



## **I'm an ISP – Get me out of here!**

*Fierce price competition and rising traffic levels are undermining ISP profitability*

**London 14th October 2008:** With 68 per cent of homes in Western Europe and 77 per cent in US expected to have broadband by 2012, the battle between internet service providers (ISPs) is intense. However, according to the latest report by media analyst Screen Digest ([www.screendigest.com](http://www.screendigest.com)) entitled '*Will the internet break? ISP economics assessment to 2012*', some providers are unlikely to survive using existing business models.

Two main factors are squeezing profit margins: robust price competition and a swell in traffic which is pushing up bandwidth costs.

### **In Western Europe monthly user revenues have fallen over 30 per cent in the past five years**

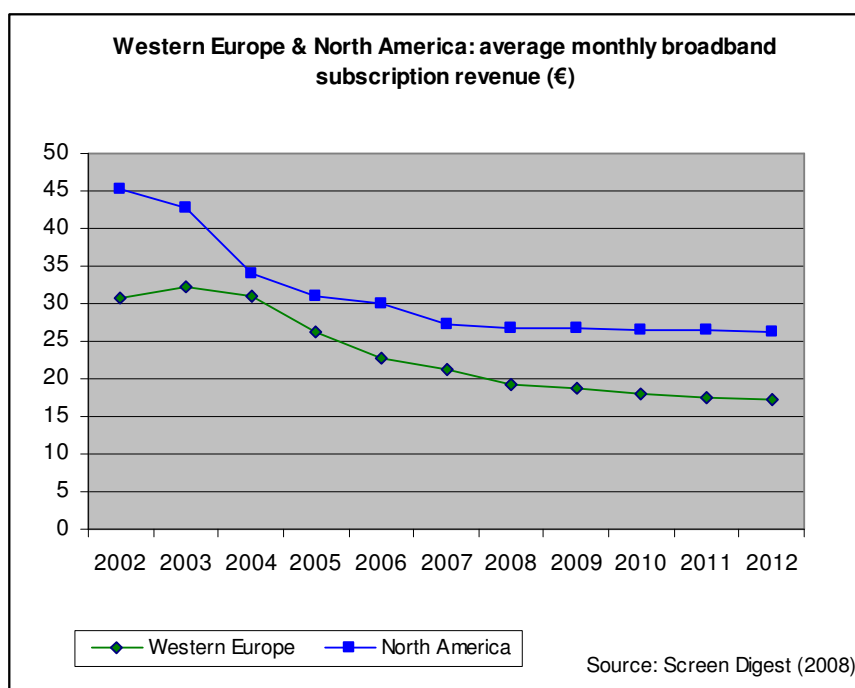
Price rivalry has gradually eroded ARPU (average revenue per user) from broadband subscriptions. Screen Digest predicts that ARPU in Western Europe will continue to decrease from €21 in 2007 to €17 by 2012, more sharply than in North America, where it will see a marginal drop from €27 in 2007 to €26 in 2012 (see chart).

The decline is particularly acute in Western Europe where the regulatory environment has fostered strong rivalry, especially in the local loop unbundling (LLU) sector. By contrast, the US enjoys higher ARPU, which reflects a different regulatory approach that has weakened competition, principally in more rural areas.

Such is the pressure on margins in Western Europe that even before a host of other ISP expenses have been taken into account – like mounting data costs, heavily subsidized end-user hardware, staffing and network equipment – many ISPs' balance sheets are already looking slim. Screen Digest analysis reveals that in the European 'Big Five', DSL providers, which dominate the region's broadband market, were left with monthly returns of around €6-€7 once ongoing line fees were paid to incumbent telcos. This has fallen from over €16 in 2002 and could slide to as low as

€5 by 2012 if pricing trends continue, meaning some ISPs could struggle to maintain profitability.

The big losers of the margin squeeze are the pure-play ISPs which are facing tight competition from well-backed new entrants relying on another core revenue segment, such as pay-TV and mobile phone companies. These large players have transformed broadband access into a low-cost bolt-on as part of packages. As such, standalone broadband provision is increasingly becoming unviable.



### **Owning the network likely to be key to competitive advantage**

Rising data costs are a second factor straining ISPs' margins. An explosion in usage of online content services delivering ever-larger files is behind the traffic upswing. This is set to intensify with mass consumption of online video via platforms bringing it to the living room TV.

Confronted with a flood in traffic, the key to survival is increasingly becoming ownership of the network. However, only those providers with the deepest pockets can afford to build out their own infrastructure close to end users with an eye on operational cost-savings and future competitive benefit.

James Garlick, Analyst says "The internet as a whole is unlikely to break. What is being challenged, however, is the sustainability of many ISPs' current business

models where competition has led to unfeasibly low retail prices and the cost of traffic is booming. In addition, ISPs face the prospect of continuing price rivalry in the emerging next-generation broadband market, particularly in Western Europe, which is unlikely to dramatically alleviate pressurized margins.

To help bolster revenues, providers are likely to look more to bundled services, a re-think of user payment models and new ways of monetizing the content running through their pipes.”

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**About this report**

The research in this press release is based on data from Screen Digest's latest report, '*Will the internet break? ISP economics assessment to 2012*'. The report includes an assessment of the current economic pressures on ISPs, in-depth analysis of the capabilities and financial viability of current and emerging fixed broadband access platforms and refers to Screen Digest subscriber and revenue data covering 20 Western European markets alongside North America and Mexico.

**About James Garlick**

James analyses global broadband market activity and reports on current developments in broadband content for the Screen Digest monthly newsletter and online intelligence service. He also authored the report 'Video by numbers: the digital retail revolution'.

**About Screen Digest**

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