

"Satellite will always be our key delivery mechanism:" Freudenstein

The Chief Operating Officer at BSkyB, Richard Freudenstein is one of the key players in UK television. He talks about the industry to KATE BULKLEY.



You turned on Freesat from Sky in October. I know it's early days but what have you seen in terms of spin-down from your pay subscribers?

We've seen no spin-down. We haven't promoted it as yet, so it's really early days. In terms of spin-down, we haven't seen any from Sky packages to Freesat.

You're not marketing Freesat from Sky heavily, so who's the target?

The whole strategy behind Freesat is that there is clearly a push for digital switchover starting. The BBC is heavily promoting its digital services, and always has, and we are offering it in the context where only half the population can get Freeview on a plug-and-play basis and 27 per cent can't get Freeview at all and another 23 per cent require an aerial upgrade. Particularly, those who can't get Freeview at all or where they have to get an aerial upgrade, Freesat is an obvious opportunity for us. Freesat now has over 140 digital TV channels, 80 digital radio stations, you can access Sky Active and you also get a better range of interactivity from other broadcasters than you can get on Freeview, so we think there is clearly a market for those people, who the BBC are promoting to, who want to take the first step into digital TV.

But you're in the business of pay-TV, not free TV, so what are you really trying to do with this?

That's absolutely right: we are a pay-TV company and this is a pay-TV strategy. It's a way of getting people on to a digital platform and converting them into pay-TV over time. The people who take Freesat from Sky will have access to our electronic programme guide (EPG) and they'll start to see what they're missing out on. We believe over time some of these people – we don't know how many at this stage – will come across to be pay-TV subscribers. That will be a low acquisition cost for us because they will have already paid for the box and the install. We definitely see Freesat from Sky as a pay-TV strategy.

The uptake of Freeview has been so tremendous that you must be thinking 'My God, these people are lost to pay-TV forever'.

I don't think they are lost to pay-TV forever. What we are in is an equipment replacement cycle. Everyone in this country will have digital reception equipment in the next six, eight, 10 or however many years, so there will be a take-up both on Freeview, Freesat and pay-TV services. We are just taking advantage of that replacement equipment cycle to make sure as many of them as

possible have digital satellite equipment.

You want them to have digital satellite equipment, but it has to have some pay-TV upgrade capability because the BBC is talking about a Freesat without a pay-TV upgrade facility. Should these two offers co-exist or are they going to confuse the market?

What the BBC do is up to them. We may question why they need to do their own Freesat offering and whether they are going to spend any licence-fee money on that and whether it's going to encourage an open market. But we are certainly not afraid of competition and we're confident that, at £150 for a box, card and professional install, we [Freesat from Sky] are very competitively priced. And, in addition, our Freesat offer is the way you can get all the terrestrial channels, which you won't with the BBC's offer if they do launch it.

What you are underlining is that the BBC's Freesat offer would not include the terrestrial encrypted channels, which at the moment includes all of them (ITV, Channel 4 and Five) except the BBC.

Exactly.

This may all be changing given the fact that you have just done this deal with ITV for GSKyB to create ITV3 and you didn't actually bundle in a new encryption deal for ITV1. Maybe when their encryption contract runs out ITV will want to jump off the encryption bandwagon like the BBC has already done. And there is also the possibility that the others – Five and Channel 4 – may leave the encrypted garden as well.

The ITV-GSKyB deal was completely separate from a conditional access deal we may do with ITV. Look, there is a distinct possibility that ITV may decide that they don't want to take encryption, but in terms of a conditional access deal, they will still want regionalisation from us so that the correct regional ITV signal goes to the correct part of the country. This is very important for their regional ad sales. So I'm sure we'll have an ongoing relationship with ITV in any event, but it remains to be seen how that plays out.

If one or more of these terrestrial TV channels goes unencrypted, that certainly takes away one of your arguments that Freesat from Sky is a better deal than a possible Freesat from the BBC.

The other two terrestrial channels have encryption deals for a number of years to come. We'll just have to wait and see what ITV does.

One thing that Carolyn Fairbairn of the BBC said to Digital News [October 2004] was that the BBC doesn't like the idea that if people go for a "free" satellite service that they will then be contacted by Sky and given a "heavy sell" – her words – to try to make them upgrade to a Sky pay-TV package.

That's where we and the BBC have a slight philosophical difference. We tend to think that people should be free to make a choice and, provided that there is an ability to take Freesat and not take a subscription service, then we think we can also offer them a subscription service at the same time or later. It's an additional benefit. People don't have to take it if they don't want it. The BBC seems more inclined to never mention pay-TV because they clearly see it as competitive. We are more of a view that we are making available a free service and, if people want a free service then that's absolutely fine, but why not give them the choice? I don't think we need to get emotive about "hard sell". It will be available.

So how hard a pitch are you planning on making to your Freesat users? How often are you going to call them?

We'll see how that plays out. The biggest sell for these people will be that they are seeing our EPG and they are seeing all the channels they are missing out on and they're seeing, in general, our new marketing campaign and our new approach to segmentation. They'll see what's available for only 64p a day. I think all that will play in their minds and it'll be a very easy upgrade path for them to pay-TV because all it will take is a phone call.

What channels are on Freesat from Sky? Sky News, obviously. Why not Sky Travel? It's on Freeview.

Sky News is the only Sky channel on Freesat. Sky Travel is on Freeview, but on satellite, Sky Travel is on our pay package and, unlike some broadcasters, we are very conscious of rights issues.

The BBC's decision to decrypt. Understood! So, do you think there's any room for a deal with Sky and the BBC on their Freesat offer? Carolyn Fairbairn was saying that she wants the market for Freesat to be horizontal. So will Sky work with the BBC or will there be two separate, rival offers for Freesat?

We're very hopeful that we'll work with the BBC. First of all, we don't care if there is more than one offer, that's just competition. But what we do ask for from the BBC is a level playing field. If they are promoting Freeview, they should also be promoting Freesat and any Freesat offer that is out there. What I mean is including these in their marketing and in their on-air promotions. We're in discussions with the BBC about those issues.

Now that Carolyn is leaving the BBC by Christmas, is that going to cause a problem for you with your negotiations? We are running against the clock here if, as the BBC says, the goal is to turn the analogue signals off in 2012.

We've always had a constructive relationship with the BBC and I've personally had a very constructive relationship with Carolyn and I'm sorry to see her go. But I'm sure whoever takes her job, we'll continue to talk to them about getting something done.

What do you think about the 2012 date? Is it do-able?

All the terrestrial broadcasters – including the BBC – have said that this is the earliest analogue switch-off can be. It's certainly

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Richard Freudenstein

Richard Freudenstein joined British Sky Broadcasting in the autumn of 1999 as General Manager and was promoted to the position of Chief Operating Officer in 2000. As well as Sky's commercial relations with third-party channels on the digital satellite platform, he is responsible for the company's portfolio of channel investments, the distribution of Sky channels on other platforms and customer service.

Richard came to BSkyB from FOXTEL, the Australian pay-TV platform, where he was Director of Operations and Business Development. Previously Richard had worked at News Limited in Australia.

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challenging. There are a lot of issues to work through. One issue that people haven't really come to full terms with is the cost of building out digital terrestrial to as far as I think they need to build it out and if this is the right thing to do or not.

David Elstein told Digital News [August 2004] that it's going to cost about one billion pounds to achieve switchover. Who knows if that's a correct number, but certainly there are a lot of transmitters to be upgraded.

I don't have a number, but I'm glad we're not paying it.

What would be the other alternative to upgrading those transmitters?

Satellite and cable! The policy should be that the five terrestrial networks should be able to reach 100 per cent of homes digitally. There are lots of ways that this can be achieved, but I don't think that people are necessarily looking at it in the most cost effective way.

Is Sky looking at another route to digital switchover? Do you have some kind of policy working paper project or something?

There is no major formal piece of work going on at Sky on this issue. We make observations when we're asked questions.

Well, here's one for you! There's been a lot of talk about Switchco, the company that will manage the transmission. The BBC is talking about a non-profit company limited by guarantee; a couple of names have been thrown around for chairman; there has been talk about a group from outside the industry to run it. What do you think about Switchco? What's Sky's perspective?

We need to understand exactly what Switchco is intended to do and I'm not sure it's 100 per cent clear yet. It makes sense for the industry to be talking about the best way to do this and it's just a question about what is the best forum for that to happen and what Switchco is going to do and I think we're still looking at that.

So you agree Switchco should spearhead the transition and handle the mechanics of switching to digital?

When you say that, what do you mean? Is it only an information source for consumers? I don't think anybody is talking about it funding transmitter re-builds, are they?

I think the discussion is about managing the switchover and the BBC see themselves as taking a lead role in managing a lot of the mechanics because they have a lot of engineers who know a lot about this. Maybe that rubs some of the other potential shareholders in Switchco the wrong way, including Sky.

Our fundamental concern is that it's platform neutral. Provided satellite is represented fairly in any of these discussions, then that's fine by us. If the BBC is willing to fund a big chunk of what is required then presumably it should have a big say in it. The BBC has always said they are platform neutral; so has the Government. So, provided whatever is done in this whole switchover debate includes platform neutrality as part of it, then we are fine.

...and Sky shouldn't have to pay for any of this presumably?

We have channels on Freeview and if our multiplex provider decided to invest in more transmitters, we'd have a discussion about that. But other than that, Sky as a satellite platform shouldn't be involved in funding switchover, no.

What role do you want Sky to play in Switchco?

We are still discussing that internally.

I would assume you want, and need, to be inside of the organisation because how UK becomes 100 per cent digital is pretty crucial to your business plans going forward. Right?

The platform neutrality thing is important but we don't think that it is appropriate to do anything else. But I think it would be bizarre to contemplate a discussion about digital switchover without the biggest digital provider being involved.

Let's talk about distribution platforms other than satellite. Telephone companies like BT and others are starting to launch DSL (digital subscriber line) technology that basically turns phone lines into pipes for all kinds of things, including TV. BT is talking about a DSL-connected Freeview set-top box. How important is DSL to your strategy in the UK?

At this stage it is very, very early days. Over time, DSL could become an opportunity for us. We've recently done a deal with Video Networks (Home Choice) to provide our sport and movie networks on their network.

And I understand they are very grateful!

Importantly for us we are the retailer in that deal. We have the retail relationship with customers on their network and we pay them a fee for the privilege. This is important because we think we are very good at packaging and marketing channels. That is our core business. Being able to retail on other distribution platforms is a real opportunity. But in terms of DSL... it's very, very early days. There is a long way to go, but it is an opportunity for us to reach homes that we maybe couldn't reach through satellite.

Sky's strategy right now seems to be focused on PVRs rather than a DSL-connected set-top box. Is that true?

We are always evaluating these things. A DSL-connected set-top box is not something we are going to announce next week. PVR is a very key component of our strategy going forward, absolutely.

When James Murdoch laid out the strategy for Sky earlier this year, he said storage always beats bandwidth. So is the emphasis on the storage bit at the moment?

Absolutely. We have just launched our 160-gigabyte PVR box; it's a great product. And depending on what you record, it's about 80 hours of programming. You can record a lot of good stuff with that!

You've sold about 400,000 of your current Sky+ boxes, but how do you see the sales going for the 160-gig boxes?

Our business is all about choice. This is another case of making more choice available for people who want it. The price point is reasonably expensive, but it's a great product, so I think it will depend on what customers want. For existing customers who already value the Sky proposition, the Sky 160 is a very good offer.

It will be a niche product for a while and the original Sky+ 40-gig product is going very well at the moment. The 160-gig box will be much less volume sales because of the price (£399).

Going forward, it looks like Sky is betting a lot on PVR. Is the vision to eventually replace the Sky boxes with a Sky+ box?

Our target is 25 per cent penetration of our Sky base by 2010. So it's not quite all, but it's a big chunk.

Another part of James's strategy going forward is to switch away from an emphasis on ARPU and toward bottom-line profitability. So, how does the Sky+ strategy fit in to that?

I think our overall strategy is to grow our subscriber base and our profits, increase margin, and track value for the shareholders. Sky+ is a key component of that in a number of ways. It helps the perception of Sky as a platform; it helps generally with ARPU because subscribers get more value from their subscription and are therefore more likely to take more premium products. If they don't take a premium product with their Sky+ box subscription, they have to pay an extra £10 a month so they are either taking our premium product or contributing directly to ARPU with the £10 a month. Sky+ is also a key component of our churn strategy because 92 per cent of people who have this product have satisfaction levels of between eight and 10 which is much better than our standard customer and the churn rates are lower.

That sounds like the Sky+ is a higher ARPU product, but James is also emphasising a new focus on broadening the subscriber base, i.e. – getting a smaller amount of money from a lot more people.

You're right in the sense that what we are creating is more choice. We've started marketing our £19.50 pack as 64p a day. It is a very high-margin pack for us. We make good money on that, so it fits completely into our strategy of operating margins and increasing our profit overall. We are not sacrificing ARPU to do this strategy. We are just introducing a broader range of products whether it's Sky+ or high definition television, which will get more money out of certain homes. There will be other products where, by marketing lower-priced packages, we will absolutely expand the customer base.

This £19.50 isn't a new pack, you're just marketing it differently.

Exactly. We've never actively sold it before. We have previously very much sold top-down with an emphasis on the most expensive package. We did a lot of research and what people came up with was a package that was around £19.50 so we think that by marketing that package we will grow the base.

You've recently opened up the facility to use the second smart card slot on your set-top boxes. What is that all about?

We've announced that slot is available for other broadcasters, but we haven't yet announced what Sky is going to do with it.

Was there pressure from other broadcasters to open this up or is this just another way to create more revenue for Sky?

It's just another opportunity to exploit our platform. It's one of those things that have evolved over time. There are a lot of things

that have happened with the platform and this is just one of the things that has come around.

Are we talking about loyalty programmes or clubs? What exactly?

You'll have to wait and see what people decide! And I don't want to say anything about what we have in mind.

HDTV is another premium product that you've said you'll launch in 2006. This is still a while away, but you're the first British broadcaster to announce HD.

We've announced the launch of HD now because we are having to talk to channel suppliers, equipment manufacturers, satellite operators, so it was going to become public anyway. It's a good opportunity for the satellite platform to differentiate itself. We will be the only platform in the UK to have HD for many years to come. We're in a situation when there'll be a million plasma TVs sold in the UK this year. By 2008 there'll be a forecast four million of those sets sold every year. Once people have those screens, there will be a big demand for even higher quality pictures and we want to be leading the charge in that. Sky is a technology leader so we need to continue to develop.

...and what is the HD offer going to look like?

It will be a package of channels, but we haven't announced which ones. You can probably guess it will be sports and movies, but there will be other channels as well. It will be a premium package, but we haven't told anyone the price yet.

BBC is going through Charter Review right now. From Sky's perspective, how should the BBC function in the world going forward where we don't have scarce spectrum issues and, in your opinion, how should the BBC be funded?

That is a big question! Society generally has to decide what they want the BBC to do. If you look back at what a lot of very prominent and important people have said over time, including Gavyn Davies [former chairman of the BBC], it comes back to looking at what does society want from television and then you have to have a very vigorous debate about how much money they need to do that. And you have to have to look at how that will affect commercial broadcasters. Once you have decided that, then you have a debate about how to fund that money. I think that is something that people are starting to debate. We at Sky are happy to participate in that, but I don't think at this point I can say anymore.

You're involved in Freeview and DSL through Video Networks, but it sounds to me like satellite is still the main outlet.

Satellite will always be our key delivery mechanism. It will always be the most cost-effective way to deliver broadcaster television in the home. If there are other opportunities on other platforms and we can have the retail relationship, we will explore that.



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