions also have the shortest duration – 15 minutes compared with more than an hour for gamers planted in front of their consoles.

Online consumer segments

Size of segment, indexed

			Gender	Age	Social class
1 | **"Video digerati"**	20%	More online videos than average viewer	Male (55%)	30	Middle (51%)
2 | **"Professionals"**	8%	More e-mail vs. average	Male (56%)	37	Up. middle (71%)
3 | **"Gamers"**	5%	More time spent on video games/day	Male (58%)	26	Up. middle (52%)
4 | **"Digital media junkies"**	13%	More likely to be an early adopter of new technologies	Male (63%)	28	Upper middle (47%)
5 | **"Digital communicators"**	26%	More time spent on social networking	Female (61%)	30	Upper middle (64%)
6 | **"On-the-go workers"**	13%	More mobile phone time vs. average	Female (60%)	32	Middle (55%)
7 | **"Traditionalists"**	15%	Less time on social networks	Female (55%)	33	Middle (45%)

Exhibit 1

SOURCE: McKinsey iConsumer (Brazil, 2011)

This, however, could change as more Brazilians buy smarter phones. Fewer than one of every five Brazilians own a smartphone – a higher percentage than among the Chinese or Indians, but not very many compared with US Americans (43 percent), Germans (49 percent), or Koreans and Japanese (both about a third). Survey evidence indicates that many more Brazilians intend to buy a smartphone – and are, in fact, making that happen. Around 900,000 Android and iPhones cross the sales counter every day in Brazil, and almost 7 million were sold during the 2011 Christmas season alone.

Not surprisingly, smartphones are much more common among more affluent Brazilians – about half of those in the upper economic class have one, and almost a third of those in the middle class. For companies that serve this latter segment of the population, the market may be near a tipping point. As Lorenzo Linder, Chief Marketing Director at TIM (a major wireless communications company) notes, "Our smartphone sales used to account for 25 percent of our total sales; this figure is now 60 percent. It's cheaper to have Internet on your mobile than to pay to use the Web at a cyber café."

So, what don't Brazilians do much of online? The answer is clear: they don't shop much online. Although e-commerce has been growing at rates of 30 to 40 percent each year over the past five years, it accounts for only about 3 percent of total retail sales. Fewer than 40 percent of iConsumers have actually bought online in the last few months. This figure is much, much lower than in other countries surveyed, where two-thirds or more have made online purchases. Still, the potential for growth is both apparent and impressive. Around two-thirds of Brazilians, for example, conduct research online prior to making a purchase – regardless of the ultimate purchase channel. In short, the Internet is already an important influencer in retail sales.

Why don't Brazilians shop more on the Internet? There are two types of key barriers (Exhibit 3). The first is cultural, related to the unwillingness to wait for an item and the desire to touch and feel it. There is little online retailers can do to completely remove

Generation gap

First generation		*Intermediate generation 18 - 49 years old*	Second generation	
Upper/upper middle class	30 - 34 years old		Middle class	13 - 17 years old
57% ✓✓	60% ✓✓	Use e-mail daily 45%	21% ✗	25% ✗
7% ✗✗	21% ✗	Only browse social networks 19%	42% ✓✓	28% ✓
21% ✓	14% ✗	See video clips on the Internet daily 25%	27% ✓✓	20% ✓

SOURCE: McKinsey iConsumer (Brazil, 2011)

Exhibit 2

Why not buy online?

Main reasons for not buying online per category; percent of users[1]

	Entertain-ment electronics N = 51	Mobile phones N = 174	Computer hardware/ periphery N = 47	Software/ games N = 40	Household appliances N = 72	Books N = 98	Clothing N = 315	Foot-wear N = 41	Fashion acces-sories N = 169
Wanted to have the product immediately	17	29	40	22	35	39	27	2	35
Previously had bad expe-rience with online purchase	40	15	19	26	18	19	11	19	14
Wanted to touch/feel/try the product before purchase	12	20	10	3	24	7	29	10	26
Did not know that product could be purchased online	19	5	16	4	8	8	8	39	6
Did not want to pay shipping	7	5	7	10	4	2	5	8	5
Was worried about Web site reliability or data security	2	8	0	7	5	10	7	0	4
Needed to talk to shop assistant during purchase	5	8	0	2	2	4	1	0	2
Preferred payment method was not offered	1	0	0	11	0	4	1	0	0
Other	2	11	8	15	6	8	11	0	8

1 Only asked to users not buying online per category

Exhibit 3

SOURCE: McKinsey iConsumer (Brazil, 2011)

barriers – but they can certainly explore aspects such as generous delivery policies and multichannel options such as online purchase with in-store pickup.

The second barrier type is practical in nature. Up to 20 percent of Internet users who did not buy online over the past six months said that this was due to a previous bad experience. This finding is consistent with survey evidence from other sources that rank consumer complaints handling as a top customer experience factor. Thus, a clear priority for online retailers is improving the online experience – something squarely within their capabilities.

Another reason to believe that online retail could get much bigger in Brazil is apparent from underlying breakdown of economic classes. Middle-class Brazilians account for more than 60 percent of iConsumers, but only 12 percent shop online – accounting for only a third of all online shoppers. Among the more affluent Brazilians, by contrast, 70 percent of the upper class and 52 percent of the upper middle class shop online; these account for two-thirds of all online shoppers. Thus, the potential is definitely there.

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More and more Brazilians are migrating up the economic ladder as the country continues to prosper. The proliferation of the Internet is broadening and usage is intensifying. More stores are opening online outlets. Given all of these factors, Brazilians will likely open up more to online shopping. At that point, it's up to business to deliver the goods.

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8 High influence: China’s social media boom

By Cindy Chiu, Davis Lin, and Ari Silverman

While messaging and sharing photos is as popular in China as in other regions, one aspect of usage in the country stands out: social media has a greater influence on purchasing decisions for consumers than in any other country. But how can companies use China’s social media to create value for their businesses?

Social media is exploding worldwide, and China is leading the way. A new McKinsey survey of 5,700 Internet users in China revealed that 95 percent of those living in cities with populations over 2.5 million are registered on a social media site. Beyond this, the country has by far the world’s most active social media population, with 91 percent of respondents saying they visited a social media site in the previous six months, compared with 30 percent in Japan, 67 percent in the United States, and 70 percent in South Korea.

Chinese consumers say they are more likely to consider buying a product if it is mentioned in social media and more likely to purchase a product or service if recommended by a friend or acquaintance on a social media site. This can be explained in part by a cultural difference: Chinese consumers prize peer-to-peer recommendations because they lack trust in formal institutions. In general, the Chinese populace is skeptical of information from news sources and advertising; people rely more on word of mouth from friends, family, and key opinion leaders – many of whom share information via social media.

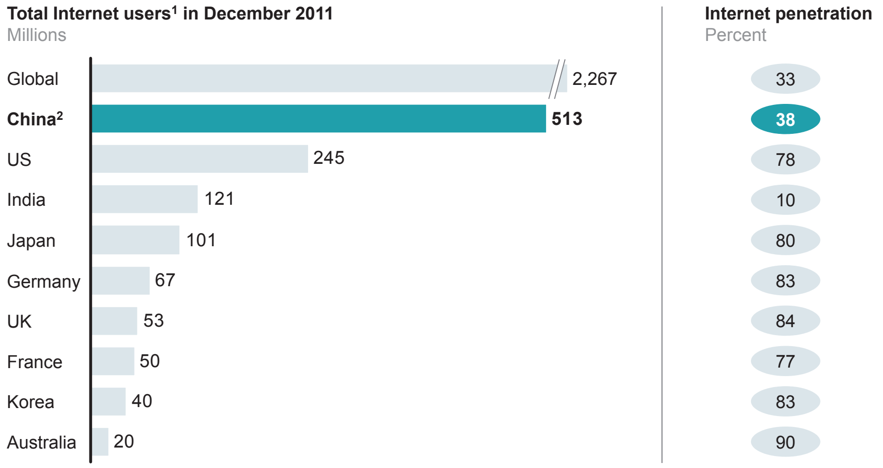
The popularity of these sites in China is critically important for companies looking to engage the vast and increasingly affluent online audience that uses social media as a vital source of information for brand and product decisions. China’s social media landscape is a complex environment at huge scale. Yet not all social media users are alike. They have distinct reasons for joining social media and different usage patterns – and companies forming social media strategies should consider these elements. Our survey identified six user groups; understanding these target segments will facilitate analysis of consumer engagement to form insights on a broad spectrum of business activities, such as product development, brand and marketing strategy, sales lead generation, and customer service and support.

The most populous nation moves online

Internet usage has expanded more quickly in China than anywhere else in the world. In December 2011, China had 513 million Internet users, compared with 67 million in Germany, 121 million in India, and 245 million in the United States (Exhibit 1). The largest group of Chinese Internet users consists of people under 35, with 40 percent between the ages of 25 and 34. Some 250 million Chinese Internet users are concentrated in cities with populations exceeding 2.5 million. More than 50 percent of Chinese users spend more than 12 hours online each week.

The increasing popularity of the Internet – coupled with maturing online payment systems and enhanced logistics service reliability – has fueled e-commerce growth in China, with over 2,000 companies vying to become China’s version of Amazon. Chinese e-commerce is expected to triple by 2015, when sales could reach the equivalent of

China already has the world's largest population of Internet users

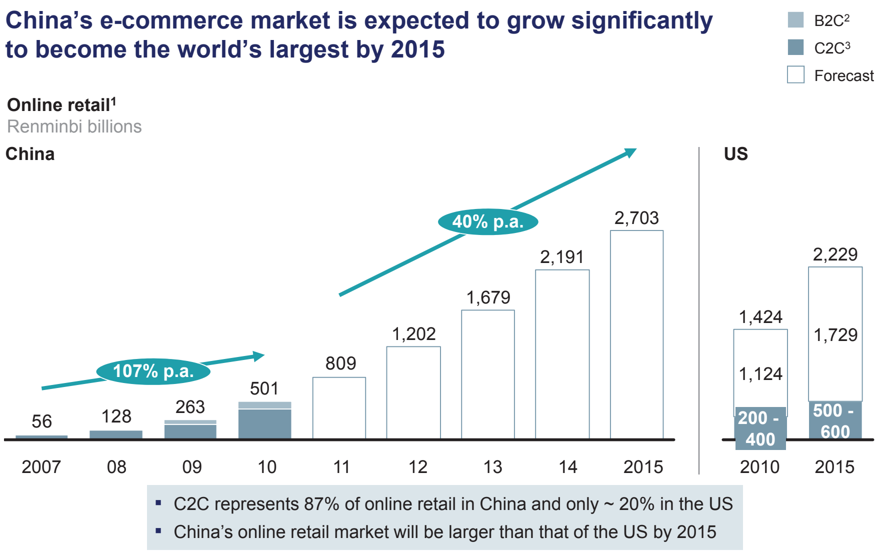


1 Including people accessing the Internet via personal computer and mobile phone; data as of the end of 2011
2 Percentage of overall Chinese population over age 6

Exhibit 1

SOURCE: Internet World Status, December 2011

China's e-commerce market is expected to grow significantly to become the world's largest by 2015



1 Excluding financial products, travel package/ticketing, and utility fees
2 Business to consumer
3 Consumer to consumer

Exhibit 2

SOURCE: CMM; CCID Consulting; Sino Market Research; Gartner; IDC; Euromonitor; Planet Retail; Forrester; BBE; GfK Market Consulting; McKinsey

USD 420 billion – 20 percent higher than the projection for the US market (Exhibit 2). As e-commerce rises, a compelling opportunity for brands will be to prompt immediate purchases online by consumers using social media to access product information.

Chinese consumers gain access to the Internet primarily through personal computers; however, they are moving quickly to mobile devices. About 50 percent of mobile phone users in the survey said they were planning to buy a smartphone in the next six months; 35 percent said they have already used a tablet computer, and one-fourth of consumers who do not own a tablet computer said they plan to buy one in the next year. Some 58 percent reported using a smartphone to browse social media sites at least once a week, compared with 43 percent of consumers in the United States.

China's unique social media landscape

Local Chinese sites dominate the landscape. While Facebook and Twitter are fixtures of daily online use in the West and in other Asian countries, there is no access to these sites in China. In our survey, Chinese consumers identified the following social media sites as their favorites: Qzone, which 44 percent of respondents said they use the most; Sina Weibo and Renren, each the favorite of 19 percent of those surveyed; Tencent Weibo, with 8 percent; and Kaixin, at 7 percent (see text box below).

Chinese social media sites possess some distinctive features compared with counterparts elsewhere:

Qzone. Media conglomerate Tencent Holdings owns this site, which is bundled with the company's popular Internet messaging tools. It bears similarities to MySpace in that it allows users to create their own Web pages to post their own content such as updates, photos, and videos.

Sina Weibo and Tencent Weibo. Weibo means "microblogging" in Mandarin. Weibo products offer many of the features that Facebook and Twitter do. Users can, for instance, post personal updates with a 140 character limit, upload photos and videos, and message other users. Sina Weibo introduced a multimedia function a year and a half before Twitter did. Tencent Weibo, its primary competitor, is owned by Tencent Holdings and recruits users from its QQ instant messaging base. It has more users from smaller cities than does Sina Weibo.

Renren. Ren means "people" in Mandarin, and the name Renren suggests people communicating with other people. Like Facebook, it began as a social networking site exclusively for college students. While now open to a general audience, it is still dominated by university students and recent graduates.

Kaixin. Kaixin means "happy" in Mandarin. Kaixin is also a Facebook-like site. The company started off by offering online games. It targets white-collar office workers.

The survey elicited several other important findings:

- Chinese social media sites are already nearly as important as portals in serving as an entry point to obtain content. Around 40 percent of personal computer users said they prefer portals for this purpose, while 36 percent opted for social media sites. Search is still by far the largest source of content, with 80 percent of users employing this tool.

- Chinese Internet users spend more social media time than their counterparts in Japan and the United States. In China, they spend 46 minutes a day visiting social media sites, compared with 7 minutes in Japan and 37 minutes in the United States. As time on social media sites increases, consumers are spending less time on other sites (Exhibit 3). The trend is also changing how consumers communicate (Exhibit 4).

- Different social media sites attract different kinds of users. For example, consumers who favor Sina Weibo tend to be in higher income brackets, earning more than USD 1,300 a month – and they are much more likely to live in the country's tier 1 cities of Beijing, Guangzhou, Shanghai, and Shenzhen.

China's expanding social media universe includes online product reviews, blog posts on the latest in technology and services, and a remarkably vocal group of consumer advocates who don't hesitate to condemn products they consider shoddy or substandard. Chinese bloggers enjoy huge audiences. Laoluo, a language teacher, for example, has 1 million followers and frequently writes about defective products and technology. Little S, a Taiwanese actress with 12 million followers, blogs about celebrities and other popular topics. One challenge is the increasing amount of "seeded" content generated by companies looking to generate positive sentiment toward their brands and negative sentiment toward competitors. This complicates analysis of Internet voices, increasing the importance of screening out commercial noise to get at authentic consumer sentiment.

The popularity of social networking has resulted in a significant decrease in time spent elsewhere online

How has your time spent on the following changed since you started using a social networking site?
Percent, n = 709

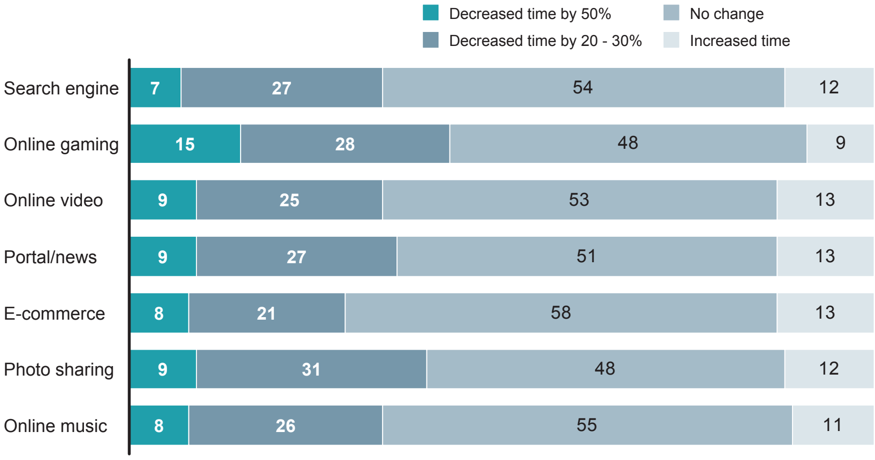


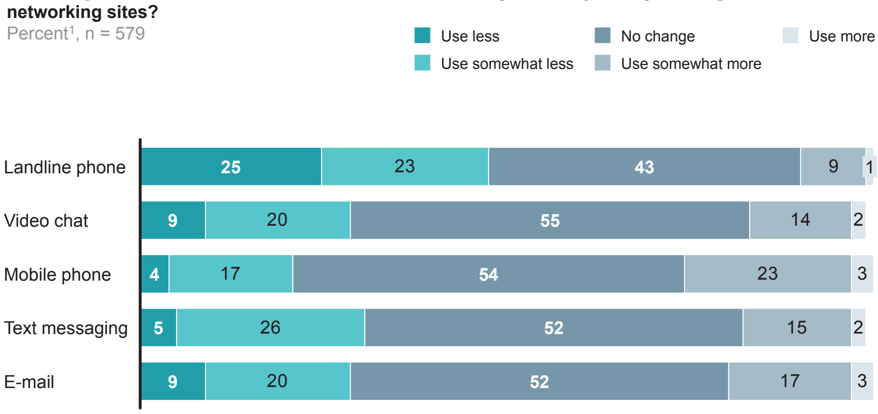
Exhibit 3

SOURCE: McKinsey iConsumer (China, 2011)

Social networking is becoming more important as a communication channel

How has your use of other communication channels changed since you began using social networking sites?

Percent[1], n = 579



1 Some categories exceed 100% due to rounding

SOURCE: McKinsey iConsumer (China, 2011)

Exhibit 4

China’s distinct social media users

To better understand Chinese social media users, McKinsey segmented them into six groups based on motivation and behavior:

- *Social enthusiasts* spend a large portion of their time maintaining friendship networks; they account for about 15 percent of social media users.
- *Resenders* account for 15 percent of participants, actively reposting messages – such as jokes – from other sources. Although they do not post original material, they often have large numbers of followers.
- *Readers* generally do not participate but read what others have posted. They make up about 14 percent of users.
- *Opinionated users,* about 14 percent of participants on social media sites, express their own – often strong – opinions and build large personal followings.
- *QQ spillovers* gain access to social media sites thanks to their use of the QQ instant-messaging service owned by Tencent. While this group accounts for 21 percent of the audience for social media, participation from such users is minimal.
- *Inactives* belong to social media sites but do not participate in a meaningful way.

The first four user segments tend to be more important than the last two for companies trying to reach Chinese consumers. Companies should consider these consumers’ differing motives for using social media and their purchasing patterns along with influencing factors when thinking about how to engage them.

Social enthusiasts are a brand's best friend. They spend more time on social media sites than any other segment – 69 minutes a day, compared with an overall average of 46 minutes a day. They use social media to build and maintain their circles of friends: 68 percent of respondents in this segment post daily updates on their lives, while only 41 percent of all users do. And they care about the number of friends they have: 76 percent agree that having a large circle of friends is important to them, while less than half of average users claim this. What is also apparent is that this segment is more educated and slightly younger than average.

These consumers are happy to see brand ads on their sites. They are by far the most likely to use social media to learn about products and services that they want to purchase. Around 46 percent of respondents in this segment agree that this is an important feature of social media. This is the case for only 30 percent of users overall. Social enthusiasts are the most open to advertising and special purpose apps sponsored by brands. Social media is used most for sharing reviews of products and services and telling friends about their recent purchases. People in this segment are more likely to use Groupon-type coupons issued to large groups of consumers than are people in other segments.

Resenders are also brand-friendly. They see social media sites as a means to promote themselves: 32 percent of respondents in this segment indicate that "driving traffic to my blog and generating followers" is important, compared with an average of 18 percent for all respondents. They achieve this by building on other activity, for instance, commenting on others' blogs, writing on their walls, or reposting videos. They have somewhat lower education and income levels than the survey average, and more of them live in lower-tier cities.

In addition to being friendly to brands, these users are happy to contribute to Web pages devoted to a particular brand's products. More than 40 percent say they make Groupon-type purchases, and 69 percent claim they spend money on things they see on social networking sites every month – a level that exceeds even that of social enthusiasts.

Readers also spend significant time on social media (55 minutes a day), but a big portion of that is devoted to reading content. For example, they typically follow a number of microblogs and read them on a daily basis, but only 13 percent of respondents say they comment on blogs, and only 7 percent state that they write on someone else's wall. They also rarely post their own content on the Web. Consistent with their behavior, consumers in this segment tend to be neutral about brand advertising on social media sites, but they could be influenced by bloggers talking positively about products. Like social enthusiasts and resenders, they strongly agree that they make friends with companies online.

Opinionated users could become a brand's worst enemy if not managed well. They spend an average of 60 minutes on social media sites every day, and more of that time is devoted to uploading content than reading it. More than 60 percent of respondents in this segment view social media sites as important places for them to express their opinions, while only 26 percent of overall respondents do. This group of consumers does not want to see brands advertised and will speak out if they have had a bad experience with either a product or a brand. They are much less likely than people in other groups to purchase an item that a site has featured.

Our segmentation suggests that a one-size-fits-all approach to marketing on social media sites could be a waste of time and money. Instead, it's important to recognize different patterns of consumer behavior in social networking, as receptiveness to commercial activities and preferences about modes of interaction clearly vary. It's also essential to deploy strategies appropriate for each segment as they apply to target consumers.

Engaging with digital Chinese consumers

Companies face three major challenges in China when seeking to extract value from social media. First, some executives lack familiarity with social media and do not know how to mine consumer insights from this ocean of data – or how to translate those insights into actions, especially in the country's dynamic ecosystem. Second, existing social media knowledge and analysis is often not actionable. Participating in the social media space requires companies to build capabilities and focus on execution. Third, executives may be unsure how to fit social media insights into traditional brand planning processes, who should own social media within the organization, or how to measure impact. A few important areas should be considered when exploring how to create value from social media:

Social media objective and baseline setting. Companies should decide what they would like social media to achieve for the business – for example, product development, brand and marketing strategy, sales lead generation, or customer service and support. They should develop an understanding of the social media context by systematically tracking buzz volume and brand sentiment against competitors. And they should identify important platforms and individuals who matter to their brand – especially opinion leaders who have a significant number of followers.

Case study 1

One multinational appliance maker learned a hard lesson about the power of social media in China. After a popular blogger complained about a defective product, the company responded through Weibo, but it refused to recognize the quality problem. Other consumers soon joined in and uploaded videos of and posts about their own problematic appliances, severely damaging the brand's equity. Takeaways from the episode: companies must learn the rules of the game in social media and engage consumers accordingly; additionally, they should build relationships and engage with key opinion leaders before a crisis hits. In our view, having a few dedicated members to seed content is usually not sufficient, given the sheer scale of the landscape and consumer expectations. Companies should adjust their organizational models and use new approaches to handle the requirements of consumer engagement on social media.

Case study 2

A good example of how social media can be used in marketing stems from a thunderstorm that drenched Beijing in June 2011. It began with a post on Sina Weibo: photos of a young man putting Durex condoms over his shoes. This post was then picked up by the official Durex Weibo account. The post went viral and reached an estimated 50 million users throughout China. China Daily described this effort as one of the most successful uses ever of social networking for marketing purposes.

Social media engagement. Companies should prioritize platforms to build a presence and reach target consumers. They should clarify the role that each platform will play in the overall engagement strategy. What is also important is for companies to have two-way conversations that involve consumers, rather than carrying on a monologue. They should engage on topics that are of interest, determining these by observing discussion topics in consumer posts, for example. Additionally, companies can host events for key influencers to create positive experiences and encourage them to become brand advocates.

Organization, IT enablement, and capability building. Organizational needs must be defined, and talent should be recruited to close key capability gaps. Companies can use social media tools to monitor consumer discussions, and they should integrate social media insights and engagement into regular business processes. They should define key performance indicators to track social media performance and foster cross-departmental collaboration to take full advantage of this opportunity.

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The eager adoption of homegrown social media sites by Chinese consumers has created unique opportunities for companies that want to gain insights about and engage with a vast and increasingly affluent market. Companies that want to tap into the power of social media should understand the landscape and different types of users. This can help them glean insights and engage consumers. And companies should also be prepared to make significant organizational and operational changes, including shifting mindsets to capture the full value of social media for the future of the business in China.

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9 Streaming success: Video's new vantage point

By Steven Neubauer, Pierre Pont, and Oliver Strutynski

Over-the-top content and non-linear video streaming are giving consumers more choices than ever when it comes to watching what they want and when they want. In this context, traditional actors need to cope with threats to their business models in the long run and prepare for the changes ahead, while investigating how to best capture new opportunities.

Gone are the days of racing home to catch your favorite TV show, standing in line at the local video store, or endlessly channel surfing with your remote in hand. Although traditional viewing will remain the primary mode of video consumption for years to come, the shift toward non-linear viewing is well under way and here to stay. Moreover, OTT offerings are already creating fundamental game-changing consumption patterns. These patterns are affecting the broader telecommunications, media, and technology (TMT) space and are increasing competition throughout the value chain.

A growing piece of the pie

McKinsey's most recent iConsumer survey highlights the quickening pace of OTT service adoption, most notably in the United States and in Europe. Between 2008 and 2011 in the United States alone, the share of Internet-enabled households that used OTT services at least once per month jumped from 8 to 31 percent (Exhibit 1). The survey also uncovered that growth in the use of OTT services spans all age groups; usage over the age of 55 is on par with the 18- to 24-year-old user segment.

Beyond the inherent attractiveness of OTT services (e.g., personalized content, viewing flexibility), the quickening pace of service adoption is grounded in four key converging factors:

- *Digitization.* From movies and television shows to podcasts, the amount of content either created or converted for non-linear consumption has skyrocketed.

- *Lower streaming costs.* Just a few years ago, data costs might have prohibited the widespread proliferation of OTT services. As costs have decreased by about 20 percent per year, streaming video has become a viable alternative.

- *Broadband penetration and connected devices.* Throughout the United States and Europe, the overwhelming majority of households are broadband-enabled. In addition, households are increasingly connecting video-enabled devices to the Internet.

- *A growing number of attractive offerings.* Just a few short years ago, what was available through OTT services were largely niche offerings. Now, most large studios and license owners have recognized the potential for new audiences and new revenues from OTT distributors (especially for their back catalogs), so the breadth and depth of content available is extensive and growing.

Despite their growing popularity, OTT services and non-linear viewing are still a distant second to traditional linear viewing. In the United States, for example, online video and

OTT service adoption has increased among US and European consumers

Percentage of Internet-enabled households using OTT services on their TVs at least once per month (self-reported)

Exhibit 1

SOURCE: McKinsey iConsumer

time-shifted video consumption represented only 11 percent of overall video consumption in 2011, while linear TV remained the dominant form. Even among younger consumers, the preference for linear viewing over on-demand for key genres – including live sports – is overwhelming. As user interfaces become simpler, more devices become connected, the amount of content grows, and consumer prices fall, non-linear viewing is expected to make up an increased share of the overall viewing experience for consumers, and OTT is likely to account for up to 20 percent of all video consumption in 2016.

Coming of age

As might be expected, OTT's small share of the video consumption pie has translated into relatively small revenue pools to date. And despite the fact that growth in consumer spending on online video is significantly outpacing growth in physical video and pay-TV subscriptions, forecasts for 2014 predict that the amount spent on online video will account for just 5 percent of overall consumer spending on video. The other side of the revenue equation tells a similar story. Of the USD 196 billion expected to be spent on video advertising in 2014, only USD 9 billion is predicted to be spent on online video and mobile TV.

That said, the industry is maturing quickly, and big pure-play names are addressing consumers on a massive scale. Netflix reached 27.5 million subscribers worldwide in Q2 2012 and offers over 1 billion streaming hours per month; in addition, local players are emerging, such as Maxdome in Germany. Three business models exist: advertising-based (e.g., Hulu), subscription-based (e.g., Netflix, or LoveFilm in the UK – with their flat-fee structure), and transactional (e.g., Apple iTunes) – with most pure online attackers focusing on one clear business model, Amazon being the rare exception. Because ad- and subscription-based models capture the most value, it is likely that transactional models will take a backseat to the other two. Online rental and subscription are predicted to show double-digit growth this year (30 to 50 percent in advertising alone), while online purchasing is expected to slow.

Beyond the emergence of major business models, the industry's coming of age is further characterized by the fundamental transformational shift taking place due to globalization – like Netflix moving into Latin America, the UK, and Sweden – and differentiation-related challenges. With regard to the latter, we are witnessing the first steps of OTT players' vertical expansion in the value chain.

Current global OTT giants need to become more than mere pipes for transmitting content produced by big studios or individual users. Driven by the increased commoditization of movie content, the growing competition for TV content, and the increased bargaining power of content producers, Netflix, Hulu, and Amazon have all begun investing in the production of original content. In addition, YouTube – the largest OTT player in terms of size – has invested significantly in its own channels (YouTube Original Channels); Netflix produces 5 to 12 original series a year; and Amazon is in the process of building its own production studio.

Since movies are commodities that are now generally available to all big OTT players, consumers have found that there are limited differences between the movie content available on platforms with comparable business models. OTT players have reacted by increasingly competing for TV content – with a focus on TV series. This, in turn, has led to skyrocketing prices for content rights. Significant value and power has also shifted from content distributors to producers. To increase their control over content rights and to increase differentiation, OTT players are now beginning to invest in original content – even though they have done so only to a limited extent to date.

Immediate implications for traditional TMT players

OTT and other non-linear video services are here to stay and will have a lasting impact that extends beyond the players themselves and the customers they serve. Already, McKinsey's iConsumer survey provides evidence of a growing consumer segment that uses OTT and that has never had cable or satellite service.

Just as OTT companies have to adapt to the world of video that they themselves have created, players in the broader TMT world must consider their positioning when consumers begin to view those services as standard that they once considered exceptional. Viewers are increasingly expecting to be able to watch their favorite programming whenever they choose and from wherever they happen to be. There is also a growing expectation that their program options will be virtually limitless and that they will not be confined to watching on their television sets. As viewers expect more, companies that operate the traditional modes of video will have to step up their games.

Pay-TV players. The value of the pay-TV business – driven by cable, satellite, and IPTV companies – could come under pressure from OTT attackers in the medium to long term. The obvious threat here is that with the rise of original content and viewing flexibility, consumers might abandon their traditional services altogether. The threat of churn exists, of course, but not all pay-TV players are equally implicated. Pay-TV customers with a "movie-only" focus would be among the first to abandon their pay-TV subscriptions, whereas subscribers who are driven by live entertainment content aren't as likely to abandon their services entirely.

For this latter category of pay-TV customers, McKinsey's iConsumer survey reveals two other likely responses that have a potentially greater impact on traditional pay-TV players. In the United Kingdom, only 2 percent of OTT users who subscribe to cable or satellite say they cancelled their service in the last three months (cord-cutting), but more than 15 percent report having already downgraded their service (cord-shaving) – almost triple the rate of non-OTT users (Exhibit 2).

While OTT attackers may drive pay-TV downgrades in the medium to long term, this remains unlikely in the short term. The most short-term negative impact will probably be an increase in content cost, particularly for non-live content. On the flip side, OTT has forced actors to innovate and create further value beyond content for their customers.

Indeed, the increase in functionality is also forcing traditional subscription video service providers to make improvements; cable and satellite operators are developing offers in order to keep up. By growing their on-demand libraries and introducing "TV everywhere" digital offers, these traditional distributors are closing the "watch whatever/whenever" and "watch wherever" gap that OTT services opened.

Free-to-air broadcasters. The underlying value drivers of free-to-air (FTA) appear resilient to near-term trends but could come under pressure in the long run. Players in this traditional category are better positioned to defend their profitability than their pay-TV counterparts for a few key reasons: first, broadcast TV remains the medium with the broadest reach and highest usage frequency. This makes FTA broadcasters the most sought-after destination for advertisers. Moreover, FTA inventory is an established currency among advertisers, agencies, and broadcasters, and online attackers are struggling to establish a similarly accepted advertising currency. Second, when it comes to content, FTA broadcasters either own or have privileged access to the most popular local and international programming, and the acquisition costs of this content are largely

UK OTT users downgrade rather than cancel pay-TV services

UK EXAMPLE

Percentage of users who downgraded and/or cancelled their pay-TV services in the last three months;
n = 991 OTT users and 3,863 non-OTT users, 2011

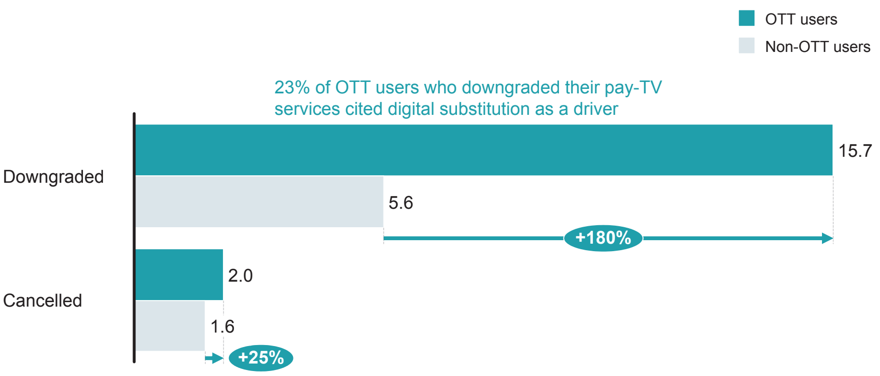


Exhibit 2

SOURCE: McKinsey iConsumer (UK, 2011)

fixed (at least for the medium term). Third, FTA broadcasters are naturally suited to either create their own OTT offers based around their content or to partner with OTT players for online distribution of their content, since they exercise strong control over content rights.

Nevertheless, broadcasters need to act now to reserve their right to play and to defend against potential attacks over the long term. A clearly articulated strategy is needed – one that takes into account both the short- and long-term impact of various strategic moves.

As key players in the industry, broadcasters have the opportunity to shape the development of the ecosystem as well as their positions within that ecosystem. In particular, broadcasters need to ensure comprehensive and long-term control over rights, decide on a clear position regarding potential partnerships, and realistically assess their capabilities, in light of growing competition from global technology players.

Telecommunications operators. In addition to cable companies and other traditional distributors, telecoms providers are also heavily impacted by the rise of OTT services. In particular, as more users consume more OTT services, the strain on fixed operators' networks will increase rapidly, and mobile operators will be impacted as OTT services increasingly migrate to smartphones and connected tablets. While forecasts vary dramatically depending on country (due to different population densities, ways of using video, and video offerings – notably HD and 3D) and network deployment plans (VDSL, FTTH, LTE, etc.), it is possible to begin estimating consumption's evolution at the granular level.

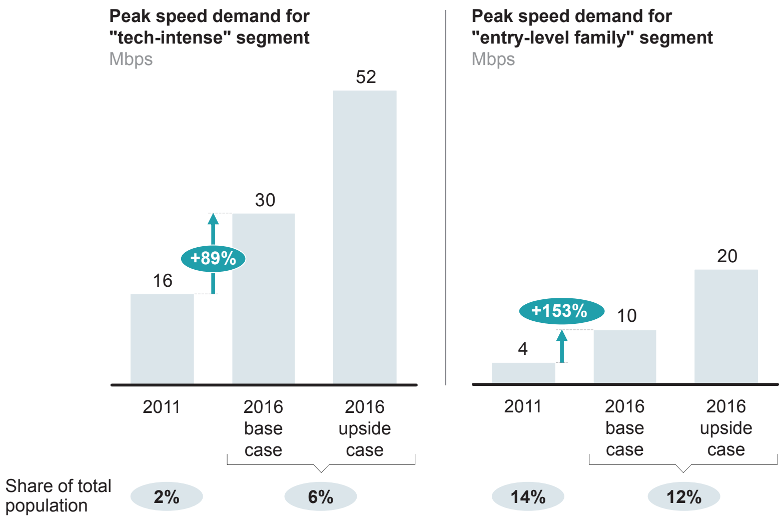
Based on iConsumer data, McKinsey examined a possible bandwidth demand scenario for two different types of household segments: a "tech-intense" segment for which all digital services run over IP as well as an "entry-level family" segment for which only 50 percent of all digital services go through IP (e.g., OTT).

Conservatively speaking, the results suggest that networks will need to be upgraded and expanded in order to allow peak speeds to be increased to a level that is almost two times faster than current levels by 2016 in the "tech-intense" user segment. In a more aggressive scenario, demand for speeds could expand threefold (Exhibit 3). An "entry-level family" segment would require a two- to five-fold increase in speed, but would still remain on par with current "tech-intense" needs. Nevertheless, the much larger size of this segment (compared with a "tech-intense" family) generates its own challenges.

Beyond these technical challenges, the financial equation – notably in terms of return on investment – is increasingly complex. In terms of costs, telecommunications companies do not have measures for meeting demand that are as cost-effective as cable, largely due to the capex requirements associated with building such a network.

Telecommunications companies are becoming increasingly commoditized and are facing increased competition and regulatory pressure. Having said that, they are also ideally positioned in the current TMT space to benefit preemptively from the new value pool that OTT is in the process of creating. While up-front investment costs – for content in particular – could rise quickly, telecommunications operators are in a privileged situation given their infrastructures, retail footprints, and strong cross-subsidization potential (mostly impacting churn based on current case examples). This means they can absorb up-front losses and leverage the OTT services if they are able to overcome the most commonly observed internal challenges – e.g., different capabilities, different cultures, and lack of managerial attention.

Network peak speeds must increase to meet demand in 2016



Note: Aggregate peak speed demand values include browsing, video, file sharing, online gaming, and communication
SOURCE: FCC; Nielsen; Cisco VNI; expert interviews; McKinsey

Exhibit 3

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OTT is here to stay. Although evidence suggests that it will not overrun the video landscape by 2016, it is already fostering fundamental, game-changing consumption patterns as well as impacting new consumer expectations. As usage increases and the OTT industry finalizes its coming of age during the next few years, TMT companies will be increasingly impacted. In the immediate future, content owners will likely be the big winners, benefitting from new incremental audiences, new distributors willing to pay for content, and the ability to drive pricing and build brands. New and local OTT entrants in particular will have to understand that content owners may be the entities who decide on what companies survive. More players are struggling to differentiate themselves and, accordingly, must compete for a fixed pool of content while dealing with potential cost increases and content shortages. In a new digital world of unlimited access and limited content, companies need to act now in order to reserve their right to play.

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