Final report

Investigation of business models for content in the online children's and local and regional market

September 2008

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1 Introduction

As part of Phase One of its second Public Service Broadcasting Review, Ofcom engaged MTM London to conduct a short, structured review of the extent of current provision of online Public Service Content (hereafter, PSC) and to develop a high-level estimate of the overall levels of expenditure by UK public, commercial and third sector organisations on online PSC. The analyses demonstrated that UK internet users are able to access a broad range of online content that displays some or all of the characteristics of PSC, and that UK companies and institutions in 2006/07 were spending significant sums of money to develop and provide online PSC.[1]

The research also suggested that the availability of online PSC varies widely by sector or genre – in general, online provision of PSC is strongest in areas underpinned by competitive markets with a strong mix of well-funded, committed providers pursuing sustainable commercial models. However, even in these sectors, the analysis suggested that the strength and characteristics of the commercial (and other) models underpinning provision would have important implications for the nature of the services being provided and for the evolution of provision going forward.

MTM London was subsequently commissioned by Ofcom to conduct a detailed investigation into the nature, sustainability and consequences of the business models underpinning the provision of content in two genres - local and regional and children's. In both areas, previous work undertaken by Ofcom has highlighted significant uncertainties about the sustainability of provision in the broadcasting market. The project team focused on children aged 5-12 on the basis that teenager's needs tend to met by sites targeting a general audience.

The project was completed during a five-week period from July through to August 2008 by a three-person project team from MTM London (Richard Ellis, Ross Parker and Bianca Abulafia) and was managed internally at Ofcom by Mark Bunting and Rhona Parry.

The findings set out in this report are based on an extensive programme of synthesis research, drawing upon a broad range of secondary sources to produce a view of industry developments, and a limited series of 15 interviews with senior representatives from across the industry, used to test and refine emerging hypotheses.

This report sets out the key messages and conclusions coming out of this project – the conclusions presented here represent our best professional judgement based upon the available information.

[1] Ofcom, Public Service Broadcasting Review, Annexes 8 and 9 (April 2008)

2 Executive summary

2.1 Introduction

This report sets out an analysis of the strength and characteristics of the commercial (and other) models underpinning provision in two key areas of the online market – local and regional and children's. It is intended to stimulate further discussion and debate about the manner in which online provision can complement and extend broadcast provision. We anticipate that our conclusions will be refined and, in some cases, revised, as Ofcom's review continues.

2.2 Review of local and regional online market

The market for locally-focused online services is experiencing a period of significant growth and development, driven primarily by three main factors:

- Increased consumer demand for local information, content and services, with online services increasingly substituting for offline information sources
- Ongoing growth in the display, classifieds and local search advertising markets, with a wide range of industry participants competing for market share
- Reduced barriers-to-entry, driven by the availability of low-cost technologies and enabling platforms, stimulating a proliferation of UGC content and (mostly small-scale) local properties and online businesses.

In general, the largest individual properties addressing local and regional markets in the UK tend to be classifieds, directories, and local search services operating alongside a number of local news and information platforms that aggregate user-generated and third party content. These services tend to operate nationally – many of them are provided by major international businesses that operate in multiple territories, allowing them to amortise their costs across many markets and to invest at scale in fragmented markets.

There are established and powerful market leaders in the largest categories, with major industry participants including Rightmove, Monster.com and Autotrader in the property, recruitment and automotive classifieds market respectively, and Yell and Google in directories and local search. However, these markets are developing rapidly and are characterised by high levels of innovation, increasingly blurred boundaries between different services (e.g. between directories and local search services), and by high levels of competitive intensity, with a wide range of new entrants and alternative providers entering the market. The majority of these services are aggregators and do not tend to invest significant sums in 'original' professionally produced content, per se.

There are also a broad range of cross-platform media companies and local organisations investing heavily in local and regional markets, notably including the national and regional newspaper groups, commercial radio companies, and the PSBs. Local Government bodies and public sector institutions are also investing heavily in online offerings and services, often providing improved online access to local information and public data. It is clear that these organisations are, in general, strongly committed to their online ventures and that they will continue to invest in building and developing significant online properties.

However, it is also clear that many commercial companies face a challenging market environment:

- Local news content is, by definition, location-specific and much of it has a limited lifespan and archive value, limiting the commercial returns that can be generated
- The market is highly fragmented, with a broad range of providers, offerings and propositions competing for the time and attention of local audiences

- There is significant competition for advertising revenues from the powerful national and international online specialists mentioned above, many of whom are investing heavily in local services, and from a growing number of (mainly ad-funded) local online-only businesses, especially in major urban population centres.

The market is clearly at an important stage in its development and is evolving rapidly. The volume and quality of content and services provided by online communities and users will continue to grow, complementing an increasingly sophisticated range of local information services, many of them provide by major international businesses. In addition, 'traditional' media players will continue to invest heavily in their local online properties, evolving their offerings as they migrate towards cross-platform business models and providing a substantial body of professionally produced 'original' content. Taken together, this provision comprises a rich and valuable addition to the media mix. However, there are significant uncertainties about the commercial sustainability of many current offerings, especially those requiring significant investment in newsgathering and original content creation.

2.3 Review of market for sites targeting children aged 5-12

Today's 5-12 year olds are, for the most part, digital natives: they have grown up with digital technologies, and are heavy users of many of the same large-scale services used by older demographics, such as Youtube, Google, eBay and Bebo.

The major properties targeting children tend to focus on entertainment and games, and are provided primarily by large-scale international cross-platform media companies, the BBC, online gaming providers, and children's toy brands. Although advertising is the main source of revenue for most of these properties, the children's genre is notable for the presence of a small number of large-scale pay and subscription sites, and the evolution of innovative micro-transaction ecommerce models. By contrast, toy brands and manufacturers tend to treat the creation of online content as a marketing cost.

Although important, the UK market is relatively small and highly competitive, which makes it difficult to invest in content that cannot be leveraged across multiple territories and heavily cross-promoted. Moreover, the costs of producing and providing rich, multimedia entertainment and gaming experiences tend to be relatively high and there are significant barriers to entry in the pay and subscription markets, where demand is relatively limited. As a result, the economics of the children's market tend to favour international (and predominantly US-based) cross-platform media companies operating in multiple territories, enabling them to spread development costs and to invest at scale. As the market matures, many of these companies are consolidating their position by acquiring successful online sites.

As a result, the largest properties do not tend to be UK-originated or UK-focused, with many providers focusing on propositions that are 'culturally neutral' in order to maximise their returns in what is, increasingly, an international marketplace. Moreover, providers tend to cluster around a narrow range of genres focused on entertainment and gaming, with only limited factual, informational and educational content. Given this situation, the BBC is likely to remain the leading provider of original, UK focused content for pre-school and younger children.

3 Methodology

Overview

The investigation had three inter-related objectives:

- To identify and provide a detailed description of the main business models for online content, highlighting their key characteristics and identifying the trends and dynamics impacting each funding model going forwards
- To conduct a detailed investigation into the nature, strength and sustainability of funding for online content in two key genres: children's aged 5-12, and local and regional
- To assess the extent to which funding is encouraging or inhibiting the provision of online PSC and analysing the experiences, incentives and obligations for public and private sector industry participants within each sector.

Our approach relied on synthesising a broad range of resources, including audience measurement data from Nielsen, Annual Reports from key providers, expert blogs, industry reports, and a series of off-the-record interviews with industry experts. Importantly, MTM London was not commissioned to undertake any primary research or modelling of the size of either the children's or local and regional markets in the UK. In addition, the project team did not undertake a review of the sustainability of the BBC or other state-funded provision and business models, on the basis that this is already well understood by Ofcom.

Key issues and considerations

In developing the methodology, the project team addressed a number of important issues and challenges.

Agreeing a broad definition of content

We adopted a broad definition of content, to encompass professionally produced content, user-generated content and social media, and platforms that provide utilities and applications that cut across content genres but can potentially deliver public service outcomes by enabling users to generate, discover and interact with content.

Agreeing a definition of each content genre

The project team adopted a broad definition of local and regional content to cover all content relating to or aimed at geographically specific audiences: this includes content about an area and content about local businesses or organisations that happen to be located in that area. We excluded content about a certain location that is aimed at visitors (e.g. travel web sites and tourism) from this analysis.

In the children's genre, the project team conducted a high level review of all sources of content used by children aged 5-12, but only reviewed the business models underpinning sites primarily targeting children aged 5-12, on the basis that the business models of providers targeting a more general audience were not dependent on children.

Assessing demand and usage across key genres

The project team did not undertake primary consumer research into demand for and usage of content in the genres under investigation. As such, the project team relied on a combination of secondary sources, audience measurement data supplied by Nielsen for the month of June 2008, and off-the record interviews with industry stakeholders.

There are challenges associated with accurately measuring online audiences and limitations to the insight that can be derived from Nielsen audience measurement data in these genres. Whilst Nielsen supplies a breakdown of user behaviour amongst the children's 5-12 demographic, the panel is too small to provide a reliable picture of audience usage of the majority of sites, and as such the analysis is limited to usage of in the region of fifty major sites that are heavily used by this age group.

Children's usage of certain sites may be under-represented for several reasons, including:

- Usage while at school is not measured due to logistical challenges
- Usage by children accompanied by parents is only counted when the child is logged in to the monitoring software as the primary user (i.e. when a parent logs in, the child's use will be counted as the parent)
- Smaller levels of usage are discounted due to a lack of representation (specifically, sites used by fewer than 10 panelists are not included in reports)
- Panel members may change their behaviour knowing that they are being monitored – this may particularly apply to the use of adult sites.

The panel data must be treated with particular caution with relation to the local and regional market, as many local sites by definition target a relatively small audience, and are too small to register on Nielsen's panel, making the scale of the local and regional genre itself hard to measure. In addition, Nielsen does not operate a geographically specific panel, which further limits analysis.

Assessing market size

There is relatively limited data available on the size the UK local and regional and children's online advertising, pay and subscription and ecommerce markets. The project team was not commissioned to undertake a detailed analysis of market size in either case. However, in order to provide context to the analysis, and to act as a basis for further debate, the project team have provided high level estimates of online advertising market size in each genre, drawing on a wide range of data including IAB/PWC online advertising market data, the annual reports and SEC filings of major providers, and interviews with industry stakeholders.

4 Review of business models for online content

There are three broad commercial business models for the provision of online content: advertising, payment and subscription, ecommerce and many variations within these categories.

However, the internet includes a wide range of content that is funded through other routes: content that is publicly funded, created as part of a marketing or Corporate Social Responsibility campaign, or, most importantly, created through the activities and interactions of individuals and communities with no commercial return in mind.

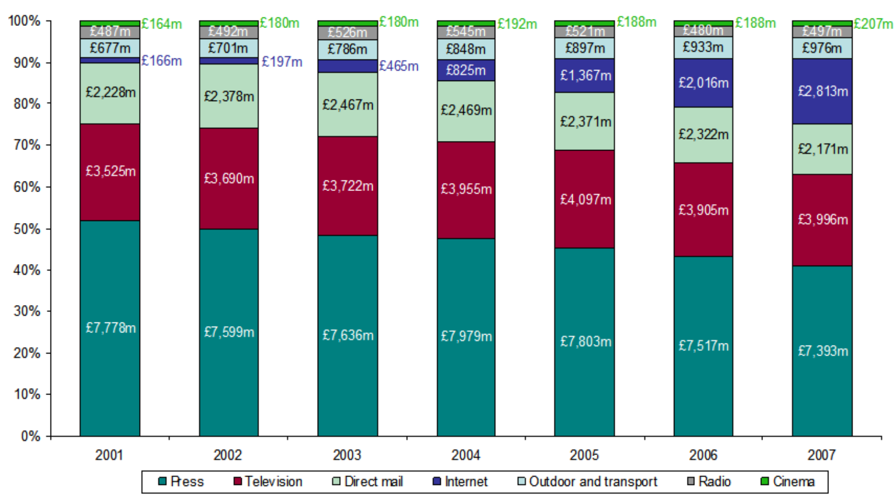
This section considers each of these business models in turn, setting out their headline characteristics, the types of content they tend to encourage, and the impact this has on the nature of content available on the web.

4.1 Online advertising

4.1.1 Introduction

Online advertising is the third largest segment of the UK advertising market after press and television. It is growing rapidly, up 38% to £2.8 billion in 2007, against total advertising market growth of just 4.3%. Online advertising revenues now exceed both regional newspaper revenues and all press classified revenues, and account for 15.3% of the £18.4 billion UK advertising market.[2]

Exhibit 1: UK advertising spend by media



Source: World Advertising Research Center (WARC), *Advertising Statistics Yearbook 2008*

At a high level, online advertising can be divided into three broad segments:

- Search advertising – advertisers bid to have text ads placed alongside search results
- Display and contextual advertising – advertisers purchase inventory from publishers or intermediaries
- Classified advertising – individual or business advertisers pay publishers for inclusion in grouped listings.[3]

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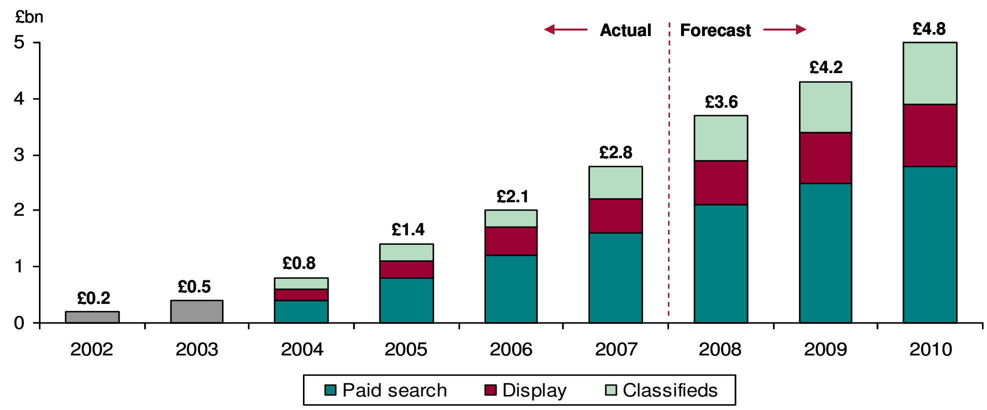
[2] IAB, *UK Online Adspend Study* (2007)
[3] A fourth category of online advertisement, direct email marketing, is excluded from our analysis as it represents a limited revenue stream and is of little importance to content publishers

In 2007 search was the largest segment of the online advertising market, accounting for £1.6 billion in 2007, followed by display advertising at £592m, and classified advertising at £585m.

Exhibit 2: UK online advertising spending

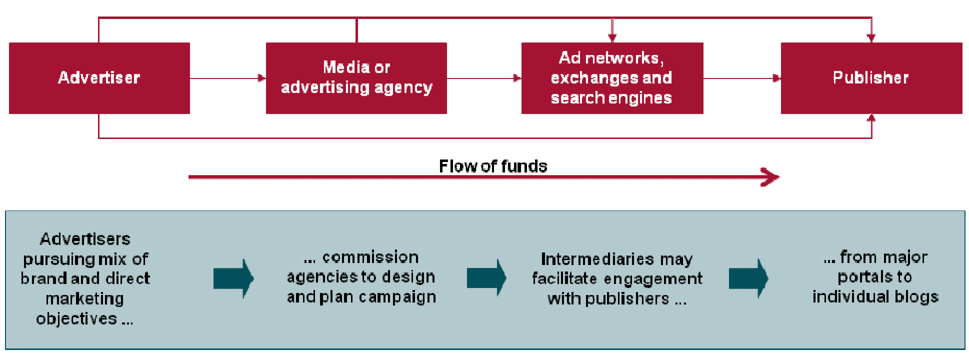


Source: MTM London analysis of IAB, UK Online Adspend Study 2007

In many ways, the model for online advertising resembles other channels: the advertiser briefs an agency with their marketing objectives, and then the agency (or agencies) designs and plans a campaign, and buys inventory from publishers. However, the economics of online advertising are distinctive for a number of reasons:

- The market is fragmented, with a wide range of media owners and advertisers – advertising networks, exchanges, sales houses and publisher networks act as intermediaries, brokering relationships between buyer and seller
- The agency segment is complex, incorporating traditional agencies, full-service communications agencies, digital generalists, and digital specialists with overlapping capabilities
- Advertisers often buy inventory directly from publishers, without using an intermediary
- Emerging technologies such as behavioural, contextual and geo-targeting and advertising exchanges could rapidly change the way in which advertising is bought, sold and priced
- In many cases, advertisers are able to reach consumers directly by creating their own media or distributing marketing materials directly across networks or platforms.

Exhibit 3: Illustrative flow of funds in online advertising



Source: MTM London analysis

Importantly, the different segments of the online advertising market play very different roles in supporting the development of online content.

Search advertising

Search advertising systems allow an advertiser to pay to have a logo or link appear as a 'sponsored' search result above or alongside non-paid (or 'natural') search results. Search engines may receive their commissions in different ways, such as on a per-view, per-click, or per-action basis, with returns accruing disproportionately to the largest or highest-volume providers. The largest search engines also benefit from network effects, with search providers using consumer search and purchasing information to improve and strengthen search results and accompanying advertisements, thereby attracting more users and more advertisers.

Google, the dominant search provider in the UK market, generates the majority of its revenues from its advertising programmes, notably including AdWords (which allows advertisers to display paid-for adverts, often labelled as 'sponsored results', against search terms, appearing above or alongside the non-paid or 'natural' search results) and AdSense (which allows advertisers to purchase contextualised display ads on third-party web sites sold by Google).

Search plays a vital role in the online market as the main mechanism through which content is discovered, driving traffic to major publishers and supporting the discoverability of content and small sites. Search therefore plays an invaluable role in supporting the business models of other commercial organisations.[4] In June 2008, search engines were the most important source of internet traffic in the UK, accounting for 36.3% of upstream visits to all web sites tracked by audience measure provider Hitwise. A typical web site now receives almost four out of ten of its UK visits from a search engine, up from three in ten, three years ago.[5] Importantly, social networks and social media are also playing an increasingly important role in driving traffic to online properties, although this is harder to quantify.

Search queries can fall into various categories – for example, queries can be navigational (the searcher wants to visit a particular property), informational (the searcher is looking for a particular fact or wants information about a particular topic), transactional (the searcher wants to purchase a particular product or service) or content-related (the searcher is looking for a story or article). However, consumers tend to search primarily for known brands (e.g. television programmes, football clubs) and needs: of the top 2000 UK search terms in H1 2008, 88% were for distinct brands, up from 68% in 2005, with nine out of ten people using a search engine to look for a brand and then going to the brand owner's web site.[6] To some extent, growth in branded search is being driven by consumers using search engines rather than address bars for navigation. However, it is also clear that brands play an important role in driving internet traffic.

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[4] Fortunato, S., A. Flammini, F. Menczer and A. Vespignani, *The Egalitarian Effect of Search Engines* (2005) [http://arxiv.org/abs/cs.CY/0511005]
[5] Hitwise (August 2008)
[6] Hitwise (August 2008)

Exhibit 4: Top 10 search terms in UK, May 2008 & May 2007 (Hitwise, August 2008)

	May 2008		May 2007	
Rank	Search term	Share of all UK Internet searches	Search term	Share of all UK Internet searches
1	facebook	1.39%	bebo	1.12%
2	bebo	1.18%	ebay	1.11%
3	ebay	1.06%	youtube	0.51%
4	youtube	0.88%	myspace	0.35%
5	you tube	0.40%	argos	0.24%
6	myspace	0.29%	amazon	0.22%
7	argos	0.28%	facebook	0.20%
8	bbc	0.22%	bbc	0.17%
9	amazon	0.19%	you tube	0.16%
10	bbc weather	0.18%	rightmove	0.14%
Sum		6.08%		4.23%

Source: Hitwise, Managing Your Brand Online, August 2008

While search accounts for 57.6% of the UK online advertising market[7], the majority of search revenues accrue to search engines, and do not provide a revenue stream that directly supports publishers or the generation of content, per se. However, UK search advertising figures include revenues from contextual advertising, which do accrue to (predominantly) long tail publishers. Neither the IAB nor the search engines provide estimates of their UK contextual advertising revenues, although they are likely to remain relatively small, accounting for less than £50m in 2007.[8] In addition, some (limited) revenues accrue to publishers from search engines in return for inclusion of search tools on a publisher's site. These publisher payments are referred to by search engines as 'traffic acquisition costs.'[9]

Display advertising

Display advertising allows advertisers to buy advertising placements ('inventory') around publisher content. A wide range of web publishers, from the major portals through to mid and long-tail sites, use display advertising as a primary revenue source.

The UK display advertising market was worth £592m in 2007, representing 21% of the total online advertising market and up from £453.7m in 2006.[7]

The display advertising market has to date primarily involved advertisers paying to place a range of standardised inventory on publisher sites. The advert is matched with the site's content using a range of techniques, such as behavioural, contextual and geo-targeting, and price is determined either based on the performance of the advert (the advertiser might pay a pre-arranged sum for each click-through they receive, for example) or on the number of times the advert is shown (cost per thousand).

However, digital marketing is evolving rapidly. Advertisers are pursuing an increasingly diverse range of strategies, from creating engaging brand experiences through to direct marketing campaigns designed to acquire new customers. As a result, display advertising is no longer simply about buying advertising space, but rather a discipline focused on distributing experiences – through social networks, sponsorships and tenancies that are closely linked with the content on the publisher site, videos, widgets and applications, and branded content, as well as ad placements.

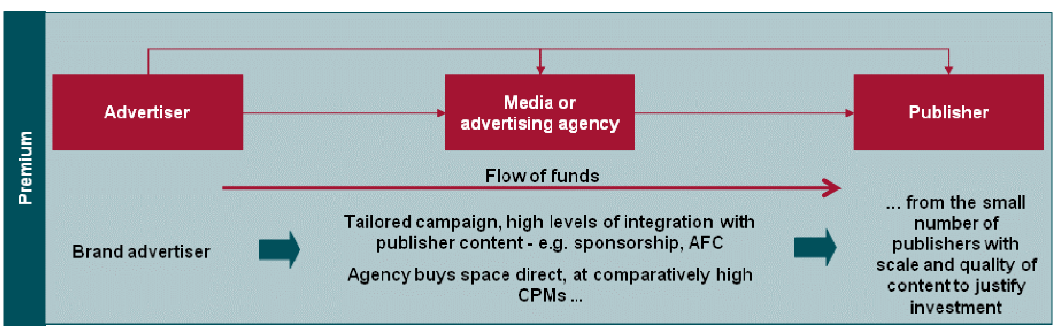
[7] IAB, *UK Online Adspend Study* (2007)
[8] Google's 2008 Q1 SEC filing reports that 31% of their US revenues came from contextual advertising – i.e. AdSense – as opposed to paid search. Google does not provide a breakdown its contextual advertising revenues for the UK; however, the blogging market is less developed in the UK, and we estimate the search engines' contextual advertising revenues will be closer to 5% of their UK revenues
[9] Traffic acquisition costs (TAC) include payments to publishers for incorporating search tools on their sites ('search TAC') and for payments for participation in contextual advertising programs. In Q1 2008, less than 10% of Google's global TAC were related to search tool payments

This diverse range of advertiser strategies and objectives means that the display advertising market is not one market but rather a series of separate but inter-related marketplaces, each of which has different characteristics, and in turn encourages different types of content. At a high level it is helpful to view the market as comprising two main subcategories – 'premium' and 'performance'.

In the premium display market, the advertiser is typically pursuing objectives more closely related to brand marketing rather than direct marketing, such as generating a shift in attitudes towards a given brand or product. They are prepared to pay a premium to ensure that their message is both targeted at the right audience, and sufficiently engaging to achieve the required shift in perception. As a result, the economics of premium display advertising campaigns tend to be distinctive for the following reasons:

- The advertiser pays a premium to have their message on a site with high quality content and a high value audience – context and integration with the environment can be as important as the advert
- The inventory is often priced on a CPM basis, rather than on a CPC or CPA basis
- The advertiser message tends to be tailored to the environment in which it appears – this may take the form of a sponsorship of a given section on the publisher site, or the creation of new content (paid for by the advertiser)
- The campaign tends to be planned, bought and sold directly, through people-based sales teams, rather than indirectly through an automated network
- There are only a relatively small number of online publishers with both the high value content and audience and sufficient reach to make them attractive to premium advertisers – many smaller advertisers find it difficult to access this market.

Exhibit 5: Characteristics of premium display advertising



Source: MTM London analysis

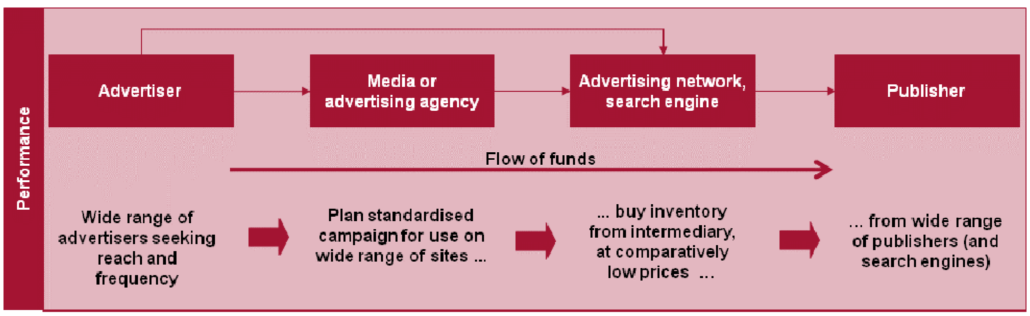
In contrast, in the performance display market the advertiser is typically pursuing direct marketing objectives, such as customer acquisition. As a result, there is a greater focus on reach and frequency, which makes performance display advertising distinct from premium advertising:

- Campaigns tend to involve higher levels of standardisation in order to ensure that the campaign can work across a wide range of web sites (and therefore achieve reach and frequency)
- The buying and selling of inventory tends to be automated, with advertising networks playing a more central role in enabling advertisers to purchase inventory across a wide network of sites
- Inventory tends to be priced on a CPC or CPA basis – the publisher is rewarded based on how well a given advert performs on their site

- Inventory tends to be cheaper – i.e. the publisher will in general receive lower returns per page view than they would in the premium market
- The barriers to entry for publishers are lower than they are in the premium display market (but not as low as in the contextual advertising market).

Importantly, the performance and premium advertising categories are closely interrelated – a campaign will most likely involve elements of both premium and performance advertising in order to achieve its objective. For example, an advertiser might pay to create a piece of branded content (such as an online soap opera) that is hosted on a social network, and then buy a range of targeted performance inventory in order to drive traffic to that content.

Exhibit 6: Characteristics of performance display advertising



Source: MTM London analysis

Implications

Display advertising is one of the most important business models supporting the creation of online content. However, the market tends to encourage certain types of content and services:

- Publishers are incentivised to produce content in genres such as finance where advertiser demand is high relative to genres such as arts and culture[10]
- Buying patterns tend to favour major online networks and larger media owners with in-house sales teams, a broad range of inventory across different products and services, and advertising platforms that provide targeting options
- Although display campaigns can involve standard formats and be highly commoditised, many are complex and resource intensive to plan and administer, involving novelty or 'media first' factors, bespoke components and significant input from media owners. In many instances, this can favour larger media owners with the resources to service the requirements of advertisers
- The performance market is driven by volume and context, which tends to support certain kinds of property, such as aggregators of third party and user-generated content
- The display advertising market is extremely fragmented, with returns spread across a wide range of properties. This, and the inherently international nature of content distribution online, tends to lead publishers to generate content that is attractive to an international audience.

[10] For example, AOL's book rate is £60 CPM for a banner in money or autos verticals compared to £25 CPM in kids or learning verticals; MSN charges £20.25 for a 'super-banner' in their cars vertical compared to £10.50 in their careers vertical

Contextual advertising

Overview

As with display advertising, contextual advertising involves an advertiser buying ad space on a publisher site. However, unlike display, contextual advertising is predominantly text-based, and the contextual market is dominated by international search engines, who act as intermediaries between advertisers and publishers, using their search algorithms to match publisher-submitted ad unit inventory with the highest bidding advertiser for a particular contextual search term. Because of the highly automated sales process, there are almost no direct publisher/advertiser sales and a large proportion of the value chain is controlled by international scale players. Importantly, contextual advertising platforms and products are increasingly making use of rich media (graphics, animation and video), which further blurs the distinction between contextual advertising and the highly automated performance end of the display advertising market.

Google does not provide data on its UK contextual advertising revenues. However, the UK contextual advertising market is likely to be small given the relatively limited number of successful UK commercial blogs, by comparison to the US online market.[11]

Implications

Contextual advertising has becoming the default choice for low-level revenue generation by profit-seeking sites in the long tail, due to the low cost of entry and low overheads for publishers. The economics of contextual advertising mean (as with display advertising) that providers are encouraged to produce certain types of content and services:

- Publishers can generate greater returns in areas where advertisers have large budgets or can aggregate large audiences – of the (reputed) highest-earning AdSense publishers, five are technology sites, two are large-scale international content aggregators, two are themselves guides to maximising AdSense and only one (Askthebuilder.com) is a non-technology, content-led site[12]
- Even the highest-earning publishers generate moderate returns from contextual advertising. The highest earning US sites reputedly generate in the region of $1,000 per day, but the majority earn far less; in the less developed UK market, few (if any) sites will earn over £250 a day.

Classified advertising

Overview

Classified advertising encompasses a range of scenarios in which either an individual or a company pays to have their company, product or requirement placed in a listing or directory. According to IAB figures, online classified advertising was worth £585.3m in 2007, up 54% from £379m in 2007.[13]

Classified advertising sites either offer free listings surrounded by display advertising (captured under display advertising) or paid listings with no accompanying ads. In general, sites that have a specific focus on a high-value vertical, such as houses, jobs or cars, are more likely to adopt a paid-listing model, whilst generalist sites carrying mainly lower-value items, such as Loot.com and Preloved, tend towards free listings supported by display

[11] See *Taking the shine off: Why blog publishing 'failed' in the UK (or at least didn't create a $30m exit)* by Ashley Norris on TechCrunch UK, August 2008.
[12] Anecdotal and unsupported lists of AdSense top earners have been published at http://www.thegoldenparachute.com/2007/05/top-adsense-earner-ranking-list.html and http://moneygeek.blogspot.com/2006/09/high-adsense-earners-and-their.html
[13] IAB, *UK Online Adspend Study* (2007)

advertising. There are some notable exceptions: Craigslist provides the vast majority of listings both free of charge and without supporting advertising, and eBay's Marketplace both charges for listings and places ads above listings.[14]

Implications

There are a wide range of stand-alone classified advertising sites which carry no content other than the adverts themselves – as such, a significant proportion of classified advertising revenues do not support the generation of content other than the listings themselves.

However, many content providers – especially newspaper groups – see classified advertising as both an important part of their content mix and a key revenue stream going forwards. According to one national publisher: "*around 20% of visitors to the news section of our site go on to the classifieds section: the classifieds help drive traffic to our site, but they also help monetise the traffic that we generate through our news section*".[15]

The classified advertising market is still evolving as it shifts online. However, there are already established and powerful market leaders in the largest categories, with major industry participants including Rightmove, Monster.com and Autotrader in the property, recruitment and automotive classifieds market. It is clear that classifieds services benefit from economies of scales as they grow: the larger a site is, the more attractive it will be to both buyers and sellers. As a result the classified market is likely to be increasingly dominated by large national and international players – this could potentially reduce the degree to which classified advertising can support localised or UK-specific content.

4.2 Pay and subscription

Overview

Pay and subscription encompasses a broad range of online business models in which users are charged one-off fees for access to content or a subscription fee for access to content and services over a given period of time. Although it is easy to find examples of such services, pay and subscription is not the dominant funding model in most business to consumer genres.

There is limited information available about the size of the UK online subscription market, as commercial providers release limited information about returns. It is clear that successful pay and subscription properties can deliver very significant returns – for example, Club Penguin was reported to have an international user base of more than 12m registered users and 0.7-1m paid subscribers before it was acquired by Disney, yielding annual (global) revenues of $40-60m and revenue per user (RPU) of $3-5.[16] However, like the film market, the games market is hits driven at the top end, with many properties performing significantly less well. Moreover, the up front development costs for large scale online subscription games can be significant. As a result, the most successful providers tend to replicate studio models, pursing portfolio investment strategies.

Where pay models do exist, there is considerable variation in how pricing is structured as providers seek to find models that are attractive to both provider and user: for example, in July 2008 BSkyB unveiled plans for a digital music service that would operate on an 'all you can eat' subscription model, in contrast to iTunes pay per download model.[17]

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[14] Craigslist charges listing fees only for jobs and property ads in specific US cities
[15] Information provided as part of MTM London's confidential interview programme
[16] *Metue*, "Disney buy Club Penguin, also releases earnings" (8th February 2008) [http://metue.com/08-02-2007/disney-club-penguin/]; *NMA*, "Who will fill the gap between Second Life and Club Penguin?" (8th September 2008)
[17] *The Guardian*, "Music industry: Sky sets up rival for iTunes with Universal deal" (23rd July 2007)

Exhibit 7: Subscription models offered by FT.com

	UNREGISTERED	REGISTERED	STANDARD SUBSCRIPTION	PREMIUM SUBSCRIPTION
News content	✓	✓	✓	✓
Archive content	✓	✓	✓	✓
RSS feeds	✓	✓	✓	✓
Mobile content	✓	✓	✓	✓
Articles per 30 days	5	30	Unlimited	Unlimited
Company financials	3 year archive	5 year archive	5 year archive	5 year archive
News by Email		✓	✓	✓
Portfolio		✓	✓	✓
Lex				✓
Mobile news reader				✓
Price Monthly Annual	FREE	FREE	£98.99	£199.00 (£390.00 inc. FT newspaper)

Source: FT.com

Implications

To date, user pay and subscription models have been sustainable when the content provided is unique (not easily substitutable for a free alternative) and targeted at a high-value audience: notable areas include financial news and gaming. The set up costs are often high for a service that is sufficiently unique as to justify a pay model – setting up a gaming platform, for example – and as a result paid content products often target an international audience so that the set up costs can be shared across multiple markets.

Importantly, there are few examples of successful pay models in sectors such as arts and culture, education and general news, as consumers can often find equivalent content for free – many UK newspapers set up paid-for online services such as digital archives, but almost all have gone free due to low uptake.

4.3 Ecommerce and transactional revenues

Overview

Content providers are increasingly seeking to diversify their revenue streams by capturing a share of ecommerce revenue. This can take a number of forms, for example:

- A lifestyle site developing affiliate partnerships with retailers or holiday companies
- A general entertainment or news site white-labelling a dating or bingo service
- Children's virtual world selling virtual clothes or real world product.

The UK's online retailers generated £46.6 billion in sales in 2007, up 54% on 2006, and a further £26.5 billion in the first half of 2008, an increase of 38% on the £19.2 billion spent online in the first half of 2007. The UK market for affiliate marketing grew by an estimated 45% in 2007, taking the total value of online sales generated through this channel to more than £3.13 billion, whilst commissions and fees paid out to affiliate networks (covering payments for both networks and affiliates) amounted to £186m in 2007, up 40% from £133m in 2006 (and compared to £83m in 2005).[18]

Many content providers are seeking to integrate transactional services into their offerings. Online gaming, gambling and other commercial partnerships account for over 50% of many UK red top newspaper sites. A large proportion of this comes from bingo, which is estimated to have generated £650m of online revenues in 2007, or approximately 65% of the UK's £1 billion online gambling industry.[19] Many commercial partnerships have already been formed in this area – for example, gaming provider CashCade works with Trinity Mirror, STV and Closer magazine.

Implications

It is difficult to establish the scale of the opportunity for content producers, although it is likely that the majority of ecommerce revenues are remote from, and do not directly support, the provision of content per se. Moreover, the market is clearly dominated by major retailers and ecommerce providers, limiting the returns that can be generated by other participants.

However, there are a number of significant implications to the integration of ecommerce and transactional revenues:

- Publishers are incentivised to produce content in areas that are conducive to commerce - for example, a publisher is likely to extend sections relating to shopping and entertainment rather than its arts, culture and education offering
- Publishers are incentivised to produce content that encourages consumers to make a purchase, thereby reducing editorial integrity and independence (or the consumer's perception thereof)
- Demand for pay services in many markets tends to be limited to one account per customer. As a result, many of the markets tend to be dominated by a relatively small number of providers
- Although many of the major online ecommerce and transactional providers have affiliate schemes to help build reach and scale, in general they yield relatively low returns to providers.

4.4 UGC and social media

Overview

Unlike 'traditional' one-to-many broadcast media, online media is participative, interactive and collaborative, creating a wide range of opportunities for individual users, groups and communities to communicate and interact with one another, to create and distribute their own media, individually and collaboratively, and to engage in entirely new forms of activity.

It is difficult to overstate the importance of this category of provision and the potential for innovation it creates, with new forms of activity and offering including: internet forums; personal blogs (increasingly incorporating audio, video and multimedia), often on 'open' blogging platforms such as Typepad; audio and video podcasts; wikis; social networks; user-driven aggregation platforms such as YouTube and Flickr; recommendations, reference tools and reviews services, often incorporated into ecommerce sites such as Amazon; P2P networks and media-sharing platforms; virtual worlds and community or multi-player gaming environments; and a wide range of messaging, communications and microblogging platforms.

Importantly, many of these activities are enabled, supported and aggregated by major international internet companies such as Google, Yahoo!, Microsoft and AOL, and are increasingly integrated into the online offerings of

[18] IMRG (July 2008)
[19] *NMA*, "Gambling Special: Branded bingo" and "Gambling special: UK regulation" (14th August 2008)

commercial publishers, many of whom now distribute content across third-party social networks and allow users to comment, share and recommend services. In addition, many government and public sector organisations are also active in this market, distributing services and making data and information available to users through open APIs and other interfaces and applications. The segment is also characterised by rapid innovation, with a wide range of innovative start-ups and new market entrants developing new platforms, tools and services.

In practice, there may be little distinction between user-generated content and professionally-produced content in many segments, as much professional content is placed in 'non-professional' contexts (e.g. a music video on YouTube), and professionals are increasingly participants in the user-generated world (e.g. a journalist might operate a personal blog). Importantly, traditional media providers encourage user generated content and incorporate this into their offer – this is particularly the case in local news, for example.

Implications

The economics of online publishing are well suited to voluntary and user-generated content, as in general content can be produced at low cost, and distribution costs are often negligible. As a result, these developments have led to a dramatic expansion in the range of services available in many genres or segments of the market, leading in some cases to significant fragmentation, but also stimulating widespread innovation.

However, the result of such low barriers to entry is that whilst there may be a considerable volume of content, it can prove hard to find and of variable quality. In addition, the nature of the content being provided is often strongly determined by the expertise, tools and resources available to the user. Users also tend to aggregate around major platforms such as social networks, connecting to other users and making use of freely-available tools – as a result, the market may in time become more concentrated, with the major platforms exploiting network effects to consolidate their positions.

Importantly, many industry participants argue that the dramatic fragmentation resulting from reduced barriers to entry is making investment in high-quality services more challenging in some markets. As a result, many providers are relying on offset economics to provide services, generating income from other sources to cover the costs of providing their online offerings.[20]

4.5 Public funding

Overview

A substantial body of online content is created by organisations in receipt of public funding from central, local or devolved government bodies. These organisations fall into two broad categories:

- Public sector bodies, from government departments through to NDPBs such as the Tate Museum
- Private and third sector organisations and web sites in receipt of grant-in-aid funding.

These organisations produce a diverse array of content: major properties include the DirectGov site (the portal into UK government online for the UK citizen), and the NHS Choices site, which will in time provide a wide range of health related content at a cost of around £20m per annum. Beyond these, there is a wide range of publicly funded sites, including institutional sites for public sector organisations (e.g. The Tate), campaign–based sites such as TalktoFrank.com, and third sector sites in receipt of public funding.

[20] See *Freeconomics Part I – or who is paying for your Free lunch?* (May 2008) at http://broadstuff.com/archives/986-Freeconomics-Part-I-or-who-is-paying-for-your-Free-lunch.html for an expansion of this argument

Although difficult to assess, public sector spending on online public service content for 2006/07 is estimated to be in the region of £300m, with the BBC spending £116m on bbc.co.uk and a further £37.7m on BBC Jam in 06/07.[21] However, the market is fragmented, and with the exception of the BBC there are only a small number of organisations regularly spending in excess of £10m per annum.

Implications

Government funding is relatively stable for the core institutional sites (though still subject to policy changes). However other major public and the third sector organisations tend to operate on one to three-yearly funding cycles, or to receive one-off grants. This 'monsoon' funding is particularly ill-suited to online, where ongoing operating costs are as important, if not more so, than set up costs, and tends to lead to a range of online properties that are set up and then abandoned after a relatively short life-cycle, rather than developed and evolved. The lack of sustainability can make it challenging for such organisations to secure talent.

In addition there can be a trade-off between public funding and editorial independence. Many organisations in receipt of public funding must work with a broad array of funding bodies, many of whom will be pursuing diverse and not always complementary agendas: one interviewee stated that "*last year we were creating an arts and culture site, because that's what our funder wanted; this year, we are a formal education resource*".

4.6 Marketing

Many companies produce a wide range of sophisticated content in order to showcase their products, encourage consumers to make purchases and build engagement with their brands. Marketing-related content can take a number of forms – for example:

- Supporting ecommerce activities: Mothercare has developed a substantial online parent's resource, incorporating a range of professionally produced content and forums to encourage user-generated content (such as a new mother's community forum) in order to establish their ecommerce site as a destination for new parents
- Brand-building: Nike has invested in a sophisticated online resource to complement the Nike+ 10k Human Race, incorporating a range of advisory and community resources for runners in general, as well as individuals participating in the 10K race.

Marketing content is a major area of innovation in the online market, with major brands and advertisers investing significant sums to produce online offerings that support their broader business objectives. In addition, many marketing organisations have substantial CSR budgets.

[21] BBC Annual Report and Accounts 2006/2007

5 Review of market for content targeting children aged 5-12

This chapter reviews children's usage of the internet, the range of online content and services primarily aimed at children aged 5-12 years old, and the business models employed by organisations supplying this content. The project team focused on children aged 5-12 on the basis that teenager's needs tend to met by sites targeting a general audience.

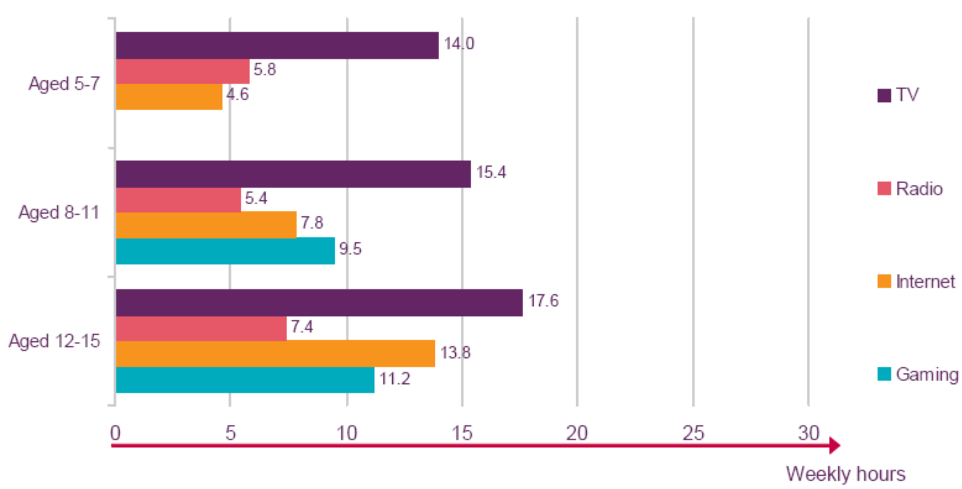
The analysis synthesises a wide range of secondary sources, including primary research already undertaken by Ofcom and Nielsen audience measurement data. Although there are important limitations to the evidence base, notably in relation to the audience measurement data, this analysis serves to highlight some of the challenges facing online content and service providers operating in this market.

5.1 Children's usage of the internet

Today's 5-12 year olds are, for the most part, digital natives: they have grown up with digital technologies such as computers, the internet, mobile phones and MP3s. Their usage of the internet has distinctive characteristics that mark them apart from older internet users, with significant implications for the business models supporting content and services targeted at them.

Almost all children in the UK access the internet in some way, with Ofcom's 2008 Media Literacy Audit 2008 reporting that use of the internet is well established with children as young as five. However, children's use of the internet increases significantly with age: 5-7 year olds spend an average of 4.6 hours online a week, growing to nearly eight hours a week online for 8-11 year olds.[22]

Exhibit 8: Weekly media consumption at home among users by age



Source: Ofcom, Media Literacy Audit (May 2008)

Children's motivations for going online also change as they get older, with the internet playing a more diverse role in the lives of older children. The majority of 5-7 year olds are supervised by a parent when online at home, and mainly use the internet for fun, such as playing casual games and visiting their favourite television programme web sites. Many of these applications have a broadly educational purpose. By contrast, 8-12 year olds indulge in a wider range of uses, including doing their school work, downloading music, and social networking.

[22] Ofcom, *Media Literacy Audit* (May 2008): household penetration of Internet access is 86% for ABC1 households, and 63% for C2DE households

Importantly, there are a range of distinctive characteristics to children's usage of the internet which have a significant impact on the nature of the content and services targeting them, and the business models that support those services:

- Younger children primarily use the internet for play and tend to favour games over other content – much of their game play is focused on small-scale casual games rather than more complex multi-player immersive games
- Much of children's usage is mediated by parents, who are often concerned about the safety of their children online, feel like they are less sophisticated users of the internet, and are therefore willing to pay a premium for a secure environment for their children to play in[23]
- In general, 5-12 year olds have no access to credit cards and rely upon parents for access to them – ecommerce still plays a major role in many children's sites, but providers tend to integrate commerce with entertainment content and rely on 'pester power'
- Importantly, the online activities of children tend to be strongly driven by known brands, with cross-promotion from television, major film and gaming franchises, and toy brands
- Children feel confident about using the internet, with a high proportion (94%) claiming that they can always find what they are looking for. However, in practice younger children's ability to discover new resources is limited by their reading and writing skills and their relatively narrow range of needs compared to older, less closely-supervised children.[24] As one interviewee from a commercial provider noted: "*children search for what they know about, and rarely click beyond the first three returns*"[25]
- Girls and boys tend to like very different products, and customer lifecycles are short at this age (what appeals to a six year old will not be attractive to a 10 year old), so target audiences for a given product are often relatively small.

As a result of these characteristics, children's usage tends to be focused on properties that provide entertaining multimedia based content, often on large scale properties with brands that are known and trusted by parents, or a small number of major online properties that have developed leader status in their genres, such as the BBC, Disney, Nick Jr and Cartoon Network, and major games sites or virtual worlds like Miniclip, Runequest and Club Penguin.

There are five broad types of site that children aged 5-12 use:

- **Children's entertainment**: entertainment, edutainment and games sites, such as Everythinggirl, primarily targeted at children aged 5-12
- **General entertainment:** games and general entertainment sites such as YouTube that are either targeted at an all-age or teenage audience
- **Social networks and messaging:** social networking sites such as Bebo (most of which attempt, to some degree, to exclude children under 13), and communications tools such as chat and email
- **Search, commerce and utilities:** search engines, ecommerce sites such as eBay and Amazon, and general information resources and utilities such as Wikipedia
- **Education:** formal and informal learning resources targeted at children aged 5-12, such as CBBC.

[23] Ofcom's tracking study *Young People & Media* found that the majority (69%) of 5-7 year olds are supervised by an adult when online. This falls to 28% among 12-15 year olds. More recently, Ofcom's *Media Literacy Audit* (2008) found that 50% of 8-11 year olds access the internet on their own – data for other age groups is currently unavailable
[24] Ofcom, *Media Literacy Audit* (2008)
[25] Information provided as part of MTM London's confidential interview programme

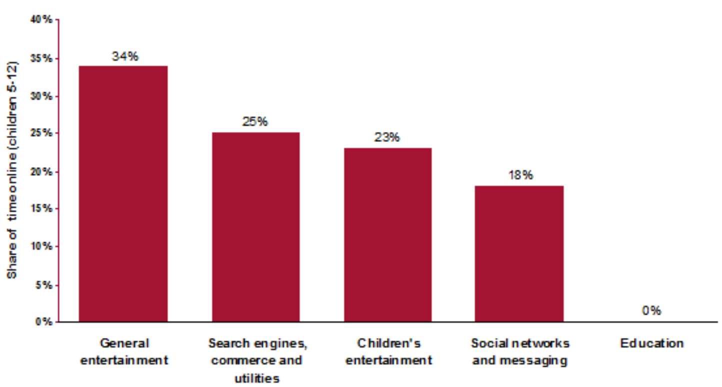
Exhibit 9: High-level typology of sites used by children aged 5-12

	1 Children's Entertainment	2 General Entertainment	3 Social networks and messaging	4 Search, Commerce and Utilities	5 Education
Description:	• Casual and immersive games • Virtual communities • Professionally produced content	• Casual and immersive games • Portals and aggregators • Professionally produced content	• Social networks • Messaging platforms	• Search engines • Retail and commerce • General information	• Formal learning resources and platforms • Informal learning
Example:	• Club Penguin • CBBC, Cbeebies • Stardoll	• Habbo, Runescape • Miniclip • Youtube	• Facebook, Bebo • Windows Live Instant Messenger	• Google, Google Images • eBay • Wikipedia	• Espresso • Show me
Share of children's time online:	23%	34%	18%	25%	<1%

Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

In general, the sites attracting the largest number of children aged 5-12 are sites that attract high user levels amongst the population in general, such as Amazon, YouTube and Wikipedia: only 23% of children's time online is spent on sites primarily aimed at their age group; a third of time is spent on general entertainment sites such as YouTube, 18% on social networks and messaging, and 25% on a mix of search, ecommerce and utility sites.[26]

Exhibit 10: Share of time spent by class of web site, June 2008

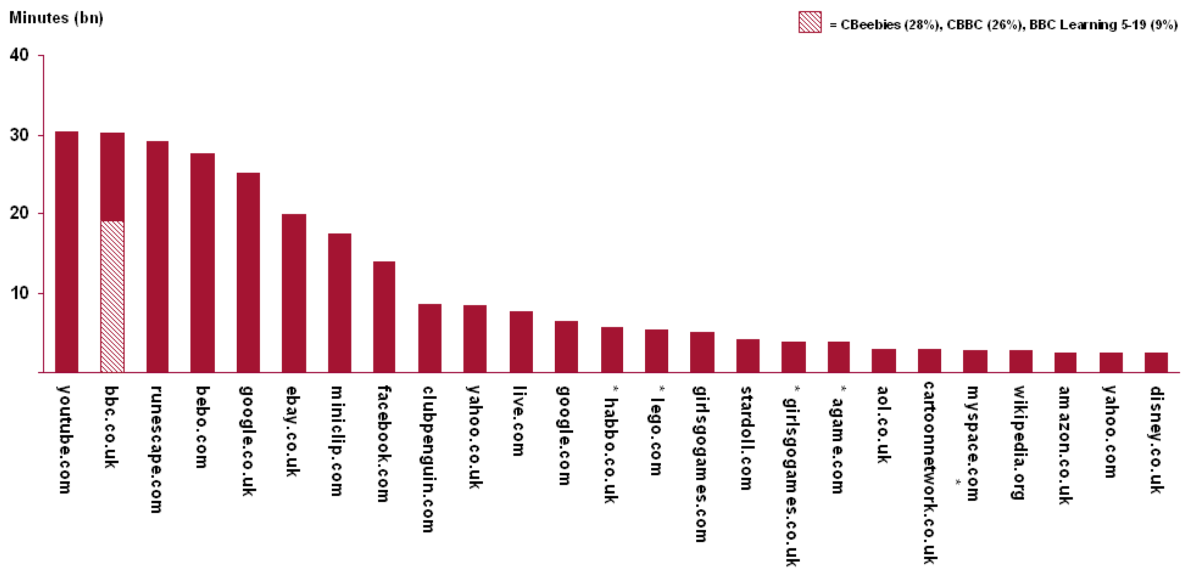


Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

The largest site in terms of time spent is YouTube, followed by the BBC. Other sites in the top 10 by time spent include gaming sites Runescape and Miniclip, and social networking sites Bebo and Facebook. Only seven of the top 25 most popular sites by either reach and/or time spent were primarily targeted at children, and only 2 of the top 10 (BBC and Club Penguin). The other children's sites in the top 25 include casual games portals aimed at girls, toy brands such as Lego, and major cross-platform media companies such as Cartoon Network and Disney.

[26] MTM London analysis of Nielsen//NetRatings data (June 2008)

Exhibit 11: Top 25 sites by time spent, children aged 5-12, June 2008



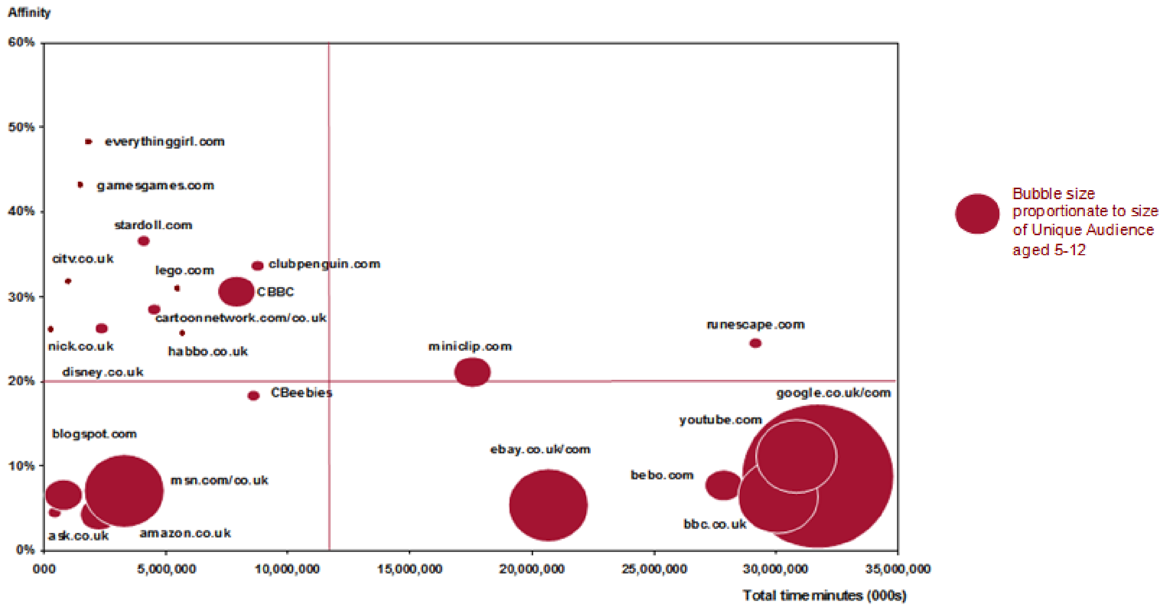
Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

When sites attracting substantial children's audiences are analysed by reach, time spent and affinity (the percentage of a site's audience that are in the 5-12 age group) a pattern emerges that has implications for the business models of children's providers. Exhibit 12 plots the most popular sites accessed by children aged 5-12 in June 2008 by total time spent, affinity, and reach. Interestingly:

- The market tends to be dominated by a small number of major properties, the majority of which are not targeting 5-12 year olds over other age groups
- Sites that target children aged 5-12 all have relatively small reach compared to the generalist sites. As a result, there are no sites in the top right quadrant, where sites that have both high levels of affinity with children and high levels of time spent would chart
- The social networking and gaming sites Miniclip, Runescape and Bebo all stand out as being particularly successful – however, they are predominantly targeted at teenage, rather than 5-12, audiences.

This suggests that sites predominantly targeting children secure both a lower reach and a lower share of media time than sites targeting a more general audience, which potentially limits the returns they can secure compared to sites targeting a broader audience – although this is partially offset by the premium the high value sites can charge for their inventory relative to the large scale social network and social media sites.

Exhibit 12: Map of sites used by children aged 5-12 by affinity, time spent and reach



Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

5.2 Providers of children's content online

There are four major categories of provider targeting the children's market:

- **Cross-platform media companies:** major international media companies, such as Disney, AOL/Time Warner and Viacom, who are predominantly US-based, and provide a broad mix of professionally-produced entertainment content, casual and immersive games. In addition, UK-focused commercial media companies such as ITV, and cross-platform children's media specialists such as HIT Entertainment and Entertainment Rights also provide services, although they tend to be smaller scale
- **The BBC:** which has three separate channels targeted at this age group – CBBC, CBeebies, and BBC 5-19 Learning – which operate across platforms and are heavily promoted through television
- **Online-only children's entertainment specialists:** mainly either aggregating casual games or providing targeted member communities, virtual worlds and children's social networking sites (SNS)[27]
- **Toy manufacturers and brands:** providing entertainment properties to support their products and brands.

In addition to these major categories of provider there are a range of specialist education providers and public and third sector sites targeting children.

[27] A number of the online children's entertainment specialists are now owned by major media companies (for example Disney acquired Club Penguin)

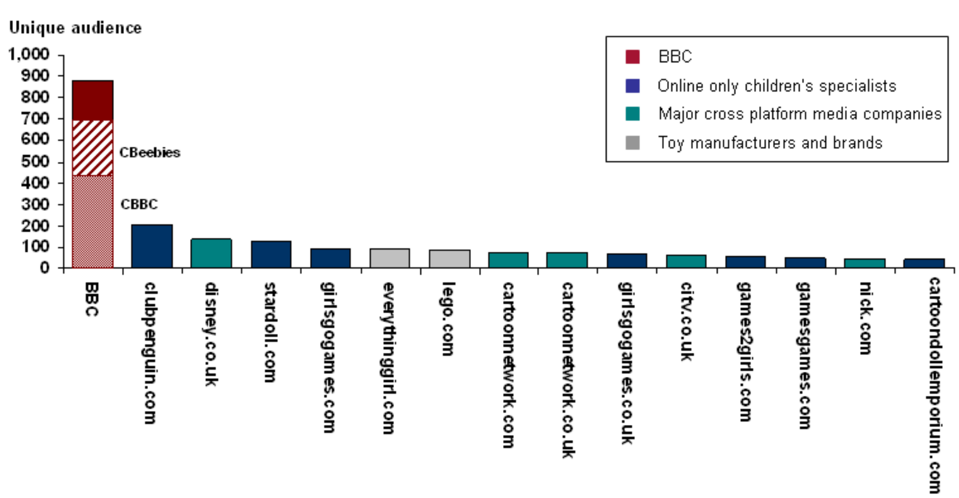
Exhibit 13: Categories of provider of children's online destinations

Categories of provider	Description of content and service	Example
Cross-platform media companies	Broad mix of professionally produced entertainment content, casual and immersive games, virtual communities and SNS	Disney, AOL/Time Warner Entertainment Rights
Toy manufacturers and brands	Broad range of offline companies providing marketing content around children's products and services	Lego
The BBC	A mix of entertainment, edutainment and formal learning	CBBC, CBeebies, 5-19 Learning
Online-only children's entertainment specialists	Aggregating casual games or providing virtual worlds and children's SNS	SPIL Games
Commercial education providers	Formal education resources and learning platforms aimed at children, parents and teachers	Espresso Education, Grid Club
Public and third sector	Mostly small-scale education content aimed at children, often linked to offline institutions and events	Science Museum

Source: MTM London analysis

There is relatively little evidence of start-up activity in the children's sector compared to the first half of the decade, when the market was immature and the properties targeting children were of limited quality, enabling a number of start-ups such as Habbo and SPIL GAMES to launch and grow new services. Today, new entrants into the market tend to require high profile brands and substantial cross-promotional capabilities, ideally across multiple territories.

Exhibit 14: Top 15 sites aimed at children by unique audience, June 2008



Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

5.3 Review of funding models in children's market

The major commercial providers in the children's market operate a mix of advertising, subscription and ecommerce funding models. Of the largest 25 sites targeted at children (based on Nielsen), 12 carry advertising, eight are engaged in some form of ecommerce, from the purchase of physical items through to micro-transactions for virtual products, and three operate a tiered subscription model.[28] Importantly, just over half of the sites are at least partially marketing and promotions-led.

Exhibit 15: Business models operated by leading children's online destinations

Domain	Advertising	Pay and subscription	Marketing	E-commerce	Direct public funding	Comments
clubpenguin.com		✓		✓		Free for basic use - subscription for access to enhanced features; branded products (e.g. T-shirts) available for purchase
BBC					✓	Including Cbeebies, CBBC and BBC Learning
lego.com			✓	✓		Predominantly marketing and promotion for lego products; also sell console games
girlsgogames.com/co.uk	✓					Display advertising on main page; advertising pre-roll before games
stardoll.com	✓	✓		✓		Free to join; subscriptions or micro-payments via credit card, Ukash or PayPal; via mobile phone and land line (regulated to 3 or 4 purchases a
cartoonnetwork.co.uk/com			✓	✓		Predominantly marketing; some branded products available to purchase
everythinggirl.com			✓			Predominantly marketing for Mattel brands (Barbie, Polly Pocket); display advertising for limited Disney products
games2girls.com	✓					Display advertising
citv.co.uk	✓		✓			Marketing; display advertising
disney.co.uk	✓		✓	✓		Predominantly marketing; limited display advertising; extensive e-commerce shop
gamesgames.com	✓					Display advertising and pre-roll before games
nick.co.uk/com	✓		✓			Predominantly marketing; display advertising; some branded products available to purchase
cartoondollemporium.com	✓					Display advertising
nickjr.com	✓		✓			Predominantly marketing; display advertising; extensive e-commerce shop
bratz.com			✓			Marketing
primarygames.com			✓	✓		Marketing; games also available for purchase on CD
neopets.com	✓			✓		Display and contextual advertising; micropayments by credit card or PayPal
icarly.co.uk						None
dressupgirl.net	✓					Contextual advertising
popcorn.co.uk						Owned by CITV
dressupgames.com	✓					Display advertising, contextual
barbiegirls.com		✓	✓			Predominantly marketing; free for basic use - subscription for access to enhanced features
pollypocket.com			✓			Predominantly marketing; access to e-commerce site
hasbro.com			✓	✓		Predominantly marketing; access to e-commerce site
buildabearville.com			✓			Free for limited use; children who have purchased a soft toy have access to enhanced features

Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

The children's online advertising market

Whilst display advertising is an important commercial funding model for children's content, the returns that can currently be generated in the UK are limited:

[28] MTM London analysis of Nielsen//NetRatings data (June 2008)

- The majority of sites self-regulate and do not accept advertising from categories deemed unsuitable for children such as HFSS food; other exclusions (such as competitor advertising) also restrict returns
- Children's web sites are unlikely to capture a significant portion of the search and classifieds markets, so revenues are largely limited to display advertising
- The fragmented nature of the display market limits the returns that any one site can generate – there are a wide range of properties chasing advertiser spend.

There is relatively limited data available on the size the UK children's online advertising market, as the IAB does not include a children's category in its breakdown of online advertising revenues by sector, and many of the major children's web sites are owned by international companies, such as Disney and AOL/Time Warner, which do not release breakdowns of their UK revenues.

However, our analysis suggests that sites aimed primarily at children aged 5-12 captured in the region of £5-15m of the £590m display advertising market in 2007:

- The major advertisers on children's sites are the toys and entertainments companies, who spent in the region of £100m across all channels. Media planners estimate that children's advertising sites capture up to 5% of that spend, making the market worth about £5m[29]
- However, over 50% of the advertising carried on children's sites is aimed at adults, potentially because it is being sold through networks.[30]

There are a broad range of sites seeking to capture a share of this spend, and therefore the scale of the opportunity for any single property is limited.

The children's pay and subscription market

There are a number of major sites in the children's market that operate a predominantly pay and subscription funding model, such as Club Penguin, which sets the children's genre apart from the majority of other business to consumer genres. There is limited information available about the size of the UK online subscription market, as commercial providers release limited information about returns. It is clear that successful pay and subscription properties can deliver very significant returns – for example, Club Penguin was reported to have an international user base of more than 12m registered users and 0.7-1m paid subscribers before it was acquired by Disney, yielding annual (global) revenues of $40-60m and revenue per user (RPU) of $3-5.[31]

Importantly, there are high barriers to entry to the pay and subscription service market, and competition for pay models is intense. Like the film market, the games market is hits driven at the top end, with many properties performing significantly less well. Moreover, the up-front and ongoing costs for large scale online subscription games can be significant. As a result, the most successful providers tend to replicate studio models, pursing portfolio investment strategies. Moreover demand for pay services is limited by the proliferation of free content – one interviewee noted: "*we work on the basis that parents are unlikely to subscribe to multiple services*".[32]

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[29] The World Advertising Research Center's *Advertising Statistics Yearbook* estimates the Toys and Games display advertising category (all ages, all channels) as £104m in 2007. This cross-checks with media planners interviewed as part of the project who estimated that the UK children's advertising market was worth in the region of £100m in 2007 (all channels, source Media Monitoring Systems, which is part of Nielsen), with £80m coming from toys and entertainments

[30] The project team were not commissioned to estimate the size of the children's online advertising market. However, in the absence of estimates from other sources we have produced this high level estimate based on privately disclosed revenues and data secured from a range of secondary sources.

[31] *Metue*, "Disney buy Club Penguin, also releases earnings" (8th February 2008) [http://metue.com/08-02-2007/disney-club-penguin/]; *NMA*, "Who will fill the gap between Second Life and Club Penguin?" (8th September 2008)

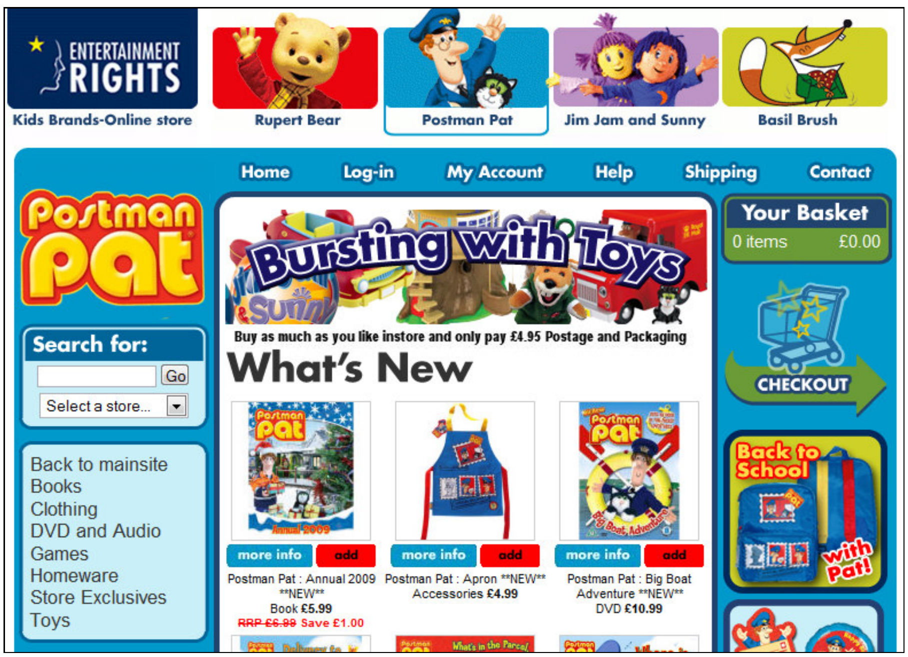
[32] Information provided as part of MTM London's confidential interview programme

Whilst it is feasible that a UK provider could set up a successful pay model with UK-focused content, there is no evidence of such a service to date. For the reasons stated above, interviewees felt it was unlikely that such a service would emerge in the immediate future.

The children's ecommerce market

Of the top 25 sites targeted at children by reach in June 2008, eight contained some form of ecommerce facility, from online shops on toy brand sites offering real world products through to micro-payments on sites such as Stardoll, where parents can purchase virtual currency for their children, who can then go off and spend on small web transactions such as virtual clothing for their online doll.[33] Beyond the top 25 sites there are a number of significant mid-tail sites with ecommerce functions such as Entertainment Rights' online store. In addition, children are heavy users of mainstream ecommerce sites such as eBay and Amazon.

Exhibit 16: Entertainment Rights' online shop



Source: Entertainment Rights

5.4 Review of business models of key providers

The different categories of providers operate relatively distinct business models, described in greater detail below.

1. Cross-platform media companies

This category is dominated by a small number of international (and predominantly US-based) cross-platform media companies seeking to leverage assets across multiple territories and channels. Key players include Disney, AOL/Time Warner, and Viacom. They are generally shareholder-focused, profit-maximising businesses with aggressive growth targets. They operate a broad portfolio of online properties, including persistent channels which are typically a mix of entertainment portal and promotional tool for core brands and franchises, and stand-alone

[33] MTM London analysis of Nielsen//NetRatings data (June 2008)

products and services such as virtual worlds. The international media companies have a number of important sources of competitive advantage over their smaller (and predominantly national) competitors:

- Their online properties benefit from extensive cross-promotion with television, film and retail products, and in particular from their ability to build on valuable film franchises – consequently, their brands tend to be better-known and trusted by both parents and children
- Costs (such as the development of a virtual world or MMOG) are amortised over a wide range of territories
- They are able to maintain in-house sales teams and have the scale to maintain direct relationships with the key media planning and buying agencies.

In addition to the major international media companies, there are a range of national media companies and children's entertainment specialists such as ITV, Entertainment Rights and HIT Entertainment. They tend to operate on a smaller scale to their international partners and rely heavily on cross-promotion between television, radio and online. They are often rights holders who are reliant on agreements with third party companies to gain access to the global children's entertainment market: for example, Entertainment Rights has an agreement with Touchstone for use of its content on digital gaming platforms, and with AOL to provide distribution of its content on AOL's kids' platform KOL Jr.

2. The BBC

The CBBC and CBeebies online channels are the leading sources of new UK originated content for pre-school and 5-12 year olds in news, factual, drama and entertainment. They offer a mix of programme sites, games, and virtual worlds as well as a personalised online space called myCBBC to encourage participation and UGC. Funding is provided by the licence fee.

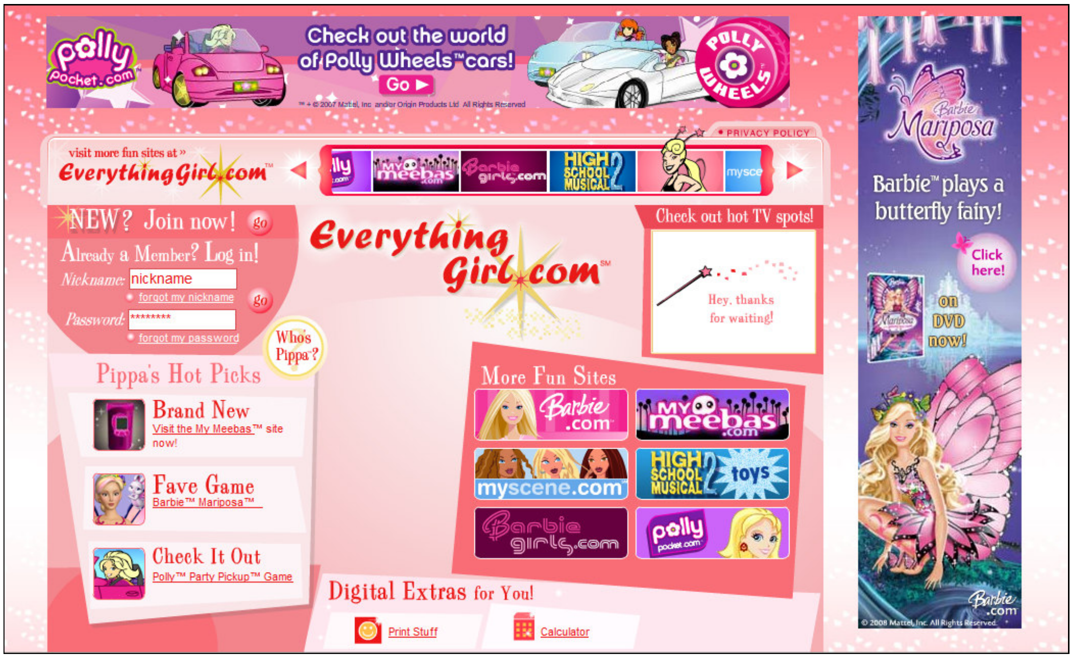
The BBC does not break down the cost of the online CBBC and CBeebies channels in their annual report, although it does include costs for the television channels (£48.7m and £23.3m respectively in 2007/08).[34] The sites benefit from extensive cross-promotion, shared infrastructure and content and well known brands and characters.

3. Toy manufacturers and brands

The leading toy manufacturers tend to invest heavily in online properties, primarily for marketing and promotional purposes. For example, Mattel's Everything Girl site provides a range of activities for young girls, including character-themed casual games, designed to entertain their target audience and through this encourage them to make an offline purchase. Similarly, Lego have launched a massively multiplayer online game (hereafter MMOG) that is free to play and designed to keep young people engaged with their product and extend their brand. Importantly, there is a strong overlap between the toy market and the major entertainment franchises – for example, leading US entertainment companies such as Disney and Warner Bros tend to licence their leading film brands to major toy manufacturers, increasing the returns generated by these properties.

[34] BBC, *Annual Report: BBC Executive's review and assessment* (2007/08)

Exhibit 17: Home page for Mattel's Everything Girl site



4. Online-only children's entertainment specialists

This category comprises a range of digital (mainly games) specialists: key players include SPIL GROUP, who operate a range of advertising-funded casual gaming portals aimed at children and teenagers, and Jagex Ltd, creators of the MMOG Runescape, who fund their properties through a mix of advertising, subscription and commerce models. Many have in-house studios for games development, but they also aggregate third party content, particularly casual games.

Importantly, as with the children's entertainment market overall, they operate on an international basis, allowing them to:

- Spread development costs across territories
- Incrementally build sufficient scale in their user-base across territories to generate attractive overall advertising returns
- Maintain close relationships with advertisers (primarily the major toy manufacturers), who buy a significant proportion of their online advertising on an international basis.

Many leaders in this category have been purchased by the major media owners (e.g. Disney's acquisition of Club Penguin).

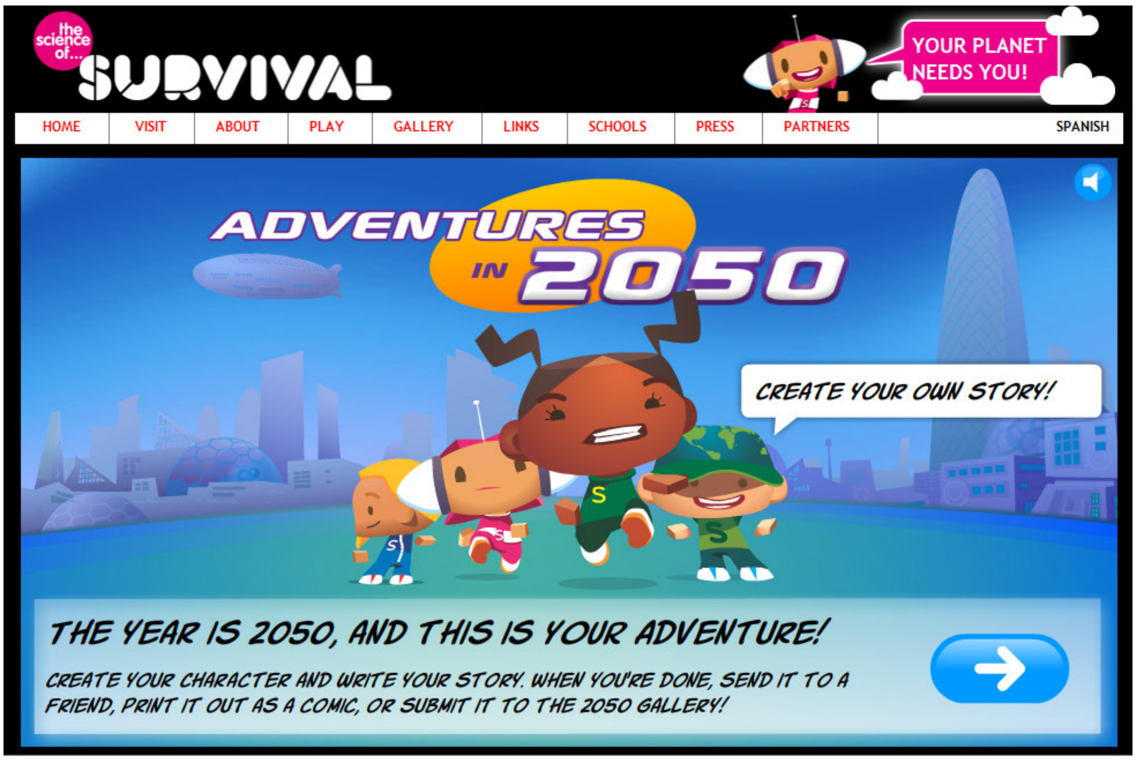
5. Commercial education providers

There are a small number of (predominantly business-to-business) commercial education providers such as Espresso Education and Grid Club, who provide formal online education resources and learning platforms to primary schools on a pay and subscription basis. Some of these providers also offer learning resources on a business to consumer basis; Espresso's home edition sells to parents on a subscription model, and Grid Club has sold on a subscription basis to parents via The Telegraph web site.

6. Public and third sector

This category comprises a wide range of (mostly small scale) online resources funded by public and third sector institutions, many of whom are pursuing cultural or educational remits. These resources are a mix of permanent destinations funded out of core institutional funding (such as the Tate or the Science Museum's children's section) and project-based informal or formal education resources. In general these projects are characterised by a lack of funding security (funding is normally either a one-off or on a three year cycle).

Exhibit 18: The Science Museum's Adventures in 2050 game



5.5 Implications for future provision of children's content

There are three major implications for the future provision of children's public service content online arising from this analysis:

- The Children's 5-12 genre is likely to be dominated by international media companies and big brands that can leverage economies of scale across multiple territories
- Much of the content produced by the commercial providers is unlikely to exhibit the characteristics of public service content
- The BBC will remain the leading provider of original, UK-originated entertainment and edutainment content for pre-school and younger children – other UK providers will struggle to gain traction in a competitive market.

The Children's 5-12 genre is likely to be dominated by international media companies and big brands that can leverage economies of scale across multiple territories

As children's use of the internet continues to increase in the UK and other territories, it will in turn stimulate greater investment in online children's content by major media companies. In July 2007 Nickelodeon Kids and Family group announced it intended to invest $100m to create games for its Nick and Nick Jr portal through 2009, whilst MTV Networks separately announced a month later that it would spend $500m on creating games on its websites through 2009 as well.[35] Similarly, whilst Disney acquired Club Penguin for $350m cash plus $350m earn out, it has since invested in the development and launch of a series of other virtual worlds including Pirates of the Caribbean.

These organisations have the financial backing, cross-promotional capability and expertise to continue their domination of the children's market online. Their international focus will enable them to spread their costs across territories, whilst their significant offline promotional capabilities will enable them to acquire and retain users. Crucially, they can leverage their scale to drive higher returns from their online products, as they primarily own their own rights, have the scale to drive advertising returns through direct relationships with media planners and buyers, and can invest in genre-leading propositions. As such, barriers to entry for new players are likely to remain high.

Much of the content produced by the commercial providers is unlikely to exhibit the characteristics of public service content

While much of the content produced by the market leaders will be innovative and of a high quality, it is unlikely to be UK-originated and UK-focused, as providers will be driven by commercial pressures to produce content that is culturally neutral in order to maximise returns in what is, increasingly, an international marketplace. Provision is also likely to be in a narrow range of genres focused on entertainment and gaming, to maximise usage, with only limited factual, informational and educational content available. In addition, some industry participants also argue that much of the output of these properties reinforces rather than challenges certain gender and other cultural stereotypes; for example, games for girls focused on dressing up dolls.

The BBC is likely to remain the most significant provider of original, UK-focused entertainment and edutainment content for pre-school and younger children

The BBC is currently extremely successful at reaching 5-12 year olds: the CBBC and CBeebies channels are both in the top 10 most popular channels by reach, frequency and time spent for 5-12 year olds, and the BBC site overall is second only to YouTube in terms of time spent by children aged 5-12.[36]

In addition to the BBC there are a range of smaller providers of high quality public service content targeting children aged 5-12, such as the Science Museum's Adventures in 2050 game. However, they do not reach an equivalent audience, primarily due to a lack of cross-promotion and issues with discoverability.

Importantly, there is no other UK commercial provider with sufficient cross-promotional capabilities, and an equivalent body of content to leverage online. Even if there was such a provider, it is likely that the UK display and ecommerce market would be too small and too competitive to make the creation of such a body of content attractive.

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[35] *paidContent.org*, "Nickelodeon's Game Plan: 600 Casual Games Being Developed; 185 Games Planned For Nick.com Alone", (17th March 2008) [www.paidcontent.org/entry/419-nickelodeons-game-plan-600-casual-games-to-be-developed-185-games-plann]
[36] MTM London analysis of Nielsen//NetRatings data (June 2008)

6 Review of market for local and regional content

This chapter analyses consumer's usage of local and regional content on the internet, the range of local content and services available, and the business models employed by organisations supplying this content.

We have adopted a broad definition of local and regional content to cover all content relating to or aimed at geographically specific audiences: this includes content about an area and content about local businesses or organisations that happen to be located in that area. We have excluded content about a certain location that is aimed at visitors (e.g. travel web sites and tourism) from this analysis.

6.1 Usage of local and regional content online

There is clear evidence of strong demand for relevant, local online content. Between 10-30% of all search engine queries are location specific,[37] and people are increasingly going online for information they would previously have found offline in the Yellow Pages. Market research conducted to support the launch of the BBC's local video service found that 68% of UK adults are 'likely to' use such an online local video service and a further 16% of adults would 'definitely' use it.[38]

There are three broad categories of local content and services:

- **Local search and directories:** a consumer uses a search engine or online directory to find a local business, or searches for information relating to a given locality
- **Classified advertising:** a consumer visits a classified advertising site in order to buy or sell a product or service in a given locality
- **Local news and information:** a consumer uses a site to find out the local headlines or information about the village fete.

Exhibit 19: Top 10 search terms on Yell.com

Restaurant(s)
Estate agent(s)
Hotel(s)
Hairdresser(s)
Pub(s)
Solicitor(s)
Doctor(s)
Dentist(s)
Builder(s)
Garages(s)

Source: Yell Group plc

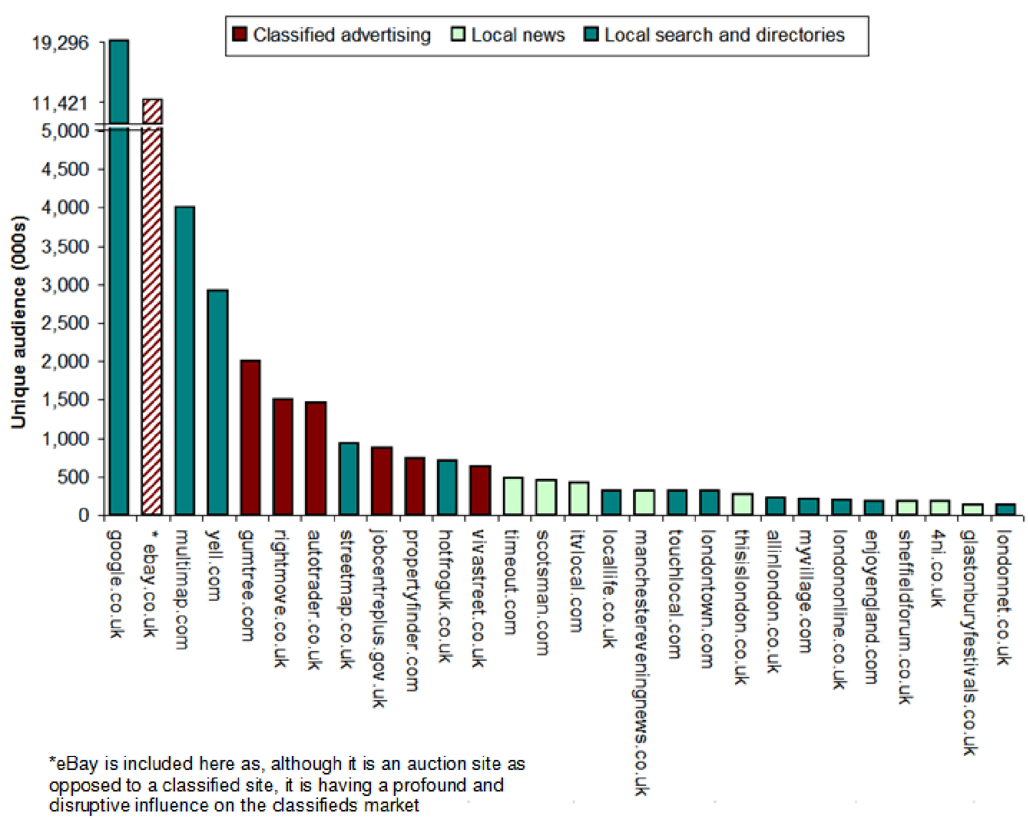
Importantly, people want to be active participants in creating and commenting on local content, as well as consuming it: "*user-generated content is at the heart of our plans for hyper-local content going forwards. People want to interact with local communities online in the same way as they interact with other interest-communities online, and plenty want to play an active role as citizen journalists.*"[39]

Whilst many local sites attract relatively small numbers of users, as they are targeting small markets, there are still a significant number that register on the Nielsen audience measurement panel, often because they are national or international platforms for local content. There are 68 sites in the Nielsen top 2,000 for June 2008 that have a significant local component, of which 27 are predominantly focused on classified advertising, 12 are local news sites, and 29 are local search or directory sites. Unsurprisingly, the largest two sites are Google and eBay, although much of their content and services is national or international. These apart, the major directories such as Yell, general classifieds sites such as Gumtree, and classifieds vertical specialists sites such as Rightmove and Autotrader have the largest audiences. The predominance of these national classified sites reflects another important trend in this market – the blurring of the boundary between national and local classifieds.

[37] Piper Jaffray, *The User Revolution* (2007)
[38] BMRB, *Quantitative research on BBC Local Video* (2008)
[39] BBC, *Annual Report: BBC Executive's review and assessment* (2007/08)

The local news sites have much smaller audiences as they tend to target smaller constituencies. The largest regional news sites are TimeOut and The Scotsman, both of which target areas with large populations. In addition there is a substantial long tail of local sites that are used and valued by local communities but are not captured within Nielsen data – for example, the Nielsen panel data captures the Manchester Evening News site, but not Manchester Confidential, an important and vibrant local rival. The editor of an online-only regional news and lifestyle site in another region estimated that there were at least fifteen similar sites in their region that were sustainable stand-alone businesses, attracting sufficient traffic to make them sustainable, albeit small-scale, advertising-funded businesses.

Exhibit 20: Unique audience of major local and regional sites by category



Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

An analysis of time spent on local and regional sites suggests that when consumers use local and regional sites they spend the majority of their time on classifieds sites (58%), followed by local search and directories (39%), with only 4% of their time spent on local news and information sites, even when adjustments are made for the disproportionate number of local news sites not captured by Nielsen panel data.[40] As we shall see, this pattern in consumer demand points to an important trend in the online local news market, with local newspapers attracting audiences through local

[40] Analysis based on Nielsen top 2,000 sites with adjustments: time spent on Google and eBay has been reduced by 75% and 90% respectively to reflect the proportion of usage we estimate to be local. Time spent on regional news sites has been adjusted upwards by 50% to reflect the disproportionate number of local news sites outside the Nielsen top 2,000 compared to other categories

news and then monetising those audiences through classifieds sites such as recruitment and property, and local search and directory services.

6.2 Providers of online local and regional content

There are four main categories of local and regional content and service provider:

- **National cross-platform media companies:** including newspaper groups, television and radio companies, offering increasingly sophisticated broadband news and information services, combined with a range of listings and classifieds
- **Major online search, listings and news specialists:** many of whom are international businesses that execute globally but have a local offer
- **Local businesses, institutions and organisations:** offering a range of content and services, from a local online news specialist through to a local merchant's site
- **Individuals and communities:** providing a range of content from blogs on local affairs through to a local history site.

Overall, the genre is extremely fragmented, with the Newspaper Society listing 1,100 commercial local media websites in the UK alone.[41] A small number of national platforms hosting local content achieve significant scale, as do sites targeting regions with large populations. However, in general local sites are too small to register on panels such as Nielsen and ComScore, making the scale of the local and regional genre itself hard to measure. In addition, Nielsen does not operate a geographically specific panel, which further limits analysis.

These providers enable users to access local content in very different ways. Firstly, there are a small number of providers such as Yell and Google news, that offering access to local content through a single national or international interface. Secondly, providers such as ITV Local, MyVillage, and the regional newspaper groups, who offer local content and services through a template-driven local interface that is rolled out across regions. Finally, there are a large number of (mainly small-scale) single region providers.

6.3 Review of funding models in the local and regional market

The local and regional online advertising market

Advertising is the dominant commercial funding model in local. However, the three main segments of the local advertising market – local search, classifieds, and display – support the development of very different types of online destination. Crucially, the two largest segments of the local advertising market, classifieds and local search tend to support listings-based businesses rather than content creation businesses.

Relatively few recent market analyses have attempted to size the UK local online advertising market. Moreover, there are a number of important reasons why this is challenging:

- A significant portion of local advertising is sold as part of online and offline bundles, so it can be difficult to separate the online component
- There is a blurring of the boundaries around what constitutes regional online advertising as opposed to national online advertising (for example, the majority of classifieds sites are both regional and national)
- There are new and fast-evolving entrants to the market, notably search engines who derive revenues from local searches and auction sites such as eBay that play a role analogous to classifieds sites

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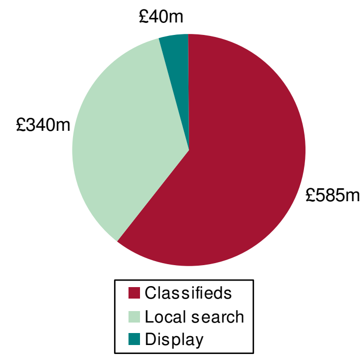
[41] The Newspaper Society, *Annual Review (*2007/08)

- Many international companies, such as Google and eBay, do not release detailed breakdowns of their UK revenues.

We estimate that the online local and regional market in the UK was worth in the region of £950m in 2007. Classifieds were worth £585m, local search £340m, and local and regional display £40m:[42]

- Classifieds (including directories) – the distinction between national and regional classified advertising is increasingly blurred, as distribution is not linked to a given locality. As such, national and regional classifieds are effectively one market. IAB/PWC estimates the UK online classifieds market was worth £585.3m in 2007. However, it is important to note that it will be very difficult for a small scale local publisher to compete for much of this market
- Local search (excluding directories) – approximately 10-30% of searches in the US are local (i.e. search includes a postcode or place name). If an equivalent proportion of UK searches were local, and they were of an equivalent value to national searches, then market would be in the region of 10-30% of total paid search revenues, or £170-510m[43]

Exhibit 21: Size of UK local advertising market, 2007



Source: MTM London analysis, IAB, UK Online Adspend Study (2007)

- Display – display advertising revenues from the five major regional newspaper groups regional teams totalled in the region of £15m in 2007.[44] Based on this benchmark and a high level analysis of traffic data we estimate that local and regional sites would capture around £40m of the UK's £592m display market.

Pay and subscription

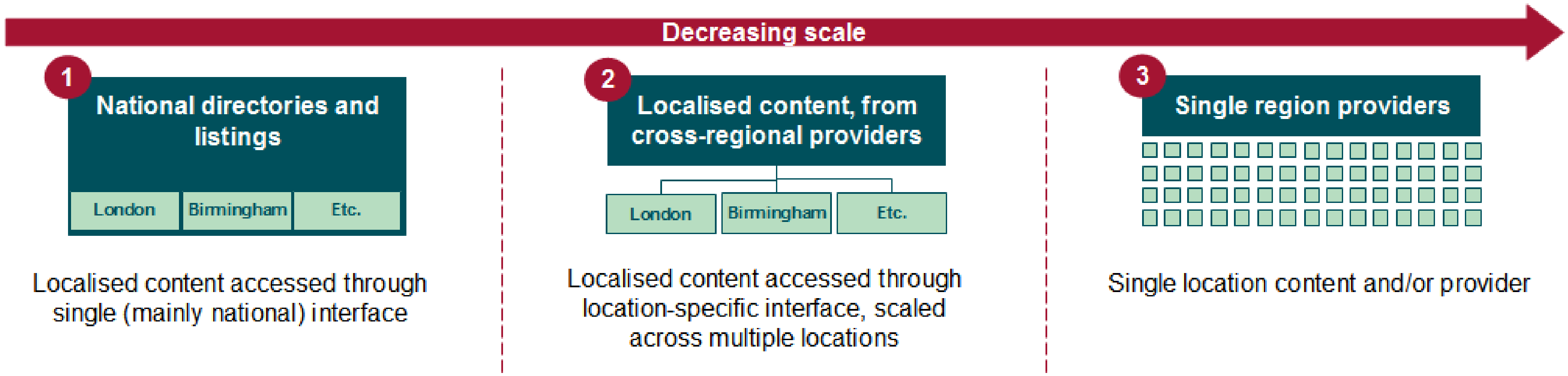
Although there are many examples of local and regional news sites trying to charge for content – such as the Scotsman archive – the trend has been consistently towards free.[45] Consumers are only willing to pay for high-value, unique local content. In contrast, services such as news, travel, weather and traffic information are increasingly commoditised, and easy to find elsewhere for free.

Ecommerce

Ecommerce is a small but increasingly important revenue stream, with providers operating a range of partnerships with third party organisations such as retailers, gaming and gambling services: for example, three of the top 20 regional sites provide prominent access to pay or subscription gambling sites**.**

[42] This is a high level estimate of the size of the UK market, drawing upon a range of sources including IAB/PWC online advertising spend data, Annual Reports and SEC filings. The project team did not undertake a detailed analysis of this market, so this analysis should be taken as directional.
[43] The IAB gives UK search revenues as £1.8 billion in 2007. Subtracting a nominal £100m for contextual advertising revenue, this leaves £1.7 billion, of which 10% is £170m and 30% is £510m
[44] Information provided as part of MTM London's confidential interview programme and various annual reports
[45] The major local news sites do not tend to charge for access to current news, although some charge for extra information. For example, the Scotsman charges for access to its archive45 and the icNetwork and the Liverpool Echo (both Trinity Mirror sites) offer paid photography downloads

Exhibit 22: High-level typology of local and regional domains



Top 10 national directories and listings

Nielsen Ranking	Domain	Provider	Unique Audience (000)
1	google.co.uk	Google	19296
4	ebay.co.uk	eBay	11421
22	multimap.com	Microsoft	3999
28	yell.com	Yell	2921
77	rightmove.co.uk	Rightmove.co.uk	1507
81	autotrader.co.uk	Trader Media Group	1458
131	streetmap.co.uk	Btex Limited	927
140	jobcentreplus.gov.uk	DWP	867
174	propertyfinder.com	REA Group	741
183	hotfroguk.co.uk	Catch/Reed Business Information	712

Top 10 localised content sites

Nielsen Ranking	Domain	Provider	Unique Audience (000)
49	gumtree.com	eBay	1997
203	vivastreet.co.uk	Viva Street	638
303	timeout.com	TimeOut	477
325	scotsman.com	Johnston Press	449
341	itvlocal.com	ITV	424
478	locallife.co.uk	Locallife Ltd	315
481	manchestereveningnews.co.uk	Guardian Media Group	314
581	thisislondon.co.uk	AND	278
839	myvillage.com	MyVillage	209
920	craigslist.org	Craigslist	195

Top single region providers

Nielsen Ranking	Domain	Provider	Unique Audience (000)
492	londontown.com	LondonTown	310
762	allinlondon.co.uk	AllinLondon	229
941	londononline.co.uk	LondonOnline	193
1006	enjoyengland.com	VisitBritain	185
1068	sheffieldforum.co.uk	Jelsoft Enterprises	177
1078	4ni.co.uk	Flagship E-Commerce	176
1426	glastonburyfestivals.co.uk	Glastonbury Festivals	139
1482	londonnet.co.uk	LondonNet	135
No further single region providers in top 2,000			

Source: MTM London analysis of Nielsen//NetRatings data (June 2008)

6.4 Review of provider business models

Although the commercial providers of local and regional content and services are predominantly advertising funded, there are important differences between their business models.

1. National cross-platform media companies

The national cross-platform media company category comprises the regional newspaper groups, broadcasters and radio companies. These companies have been pursuing integrated business models based on creating content for use across multiple channels. Online content is primarily monetised through display and classified advertising, although increasingly companies are seeking to diversify their revenue streams by establishing commercial partnerships with third-party providers such as business directories (to capture a share of the local search market) and ecommerce partners (including online gaming and gambling).

Importantly, the business models of the regional newspaper groups, who have to date been the major investors in online local news gathering, are currently under threat as offline revenues continue to fall due to declining circulations. Whilst digital revenues are an important source of future growth, this is unlikely to compensate for falls in offline revenues, with newspapers needing between 20–100 readers online to make up for losing just one print reader.[46] One interviewee reported that their offline RPU was £35-45, but only £1-2 online. A high level analysis of the regional newspaper groups suggests that their overall revenues and margins could decline significantly over the next 2-3 years, implying that going forwards these will be smaller businesses operating on lower margins (see Exhibit 23). As a result, regional news companies may well be forced to continue the current trend of reducing their cost base, including their investment in newsgathering resources, in order to maintain profit margins.

Exhibit 23: Illustrative forecast P&L for regional newspaper group

All figures £m	2007	2008e	2009e	2010e	Assumptions and comments
Print revenue	**500**	**465**	**432**	**402**	Declining by 7% per year
Circulation	125	116	108	101	
Ad sales and other	375	349	324	302	
Digital revenue	**16**	**20**	**25**	**32**	Growing by 26% per year
Total revenue	**516**	**485**	**458**	**434**	
Total costs	**390**	**378**	**367**	**355**	Declining by 3% per year
Profit	**126**	**107**	**91**	**79**	Declining by 14% per year
Margin	24%	22%	20%	18%	

Source: MTM London analysis

In addition, their digital revenues are also under threat from a range of disruptive market forces:

- Powerful new market entrants, including Google, eBay, and a range of news, classifieds and directories businesses, are threatening to capture a substantial share of the local advertising market

[46] *The Economist*, "More media, less news" (24th August 2006)

- Innovative local micro-businesses, many online news and information specialists, are threatening to steal share of readership in any given locality.

Despite these challenging market conditions, many key cross-platform media companies are developing ambitious plans for extending their local content offer, focused mainly on the development of broadband and 'hyper local' content. For example, ITV Local has announced plans to extend its service from its current scale (based on ITV regions) to a more localised model; each of the regional newspaper groups has begun to build out a video-based broadband offer across their sites, and to incorporate UGC and aggregated content into their offer. In addition, the BBC has announced plans (currently in consultation) to invest £60m over three years in local online video provision.

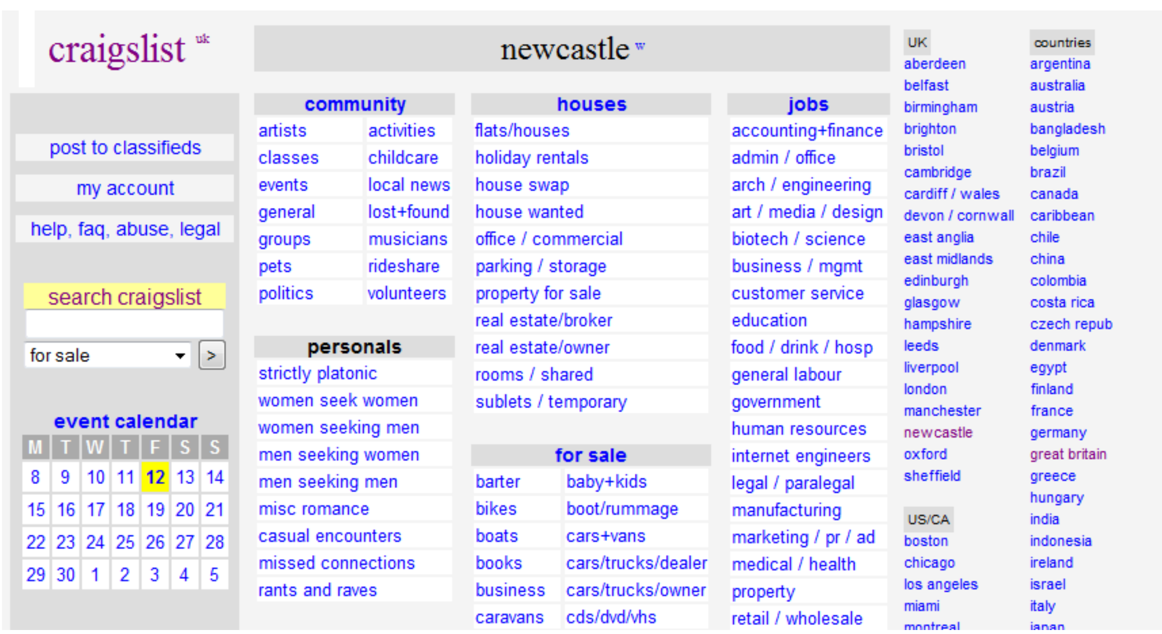
The regional news industry is currently at a critical inflexion point and it is not clear how sustainable these content models will be. Many of the cross-platform media companies have important strengths, including local sales teams that have strong relationships with local advertisers and media buyers, strong local brands and cross-promotional capabilities. At present many of these providers are investing in richer online local content offers because they have no choice, and supporting their investment with offline revenues while they search for a sustainable business model.

2. Major online search, listings and news specialists

There are a number of online specialists who tend to operate global platforms that deliver localised content and services, including:

- The search engines, who are adding increasingly sophisticated local search features, such as Google's postcode search for local news
- Classifieds and directories specialists
- National or global news and listings platforms.

Exhibit 24: Craigslist home page for Newcastle



Source: Craigslist

The majority of these companies are advertising funded, and operate on a national or international basis so as to spread development costs across territories and build sufficient scale in their user-base to generate attractive overall advertising returns. Most do not invest heavily in professionally produced content as it is not part of their business model – they are either search and listings providers or aggregators of third party content and platforms for the generation of UGC. It is unlikely that these organisations will evolve into producers of original local content because the economics are unattractive:

- The content is location specific so the target audience tends to be limited
- News and information services are increasingly commoditised and difficult to monetise: consumers are unwilling to pay and struggle to (or are unwilling to) differentiate between original and aggregated content
- Original content is easy to copy, and so quickly becomes public property, reducing the window in which the creator can monetise it as exclusive to them – even if the consumer is willing to differentiate
- There is a large volume of content chasing a limited pool of display advertising spend.

As a result of these market dynamics, content providers targeting local markets are incentivised to keep content generation costs to a minimum by aggregating content from third parties and encouraging user generated content.

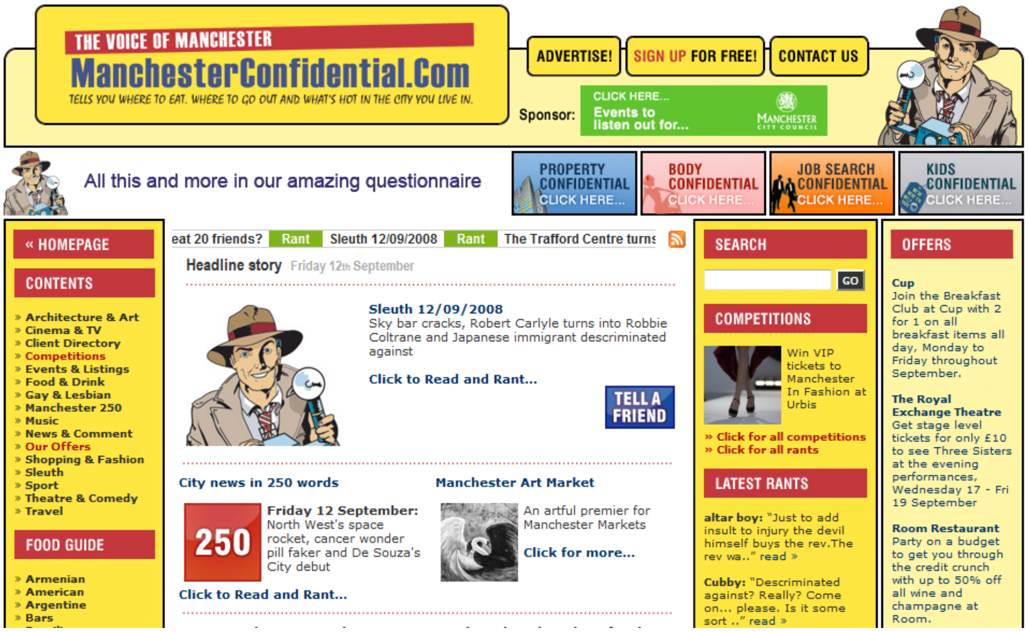
There are significant variations in the business models of companies in this category: specialist directories, classified and listing providers operate a range of business models, from paid-for listings in high value categories such as recruitment and property (e.g. Auto Trader) through to free listings. The news and listings platforms primarily aggregate third party content and UGC and then monetise it through display and classified advertising.

Overall, the local search, directories and classifieds market is a fast-evolving and extremely disruptive space, characterised by increasingly blurred boundaries between the directories and search engine market, a large number of start-ups, and high levels of technical innovation as global platform companies seek to develop local products and services they can execute globally. Some of these have the potential to be transformational, such as Google's tools for automating local advertising sales, although it is still too early to predict how the market will evolve.

3. Local businesses, institutions and organisations

This category includes a range of commercial, public and third sector organisations who contribute to the local content base. In each locality there are entrepreneurs and micro-businesses that are too small to register on Nielsen or comScore ratings, but play an important role in creating local content. This includes online only local news and information sites such as Manchester Confidential (see Exhibit 25) that operate in one region, primarily on a display and classified advertising model, and local business sites operating marketing or retail sites.

Exhibit 25: Home page of Manchester Confidential



Source: Manchester Confidential

In contrast to the major regional news organisations, many of whom say that their digital properties would not register a profit if a proportion of offline content generation costs were taken into account, interviewees from a number of independent, single-region news and entertainment sites reported that their sites were profitable on a stand-alone basis, as they operated relatively small news gathering forces and took advantage of low cost online production tools to maintain a small cost base.

In addition there are a wide range of sites operated by devolved and local governments in the UK and third sector organisations operating on a local or hyper-local basis.

4. Individuals and community

The low barriers to entry into web content production, and growth in platforms enabling blogging and UGC has led to an explosion in local content created by individuals and communities, and interaction between individuals in online social spaces.

There is an enormous range in the quality, scope and nature of this content, and the distinction between user-generated content and professionally produced content is as blurred in local as it is in other genres, with professional content placed in non-professional contexts (e.g. personal blogs), and traditional media providers incorporating UGC into their content, such as home made video of a local event. Taken together this body of UGC and voluntarily produced content adds an enormously important layer of content to the local ecology.

6.5 Implications for future provision of local and regional content

There are three major implications for the future provision of local and regional public service content online arising from this analysis:

- The low barriers to entry in the online market are resulting in a new and valuable layer of local and hyper-local content created by a combination of micro-businesses and user communities, and often integrated into provider platforms
- Cross-platform media owners are developing ambitious plans for extending their local content offer, but it is too early to say at what level these will be commercially sustainable
- Online specialists will invest heavily in local services, but these will in the main be listings and content aggregation businesses rather than creators of original local content.

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There is an enormous (and growing) volume of voluntary and user-generated content, ranging from individual bloggers to social entrepreneurialism and activism at a local level, driven by the rise in social media and the range of third-party technology and tools that have lowered the barriers to entry to the local content market.

This content, taken together with the increasingly sophisticated platforms and tools that enable it, is resulting in a new and valuable layer of local and hyper-local content, much of it increasingly woven into professionally produced content on local news platforms. In addition, local search and directories are making long tail commerce sites more discoverable, leading to an increased volume of local business content.

However, although there are many exciting aspects to this rapid growth in volume of local content, there are also some important challenges. The majority of this content will remain relatively small scale and of variable quality (although the sheer volume of content and rapid improvement in the tools that enable it will help to compensate for this by enabling increasingly sophisticated content at a low cost of production). Moreover, due to the vast quantity of content produced, it may be increasingly hard to discover the high quality content.

Cross-platform media owners are developing ambitious plans for extending their local content offer, but it is too early to say at what level these will be commercially sustainable

The BBC and the regional newspaper groups are the most significant investors in newsgathering at a local level; other cross-platform media companies (primarily broadcasters such as ITV and STV, but also radio companies) do not currently maintain substantial local newsgathering teams on the same scale as the newspapers. Importantly, the economics of online content are unlikely to justify the creation of such teams in the near future.

The newspaper groups all have ambitious plans for new and more sophisticated local broadband offers, incorporating video, UGC and hyper-local content. However, their business models are under threat from global online specialists trying to capture a share of the local advertising market, and from agile local micro-businesses. The industry is at a critical inflexion point, and it is too early to say at what level these local content offers will become sustainable. However, we believe it is highly likely that:

- Growth in online revenues is unlikely to compensate for falls in offline revenues, and going forwards the regional newspaper groups will be smaller businesses operating on lower margins
- The regional news providers will substantially increase their investment in online content in an attempt to capture a share of the local advertising market
- However, this increased investment in online will largely be a repositioning of offline editorial resource into a '360 degree' cross-platform publishing model. We expect the newspaper groups will *reduce* investment in their editorial cost base across platforms in order to maintain margins.

Online specialists will invest heavily in local services, but these will in the main be listings and content aggregation businesses rather than creators of original local content

The online specialists who are investing heavily in national and international platforms that can host local content and services are, in the main, listings and content aggregation businesses seeking to capture a share of the local search and classifieds market. Whilst some of these businesses, such as Google News and MyVillage, will carry local content (sometimes in addition to listings) this content is likely to be either UGC or aggregated from third-parties. These businesses do not, generally, maintain news-gathering teams or produce 'original' journalism, nor do they contribute to the costs of news-gathering. As a result, whilst there may be an increase in plurality of local news and information provision, with a wide range of providers offering access to local news, there is also likely to be an increase in homogeneity of provision, as this content will largely be aggregated from the same sources.

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