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ABSTRACT

The rapid growth over the last few years of online services designed to appeal to a mass market audience in the United States encouraged many of the companies operating these services to consider launching them in Europe. This paper concentrates primarily on the European market of online services. The services fall into three categories: United States-owned services which are available and supported in Europe (for example America Online); European-owned services marketed in more than one country (for example Europe Online); and European-owned services marketed in one country (for example UK Online). The following factors which are likely to affect the rate of growth of subscribers to online services in Europe are discussed: installed base of PCs and modems; teletext; telecommunications costs; value added tax; language; information culture; electronic mail; and electrnoic shopping and banking. Taking into account these market development issues, some critical success factors for market potential and business prospects for mass market online services in Europe are outlined: market positioning and service differtiation; pricing and billing; marketing; content availability; and defining the basic services. It seems unlikely that there is a sufficient market in any one European country for more than two mass market services, providing they offer national language content and support. (AEF)

The Market Prospects for Consumer Online Services in Europe

By:

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The market prospects for consumer online services in Europe

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Abstract: *The development of online services targeted at the consumer mass market in the USA is outlined and the main European services are profiled. The factors that are affecting the rate of growth of these services in Europe are described, and from this analysis it is concluded that it is very unlikely that the demand for these services is going to grow as rapidly in Europe as has been the case in the USA.*

1. Introduction

Since the earliest days of the online industry there has been constant debate over the extent to which services tailored to the market environment in the USA would be adopted in Europe. The rapid growth over the last few years of online services designed to appeal to a mass market audience in the USA encouraged many of the companies operating these services to consider launching them in Europe. At the same time a number of European companies, observing the profits generated by these mass market services in the USA, decided that the business model could be adapted to the European market, either on a national basis or on a European-wide basis.

It is still too early to give a definitive view on the success of any of these services, but an examination of them is instructive in understanding some of the fundamental differences and similarities of the market for online services in Europe and the USA. This paper concentrates primarily on the European market and does not attempt to give a comprehensive picture of market and industry developments in the USA

2. Categorising the services

The characteristics of the services to be covered in this paper are:

- they deliver a broad range of information, entertainment and transactional/e-mail services;
- they are targeted at individual users with no previous experience of using online services;
- they are often billed to a credit or charge card, on a monthly subscription basis.

Although the services are primarily targeted at the consumer market, the small office-home office (SoHo) market is also an important sector. Additionally in the USA there are a substantial number of successful services used by individual investors and these have not made any attempt to enter the European market.

Within this broad definition the services themselves fall into three categories:

- US-owned services which are available and supported in Europe, for example America Online (AOL);
- European-owned services marketed in more than one country, for example Europe Online;
- European-owned services marketed in one country, for example UK Online.

The use of the word 'marketed' is important because there are few barriers to accessing these services world-wide over the Internet.

3. US-owned services

The origins of the USA services go back a very considerable way, with CompuServe and The Source both beginning operations in the mid-1980s. GEnie was launched by General Electric Information Services in 1985, and Prodigy was launched by IBM and Sears in 1988. The Source was acquired by CompuServe in 1984. America Online also dates back to 1985, as Quantum Computer Services. All these services were targeted at the bulletin board user in the USA, which was a large market that had grown up as a result of low-cost communications, a large installed base of PCs, a keyboard literate user base and the ability to communicate in English across a continent.

In the late 1980s the four majors — CompuServe, America Online, Prodigy and Genie — all grew at roughly the same rate. By the turn of the decade it was starting to look like a two horse race between CompuServe and

Prodigy, with CompuServe having very good e-mail services and Prodigy concentrating on the games market. Then Steve Case, who had worked his way up the marketing ladder in AOL, was appointed Chief Executive Officer of the company in 1992. Case then started to market the service in some highly effective ways, and by 1994 AOL had overtaken Prodigy to take second position to CompuServe.

During 1994 and 1995 two more services arrived on the scene. In late 1994 Apple launched eWorld and in mid-1995 Microsoft launched the Microsoft Network (MSN) as part of the Windows 95 package. eWorld was developed in conjunction with America Online and offered users a very innovative front-end. The main claim to fame of MSN was that it could be accessed directly through an icon on the Windows 95 desktop, a facility that resulted in a complaint to the Department of Justice by many of Microsoft's competitors, although in the end no action was taken.

Table 1 summarises the rate of growth of subscribers to the leading services over the last five years, in thousands of subscribers.

Table 1: Rate of growth of subscribers to the leading services over the last five years, in thousands of subscribers.

	1990	1992	1994	1996
America Online	109	200	1500	5500
CompuServe	740	1130	1500	4700
Prodigy	440	1000	1200	1450
GEnie	70	100	100	55
eWorld			65	130
MSN				1000

The main issue that needs to be addressed here is the extent to which subscriber numbers are any indication of commercial success. There is no doubt a very substantial number of users who have logged on to, and registered for, these services but who have not made any substantial use of the services once the initial trial period had elapsed. It is also very likely that users subscribe to more than one service. Estimates of the level of what is often referred to as 'churn', i.e. subscribers leaving one service to move to another service, vary considerably but it could be as high as 30%.

America Online in particular has also come in for adverse comment from the US Securities and Exchange Commission for the way in which the company treated many of the costs of acquiring subscribers as a capital expense, and so writing off these expenses over time.

4. The Internet — opportunity or threat?

All the US services built their base of subscribers in a pre-Internet environment. Certainly the Internet was widely used in the USA from 1992 onwards, but the proprietary interfaces that the consumer services offered were much easier to use than Mosaic and the other browser applications available at that time. The introduction of the World Wide Web and the Netscape Navigator browser changed the market dynamics in 1995. The question for the various services was whether they should embrace the Internet or compete with it. After a number of dismissive statements from senior executives, the rush to adopt WWW standards gathered considerable momentum in late 1995 and 1996, with only America Online retaining its proprietary platform. Two of the major losers were AT&T, who had bought the Interchange software from Ziff Davis, and Microsoft, who totally underestimated the rate of growth of the WWW.

5. European-wide services

During 1994 the attention of the US service providers switched to the European market. CompuServe had been quietly building up a strong subscriber base in Europe, mainly through the provision of a good e-mail service. Without going into the complex pre-launch histories, by the end of 1995 it was clear that there would be three competitors to CompuServe. America Online announced a deal with Bertelsmann (probably the world's largest media company) to set up AOL operations in Germany, France and the UK. Microsoft's ambitions for MSN were always global and the company put quite a lot of effort into obtaining local content.

Europe Online was established by a diverse range of shareholders, brought together largely by Candice Johnson who had been involved in the launch of the Astra satellite television service. The theory was that there would be publisher-shareholders in Germany, France and the UK, together with support from the Luxembourg financial community and AT&T, which was contributing its recently acquired Interchange software.

The first to launch was MSN, followed quickly by AOL/Bertelsmann in Germany and then AOL in the UK. AOL

France was launched at MILIA in February 1996. In both Germany and the UK the AOL marketing machine has been very impressive, with (for example) deals being done to give schools low cost access to AOL in the UK. The key marketing route for AOL in Europe, as in the USA and also as mirrored by CompuServe, is to attach disks containing the registration software to magazines on display in newsagents, often referred to as cover-mounting.

By comparison Europe Online have been very low-key, a result of having to move from the Interchange platform to an Internet access route just before launch in December 1995 and apparently considerable differences of opinion between the shareholders about the direction of the business. The end result is that Europe Online has crept out, rather than launched.

Karel van Miert, the Commissioner responsible for competition policy in the European Union, initiated a review in late 1995 of the extent to which the AOL/Bertelsmann/Deutsche Telekom and Europe Online services are contrary to competition policy. The report was originally scheduled to be published in April 1996 but as of June 1996 it had not been released.

6. National services

A number of national consumer online services have been established in Europe, mainly in the UK. UK Online was set up in 1995 with support from Olivetti, which also owns Italia Online and provides services targeted at families, including games and educational content. Tel-Me, a service operated by Phone Link, provides a service of more interest to the business community with detailed maps, Yellow Pages and travel information, for example. To overcome concerns by users about telephone line charges the service provides subscribers with a substantial proportion of the database on the PC hard drive, with the indexes and updated information being accessed over the network. When the subscriber is reviewing the material the service logs off until the next search is requested.

In France there is already a mass market service, Teletel, but this was built around a dedicated terminal and a rather basic character set. Faced with potential competition from Internet services, and from AOL and CompuServe, France Telecom moved quickly in early 1996 to lower the cost of the Teletel services and to provide Internet/Teletel gateways. In addition the Wanadoo service, effectively a Yellow Pages service, was launched in early 1996 and Infonie is an entertainment service provided by Infogramme, a multimedia publisher. In the autumn of 1996 Fun Online is scheduled to become available in Germany, providing interactive entertainment for children based around a subscription to a CD-ROM which provides the backdrops to the games.

7. Factors affecting the adoption of online services

There are many factors that are likely to affect the rate of growth of subscribers to these services in Europe and the extent to which they will be used.

7.1. Installed base of PCs and modems

There are 149 million households in Europe, compared to 97 million in the USA, and so at first sight the market for consumer services would seem to be very substantial. However the penetration of consumer electronics equipment into European households is substantially lower in Europe.

Historically modem prices have been very much higher in Europe than in the USA. This situation has now changed but the costs of obtaining type approval in each country, and of supporting modem distribution, have still meant that modem prices have remained high.

7.2. Teletext

Broadcast teletext services have been widely available in Europe for over two decades. These services are usually operated by the public broadcasting organisations and use the vertical blanking interval in a standard television signal to transmit a sequence of index pages and information pages. The graphics are rather limited but the services are provided as a free public service. Virtually all current television sets have a decoder incorporated. The range of information on these services is quite wide, including news, weather, sports results, TV listings, travel information and other leisure information. The technology is also used to provide subtitling for deaf viewers. It is also possible to provide a limited degree of interaction through the use of touch-tone telephones, and in the UK there have been some trials of online shopping through teletext services. Because of the localisation of the commercial television companies it is feasible to produce local advertising and news services. One recent development has been to put personal messages and advertisements on the service. One of the most successful areas for UK advertising on the teletext services has been that for holidays, and Teletext claims that over 20% of all holidays are sold over this network. This is an area that the BSkyB Intertext service is also planning to develop. These teletext services represent a substantial challenge to the consumer online services that does not exist in the USA. Instead of having to dial in to an online service for sports results, weather, railway timetables and news, teletext services offer all this free without moving from the television.

7.3. Telecommunications costs

Compared to the situation in the USA the cost of accessing online services in Europe has always been high because of the tariff policies of the telecommunications operators. In the USA local calls are free and time-independent, and that is often all it has taken to access one of the major networks to gain access to the services. In Europe the options have been to have dial-up access over the public switched telephone network (PSTN) or to use dial-up access to the public packet-switched data networks (PSDN), both of which are substantially more expensive than in the USA. Another issue that has to be taken into account is the ease with additional lines can be installed, especially in the domestic market, to overcome the problems of extensive use of online services effectively cutting off the household from voice telephony.

7.4. Value added tax

One of the differences between the US market and the European market is the level of direct taxation on online services. Tax levels in the US are usually around 5 to 7%, but in Europe they can often be twice that level. For the business user this tax can be passed on in terms of goods and services to customers, but consumers do not have this option and (to take the case of the UK) pay 17.5% value added tax on both online subscriptions and on telecommunications charges. Comparisons between services need to take into account whether or not VAT has been included in the pricing.

7.5. Language

One of the most difficult problems to overcome in the development of a European online services business is that of language. Even within national boundaries there may be more than one language in common use, with Belgium and Switzerland being the best examples of this situation. Europe is fragmented into 40 distinct languages and language variants. Within the European Union native speakers of German (78 million) outnumber those of English (56 million) since the unification of Germany. As far as the online industry is concerned the problem is not only which is the first language, but to what extent will users who do not have English as a first language be prepared to use English-language online services. Statistics on second-language capability are difficult to interpret as the degree of skill in the second language can vary widely. It is possible for someone to be able to read an article in French offline with the aid of a dictionary, but that same person may be very uneasy about using French language commands and search terms. For business services users may be prepared to use other languages, but this is very unlikely to be the case in the consumer market. However the use of English is clearly going to increase over the next few years, and the use of Internet access to US services and Web sites will do much to stimulate this growth.

7.6. Information culture

Another important variable to take into account is the different 'information cultures' within each country. This is a rather broad term to cover the use made of daily, weekly and regional newspapers, readership of professional and consumer magazines, the use of book clubs and the development of public libraries. The demand for news is being satisfied in very different ways in Europe, and this has an implication for the extent to which online news services will be able to compete with, or complement, the newspaper industry.

7.7. Electronic mail

By 1996 it is expected that more than 80% of large companies will have access to the Internet and there is expected growth among small and medium sized companies. Mail is the simplest and most widely used network service, both on the Internet and on other networks. Online providers report that communications services, which include e-mail and the Internet, are among the most popular application. One of the most profitable elements of the service range of the online services in the USA is that of electronic mail.

It is still not clear just how strong the market demand is for e-mail in Europe. In relative terms the postal services work quite effectively, and it is difficult to see how heavy the use of electronic mail will be in the domestic market. Families in Europe tend to be more closely situated in geographic terms than in the USA, and in any case the market would be more limited than in the USA by reasons of language and to a certain extent a fear by older adults of computing. This reticence to use computers will of course gradually subside as the average age of users decreases and their computer literacy increases.

7.8. Electronic shopping and banking

Any discussion of electronic shopping had to take into account issues concerning advertising and product design in the various countries of the European Union. Although many of the barriers towards the establishment of a Single European Market have been removed there are still some significant restrictions on cross-border advertising. Apparently similar products may in fact have variations to meet regulatory requirements or consumer requirements. For example, electrical equipment with fitted plugs for the German market cannot be used in the UK market without changing the plugs. This may not be immediately apparent in the product description. Another complicating factor is that trademarks are issued on a national basis, and so it is entirely possible for a company to contravene the use of a national trade market through advertising the product in that country. Customer support for faulty goods, or the return of goods not meeting the product specification, also would need to be set up on a pan-European basis. The result will be that for some time there will be only a limited demand on a European basis for goods ordered on electronic shopping services, unlike the situation in the USA.

On the other hand, electronic banking has become very popular in many countries of Europe, in particular

Germany and France using the public videotex services, and in the UK using voice telephony but with increasing use of PCs. It is likely that accessing financial services of all types is going to be more heavily used than electronic shopping, especially now that it is possible to buy insurance policies on a cross-border basis. Many of the large insurance companies have subsidiaries in other European countries to a much greater extent than banks.

8. Critical success factors

Taking into account the market development issues outlined above, it is possible to identify some on the critical factors that need to be taken into consideration when assessing the market potential and business prospects for mass market online services in Europe.

8.1. Market positioning and service differentiation

The services currently available seem to be hedging their bets as to the most attractive market to attack. The problem is that the business community is currently the most attractive target market as it is likely to buy multiple services, and to worry less about VAT and telephone call costs. However the consumer market, because of its size, is also a very attractive market but growth initially may be rather slow. The result of this is that most of the service providers are offering a range of database content, typified by CompuServe with everything from games and reference information through to premium services aimed at the business community.

The situation in Germany is especially interesting. Information from Deutsche Telekom seems to indicate that the recent growth in the subscriber base of T-Online has been from the consumer sector, and yet in the reallocation following the recent joint venture between Deutsche Telekom and AOL/Bertelsmann, T-Online is going to be the delivery channel for business information.

The AOL approach is that it wants to attract anyone with a PC, a modem and a credit card, which gives a very large potential market but also means that the company has to have content to keep this market satisfied. EOL seem to be adopting a much more targeted approach, looking more for high-income earners and business users whose working environment includes the home.

This leads into the contentious issue of subscriber counting. The mobile telephone industry has already learned, to its cost, that it is not the total number of subscribers or the number of new subscribers that are important metrics. The key metrics are revenues per subscriber and net gain in subscribers after allowing for cancellations. AOL in particular is very aggressive with publicising subscriber numbers, but there is a difference between the many subscribers who have been given a free disk of access software and some free time, and how many of those subscribers are using the service intensively in six months time. The figures quoted by Bertelsmann suggest a revenue per subscriber target of 200DM per month. This is equivalent to a usage level of around two hours a day each month, which is in line with current levels of US usage, but whether this is realistic in Europe remains to be seen.

8.2. Pricing and billing

Just how price sensitive this market is going to be is still far from clear. The strategy in the USA seems to have been to keep the monthly subscription steady at around $10 per month, and then to change the number of free or discounted hours and the premiums for special services. If Internet access is bundled in then this also has been taken into account, which is one of the problems that has affected Microsoft in Europe. As has already been mentioned, in the USA the effect of sales tax is quite small and can almost be discounted in any comparisons. That is not the case in Europe where the valued added tax issue could be quite a substantial one in marketing terms.

Billing is also going to be a difficult problem, as the number of currencies is almost certainly going to be greater than the number of languages supported. Even for businesses this is going to be an issue as the costs of raising small-denomination cheques or bank drafts can be larger than the value of the check. For a consumer a credit card or a charge card may be the only option. In the UK credit cards are very widely used but this is not the case in Germany, and in Scandinavia in particular.

There is also an issue in the business market regarding corporate charge cards and credit cards. The corporate card, where all the expenses are reimbursed with only the minimum of due diligence, is not widely used in Europe and many companies will only reimburse expenses incurred on a personal card, or for that matter a corporate card, when there is a receipt. Direct debiting of services from a credit card will only show up in the monthly statement. Should users go over their credit limit by a major purchase in the month (for example a holiday) then the service operator could have some interesting problems collecting the monthly payments!

Another aspect of this issue is the extent to which the card issuers would be prepared to be liable for any problems experienced with the service. In summary, reliance on credit cards may give rise to some complex business problems which are virtually unknown in the US market.

8.3. Marketing

Raising the profile of their online services is going to be of extreme importance to service providers, and it is the balance of the media spend that is going to take time and vigilance to optimise. Some of the techniques that will need to be evaluated are:

- co-marketing with PC manufacturers and distributors;
- cover-mounting disks onto magazines;
- advertising;
- co-marketing with publishers and media companies;
- exhibitions;
- editorial coverage.

The marketing budgets of the major services are very substantial, with CompuServe planning to spend over $180 million in 1996 on new subscriber acquisition.

8.4. Content availability

One of the most important differences between the mass market services and professional online services is the percentage of gross revenues paid to content providers. The mass market services, exemplified by Microsoft, are giving the content provider the majority of the gross revenue, often more than 60%. For certain key databases (such as the Helicon Encyclopaedia on CompuServe) the service provider may be willing to pay to ensure exclusivity.

Working out mutually satisfactory agreements is going to be a growth market for the legal professionals in Europe. There are no precedents to work with and the experience of the US market is not applicable. In the early stages of marketing a new service the investment by the provider in terms of hardware and personnel infrastructure is going to be very considerable, and so setting out the terms of a deal that may need to last for several years is clearly going to be very difficult. On the other hand, there may turn out to be only a very limited market for a particular database and this may not be obvious for some time.

In the early stages of market development few content providers are going to want to sign exclusive agreements unless very large sums of money change hands. One problem that this gives rise to is that many sources appear on more than one service, such as the major press agencies and company information providers in the business sector, and radio/television programme listings and travel companies in the consumer sector. This is going to make service differentiation very difficult, especially where a content provider also has a good Web site.

One of the unresolved issues in Europe is the extent to which users in both the business and consumer sectors will use these services to access news. Readers of newspapers look for more than just 'news' and tend to browse through a paper. There is certainly a place for news services in an electronic format, but is it unlikely that they will represent a 'killer application'.

8.5. Defining the basic services

In the USA the core services include electronic mail, news, weather, sports news and investment information. The forums and chat groups are also very popular. Electronic mail in particular has been very profitable for the leading service providers and the US newspaper industry has embraced the online services with a substantial degree of enthusiasm, but the industry probably has less to lose from loss of advertising revenue than in Europe. It will be interesting to see what comes to be regarded as core/basic services in Europe, as this will be the pricing/service differentiation battlefield for the next few years. Although at the early stages of being a basic service, it is likely that the important differentiation will be the ease of setting up and administering World Wide Web home pages using a simple HTML compiler. CompuServe has already been quite successful in this regard.

9. 1996 — the story so far

The early part of the year saw an immense flurry of activity, with deals being done almost daily in an effort to build Internet capability and WWW browsing capabilities into the proprietary interfaces. Apple, beset by financial problems, closed down eWorld and UK Online lost two senior staff. Prodigy was sold off to a venture fund, to the considerable relief of both IBM and Sears, and MSN was effectively relaunched as a WWW service despite the considerable investment made by information providers developing content for the original proprietary platform. GEnie has also been sold to a venture fund. In June CompuServe announced a rapid migration to the WWW as H&R Block, its parent company, started the process to sell off CompuServe, as well as launching Wow! as a service targeted solely at the consumer marketplace in the USA. America Online also had its problems in June 1996 when it announced a pricing reduction, and this announcement combined with fears about the future of AOL in the Internet world resulted in a sharp drop in the share price.

In Europe all the services are struggling to maintain their ambitious growth targets. In June AOL reported that the service had 150 000 subscribers in Germany, with the announced target being 800 000 for the end of 1996. CompuServe had nearly 800 000 subscribers. Europe Online reported that the service had 25 000 subscribers in Europe. The announced target for the end of the decade was 3.3 million users. Subscriber numbers for the UK services are difficult to establish but Tel-Me has 6000 subscribers.

At this point in time the future for these services does not look very promising. CompuServe has the benefits of an established, and quite loyal, subscriber base, and AOL has considerable financial resources. The questions over the shareholding, and thus direction, of Europe Online remain unresolved and all of the national services are struggling.

It looks as though the rapid growth in the use of the WWW in Europe before the services could become established, the existence of free public teletext services, the costs of telecommunications and a rather different information culture are just some of the reasons why all the US services, and the European-owned services, have not seen rates of growth to match those in the USA.

It seems unlikely that there is a sufficient market in any one European country for more than two mass market services, providing they provide national language content and support. The question that is starting to be resolved is will these services be pan-European (i.e. AOL/CompuServe/Europe Online) or is there still a chance for a strong national service, such as UK Online or Wanadoo. By the end of 1996 it will be somewhat easier to predict the shape of the online industry but one thing is already fairly certain, and that is that the lessons learned in the USA are of little help in developing the European market.

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