

DVD Release Strategies in Europe



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PERSPECTIVES DE L'ÉDITION VIDÉO EUROPÉENNE



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1 Video rental windows: a brief history

VHS windows and premium pricing

It is accepted practice in most European countries that films are usually released to video rental before their retail release, the gap between the two being known as the 'video rental window'. Historically, the video rental release has typically come three to six months after the film's theatrical premiere and the video retail release some time later.

However, national legislation and business practices have always resulted in considerable differences between markets. Whilst some countries prohibit any cross-dealings between rental and retail and others simply prevent the rental of retail product, the UK, like the US, does not impose any such conditions.

In the US this is because the First Sale Doctrine is enshrined in law. This states that only the first sale of a physical exemplar of a copyright work is governed by the copyright holder; thereafter the new owner may deal with his purchase in any way he sees fit—including renting it out for profit—with no violation of copyright. Subsequent amendments excluded both audio recordings and computer software from the doctrine, but the powerful video rental sector has so far managed to see off any attempts to abolish it altogether.

The situation is different in Europe, largely due to the implementation in 1992 of the European Union's Rental Rights Directive. This established an exclusive rental right for a range of right holders and

stipulated that these rights holders were entitled to prevent the rental of their works or to charge royalties for such rental if they wished. The degree of separation between rental and retail video products in the various countries of Europe depends in part on the degree to which this entitlement has been taken up.

In order to maximise publisher/distributors' revenues from the video rental window, rental videos are usually priced at a premium over retail videos. The average trade price of a rental VHS cassette in Western Europe was just under €32 in 2000, compared with a trade price of €8.20 for a retail tape (although the average trade price of a newly released theatrical hit would be higher than this market average).

In countries which operate a strict segregation between rental and retail product the premium is usually simply seen as a surcharge, payment of which entitles rental outlets to rent films out to consumers. However, if there is no such segregation, premium prices tend to be accepted by the rental trade only when linked to the existence of an exclusive rental window.

The situation is further complicated by the existence of revenue sharing systems of stock management in a number of territories. In-depth analysis of the situation in each territory is difficult since not only are the details of revenue sharing deals highly confidential, but they may vary from company to company and title to title.

However, one aim of revenue sharing is that the distributor should continue to receive a similar income from the sale of a given title that he would have received under the traditional premium price model, whilst reducing the up-front cost to the rental dealer. Given that this is the case, the ratio between consumer spending and distributor revenues should remain constant, whatever method of stock management is used. We have therefore assumed for the purpose of this analysis that all titles were sold under the traditional model.

In the UK, which allows the rental of retail video, a VHS title released without an exclusive rental window is seen as a 'direct to retail' release and rental dealers are free to buy copies at retail trade price and rent it out. This has historically also been the case in some other European territories, such as Germany and Spain, where such direct to retail releases played a key role in boosting rental stores revenues from VHS during the 1990s.

However, in countries such as France and the Nordic territories, which maintain a strict legal segregation between rental and retail product, it has never been permissible to rent out retail copies of a title. Therefore, films released simultaneously for rental and retail in these countries are still made available to the two trade sectors at different price points.

DVD challenges the status quo

The separation in time and value between rental and retail products was challenged by the introduction of DVD. On the one hand, as a video product, DVD was expected to comply with the regulations and conventions that already governed the VHS business. On the other hand, however, the desire to see the new format develop as fast as possible led to the common practice of releasing DVDs directly to the retail market.

Furthermore, once initial delays due to the new production process had been smoothed out, these retail discs began to appear at the same time as rental VHS cassettes. In the US, where the process started, such retail DVD titles could, of course, be rented out under the terms of the First Sale doctrine.

In Europe a DVD rental business began to emerge during 1999. By the end of that

year research carried out by *Screen Digest* indicates that most leading European rental chains were stocking at least some DVD titles. In European countries where the rental of retail discs was permitted these were purchased at standard retail trade prices. However in territories which segregated rental and retail product many distributors had already begun charging a premium for discs sold to the rental trade. Nonetheless, at this stage all DVDs were released simultaneously to the rental and retail sectors.

Although the DVD business was still very small, Europe's rental dealers were already calling for the implementation of an exclusive rental window for DVD. They believed that this would be beneficial to their business on two counts:

- It would ensure that consumers moving from VHS to DVD, who tended to be those with a strong interest in film generally, would continue to think of the rental store as the first place to see a new title.
- It would help protect their traditional business model by reinforcing the concept of an exclusive rental window, preventing this from being eroded by other platforms such as video on demand.

From the beginning, the majority of rental dealers accepted that in exchange for this exclusive rental window they would pay a premium price for rental discs.

At distributor level, however, the issue was more complex.

■ Historically, the video rental sector provides the single most reliable revenue stream for filmmakers. It therefore appears to be in the interests of distributors to support a DVD rental window in order to ensure a rapid transition to premium rental prices for DVDs and maintain the flow of revenues from the rental sector.

■ However, moves by a number of studios towards so-called revenue sharing systems of stock management during the late 1990s made the issue of premium pricing potentially less important. Under these systems, rental stores pay a very low upfront fee for each video (often as little as €7) and in return split the resulting rental fees with the distributor. If distributors' ultimate aim is to operate the DVD rental business on this system, the implementation of higher prices

becomes irrelevant.

■ Furthermore, the initial success of DVD was based on its positioning as a retail format and boosted by the retail chains which devoted shelf space to it in the early days. This was particularly the case in the US where studios are wary of alienating powerful retail groups such as Wal-Mart by introducing a rental window. Nonetheless, Screen Digest research indicates that European retail groups have tended to be much less concerned about the introduction of a rental window for DVD than their US counterparts.

■ And finally, some distributors (primarily Warner and Columbia) believe that part of the appeal of DVDs is its early availability. They consider that discs should therefore continue to be released on both rental and retail, day-and-date with rental VHS, at least until DVD penetration reaches significant levels.

Despite all this, many European distributors are now beginning to introduce DVD rental windows. However, there is virtually no consensus on how they should be implemented. The key issues are:

■ **Timing:** at what stage of the DVD market's development should the window be introduced?

■ **Price:** how much can distributors realistically charge for a rental DVD?

■ **Content:** Should rental DVDs contain the same bonus material as retail DVDs? Should they include different material, geared towards the rental market (such as trailers)? Or should they be so-called 'plain vanilla' discs, which carry the film only and leave all the added value content for the subsequent retail release?

Opinion is divided on all these issues. With regard to **timing**, some observers believe that the earlier rental windows are introduced the sooner they will be accepted as the norm. However, others feel that they should wait until the format has become mainstream and the rental business is strong enough to support a window at full rental trade prices.

The issue of **pricing** is itself equally contentious. Most rental dealers accepted from the start that they would have to pay a premium to obtain an exclusive window. However, they also made it clear that until

rental DVDs generated similar numbers of transactions to their VHS counterparts they believed that such prices should be significantly lower than average VHS trade prices. Distributors, meanwhile, obviously want prices to reach VHS levels as soon as possible to maintain their return from the rental sector.

There is no more agreement on the issue of **content**. Some rental dealers object to paying a premium for 'vanilla' discs, when, a short while later, consumers can buy better discs at a fraction of the cost. However, others do not want their customers distracted by bonus features and find that 'vanilla' discs work better with overnight rentals. Similarly, some distributors do not consider that making two different versions of a DVD is worth the effort, while others believe that a retail release laden with new extras is key to boosting retail sales.

Implementation of a DVD rental window

The first DVD rental windows were introduced in early 2000. Roughly half the US majors have now introduced windows in some or all European territories.

■ Twentieth Century Fox announced in April 2000 that it was planning to introduce European DVD windows with plain 'vanilla' rental discs as soon as the production process allowed. Fox had indicated that it was planning to introduce a rental window in its international DVD business as early as mid 1999. The studio claimed that the move was mainly aimed at protecting the rental business.

■ Buena Vista introduced a six-month DVD rental window with 'vanilla' discs in Germany and the UK shortly after taking over the distribution of its own films on DVD from Warner in October 2000. This excluded Disney's animation titles, which are primarily sell-through performers. Buena Vista has since introduced DVD rental windows in all major European territories.

■ Dreamworks titles are distributed in Europe by Universal, which introduced a European DVD rental window in early 2001 for Dreamworks titles (and for some local deals such as films from German independent Prokino). This strategy was extended to all markets 'large enough to sustain it'—initially UK, Germany, Spain and Italy.

3 Impact of different windows on earning potential

As stated above, there is much debate in the video industry over which of the various release strategies is most profitable at which stage of the video supply chain. The analysis in this chapter is an attempt to assess the actual impact of release windows on total video revenues as accurately as possible.

Given the range of analytical information available on the UK market and the paucity of detailed data on other European territories, this analysis at present focuses entirely on the UK market. With the continued co-operation of the video industry we hope in future to extend it to other markets for which appropriate information can be identified to find out whether the findings of this research are mirrored across the industry.

Methodology

The analysis is based on a detailed study of the performance on VHS and DVD of 38 theatrically-released movies. For reasons explained below, this was the largest sample which could be obtained at the time this work was carried out (October–November 2001) and this should be borne in mind when reviewing the results. However, we believe that this represents an interesting and valuable first step in what we hope will be an on-going examination of the impact of rental windows on a title's overall video performance.

● **Selection of titles**

Titles with a DVD rental window (hereafter referred to as 'window titles') are still comparatively rare, giving us a limited pool of potential titles for this study. Furthermore, in order to ensure a fair comparison, every effort was made to match each window title with a title released without a DVD rental window ('non-window title') that matched it as closely as possible in terms of

- genre
- target audience
- budget and box office
- release date

In addition, there had to be sufficient information available about the video performance of each title selected at both retail and rental on both DVD and VHS. This immediately excluded many older titles, which were released before the monitoring of DVD rental transactions began, as well as

newer titles which have not yet completed their final retail run.

After all these considerations, we identified 19 window titles appropriate to the study. A control group of 19 non-window titles was then selected using as many of the criteria outlined above as possible to ensure the closest possible match across the two groups.

● Elimination of other factors

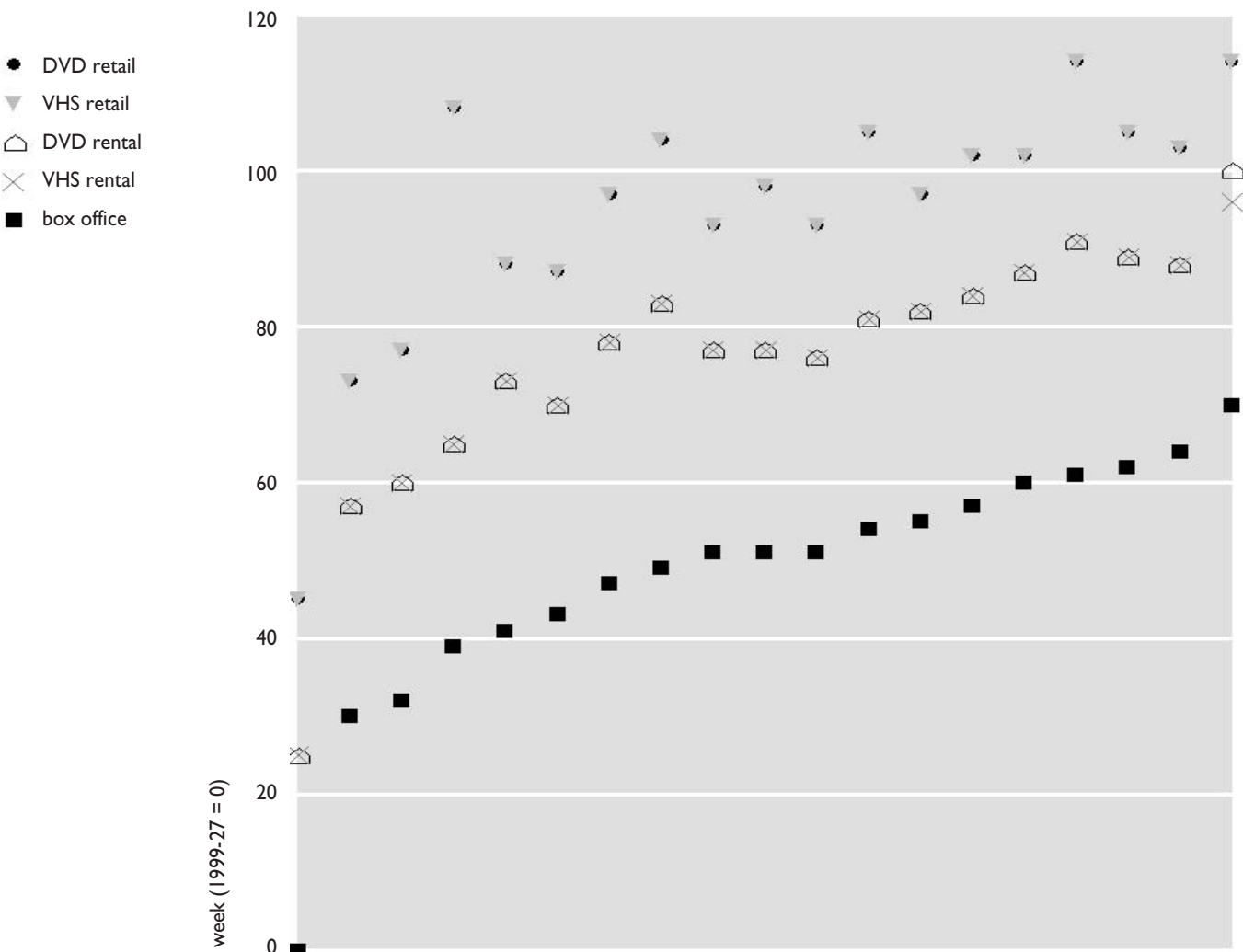
Release windows are obviously not the only factor that influences a film's revenue stream. Indeed, one might argue that many other things play a potentially more important role. These include internal aspects, such as video packaging, marketing and the inclusion of bonus materials, as well as outside influences, like seasonality and the growth or decline of the installed base of DVD Video players or VCRs.

Even social and political events that influence people's interests can have a dramatic impact on sales. Thus, sales of the Gulf War comedy *Three Kings* have apparently soared on VHS following the attacks on 11 September and the start of the Afghanistan campaign.

Given the rapid development of the DVD business over the past couple of years, the installed base of DVD hardware clearly has a significant impact on potential sales or rentals of a title on DVD. It would therefore be inappropriate to compare directly DVD performance of a title released in the first half of 2000 with one released in the second half of 2001 without taking this into account.

Any single factor can influence a title's performance by several percentage points. In order to eliminate as many other factors as possible from our analysis, the following steps were taken:

Release points for titles with DVD rental window





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