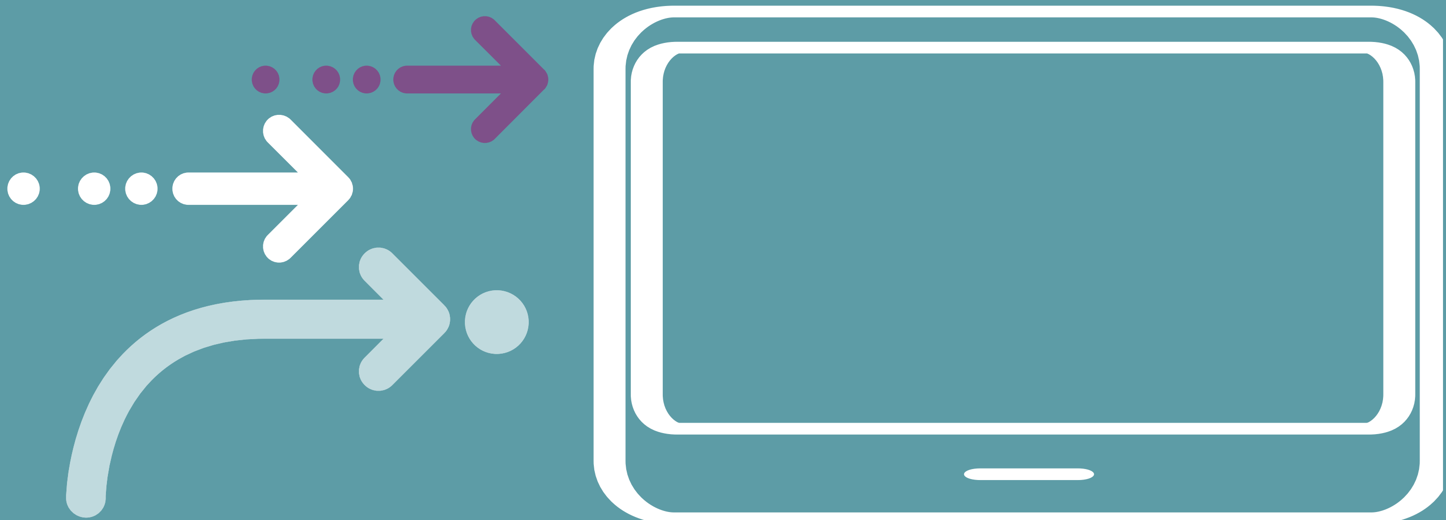
Section 3

The growth of digital television



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3.1 More than one in every two UK households now have digital TV. Reaching this milestone in just over five years since the launch of digital TV is a significant achievement. But digital TV has not grown from a standing start: it is a development of the pre-existing multichannel services and, at least until recently, most of the growth in digital TV take-up has come as a result of the investments and efforts of pay TV operators.

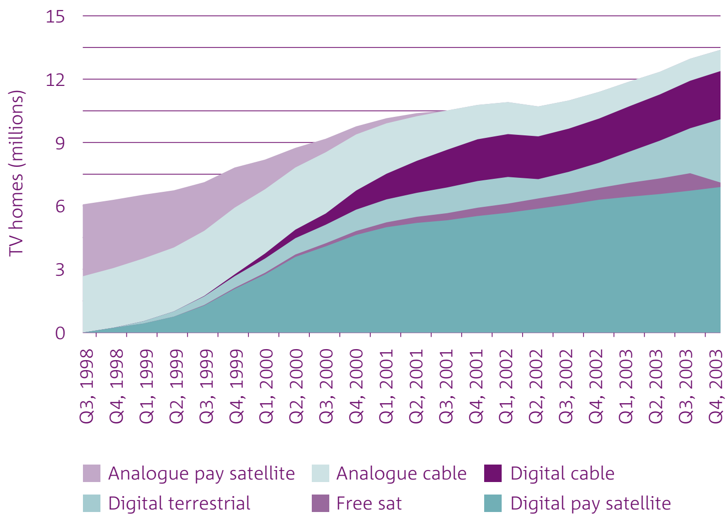
Box 3.1 History of multichannel TV in the UK

1989	Sky Television launches UK satellite TV with a four channel service.
1990	British Satellite Broadcasting (BSB) launches. Sky and BSB merge to form British Sky Broadcasting (BSkyB).
1992	BSkyB buys exclusive rights to live FA Premier League football coverage.
1993	Sky launches multichannel pay TV package.
1997	Independent Television Commission licenses digital terrestrial TV multiplexes to Digital 3&4 and British Digital Broadcasting. The BBC is also allocated one multiplex.
1998	BSkyB launches UK's first digital TV service and attracts 100,000 customers in its first month. Digital terrestrial TV broadcasts start. British Digital Broadcasting launches its pay TV service under the ONdigital brand name.
1999	Sky and ONdigital begin to offer free set-top boxes. NTL and Telewest launch digital cable TV services. Sky introduces interactive services. Secretary of State announces ambition to complete digital switchover and defines switchover targets.
2000	NTL acquires the consumer operations of Cable and Wireless Communications (CWC) to become largest cable operator. Telewest merges with Flextech.
2001	BSkyB reaches five million digital subscribers and switches off its analogue service. ONdigital relaunched as ITV Digital. NTL and Telewest launch broadband internet services. Government launches Digital TV Action Plan.
2002	ITV Digital closes down. Freeview launched. New BBC digital TV and radio services begin broadcasting. NTL applies for Chapter 11 protection in the US; it later secures recapitalisation. Half of all UK viewers have multichannel TV.
2003	At the end of the year, half of all UK households have digital TV.

Take-up of different digital platforms

3.2 Chart 3.1 shows the development of the multichannel TV market since the launch of BSkyB's digital TV service in October 1998.

Chart 3.1: Multichannel TV uptake by platform
Source: Ofcom's Digital TV Update



3.3 Most of the initial growth in digital households came from the conversion of analogue pay TV households to digital pay TV. But once BSkyB and ONdigital began to offer free digital set-top boxes in 1999, there was a steady increase in new multichannel viewers.

3.4 BSkyB in particular has succeeded in winning and retaining many customers new to multichannel pay TV while its investment in converting its existing analogue pay TV customers to digital allowed it to turn off its analogue pay TV service in 2001. BSkyB now accounts for 55 per cent of all digital homes.

3.5 Even when BSkyB customers decide to stop their subscriptions, some continue to use their set-top boxes (which they continue to own) to receive digital TV. Until recently it was possible for all of these former subscribers to continue watching all the main public service analogue channels using their set-top box. However, BSkyB replaced all its viewing smartcards during 2003 which meant that the old smartcards ceased to work. Since then, former subscribers with the old smartcards have only been able to watch unencrypted channels. This means that although they can watch the BBC channels, which are not encrypted, they cannot watch the other public service channels which are.

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3.6 BSkyB's decision to replace its viewing smartcards also affected about 300,000 households who had installed a digital satellite receiver and set-top box but had never subscribed to BSkyB's pay TV service. These households had used free-to-view smartcards, known as Solus cards, supplied by the BBC. But the BBC stopped making these cards available in summer 2003 after it began broadcasting its channels in an unencrypted form. Although a replacement free-to-view smartcard scheme was initially funded by ITV, Channel 4 and Five, this scheme has now closed.

3.7 The result of these changes is that many homes with a digital satellite set-top box but without a current Sky subscription can receive BBC channels but not ITV1, Channel 4 and Five. Ofcom no longer considers such homes to be digital households. The effect of this is shown in chart 3.2 as leading to a sharp fall in the number of free-to-view satellite households. Further details can be found in Ofcom's digital TV update[7].

3.8 The cable companies have gradually shifted their analogue customers to digital, although chart 3.1 shows that this process is not yet fully complete. Nevertheless, the cable companies together account for 25 per cent of all multichannel homes and 19 per cent of digital homes. The companies' financial problems have hindered the process, but all of the analogue

7 http://www.ofcom.org.uk/research/industry_market_research/m_i_index/dtv/

cable subscribers are likely to be upgraded to digital in the next few years. Even if they were not converted to digital cable, these customers do not rely exclusively on the analogue terrestrial signal, so would not be adversely affected if it was switched off.

3.9 In its original guise as a predominantly pay TV service, the digital terrestrial platform did not prove to be a success. The demise of ITV Digital in 2002 created an opportunity for a new digital proposition: a free-to-view digital terrestrial service which offered a limited range of channels for a one-off cost of less than a hundred pounds. This easily understood product, marketed under the Freeview brand, has succeeded in winning many customers who were not attracted by the subscription-based digital services.

3.10 Chart 3.2 shows the rates of take-up of the different digital platforms since 1998. The take-up curves of the satellite and cable services show rapid increases during the periods in which they were converting their existing analogue customers to digital and when they were succeeding in winning large numbers of new customers. Over time, however, it can be seen that the rates of growth of satellite and cable platforms have slowed. Since its launch in October 2002, Freeview has enjoyed a similarly successful launch phase and now accounts for 24 per cent of digital homes.

3.11 Chart 3.2 can misrepresent the speed of adoption of different digital TV platforms because the DTT platform has only proved successful since the launch of Freeview. Chart 3.3 shows the take-up of each digital platform in the first five quarters of their operation. It shows that Freeview has been as successful as Sky digital in 1998 and 1999 and more successful than digital cable, which accelerated later. Since the early figures for BSkyB and cable companies mostly represent their conversion of analogue subscribers to digital, the recent success of Freeview is all the more impressive.

Chart 3.2. Digital TV uptake by platform

Source: Ofcom's Digital TV Update

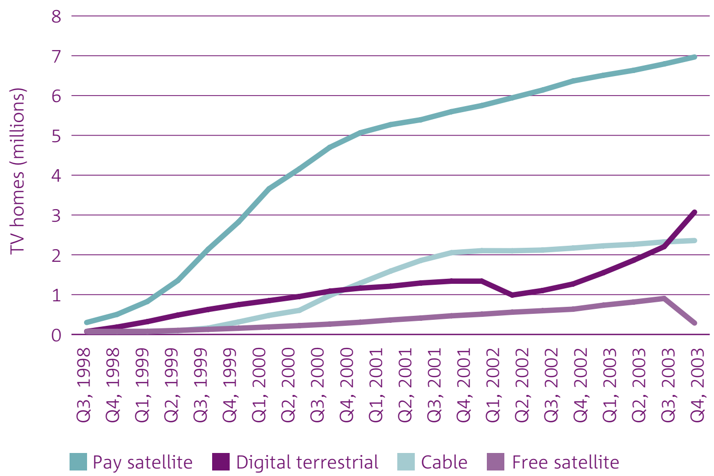
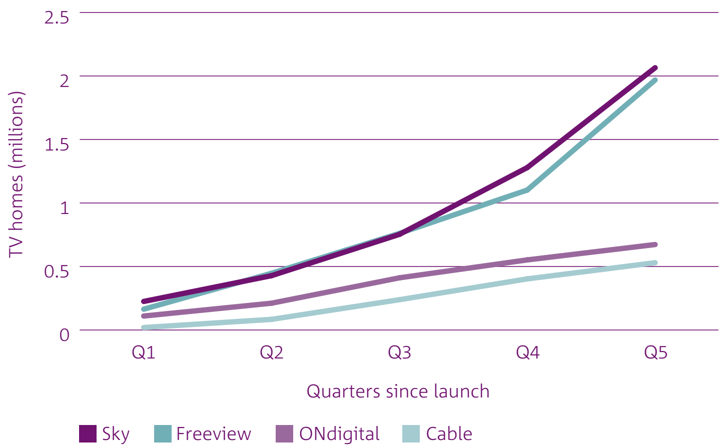


Chart 3.3: Initial take-up of digital TV platforms

Source: Ofcom



Progress in 2003

3.12 The growth of digital TV in 2003 was strong, particularly in the fourth quarter. The proportion of digital households grew from 41 per cent of households at the end of 2002 to 50.2 per cent of households a year later. Most striking was the remarkable growth of Freeview, which exceeded almost all sales predictions. By the end of 2003 there were almost three million Freeview households, up from 1.2 million a year earlier. The sales of Freeview boxes during the fourth quarter of 2003 were particularly impressive: in the run-up to Christmas more than 100,000 Freeview boxes were being sold every week. A number of reasons account for Freeview's success:

- **Appeal to new customers.** Before the launch of Freeview, the demand for greater choice without a monthly subscription had not been catered for by other multichannel services. Research conducted for the BBC[8] has indicated that almost two-thirds of Freeview customers said the one-off payment and lack of contract was extremely important to them. Freeview has also attracted a different demographic from other digital TV platforms, including older people, who often report no desire to obtain digital TV.

- **Increasing number of channels.** More TV and radio channels were launched on Freeview during 2003, including a new entertainment channel, ftn, and BBC3 which replaced BBC Choice. New radio services on the platform included new music stations from EMAP as well as from the BBC. More interactive services have also appeared, e.g. the BBC has launched an interactive news service allowing viewers to see the news headlines at any time of their choosing. A new pay TV offering from Top Up TV may make digital terrestrial TV more attractive.

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8 The BBC/Dixons Group Survey, March 2003

- **Greater channel appeal.** The channels available through Freeview have gained viewers through higher investment, greater promotion and through more tie-ins with their analogue stablemates. For instance, ITV2 increased its share of viewing from 1.1 per cent of total viewing during 2002 to 1.5 per cent during 2003. BBC3 meanwhile enjoyed a 50 per cent increase in its viewing share compared with its predecessor, BBC Choice. Part of BBC3's increase in audience was driven by a large increase in its budget.
- **Promotion by the BBC.** The BBC has heavily promoted its digital TV and radio channels and this promotion has encouraged viewers to consider the various digital platforms available as well as increasing the brand recognition of Freeview. Over the past year, awareness of Freeview has increased from 58 per cent to 80 per cent of adults[9]. BBC research[10] has indicated that more than half of Freeview customers said the BBC digital channels were a significant factor in their purchasing decision. This is a positive influence for switchover, although it may give rise to competition concerns.
- **Wider distribution of Freeview products.** As demand for Freeview has grown it is being stocked by different types of retailers, including some supermarkets. BT has also begun to market Freeview to its customers.
- **Falling equipment prices.** As the number of digital set-top boxes sold has increased, the prices of digital TV equipment have fallen as the boxes are produced in ever greater volumes and as more manufacturers begin to produce them. Whereas most digital terrestrial set-top boxes cost around £99 when Freeview was first launched in October 2002, a more typical cost is now around £80, and the cheapest retail for around £50. There are also indications that Freeview is now cheap enough for it to become

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9 Continental Research, The Spring 2004 digital TV report
10 The BBC/Dixons Group Survey, March 2003

an impulse buy for some consumers: during the second half of 2003, more than 100,000 Freeview boxes were sold in supermarkets.

- **Rising sales of IDTVs.** The prices of integrated digital TVs (IDTVs) have also fallen, although there is still a gap of over £100 between the average IDTV and its nearest analogue equivalent. More than 180,000 IDTVs were sold during 2003 – a 60 per cent increase from 2002.

- **Word of mouth sales.** BBC consumer research[11] found that more than 80 per cent of Freeview customers said that they would recommend it to a friend. This trend also applies to other digital TV platforms: research conducted by the ITC[12] showed that 81 per cent of people who were doubtful beforehand were more favourably disposed to digital TV after experiencing it.

- **Secondary sets.** Falling prices are also likely to have encouraged more people to convert their secondary TV sets. Ofcom-commissioned research and data from Freeview suggests that around 15 per cent of sales of Freeview boxes are for secondary sets.

- **Improved coverage.** At launch, all the DTT services reached only 56 per cent of UK households compared to around 90 per cent for the analogue services being broadcast from the same sites, mainly due to limits on the power of the transmissions in order to protect analogue services. The equivalent figure is now 73.1 per cent after many improvements to the broadcast signal and its power.

3.13 Freeview now accounts for one in four digital households and this proportion can be expected to increase as it is growing faster than other digital platforms as Chart 3.4 shows.

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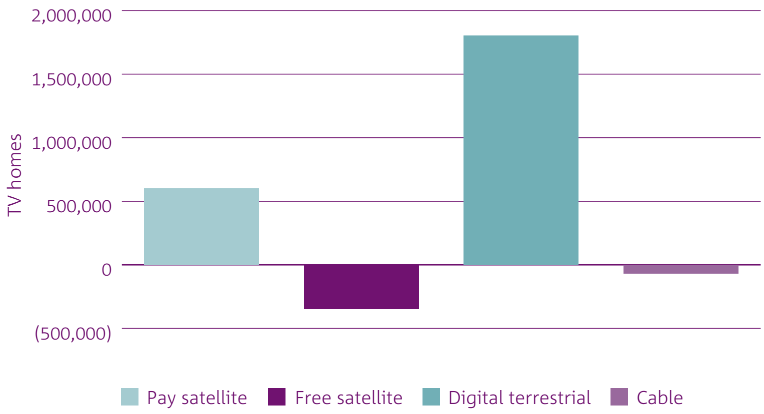
11 The BBC/Dixons Group Survey, March 2003

12 Go Digital key findings, April 2003.

Chart 3.4: Change in customers during 2003
Source: Ofcom



3.14 BSkyB has also continued to grow steadily during 2003, adding 603,000 to its total number of customers over the course of the year. At the same time BSkyB has increased average revenues per subscriber and has lost less than 10 per cent of its subscribers a year. It has recently put efforts into promoting its personal video recorder technology, known as Sky+, as a way of both attracting new customers and retaining existing ones. There are now more than a quarter of a million Sky+ customers.

3.15 As described earlier, the end of the free-to-view smartcard scheme has, however, led to a sharp fall in non-subscription satellite digital homes. Estimates suggest that just 211,000 households are now able to receive the full range of public service channels through the digital satellite platform. If the free-to-view smartcard scheme were still in operation, there could be as many as 600,000 extra digital households and the reported level of digital take-up would be 53 per cent rather than 50.2 per cent.

3.16 The cable companies have been less successful than other digital TV platforms at attracting new subscribers. The overall number of cable customers fell by 52,000 during 2003. The conversion of analogue to digital customers continued, however, and the number of digital cable subscribers increased from 2.1m to 2.3m. During the last quarter of 2003 the number of overall cable customers increased compared with the previous quarter, suggesting that the falls which took place earlier in 2003 are capable of being reversed.

During 2003, there has also been a growth in the number of people converting their second sets to digital TV.

Secondary sets

3.17 During 2003, there has also been a growth in the number of people converting their second sets to digital TV. Many people are using DTT set-top boxes to obtain digital TV on their second sets; Ofcom commissioned research and data from Freeview suggest that 15 per cent of Freeview boxes are used on secondary TVs and BSkyB also report growing numbers of households converting their second sets. BSkyB have reported that at the end of December 2003, there were 237,000 Sky subscribers with extra set-top boxes, an increase of 103 per cent on the previous year.

3.18 Given that households regularly use almost two TV sets, most digital households still have additional analogue-only sets at home. The consequence is that the proportion of TV sets which are digital is well below the proportion of households with digital TV. This need not present a problem in itself: if those non-primary sets are converted to digital when the analogue signal is switched off then people will be able to continue using them. But the figure does put the success of digital TV to date into perspective. Section 5 considers the likely levels of digital take-up for both primary and secondary sets in the years ahead.