LABRADOR VENTURES

WWW.LABRADOR.COM

Embrace Your Inner Couch Potato

by: Stuart Davidson, Labrador Ventures – May, 2006

America loves television, that's for sure, but investing in the future of IPTV is an entirely different story.

Stuart Davidson

As seen in the...

VCJ
Venture Capital Journal

LABRADOR VENTURES

101 UNIVERSITY AVENUE

FOURTH FLOOR

PALO ALTO, CA 94301

TEL: 650-366-6000

FAX: 650-366-6430

As the founder of Broadcast.com and the current owner of the high-profile Dallas Mavericks, you'd think a high-tech tycoon like Mark Cuban would be all over Internet TV – think again. Cuban, like many other digital media pundits and investors, is downright bearish on the space.

"There is no Moore's law for bandwidth to the home," explains Cuban in his blog, *Blog Maverick*. "There is a huge misconception that bandwidth will just continue to experience unlimited expansion for every broadband household. It's what we are used to with hard drives, processors, all technology. That's not the case for the next decade with bandwidth. The net result is that TV is going to be TV, delivered like TV for a long time to come. There won't be enough bandwidth for it to be any other way."

Cuban may be right. Despite advances in compression technology, future improvements to the Internet's backbone infrastructure, and innovative commercial applications for downloading video (Apple iTunes now offers episodes of prime time shows within 24 hours of their initial airing), Internet TV is going to be inherently limited by both economic and technological realities. According to Craig Moffet, analyst with Bernstein Research (whom Cuban cites in his *blog*), "Our telecommunications infrastructure is woefully unprepared for widespread delivery of advanced services, especially video, over the Internet. Downloading a single half hour TV show on the web consumes more bandwidth than does receiving 200 emails a day for a full year. Downloading a single high definition movie consumes more bandwidth than does the downloading of 35,000 web pages; it's the equivalent of downloading 2,300 songs over Apple's iTunes web site. Today's networks simply aren't scaled for that."

Yet, such hand wringing may be overstating the risks of what's truly commercially viable – let alone investible for VC's – when it comes to television/video over the Web. In fact, despite many of the technology and copyright roadblocks, video is clearly all the rage; the undeniably hot space when it comes to the Web 2.0.

Prime Time 2.0

Just last September, Verizon started selling its Internet TV services in Keller, Texas and is expected to expand the service – what it calls Fios TV – to homes in at least half the states where it now offers just telephone service. It was the first strike at the cable and satellite TV operators by a major carrier, but certainly not the last. In another recent announcement, AOL and Warner Bros. teamed up to launch the first broadband television network called In2TV, purportedly offering the largest collection of free on-demand television shows on the Web. And all of this comes on heels of the Net's current runaway success story, YouTube, the user-generated video content site that now stands as the 7th most trafficked web site on the Internet.

There's an inherent paradox here. Though the technological hurdles of feeding TV over the Internet (or at least TV as we've known it) suggests that such a milestone should likely never happen, consumer interest and current trends suggest that it already has. Here's why: There is already a growing, though fragmented, market for TV 'programs' produced just for the web. Nearly every major media site has some element of video attached to it (though granted still just a thimbleful of the content they show over traditional broadcast television.) And Google, Yahoo, Microsoft and the like are all experimenting with video and/or video search in one form or another. Moreover, inherently built into the Internet are the time-shifting and on-demand solutions for watching TV that the television broadcast industry has struggled with for years (at least until the recent adoption of TiVo and video-on-demand technologies.)

The issue now for VCs and other industry players is to figure out where the investible business models are, and what Internet users will view as 'must haves' when it comes to their online video / television viewing experiences in the future?

The Idiot Box

"This much we know, people love TV and they occupy a lot of time watching it, so there's a lot of

cont.

opportunity there," says Stewart Alsop, general partner with Alsop-Louie Partners, an emerging early stage venture firm. Yet, such a large existing market does not necessarily mean a seamless transition to offering broadcast television over the web. "The problem is that the Internet is simply not a broadcast medium," agrees Mark Hall, a former executive with Real Networks. "It's not meant to deliver large amounts of the same broadcast content to multiple millions of Internet viewers all at once. If everyone tuned in at the same time, the system would break."

Yet, like any disruption, the 'new think' is never a perfect substitute for the old. Sure, broadband will be bandwidth-constrained if it tries to be a direct substitute for broadcast / cable / satellite TV, but as a distribution infrastructure to feed hungry video-ready devices on a 'store and forward' basis, it's fine. This is an important distinction that we, as early stage VCs, should understand – just as we must understand that many of the current video delivery technologies, platforms and business models may not yet have fully evolved into the businesses they will become.

For example, despite YouTube's phenomenal success over just 11 months, the company still has no revenue model to speak of and is facing major hurdles when it comes to pirated copyrighted material being placed on its site illegally. Moreover, the large media companies – what Alsop calls the 'land of the giants' – don't yet offer much of an alternative solution for delivering their own content online; at least on the television side. Why? Because at the same time they'd love to embrace the Web, they're scared to death of it. "With a company like Disney, when it comes to video content on the web, they're not sure how they can protect it, monetize it, or even prevent it from cannibalizing their existing properties," says Jarl Mohn, a media and entertainment industry expert who sits on the Board of Directors of XM Satellite Radio, CNET, and The E. W. Scripps Company.

Selective Programming

That leaves VCs, particularly early stage VCs, with two choices: invest in the platforms and technologies that will drive video into and through the web to the consumer, or invest in the content itself and see if there's a real market opportunity there. The former certainly shows possibility – the latter appears fraught with risk.

There are plenty of opportunities to invest in IPTV infrastructure, delivery systems and basic technologies, and plenty of VC's are going after them. Slingbox, the technology that takes cable/Internet service into the home and distributes it back out to any device owned by that particularly consumer is an example of a such a play.

But ask most any VC, for an example of a video content play that looks attractive, let alone one that make sense to fund from the seed stage level, and most would be hard-pressed to come up with even a single viable idea. It's just very difficult to imagine funding the next MTV or Discovery Channel, even now with as much traction as video has garnered on the Web. "The press is particularly impressed by the self-publishing, self-production content companies that have tried to create a real disturbance in the world of publishing and journalism, but I just don't personally believe that this turns any of these small niche ideas into big business," says Alsop.

Indeed, many of the large media and entertainment companies are doing everything in their power to keep it that way. On April 3, 2006, six Hollywood studios – Warner Bros., Universal Pictures, Sony Pictures, Paramount Pictures, Twentieth Century Fox and MGM — announced they would start selling digital versions of films such as *Brokeback Mountain* and *King Kong* on the Internet through MovieLink, the first time major movies have been available online to own. Sure, that's the movie business and not live TV, but many of the same rules of economics apply. Even wildly successful startups in the wireless television space are more apt to be distribution pipes than content creators. MobiTV, an Emeryville, CA-based startup, has become the industry leader in wireless television as it closes in on 1 million subscribers for its TV service delivered via cell phones, yet the content itself remains produced by CNN, FoxSports and the like.

Though it may be cheaper than ever to produce video content and post it to the web, the concept that doing so will immediately create fundable Internet TV and content plays remains a far off dream. Community sites, user generated content, interesting distribution ideas – even nascent ones such as *Dave.TV* which consolidates channels of video entertainment from Internet sources into a service that delivers them to the PC, TV, portable and mobile devices – all have promise, and the best ones should, indeed, be funded.

But the concept of the Internet replacing your television – or that VCs should fund such ideas wholesale – remains yet another myth resulting from an overly excited market long on buzz but short on business models. It won't be that the Web will replace your television – it'll more likely be that the web will extend your television viewing experience to wherever and whenever you want to watch it, with content designed specifically for each type of consumer taste and viewing experience. It's the evolution of an industry that's unfolding right before our eyes.

This is one in a series of monthly columns on seed and early stage investing that Labrador Ventures was selected to contribute to the *Venture Capital Journal.*

Stuart Davidson is a Managing Partner of Labrador Ventures. He has been an early stage investor for the past 15 years and is active on the boards of Intruguard Devices, NextHop Technologies, Traverse Networks and Sentinel Vision. He may be reached at sdavidson@labrador.com