

The Impact of Digital Distribution - A Contribution.

This document is a follow up to the Seville Think Tank meeting, and was prepared for the Think Tank (www.filmthinktank.org) held in Istanbul on 17 April 2009 by Philippe Kern. It is aimed to inform members of the Think Tank on the possible changes triggered by digital distribution in the cinema value chain and consider issues requiring policy attention and possibly intervention with a view to enable the European film industry to adapt.

It is an attempt to structure and list issues confronting the film community with the emergence of either merely a new window of exploitation or a complete change of economic paradigm for film production and distribution, or something in between.

The document features a description of the VOD market in Europe, and is essentially based on point of views expressed by cinema professionals on digital distribution, the possible scenario of the future. It reflects on the implication for public film bodies.

VOD is defined as non linear distribution services of dematerialised audiovisual content. Non linear means that the content may be consumed independently of a programme, at the time chosen by a consumer. The methods of access are varied: to be viewed once or several times, downloadable on a media to own or to rent, rented for a given period. Pay per View (purchase of a programme made available at a fixed time) is excluded from VOD. Above all VOD is a new method of distribution of audiovisual content. This method of distribution is by law subject to the authorisation of right holders and theoretically to their willingness to invest in this new method of distribution. However the development of this new market is also conditioned by the attitude of the traditional players in the value chain, the impact of illegal peer- to-peer file sharing and piracy and the readiness of digital distribution platforms to support the enforcement of copyright rules.

General Introduction

Digital distribution has upset traditional business models in the music and the press industry. It has a profound impact on all forms of media consumption including book publishing and television. It represents a major challenge for traditional broadcast. Just about every network TV show in the USA can now be watched online. YouTube and other web video can now be accessed through TiVo and other set-top boxes. Televisions are increasingly plugging directly into the Internet to access new forms of content and interactivity. Streamed or

downloaded VOD is a growing presence, with for instance the BBC's iPlayer accounting for 5% of all UK Internet traffic.

Consumers spend more and more time online. They like the interactivity of the medium and the choice and freedom it offers. This medium competes for audiences' limited time attention with other media, including films. This digital shift cannot be ignored. Some predict that more viewers will move from broadcast and cable TV to ad-supported online video¹. The social network based on content sharing is replacing the broadcast network

Digital distribution has given consumers more control over how to access content, particularly in terms of scheduling. In the digital economy money is not necessarily the main term of exchange. Film like music or picture is a main commodity in the "sharing economy" whose aim is to constitute social networks. The sharing economy is an economy in which trade takes place for no monetary gains - it is best illustrated by Wikipedia, people participate to the building of the encyclopaedia for the fun of it. This needs to be apprehended by the industry as it is confronted with a situation in which people exchange digital files as part of a network (file sharing) with no intention to make money as distributor of content or to pay, as consumers. This sharing "en masse" (through BitTorrent or LimeWire) gives value to the product. It gives opportunity for artists to get their works distributed but may limit the industry's return on the investment. On the other hand this provides also new marketing opportunities (in particular for smaller films by making "the word of mouth" again possible).

The futurist and university professor Jeremy Rifkin calls the new economy the age of access where ownership is no longer central. Chris Anderson, in his next book, anticipates a digital economy where prices fall towards zero. Chris Schmidt the CEO of Google expressed scepticism as regards the willingness of consumers to pay to access news². Reputation, measured against traffic would become the main currency - which would be monetised essentially through advertising. Distribution gatekeepers are stripped of their power. The audience dictates the terms of trade³.

As a result of new economic paradigms the way films are made and distributed is likely to change. Some business intermediaries may remain less relevant.

Other visions are less radical. Digital distribution may only be another window of exploitation. Copyright enforcement - the only way to enforce the different versioning schemes - will enable economic benefits of VOD versions because all main actors in the value chain (including ISPs, telecoms) will have an interest in copyright enforcement. Today consumers pay their internet connections to access mainly "unpaid for" content. These unauthorised activities benefit the ISPs and telecoms and have the effect of subsidising the expensive broadband roll out as access to "free" content is an incentive to subscribe to high speed internet connection. The effect of this subsidisation is less of a concern in countries with

¹ Is online video a threat to TV? <http://newteevee.com/2009/03/26/is-online-video-a-threat-to-tv>)

² speech on 7th April to US news agencies and papers - reported in Le Monde 8 April 2009

³ Mark Pesce "The Human Network" Unevenly Distributed: production model for the 21st Century 31.01.2008

limited production capacities in the cinema sector. The policy priority has been on technology penetration rather than on content distribution.

Cinema has not much to fear at such - people will need more than ever story tellers and entertainment. Internet service providers will and telcos need films to make their services more attractive and, for instance, stimulate social networking. There should be more demand for films and entertainment. Therefore people will still invest in films but the scale might be different and the whole economy may be put upside down.

To illustrate the scale of changes lets consider music the first cultural media confronted with digital distribution.

Of course music operates a different business model than film. The release of music on the market place is not sequential (but one might argue that the release of films is less and less sequential). However since Napster which introduced peer-to-peer file sharing in 1998, the record industry is still struggling to find a business model. The following should be highlighted as this help to understand the changes that can be triggered by digital distribution, even if all these changes are not relevant to cinema:

- Between 1997 and 2007, physical sales declined by 46%. The turnover of the music industry went from USD40bn to USD27 bn. The industry now predicts the end of the CD as a main format by 2011.
- Since its inception, the iTunes store has sold 6 billion songs⁴, today over 10 million different tracks are available on iTunes. This not only does illustrate the enormous potential of online distribution but also the dominant position of Apple in music world. Today, it accounts for almost 80% of digital music sales worldwide and is obviously the largest legal music retailer. Record companies lost control of distribution. Somebody else is fixing prices (an operator whose main business is to sell hardware not music).
- According to the IFPI tens of billions of illegal music files are traded annually worldwide at an estimated ratio of 20 illegal downloads for every track sold" (IFPI Digital Music Report 2008). In 2008 IFPI estimated unauthorized file-sharing at over 40 billions files. "This means that globally around 95% of music tracks are downloaded without payment to the artist or the music company that produced them". (IFPI Digital Music Report 2009)
- The effect of eroding revenues has brought a massive consolidation: 2 record companies (Universal and Sony) now control 65% of the worldwide music market (There were 6 majors 10 years ago sharing 75% of the market). EMI and Warner are on the brink of oblivion. They no longer invest in local music and subsidiaries have become marketing outlets.
- Subscription represents only 5% of digital music sales.

⁴ <http://www.techcrunch.com/2009/01/06/itunes-sells-6-billion-songs-and-other-fun-stats-from-the-philnote/>

- In 2008 digital sales represents 20% of the industry's turnover (USD3.7bn trade value in 2008 from USD0.4bn in 2004 (1%) - source IFPI).
- Digital sales are much larger in the USA (50% of global digital sales) than in Europe (only 20% of worldwide digital sales). There is more revenue on mobile phone in Europe than in the US.
- In a concession to consumers and Apple's wishes, music is now largely made available DRM-free on a la carte song purchase.
- While in 2003 only 1 million music tracks were licensed on Internet, consumers could in 2007 legally access more than 6 million tracks⁵ (10 million according to Apple).
- Large music retailers such as HMV, Tower Records have closed. Record specialists are struggling. Packaged music is essentially distributed in hyper markets in Europe.
- Marketing of music has dramatically changed. There is a need for the industry to connect with music fans directly and be pro-active in generating social networks.

Like record companies, film producers rely on copyright to exercise control over commercial exploitation.

Not everything is doom and gloom in the music sector. It is important to highlight that music publishing and live performance have not been disrupted as much by the introduction of new digital technologies in comparison with the recording industry. Revenues have increased. Artists are less likely to become millionaires but they can get to a larger audience more quickly, provided they go back to touring and meeting fans.

Trends indicate that the main source of revenue might be rather in the management of rights, through licensing, than in the physical sale. If this is the case copyright licensing and management (as opposed to DVD sales which now represents the bulk of Studio's profits) will be a key tool in extracting monetary values (provided copyright and IPR in general are upheld as a tool to stimulate creation and investment in creation). This means that European producers and distributors by enlarge SMEs, will have to find ways to leverage their negotiating position with network gatekeepers to extract the best licensing terms.

Already an important feature of VOD is the fact that deals are made on a non exclusive basis, a new feature in commercial exploitation in films and deals are made for package of films instead of single films. The ability to aggregate catalogue is therefore important to leverage a better bargaining position and extract better terms with VOD platforms. Internet is about scale.

Clearly the US market is setting trends. However the European market is characterized by a highest use of content on mobile platform - technology standardization is more advanced in Europe than in the USA in this respect.

⁵ IFPI, *Digital Music Report 2008 – Revolution Innovation responsibility*, January 2008

I. The video on demand market

The VOD market has not made any mass market impact in Europe or in the USA.

The essential reasons are:

- Technological (broadband penetration)
- Legal offer remains unattractive.
- Reluctance for the cinema industry (majors) to push for a system of distribution it will not control and whose profitability is questionable.

1. The VOD offer increases, but the offer is not hit driven and is essentially back catalogue (with a very limited pan-European offering)

- There are more and more VOD services in Europe: 258 VOD services in the EU at the end of 2007⁶, out of which 191 were internet-based services, 67 Internet Protocol Television Services (IPTV), 26 cable services, eight satellite services and one digital terrestrial service. This represents almost twice as much as in 2006. In France alone, there are today around 48 operating VOD services⁷ and approximately 40% of all films that get a theatrical release are subsequently made available on VOD.
- Most of the services operate on a national basis for language reasons. However with the support of the EC several of them aim at the international market even if language availability of the original version limits the reach.
- The **European film industry** is also increasingly catching up the VOD trend. Sales agent are organising themselves to exploit this new window (ex Celluloid Dream, Wild Bunch, Match Factory or TrustNordisk). In Spain the industry has entrusted a rights management society (EGEDA) to license VOD rights to VOD platforms as well as to set up a VOD portal. French portal Universciné is an attempt by 41 independent film producers (shareholder in the company) to offer an independent cinema VOD portal and to license collectively to other platforms (Fnac, Virgin, Orange, Canalplay).
- The VOD offer continues to increase: the number of films accessible through the net has doubled in some markets. For example, the offer of feature films on the eight major French platforms (Canalplay, TF1 Vision, Virgin Mega, France televisions, Arte VOD, Club internet, Universciné) increased by 1206 films in one year (2007/2008) to more than 4000 feature films.
- According to the NPA Study for the Audiovisual Observatory on Video on Demand in Europe in 2007 on all paying VOD service platforms (via all transmission modes) 60% of the catalogues were feature films⁸. Important differences between countries do however exist:
 - While for instance platforms in Poland or Portugal offered 100% of feature films in 2007, Italian platforms offered 76%, German platforms

⁶ NPA Conseil, *La vidéo à la demande en Europe*, 2nd recensement des service VoD de janvier 2008, study for the European audiovisual observatory, 2008.

⁷ Source CNC March 2009

⁸ NPA Conseil, study for the European Audiovisual Observatory *La vidéo à la demande en Europe*, 2007

68%, Dutch platforms 62%, UK platforms 52%, and Irish platforms around 23%⁹.

Taking a closer look on some of the most important generalist French VoD platforms (Canalplay, TF1 Vision, Virgin Media, France Télévisions, Arte, Club Internet, Universciné) it can be said that in 2008¹⁰:

- 57,6% of all titles were feature films, 37% adult content, 1,6% TV-Series, 0,9% children's programmes, 0,7% documentaries, 0,6% music and 0,4% other content.
 - 44% of the feature films were French productions, 37% US productions and 14% non-national European productions.
 - 57,6% of revenue in 2008 comes from feature films, among which 58,1% comes from US films, and 30,3% from French films.
 - 63,8% of films in the catalogue did less than 500.000 entries in theatres (not B.O success) and 50% of all films in the catalogue are classified as "arthouse" films.
- **A majority of US-films:** in 2008 on all VOD transmission forms (cable, satellite, Internet) in Europe 56% were US-films, 16% were national productions, 18% were non-national EU productions while 10% were from other countries¹¹.
 - **Few recent releases:** most platforms have a large offer of older films (released since three years or older) and a small selection of new releases
 - Most of feature films offered are so called "classics". Titles older than 5 years make up 42% of the US films and the majority of national European films on European platforms¹².
 - One third of national films are younger than 5 years.
 - But there are markets (France, Sweden, and Germany) where more recent films (2 years old) make up more than one third of the catalogues. They are not necessarily feature films.
 - Increased demand for short films and animations, as mobile operators enter the VOD market asking fast and entertaining content.

Some examples:

- **Universciné** in France was launched two years ago with a catalogue of 300 films. In 2008, the catalogue comprised around 800 titles (and around 600 exclusive mandates)¹³.
- Spanish **Filmotech** offered 215 Spanish feature films in 2007. Since its creation, its catalogue has steadily grown and includes more and more

⁹ Ibid p. 364/65

¹⁰ Centre national de cinématographie, Le marché de la vidéo, dossier CNC N° 309, Paris March 2009 p. 46

¹¹ NPA Conseil, Study for the European Parliament, « L'origine des contenus proposés sur les services de vidéo à la demande dans l'UE », European Parliament, Brussels, 2008 p.23

¹² Ibid.

¹³ Universcine.com/home consulted 23 March 2009

European and Latino-American content. In Spain some 860 films are accessible at the moment, and some 470 in other countries¹⁴.

- **Apple's iTunes**, the biggest online platform for music, launched its digital movie platform in 2005, offering today over 40,000 TV episodes, and over 5,000 movies on demand. Since then it has extended its services from the U.S. to the UK, Canada, New Zealand and Australia, while it there remains problems for its roll-out in continental Europe (see below).
- The **international platform Jaman**, launched in 2007 offers more than **4500 films** from independent producers on a platform that operates internationally. Jaman offers films for rental, for sale and in some countries for free (advertising based model). Other international platforms such as for instance **Hulu**, **Joost** and **Play4film** offer similar types of services.
- **YouTube** is also increasingly looking to license professional films. It launched in June 2008 a new service, The Screening Room, "to create new business opportunities for film makers" and to "connecting films and audiences in the world largest theatre". Every two weeks, 4 independent short films are added for viewing. The service is available in the USA only. YouTube also made a deal with MGM on catalogue films.
- **Amazon.com** also offers a VOD service offering thousand of titles. The price is 3.99 USD to rent (24hours) - high selling titles include Milk, Twilight, Australia, Burn after Reading, Changeling (on 28 March 2009). The service is offered in the USA only. The DVD is sold for 17.99 USD and you can buy for permanent download for 14.99 USD. There is around 10 000 titles on offer with only 7 "international title" (i.e. non US). It is essentially back catalogue titles - DRM encoded.
- **Canal play** offers 6000 films. Rental costs less than €5. Most recent titles include Indiana Jones 4, Wall-E, and Phenomenon. The offer is essentially back catalogue, also in relation to French films for which Canalplay probably hold most of the VOD rights as premier investor in French cinema. According to a LeMonde press article on 1.11.2007, Canal Plus counted 5 million act of purchase since the start of its service. At the end of 2007 Canal Plus boasted 200 000 monthly order. Canal Plus is not opposed to a window of 6 months from theatrical release that would coincide with the DVD window but like other French broadcasters would like this window to close down 6 month later to protect the pay TV and free TV interest. For the CNC and film professionals "catch up TV" is VOD and therefore requires a definition of window. Under its required anti-trust commitments from when Canal Plus bought TPS (a competing Pay Satellite service), Canal Plus is prevented from acquiring films for VOD on an exclusive basis. Furthermore, Canal Plus is the premier financier of the French film industry investing more than €140 million in feature films, and legally cannot abuse their position.
- **Arte**, has the ambition to develop a European VOD offer (although somewhat limited to German/French titles) today offers around 1500 titles on its French

¹⁴ Filmmotech.com

online service on the open Internet. This service has been launched in 2006 with 350 titles in France. 54% of these are documentaries, 26% are films, 17% are magazine titles and 3% are recordings of performing arts events. The German VOD website (launched early 2008) offers 200 programmes in German for the moment. 83% of its catalogue is made of French works. Arte wants to make its offer accessible also in Belgium, Switzerland, and Luxembourg (territories where Arte is allowed to broadcast). Arte makes available around 400 titles on several closed circuit VOD platforms (Virgin Media, Imineo, I-tunes, Numericable, Alice) a market which it considers to be crucial for the development of VOD in the coming years

Platforms by Telecom operators:

Most platforms offer a large number of film titles, a majority of Hollywood films:

- The telecom operator Orange offers on his VOD platform accessible on IPTV and Internet (download-to-rent) approx 1200 feature films in France (entire offer is around 5000 titles). The company offers services in France, Poland (in both markets they are among the market leaders) and Germany, UK (new entrants)
- The Belgium telecom operator offers on his IPTV platform approx. 700 feature films and 1500 titles¹⁵ in total (films and TV programmes/series).
- Dutch **Moviemax**¹⁶, the IPTV platform by Telfort net (former Tiscali) in the Netherlands offers 70% of US productions, 11% of Dutch productions, 19% of Non-national European productions¹⁷.
- German platform **videoload.de** run by the Telecom operator T-online offers 72% of US productions, 15% of German productions, 9% of EU non-national and 5% of others¹⁸.

A short review on the platform's website shows that most of the films offered are however older than two or three years.

The most recent films on platforms are

- *Mamma Mia*, US production released in September 2008
- *Get Smart* (Max la Menace), US production, released in September 2008
- *The Dark Knight*, US production, released in July 2008
- *Narnia II*, US production, released in July 2008.

¹⁵ Figures from research on their website

¹⁶ www.moviemaxonline.eu/pced/

¹⁷ NPA Conseil, L'origine des contenus proposés sur les services de vidéo à la demande dans L'union Européenne, op.cit. p. 43

¹⁸ Ibid. p. 47

2. VOD revenues

Existing figures on VOD revenues provide only approximate estimates, as many players in the field are reluctant to provide information. Therefore the potential market might be larger than indicated.

- In 2008 global VOD market turnover (including TV-programmes and film) was estimated at USD 2,2 billion, with forecasting it to USD 3,7 billion in 2012¹⁹.
- A market analyst predicts that consumers of online video will quadruple by 2013 generating revenues of 6 billion²⁰.
- Recent figures on the UK VOD market (rental and retail) for film estimate the market at €129 million (£120 m), out of which €122m come from TV-based services (VOD and NVOD) and the remaining €7m from online services.
- Recent figures on the French VOD market show a consumer increase of 84,2% from 2007 to 2008²¹. French VOD market value is estimated by the CNC at €53 million. However an industry source believes that Canalplay on its own has a turnover of approx. €60 million in 2007.
- Universciné has seen a rapid evolution in the demand that has gone from 50 transactions per month (in 2007) to 7000 per month today (February 2009). It projects in 5 years 150 million transaction/month.

Revenue for film professionals from VOD exploitation is less than 1% of their total revenues. TrustNordisk - probably the most aggressive sales agent on the VOD market - estimates its VOD turnover at less than €100,000 for last year. It has uploaded 80 films on VOD platforms out of a catalogue of 500 feature films.

3. The business models

There are different business models:

- catch up TV
- streaming on generalist platforms (Free VOD on YouTube, DailyMotion, Joost) or on dedicated VOD platforms requesting payments (Universciné, Filmotech, Canalplay, Amazon, I-tunes)
- Subscription services (through Internet, cable or IPTV) - a market essentially targeted by telecom companies but also Pay TV companies
- Download to copy and own (very limited success despite a substantial offer).
- Peer-to-Peer services that are often illegal.

¹⁹ ScreenDigest estimates 2008

²⁰ Figures quoted by Peacefulfish, *The Role of SMEs and European audiovisual works in the changing home entertainment sector*; study for the European Commission, November 2008

²¹ Centre national de cinématographie, Press release 16 March 2009 and Le marché de la vidéo, dossier CNC 309, March 2009

The question as to which business models will prevail remains:

- Many different players experiment with different models at the moment,
- Some industry actors, believes that the ad-based free VOD model will become dominant in future. However it is likely that all models will coexist - subscription, transaction based (rental or permanent download) or advertising based.
- Services are competing against illegal offers (peer to peer file sharing) which offer more film, that are mainstream and just released.

IPTV might become the dominant transmission mode. 90% of all paid transactions in France are made via IPTV. Arte and Universciné think that subscription VoD (sVoD) will become a successful business model.

For the moment the dominant business model is VOD rental - streaming service rather than pay for permanent download.

- Most platforms offer rental services: prices vary from €0.5 to 5€ for item: for example at SF anytime film rental costs around €1 for internet offers and around €6 on IPTV and Universciné rents for €4.99, but packages of 4 or 11 films can be rented for €18.99 respectively €49.99. The price is € 1.74 Euro on Filmotech.
- Universciné intends to launch a subscription service - access to a range of 50 films for €7 to €9 a month. It plans on guaranteeing film producers a minimum price of € 1.6 for any transaction on a film. However Canal Plus is opposed to such offer. Universciné still operates on exclusive mandates - to justify special marketing campaigns.
- In France 90% of all paying transactions occur on a rental basis.
- On the platform Jaman, 96% of customers selected online rental format in the past as opposed to download-to-own for a price of approx €2 each²².

Most VOD contracts with platforms are based on non-exclusive conditions. Only major Hollywood studios have been able so far, to the best of our knowledge, to extract advance payments in relation to deals, in particular as part of IPTV offers with telecom companies. Most contracts provide for a revenue share mechanism (in general 50/50 or 60/40). The majors also require a minimum price per transaction (around € 2)

There are discussions in France to set a minimum price - like a minimum retail book price in order to guarantee revenue to film producers and other right holders when the film is exploited on a VOD platform.

²² Interview with Thomas Mai, from TrustNordisk

4. New cultural practices and consumption

Digital distribution is changing cultural practices. Consumption of films will no longer be dependent on location of consumption (proximity of cinema or a retail chain). VOD is therefore likely to increase film consumption. There is a strong correlation between heavy internet usage and cinema going thus highlighting the potential of Internet to increase cultural participation²³. However the same is not true in the relation between Internet and TV. Heavy internet users watch less TV. The age group 15-24 is more focused on game, socialisation on the Internet and download. The challenge for the cinema industry is to re-capture the interest of this user group to go to the cinema or to get them to pay to access content. The practice of video sharing is increasing (in particular for the age group 15-19 years) and video sharing sites such as YouTube and Dailymotion are extremely popular. 9% of French people using Internet have already paid to watch feature films or TV programmes on IPTV (vs 6 % on PCs)²⁴.

II. The reactions from the industry

In general industry players are not pro-active in the field. VOD is not yet a revenue opportunity and there are too many disincentives to spend time on this as VOD is upsetting the traditional business partners, the buyers - theatrical distributors, TV and video distributors (99% of industry revenues).

Producers (which under national legislation) are entrusted with commercial exploitation also remain focused on finding production finance than on looking for distribution opportunities or maximisation of distribution revenues as upside in distribution success is difficult to access anyway. A VOD strategy is not a condition to access state or regional funding, the main financier of film companies.

The regulatory environment has also a strong impact on the way the industry is reacting to VOD. For instance the position of Canal Plus as the main financier of French cinema (and therefore main holders of VOD rights) will act as a brake to VOD distribution which may cannibalise pay TV revenues.

In the following section we will focus on possible options to the film industry to engage in this market. We will distinguish between the "VOD enthusiast" and the "VOD pessimists". They all agree that VOD will become important but they disagree on the actions to be taken to influence market developments. The general "wait and see attitude" could be qualified as dangerous because peer to peer file sharing may do the same to film that it did for music.

²³ Cultural practice and Internet Usage - Olivier Donnat for the French Ministry of Culture - DEPS

²⁴ Study CNC, March 2009 p 48

1. VOD enthusiasts urge for an engagement in the market:

For some representatives of the industry, VOD will become a key distribution platform for European films. These industry representatives are working in VOD distribution. They highlight the following:

1. Technological evolutions (high definition) and fast broadband will make VOD more attractive and make film streaming a more positive experience.

- The rapid development of broadband internet makes audiovisual content quickly accessible on internet, satellite and cable platforms.
- In the first quarter of 2008, 60% of the EU 27 households had access to the internet (54% during the first quarter of 2007)²⁵ and 48% of EU-households had a broadband internet connection (42% in 2007). There are however huge differences between countries regarding broadband connections: households in the Netherlands and Denmark (both 74%) and Sweden (71%) have the highest proportions, while Bulgaria (21%), Greece (22%) and Romania (13%) had the lowest.
- The storage capacity of desktop computers has grown substantially and has become cheaper, enabling consumers to accumulate huge amounts of files, music and audiovisual content.
- It is possible to connect TV sets to the PC/internet, making VOD as comfortable for consumers as television or DVD.
- The use of mobile phone devices for receiving electronic content has also increased constantly. Europe leads the world in mobile phone services with the number of subscriptions in 2008 at 119% of the EU population (112% in 2007), well ahead of the US (87%) and Japan (84%).²⁶ 3 G licenses will make access to video content easier when deployed in the near future. Young people are used to watch films on small screens (the Nintendo/Archos generation)

2. There is an increasing consumer demand for online entertainment.

- Television and cinema audiences increasingly move online for their share of entertainment. Social networking websites, online-communities and portals for user generated content are very popular. The film industry does not want to lose this audience - which is increasingly spending time chatting on the Internet instead of watching films. A Warner representative highlighted for instance the marketing

²⁵ Eurostat, news release STAT/08/169 December 2008, figures excluding Belgium and European Commission,

²⁶ European Commission, Progress Report on the single European Communications market 2008 (14 report), 24 March 2009.

difficulties of reaching young girls aged 12-18 because of their shift to social media.

- The development of user-generated video platforms such as YouTube, who register huge amounts of videos streamings per month (2 billion in January in Britain alone). This gives an indication on the enormous potential new distribution platforms may have for the film industry. In Music - iTunes (since 2004) enabled the download of a staggering 6 billion music songs.
3. **Traditional film players such as broadcasters and distributors have less and less means to finance cinema (or have less interest) and the financial crisis will add to this problem. It is important to look at new revenue opportunities.**
 4. **Some major Hollywood studios are pushing for a broader VOD offer (Warners notably). The policy is increasingly to launch films on DVD and on VOD the same day ("day and date release").**
 5. **The "long tail" opportunity - VOD enables exploitation of back catalogue and films that had limited release or are no longer to be found in shops and cinemas. A good example is the film "Credo" (orig."Sekten") by Susanne Bier from 1997, which is the third best selling film on Jaman. (The film is no longer available on any other traditional distribution channel). Lovefilm, Netflix (the rental DVD shops) and Amazon are confirming that a large proportion of revenues come from non-hit titles. The CEO of Netflix reported that 80% of rentals related to films that are more than 3 months old - Netflix stores 70 000 titles²⁷. However some argue that NETFLIX forces people into the long tail when blockbuster films are no longer available for rental²⁸.**
 6. **Digital VOD platforms allow for new marketing techniques: as consumer preferences can be known with more precision, it is easier to suggest other films to consumers and enlarge the market potential of a film. Digital VOD distribution enables film to travel internationally without the need to master a distribution network. Distribution in the USA for instance becomes possible through Internet.**
 7. **Digital distribution will reduce distribution costs and will increase right holders' margin. It takes 10 000 USD to make a DVD master and only a couple of hundreds USD to make a digital file. Cost of marketing should also go down as internet enables to target consumers more effectively. Cost of digitisation is taken care of by VOD operators in most cases.**

²⁷ source Dow Jones Newswire on 04.3.2009

²⁸ Should you invest in the Long Tail ? by Anita Elberse in Harvard Business Review , July 2008 - unconvincingly challenging the findings of Chris Anderson

8. The DVD market is maturing or declining.

- DVD SALES

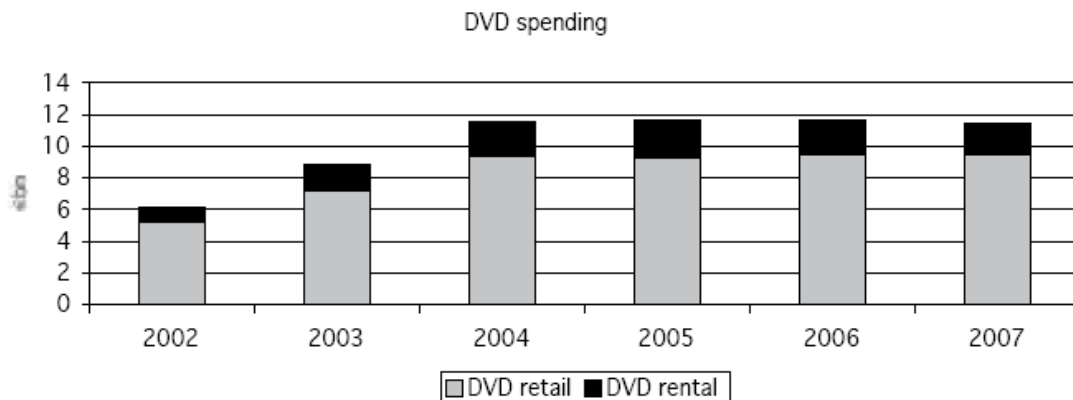
DVD unit sales in Europe (including Switzerland and Norway) increased by 4,5% in 2007, but growth in volume was slightly less pronounced than in 2006 (8% in 2006). However several important markets such as the French market or the Spanish market experienced important declines (-9,8% in France and - 4,9% in Spain). Portuguese unit sales declined even by 30,4%²⁹

- DVD RENTAL

European consumer spending on DVD rental however fell for the second year in a row in 2007, down 13 % from €2.1 billion to €1.9 billion, - it fell by 9% in between 2005 and 2006.

Rental spending through the traditional rental shops and renting machines fell by 16% from €2.0 billion in 2006 to €1.6 billion in 2007. Four of the big five European markets experienced important declines in 2007 in rental spending, but consumers in the whole EU rented half as many disks as they did five years ago. DVD rental transactions decreased by 25,5% in Spain, 25,2% in Sweden, 23,7 % in France, by 24,1 % in Portugal, by 15,2 % in the UK. The erosion of average retail prices and the availability of cheap products via newspaper kiosks and cover-mouths are quoted among the main reasons for the decline, as well as the effects of online piracy of audiovisual content.

Online DVD rental business continued to grow in 2007: consumer spending in Europe rose by 31% from 158.2 million in 2006 to 206.9 million. It stays however far below the spending levels reached by physical DVD rental and does therefore not compensate for the decline in traditional DVD rental.



²⁹ International Video Federation, European Video Yearbook, 2008

- INTERNATIONAL CONTEXT

European consumers spent \$15.7bn on video software (all sectors, all formats) overall in 2007, giving the region a 29 per cent share of worldwide video spending. This represented an increase of seven per cent in dollar values - but a decrease of one per cent in euro values. The US market did not perform as well by comparison, with consumer spending on video falling by three per cent in local currency to \$24.1bn (€17.6bn at 2007 rates). The US remains the single biggest contributor to the worldwide video business, accounting for 45 per cent of total video spending worldwide (see graph below).

9. **With new actors entering the market, there is increasing competition for content.** The entrance of many non-traditional distributors, mainly telecom companies and internet service providers but also telephone companies to the market add a new class of content buyers. They are likely to push for the VOD market to develop as part of their quadruple play offering for VOD content (for instance Orange, Belgacom, and Telefonica). However there is problem for Orange to bundle its exclusive sport TV channel offer with its other services (internet and telephony). The French ministry of economy has requested an opinion in January 2009 to the French competition authorities on the legality of orange exclusive content offer (sport and cinema).

Unless the film industry increases its online offer, consumers will get films for free on pirate sites. According to French statistics from the film industry body Alpha, 450 000 films would be pirated online every day! ³⁰

2. The VOD pessimists

They do not see a rapid take off of VOD at this stage for the following reasons:

- **VOD does not generate revenue and will not generate sufficient revenue in the medium term.** The VOD business model - rental for less than €5 is less lucrative than DVD sales. This makes industry players reluctant to shift business models. VOD threatens current revenue sources such as DVD sales. The licensing of VOD is time consuming for little upside.
- **Traditional actors have an interest in the status quo and the release window strategy reflects this willingness to stick to the current and safe business model.**

³⁰ Alpha, a movie industry group in France that fights piracy, commissioned a study to examine the number of films downloaded on the Internet via P2P file sharing with movie ticket sales. Internet users in France illegally downloaded over 13.5 million films in May, according to the study. The [National Centre for Cinematography](#) tracked movie ticket sales of 12.2 million for the month. American movies represent 66 percent of French illegal downloads with French films coming in second at 19 percent. <http://www.webpronews.com/topnews/2008/08/06/film-piracy-increasing-in-france> (June 2008)

- Large ISPs such as Google may push for a “free” business model

Pay-TV operators see VOD as cannibalising their subscription model and the exclusivity model.

Theatres are not against VOD per se but they resent a reduction of windows endangering the theatrical window. In 2006, they boycotted in some countries such as the US, UK and Germany for instance the theatrical release of Steven Soderbergh’s film “Bubble” (budget of \$1.6 million) that was one of the first films testing the day-to-date release in theatres, on DVD and on one pay-TV channel in the US market. Its failure (box office revenues were \$2 million in the USA) proved how difficult it is for the moment to find alternatives to the traditional distribution model.

Public funds are afraid that committing resources to VOD may unbalance the system against the interest of some stakeholders (cinema chains concerned by windows, retailer but also Pay TV or broadcasting companies in countries which impose investment obligation on them) in the value chain thus threatening the financing of cinema. VOD poses a great risk to independent distributors which cannot act as aggregator of film rights. They will find it difficult to reach the VOD market if their offer of catalogue is not substantial enough to interest a VOD operator.

DVD distributors, retailers, powerful video units within the Majors’, which want to protect the DVD window (in particular at the time of the launch of the Blu-Ray discs) are also reluctant to support VOD.

III. The possible scenario

Different views and different forecasts on the VOD development in Europe do exist among film industry representatives. Moreover, the degree of optimism about VOD development and its significance for the film industry heavily depends on the national context and on one’s position in the value chain.

Two scenarios for the VOD market can be imagined and summarized as follows:

1. VOD will be an additional version of exploitation that will fit in between the DVD sale and the pay TV window

- This will require enforcement of copyright to prevent that the illegal market cannibalise the different windows.
- It is accepted that VOD will mainly “cannibalise” the DVD sale market.
- More or less business as usual with film operators in control to maximise revenue by implementing the different versioning.
- Legislation is required to enforce copyright and avoid piracy taking over (Graduated response as proposed in France for instance).

- The alternative to legislation is put more pressure on ISPs and telecoms to monitor illegal activities by implementing a notice and take down process (as in force in the USA).
- Adapt marketing.

2. Interactive digital distribution becomes a major trend that affects film consumption and production

This worst scenario implies that the industry is no longer able to control the different versioning because of large scale unauthorised activities on the Internet.

The most likely scenario is that illegal offer will co-exist alongside a legitimate offer which will be attractive enough to make VOD a credible source of revenue. Consumers are still prepared to pay to access films (à la carte, subscription, to own or to rent) or advertised-based business models can establish themselves.

In any event whichever scenario wins will require the industry to adapt to a new business environment:

- Film companies will have to adapt to new methods of distribution and licensing.
- Marketing strategies and policies will have to be reviewed, enabling tracking of usage and consumption. A better understanding of consumers' usage will be required.
- All industry agreements have to be reviewed (with talent, distributors, theatres, TV). Talent are likely to require revenue share in VOD exploitation as a % of revenue (managed by collecting societies).
- Licensing of rights on a non-exclusive basis becomes an important activity.
- There is the need to address availability of local language films in international language to benefit from Internet international outreach.
- Wide implementation and standardisation of data transfer to facilitate online exploitation - identification codes (ISAN), metadata, and digital files.
- Hollywood majors will no longer control distribution to the same extent. Distribution power should be more spread in the online environment.

This will also have an impact on the regulator and film policy.

IV. Key Regulatory and Policy issues

Regulators may have different perspectives on VOD. Countries with a strong Cinema Industry may have more of an interest to privilege the interest of the film industry than the interests of ISPs and telecoms. Should the regulator privilege access to content (also more favourable to consumers) or should the ability for right holders to get paid for usage of content be favoured? This may make the adoption of a coherent EU policy more difficult.

The business environment is affected by the following:

- The on-going financial crisis,
- increased competition from other entertainment media (games, Internet),
- piracy,
- less investment in cinema from distributors and TV companies,
- increased constraints on State support to film production,
- new forms of cultural consumption triggered by Internet.

This leads to a review of audiovisual policy. This review will mainly relate:

1. At the National Level:

Copyright enforcement

The industry is requiring support from policy makers to control piracy and enforce copyright. Some countries want to adopt a law (enabling authorities to cut off access to connections for repeated offenders). France is on the verge of adopting such a law. Other countries favour soft law or promote inter-industry agreements aimed at controlling large scale upload on peer to peer file sharing networks.

Rights management

Right licensing should be made easy and the different right holders (producers, film directors, talents) should be encouraged to work together on developing a single offer to would be licensees; Local film producers and distributors should be encouraged to develop a joint licensing offer to avoid the multiplication of local offers that could deter international and national VOD platforms to seek licences for European films.

Public support as an incentive

Film producers should not be prevented from experiment with new business models and new versioning by making public support dependent on theatrical distribution, for instance. Public support should take into account the potential of VOD.

Windows

Some countries feel obliged to regulate windows of exploitation to avoid that deregulation smashes financing structure (France, Germany and Austria).

Release windows in some countries :

| Country | DVD | Online Distribution (VOD/EST) | Pay-per-View Window | Pay TV Window | Free TV Window | Comments |
|---------|--|--|---------------------|---------------|----------------|--|
| France | 6 | 33 weeks (one year industry agreement of December 20, 2005-not renewed but generally applied) | 9 | 12 | 24-36 | <u>New law in discussion</u> Foreseeing to shorten the release window for DVD and VOD to 4 months. |
| Germany | 4 (6 months for films with subsidy) | paying VOD, nVoD : 9 month (can be 6 if negotiated) Free VOD: 18 month | 9 | 12 | 18 | Legislation is applicable to productions which have received film subsidy. A window reduction is possible following application by the producer. |
| Hungary | 6 | | - | 12 | 24 | The trend is towards shorter windows, especially around seasonal markets (Christmas, Easter). |
| Italy | 3-6 | VOD rental :same as DVD VoD sell-thru: local DVD release + 4 months; Sometimes longer periods for titles released by independent distributors | 12 | 12 | 24 | |
| U.K. | 3-4 | 3-4 onwards VOD | 4.5-6 | 9-12 | 24 | Windows are settled in contracts between the parties. The trend is towards shorter windows. |

Competition policy

Prevent abuse of dominant position of large distributors. It is likely that the main VOD service providers will be companies such as Amazon, iTunes, Microsoft, Nintendo, Sony, Google. It will be important for European films to access those platforms in order to exist on the international VOD market. This point relates also to the ability of the industry to provide licences, and preferably multi-territorial licences.

Review statistical information related to the AV sector.

- To capture VOD revenues and statistics
- To understand consumers' behaviours and monitor availability of local language content as well as consumption patterns.

2. At European level

Subtitling

The MEDIA programme should help the subtitling of films in other European languages; It costs approximately €1500 to subtitle a film in one other language. This will enable international distribution on VOD platforms and facilitate the licensing.

Branding

European films that won awards at A list festivals for instance should receive a specific branding on VOD platforms throughout Europe so as to brand European cinema. Financial support should be given to VOD platforms making a special editorial effort in this respect.

Collaboration

European film platforms that received MEDIA funding should be encouraged to work together to share data and link each other offers so as to increase international distribution opportunities of local language titles.

Licensing

Film right holders should ease the licensing process. Rights fragmentation and licensing should not be an obstacle to the availability of European films on international platforms. An agency could guide potential licensees in their quest for European catalogues.

Philippe Kern - 10.04.2009

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