Howard Horowitz on the Transition to the Digital Home

Howard Horowitz, President
Horowitz Associates, Inc.
Howardh@horowitzassociates.com

Over the span of my two-decade career conducting consumer research on the market for cable, and now broadband, services, the landscape of this industry has changed dramatically, and now we are witnessing the transition to the digital home. This transition is rife with opportunities and with challenges for all of us in the industry today.

Over the years, Horowitz Associates has tracked this transition through our annual surveys of consumers and the market for cable, and now broadband, services. From our most recent research on the national market, **State of Cable and Broadband 2003**, we know that today, multichannel penetration overall is at 85% in the cable homespassed universe. Moreover, the data show that now, more than four out of ten multichannel homes in the U.S. today are digital—whether they receive those digital signals via their cable company, or from a satellite provider.

State of Cable and Broadband 2003 also shows that Internet and high speed broadband will soon reach the critical mass of multichannel services. Six out of ten homes in the U.S. (cable homespassed) now have Internet access to the PC and one quarter get High speed Data. Importantly, data from the new **High Speed Data: Challenges and Opportunities** study shows that, in markets where cable modems are available, almost half (45%) of homes with Internet access have High speed—either through a cable modem or DSL.

Along with our successes and the opportunities they afford come the challenges. What will be the impact of PVR, VOD, and HDTV on the traditional cable business model? What will be the outcome of the competition between cable and satellite and now cable modems and DSL? What will we do about the complex issue of digital rights management?

Our **Transitioning to the Digital Home** report chronicles 10 years of data from **State of Cable and Broadband.** This report also identifies what I believe are some of the most important issues that have influenced the cable and broadband market over the past decade, and that will be of key importance as we transition to the digital home. How we address these issues will play a key role in current and future market for advanced television and broadband services. The key industry issues causing and caused by this transition are: ***competition, convergence, compatibility,*** and ***cultural and generational shifts.***

Competition: Looking back over the past decade, it becomes clear that the transition from analog to digital was driven by competition, ushered in by the introduction of small dish satellites in 1994. No longer did cable have a monopoly on the delivery of video to the home. And while, over the past decade, the cable business has remained steady, satellite penetration has grown from a mere 1% in 1994 to 17% of all cable homespassed in 2002.

The ability of satellite to deliver digital signals to the home meant that cable had to respond in kind, and so digital cable was introduced. Today, cable and satellite providers are neck in neck for digital customers, with digital cable actually a step ahead: digital cable penetration has grown from 3% to 21% in a mere five-year span.

Yet, cable companies face a tough decision each time they launch a new marketing campaign for digital cable, or introduce a new and better service. There is no competitive dynamic for analog customers. But each time they upgrade an analog customer to digital, they essentially introduce that consumer to a new—and competitive—marketplace. And the competitive market for digital customers has become more and more aggressive as consumers' awareness and demand for digital technology increases. Cable's unique ability to offer interactive services, as well as High speed cable via cable modems, will keep traditional providers just one step ahead of the competition—for now.

Convergence: The past decade also saw the explosion of the Internet. Data from **Transitioning to the Digital Home** tracks this incredible growth: in 1994, only 23% of cable homespassed had Internet access. In December of 2002, Internet penetration in that universe is at 61%. Most importantly, in the cable homespassed universe, one out of four (25%) homes now have high speed data service, up from 5% four years ago.

We are on the brink of the era of convergence, as cable/DSL modems and digital television have the potential to breach the divide between the TV and the PC.

For the consumer, two-way Interactive TV services brings television functioning akin to computers and the Internet. In turn, high speed access makes computers look like television. There is debate about whether consumers will ever be able to merge the passive world of the TV and the active, engaged world of the Internet. But as consumers become more accustomed to being active participants of their TV viewing experience (going online to vote for favorite contestants or entering contests related to TV shows, for example) and to being passive Internet users (like viewing streaming videos and movies), those differences will blur. Not surprisingly, the transition to convergence is happening most aggressively among our young people, not hampered by discomfort with digital media tools.

This consumer form of convergence constitutes a major opportunity and, potentially, a major dilemma for the cable industry. On the one hand, the cable wire is a powerful delivery mechanism for both television and broadband-Internet services, as well as a great market opportunity for the cable operator. On the other, what will the implications be when consumers receive video signals over the Internet that go directly to a television set with excellent picture quality? Without a clear answer and with crucial issues in digital rights management remaining unresolved, the true consumer market for convergence remains untested since no one on the business side is really providing a truly converged alternative (and some may even be trying to turn back the tide).

Compatibility: Intertwined with the developing issues of competition and convergence, the issue of compatibility represents another important issue in the transition to the digital home. The issue lies in the *incompatibility* between television equipment—both analogue and even the latest digital equipment-- and digital cable (and satellite) TV signals.

Eight out of 10 homes in the U.S. have more than one TV, yet the digital signal can only reach those TV's with a set-top box -- little more than half the installed base of TV's even in homes that have digital services -- diminishing the value of high-end, digital service in consumers' minds.

In fact, both consumers and the industry find themselves in a paradoxical situation. After all, the era of cable and pay TV ended the shared viewing experience. The days when the family gathered around the TV set in the living room ended when cable was able to provide programming tailored to the needs of each individual in the household. Yet, now that we have the interactive technology for *truly* personalized, on-demand viewing, we are sending everyone in the home back to one TV set. This structural problem needs resolved. If we can't "address" all the TV locations in the home, what is the real prognosis for the penetration of digital, broadband and interactivity-- and concomitantly, the development of "valuable" content?

Cultural and Generational Shift: One thing is clear as we transition to the digital home. In order to succeed in this new marketplace, it will be increasingly important for media companies to understand and cater to the next generation of TV and Internet consumers, which is *fundamentally different* than any previous generation of media consumers. **America's Multicultural Youth: The Next Generation** (also the title of our latest study) is growing up digital as well as multicultural. The generally accepted perception of what constitutes America's "general market" must change, as Americans of African, Hispanic and Asian origin will soon begin to outnumber those of European descent. In fact, over the past 20 years, the "minority" population in the U.S. grew eleven times as rapidly as the white population, and now, one out of every four Americans are of a race other than white, and about 39 million Americans are of Hispanic origin.

Leading this cultural transition are America's young people, who are not growing up in the same ethnically isolated enclaves of their parents but rather in a world characterized by inclusion, diversity, multiculturalism, urban sensibilities, and, of course, digital technology. These young people -- black, Latino, Asian, white-- are as *culturally* fluent as they are fluent with *digital media*.

Our **America's Multicultural Youth: The Next Generation** study illustrates just how digitally oriented today's young people are. In the households where this country's 12-24 year olds are living, digital television penetration is at 45%. Almost half of young people today are growing up in a digital, not analog TV environment. And among these young people, Internet access is almost as ubiquitous as cable—eight out of ten young people have Internet in the home, and four out of ten have high speed.

America's next generation of media consumers anticipate and embrace the advanced, interactive applications that digital technology promises, and they will expect and demand media images reflecting their cultural and ethnic diversity. Will the industry deliver?

Moving forward, the general issues of competition, convergence and compatibility bring to light some *specific* policy and strategy matters of immediate urgency that need to be addressed in order to fulfill the promise of new technology. The impact of HDTV mandates, the implications of PVR and VOD, and most importantly, the problem of digital rights management do pose real challenges for the industry, but are more constructively viewed as *creative opportunities* instead of problems. At the same time, the demographic shift occurring in America means programmers will need to approach content in a fresh new way that reflects the changing face of America and adequately serves cable and broadband's new audiences. We have created the gaps between consumers, content and technology. We can now bridge them by addressing these important issues—competition, convergence, compatibility and multiculturalism.