Do I Have to Pay for That Smartphone?

Not many consumer-electronics market segments can point to meteoric growth during one of the longest and slowest economic recoveries in recent memory. But the smartphone, and now its cousin, the tablet, have defied the laws of economic gravity and logged spectacular growth in recent years.

They have also fixed a spotlight on the role of intellectual property rights (IPR) and innovation in the consumer technology business. The epic and costly patent infringement battles fought among the major players in this market (Apple and Samsung being litigants with the highest profiles) quantify how high the stakes are for dominating this market. But it also highlights how useful a tool patents can be for building up market share, negotiating with competitors, and building a long-term strategy.

A somewhat odd proclamation widely stated in the wake of the recent jury verdict from the Samsung/Apple case is that IP rights still matter after all – as if the thicket of costly infringement lawsuits and eye-popping purchase prices for smartphone-related patents by the likes of Google, Microsoft, et al. hadn’t already proven that point.

Nevertheless, it has been somewhat fashionable in certain circles to treat the idea of IPR with a measure of derision as an antiquated notion in the age of a seemingly proprietary-less Internet. But smartphones actually closely resemble the mix of proprietary and open standards-based technologies that constitute the applications running on the internet. Most of which – whether industry standard or not – is not royalty free. It is true that some of it, such as the Android operating system, comes without a royalty. That is a notable exception, though, as many widely-adopted industry technical standards come with royalty price tags by the companies that contributed their IP to the standards-making process. According to a recent analysis DTC conducted on major technical IP (as opposed to design IP) in standard smartphones, the bundle of standards-based radio technologies, such as GSM, LTE, messaging technologies and more, can contribute costs from about $60-$95 per smartphone depending upon device pricing and individual licensing deals with patent owners and device makers. And adding in royalties for other industry standards like MPEG audio and video compression, Wi-Fi and transport technologies hangs a healthy IP price tag on the smartphone.

Recent patent infringement lawsuits call into question whether or not the patent system needs to be overhauled or amended. Whether or not developers should be allowed to patent every idea and every design element of a device is worth debating. Yes, the ethos of the internet – an open and somewhat formless system that is relatively nondiscriminatory as to who has access to it – has liberated the flow of information and transformed business models, but there’s still an intellectual property price tag for it and the sophisticated devices that allow access to it.
The Epicenter of Digital TV Sales: China

In the face of slowed down TV sales in the North American and European markets due to economic malaise and market saturation, China remains an epicenter of Digital TV shipment growth according to DTC’s latest domestic Chinese television market research in conjunction with China-based RedTech Advisors. In a market where there are still millions of analog sets as competition, basic LCD TV sales are the catapult for growth.

Demand for LCD TV in China is high and DTC expects that it will remain high for years to come. Sales in larger cities and urban areas where the middle-class population is growing are the biggest drivers in the market, but sales in small cities and rural areas are also growing.

The vast majority of LCD TVs sold in China are supplied by domestic Chinese suppliers. In 2011 of the 50.9 million sets shipped into the distribution channel, 36.1 million were from the top supplying domestic brands. In the second quarter of 2012 75% of LCD TVs were supplied by domestic brands. Top suppliers included Hisense, Skyworth, TCL, Changhong, Konka, and Haier which combined to ship nearly 9 million units in the second quarter of 2012. Of the sets sold, Chinese consumers prefer larger screened LCD TVs. DTC estimates the sales of TVs with screen size over 42” have accounted for 77% of overall LCD TV sales this year.

With sales booming and significant growth forecasted, China is positioned to retain the top market position (in terms of volume of shipments) for years to come. With nearly 400 million TV households in the market and only a fraction of those households with LCD TVs, domestic suppliers are set to continue to reap the benefit of arguably the most significant digital TV market in the world.

DTC’s Domestic Chinese LCD DTV Quarterly Tracking Service, which reports on quarterly shipments by screen size, suppliers, chip suppliers, and video compression technology, is available either by quarter or cumulatively for 2010, 2011, and 2012 (Q1 and Q2 are currently available, Q3 and Q4 will be available later this year and early 2013 respectively).

Internet Distribution: The Key to Niche Programming Sales

Placing pay niche video programming in front of viewers used to be an expensive and prohibitive exercise that required distribution agreements with traditional pay TV service providers. But the cost savings, flexibility and autonomy afforded by the internet makes for an optimal environment for offering ultra-niche pay programming.

It’s no secret that paid internet video subscription numbers are on the rise (from around 37 million subscribers in 2011 to 53 million in 2013, according to the latest analysis from DTC), and will log significant increases for years to come. To date, however, the most prominent internet-delivered pay video programming services are comprised of traditional Hollywood-produced movies and TV series. Currently, pay services such as Netflix, Hulu Plus and Amazon Prime, make up the bulk of internet video subscribers, but niche programming offerings, such as sports and adult video subscriptions, make up a constantly increasing piece of the pie.

Despite the popular buzz, only a handful of internet video subscribers are “cord cutters”. Most are supplementing existing pay TV services. DTC believes that niche programming fits nicely into the “supplementer scenario.” Supplementers use the following logic: Subscribe to the basic traditional pay TV service offerings and supplement those offerings with services such as a separate MLB package for the tablet, or being able to purchase a VOD adult title on the internet for less than on the pay TV network. Despite some success in selling adult-video program services, adult sites struggle with converting viewers to paying for services, and this seems to be a trend that will continue until the industry gets a better handle on piracy. Having the option of safe, virus-free viewing on one’s phone, tablet, TV and PC should increasingly encourage consumers to take the plunge into adult online video content subscription packages. And the more adult sites incorporate anti-piracy measures and seamless DRM systems, subscription options will likely be more accepted.
Perhaps the Holy Grail in niche programming is sports. Broadband sports subscriptions range from expensive and tethered to a pay TV service (NFL), to reasonably priced and free of traditional pay TV ties (MLB and NBA). The ability to expand into individual teams and leagues allowing viewers to tailor their subscription packages is an important feature for selling online sports content.

Sports and adult content have always been and will always be in high demand and may be tailor made for internet distribution. Netflix knows that subscribers want access to their content on multiple devices and aren’t necessarily willing to give up their pay TV services. Many viewers simply want to supplement with niche-based content and be able to view that content at their convenience. These desires can be exploited by internet-based niche content providers, of which sports and adult video are only two. Instead of a pay TV content environment that represents an “either or” mentality when it comes to business models, a blending of broadcasted programs (via cable, satellite, terrestrial) combined with supplemental niche programming delivered over IP may be a more realistic representation of convergence.

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Examples of Niche Internet Video Services

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<td>NFL Sunday Ticket Max</td>
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<td>MLB.TV Premium</td>
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<tr>
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“Despite some success in selling adult video program services, adult sites struggle with converting viewers to paying for services, and this seems to be a trend that will continue until the industry gets a better handle on piracy.”

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