Briefing

Thomas Künstner
Matthew Le Merle
Dr. Hannes Gmelin
Christian Dietsche

booz&co.

The Digital Future of Creative U.K.

The Economic Impact of Digitization and the Internet on the Creative Sector in the U.K. and Europe

CONTEXT

Digitization—the mass adoption of connected digital technologies and applications by consumers, enterprises, and governments—is a global phenomenon that touches every industry and nearly every consumer in the world. For each industry, digitization changes how things are produced, how they are sold and distributed, how the firms are managed, and how and with whom they compete. For many industries, digitization completely revolutionizes the way companies interact with their customers.

Among the sectors most profoundly affected by digitization is the creative sector, which, by the definition of this study, encompasses the industries of book publishing, print publishing, film and television, music, and gaming. Nearly all of these have been fundamentally altered by the penetration of digital media into everyday life. Some industries, such as the music industry, have been wrestling with digitization for a decade or more; others, like print publishing, are only now feeling its full impact.

The objective of this report is to provide a comprehensive view of the impact digitization has had on the creative sector as a whole, with analyses of its effect on consumers, creators, distributors, and publishers.

It is particularly important to look more closely at the prevailing myth of digital erosion—the idea that online media and the accompanying "for free" culture have, in effect, led to a slowdown in growth and a loss of jobs. Indeed, digitization and the Internet are often named as the root causes for some of the creative sector's problems; this is a perspective that fails to take into account many of the benefits of digitization.

In this report, we take a more differentiated perspective, looking at each industry in detail. Our conclusion: The vast majority of all growth generated by today's creative sector is digital. Depending on the industry, the non-digital part of the business is generally stagnating or even shrinking, but all industries have one thing in common: Digital is growing, enabling a 2 percent yearly growth for the entire creative sector in Europe. This growth is primarily driven by direct consumer payments, which are up 25 percent from the numbers in 2001—underlining the point that consumers are sustainably willing to pay for creative content.

Furthermore, overall employment in the creative sector has been stable over the last 10 years, whether despite digitization or (more likely) because of it. Finally, benefits to consumers have been significantly increased by digitization. For example, access to creative products and services has increased, and so has consumers' use of them. This report presents data and case studies on how some creative industries and companies across Europe, and the U.K. in particular, are successfully leveraging these developments and seizing the opportunities while others are struggling to maintain their position.

Digital is and will be at the heart of the sector's future, if only because the consumer has decided it should be.

This report was commissioned by Google Inc. and Creative England, and independently researched and written by Booz & Company.

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4t2 (U.K.)
Adese (ES)
Aeria Games Europe (D)
Allianz Deutscher Produzenten (D)
All3Media (U.K.)
Audioteka (PL)
aufeminin.com (F)
Baltic Creative (U.K.)
Base Creative Agency (U.K.)
Base79 (U.K.)
Beatpick e Soundreef (I)
CD Projekt RED (PL)
Colorado Film (I)
Creative England (U.K.)
DCMS (U.K.)
De Tullio & Partners (I)
demosEuropa (PL)
Double Negative (U.K.)
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Fapae (ES)
FAPAV (I)
Fedicine (ES)
Finetunes (D)
Fluffy Logic (U.K.)
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Goldmedia (D)
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La Stampa (I)
Lyra Media Group (F)
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MillionYou.com (PL)
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MTV Northern Europe (D)
My-Music.pl (PL)
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Newbaz (U.K.)
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Piano Media (PL)
Platige Image (PL)
Promusicae (ES)
RAI Cinema (I)
Sapienza Università di Roma (I)
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SPI International Poland (PL)
Spotify (U.K.)
Startnext LAB Berlin (D)
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Tuenti (ES)
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This report was commissioned by Google Inc. and Creative England, and independently researched and written by Booz & Company, drawing on expertise from its communication, media, and technology practice and its digitization team, and also on academic and public research, public information, and primary research.

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KEY HIGHLIGHTS: CREATIVE GROWTH IS DIGITAL

Mass adoption and high usage of the Internet have revolutionized the creative sector—but the biggest changes are yet to come.

Media usage accounts for more than 60 percent of time spent in leisure activities across Europe; the Internet has driven consumption levels of creative products to record levels (+20 percent from 2004 to 2011 for the EU-27). U.K. media usage was among the most dynamic of the EU-27 countries with an increase of over 30 percent.

Overall, **consumer spending in the creative sector is up by 28 percent** from spending in 2001 in the U.K. and up by 25 percent across Europe; as further analysis shows, there is no lower consumer willingness to pay.

Consumers benefit from a greater variety of content available anytime and anywhere, generally at lower prices.

These changes have been reflected in industry growth (+20 percent in the 2001–11 period in Europe; +15 percent in the U.K.); yet the creative industries surveyed have developed at a rate slightly below GDP growth, which also mirrors the sector's digitization efficiency gains.

All growth in the creative industries is driven by digital media (an additional €30 billion in revenues in 2011 versus 2001) in Europe as well as the U.K. with additional revenues of €6 billion.

The overall **number of jobs in the creative sector in Europe has been stable at 1.2 million** on macro level albeit large variations on industry or country level, e.g., job growth in Poland – whereas the U.K. saw a slight decrease in the number of jobs.

Content creators benefit from easier access to distribution and more channels of communication with their audience members; their value captured seems to be stable, if not growing, in most industries analyzed.

In some industries, such as film, digital growth has already made up for losses in non-digital media; in other industries, such as book publishing, growth opportunities are emerging as digital media begin to mature: **New consumer experiences are being created and effectively monetized.**

The transformation to digital is challenging for many creative industry players, particularly those established players that focus on packaging and distribution of content, including many recorded music companies, which find it difficult to transfer their capabilities and business models to the digital ecosystem. New entrants and local companies, though, have gained easier **access to global consumers.**

The Internet has unearthed efficiencies in the creative sector, especially in manufacturing and distribution. Lower revenues are not necessarily a sign of weakness in these industries, as they are often accompanied by lower cost and the impact on company profits thus might vary significantly depending on the cost structure.

A new ecosystem architecture is emerging and presenting great opportunities. At the heart of the most successful business models is a seamless consumer experience, increasingly realized by new market entrants or involving their partnerships with incumbents.

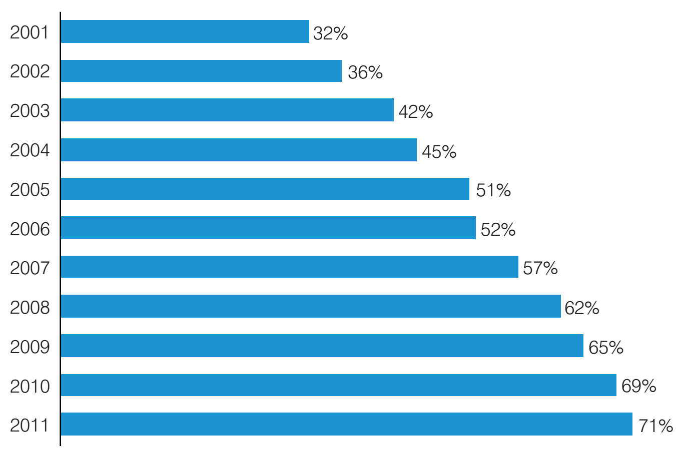
1. INTRODUCTION: SETTING THE PACE FOR CHANGE

Digitization—the mass adoption of connected digital technologies and applications by consumers, enterprises, and governments—is a transforming force for all industries. It changes the way products and services are produced, marketed, and consumed. This change is especially pronounced for creative industries. Consumers now expect to find information about media and entertainment on the Internet; they shop online for the media they buy; and they often receive the product online in fully digitized form, as a download of (for example) a movie, software package, publication, or audio recording.

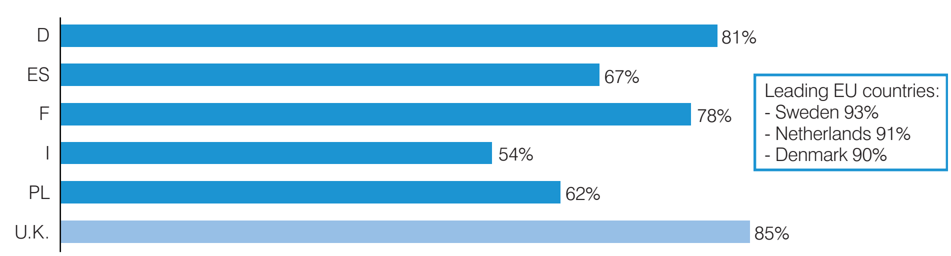
One primary enabler of this shift has been the build-out of broadband infrastructure. This development is already quite advanced in the mature European economies, where usage has evolved to mass adoption during the last 10 years. In the EU-27 countries today, more than 70 percent of all inhabitants use the Internet (*see Exhibit 1*). Although there still are large disparities between the different countries—in 2011, Internet usage ranged from a top 85 percent of the population in the U.K. to 54 percent in Italy—the penetration of digital infrastructure and services is generally high.

Exhibit 1
Internet Usage Has Grown Significantly between 2001 and 2011

INTERNET USAGE IN LAST 3 MONTHS
EU-27, 2001-11, Percentage of inhabitants



INTERNET USAGE IN LAST 3 MONTHS
Focus countries, 2011, Percentage of inhabitants



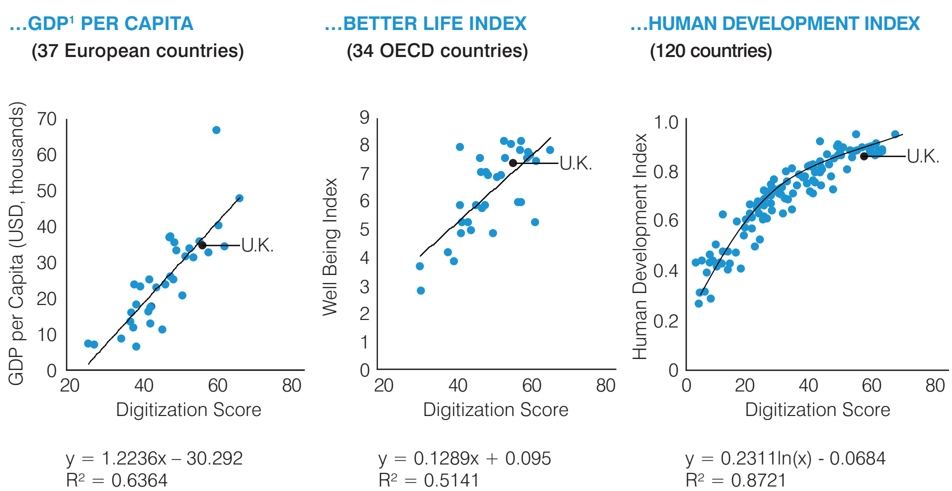
D	Germany	**F**	France	**PL**	Poland
ES	Spain	**I**	Italy	**U.K.**	United Kingdom

Source: Eurostat, Booz & Company analysis

All indications suggest that the impact of digitization will only increase during the next few years. The European Commission's Digital Agenda is actively promoting this; one of its key objectives is 100 percent population coverage with 30 Mbps+ broadband by 2020.[1] Technological change also has its own momentum. According to a study by Ericsson, by the year 2018, all mobile phones in Europe will be smartphones.[2] That will enable more and more people to communicate conveniently, to access digital services, and to receive personalized and localized information on the go. "Generation C"[3]—born after 1990, always connected, communicating, and clicking—already behaves in that way, and other demographic groups will follow suit. Older generations will use different services, e.g., online health monitoring or specific modes of communication, but they will go digital as well.

This is all welcome news. A 2012 study conducted by Booz & Company for the World Economic Forum (WEF) found that a higher degree of digitization tends to benefit consumers and the economy at large.[4] In Europe, performance indicators of economic and societal well-being, such as GDP and the OECD Better Life Index,[5] are positively influenced by rises in the ubiquity, reliability, and speed of digital services. These factors are all used in determining a country's or region's score on the Booz & Company Digitization Index. In other words, the higher a country scores on the Digitization Index—the U.K. ranks in the Top-15 of over 120 countries assessed, the higher it is likely to rank in dimensions such as GDP per capita, the Better Life or the Human Development indexes (*see Exhibit 2*).

Exhibit 2
Correlation between Digitization and Quality of Life



[1] Real GDP 2011
Note 1: Better Life Index brings together internationally comparable measures of well-being (Stiglitz-Sen-Fitoussi Commission)
Note 2: Human Development Index is a composite statistic of life expectancy, education, and income indices
Source: OECD Better Life Index, Gallup Well-Being Index, UNDP HDI, IHS, Booz & Company analysis

Future changes will go beyond the media and entertainment industries. For example, innovations in digital fabrication, machine-to-machine communication, and wearable computing will lead to the emergence of an "Internet of things," in which material goods become far more fungible and customizable than they are today. Thus, the issues facing the creative sector today will face all industries in a few years. By putting the right kinds of measures in place with media today, society has an opportunity to pave the way for a highly beneficial continued rollout of digital development.

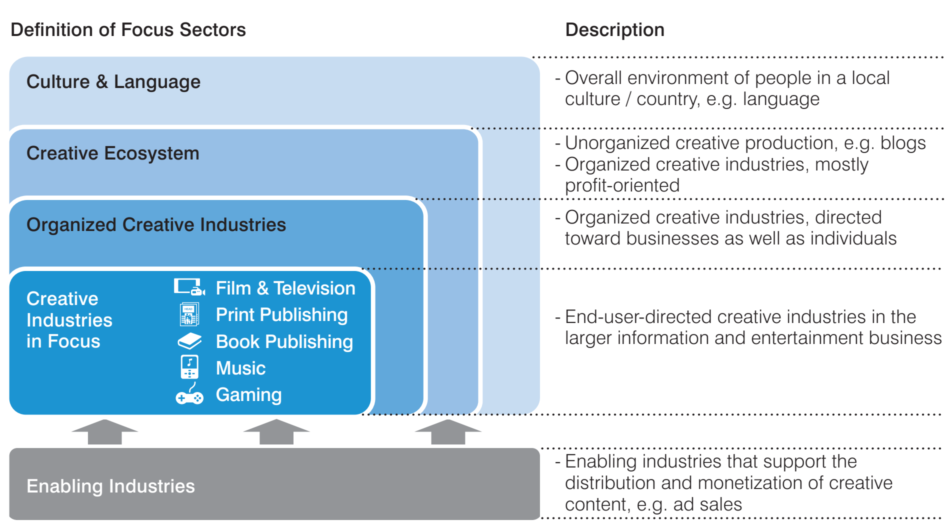
2. SHIFTING VALUE IN THE CREATIVE SECTOR

Everybody has an initial understanding of the "creative sector," but there is no uniform definition. To create a common ground that is comparable across the EU-27 countries, this report defines that sector as the end-user-directed creative industries in the larger information and entertainment business. Our research focuses on five industries: film and television, periodical (newspaper and magazine) print publishing, book publishing, music, and electronic gaming. These five are the major copyright industries from a revenue perspective, and within those industries most of the revenue-generating activities are included, both digital and non-digital.

The excluded industries include the live performing arts and sports events; fine arts, such as painting and photography; blogs and other content production not organized in a commercial format; and all business-to-business (B2B)-directed creative production, including product design and architecture. The creative sector is supported by "enabling industries" such as advertising agencies, search engines, and social media; these providers are also excluded from creative industries as defined by this report. (We thus include advertising-supported media, such as television and online newspapers, but not the advertising industry itself.) In short, our goal is to capture the impact of digitization on consumer-oriented creative media, where the works produced have a for-profit, commercial return (*see Exhibit 3*).

All the creative industries in scope include traditional products and services as well as digital ones; book publishers, for example, still produce hardcover and paperback print volumes as well as e-books. In all five industries, the major digitization trends are evident and active. The film and television industry has seen the introduction of a wide array of digital products—IPTV, over-the-top streaming, video-on-demand offers—revolutionizing the industry and pushing revenues to new levels since 2005. The music industry has

Exhibit 3
The Largest End-User-Directed Creative Industries Are the Focus of the Study



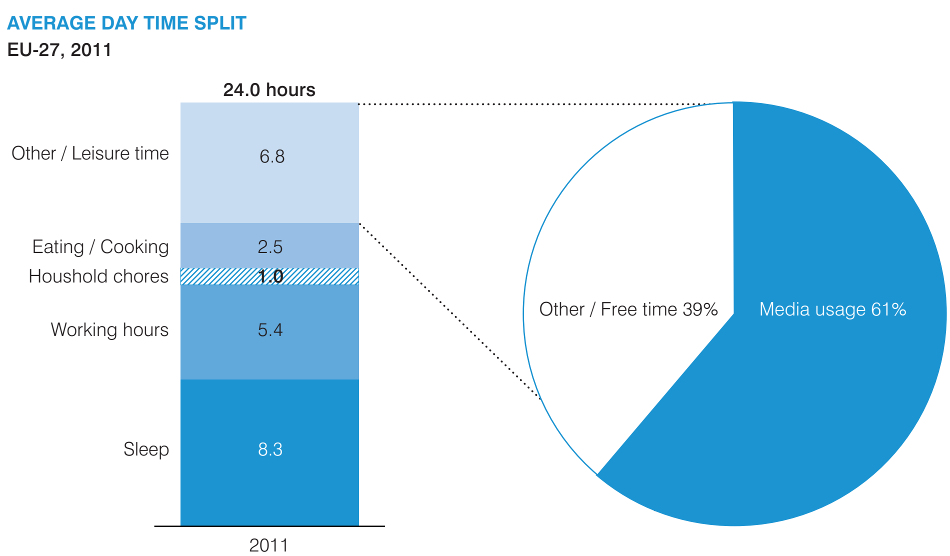
Source: Booz & Company analysis

experienced a dramatic shift in distribution and consumption patterns; the print publishing industry is beginning to undergo a similar shift. The gaming industry saw the introduction of completely new creative opportunities and revenue models. Finally, the book publishing industry is at the starting point of a paradigm shift as more and more people receive and read their books on e-readers and tablets.

The creative sector, of course, is part of a social system that includes, at the outer layer, the language and culture of a country or region on which all creative production is based. From a geographic scope, the report covers the EU-27 (also simply referred to as Europe) and in addition zooms in on six focus countries: France, Germany, Italy, Poland, Spain, and the United Kingdom. These six jointly account for more than 60 percent of both the entire EU-27 population and GDP. Our study of the creative sector in these countries has yielded a number of observations:

- Creative industries dominate leisure time: The importance of the creative sector is best illustrated by the share of time people spend consuming creative products. Of the approximately 6.8 hours per day the average European consumer has available for activities other than work, meals, sleep, and household chores, more than 60 percent are spent consuming creative industry products. This includes reading the newspaper or watching television (*see Exhibit 4*). The role this sector plays in people's lives can hardly be overstated.

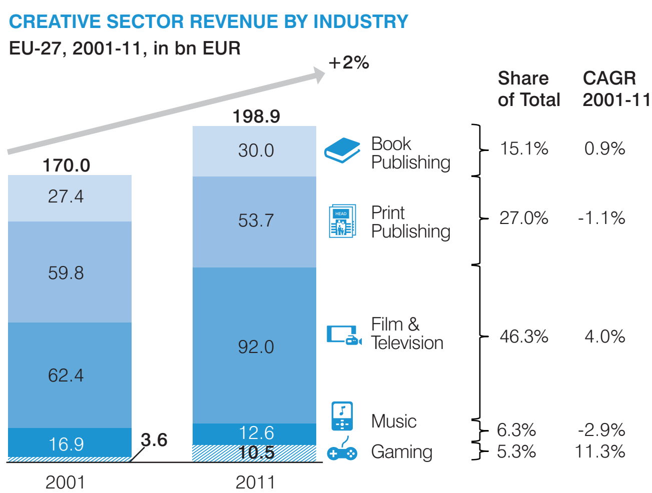
Exhibit 4
Creative Industries Dominate Leisure Time

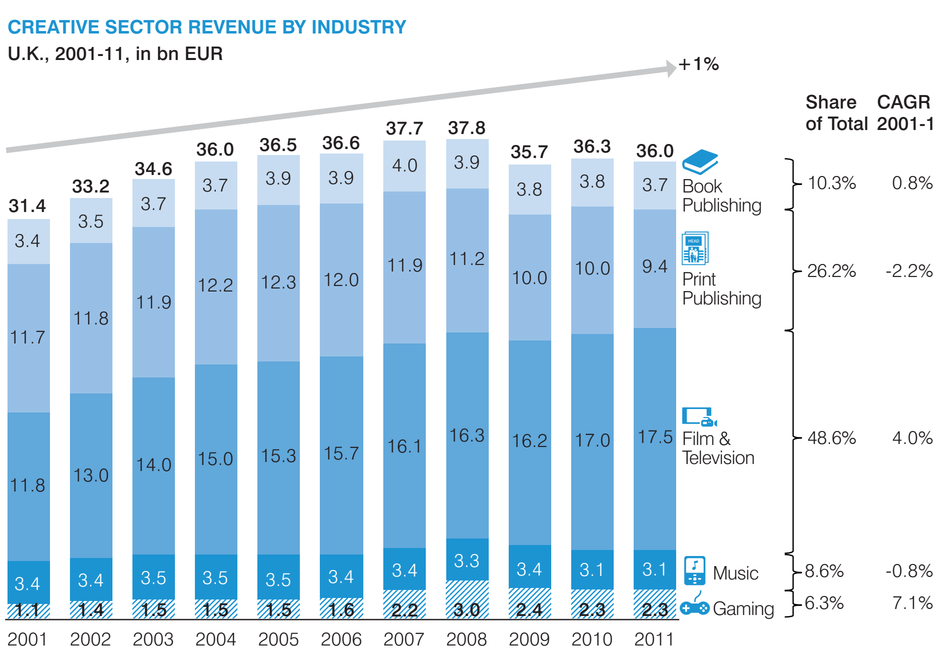


Source: Eurostat, IAB, Booz & Company analysis

- Different segments develop at different rates: The aggregate value of the creative sector was roughly €200 billion across the EU-27 in 2011. It has grown from €170 billion in 2001 with a compound annual growth rate (CAGR) of 2 percent (*see Exhibit 5*). This growth rate is slightly below the general GDP growth rate overall, but the individual segments' growth rates vary considerably. The print publishing industry and the music industry have both contributed negatively to the creative sector's top-line performance, showing—on average—negative growth rates over the last 10 years. On the other hand, gaming and the film and television sector have outpaced GDP.

Exhibit 5
Creative Sector as a Whole Has Been Growing around 2 Percent Annually in EU-27 countries and 1 Percent in the U.K.





Note: Includes consumer spend and advertising revenues. Copyright fees are not included here
Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

The film and television segment accounts not only for nearly 50 percent of the creative industry's total revenue in the EU, but also for a major share of its growth. This segment grew by an average of over 5 percent annually throughout the last 10 years and was barely hit by the economic downturn in 2009. The main driver of film and television growth is the increase in subscription revenues, including those for premium cable and IPTV channels. Subscription revenues grew by nearly €20 billion and are generating around 2.5 times the revenues of 2001. Also in the U.K., film and television subscription spending was the major growth driver with average annual growth rates of nearly 9%. Overall, this industry has benefited dramatically from the digitization of distribution networks, like IPTV and digital terrestrial television, as well as from the growth of new services such as YouView, Maxdome, iTunes and Apple TV.

Online gaming has also proven to be a strongly growing segment, especially since 2008, while video console games have decreased in value. Online gaming accounted for around €3 billion of revenues in Europe in 2011—with strong growth prospects ahead. Similarly in the U.K.: the online gaming market today makes up nearly 30% of the gaming industry but could only partly compensate the decreasing sales in video games after 2008.

The book publishing sector has grown only slightly in the past 10 years. With e-books making up around 2 percent of the total market value in Europe and 6 percent in the U.K. in consumer as well as educational books, the digital revolution in the book publishing market has mainly been in commerce platforms (such as Amazon) and not in the product itself. However, according to expert opinions and forecasts, strong growth in e-books is imminent.

As an industry, print publishing (newspapers and magazines) has experienced challenging times since 2001. The 10-year compounded growth rate of negative 1.1 percent translates into lower revenues of almost €6.1 billion in 2011; in the U.K., a negative growth rate of 2.2 percent results in around €2.3 billion of lost revenues. A shift in consumer behavior and changing usage patterns have led to stagnating offline circulation and dramatically decreasing offline advertising revenues (a loss of €7.7 billion since 2001 in Europe and €2.3 billion in the U.K. alone). By contrast, revenues for digital periodicals have increased by about €1.6 billion (€300 million in the U.K.). This relatively small amount indicates the industries' challenge from digitization. By further embracing the Internet as an attractive source for advertising eyeballs and pay revenues, established players still have huge opportunities; they have the content capabilities and brands to develop viable business models that meet consumer needs and expectations. Some publication companies have shown that digital content can be monetized through new value propositions and that consumers are willing to pay for them (*see "The Financial Times and Its Subscription Model," page 14*). This trend is also evident in recent successes in the U.S. (for example, a metered model for innovative Web presences by such publications as the *New York Times* or more than 75 local titles of Gannett).[6]

The *Financial Times* and Its Subscription Model

One of the most successful examples of digital pay revenues for newspapers is the *Financial Times*. As early as 2001, it introduced a version of paid online content. Its current model dates back to 2007; users get a certain number of free articles each month, after which they have to buy a subscription.

In mid-2012, digital subscription for the first time passed 300,000 users, overtaking the number of print subscribers. This is equivalent to 30 percent year-on-year growth in digital. Overall sales and profit were both up year-on-year.

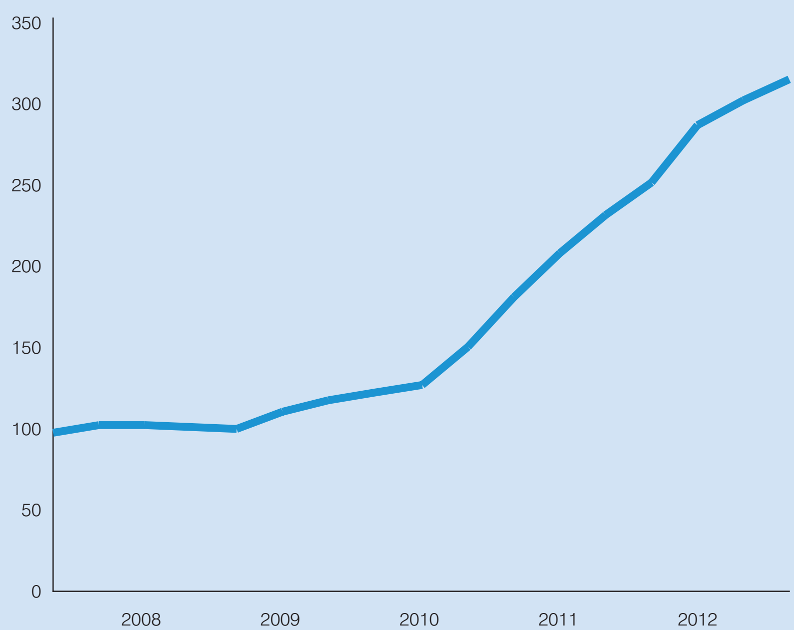
FT.com offers a subscription package that works on PCs, mobile devices, and tablets. About 20 percent of FT.com traffic is generated through mobile devices today—for an additional fee, access to the e-paper version is available as well. A yearly subscription to the print edition costs £624; the premium digital subscription (including e-paper access) costs £353 or around 43 percent less.

The electronic versions offer additional content beyond the print edition, making them valuable options for consumers. Among these added features are universal access on mobile, tablet, and desktop devices; continuous updates; and interactive videos.

According to John Ridding, chief executive of the *Financial Times*, it "is very unlikely that advertising will support the kind of newsrooms that produce good-quality journalism"; consequently, the *FT* monetizes its online and offline content through pay revenues as well as advertising. Today, 35 to 40 percent of revenues are from advertising, versus around 85 percent 10 years ago[7] (*see Exhibit 6*).

Exhibit 6
Positive Development of FT Digital Subscriptions

FINANCIAL TIMES DIGITAL SUBSCRIPTIONS
in thousand, July 2007 to October 2012



Note: Strong subscription growth after 2010 mainly due to new features such as the introduction of mandatory registration for all users and new/improved access on mobile devices
Source: Company Information

The music industry is the most developed industry when it comes to a shift in consumption patterns and changing revenue streams. Since 2001, overall revenues (recorded music and concerts) have decreased by nearly 3 percent annually in Europe, but only around 1 percent in the U.K. In Europe recorded music sales (digital and physical) have lost 50 percent of total revenues; physical music sales in 2011 reached only 40 percent of the 2001 level—in the U.K., physical music sales are about 45 percent of the 2001 level (the top-line decrease does not lead to lower artist and label income on average across Europe though, as outlined in *Exhibit 13*). However, concerts and digital music sales in the U.K. are growing—digital music revenues have increased by nearly 20 percent annually since 2007. For this reason, the decline in overall revenues stopped in 2010 in Europe, and also in the U.K., revenues stabilized around the current level. Forecasts for 2012 show growing recorded music sales again as new revenue models are being established and gaining traction with consumers. (*See "The Spotify Story," page 15.*)

The Spotify Story

Spotify represents one of the clearest cases in which the benefits of digitization have created an entirely new value proposition for the consumer. This and similar services have revolutionized the music industry by providing a valid digital business model beyond paid downloads.

Launched in 2008, Spotify today delivers its services to 15 million users in 16 countries. It is the leading music streaming service in Europe, with growth to match; it has at least doubled its revenue each year for the past three years, reaching an estimated €500 million in 2012. Spotify users have the choice between a free basic streaming service that is financed by advertising, and a premium service for a subscription fee (€10 a month for full access, including mobile) that allows music streaming to multiple devices, an offline listening mode, better sound quality and exclusive content—all without advertising.

With its two-service model, Spotify successfully implemented current digital trends to deliver a better product to the consumer:

- Superior *discovery and search functions* allow users to navigate through a vast musical repertoire.
- *Personalized* radio channels and recommendations based on the music users usually listen to and personal ratings help find new favorite songs and artists.
- *Offline and online modes as well as mobile solutions* and broad platform compatibility allow subscribers to listen to music everywhere and on almost any device.
- *Social integration* features enable users to integrate their Spotify accounts with existing Facebook and Twitter accounts and share music and playlists with friends and followers.

Notwithstanding its success with consumers, the commercial viability of Spotify is to some extent still to be proven. Up to now, losses have been mounting, because the majority of users are free subscribers and there is still insufficient monetization of this model through advertising. But the potential for profitability is huge, and commercial dynamics will likely change with further growth. Due to the nature of the contract that Spotify has signed with record labels (a minimum of 75% of total revenues is distributed to artists & labels) and its tremendous growth so far, industry sources expect it to break even for the first time in 2012 or 2013.[8]

As a harbinger for other sectors, the music industry entails also positive news; it seems to have found some viable digital business models and is successfully establishing them in the marketplace.

- The creative sector shows robust growth in some countries: Within the six focus countries, the development of the creative sector was only slightly below GDP development (*see Exhibit 7*). The Polish creative sector exhibited the strongest revenue growth of all countries, and Germany and Spain lagged behind the other focus countries. The general industry trends, however, are very similar in all six countries: Print publishing is declining (except in Poland, where even print publishing is still growing—though this trend is forecasted to reverse in 2012), music is stabilizing thanks to the growing importance of digital sales and film and television as well as gaming (especially online gaming) are growing industries.

Despite solid growth over the last 10 years, the size of the creative sector, relative to GDP, has decreased. When compared with GDP of the EU-27 countries, the creative industries' share of GDP was around 1.6 percent in 2011, a slight decrease from around 1.9 percent in 2001. The U.K. experienced the sharpest drop relative to GDP—from around 2.6 percent in 2001 to around 2.0 percent in 2011. However, as explained later in this report, the most important reason for the lagging revenue development relative to GDP is a shift in the industries' value distribution, where particularly intermediaries are losing revenues as electronic distribution eliminates parts of the manufacturing and distribution costs.

Exhibit 7
Creative Sector Revenues by Country, 2001 and 2011

Focus countries, 2001 and 2011, in bn EUR

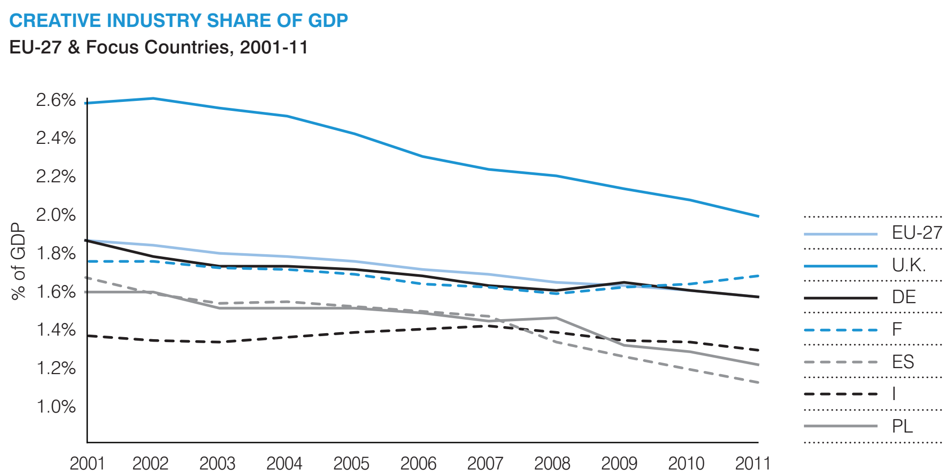
	2001	2011	CAGR
DE	39.2	40.2	0.2%
ES	11.3	12.1	0.6%
F	26.3	33.5	2.5%
IT	17.1	20.4	1.8%
PL	2.8	4.2	4.1%
U.K.	31.4	36.0	1.4%

Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

As a result, the revenue figures lag GDP, but the profitability of individual companies still increases in many cases (*see chapter 5*). Adding it all up, this is still a sizable industry and it remains an important part of the economy (*see Exhibit 8*).

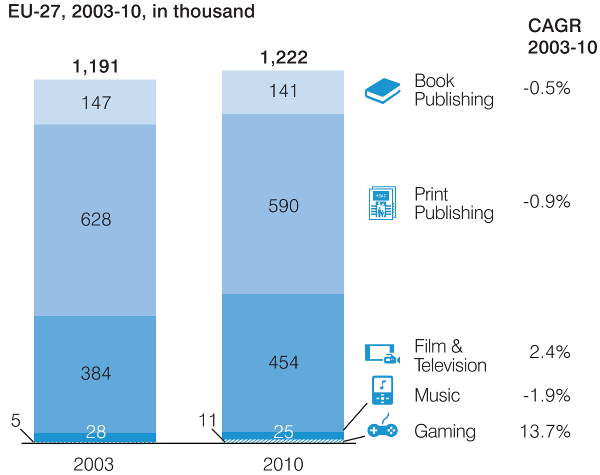
- The overall number of jobs in the creative sector has remained constant at 1.2 million over the last 10 years: Employment has actually grown in aggregate by 5 percent for all the EU-27 countries. But the pattern of job growth varies by segment. As with revenue development, film and television is a significant driver of job growth, whereas print publishing has seen job numbers decline by about 6 percent over the seven years

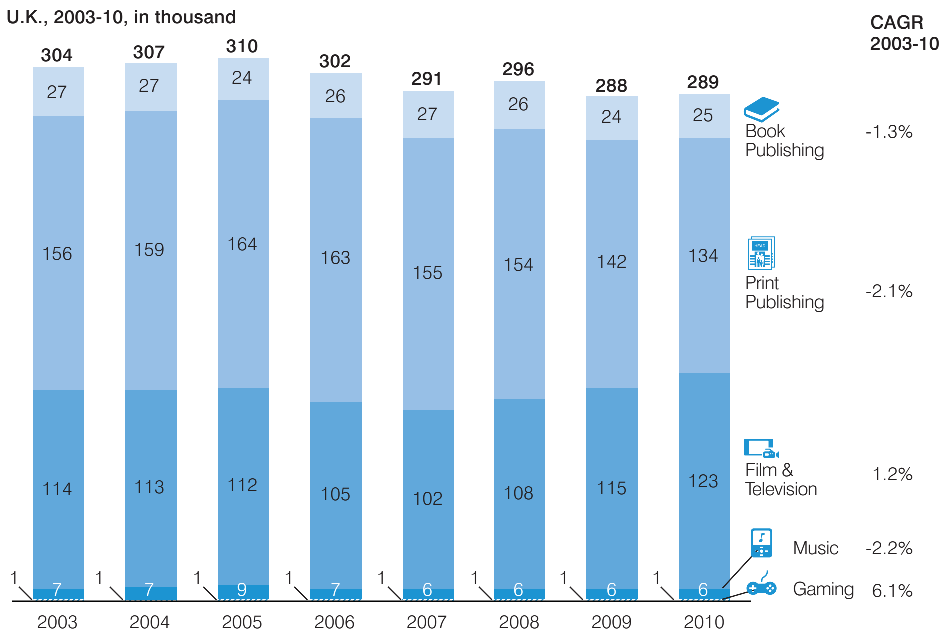
Exhibit 8
Creative Industries in Comparison to GDP



Source: PWC, eMarketer, Booz & Company analysis covered in the statistics below (*see Exhibit 9*). Analysis by country also shows differentiation; creative industries in the United Kingdom and Germany have experienced declining employment (with a CAGR of negative 0.7 percent and negative 1.1 percent, respectively), whereas the numbers for Spain, Italy, and Poland grew by more than 2 percent annually, in part possibly driven by different maturity levels of the creative sector in those countries.

Exhibit 9
The Number of Jobs in the Creative Industries Has Remained Constant Over The Last Decade[1]





Note: Numbers do not include freelancers
Source: Eurostat, National Statistical Offices, National Business Associations, Booz & Company analysis
[1] Jobs in the music industry appear relatively low relative to revenues generated; this is mostly due to the fact that independents (due to a lack of reliable data on a EU-27 level), distribution and manufacturing are excluded altogether

Once again, the film and television industry is the primary growth driver. It increased its employment significantly across all focus countries except Germany. Employment in the music industry declined in all focus countries except Poland. Print publishing was hit hard in the United Kingdom and Germany; employment in that sector has declined 14 percent (an equivalent of over 20 thousand jobs) and 11 percent, respectively, since 2001. Some of this job loss can be explained by the strong restructuring measures that these industries have undertaken. In contrast, print publishing employment in the other focus countries held constant or even increased a bit. Book publishing decreased in all countries except Spain and Germany, and the gaming sector represents a growth story in all countries, tripling employment in the time from 2003 to 2010.

3. THE CONSUMER'S PERSPECTIVE

There is little doubt: The consumer is a big beneficiary of digitization in the creative sector. He or she gets easier access to additional, more diverse, and more relevant content. This view of the consumer's digital dividend appears to be widely shared among creative industry representatives. In our survey of experts, nearly 100 percent of the respondents agreed that consumers use more creative content today than ever before and that they gain access to more relevant content as a result of digitization. Consumers benefit from a rising number of TV channels, online access to nearly the entire music catalog through streaming or download platforms, access to global news providers across the world, insights into recommendations from friends and opinion leaders, and many more elements.

One important driver of the changes is the proliferation of new devices, such as smartphones and tablets. Starting in 2010, a much larger number of consumers started to access the Internet through platforms other than the PC, especially smartphones and tablets. Time spent on the Internet via mobile phones has multiplied since then and today makes up around 15 to 20 percent of the entire time spent online for our focus markets. Smartphones and mobile devices enable a growing number of local services, such as Facebook check-in, a feature in which people use their smartphones to tag themselves with their current location as a way to connect with others they know who may be nearby.

According to comScore, 24 percent of the total time spent online in Europe is spent on social networks (such as Facebook and LinkedIn). This is partly driven by new access models; nearly 50 percent of users regularly access social network via mobile phones' apps or browsers. Furthermore, social networks are not a phenomenon of the young anymore; they reach the 55-plus demographic to nearly the same degree.[9] These numbers impressively back up the current buzz around consumers going "social, local, mobile."

With most new platforms, the consumer gets the opportunity to participate—in everything from rating restaurants to uploading videos to commenting on articles to participating in the democratic process. Political campaigns today require candidates to be present in social networks and answer to individuals' concerns. Recent political movements around the world, most notably in Eastern Europe, Africa, and the Middle East, have demonstrated the power of digitization and its positive effects on democracy and free speech.

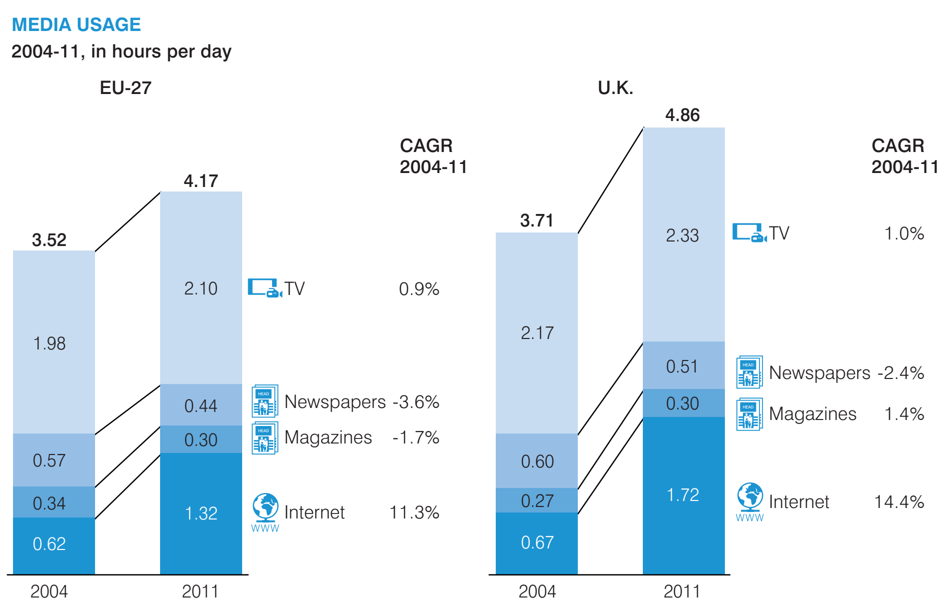
There are a number of striking findings about the evolution of consumer demand as digitization has spread:

- Growing use of creative products in Europe: Since 2003, the average time spent on media platforms has increased by nearly 20 percent, to more than four hours in 2011. The main driver of this development was the increase in Internet and film and television usage. It partly represents an overall increase of media use; in part, it represents time taken from print publishing (*see Exhibit 10*). The time spent online has more than doubled across the EU-27 population in the same time frame. The Internet growth rate also increased to 15 to 20 percent annually in 2011 and 2012, which suggests further increases in Internet usage ahead, not a weakening of the trend.

- In the U.K., the developments are even more pronounced: media consumption increased by over 30 percent; contrary to other countries newspapers and magazines remained at a relatively high level (magazine usage even increased). Like in most countries, TV usage increased slightly, whereas Internet usage grew stronger than in most other markets: above 2.5 times in the 7 years observed.

- Increased time spent on the Internet is driven by a multitude of factors, not just the proliferation of smartphones and tablet devices. New and improved product offerings for media consumption, e-commerce, and social networks have contributed greatly to increased usage. Only an estimated 20 percent of time is dedicated to reading content and 13 percent to multimedia sites. The rest of the time is split between social networking (22 percent), search (21 percent), email and communication (19 percent), and online shopping (5 percent).[10] Nevertheless, more time online also benefits time for media usage. Bottom line: between 2004 and 2011, media usage has increased by almost 20 percent in Europe.

Exhibit 10
Media Usage Evolution across EU-27 Countries and the U.K. of Selected Media Types



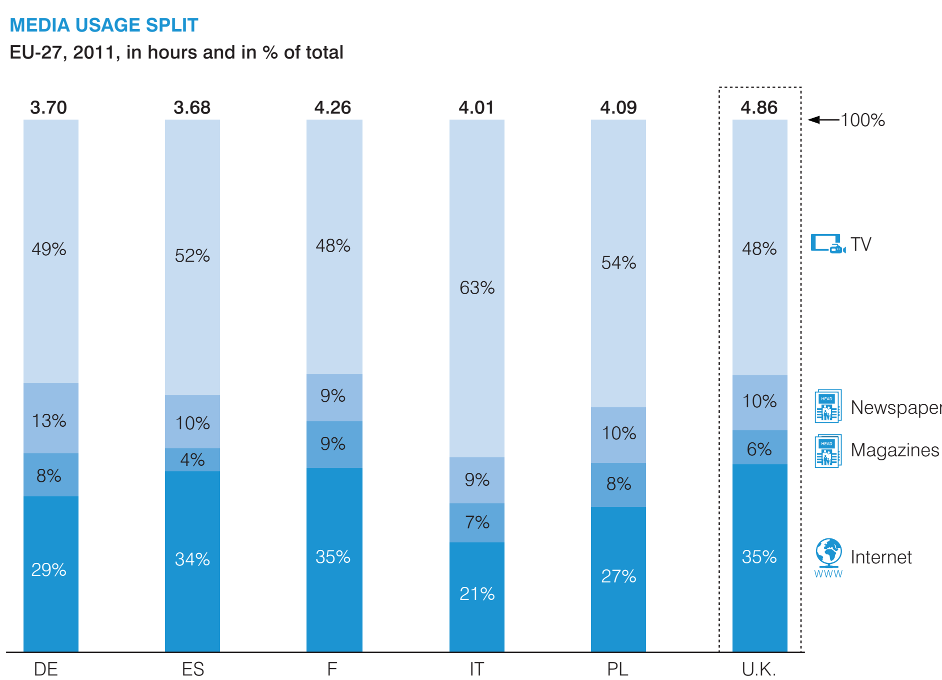
Source: IAB, Booz & Company analysis

- Different stages of development: There are substantial variations in development and usage patterns among European countries. To be sure, all countries have two things in common: TV is the most frequently used platform in all countries, and the Internet ranks second. Beyond that, however, the patterns of segment use shift from one country to the next (*see Exhibit 11*).

- For example, time spent with the Internet exceeds time spent with print publishing by between 50 and 100 percentage points in all countries except Italy. In Italy, the share of Internet usage is only around 21 percent, less than half of Sweden's share. The reason for the difference is not the intensity of the Italians' daily usage (the time spent online) but the penetration of access (the percentage of people having access to broadband). Industry experts point toward a renewal of government interest in supporting broadband penetration and the rollout of mobile technologies; these will likely increase broadband access throughout the country during the next few years.

- Management of perceived risks: Several public concerns have affected attitudes about digitization. These include data security concerns, fear of online fraud, and concerns about viruses and malware. These must be taken seriously but can be managed through appropriate technological and governance mechanisms. Booz & Company has determined a number of pillars that are important for online services to have, to provide consumers with digital confidence.[11] Among them are threshold standards for network integrity and quality of service, protections for privacy and data security, protection of minors, and theft avoidance. When these measures are ignored, the spread of digitization is negatively affected; this would have detrimental effects on the economy as a whole.

Exhibit 11
Split of Media Usage in Focus Countries



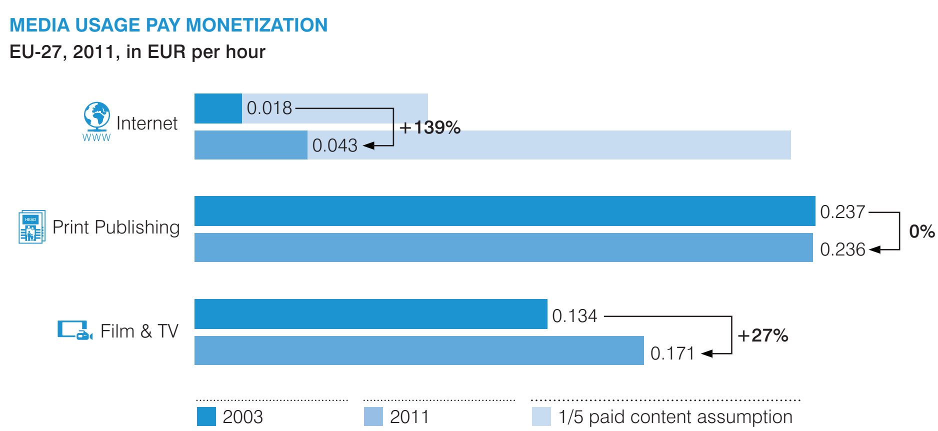
Source: IAB, Booz & Company analysis

The rising awareness of those risks to the general public has been spurred by several news events: Concerns about apps that transmit consumer data; current legislative efforts involving privacy, piracy, and ancillary copyright; and the emergence of the "pirate parties," political movements centered in Sweden and Germany that aim to prevent legislative efforts that hurt the freedom of the Internet.

- Willingness to pay: Analysis shows that consumers remain willing to pay for content in the digital arena. Although observers question whether online business for the creative sector is sustainable, and many believe that consumers are less willing to pay for digital products than their physical equivalent, research is leading to a different conclusion. Consumers overall are spending *more* on products and services from the creative sector than they have in the past, and this revenue stream will continue to constitute the largest growth opportunity.

This significant increase in media usage is reflected in increasing pay revenues from online products and services, up 25 percent from 2001 to 2011. Pay revenues per usage hour in the EU-27 countries have increased by 27 percent for film and television, remained about constant for the publishing industry, and increased by more than 130 percent for Internet-related products and services like digital newspaper editions or online games (*see Exhibit 12*). The relatively small actual pay monetization of Internet usage hours has two major explanations. First, usage is split among many more outlets and providers; on average, they collect less of a share of overall revenue. Second, included in the usage hours are all products and services currently available free of charge. For example, most news websites are still available without a paywall and solely supported by advertising. If we excluded non-paid content usage from the analysis (assumed at 80% of time spent on the Internet), the monetization per paid usage hour in 2011 would jump to the level of print monetization.

Exhibit 12
Pay Monetization of Media Usage per Media



Source: PWC, eMarketer, IHS, Euromonitor, IAB, Booz & Company analysis

The results of a survey conducted with more than 100 representatives from the creative industry in the focus countries suggest a similar perspective: Only 21 percent of respondents believe that there is a general lower willingness to pay. About 57 percent saw clear improvements and another 21 percent saw no change.

4. IMPACT ON CREATIVE PRODUCTION AND OUTPUT

New technologies are broadly used throughout the creative community. Thus, entirely new content, processes, and markets are created and growing at a rapid pace, e.g., by local players becoming global in their reach.

Almost as much as consumers, creators are great beneficiaries of the digital revolution. In nearly all sectors, they are using the Internet and other digital technologies consistently in their works. (This trend was again confirmed by the group of European industry experts surveyed for this report.) There are several reasons for this. First, digitization has revolutionized the way creators work and collaborate. Even data-heavy film production is fully digitized today, and collaborators from around the globe can access the same video material in real time.

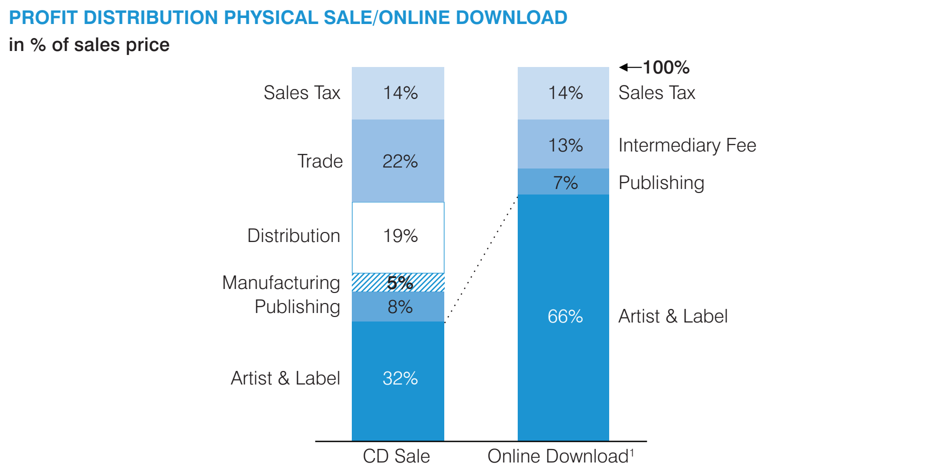
Second, digitization has brought the creator a lot closer to the consumer. As a result, distribution of content is less of a bottleneck in many markets. It is possible for creators to reach the consumer directly by complementing or circumventing intermediaries and prior gatekeepers. To be sure, this power shift implies a significantly changed economic model in most of the creative industries, but it also gives creators the opportunity to build closer relationships with consumers, learn more about consumer preferences, and tailor their products to the consumer's need.

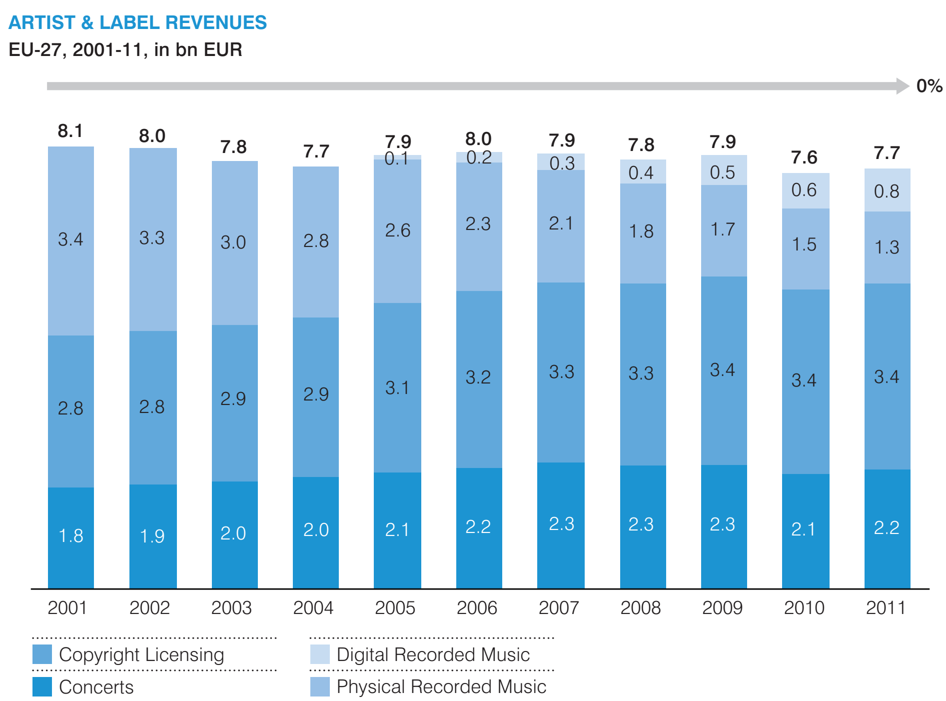
Third, digitization enables a greater pipeline of creative material from consumers—which has the effect of creating broader communities of creative involvement. Today, many more people can become creators with (theoretically) the same chance of reaching a mass audience and achieving mass success. In other words, the distinction between consumers and creators has become blurred.

This is often perceived as a threat to creators, but it also represents a promise; their audience, in becoming more sophisticated and engaged, raises the level of interest and awareness in all forms of creative content. That is one of the reasons the music industry has been able to reverse the past trend of declining revenues, with new models building on this promise.

A shift in the value distribution away from intermediaries and toward consumers and creators accompanies this change. Digital innovations have made creative production and distribution more efficient—driving down the overall top line of the sector but not necessarily affecting the bottom line, thus the industry's profits. For the creators, a higher share of value partly compensates for the overall lower revenue of the sector. This dynamic is most evident in the music industry, the most digitally advanced creative sector. With the establishment of digital downloads as an alternative to physical recordings, the economics of the industry fundamentally changed. Today, on a European average, around 66 percent of revenues from a download go to the artist and label, compared to around 32 percent for a CD sale. The additional share for artists and labels is coming nearly entirely from intermediary and distribution costs that have been reduced as a result of the new format (*see Exhibit 13*).

Exhibit 13
Artist and Label Profit Distribution and Total Revenues





¹ Based on 99-cent download and 65-cent PPD (published price to distributors)
Note 1: Sales tax based on 16% VAT rate
Note 2: Artist share in concert revenues estimated 30%
Source: Interviews, Collection Societies, PWC, IHS Global Insight, Booz & Company analysis

Despite the decline in recorded music revenues since 2001, the overall artist and label revenues have remained largely constant. In 2011, the split of artist and label revenues in Europe was around 28 percent from recorded music (42 percent in 2001), 44 percent (35 percent) revenues from copyright licensing, and 28 percent (23 percent) from concerts and festivals. This indicates a significant diversification of revenue streams for artists and labels beyond recordings.

In short, although recorded music revenues are down around 40 percent from 10 years ago across Europe, most of the decline took place in the early stages of change. Since 2007, mainly as a result of increasing digital sales, recorded music revenues have remained stable and were even expected to rise again in 2012. A relevant factor in making up lost revenue from recorded music sales is licensing fees paid to artists and labels—the amount paid out increased from €2.8 billion in 2001 to €3.4 billion in 2011 across Europe. (These licensing fees are not explicitly covered in the overall music numbers, thus this artist view does not match to the music industry revenues.)

Copyright licensing has benefited from the increased usage of music in a rising number of TV channels, more flexible online fee structures that enable new business models to prosper (such as Spotify), and improved international licensing. Furthermore, concerts have remained a stable source of revenue for artists across the years. The effects of digitization on those value pools are almost paradoxical. Revenue from sales of recorded music has gone down, on the one hand, but on the other hand, the digitization of TV distribution has led to a plethora of new channels, significantly driving usage of music and licensing fees.

The fourth reason that creators are major beneficiaries of the digital revolution is that new models like crowdfunding are complementing creative traditional financing models. A major obstacle for the "consumer/creator" model (in which the boundaries between consumer and creator are blurred) has been access to the financing needed to make professional products that consumers are willing to pay for. Traditional players with a proven track record still have easier access to financing than the independent consumer/creator does. However, new sources for funding, such as European crowdfunding platforms, are establishing new niche markets, where everyone can pitch projects to the "crowd" in order to receive financing by multiple (mostly small) donors, in return for receiving the to-be-created product and other benefits (like access to special concerts and events).

The crowdfunding industry is still in its infancy, but has shown tremendous growth in the past few years; total funds raised in 2011 reached more than €1.1 billion worldwide and were expected to nearly double in 2012, to around €2 billion.[12] Around 40 percent of that number is expected to be raised in Europe. As a result, crowdfunding will further disintegrate the traditional creative value chain and blur the distinction between creators and consumers. (*See "Studying Startnext," page 27.*)

Studying Startnext

Startnext is one of the most successful German crowdfunding platforms, with a market share of around 85 percent of crowd-funded projects in Germany in 2012. In a nascent market, Startnext has already distributed more than €2 million to more than 600 projects—85 percent of which went to creative ventures of some sort. Generally, two main crowdfunding models are available:

—*Equity-based* funding, wherein the financial backers take an equity stake in the firm—an extension of the family and friends founding rounds, to some extent.

—*Reward-based* funding, wherein the creator receives backing for a defined product or service he or she promises to deliver in order to enable the production.

In Europe, both the reward- and equity-based funding options are popular. By contrast, in the U.S., because of current regulation, equity-based funding is negligible. Startnext has a clear focus on the reward-based model, which is also the most suitable approach for creators to achieve financing. The most popular creative products that are looking for crowdsourcing are (in December 2012): financing for small film or video productions (413 projects on Startnext), music projects (315), literature projects (137), and game development (57).

Unlike other crowdfunding platforms, Startnext does not charge a fee for its services. Individual backers are asked to contribute a voluntary amount in order to sustain and further develop the platform.

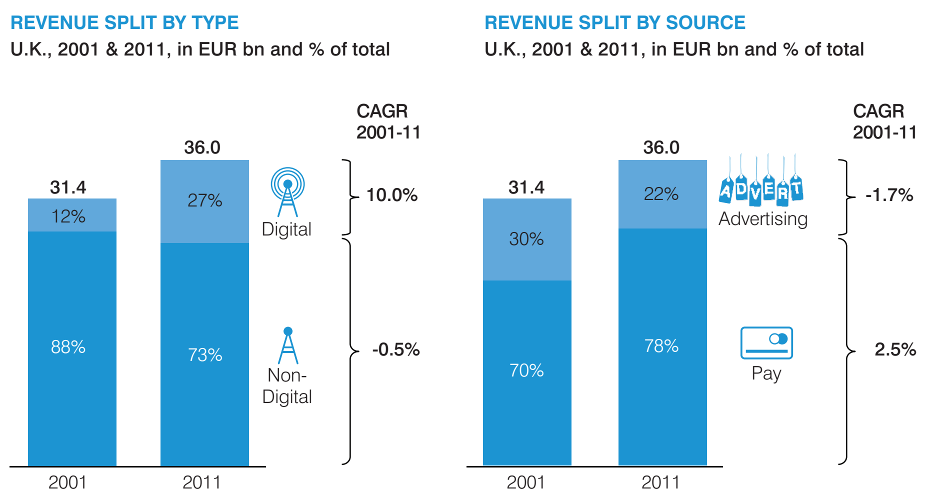
Startnext also offers *regional crowdsourcing platforms* in close cooperation with local culture funding authorities and private foundations (for example, in Hamburg and Dresden), where selected projects get access to the platform. The sponsoring foundation or cultural authority matches the investments or donations that come from the crowd.

5. VARYING DIGITAL MATURITY ACROSS CREATIVE INDUSTRIES

Digital growth amounted to €30 billion in Europe and €6 billion in the U.K. during the 10 years from 2001 to 2011. In some industries, digital revenues made up for losses in non-digital revenues; the opportunities from this change are available to be captured by all industry players.

This report considers the changing prospects for a diverse set of creative industries, from five-centuries-old book publishing to the recently established gaming industry. As is to be expected, the digitization trends play out differently and at different speeds in the various industries, and even more so across different countries. Nevertheless, two trends are very clear from the data: All growth in the creative industries is digital, and it is driven by consumer payments (*see Exhibit 14*).

Exhibit 14
Revenue Split by Type and Source



Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

In 2011, EU-27 digital revenues accounted for 25 percent of the total creative sector revenue. In absolute terms, digital revenues now total nearly €50 billion, an increase of €30 billion over 10 years. A large part of that growth can be attributed to TV subscriptions like IPTV or premium pay models that oftentimes operate in separated ecosystems and walled gardens. (Premium pay generates around €21 billion annually.) The remaining revenue increase of €8.6 billion can be attributed to growth in pure Internet-based media use. In the U.K., digital revenue accounted for around 27 percent of the total creative sector revenue, or a total of nearly €10 billion. Like in Europe as a whole, a large part of this growth in the U.K. is due to TV subscriptions – pure Internet-based growth amounts to around €2.1 billion.

Still being small by the numbers, Internet television platforms already have a significant impact: they increase the breadth of content offered; they offer the possibility to upload content, both (semi-)professional and user-generated; and they foster new consumption habits, e.g. on demand or parallel usage with other platforms, like social media. Platforms such as Dailymotion, YouTube, Clipfish, Wuaki have already accumulated significant reach and with pay models being introduced for premium content and advertising money following the usage, the growth prospects of these new ecosystems are very positive.

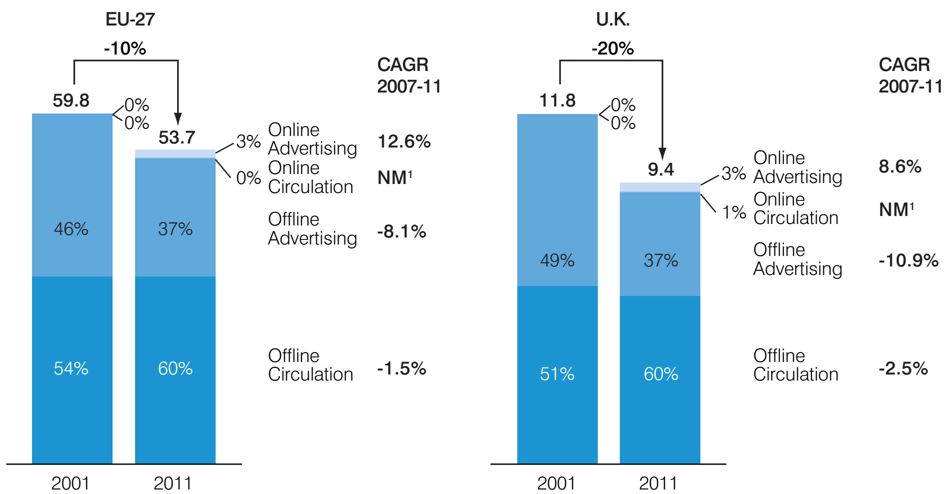
Many media companies have expanded their revenues by following consumers online. As noted in chapter 2, they have successfully introduced a variety of new business models to monetize their content and create new experiences, such as music streaming services and high-definition downloads on video platforms. Double-digit growth is expected to continue, because innovation in media business models is accelerating.

Digital and non-digital revenues are also becoming more interdependent. For example, many newspaper newsrooms file both Internet and print versions of stories, often with extra interactive features on the Internet site but the same basic content. Subscriptions often conflate print and digital versions. Despite these fundamental usage shifts, revenue from non-digital sources was stable over the 10-year period from 2001 to 2011 across all media in focus. Established print models such as newspaper distribution and traditional TV advertising still provide the majority (about 75 percent) of the sector's revenues. But the industry should not rely on this stable basis going forward. New developments can accelerate substantially after having reached certain inflection points—as the steep decline of the US newspaper market has shown with its 51 percent loss in revenues since 2006.[13]

Another broad trend is the growth of pay revenues. The creative industries have always relied on two distinct value pools: revenue from advertisers and payments from end consumers in the form of subscriptions, product purchases, and admissions. Over the last 10 years, advertising revenues have been stable at best, whereas pay revenues have grown by more than 2 percent year-on-year in Europe. In the U.K., pay revenues grew by 2.5 percent annually, but advertising lost significantly over the 10 year period: an annual decline of negative 1.7 percent translates into lost revenues of around €1.5 billion. Growth has been especially strong in the TV sector, where new and better services of digital TV have lured many consumers to a premium pay model (as in IPTV). Despite a perception that consumers are interested in free media only, and the price erosion induced by the Internet, the facts are clear: Consumers spent more money on creative products in 2011 than ever before. This trend may well accelerate as consumers become interested in new offerings with new value propositions.

A third trend is the change in advertising that has come about through digitization. In contrast to offline advertising, which has had flat or limited growth since 2001, online advertising has been continuously expanding (*see Exhibit 15*). Newspaper and magazine publishers have been hit hard by this transition. Between 2001 and 2011, their overall revenues decreased by 10 percent across Europe, to €54 billion, and to €9.4 billion in the U.K., a decrease of 20 percent. The reasons for this development are as varied as demographic challenges, an abundance of news content on the Internet, and usage shifts already at work for the last decades. And although display advertising on print-related

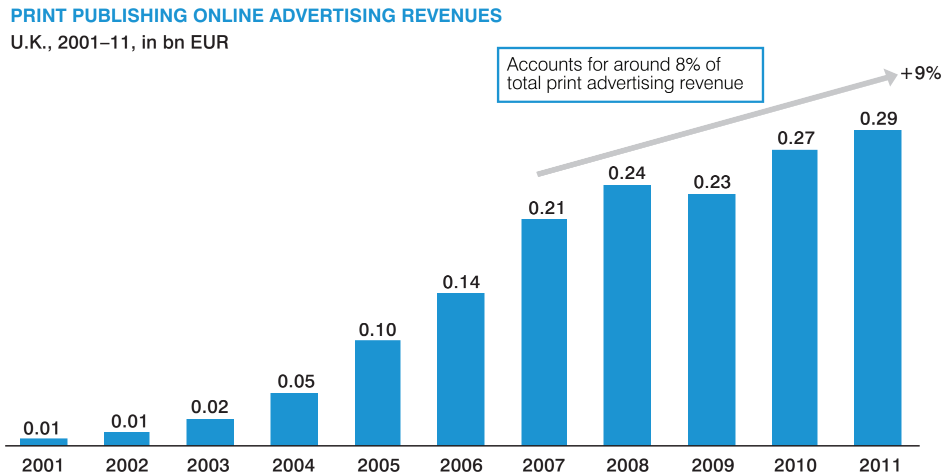
Exhibit 15
Print Publishing Revenues 2001 & 2011 for EU-27 and U.K.



[1] Not meaningful
Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

Internet sites today represents a sizable category of almost €1.5 billion in Europe and nearly €300 million in the U.K. with an annual growth rate of 9 percent in the last four years (*see Exhibit 16*), this form of advertising will not make up for the drop in overall revenue in the short term.

Exhibit 16
Print Publishing Online Advertising Revenues



Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

As consumers spend more leisure time on the Internet, their media consumption will fragment across an ever-wider range of products and services: professional media content, user-generated content, search, social networks, classifieds, and e-commerce. Advertising money will follow the eyeballs and thus fragment even more across an abundance of providers. Therefore, even as the overall pool of advertising revenue increases, individual sites and venues will not be able to count on the same levels of revenue they enjoyed in the past.

At the same time, online advertising does not always require traditional creative content or production values. For example, a successful Facebook ad can be relatively simple. As a result, supply and demand are out of balance in online advertising, and creative production costs are by definition harder to recoup. This increased competition for online revenues has led to a strong segmentation of inventory, especially for display advertising. Some selected online properties—front pages of online news outlets like Spiegel.de or Lefigaro.fr—can generate significant reach with premium target groups and can charge premium prices for their inventory. Another large amount of inventory is of lower value and is traded as a commodity in real time through automated auctions or algorithms. A large part of professionally produced and curated content is squeezed in between these two poles, a position that does not enable the same level of monetization these professional publishers were used to in the offline world.

The solution going forward will not solely be to monetize print content better on the Internet but to continuously create relevant consumer experiences. Print publishers have great assets with their established brands and existing content capabilities. These will need to be consistently complemented by a larger variety of content types, such as video. The value of ad inventory for marketers in such an environment will also increase, even more when supported by a detailed and data-backed understanding of the audience.

Online video and music portals, such as Vimeo, Vevo, Spotify, and YouTube, have shown tremendous growth in the past years. YouTube alone streams more than 4 billion videos per day (providing it an annual growth rate of around 25 percent[14]). Even though these new media outlets are very diverse in their types of content and business models—they range from professional to user-generated content, and from purely advertising-funded to freemium and paid business models—they have all attained an enormous reach by providing a new or more convenient user experience. They all recoup at least part of their cost by selling advertising. For many professional content producers, these venues either provide an additional and very easy-to-use distribution channel or an attractive marketing platform, promoting products to be monetized elsewhere. (For example, YouTube and Vimeo are often used to watch trailers for box office movies.)

In some instances, the revenue from these platforms is already sizable. And if the service is of value to consumers, they will continue to shift their time to these sites—and the advertising money will ultimately follow. Like other new media before them, Dailymotion, YouTube, and others will not replace existing TV and broadcasters. Rather, they will complement the media landscape and increase consumer choice, providing new forms of reach, monetization, and customer data collection. (*See "Successful Online Video Monetization," page 33*.)

Successful Online Video Monetization

Base79 is a U.K.-based online video company offering rights-management and audiovisual distribution services for high-quality content rights holders; revenue is generated as a share of advertising income from rights holders.

The core capability Base79 offers to its clients is the monetization of content on digital video platforms, such as YouTube or Dailymotion, and the management of their rights to protect from fan-based or pirated illegal distribution of content. In comparison to traditional video distribution (e.g., broadcasters), online video requires entirely new skills in audience building and management, because the content has to be discovered by users among millions and millions of options instead of stumbled upon on a TV channel. With 500 million views a month across its 600 channels, Base79 is the most successful online multichannel network in Europe.

At the core of Base79's strengths is its ability to build and grow audiences and steer existing audiences effectively in order to keep them in their environment as long as possible. Deep platform knowledge, technical expertise for automated solutions, effective video search engine optimization, and sufficient scale to cross-promote within the network are critical success factors in this field. Base79 is doing this for productions such as Hat Trick's *Have I Got News for You*, for which it built a successful YouTube channel; moreover, together with Hat Trick, it is starting an original content channel (available only on YouTube) called *Bad Teeth* in January 2013 featuring British comedy.

As underlined by the success of Base79 and other players in the past few years, online video and the monetization of it is a field that has exhibited tremendous growth and is expected to grow even stronger through connected devices (connected TVs, game consoles, etc.). Moreover, as a result of YouTube's push to promote and monetize original content channels by professional producers, more quality content is moving online—potentially taking away substantial advertising revenues from established video platforms in the future by offering more targeted and measured advertising.

Base79 is planning to grow aggressively in the next years through an expansion of its ad sales and business development presences in continental Europe (e.g., France, Italy, and Germany) and is only one of many multichannel networks that have recently raised growth capital from investors.

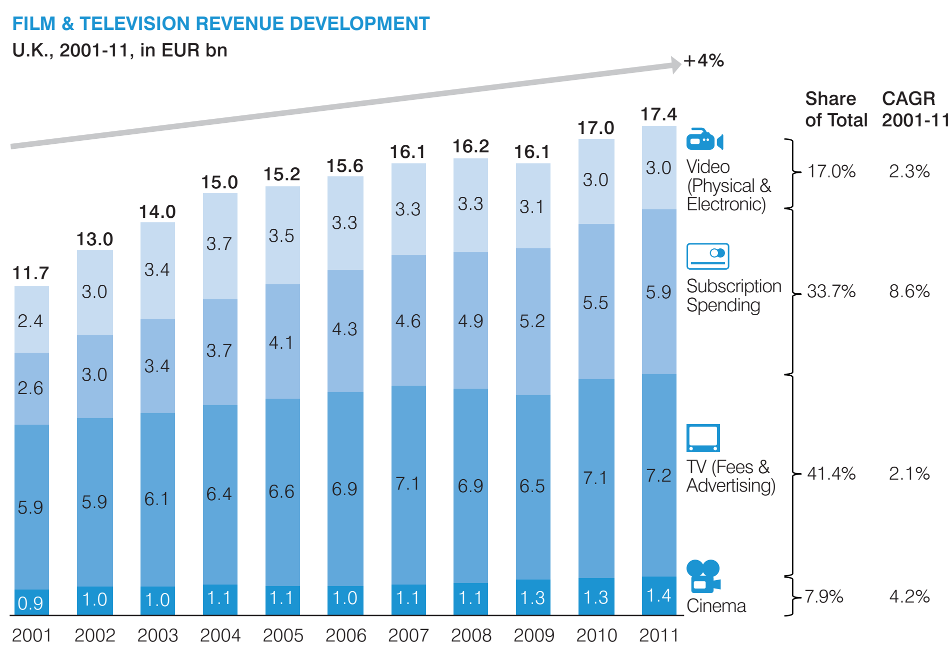
The challenge to specific parts of the creative sector is clear, and it will not go away. Due to competition and increased expectations from both users and advertisers, online advertising will remain difficult. Monetizing existing content better with more online advertising will not alone solve this challenge for established players that originated in the offline world. Instead, new types of content and new ad inventory will need to be developed. New ad formats will need to be explored like actionable generation of leads. A buildup of new assets and brands will take place; the expansion by Springer and Schibsted into the scaling business model of international online classifieds is a prominent example. Other alternatives include the move into new businesses such as e-commerce or data analytics.

Again, this will represent only a part of the monetization solution. Digital activities can be tracked and the respective data gathered, either very prudently or—with the consent of the user—more thoroughly. Most online platforms (including YouTube, Spotify, and Xing) provide extensive dashboards via which the content owners can monitor and analyze consumer behavior. This data can represent a rich source of information. For online video, for example, the number of views can be tracked along with the time spent with the stream, the comments posted, and the search terms that led to the video link. Mining and analyzing this data can lift the value of advertising significantly. The TV CPMs (cost per mille/thousand impressions) of an anonymous broadcast ad versus an actionable ad delivered to a specified target group can vary by a factor of 20 and the latter can attain up to €50.

The final source of revenue is online pay mechanisms. These are increasing steadily, supported by the emergence of new devices and driven by a larger number of improved service offerings.

As we have already noted, pay revenues have been the most powerful growth driver for the creative sector over the last 10 years. These revenues all come directly from end consumers, in the form of subscriptions, one-time purchases, admissions, or transactional commissions (from selling merchandise). Across Europe, TV subscriptions are the single most important category within this type of revenue. Attracted by better-quality products—high-definition (HD) channels, premium content, and improved services like VOD or user-friendly program guides—many consumers have switched their model of TV provisioning from a full free-to-air model of terrestrial or satellite supply to a paid model on a terrestrial, satellite, cable, or IPTV platform. This revenue growth has benefited not only the infrastructure providers but also the creative sector. Channels like RTL in Germany are using the HD+ platform—a satellite-based subscription service for high-definition channels—to build up sustainable customer relationships. As a result, subscription spending turns out to be the largest driver with an annual growth rate of nearly 9 percent, reaching a share of close to 34 percent of total film and television revenues in the U.K. or an equivalent of nearly €6 billion (*see Exhibit 17*).

Exhibit 17
Film & Television revenue development 2001-11 in the U.K.



Note: Note: Video includes electronic home video/OTT-streaming/through TV subscriptions, physical rentals and sell through; TV includes public TV license fees, mobile TV, online & mobile TV advertising and broadcast advertising; Cinema includes box office and cinema advertising
Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

With respect to the audiovisual production sector, the changes driven by Internet distribution probably have the highest disruptive potential. Online platforms such as YouTube offer the possibilities to reach large audiences without traditional intermediaries to directly benefit from additional revenue streams, like advertising, and to explore specific new content formats. The German production company UFA, for example, is testing innovative ideas via their UFA LAB. (*See case study "The Future of Online Video" page 36.*) For production companies, this represents a true paradigm shift as they are able to produce content more independently from the traditional distributors, interact directly with the audiences and experiment to a much larger degree due to the moderate costs involved, also facilitated by fully digitized production processes.

The Future of Online Video

An emerging field of audiovisual entertainment is *online video*—especially original online content, i.e. produced specifically for online portals such as YouTube or Dailymotion. This area is still in its infancy and therefore barely visible in revenue data as of yet. However, many industry professionals see online video as the next revolution in the creative industry's digital future: from a few TV channels available forty years ago (i.e., broadcasting), there are several hundred channels available today (e.g., digital cable) and there will several thousand channels available in a few years' time (i.e., online video)—although "channel" might not be the right term anymore.

Until recently, there have been multiple hurdles for content owners and producers to move original video content online. Firstly, the issue of cannibalization is often cited as a primary reason; the loss of offline viewers in order to gain online viewers does, at recent monetization levels, not add up. However, multiple expert interviews suggest that online video does not lead to a loss of offline users, quite the opposite: it supports offline TV episodes by attracting new demographics or by offering catch-up opportunities and therefore complementing the offline service. Secondly, as illustrated by various best practice examples across markets, the monetization of online video is getting more effective and established in the market as it offers new targeting opportunities for audiences and advertising.

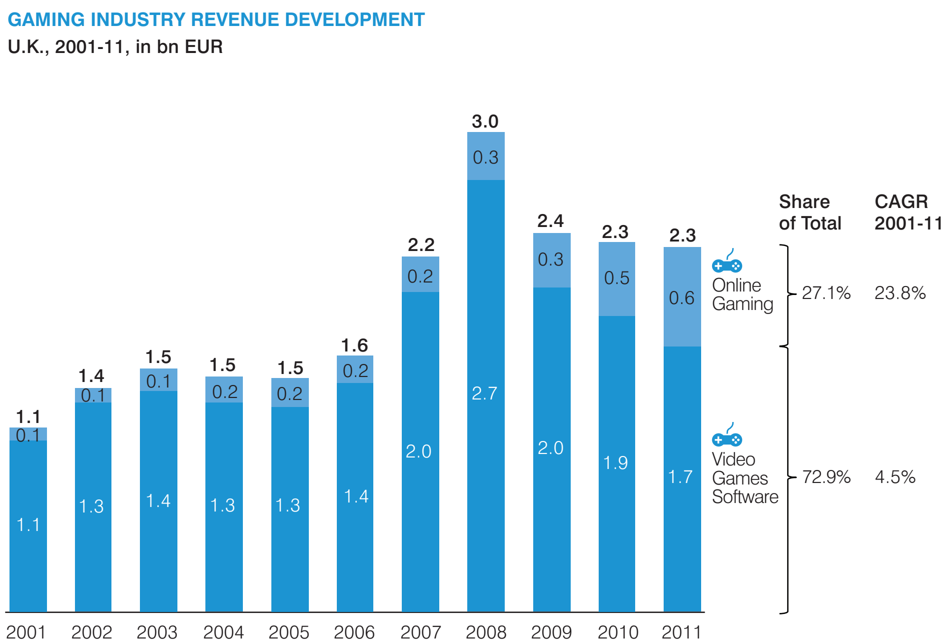
There are multiple examples of companies that are successful in developing, managing and monetizing original content online: *Base 79* (*see page 33*) shows that high-quality video content can be successfully monetized online through advanced audience building and steering. *All3Media* is another U.K.-based example of successful monetization of online video with the right scale to steer audiences and the right sort of content that works well on online platforms (i.e., mostly scripted and reality formats). *Yam112003* (which is part of Endemol) is an Italy-based developer of online video that they successfully promote and monetize across platforms (i.e. through social media, web magazines, etc.) and that manages its own YouTube channels. *UFA Lab* is a Germany-based developer of innovative online content but also transmedia formats such as Dina Foxx; it recently launched two original content channels on YouTube that are monetized through advertising on the platform.

Online video offers multiple advantages for content owners around reaching new demographics, targeting specific niche-audiences, building an in-depth understanding and relationship with audiences, and monetizing this understanding through relevant advertising. While original content is being produced and reach built up, opportunities for online video are rising.

To further illustrate the broad range of new models that creative industries are using, we will look more closely at two industries: gaming and books.

The gaming industry is a natural candidate for successful digital-download business models, because its products have been digital from the very beginning. The software-only game industry (excluding consoles) in Europe has grown considerably since 2001, from €3.6 billion to €10.5 billion in 2011. The economic crisis mitigated this growth somewhat; revenues in 2011 still trailed the peak level of 2008. But the share and absolute volume of online gaming have risen steadily since 2001; in 2011, online gaming revenues of €2.9 billion were recorded—a share of 27 percent. This number is well above the average digital share in the creative industries. U.K. online gaming has about the same relative importance as in other EU-27 countries, but that is mostly due to the fact the video games sales suffered a significant drop in 2008, whereas online gaming remained on its growth track (*see Exhibit 18*).

Exhibit 18
Gaming Industry Revenue Development from 2001 to 2011



Source: PWC, Euromonitor, Booz & Company analysis

There are several reasons for the success of online models in gaming:

- Enabled by a higher-performance broadband infrastructure, online browser games were fully embraced by the industry.
- New platforms and the reach of networks were leveraged to their full extent, by Facebook, the iTunes app store, Zynga, and many others.
- In addition to paid games, freemium models were introduced, in which the basic app is provided free but additional features or levels are for pay (e.g., Fruit Ninja, Pocket Frogs).
- New customer groups were successfully targeted with games and applications designed for very small kids or for older generations, e.g., brain teasers.
- New devices like tablets were instantly adopted, and user behavior turned to a shorter duration of single plays, as in the case of Angry Birds.

The great flexibility and openness to new models has prepared the industry well for the next wave of changes in consumption patterns. (*See "Zed—Mobile Content Solutions," page 38*.)

Zed—Mobile Content Solutions

Zed is a Madrid-based company that offers value-added services for mobile phones for B2B as well as B2C clients. It is partnering with 130-plus mobile providers in more than 60 countries and has more than 140 million direct customers generating annual revenues in excess of €344 million.

Founded in Spain in 1996 as a content provider under the name of LaNetro, the company has provided interactive entertainment products via the Internet from the very beginning. Based on its first success with ringtones for mobile phones, strong organic and inorganic growth in the 2000s allowed Zed to address a variety of digital content growth areas.

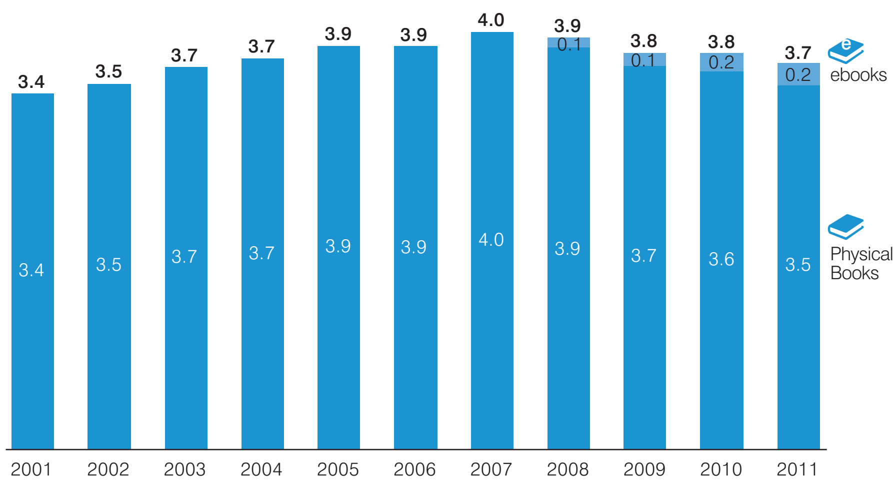
In the B2B area, Zed provides own and white-label end-to-end solutions to develop, distribute, and sell mobile content (music, videos, games, apps, news) for mobile phone providers. This allows customers to increase sales by addressing their audience with targeted mobile marketing solutions through multiple channels and on most existing platforms (iOS, Android, Java, RIM, Windows). A partnership with the National Basketball Association (NBA) in North America to improve its mobile phone offering in 2008 was one of Zed's most visible deals.

In the *consumer market*, Zed developed a platform through which content producers are able to market their own content on mobile phones. Moreover, Zed increased its content catalog through the acquisition of U.K.-based MonsterMob in 2007, which sells mobile content including ringtones, wallpapers, music, and games. With Planet 51, it also offers a very successful multiplayer online game allowing users to explore a virtual world based on the animated movie *Planet 51*.

Book publishing is said to be the next industry to be fully revolutionized by digitization. Up to now, European as well as U.K. numbers show only a moderate impact, but that, too, is changing. Revenues for physical books are growing or stable in all countries, and the share of digital revenues was still only around 2 percent in 2011 (*see Exhibit 19*); the U.K. was a notable exception with a revenue share of around 6 percent. But there are a range of indicators that put digital on a clear growth track for the book publishing industry. For example, estimates of e-book revenues in Germany project a doubling of the market share, to reach more than 4 percent in 2012 already.[15] (*See "Hachette's Digital Strategy," page 40.*)

Exhibit 19
U.K. book industry revenue development from 2001 to 2011

BOOK PUBLISHING REVENUE DEVELOPMENT
U.K., 2001-11, in EUR bn



Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

Hachette's Digital Strategy

Hachette Livre SA is one of the four pillars of the media activities of Lagardère, one of the world's leading media companies, with net sales of more than €7.6 billion in 2011. Whereas Lagardère Active SAS, a second media pillar, comprises all activities on digital media, Hachette Livre is focusing on the worldwide publishing of education texts, fiction, and other literature, such as dictionaries. Like other publishers with a strong focus on printed literature, Hachette Livre is facing many challenges due to digitization in general and also the unauthorized reproduction of e-books. Nonetheless, sales of e-books continue to grow at a strong rate while the overall book market is decreasing slightly in France. To participate in this growing market, Hachette Livre has developed a digital strategy that addresses various topics:

- Digitization of all new content and selective past works, making them compatible with all digital platforms and devices
- Creation of new digital platforms to sell e-books
- Improved digital services and online activities on social networks to strengthen ties with authors
- Aggressive fighting against piracy, leading, for example, to a specific agreement on conditions for the digitization and reproduction of books
- Offering of dynamic and selective logistics services to allow for a profitable operation of own-distribution infrastructure

In 2011, Hachette generated more than €2 billion in revenue, almost 70 percent of which was in France, the U.K., and the United States. The e-book business grew by 100 percent in the U.S., and now represents 20 percent of US operations. Because production and distribution of e-books is less expensive, they are generally priced about 30 percent below the price of printed books. In the U.K. (6 percent) and France (1 percent), e-books are still underrepresented. As Hachette does not have own B2C sales platforms, its digital catalogs, which contain more than 15,000 titles (in France) are marketed via various platforms like Amazon, iBookstore, and Barnes & Noble.

Also, various apps have been developed that are based on digitized books. These apps include dictionaries, encyclopedias, language learning and reading software for children who are beginning readers, and a health guide for parents.

Several still-uncertain factors will affect the speed with which digitization changes book publishing:

- The further move of educational publishing into e-books (already making up 60 percent of total e-book sales) with manifold advantages for this subcategory. The value drivers include easy and fast review cycles, combinations with other electronic formats, and the ability to customize textbooks for individual courses.
- The entry of Amazon into the publishing business and the impact on traditional publishing houses.[16]
- The development of the US as a leading market for e-books: The total market share for e-books has already surpassed 6 percent and is growing. In the EU it is at 2 percent.[17]

E-book sales overtook hardcover sales for the first time in Q1 2012 (in the adult hardcover fiction and nonfiction categories).[18]

- With the mass penetration of e-book readers and tablet computers, the catalyst for change is here. Just as the development of the iPod triggered changes in the music industry, the tablet will reshape publishing. To be sure, consumers will still buy printed books, but those will increasingly be artifacts with a high level of offline value (such as high-quality photographic books).

Already today, there is a pronounced difference between the best-selling general interest titles in physical and e-book sales (*see Exhibit 20*). Whereas the top titles in e-books continue to be novels, there is a clear tendency in physical books toward nonfiction titles (including cookbooks), books with high graphic appeal (such as graphic novels), and books that are suitable as gifts. If managed well, this differentiation can benefit the entire industry. The quality of writing and editing will not diminish in value with e-books; indeed, it may rise as people find it easier to test a book by downloading one chapter free, and buying the rest of it only when they are drawn in.

Exhibit 20
Bestsellers for E-books versus Print Books

BEST-SELLERS ON AMAZON.CO.UK
November 2012

PLATFORM	RANK	AUTHOR AND TITLE	GENRE
All Books	1	Jamie Oliver: Jamie's 15 Minute Meals	Cooking
	2	Jeff Kinney: Diary of a Wimpy Kid 7	Comic
	3	Bradley Wiggins: My Time. An Auto-Biography	Auto-biography
	4	Guinness World Records 2013	Non-fiction
	5	Miranda Hart: Is It Just Me?	Comedy
	6	Nigel Slater: The Kitchen Diaries 2	Cooking
	7	Rod Stewart: Rod. The Auto-Biography	Auto-biography
	8	James Bowen: A Street Cat Named Bob	Auto-biography
	9	Paul Hollywood: How to Bake	Cooking
	10	Danilo: One Direction Official Calendar 2013	Non-fiction
Kindle Ebooks	1	John Lloyd et.al.: 1,227 QI Facts to Blow Your Socks Off	Comedy
	2	Hilary Boyd: Thursdays in the Parl	Novel
	3	Mhairi McFarlane: You Had Me at Hello	Novel
	4	Chris Ewan: Safe House	Thriller
	5	Louise Doughty: Whatever You Love	Novel
	6	Kate Morton: The Secret Keeper	Novel
	7	Peter James: Not Dead Yet (Roy Grace 8)	Thriller
	8	Chris Pavone: The Expats	Thriller
	9	Peter May: The Lewis Man	Thriller
	10	Tiffany Reisz: The Siren (The Original Sinners 1)	Novel

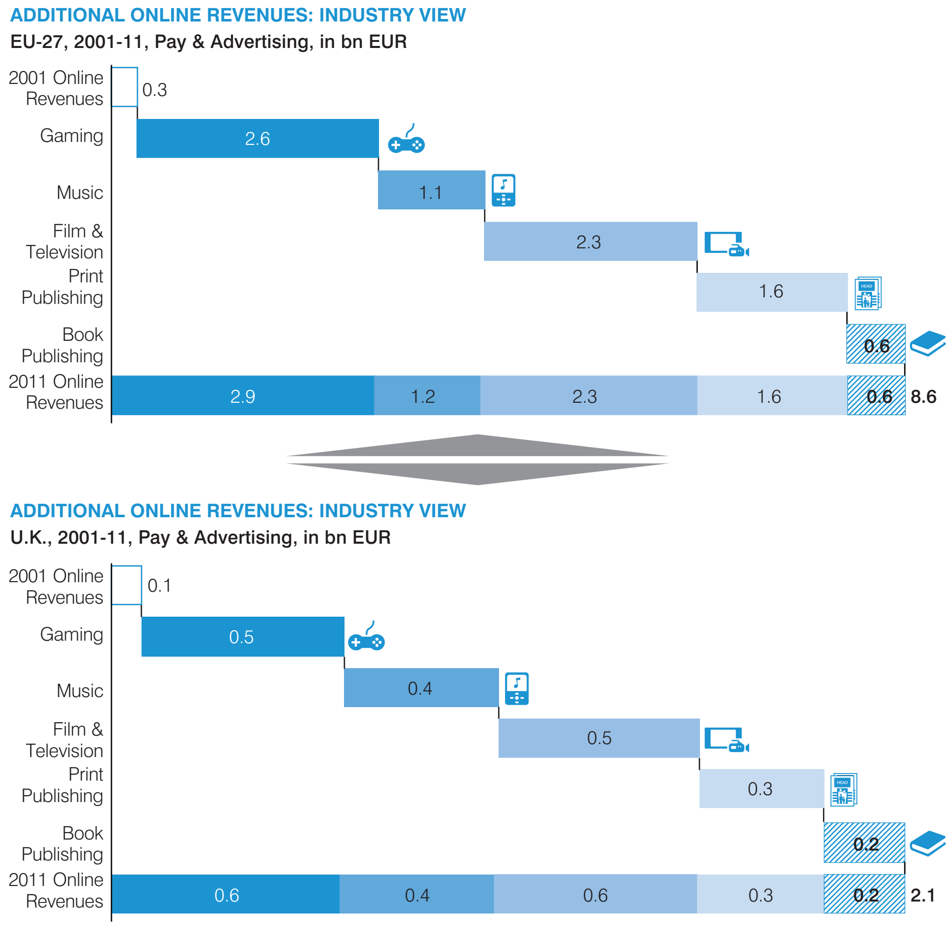
Source: Amazon, Booz & Company analysis

In general, revenues are set to grow for the creative sector if the consumer experience can be further enhanced. To participate in the growth of pay revenues, a high level of innovation and agility is needed in the digital domain. The creative sector has always been used to a hit-driven business model that entails a large share of less-successful products and services. But the speed and complexity of the business have risen considerably over the last years. It is not sufficient anymore for a music band to produce an album and market the production via interviews in TV and print and via a tour. Instead, fans are expecting a constant conversation with the star, availability across different platforms, and valued services above and beyond the music. Lady Gaga is probably one of the most successful celebrities catering to this shifting customer expectation; her Twitter account had more than 31 million followers in November 2012.

In addition to addressing rising complexity in the core business, media companies need to expand their product range and cater to new consumer demands. The companies will need to transform into diversified digital media companies to grow, or even to sustain their revenue level. Most major publishing houses have moved into online ventures not directly related to their core capabilities—for example, online dating platforms or professional networks. Even though these ventures are somewhat related to their traditional classified advertising business, the dynamics of the online ecosystem are quite different for these new services, and it isn't clear how many of them will be sustainable. So far, book publishing accounts for the smallest piece of the creative sector's online revenues, and the major challenge that this segment faces is finding and expanding its audience.

In summary, all creative industries are successfully establishing new models to monetize digital usage. Internet-driven online revenues now account for €8.6 billion across the EU-27 and €2.1 billion for the U.K. Pay revenues are expected to remain the main growth pocket for the creative sector, if consumer experience can be further enhanced while managing the resulting complexities. Growth in advertising revenues will continue to be challenging for the sector given the competition in digital and the existing gap with advertiser expectations. All the creative industries, however, are destined for significant growth online. Once the penetration of broadband and mobile devices is more complete, the tipping point for acceleration will be crossed (*see Exhibit 21*).

Exhibit 21
Growth Prospects and New Business Models for Creative Industries



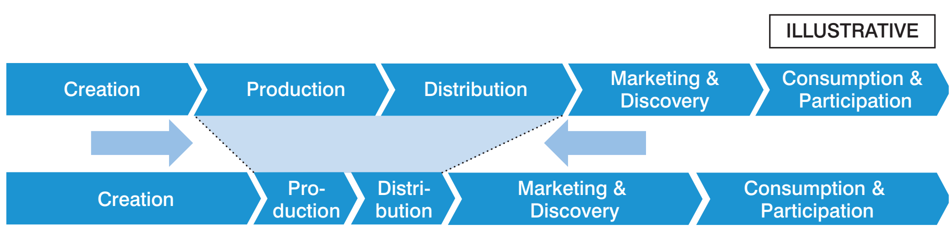
Source: PWC, eMarketer, IHS, Euromonitor, Booz & Company analysis

Gaming, already making some revenues online in 2001, has become the single largest online category, driven by consumer pay revenues. One particularly interesting reason for this growth is the introduction of innovative virtual goods, e.g., additional capabilities or weaponry for online characters. These pieces of software are, of course, very cost-efficient to produce but greatly enhance the experience for the individual consumer.

In all the digital segments, creative production has benefited tremendously from technological change. Entirely new content is possible—for example, new special effects and 3-D rendering in feature films. New models of collaboration make creative processes much more effective and enable real-time interaction with experts, colleagues, and friends around the globe. The means of distribution have by now outgrown the supply of high-quality content, putting the creators in a better bargaining position; VOD services, video platforms, and streaming services are additional outlets to monetize content and create entirely new experiences for consumers. In some cases, the new setup bypasses traditional intermediaries. For music and other creative content, crowdsourcing and distribution on digital platforms is gaining importance; one early adopter is the German rock band *Einstürzende Neubauten*, which financed and published entire album productions with the help of supporting fans.

As a result of these developments, a number of established business models of publishers and distributors have become obsolete—for example, the production of printed encyclopedias. Other business models, like advertising in the print publishing industry, do not (yet) deliver the same digital revenues as their offline equivalents. The non-digital creative ecosystem has been largely dominated by horizontally integrated intermediaries across production, distribution, and marketing. These functions have been dis-integrated by, e.g., very cost-efficient digital alternatives.[19] Thus, the relative economic importance of these players in the value chain has decreased *(see Exhibit 22)*.

Exhibit 22
New Usage Patterns and Technology Lead to Changes in the Creative Sector's Value Distribution



Source: Booz & Company analysis

These efficiency gains from digitization might be reaped by consumers, creators but also the industry itself. A comparison of large European media companies in print publishing, television and the larger entertainment space shows that 50 percent of the companies were able to grow their EBIT stronger from 2011-13 than in the 2005-07 period. And 50 percent were even able to increase profits stronger than revenues.[20] Yet the economic performance differs significantly from company to company. In this time of transition, the established players still have to maintain the physical distribution of e.g. magazines while at the same time build up the new digital infrastructure and capabilities. New entrants are able to benefit from a digital-only approach.

In the next and final chapter, we will sum up these trends and the prospects for the creative sector in Europe during the next five years.

6. OPPORTUNITIES IN A NEW CREATIVE ECOSYSTEM

The creative industries are successfully establishing new digital models. Pay revenues are expected to remain the main growth pocket for the creative sector if consumer experience can be further enhanced while managing the resulting complexities.

Across all creative industries, digitization requires an extended use of trial and error. New businesses need to be launched quickly, tested in the market, adapted if necessary, and closed down if they do not work. This approach is often challenging in large corporate settings; new entrants and startups tend to find alternative ways to thrive in the creative sector more easily.

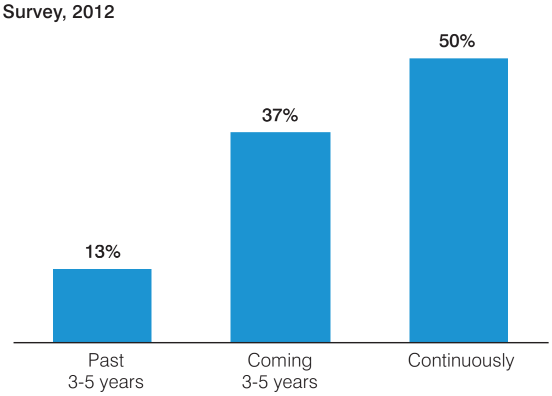
Business will get more complex as companies have to deal with a high number of small revenue pockets. Agility and speed will be as important as size, very often favoring new players. Cannibalization of traditional revenue streams or fear that their current assets will be devalued is holding back some of the established players. But as long as the consumer benefits—through increased usage and a significantly enhanced user experience—the creative sector will find a way to thrive.

The quantity and relevance of creative products have increased steadily, the barriers to become a creator or contributor have decreased, and new usage patterns have emerged ("social, mobile, and local"). These patterns are still more pronounced in the younger age groups, but older age brackets will follow suit. As with new media in the past, the new possibilities will not replace old media but augment them—and impact the value chain.

Experts agree that the biggest changes are still to come. An overwhelming 87 percent of those surveyed believe that the greatest changes from digitization will come in the next three to five years or that they will happen on a continuous basis (*see Exhibit 23*). This projection is clearly supported by industry data. Smartphone penetration in Western Europe will reach 100 percent within the next five years, and tablet computers will continue their growth trajectory, until Europe is comparable to the US, where 19 percent of all consumers own a tablet PC already today.[21] Consumers will spend a greater share of their leisure time on these devices and access creative products and services, among many other entertainment, information, and communication offers.

Exhibit 23
Expected Changes from Digitization

CHANGE IMPACT FROM DIGITIZATION
Convener Meeting Survey, 2012



Source: Interviews, Booz & Company analysis

For the creative sector, these expected changes represent good news. The demand for creative products is set to grow further. Digital revenues have already been the growth driver of the creative sector over the last 10 years. In aggregate, the entire revenue uptake of €30 billion (nearly €5 billion in the U.K.) can be attributed to digital, growing at a yearly rate of 11 percent (10 percent in the U.K.). But the traditional world of a stable value chain with integrated players is not going to come back, making further changes to the business model of traditional players necessary if they are to return to a growth track. The evolving digital ecosystem will be much more fluid and will present abundant opportunities for all players. New products and services will offer consumers the following sorts of benefits, e.g., selecting and reviewing relevant content from a significantly increased supply base, thereby enabling discovery.

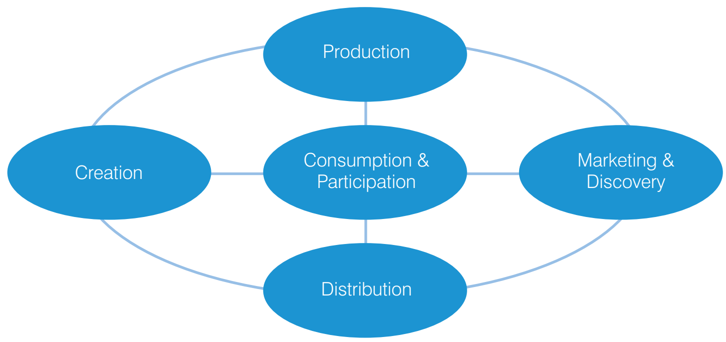
Digitization also presents significant challenges for traditional business models and established intermediaries in the creative sector. Although demand for creative products is increasing, it is also fragmenting to a much greater degree. Non-digital-born media franchises have to compete with purely digital brands and platforms for the time and attention of the consumer—and already more than 20 percent of the time spent online is spent on social networks.[22] Incumbent offline media positions will be hard to defend. The value of some older capabilities—for example, design for the printed page, or physical media distribution—will be significantly reduced as media companies become more like tech companies.

Along the same lines, the new economics of content production and distribution greatly reduce the value of physical infrastructure for players in the creative sector and lead to a reshuffling of the sector's power balance. Distribution and consumer access become "free goods" and shift key success factors from infrastructure ownership to an effective marketing capability. Intermediaries will continue to play a significant role only if they can secure and manage reach by combining attractive brands with deep content skills to create unique consumer experiences.

In this digital world, the established concept of a stable value chain will eventually disappear. It will be replaced by a network of relationships among the various constituencies (*see Exhibit 24*).

Exhibit 24
A Much More Fluid Creative Ecosystem Architecture Is Evolving

NEW CREATIVE ECOSYSTEM ARCHITECTURE



Source: Booz & Company analysis

So far, the changes in the creative ecosystem have had no major impact on the overall number of jobs in the sector (negative growth of 1 percent annually in the U.K.). A projection of this trend into even the near future is very difficult. But we can be confident in the need for a dramatically changed composition of needed skill profiles going forward: The number of employed software engineers in the sector will increase at the expense of jobs residing in the physical distribution infrastructure, such as printers.

The creative sector in the U.K. can thrive online and will continue to develop new and working business models. In contrast to the traditional models, providing a seamless user experience across devices and media types will become an important differentiator in the fast-moving consumer market. Successful companies or services like Spotify or iTunes show that these new features will most likely be first introduced by nontraditional players in the creative sector. Therefore, case-by-case alliances and partnerships will be critical to success in the new creative ecosystem; no single player will be able to deliver this experience on its own. The ability to quickly think through, understand, and make deliberate choices about where to compete and where to join forces will become one of the most critical capabilities for success.

APPENDIX: METHODOLOGY

This report is supported by desk research, expert surveys in focus countries (France, Germany, Italy, Poland, Spain, and the United Kingdom), and numerous selected deep-dive interviews with industry experts across Europe.

The results of our desk research are based on respected industry sources, such as PWC Global Entertainment and Media Outlook, Eurostat, IHS Screen Digest, and IAB, to name only the most important ones used. For data regarding jobs, we contacted most local associations in our focus countries and built the employment development bottom-up. Wherever possible, we used source data; if no original data was available, we derived it through comparable country data. For example, if no full EU-27 data was available, we scaled up the existing data in five European country clusters; for example, the U.K. and Sweden were used to scale up the entire cluster consisting of the U.K., Ireland, Denmark, Finland, and Sweden. The scaling factor used was around 1.19 on average for revenue scaling—in other words, 84 percent consists of original data, 16 percent was scaled up in a country cluster according to 84 percent comparable original data. Data in the report is always presented in euros; if the reporting currency was not euros, we used 2011 FX rates to translate it into euros for all years in order to avoid the impact of currency fluctuations.

At the start of the research, we also conducted an expert survey with representatives from the creative industries in each focus country. In order to quantify their views and opinions across the countries we used an anonymous live voting system; we had 54 participants voting on 13 different questions, gathering a total of nearly 800 data points. To present the numbers in this report, the country voting results were normalized in order to account for the different number of participants in each country. Additionally, we conducted one-on-one interviews in the focus countries to capture further perspectives from industry representatives and conduct research for the sidebar case studies—some of which, but not all, have been written on the basis of in-depth interviews with company representatives.

The impact of the Internet was assessed on a quantitative as well as qualitative perspective and was not summarized in a single number. We analyzed the impact of the Internet along the consumer perspective as well as the creator and industry perspective, providing a differentiated perspective on each player.

The employee numbers are included according to the definition of Eurostat: book publishing excludes distribution of books and independent writers; print publishing includes newspapers, journals and periodicals and other publishing activities and excludes independent writers and photographers; film & television includes motion picture, video and television production and post-production and motion picture projection and excludes independents; music includes sound recording and music publishing activities but excludes all independents and performing arts, theaters, etc.; gaming includes the category publishing of computer games.

The revenue definitions are as follows: book publishing includes all revenues from electronic and print consumer retail spend for consumer and educational books but excludes B2B publishing (i.e. professional books); print publishing includes all electronic and print advertising and circulation revenues; film & television revenues includes box office and cinema advertising, electronic home video (video on demand, pay-per-view and over-the-top streaming), physical home video (sell-through and rental), broadcast/mobile/online TV advertising (e.g., YouTube—except music videos, which are counted in the music category), public TV license fees, subscription spending (subscriptions for basic and premium channels) for e.g., cable operators; music revenues includes digital recorded music (incl. streaming subscriptions and advertising revenues) and physical recorded music as well as concerts and sponsorships; gaming includes revenues from console games (incl. PC games) and online games (incl. downloads, online and mobile games).

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About the Authors

Thomas Künstner
thomas.kuenstner@booz.com
is a partner with Booz & Company based in Düsseldorf. He leads the firm's digital media practice in Europe, and assists leading telecommunications and media companies as they seek to define winning strategies for the digital future.

Matthew Le Merle
matthew.lemerle@booz.com
is a partner with Booz & Company based in San Francisco. He works with leading technology, media, and consumer companies, focusing on strategy, corporate development, marketing and sales, organization, operations, and innovation. Matthew is a director of the Bay Area Council and an advisor at BayBio. He was formerly the president of Keiretsu Forum and is a member of Band of Angels, both leading angel investor organizations.

Dr. Hannes Gmelin
hannes.gmelin@booz.com
is a principal with Booz & Company based in Berlin. Within the firm's Communications, Media & Technology practice, his focus is on market developments in the digital sector and its corporate implications such as large-scale Fit for Growth transformations.

Christian Dietsche
christian.dietsche@booz.com
is an associate with Booz & Company based in Zurich. He works in the media and digital practice, advising clients on a range of strategic issues, including revenue growth strategy, market entry, and organizational redesign.