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The Necessity of Convenience: Film Rental in the Digital Age

Copyright 2010. Gatton Student Research Publication. Volume 2, Number 1. Gatton College
of Business & Economics, University of Kentucky

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Introduction

Visualize a television set being stared at by undergraduate students. This television set, via PC-to-TV Converter¹, is connected to a PC. Inserted into this PC is a USB wireless card² capable of intercepting wireless internet signals from adjacent homes. The PC's internet capabilities allow its users, with a single click of their mouse, to arrive at a web page where they can view the latest popular films and television programs free of charge. This scenario, once observed by the author in the student community, demonstrates the ease with which a person of low income can access and view the copyrighted creative content of a media conglomerate in the digital age. Given the free and convenient nature of black market video streaming web sites and illegal downloading, movie and television studios are currently being forced to come up with innovative ways to make their product widely available to consumers at a low price. When coming up with new ways to distribute their content, an important consideration for companies in the industry is how to properly balance convenience with profitability.

Pandora's (Red) Box

Redbox Automated Retail LLC, a subsidiary of Coinstar Inc³, operates over 20,000 DVD rental kiosks in the United States. For the price of \$1.00 per night, a relatively small fee compared to the \$3.00 or more Blockbuster rental stores charge for a new release rental, a customer may take home one of the approximately 500 DVDs offered by the company's typical kiosk. Conveniently located outside of many high traffic retail outlets, such as a

¹ Available on eBay for \$38.95, this device can render a user's television set into a rather large computer monitor.

² A Netgear WG111v2, acquirable for \$10.00 on eBay.

³ Well known for its coin counting kiosks.

grocery store or fast food restaurant, Redbox kiosks are driving traditional rental chains towards bankruptcy while at the same time ruffling the feathers of major movie studios (McBride).

Blockbuster, losing big, is rethinking its strategy

Blockbuster had a market capitalization of \$2 billion in 2005; its shares are currently worth \$50 million. In the fourth quarter of 2009, Blockbuster's sales dropped 16 percent (Financial Times). In an effort to cut costs the company closed over 500 of its stores in the past year. It also slashed \$200 million from its payroll and advertising budgets. Despite these efforts, the company's total liabilities exceeded its total assets by \$314.3 million at the beginning of 2010. Given these facts it should come as no surprise that Blockbuster may soon have to consider filing for bankruptcy (Lloyd).



Figure 1: 5-yr comparison of Blockbuster and Redbox parent company Coinstar stock prices (Source: Google Finance)

In a press release, Blockbuster Chairman and CEO Jim Keyes said that “disappointing holiday sales due primarily to aggressive new competition” contributed to the company’s financial woes. In the past year, he said Blockbuster had “introduced a new a la carte by-mail program that provides our in-store customers access to over 95,000 titles and launched Blockbuster

On Demand, making streaming video-on-demand available to millions of households.” He also said that, through an alliance with NCR⁴, the company had opened 2,000 Blockbuster Express kiosks and hopes to open 7,000 new kiosks in 2010 (Blockbuster Inc).

By offering DVD rental kiosks, Blockbuster seems to be making a play for Redbox’s residual demand. At the end of 2009, 200 Blockbuster Express kiosks appeared in New York City. Redbox has only three kiosks in Manhattan. The Blockbuster kiosks also have potential in the southeast, where NCR has an existing partnership with Publix Supermarkets. Blockbuster’s move towards kiosks will probably speed up the emerging trend of low-price DVD rentals. This trend seriously threatens the bottom lines of movie studios (McBride).



Seeing red, movie studios prepare to box

News Corporation's Twentieth-Century Fox, Time Warner Inc's Warner Bros, and General Electric's Universal Pictures each recently refused to supply Redbox with DVDs of their films on the DVD release date. The studios said that the kiosks devalue their product and deter consumers from purchasing DVDs of their films. In response Redbox filed suit in federal court, alleging restraint of trade and anti-trust law violations (Smith). It also began acquiring the studios’ DVDs from alternative sources at a higher cost. In the last quarter of 2009 Redbox’s supply of DVDs fell short of consumer demand. With supply costs rising and revenues stagnant, Redbox needed to make a deal (Peers).

⁴ The NCR Corporation (NYSE: NCR) had revenues of \$4.61 billion in 2009. Product information offered on their website included point-of-sale terminals, self-service kiosks, and ATM/ financial terminals. (Source: NCR.com)

The deal

In February 2010, Warner Bros. and Redbox reached a two-year agreement. The deal, which Warner Bros. president Kevin Tsujihara said he hopes will drive consumers to “higher margin activities,” will keep the studio’s films out of Redbox kiosks for a 28-day window after their DVD release⁵. In exchange for their concession the kiosk company will receive a “significant,” though undisclosed, discount on wholesale purchases of the studio’s films. Another stipulation of the agreement is that, in lieu of selling them for \$7.00 as it typically does, Redbox will physically destroy all Warner Bros. DVDs after it is done renting them. This stipulation was presumably added in order to preclude Redbox’s competition with Warner Bros. in the DVD sales arena (Smith).

Not the first deal of its kind

NetFlix, an online DVD rental service, signed a similar agreement with Warner Bros. in January 2010. The agreement, which restricted NetFlix’s offering of Warner Bros. films for a similar 28-day window, also allowed NetFlix to offer streaming versions of Warner Bros. films. In order to compete with the convenience of Redbox kiosks, Netflix’s current business strategy is to move away from mail-order rentals and expand their offering of digitally streamed films (Wilkerson). One can theorize that Redbox, not wanting to give NetFlix the competitive advantage of having a stable supply of Warner Bros. films, was leveraged into signing an agreement that they otherwise would not have signed.

Pushing consumers to piracy?

TechCrunch.com writer MG Siegler speculates that the Redbox-Warner deal will push more movie fans to piracy. He writes that: “People aren’t buying fewer DVDs on a large scale

⁵ A significant portion of a film’s DVD sales typically occur in the first 28 days after release.

because of rentals, they're buying fewer ones because most DVDs simply aren't worth owning. And consumers are finally waking up to that fact." So, a movie fan who would normally rent a Warner Bros film on the day it came out will soon face a dilemma; should they buy the movie on DVD, wait 28 days to rent it, or find a way to view it illegally? By restricting rentals during the 28-day window, he argues, Warner Bros is increasing the demand for movie piracy (Siegler).

Video-on-demand

Presently there seems to be a trend of consumer demand shifting away from DVD sales and towards rentals. Screen Digest, a media research group, found that in 2009:

"The volume of feature films, new-release and catalog, consumed across all the transactional markets—theatrical, home video retail and rental, video-on-demand and electronic sell-through—was up 4%. But the continued weakness in disc sales, where we estimate feature-film spending on DVD and BD combined will be down 13%, means spending on in-home film consumption will be down about 5%." (Screen Digest)

Movie studios such as Warner Bros are quickly coming to find that in order to survive in the evolving global economic climate they must find new ways to profitably market and distribute their films. Video-on-demand is one of the methods they are exploring (Garrahan).

On-demand movie rentals through cable TV

A television video-on-demand system streams content in real time to a cable box supplied to the consumer by their respective cable company. Typically the consumer of television video-on-demand content pays a monthly subscription fee to their cable company in addition to a nominal fee for content they choose to purchase and view (Video-on-Demand).

Early On-Demand availability

Time Warner Cable customers in the United Kingdom, France, and Germany are now able to rent Warner Bros films on-demand the same day they are released on DVD. Studio returns for on-demand rentals are about \$0.65 per film compared to \$0.25 per film for DVD rentals. Warner Bros. is hoping that the convenience of on-demand rentals will be a determining factor in the consumer's decision to choose on-demand over DVD rental. In South Korea, Warner Bros. has plans to release its films to on-demand two weeks before their DVD release date. A similar North American trial is in the works. Time Warner Cable currently charges \$3.00 to rent a new release film via on-demand (Garrahan).

Streaming Web Content

Another form of video-on-demand technology is the web-based streaming of video content. This form of content distribution especially appeals to consumers with interests that deviate from the norm. Due to capacity constraints, a DVD rental kiosk or mainstream cable network is unlikely to offer content that is appealing to a niche audience. But streaming video websites are able to cater to the demands of niche consumers. Content creators like the fact that streamed videos never physically reside on the user's hard drive, thus inhibiting illegal redistribution. Streaming-video websites typically follow one of two revenue models; they either charge a subscription fee or they rely on advertising revenue (Marriot). Hulu.com, the 2008 Associated Press website of the year (Coyle), is a prominent example of the latter.

Hulu.com - Ad-supported streaming web content

For television fans that cannot afford cable, or just missed an episode or two of their favorite network TV series, Hulu is great. The site allows them to watch recent episodes of

new TV shows with 15 to 30 second ads in place of the traditional commercial breaks. Hulu was jointly formed in 2007 by News Corp. and NBC Universal with the goal of creating a means for the companies to profitably distribute their content over the internet. In August of 2007 a 10% stake in the venture was sold to Providence Equity Partners for \$100 million. The cash the deal raised was used to build and market the website (Wall Street Journal). On April 30, 2009, Disney officially confirmed that it intended to become an equity partner in Hulu and would allow some of its own content to be shown on the site (Atkinson).

Hulu's media information page states that it currently houses content from "nearly 190 leading content companies, including FOX, NBC Universal, ABC, Comedy Central, ABC Family, Biography, Lionsgate, Endemol, MGM, MTV Networks, National Geographic, Digital Rights Group, Paramount, PBS, Sony Pictures Television, Warner Bros. and more." (Hulu - About).

Conspicuously absent from the listed companies are CBS and Viacom.

Sustainability Issues

The Daily Show and The Colbert Report, popular satirical news programs aired on Viacom's Comedy Central cable network, were pulled from Hulu on March 9, 2010.

Viacom issued no official explanation of the drop. Hulu senior vice-president Andy Forsell stated in his blog that, although the shows were two of Hulu's most popular programs; "After a series of discussions with the team at Comedy Central... we ultimately were unable to secure the rights to extend these shows for a much longer period of time." (Forsell) According to Financial Times reporter Kenneth Li, the shows' departure epitomizes the problems Hulu and other subscription-free TV and movie services face. Despite their increasing popularity, the sites can't generate enough revenue to be self-sustainable. Under pressure from equity holders, Hulu executives have publicly discussed the possibility of charging a fee for some of its

programs (Li). Hulu will certainly need the additional revenue if demand for its ad space does not increase. Of the \$23 billion spent on internet advertising in 2008, only \$734 million went to streaming video sites (Atkinson).

NetFlix – the leader in streaming video

For \$8.99 per month a NetFlix member may rent one DVD at a time through the mail; they also have unlimited access to over 17,000 digitally streamed movies and TV episodes (NetFlix). A leader in e-commerce customer satisfaction (Chain Store Age), the company began as a mail order DVD rental service. Their strategy for the future is to become more focused on streaming video.

NetFlix has successfully expanded its presence to numerous digital devices. According to Beth Snyder Bulik of Advertising Age, “Netflix is now available on Samsung, LG, Sony and Insignia Blu-ray players; Roku and TiVo set top boxes; TVs from Sony, LG and Vizio; and on the Xbox 360 and PlayStation 3 gaming consoles. And this spring, Netflix is coming to the Nintendo Wii, a big statement considering that the best-selling system is known for being notoriously insular.” Deals made with NetFlix are mutually beneficial. A Netflix-enabled device sees increased demand among current NetFlix subscribers; NetFlix enjoys increased demand among current users of the device. NetFlix’s subscriber base is expanding, growing by 31% in 2009. There is still potential for more growth though, only 48% of those 12.3 million subscribers watched streamed video in the fourth quarter. NetFlix does not currently offer an application for Apple’s iPhone or iPad (Bulik).

Apple: elephant in the room

In 2008, Apple's iTunes Store began offering movie rentals from all the major movie studios. For \$3.99- \$4.99 for the HD version- An iTunes user can rent a new release movie. Once the user pays for their rental they have 30 days to start watching it. Once they start watching their movie, the customer has 24 hours until their rental expires. Movies rented from the iTunes Store can be viewed on the customer's iPhone or iPod as well as on their computer. The company's new iPad device will also support the viewing of rented movies when it is released (Apple).

An emerging alliance?

Movie studios certainly seem to prefer the iTunes rental pricing plan to the Redbox pricing plan. Warner Bros film *The Blind Side*, for example, was available for rental on iTunes a month before its March 23 (USATODAY.com) release date; the film won't be available in Redbox kiosks for almost a month after its DVD release (Smith). *The Blind Side*'s early availability on iTunes does not seem to have been highly publicized. While the film's release date is clearly given as February 23 in the iTunes store, there is no press release promoting the early availability. A February 16 press release, jointly issued by Redbox and Warner Bros, specifically mentions *The Blind Side* as the first movie to be restricted by the 28-day delayed availability window (Redbox press room). It is possible that Warner's handling of *The Blind Side*'s release foreshadows a new trend. Movie studios, trying to drive customers away from low-pricing rental outlets such as Redbox and NetFlix,

could begin giving preference to retailers who charge a higher price for film rentals. Warner certainly seems to be forging an, albeit quiet, alliance with Apple.⁶

Findings and conclusions

The biggest problem faced by the entertainment industry right now is managing convenience and price. Sales of high-priced DVDs are falling because a customer can now rent the same DVDs for one dollar. There will always be illegal web sites out there to take away from DVD sales. To dissuade fans from using these websites the film industry should follow Warner Bros' lead and allow their films to be available for digital rental (via iTunes and On-Demand) prior to the DVD release date. If a movie is available through legal channels before it is available on black market websites⁷, fans are more likely to pay to rent it. By delaying rental availability and trying to keep rental prices high, movie studios are only pushing their customers towards the black market. It is unlikely, especially in the current economic climate, that a discriminating customer will purchase a DVD of a movie they have never seen. By making their films available for electronic rental prior to the DVD release date, movie studios will preempt piracy and at the same time give fans a view-before-you-buy option which could ultimately increase DVD sales.

⁶ Also notable is the fact that on March 23, well after it had signed the restrictive deals with Netflix and Redbox, Warner signed an agreement with Blockbuster. The deal allows Blockbuster, who prices their rentals higher than the other two companies, to continue to offer Warner's films for rental the day they are released on DVD (Goldman).

⁷ Typically films do not become available on the black market until the DVD is released and someone with a physical copy of the DVD "rips" the contents to their hard drive and uploads it to the internet.

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