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## **TiVO—The Next Big Thing? DVRs and Television Advertising Models**

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*Television programmers as well as advertising agencies and their clients have expressed varying levels of concerns regarding the introduction of digital video recorders. These devices enable viewers to create their own schedules of programs and to remove commercials from those programs. Using elite interviews, this paper investigates whether advertising agency executives believe advertising models will need to change in response to this technology. Some of the approaches that agencies and their clients are currently testing include increased product placement, sponsorship, brand integration and interactivity. While it's too soon to tell definitely what impact the DVR will have, it is a virtual certainty that this and other technologies will spur the development of more personalized, targeted, and entertaining methods of reaching consumers.*

### **Introduction**

Your contract with the network when you get the show is you're going to watch the spots...Before we damage the economics of this industry, which are fairly frail on the network side. Before the American people go off and think that this whole thing can go on without them watching commercials, we should all understand what the cost is going to be. (Ostrow, 2002).

This quote from Jamie Kellner, Turner Broadcasting System Chairman and CEO is an example of the concern expressed by television programmers about an electronic device called a digital video recorder or DVR. Digital video recorders first appeared in 1999, (then called personal video recorders, or PVR's), and are equipped with technology designed to give users maximum freedom in both television program selection and viewing times. The DVR is primarily used to download programming that can then be watched at the user's convenience. Shows can be paused and replayed t will, even during initial

recording. Preferences can be loaded that will direct the box to find and record, say, all episodes of *CSI*, excluding reruns. Commercials can either be removed or allowed to remain, at the viewer's discretion. Initial user reaction has been exuberant to say the least.

Two features of this new product are of great concern to the television advertising industry which currently generates \$50 billion a year in revenues from advertisers for the placement of their ads on television (Freedman, 2002). Of primary concern is the ability users have to strip or "zap" all commercial interruptions. This flies in the face of a long-held industry standard, centered around viewers being made to watch advertisements in exchange for receiving the show's main content free of charge.

Jim Nail, senior analyst for Internet media at Forrester Research has prognosticated that "...TV as we know it is going to die in the next five years. Instead of being on a network schedule, it's going to be demand-driven... Consumers will be able to watch what they want when they want it, and this will clearly change how they relate to advertisers." (Elkin, June 19, 2002, p. 1).

TiVo is currently the industry leader in DVRs and has amassed 625,000 subscribers to date or just over .5 percent of the 100 million plus households in the U.S. with a TV. (Timms, 2002). All estimates indicate that this number is expected to rise to approximately 25million by 2008, or 20 percent of U.S. homes with televisions. (Posnock, 2004).

The projected growth for DVRs will be spurred in part by cable companies' plans to integrate DVR technology into new generations of set top boxes. (Harmon, 2002 and Posnock, 2004). "Initial industry research results on TiVo users' viewing habits show that viewers skip commercials 72.3 percent of the time – a much higher rate than those watching live TV or those using videotape recorders." (Friedman, 2002, p. 1).

In part to address some of the concerns surrounding its product, TiVo has stressed that its "aim is to get viewers to actually choose to view ad content by making it as compelling as the programming." (Elkin, June 19, 2002, p. 1). Well aware of advertiser concerns, TiVo recently unveiled a new concept called advertainment, "...that allows advertisers to repurpose and edit existing commercials or create

entirely new advertainment executions without the usual time constraints for TV spots.” (Elkin, May 20, 2002, p. 1).

While some entities view DVR technology diffusion inevitable and have begun making adjustments to their current way of thinking, others are not so accommodating. “...[S]enior executives at networks and entertainment companies are using lawsuits to attempt to block a technology that demonstrably turns the TV into the versatile home entertainment center it was always meant to be.” (Rothenberg, 2002, p. 1).

Nonetheless, given the less than dramatic initial diffusion of this product, it appears everyone with a stake in the game still has a little time to adjust. Audiences have proven they will watch engaging advertising spots. Advertisers and programmers understand this and are already exploring techniques that will keep their products fresh and appealing in this new audience-controlled environment. What will these new techniques be? How will current advertising models change in order to reach and engage television viewers utilizing digital video recorder technology? Using elite interviews, this study investigates those questions.

## **Literature Review**

In considering the likely impact of DVRs on television advertising models, it is instructive to consider the diffusion and impact of VCRs and the remote control device (RCD). The introduction of the videocassette recorder (VCR) by Sony Corp. in 1975 created great unrest as advertisers worried about consumers taping TV programs and fast-forwarding commercials during playback while TV networks fretted about the potential audience erosion due to time shifting (Cahners, 2000). When the remote control device (RCD) was introduced in the 1980's television viewers quickly learned how to skip ads and it's been a struggle to keep them tuned in ever since (Frutkin, 2000). Additionally, as cable television grew in popularity during the 1980's it gave viewers more options spawning new 'channel surfing' behavior, also known as grazing, where viewers used their RCDs to flip from channel to channel in search of interesting programming.

Concerns about the impact of VCR technology on television viewing behavior began soon after the deployment of the first models, the Sony Betamax and the JVC VHS system in the late 1970's. A study completed by Integrated Circuit Engineering Corps, predicted that once videotape recorders and video games were actively in use in a few million homes the technology would significantly "upset the concept of prime time" and "drastically alter" television as it was then known (*Advertising Age*, May 1977). Some television advertisers however initially viewed VCRs positively, seeing them as a way to introduce more advertising into the home via the production of pre-recorded videocassettes that could then be mailed to individual homes. Levy forecast that VCRs would increase the overall television audience size because viewers would be able to watch shows aired simultaneously and watch the same show repeatedly.

Some of the concerns that were expressed when VCRs were introduced resurfaced with DVRs. As is the case with any new technology, the impact of that technology depends in large part on how quickly it is adopted by a critical mass of people.

### ***Diffusion of innovation***

This adoption may happen quickly, slowly or not at all. In Everett Rogers' studies about the diffusion of new technology he found that an individual is more likely to adopt an innovation if more individuals in his or her personal communication network have adopted it previously (Rogers, 1995). The rate of this adoption follows an S-curve. Slow initial implementation is followed by a quick, marked rise due to opinion leaders within a communication network adopting the new technology and sharing their experiences with other members of the network.

Four characteristics are generally positively related to the likelihood of innovation adoption: 1) relative advantage to earlier technologies already on the market, 2) compatibility with existing technologies, 3) trialability with little or no investment, and 4) observability (Klopfenstein, 1989). Access to other media, urbanization, income and price, and television content diversity are also correlated with technology diffusion (Straubhaar and Lin, 1989).

VCRs introduced in the mid-1970's initially cost between \$800 and \$1000 and by 1980 VCRs were in 1.2 million (or 1.5 percent) of U.S. television households. Over the next several years consumer elation about increased control over content coupled with rapidly decreasing prices and an increasing number of Hollywood films available for rental resulted in the explosive growth of VCRs. Annual sales increased from 2 million units in 1981 to over 12 million in 1987 (Lin, 1990). In fact, the VCR diffused more rapidly than any previous communication technology except color TV (Klopfenstein, 1989).

### ***Commercial avoidance studies***

As VCRs were deployed throughout the 1980's concerns mounted. Most advertisers feared a "value" reduction in the process of converting program viewership to commercial exposure to useful message perception (Greene, 1988). A number of studies were begun in the 1980's to try to understand the potential impact of both VCRs and RCDs on television viewing behavior in general and commercial avoidance behavior in particular.

Prior to the 1980's, few consumers had control over what they watched on television or when it was viewed. The only choices available were provided by the broadcast networks. Advertisers widely and effectively used the hypodermic needle communication model in which a source crafts a message that, once sent, has an immediate effect upon the viewing audience. Watching television ads, it was thought, involved little effort and was only affected by selective exposure, distortion or retention. Advertisers knew this but, prior to the use of VCRs and RCDs, could comfortably count on these effects being roughly the same across all audiences. These new devices however gave viewers the opportunity to avoid commercial breaks, either by fast forwarding past them or changing channels. This behavior became known as zapping. Additionally, time shift viewing allowed viewers to edit out commercials entirely. As this behavior increased, questions arose regarding how these new viewing behaviors could effectively be measured (Kitchen and Yorke, 1986).

Harvey and Roth (1984) found that 50 to 60 percent of all commercial messages were being zapped by VCR owners. They posited that time shifting would ultimately affect ad pricing and traditional

day part scheduling, and that viewer fragmentation would continue to increase as more viewing options emerged.

Audience monitoring equipment at the time had no way of determining what percentage of viewers were using VCRs and RCDs to avoid watching commercials. Nielsen released a zapping study in early 1983 that had analyzed both actual tuning and zapping activity. The survey found a relatively low level of tuning taking place during the six minutes that surround the half-hour break, and that commercials had surprising little effect on channel-switching behavior. The results were based on minute-by-minute data, and since viewers can zap faster than that, these results didn't represent a definitive analysis of zapping behavior but the study was the first significant piece of research on zapping and set the stage for additional, expanded research (Frank, 1983).

A follow-up study by IRI-Media Services showed that only 2.6 percent of all 30-second commercials were zapped and that the first commercial in a break was zapped earlier than others. The study also found that the highest incidence of zapping was in sports programming, followed by adventure, situation comedies and feature films. The lowest zapping rate was in daytime quiz shows, followed by daytime dramas and mini-series. This lower incidence of zapping was considered a result of a more involved audience, one that had actively pre-selected desired programming and was therefore less willing to change the channel during commercial breaks. As a result, researchers recommended that advertisers maximize the first 10 seconds of a commercial, avoid first position commercials, maximize in-program slots and purchase ad space in programs shown to have less zapping activity, such as soaps and prime time mini-series (Frank, 1984).

By 1984, remote control penetration in the U.S. was at 18 percent and one in every three television sets being purchased included the device. Viewer fragmentation was increasing and broadcast network share was being eroded as a result of the growth of cable, pay TV, VCR's, home computers and electronic games. To forestall further erosion by zapping, the practice of placing commercials at approximately the same time across all networks and cable channels was begun (Kostyra, 1984).

As commercial zapping increased, advertisers became interested in learning more about this phenomenon. To more properly categorize and study zapping behavior, three types were delineated: physical zapping when the viewer is not physically present in the room during the commercial, electronic zapping, when a viewing household switches the channel at the start of or during a commercial break and time-shift zapping when a household which owns a videocassette recorder, fast forwards past a commercial.

A 1983 NTI (Nielsen Television Index) study time showed only 5.2 percent of the program audience, in prime time, switched channels during the commercial break, a loss of less than one rating point. This switching took place primarily on the hour and half-hour with much less switching occurring during the in-program commercial breaks (Fountas, 1985). However, another Nielsen study focusing on VCR zapping behavior found that only 80 percent of previously recorded programming was ever played back and that viewers were fast-forwarding over more than 50 percent of the commercials when viewing a previously recorded show. This led advertisers to demand that VCR playbacks be removed from audience rating scores and that Nielsen devise a way to measure commercial audiences separately from program audiences (Kaplan, 1985). The results of similar studies in the United Kingdom prompted advertisers to ask the Broadcasting Audience Research Board (BARB), the U.K.'s equivalent of Nielsen, for changes in the commercial rate cards that properly reflected the loss of audience due to both VCR playback and remote control zapping (Yorke and Kitchen, 1985).

Largely in response to these demands, Nielsen developed people-meters that could track the size of 'true' commercial audiences. Buttons were assigned to each family member and viewers were asked to push the appropriate button each time they viewed a particular program and again when they stopped watching the program or left the room. Because people-meters captured station switching during commercials, they provided a closer approximation of TV audience sizes than other research methods during this period (Abernethy and Rotfeld, 1991).

### *Uses and Gratifications*

From 1980 to 1990 cable subscription increased from 22 percent of U.S. households to 59 percent, VCR ownership increased from one to 73 percent, and remote control penetration increased from 18 to 66 percent. Obviously, consumers were enjoying these technological advances and learning to interact with them.

Uses and gratifications research by Ferguson and others provides clues as to the motives of the user when zapping commercials. A viewer's level of involvement when watching television will dictate the level to which she changes channels both during commercial breaks and during the programs as she continually reevaluates each choice. Ferguson's (1992) study of channel repertoire in the presence of remote control devices, VCR's and cable television found that channel flipping frequency was most associated with avoiding commercials and watching two or more shows at once.

Subsequently, Ferguson (1994) found that viewing motives could be either instrumental or ritualistic; channel flipping motives could be either active or passive, and that resultant gratifications could then either be excitement or ritualistic use.

In a 1988 study, Ainslie determined that watching TV as compared to watching a particular program is a form of entertainment in itself. Although some viewers reported grazing because they enjoy it, in general, grazing was a measure of dissatisfaction with programming offered. The survey found that of the 34 percent of viewers with remotes, at least half switched channels during commercial breaks and that grazing behavior differs by respondent age. Half of the 18-to-24 year olds flipped through all the channels while the majority of 35-and-over viewers tended to flip to predetermined channels. Further, viewers were most likely to watch two shows at once and switch back and forth as commercials appeared in each. Ainslie concluded that better programming, causing higher viewer involvement would reduce the likelihood of channel switching behavior during commercial breaks.

Heeter and Greenberg (1985) profiled these zappers. In general, younger people and men were more likely than women to report zapping commercials, but there was no difference in zappers in terms of income, education, marital status, household size or number of children.

Conversely, Walker and Bellamy (1991) found that RCDs require more active participation by their users to derive the full benefit from television, cable or VCR use. The widespread diffusion of the RCD altered the relationship of viewers to their televisions by enabling them to become more active participants in selecting media content. The researchers found selective avoidance to be a distinct motivation for using a RCD, particularly for political information, and that a separate commercial avoidance factor was present as well (Walker and Bellamy, 1991).

Unlike previous research, Eastman and Newton (1995) did not find commercial avoidance a frequent result of RCD use, suggesting that industry concerns about radical changes in viewing behavior resulting from RCD use may have been overblown. The content itself was found to lead to either more or less grazing and that viewers used RCDs for more purposeful reasons such as switching to a particular predetermined channel.

#### ***Advertising models used to combat VCR and RCD zapping***

Throughout the history of advertising from newspapers and magazines to radio and television the goal has always been the creation of bigger and bigger audiences with whom to communicate. The increasing number of television programming choices available in the 1980's however began to erode the number of viewers available during any given program. Audiences became smaller, more fragmented and more sharply defined by individual interests and attitudes (Kaatz, 1986).

In the late 1970's when television advertising was at its peak, the average network prime time show earned a 30 percent audience share. Viewers were fairly homogenous and watched the same programs making them easier to reach and persuade. By 1984, average share had decreased to 25 percent and to 20 percent by 1989. The average prime time rating, which stood at 17 at the end of the 1970's, was a 15 in 1984 and was expected to only reach a 12 at the close of the 1980's (Kaatz, 1986).

To address the increasing difficulty of reaching a mass audience, advertisers adopted a number of strategies. These included top-loading (intense/very interesting programming in the first few seconds of a new show), squeezed end credits, lagged scheduling, within-program roadblocking (scheduling the same commercial at the same time on all major networks) and seamless transitions between programs (Eastman

and Newton, 1995). Advertisers also began creating more interesting commercials and placing them in targeted media compatible with the advertising buys (Banks, 1987).

As noted earlier, with the introduction of the DVR, and the ability of users to easily strip out commercials from recorded programming, many of the concerns raised by VCRs and RCDs have resurfaced. Central to the problem is the persistent belief that a large number of viewers can still be broadly promised and delivered to advertisers at one set price regardless of where within the programming the commercial spot is placed. The ability to deliver a critical mass of viewers in order to economically support the high price of programming with high-priced advertising was for decades the exclusive and highly successful domain of the broadcast networks (Mermigas, 2002). As control moves from the information provider to the viewer and technological advances allow viewers to more fully interact with the technology, advertising must become more personalized to be effective in the future (Dignam, 2000 and Donaton, 2000).

As savvy advertisers discovered with VCRs and RCDs, the ultimate defense against having a commercial zapped is to involve the viewer. In order to be involved, there has to be some incentive for the viewer. These incentives can be in the form of information or entertainment. As DVRs become more widely adopted, it is likely that advertisers will be forced to further refine the techniques used to attract and hold the attention of consumers. Some advertisers and networks have begun testing a variety of approaches.

For example, The Game Show Network (GSN) has been successful in integrating product sponsorship and play-at-home-and-win elements into its programming to encourage viewers to watch the programs live. M&M's sponsorship of the network's most recent original program "Whammy! The All-New Press Your Luck" is an example. M&M has product placement on the game board that is on screen about 15 minutes per episode. The concept is to watch GSN on TV and play along at home on your computer to win prizes. Viewers win bonus points toward their score for correctly answering questions about the sponsor's commercials. This also gives the advertiser an opportunity to ask key marketing questions of viewers (Chunovic, 2002).

Although this model won't work for more traditional programming, TiVo viewers can be encouraged to watch ads in exchange for prizes and discounts and will be able to request product information and make purchases via their RCD. Viewergraphic profiles, pieced together from program and genre selections made by individual viewers, can be used to replace network ads with more pertinent ads based on these profiles (Wilkinson, 1999). This approach known as ad versioning allows advertisers to customize their messages depending on the interests of the viewer. This customization could be in the form of an interactive ad or a five-minute video that's waiting in the set top box when the viewer returns from work. Ads can be uploaded via a telephone line onto the set top box's hard drive and watched at the viewer's convenience. The ads sold by DVR makers do not replace those in broadcast or cable programming, but are incremental options for advertisers to purchase.

Some advertisers have already begun experimenting with of these alternatives. For example, General Motors Corp. used TiVo technology to test addressable and interactive advertising via GM Cyberworks, its new-media applications unit. The company used TiVo to store five different spots that could each be inserted in a commercial break based on a household's zip code. Consumers in more upscale zip codes saw Corvette or Cadillac Seville spots versus the Geo spot shown elsewhere. Viewers could also use their remote controls to get more information on GM cars (Cahners, 2000). Miller Brewing and the Professional Golfers Association signed similar partnerships with TiVo in early 2001 and Universal Pictures purchased an interactive advertising package from Replay TV (Hall, 2001 and Sporich, 2000). It is also expected that ads will become more interactive with links to additional information or direct purchasing (Sansonetti, 2000). Some viewers skipping commercials with DVRs may land on a frame with the advertiser's designated branding message and an invitation to interact. Uninterested viewers will skip the ad, but some will accept the invitation, viewing a version of the commercial customized to their tastes (Centaur, 2000). In still other models, ad messages can be embedded in the program guides (Cooper, 2000) or what are known as transport ads will pop up when the viewer pauses the programming (Cahner, 2000).

### ***Product Placement***

Another advertising concept gaining interest in the wake of DVR technology is product placement within the programming content itself. Advertisers have always seen the benefit in attaching products to highly popular characters or shows. They question whether placing an ad in between breaks in a popular show will ‘rub off’ on the product itself. When the product is used or positioned in the show itself, there is more evidence that it will receive additional recognition due to this attachment (Frutkin, 2000). The message can no longer be separated from the content. Target for example, purchased the right to have its logo used in an episode of *Survivor*. AT&T did the same on *Who Wants to be a Millionaire*. *Survivor* is the poster child for this trend though. Every advertiser that buys airtime in the top-rated show’s commercial breaks also gets prime placement in the program (Lefton, 2001).

Program sponsorship is another way of attaching a product name to a particular show. The North Face did a series of time buys over several Sunday mornings on NBC in late 1999, airing five one-hour programs under the title *The North Face Expedition*. Using North Face athletes in North Face gear, the documentary-style series explored the world of outdoor enthusiasts and created a natural platform from which the show’s sponsor could promote its products. Both product placement and program sponsorship create more interest by advertisers in the actual content of the programs to which they are attaching themselves. In order to protect brand image advertisers will want to push for more control over such content. This will likely be met with resistance from programmers wanting unfettered editorial discretion. In any event, the placement or sponsorship needs to make sense or consumers will balk at it.

### ***Current State of DVR Diffusion and Consumer Use***

DVR set top makers sell the idea that they offer a revolutionary transfer of power to the consumer (Tomkins, 2000). For instance, the Replay TV digital video recorder has a QuickSkip feature that allows ad-skipping in precise 30-second intervals that consumers rave about, the legality of which is currently being tested in the courts by opponents in both the programming and advertising industries (Linnett, 2000).

A study of TiVo users done in May, 2000 by Frank N. Magid Associates showed that 59 percent of respondents were watching programs that were once unavailable because of inconvenient scheduling. The report also noted that channel surfing dropped dramatically, down 31 percent, while 62 percent of respondents said they watch television more often with the DVR service (Lafferty, 2000). More recently the Yankee Group has estimated that 80 percent of DVR users view recorded programming and 65 to 70 percent are fast forwarding advertisements (Posnock, 2004).

Initial forecasts of DVR technology adoption were greatly overestimated but the numbers are starting to climb. Today there are two million DVR users and current predictions place the number of homes utilizing this technology by 2005 somewhere between 20 to 30 million. (Elkin, 2002). Further, interactive advertising is gaining momentum as advertisers grapple with potential solutions to viewer tune-out in this new environment. The emerging interactive-TV landscape is filled with complex revenue-sharing arrangements between DVR marketers, cable operators and programmers, satellite providers, broadcast networks and the consumer-electronics manufacturers that produce the set top hardware. All are eager to collect a cut of forecast profits as this technology matures and penetrates the market (Elkin and Linnett, 2000).

There has been much debate over how pervasive the change will be in commercial viewing habits. Many claim there will always be a large segment of viewers who just want to come home and watch TV. The commercials in event and live television programs are still reaching more people than all other media combined (Frutkin, 2000). Where TV is the foundation of most media plans today, in the future it may just become another piece of the pie. Forrester Research forecasts that the only time-slot programming that will survive the personal TV revolution is live event programming – sports, political coverage, award shows.

## **Method**

All of these developments beg the question, how do advertising agency executives and their clients view TiVo and its competitors? What if anything are they doing to prepare for the emergence of this technology? Specifically, do they believe current advertising models will need to change in order to

reach and engage television viewers utilizing digital video recorder technology? The supposition that some change will have to occur is based on industry observations and the literature written to date about this topic. Industry experts have theorized that, with increased consumer control of programming content, ads interspersed within programming will be skipped. This will cause advertisers to be less willing to pay for commercial time if embedded ads are not being watched.

Because of the complex dynamics between multiple entities, and because of the exploratory nature of the study, the method used was the elite interview. The top 25 advertising agencies in terms of billing (as listed in the Advertising Age 2003 Agency Report) were approached with a request to interview the most knowledgeable person in the firm on the topic of DVRs and their potential impact on advertising models. Initial company contact was made through the public relations department at each agency. These departments are set up to receive outside inquiries from the press and typically have someone available to talk with immediately.

Full disclosure of the true purpose of the interview was made. After giving a short verbal background of the study to the public relations representative, documents were then e-mailed to this person further outlining the research along with the list of eight interview questions that focused on the current level of concern about DVRs, advertising strategies used or planned to respond to the technology, and future audience reporting and tracing needs. The PR representative then initiated an internal search for the most knowledgeable and senior person willing to be interviewed on the subject and prepared them for the interview by sharing the above-mentioned documents.

The interviewees were interested in the study and, for the most part, very willing participants. The participants were senior level executives primarily engaged in directing strategic planning and creative within the organization. They held titles such as Director of Consumer Insights, Media Knowledge, Interactive Strategies, Media Futures and the like. All but one was male and 9 of the 16 were headquartered in New York. The others were headquartered in Los Angeles, San Francisco, Chicago, Minneapolis, Portland and Miami. These companies generate annual revenue in the billions with

McCann-Erickson individually contributing 30 billion in 2002. Most firms employ an average of 5000 to 10,000 employees.<sup>1</sup>

These interviews were conducted by telephone between August 27 and September 25, 2003, each taking approximately 30 minutes to complete. A voice recorder was not used during the interviews as originally planned because of variations in state laws regarding telephone-recording protocol. Hand-written notes were taken instead which were later transcribed into individual permanent electronic records.

After the interview, all notes were categorized within two hours of completion to preserve as much of the initial conversation as possible while the memory of it was still fresh in the researcher's mind. All information gathered and categorized during the study was placed in an electronic file to preserve the reliability of the data gathered. The data collected were analyzed and compared to determine if any overarching themes surfaced. Patterns were matched and logged to increase internal validity (Yin, 1994).

The goal was to view this topic from the perspective of those most intimately involved. By conducting this series of interviews with advertising industry professionals and comparing the results of those interviews to the literature that currently exists about the likely impact of DVR technology on advertising models this study was designed add to the current base of knowledge on the subject.

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<sup>1</sup> The participants in the study were: Page Thompson, CEO OMD North America, DDB Worldwide Communications; Peter Stabler, Media Director, Goodby, Silverstein; Jason Kuperman, Director of Operations—Tequila, TBWA/Chiat/Day; John Rash, Director of Broadcast Negotiations, Campbell Mithun; Bov Gervason, Executive VP/Director of Media Communication, Campbell-Ewald; Peter Gardiner, Partner, Chief Media Officer, Deutsch; Roberta Haber, SVP Media/Relationship Marketing, Hill, Holliday, Connors; Jonathan Swallen, Director of Media Knowledge, McCann-Erickson; David Marans, Senior Partner/Director of Consumer Insights, Mindshare; Eric Bader, Director of Interactive Strategies, The Ogilvy Group, Inc.; John Blackburn, Connection Planner, Fallon Worldwide; Rus Booth, Director of Media Futures, Grey Global Group; Ken Weisberg, Media Supervisor, Crispin, Porter & Bogusky; Jim Gaither, Director of Broadcast, The Richards Group; and Lawrence Teherani-Ami, Media Director, Wieden & Kennedy.

## **Findings**

As noted above, the eight original questions developed fell into four main categories:

1) advertising industry concerns about the effect of DVR technology on television advertising models, 2) client concerns, 3) current and proposed changes to television advertising models needed to address these concerns, and 4) viewer data collection, reporting and tracking opportunities. The researcher made sure to cover these four main areas in all interviews. In some cases, because of the direction the interview was taking, a question within one of these four larger areas was omitted but the concept as a whole was covered. In two cases, because of a particular interviewee's interests or special strengths, the researcher focused primarily on that particular executive's area of special interest. For example, one interviewee, Jonathan Swallen at McCann-Erickson, is on an elite team of eight, currently developing new specifications for the data gathering and reporting methods Nielsen will use in the future to more accurately reflect viewer behavior. Because of time constraints, it became more important to get his expanded views on his special area of interest rather than to artificially push for answers to the other questions.

### ***Industry Concerns***

There was unanimity across the interviewees that widespread diffusion of DVR technology was going to have a significant impact on television advertising models. The issue for all of them was the timing of that impact. On average, the degree of concern about the impact of the technology was between 4 and 5 on a scale of 1 to 10, over the next 18 to 36 months. Concern hasn't reached a critical level yet because of low product penetration levels, estimated at between 1 and 3 million out of 108 million total TV households. Further, actual current earnings, which have been very strong this year, up 15 percent, are helping to keep concern levels low for the time being. In the long run however, over the next four to six years, it was estimated that concern will rise to between 7 and 8 on a scale of 1 to 10.

According to the one interviewee who preferred to remain anonymous, "Every year, new technology is introduced into the market that positions itself as the 'next best thing'. There is a lot of

hype about DVRs in particular. The advertising industry is discussing the potential impact generally, but there isn't a lot of concern or apprehension yet at the agency level."

Many executives noted that consumers that have TiVo are a small but very passionate group. John Blackburn at Fallon said, "The mass market doesn't understand yet what TiVo is. It really is a better mousetrap. You get to see what you want when you want to. Everyone who has it, loves it." David Marans at Mindshare however, warned that, "First, you have to separate the enormous popularity of the product within a small base of owners from real world acceptance". Respondents agreed the technology is seen as too complicated. It's great for early adopters but for the average viewer, it's too expensive and hard to install and operate. According to Russ Booth at Grey Global:

The current marketing and distribution plans are weak. Its consumer advertising campaign has been poorly executed and the sales people at the big box electronic stores aren't trained properly how to sell it. Consequently, consumers have reservations. It requires a telephone line and is too complex and intimidating. They ask themselves at \$300/box and \$10/month, is it worth it?

Peter Stabler at Goodby, Silverstein & Partners felt there was a collective denial about the coming impact of DVRs, even at the networks. He said:

The industry isn't convinced there's a threat here because they don't feel there are enough people buying it." The advertising industry is extremely profitable right now and doesn't want to look at it. Cable hit 50 percent penetration in the 1980's, yet the networks charged more than ever this last year for advertising space.

Stabler also commented that, "In the past five years the price of a thousand eyeballs has doubled. That kind of growth is unheard of in other industries." Current profitability will slow efforts to change advertising models in advance of a perceived DVR threat. According to

Swallen:

All alternative advertising strategies presuppose a high level of commercial avoidance by the DVR user and rest on that point. Later adopters and the mass market have different behaviors than early adopters who, by definition, have a higher level of interest and enthusiasm. They are power users. VCRs are instructive. Full penetration of 30 percent was achieved in 6 or 7 years. Early adopters recorded and played back recorded material at a much higher level than the mass majority. When customers did play back recorded material, 3 out of 4 fast-forwarded through commercials. So 3 out of 4 skip but early adopters watch much more recorded material. The key question is what proportion of people's total level of viewing will be in time shift/playback mode.

Ken Weisberg at Crispin, Porter + Bogusky, believes “The diffusion needs to be monitored and evaluated as it progresses. When the product is in 30 or 40 million homes, the industry will have to react.”

Eric Bader at The Ogilvy Group, felt a little differently than most interviewees. He said:

Coming from the Interactive side of the business, the opportunity to innovate is huge. We can topple 50 years of the old measurement notion of throwing darts at a dartboard...Consumers want more effective marketing. They’ll watch ads, if they are presented in a manner that is respectful of their time and in line with their needs. Everyone is always in the market for something at all times. Advertisers need to figure out how to let customers communicate more overtly that they want to collect and see *these* ads but not *those*. Any calls to action or promotions would be stronger.

A minority of respondents held that the appearance of DVR technology is just another change in the marketplace that will require only minor adaptation when the time comes. Others said they recognize what is happening but haven’t reacted yet because there hasn’t been a financial impact and any contemplated change will greatly affect entrenched work groups and partnerships. According to Jason Kuperman at TBWA/Chiat/Day, “There are so many different business models built around how things currently run. It will be hard to pick one that will work for the industry, the clients, the media properties, television show producers, Hollywood, the cable companies and the customer.”

“There is a broadly based, shared concern however about commercial clutter and avoidance in general in the industry”, according to John Rash of Campbell Mithun. The latest DVR threat is seen as just one element of this larger issue. Regarding this avoidance behavior, Swallen added, “Consumers already avoid commercials. They leave the room, multi-task, etc. The current audience measurement system doesn’t capture and reflect this. When it’s not captured and measured, it seems it doesn’t exist.”

Many executives noted that the industry has gone through periods before, during the diffusion of the VCR and the Internet, where widespread concern created knee jerk reactions leading to significant loss of capital. Because they have been wrong before, most are adopting a wait-and-see stance. The nature of the industry also promotes this. The current culture, as it exists today in the industry, is that everyone is concerned about what is going to happen in the next two weeks.

According to Page Thompson, CEO of OMD North America, the Internet was way ahead of demand:

Advertising on the Internet failed miserably, initially. Every agency and client was talking about it, spent a lot and it failed, so it went back to business as usual. Now the technology is here, it's starting to come into the home and there's consumer demand for it. That is the correct model – consumer vs. technology driven...DVR's arrived with no original consumer demand, low penetration and no one can figure out how to market it. Once the technology gets integrated into the set top box though, the whole world changes.

Many respondents noted that DVR diffusion will increase dramatically once the technology is embedded into cable systems' set top boxes. Consumers that record on VCR's now will be the primary group that will upgrade to DVR's and will continue avoiding commercials using this newer, easier-to-use technology.

According to Thompson:

There will be huge opportunities for advertisers to integrate into programming or partner with TiVo suppliers to get into the distribution points, similar to when cable launched in the 1970's and people locked up ad partners...You will start to see more impactful creative which is good for the consumer.

Roberta Haber at the Hill, Holliday, Connors, Cosmopolos agency, noted Forrester Research is predicting huge penetration numbers for DVRs in the home over the next seven to ten years. "Penetration will get there via the [cable] MSO's and dish providers through passive adoption. That's how the big, big numbers are going to get there. It will be marketed and offered as an add-on service in the set top box, but usage is another question. The mass market isn't sure right now what it's used for."

Blackburn noted that TiVo may die as a brand when the technology is embedded into cable set top boxes. The DVR service that will be provided through the MSO's will likely not have the ad deletion capability. Therefore, in five to eight years, when possibly 50 percent of households will have DVR service, three-fourths of these homes will be receiving this service through their cable operators and won't have the advertising deletion capability.

Thompson of DDB said, “The networks are lobbying heavily against the integration of fast-forwarding capability into the MSO set top boxes. I don’t believe this lobbying will be successful. It may be that boxes with this capability will cost \$150 - \$200 but only \$100 for those with recording capability only. The dollars will get funneled back to whoever...Another potential for delay in the diffusion process is that the MSO’s aren’t set up to market themselves as distribution points for DVR advertising. No one is really out there trying to address this from an advertising standpoint. ”

Peter Gardiner at Deutsch indicated he believes, “TiVo, including time shift and commercial deletion features, will become the dominant technology at some point in time and will be the way consumers view television.” There is a large lobby of media owners however, that sees this type of recording as copyright infringement. It creates a library of programming owned by others, which has resulted in content owners like AOL/TimeWarner suing for clarification around this issue.

### *Client Concerns*

In all cases the advertisers, who work with the agency representatives interviewed, had already expressed concerns about how DVR technology may impact advertising models and revenue. “The advertising community has a much higher level of awareness about DVR technology than do consumers”, according to Jonathan Swallen. Most clients are asking about it. Marans indicated it was the number 1 question a year and a half ago. “When the conversation is just about TiVo, the concern isn’t as high but when advertisers ask about mass adoption, there is more concern expressed,” said Kuperman.

Advertisers see that “technology has enabled human desire, which is to skip commercials” said Blackburn. This concern has now settled into an equilibrium. Advertisers feel it will have an impact tomorrow but not today, when today is everything. Those asking about the potential impact of TiVo on television advertising models are doing so out of curiosity and because they believe they should keep current about this issue.

The big thinkers in these advertiser groups are starting to look at what concerns and opportunities may be present. According to Stabler, “Clients are the creative innovators, not agencies.” They are constantly threatened by a whole host of things – web based integrated marketing, more efficient media

buys, etc. “It comes down to a question of alternatives, as long as advertisers continue to receive value for their ad investment dollars,” advertisers will purchase advertising space wherever they feel they will get the greatest return on their investment.

“Consumer electronics manufacturers, movie makers and automobile manufacturers are the main clients that have gravitated toward TiVo advertising. It’s an entertainment device that’s popular mainly in Los Angeles and New York”, said Booth.

### ***Current and Proposed Industry Responses***

Most agency executives interviewed had not yet created specific advertising for DVR viewers. Only the largest advertisers with the deepest pockets appeared to be doing any tests. Executives said clients are always looking at alternatives but the average client in this case prefers to just wait and see, since the technology is still in its infancy. Booth shared that the pressing need to deliver a greater return on investments now may inhibit dabbling in new technology. “It takes more time and money to dabble. I would rather find a better way to become more relevant to my consumers than repurposing ads to appeal to such a small group.”

The changes in television advertising occurring to date seem to be evolving in three distinct directions in response to the DVR threat: monetization of big events like the Super Bowl, advertiser supported sponsorships, and product placement, now more commonly referred to as brand integration.

### ***Brand Integration***

Most interviewees agreed that product placement is on the rise in general to combat commercial avoidance, but that the integration of a brand into programming content needs to be credible to the viewer. If it’s too obviously advertiser-driven, it won’t be accepted by viewers. The placement needs to make sense to the storyline.

The latest version of this concept goes far beyond simple product placement to where the product is developed into the storyline itself. According to Kuperman, “It’s a scale. At one end is product placement. At the other end is creating the content and the concept.” Full brand integration is made

possible by advertisers collaborating directly with programming producers during the creative phases of new program development.

In the *Friends* episode about furnishing an apartment for example, Crate & Barrel products were used. Other examples include BMW in James Bond films, cereal boxes in *Seinfeld* and, more recently, Absolut being incorporated into *Sex and the City*.

In some cases, the product can even become the main character in the program. Two years ago Fallon partnered with BMW to create short films with top level Hollywood talent. Eight films were placed on the web on [www.bmwfilms.com](http://www.bmwfilms.com). The films just let the car speak for itself. They were compelling and artistically done. Bader commented that, "People had no problem watching these pieces of art, knowing what it was. It was a perfect example of the craft overcoming the barriers. The site received 40 million film views. The films were then made available to TiVo users by downloading them with a message that they might find them interesting."

Some of the agencies such as Hill, Holliday have already created new content groups focused on product placement and integrated promotions. The forward motion apparent in this new level of integration is playing out in industry purchases as well. According to Stabler, Omnicom, the parent company of many large advertising agencies, recently purchased Davie-Brown Entertainment, a product placement company and both WPP and Omnicom are looking into purchasing program production companies.

However, certain forces appear to play against brand integration. Programming producers may balk at attempts by advertisers to manipulate the content in order to put forth a particular advertising message. According to Gervason, "Programming producers pride their editorial independence and may be a little standoffish about attempts to integrate brands into their work. At a minimum, they will charge a high premium for this level of integration." For some television viewers, the more complex and technological the world becomes, the more they want to use television as pure escapism. They don't want to interact with, control or buy anything from the TV screen.

Lawrence Teherani-Ami at Wieden + Kennedy explained that there are two different ways to watch TV. “One is as a willing, passive participant trying to lose yourself in the program without thinking about, or wanting to think about shopping and buying. Conversely, viewers watching a cooking show on the Food Channel, for instance, may be enticed to buy a new wok that you can click on now and buy later at the end of the show. So, it needs to be relevant.”

Kuperman, notes, “Whenever you put an ad on someone’s favorite show, you’re borrowing against the viewer’s equity.” Viewers have their own motivations for watching television and rarely welcome advertiser interruptions. The interest or entertainment value of the advertisement must be stronger than the displeasure of the interruption for the viewer to actively attend to the commercial message. TiVo ad watchers are self-selecting, so any advertising placed in this medium needs to have a high degree of either entertainment or information value to the viewer.

Ford received such a backlash for its product placement strategy on *American Idol*, it has become the standard for bad product placement. The vehicles placed in the show weren’t woven into the story line in any way and stood out as obvious and artificial. Likewise, a number of respondents saw the new program *The Restaurant*, featuring American Express, as an egregious overstep in the wrong direction. The show is about the opening of a new restaurant. The actor playing the restaurant owner regularly pulls his American Express credit card out of his wallet to purchase items for the restaurant, even going so far as to mention the great interest rate he receives with this particular card.

### ***Sponsorship***

According to Kuperman, sponsorship has its place as well. “You can have an entertainment property that’s so strong that being connected to it is very valuable. The problem with sponsorships is that you often get visibility but not meaning. It doesn’t really deliver a message about the brand. *This Old House*, sponsored by Ace Hardware, makes sense. Ideally, you’re looking for both meaning and visibility. The goal is to achieve high relevance and have it be incredibly entertaining.”

However, sponsorship is both expensive and risky. Bob Gervason at Campbell-Ewald indicated that, “Back in the *Bonanza* and *Bewitched* days, the sponsor had creative input and incredible reach. Today, because of fragmentation of media, you can’t get this kind of reach from just one or two shows.”

According to Weisberg, “To overcome commercial avoidance you need to capture the audience in the first 2.5 seconds. This has implications for television programmers as well as advertisers. Instead of taking natural breaks, you might start seeing things like sponsor logos placed on the screen during the programming where it makes sense.

An example of this would be a sponsor logo visible during the entire presentation of Sunday Night Prime Time on ESPN...Or at the start of a program you might see a little character pushing an IKEA couch across the screen.” Another option is for sponsors to create 90- or 120-second bookend spots at the beginning and end of a program. In any case, consumer relevance and network buy-in are key to an effective sponsorship plan.

Marans of Mindshare said,

As far as product placement is concerned, any good idea is copied to death. As far as sponsorship, think about the 2008 Olympics. What if every race and event was sponsored? Sponsorship will cross the line and then recede...There may be more permission-based marketing. For instance, would you rather watch *The Pianist* for \$8.99 or sponsored for \$2.99? The question is, what will need to be done to protect the value, getting the return on investment?

None of these concepts has been tried enough yet to gauge consumer response, but most executives interviewed were less interested in sponsorship than in brand integration.

### ***Enhanced DVR Viewer Tracking***

DVR providers can track subscriber viewing choices via a required two-way telephone link to the set top box. This holds great potential from a research perspective. Any time advertisers can hone in on a particular group most likely to respond to a particular message, they can customize the message to be much more effective. In general, the more data available, the more informed decision-making can be.

In this case, the desired data would be complete viewership records. Advertisers have never had access before to data for every member of a population. To date, the information advertisers rely on has been based on viewer samples. If data were available for every household or viewer, advertisers would

be able to take advantage of the availability of more precise psychographics to make ads more relevant or entertaining. They could reach the target consumer with less waste and more appealing ads.

Gathering this data is now possible but the population is too small and the platforms used to collect the data too varied to be of any real use. As this technology advances and standardizes it will become much more valuable and sought after. Once advertisers can access data about the actual viewing habits of perhaps 20 million homes, advertisers will be able to make vastly more informed decisions regarding media buys and creative content.

Jim Gaither of the Richards Group said,

Anytime you have communication back and forth, you can customize based on viewer patterns. If you had hard data indicating viewers 18 – 24 were constantly zapping everything, you would know that TV isn't the right message medium for that group. Much learning will come out of this data that will help agencies guide clients to the right media to get their message across.

Each DVR, whether it's a stand-alone, or provided by a dish or cable company, has its own technology and software interface, each different from that of its competitors. According to Swallen, "these 'semi-proprietary' box providers all have ways to capture data streams but have a problem with monetizing this opportunity and lack of standards. Any one provider only has a small piece of the market. It's similar to early forms of the Internet, which had to be made uniform across many platforms." One universal platform needs to be created, allowing all data providers to share information in the same way, in order to get at true audience measurement.

Some of the interviewees felt that although this technology represents a great opportunity to get better data, the Internet is already better because it is behavior-based. User interest levels are recorded via cookies, digital records of user page views. Advertisers can then access this recorded data to better understand user click-through patterns within a site which indicate motivation. This information is then used to make better media purchases.

Marketers are very excited about the possibility of collecting individual level data, but consumers may not share their interest. There are certainly privacy concerns that will have to be sorted out and addressed. It is expected that consumers will be very apprehensive about giving marketers increased

access to information about themselves or their television viewing patterns. Under current regulations, information of this kind may be gathered but may only be used in the aggregate, when developing marketing messages, not at the individual level. Because DVR technology can collect such precise information about viewers, any plan to use this data for marketing purposes will need to be structured in a way that's not intrusive. According to Stabler, "Once the DVR providers, primarily the MSO's, start providing this level of data it can become economically viable to begin customized creative. It's prohibitively expensive now without it. If cost efficiencies are proven, advertising dollars will follow."

Booth did not believe this technology would flourish, saying there are already a number of new home media distribution units in development with multiple broadband connections that are going to be a better solution than the DVR for recording and organizing media content. He felt more targeted advertising would be available when these boxes become available, because of their advanced technology.

### *Nielsen*

According to Stabler, "The Nielsen of today calculates and reports ratings. It doesn't differentiate between programming and ad content. People meters are relied upon to record viewer presence and absence from the room, although short absences are not likely recorded. When a viewer records a program for later playback, Nielsen counts the program as being watched at 100 percent, although a truer estimate is closer to 60 percent." All these factors work to skew reported ratings in the direction of showing more viewers present than is actually the case. Because of these recording errors, advertisers are not receiving the correct data needed to make informed media buys.

Nielsen recognizes these shortcomings and in response to industry concerns over the increased data gathering capability of the DVR boxes, is exploring enhancements to its own system. Ideally, this would include the capability to differentiate between live viewing, playback and whether or not commercials are being skipped.

Not surprisingly, the sellers of TV advertising time are lobbying against this type of development. Gaither said there is concern that with more precise measurements it will become very apparent that

broadcasters have lost more viewers than they think. However, advertisers are very interested in a service able to measure both interest levels and attentiveness.

Many agency executives agreed that although viewer data can and should be used as an indicator of where the target audience is, the data will always have limitations. The strength of the creative, the brand itself, the type of show an ad is placed in and whether the show is an event, a regular series episode or a rerun, all determine an ad's effect. According to Teherani-Ami, "Some rating points are more valuable than others, it just can't be proven under the existing system."

## **Discussion**

In the fragmented media environment of today, it is clear that viewers have more control than ever to quickly access programming that appeals to them and to avoid ads that are seen as neither interesting nor relevant. Viewing behavior can be driven by anything from a desire for escapist fare to a need for focused interactivity culminating in a specific reward. Although this study has shown that it may be too early yet to tell whether DVR technology will directly impact advertising models to any great degree, advertisers are clearly concerned about the continued shift of control toward viewers and away from content providers and are developing preliminary strategies to address these concerns.

As Blackburn of Fallon stated, "DVR technology has enabled human desire, which is to avoid commercials." Diffusion of this technology however has been extremely slow, especially in relation to its predecessor, the VCR, giving everyone involved time to react. The slow diffusion of DVRs can be explained in part by looking at Klopfenstein's (1989) model which states that the new product must 1) have an advantage over earlier technologies already in the market, 2) be compatible with other existing technologies, 3) be able to be trialed with little or no investment, and 4) demonstrate its superior qualities in an observable way. DVR technology has only one of these characteristics: an advantage over earlier technologies in the market. Otherwise, its level of compatibility is mixed, trialability is expensive and it's not intuitively clear to the potential user what its advantages are.

This adds to the uncertainty in the market as to which technology will ultimately prevail. Consumers may very well be more predisposed to embrace Video On Demand (VOD) technology that

will allow them to download exactly the programming they want versus only being able to record from this week's television listings. In any case, over half of viewers avoid commercials now and all indicators are that they will continue to do so.

As it related to the focus of this study, it was clear from the advertising agency representatives interviewed that brand integration into programming was seen as the most likely strategy that will be implemented initially to reduce, or at a minimum contain, the current level of commercial avoidance. In its fullest format, this brand integration will be achieved by partnering with content producers very early in the creation of a new show. The interviewees seemed quite aware that credibility is key to any level of success in this type of venture.

The introduction of both the VCR and the remote control device into the market are instructive in considering the impact of DVR technology on advertising models. Although either had the impact on advertising models that was predicted when the devices were introduced, it is clear from the literature of the time that the advertising industry was much more correct in its initial assessment of the impact than broadcasters, who underplayed the importance of these technologies. If the same holds true with DVR technology, the heightened level of discussion and concern in advertising trade magazines over the last four years is a strong indicator that significant change will need to occur once DVR penetration reaches a critical mass of television households.

The top executives in the advertising industry participating in this study by and large agreed that DVR technology will have a significant effect on television advertising models over the next few years, that some effort is being made to develop brand integration as a strategy, and that a certain amount of inertia is at work because of the complexity of the technology and its current negligible impact on revenue.

There was also a consensus among the executives interviewed, that DVRs will affect what they do, but it is clear that both the agencies and their clients will only react when the outcome is more certain. By default, they have adopted a wait-and-see stance and are doing little to prepare for a change. With all

this uncertainty, it remains unclear whether advertising models will have to change as a direct result of DVR technology.

In any event, it is likely TiVo and its competitors will spur the development of more personalized, targeted, and entertaining methods of reaching consumers. It will be up to the visionaries in the industry to weave together an approach that uncovers the still-hidden advantages in this new, digitally-enabled space.

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