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Mercer Study Reveals Key Strategic Issues Facing Mobile Entertainment Industry Leaders

LOS ANGELES, September 12, 2006 – The mobile entertainment ecosystem faces substantial unresolved business model questions over the next three years, according to a new study by Mercer Management Consulting. The Mercer study, presented at CTIA Wireless IT & Entertainment 2006, reveals industry leader beliefs that suggest:

- Mobile TV will not see explosive growth, but promises strong returns for the right offer and delivery system
- MP3 phones will carve out a material segment of the portable music device market; music services will remain controlled by incumbent distributors, not carriers
- Mobile web technology will evolve quickly to meet demand; the stage is set for the beginnings of mobile web displacement of fixed-line web access
- Strong consumer uptake of mobile navigation and location-based services, but flexible business models are needed for distinct customer segments
- Content owners and wireless carriers are seen as most likely “big winners,” technology providers as most needing to improve offerings, and content aggregators as not a major factor – raising questions on ecosystem alignment and the relevance of the wired Internet experience as a predictor

Mercer surveyed 300 executives from across the global wireless ecosystem: wireless carriers and MVNOs, content owners and aggregators, device and equipment OEMs, software players, and members of the venture/investment banking community.

Most respondents believe that mobile TV will not grow explosively, but will offer promising returns to the right business model

70% of the industry executives interviewed think a majority of wireless customers will still say “no” to mobile TV in 2009. Most execs simply don’t think the product is ready yet, with 66% citing device or network issues and 59% citing content issues.

Wireless ecosystem players on average expect that additional monthly revenue per user from mobile TV of \$4.90 will be achievable in the next three years, with half the amount coming from consumers and half coming from advertisers. Martin Kon, a Director of Mercer Management Consulting, notes that: “For advertisers, mobile TV offers a value proposition that is as ‘hyper-targeted’ as paid search advertising and as high-impact as television advertising. However, given modest adoption expectations, this value proposition could be tempered by advertisers’ perceptions of insufficient scale versus paid search or other emerging formats.”

Notably, one in four respondents think mobile TV will have no additional revenue associated with it – MVNOs were the most pessimistic about potential revenue increases. Kon observes:

“Even if the ‘revenue pessimists’ are right, the winners of mobile TV could still drive substantial improvement in their underlying economics by offering TV as an included part of pricing plans. The right combination of device, content, and features could raise handset average selling prices, improve efficiency of customer acquisition spending, and/or improve subscriber retention. The trick for carriers and their partners will be optimizing their consumer offers to have a ‘basic offer’ that pays for itself in this way, with an upgrade or up-sell path to gain more revenue per user from certain customer segments.”

Kon also notes that: “A modest adoption profile has many wider business model implications. For example, if these user-volume expectations prove to be real, it will be very hard to get a return on ‘Howard Stern-style’ fixed-price content deals.” Kon adds that modest adoption over the next three years “could leave the field more open for WiMAX or other disruptive video networks, without having to face a massive first-mover advantage from mobile carriers before their new networks come to market.”

There is no clear winner in the war between MP3 phones and standalone music devices

While divergent views exist on the potential for MP3 phones to supplant iPod and other standalone music devices, industry executives agree on the likely evolution of music distribution models. Wireless retailers are the most optimistic about the potential for MP3 phones – 71% see substantial usage of these devices by 2009. However, the venture and investment banking community views the battle as already won – with only 22% of respondents envisioning substantial penetration of MP3 phones by 2009.

Under any MP3 adoption scenario, 8 out of 10 respondents still agree that wireless carriers need to let users continue to use existing music aggregators (e.g., iTunes) rather than attempt to serve as aggregators themselves.

Ranjan Mishra, a Director of Mercer Management Consulting, comments: “Finding the right business model for wireless music has been an impediment to the growth of MP3 phones. The study results show that the industry now recognizes the need for the long-discussed ‘meeting of the minds’ among carriers, music aggregators, and OEMs, to bring about a converged solution with seamless access to both broadband and wireless wide-area networks.”

Will mobile web begin to threaten fixed-line web access?

Findings suggest that “Fixed-Line Displacement 2.0” – a shift by some users to wireless-only connectivity to the Internet – could be only a few product/service leaps away. Nearly all survey respondents agreed that the current mobile web offering is not yet good enough, citing the need for performance-based enhancements (e.g., better-performing devices, better website configuration, and faster network performance) that would have the greatest potential impact on mobile web usage. Only 40% selected pricing as a major current impediment to users making the move to wireless web.

However, industry executives were very optimistic that by 2009 the wireless industry will bring about those performance-based enhancements to significantly improve mobile web penetration and usage. Half of executives polled think better-performing devices, better website configuration, and faster network performance are very likely by 2009 (a 75%+ likelihood of occurring), while 8 out of 10 respondents think the enhancements have at least a 50% likelihood of occurring.

Ranjan Mishra says: “We may see a replay of what happened with wireless voice—wireless pricing gets ‘close enough’ and performance becomes ‘good enough’ for the inherent benefits of mobility to erode landline usage. So people who once ‘cut the cord’ with voice may now ‘cut the High-Speed Data (HSD) line’ also. This would have obvious implications for investments in cable upgrades and fiber – and for the different strategies of companies bundling fixed-line and wireless versus those who are wireless-only. Full fixed-line displacement will accelerate upon the full launch of 3.5G/4G solutions by wireless carriers; in the near term we expect wireless data to first erode the value of HSD locations outside the home or office, such as hotels or cafés – just as wireless voice first affected pay-phones.”

Location-based services will go mainstream among cell phone users, but business model challenges face wireless carriers in this arena

The Mercer study found considerable optimism about the 2009 usage rate for mobile phone-based navigation – one-third of industry executives think at least 50% of all mobile phone users will take advantage of these services, and three-quarters of respondents think at least 30% of all mobile phone users will take advantage of these services.

Respondents were similarly optimistic on navigation and location-based services revenues – 81% of respondents believe that a combination of subscriptions, ad-based models, and pay-per-use will drive additional revenue, while only 19% believe navigation and location-based services will be “revenue-free.”

However, despite this optimism, the study also found that respondents expect mobile phones to achieve only a 31% share of all navigation users by 2009, compared with a 55% share for specialized navigation systems installed in cars or sold as portable navigation devices (PNDs).

Mark Teitell, a Principal of Mercer Management Consulting, notes that: “Embedded navigation systems and PNDs are high-margin device businesses that could choose to discount or give away services to drive profitable device volume. The carrier business model, based upon device subsidies and profitable services, could face a challenge of services being offered for free to the users of non-phone devices. Carriers may need to differentiate on the more-advanced capabilities of 3G networks versus the FM radio-based or satellite-based delivery systems that these device manufacturers will rely upon for low-cost location-based services. Additionally, carriers have opportunities to provide the wireless connection for specialized devices, so a

detailed understanding of customer segments and creative deal-making to target all parts of the market will characterize the winners here.”

Jury still out on the winners; content owners and wireless carriers seen as most likely with implied questions on alignment of incentives

When asked who will be the “big winner” in mobile entertainment, industry executives’ views raise questions about alignment of incentives within the mobile ecosystem, and also questions about whether and how mobile entertainment will evolve differently from the wired Internet space.

Most executives said content owners (35%) or wireless service providers (30%) will be the biggest winners in mobile entertainment, while very few see OEMs (8%) or software application developers (9%) as the winners. However, when asked about key drivers of market development, 75% indicated that improvements to device and network performance – across hardware and software functions – are most critical.

Mark Teitell comments: “Infrastructure and technology players will need sufficient incentives to invest, and their revenue sources from carriers may be more certain than carriers’ revenue from consumers. Are industry executives too bearish on technology players’ prospects or too bullish on the expected value for carriers? Ultimately, there are many pieces to fall into place to make industry development a success, and ecosystem players will need to work together to create value. This study reveals a view of this ‘business model innovation in progress.’ Findings on expected adoption rates, long-term pricing levels, potential for advertising, and required technology improvements all highlight the building blocks and boundaries for this business model innovation and alignment to happen.”

About Mercer Management Consulting

Mercer Management Consulting, a part of Mercer Specialty Consulting, a \$1 billion consultancy, helps leading enterprises develop, build, and operate strong businesses that deliver sustained shareholder value growth. Mercer Management Consulting’s Communications, Information, and Entertainment practice has successfully completed hundreds of engagements for wireless and wireline service providers, communications equipment companies, enterprise IT firms, consumer electronics companies, and online and entertainment firms, and has consulted to nearly all of the major companies in these sectors. The firm serves clients from 26 offices in the Americas, Europe, Asia, and the Middle East.