VOD No Match for Portability and Standardization: Predicting the outcome of competition between VOD and packaged media

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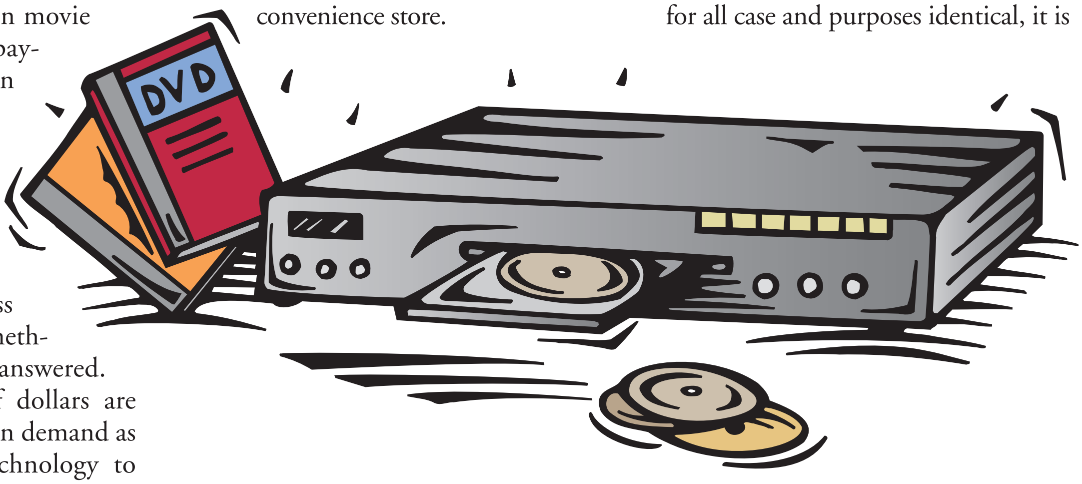
Today's consumers have many different choices for watching movies on video. These choices can be boiled down to two categories: packaged media choices and electronic media choices. Within each of these categories lie a multitude of different delivery methods. Packaged media supplies videos in two formats (VHS, DVD) and can be delivered via retail sales, retail rentals, mail order sales and mail order rental, Internet sales and Internet rentals. Electronic media supplies videos using many different formats (Windows Media, Real, QT Sorenson, MPEG1, MPeg2, MPEG4 DivX) many different technologies including impulse pay-per-view, automatic number identification (ANI) pay-per-view, subscription video on demand, and video on demand. These systems can be delivered via cable, digital satellite, Internet, and some telephone systems.

In 2002, Hollywood's box office take brought in $8.1 billion dollars while consumers spent an additional $400 million on DVD/VHS title purchases, over $8 billion on movie rentals, $2.4 billion on pay-per-view, $163 million on video on demand, and $19 million for subscription video on demand. How this $11 billion in after market demand for movies on video is distributed across these different delivery methods over time is still unanswered. Meanwhile, millions of dollars are being invested in video on demand as the most promising technology to thwart subscriber migration from cable to satellite and command the lion's share of this market with little regard to the history of consumer demand for aftermarket movies on video.

History has shown us several things that have definite relevance regarding the ultimate future of how consumers will watch movies on video. The two most pertinent examples are standard vs. technology and tangible vs. abstract. In standard vs. technology, some of you witnessed goliath Sony Corporation take Betamax and its superior technology and picture quality up against an inferior VHS and lose. Sony lost because Betamax at best represented only 12% of all the VCRs sold and VHS became the default standard such that even Sony later supported. Sony failed to realize that consumers purchase VCRs on impulse so while Betamax was being sold at high-end A/V shops, VHS players were being sold everywhere including supermarkets. Similarly, you can only buy video on demand through your cable operators meanwhile you can pick up a DVD at your gas station, supermarket, or convenience store.

In tangible vs. abstract, pay per view has been around for nearly 10 years and arguably has become nearly as convenient as video on demand, yet after 10 years it commands a mere fraction of the after market for movies on video. In fact, pay per view's true value is not movies at all but rather special events like boxing matches, world wrestling, and other closed sporting events. The record revenue from a single pay per view event was over $100 million—for a boxing match. This value will continue regardless of the success of any on demand video innovation.

However, content distributed electronically does not represent something the customer buys, can hold in their hand, or for that matter buy on impulse at their supermarket. Instead, it must be entirely purchased and viewed electronically within the closed environment of the cable or telephone system using a unique digital set top box. Compare this to news that comes in both print and electronic formats. While the electronic format is real time, convenient, generally accessible, for all case and purposes identical, it is



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not as portable or as popular as a newspaper. There is also something about holding a newspaper versus reading print on a computer screen such that the quality seems better on print. Similarly in the consumer's mind, they will always believe that DVDs will be of higher quality than anything they buy electronically. While video may represent an apples and oranges comparison to print, the tangible vs. abstract differences between packaged and electronic media remain.

There is also very little standardization among electronic media choices. There are no less than six different transmission/encoding formats, four different purchase options, four different transportation service providers, and numerous proprietary hardware and technologies in play. Compare this with DVD where you have essentially one standard along with multiple ways and means to purchase and play the content.

Today, well over a billion televisions, over 400 million VCRs, over 100 million DVD players, and over 40 million digital set top boxes are in service worldwide. Last year, electronic media choices claimed only 23% of the $11 billion spent in the US on after market movies on video and digital set top boxes represented only 7% of the 640 million available viewing devices. While these figures look attractive (7% of the viewing devices generate 23% of the revenue), they are slightly skewed as the US represents more than 65% of the worldwide cable market and less than 5% of the worldwide digital set top box subscribers come from outside of North America and Europe. Realistically, it is more likely that the electronic media claims only 10-15% of the global dollars spent for movies on video.

The DVD player has been called the fastest growing consumer electronics device in history. Over 43 million DVD players were shipped in 2002 and it is predicted that by 2006 over 125 million DVD players will be shipping. Compare that with the predicted 18 million digital set top box shipments globally by 2006 and you come up with approximately 12% of the movies on video viewing devices are digital set top boxes— the exact percentage that Sony's Betamax sales represented at its peak in terms of overall VCRs sold!

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In fact, sales of digital set top boxes have actually declined from a high of approximately 14 million in 2001. Another problem for digital set top boxes is that DVD players are everywhere— they now come standard with all new computers, all new game consoles, and even family friendly automobiles. The continual rise in DVD sales creates an overwhelming market for the packaged media business that is only becoming stronger and more powerful as the ultimate convenience that consumers are buying and continue to buy is "portability".

The fact that DVDs are now ubiquitous worldwide, while video on demand is still in its infancy, provides the most visible evidence regarding the challenges that lie ahead for video on demand. In talking to some cable operators who have deployed video on demand, they all say that purchase numbers continue to increase month to month. However, the same operators fail to point out the impact of these purchases on their pay per view sales— where a majority of these purchases are believed to come from.

Yet another benefit of DVDs is the timely availability of content. DVD's receive access to new release movies before video on demand, giving them a unique opportunity to sell this content to consumers before it is offered via electronic means. As the price of new release DVDs drops, so must the price of viewing a single instance of a show. If a consumer has the option to buy a DVD for $14.95 – $9.95 or view it once for $5 the decision to buy vs. rent becomes more challenging. Rental income is perhaps the most challenging, as 50% (or more) of the price must go back to the content owner. Many brick and mortar DVD stores have the advantage of both selling and renting DVDs while also providing legacy VHS options. When (or if) movies go on sale at the same time they are available electronically to rent on demand, it is likely that retail shops will be able to negotiate lower prices from content/distribution companies to maintain their margins such that a price between retail/rental and on demand provider will negligible.

Based on the notable absence of portability and standardization, the best educated guess about the future of electronic media choices is that they will approach (but not exceed) the highest market share achieved by pay per view. Since pay per view remains profitable in spite of the introduction of video on demand and subscription video on demand it is unlikely that it will go away. Thus, the combination of pay per view and video on demand, as well as subscription video on demand, will merely redistribute their minority share of the movies on video market but never eclipse the 22% that pay per view reached at its peak. ■

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