

Slide 1, 2: Star Wars Intro

Anyone here own an HD DVD player?

Slide 3: Format War

When we think about when we hear the term “format war?” I thought about movies and “Star Wars,” hence the silly intro.

What is war? In these modern times, it’s very difficult to define this term.
War is a conflict between two parties with different beliefs.

What is a format war?

A competition between incompatible proprietary formats, often characterized by political and financial concerns, technical standards shifting (Blue laser vs. red), Consumer confusion (Me).

The term has been used before, I certainly didn’t make it up, so just to clarify were talking about Sony with the Blu-ray vs. Toshiba with their HD DVD.

Slide 4: Distribution.

In America, we don’t really make anything anymore, but Hollywood’s still got the best movies on the planet. Sure, China’s got all the cheap labor Walmart can buy, but we have Will Smith fighting zombies. Hairless zombie vampires.

How a movie is distributed is very important in determining the victor for the format war.

Most studios do their own distribution.
Universal Pictures distributes via Universal Studios.

Viacom, a parent company, owns Paramount Pictures (studio), which owns 33% of United International Pictures (a distributor in the UK).

Most studios do their own internal distribution, and in the past even owned the exhibitor (theater). So, as you can see, there is definitely some as vertical integration, or what I like to call,

Slide 5: “vertigration.”

Slide 6: Studio Revenues

After a few lawsuits dating back to the VHS vs. Betamax format wars in the 80’s (which Sony lost, by the way) studios realized they can earn more by releasing their content outside of the traditional exhibitor.

Today, according to Standard & Poor’s,
20% is derived from domestic theater rentals

20% coming from foreign theaters
40% from DVD
20% from television (which they also own, by the way)

That's right, DVD is where the studios make a major portion of their earnings.

Slide 7: Hollywood DVD sales, 1998-2008

So how are DVD sales doing?

3rd quarter 1997.

Each anchor point represents another quarter, starting in 1998.

It takes a while to adopt the new technology, then it takes off exponentially and levels off so its an s-curve.

The oscillation relates to sales following the Christmas tradition.

You see a general trend of things beginning to level off.

One point I want to argue is that the introduction of high definition discs around this time had an effect on some of the DVD sales.

Slide 8: Blu-ray vs. HD DVD Timeline

So how is high def content selling?

Red=HD DVD

Blu= Blu ray

I'm going to give it as a percentage. Each anchor represents 1 month starting in April 2006.

It doesn't represent demand in the Malthusian sense but you can see...

HD DVD gets an early start, but Sony spends extra time differentiating its product.

Blu-ray is unarguably a newer technology, and HD DVD is more of an extension of the old format. But blu-ray needed more than product differentiation to succeed in this market.

CLICK

What caused the sudden increase in demand for Blu-ray in relation to HD DVD?

Slide 9: PS3

November 2007

Sold 13 million units worldwide

2009 Sony will begin to earn profit.

The Playstation 3 has a built in Blu-ray player.

Consumers become tied to their brand, and I really think it is as simple as, “why buy two players?”

Slide 11: Studio Market Share

We’re going back to distribution.
Is that enough to win the format war?

HD DVD still has Xbox and several of the distributors (red). May operate as a firm with residual demand.

The big 3, these guys are already exclusively Blu-ray.

Toshiba is paying Universal \$10 million a month to keep them producing exclusively on HD DVD, and gave Paramount a \$100 million package.

To what extent does content have an effect on consumer preferences between the two formats?

Slide 12: CES, Jan ’08.

One day before CES, the largest electronics expo in the US, with sales already declining from the release of the PS3, Warner Bros withdraws their support for HD DVD. It is fitting that at the CONSUMER electronics show, CONSUMERS decide that this is the end of HD DVD.

But don’t take my word for it, ask this guy.

Slide 13: RIP HD DVD

Click

This point is CES.
Right after, Netflix and Walmart withdraw their support for HD DVD.

Really the point I want to get across is how much impact content has on consumers. As the saying goes, “Content is king.”

Slide 13: Cooperative behavior.

On February 20th, one month after CES and the day after Toshiba finally abandoned its HD DVD format, Sony sells a microchip production facility to Toshiba for \$895 million dollars. Sony realized Toshiba was a committed and credible threat and negotiated its way to a more harmonious conclusion.

PS3 and Warners killed HD DVD, but I want to look at one more player in audiovisual entertainment market. The digital download.

Slide 14: Apple TV (and other digital download distributors)

Someone else has entered the distribution game.
Studios DON'T OWN the internet! The distribution field becomes leveled.

Apple TV is an example. They have contracts with all the major studios to show content.

Producer benefits:

Low marginal costs (no brick and mortar) or first copy costs (the costs associated with producing a disk)

Digital produces equal profit with DVDs.

Adverse selection (they know what you buy) (internet, two parties). TIVO? You watch one episode of the West Wing with Alan Alda, and next week you have every episode of MASH because your TIVO thinks you're this huge Alan Alda fan.

Consumer benefits:

Low search costs. (ex.)

Greater competition.

Greater access to independent content: youtube, photos, itunes, with Apple, you get it all in one place.

Consumer costs:

No tie-ins (director commentary, deleted scenes)

Lower audio quality and video quality.

Capacity Constraint: Broadband! South Korea width x3.

Apple has a library of over 500 movies but is unable to build the infrastructure to meet the market's demand, especially for new films. All the more reason to buy a Blu-ray this x-mas.

Slide 15: Matrix Sums it up.

Studio content is the blockbusters that cost hundreds of millions of dollars to make with all the special effects and the celebrities, and User-created content is the stuff you get together with your friends and make or Paris Hilton makes in a shady hotel room.

What does DVD have? The studios? What do the studios have? The classics and the stars! The consumers will follow this.

What does the internet have? More producers and distributors with lower cost distribution. The producers have to follow the consumers.

Consumers follow producers, but producers follow consumers.

We're all producing, all consuming, movie lovers.

Slide 16: Thank you!