

Analysing the Effect of Digital Technology on Channel Strategy, Power and Disintermediation in the Home Video Market: The Demise of the Video Store?

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The antecedents of channel power (e.g. El-Ansary and Stern, 1972) and the impact of channel structure (e.g. Anderson and Narus, 1984) on channel dynamics have long been important topics within the channel literature. In addition to the theoretical and methodological contributions, research in these areas has helped channel managers to understand how power is generated and used in coordinating distribution strategies in different contexts. The study presented in this paper builds upon these previous literatures, which are first briefly reviewed below.

Key Words: Movies, Electronic Distribution, Channel Structure, Channel Power

Channel Power

The literature has consistently defined the power of a channel member as its ability to control and influence the decision variables in the marketing strategy of another member (Gaski, 1984). Guided by the social science literature and market realities, researchers have identified several indicators of channel member power, including dependence (e.g. El-Ansary and Stern, 1972; Etgar, 1976; Kale, 1989,) power sources (e.g. Gaski and Nevin, 1985), and role performance (e.g. Anderson and Narus, 1984; Frazier 1983; Frazier and Summer 1986).

Using the definition of channel power defined above (Gaski, 1984), a key point raised in this paper is the potential of newly developed electronic technology to alter and perhaps even *supplant* existing channel relationships and power dynamics, *through providing the means of enabling a member of the channel to control and influence the choices of another*. The power of a disruptive technology has been raised by Christensen (1997), with McCann (2001) conceptually highlighting over 30 different digital marketing cyber-trends, some potentially disruptive. In particular, the subject of this paper is the rise of digital technology as a potential disruptor and *supplanter* of channels of home video distribution, *and as a key potential new influencer of channel power*, dynamics and strategic relationships within this network.

Channel Structure

The purpose of distribution channels is to facilitate the physical flow of product from manufacturers to consumers. Typical channel structure includes manufactures, wholesalers, retailers and consumers. The product flows through the channel to the end consumer. (Sims, Foster and Woodside 1977). While much of this literature could be cited, of particular interest to the current paper is the literature on channel structural dynamics resulting from web-based electronic commerce, and particularly on intermediaries that operated within the traditional channels.

This area of literature is only just emerging empirically, although as far aback as 1987, academics and practitioners alike have provided arguments in favour of channel disintermediation due to e-commerce (e.g. Benjamin and Wigand,1987), with Malone *et al.* 1987,1989) proposing that once electronic markets emerge, traditional intermediaries might be threatened due to an electronic brokerage effect and the use of the Web as a direct distribution channel. An existing body of literature discussing this *disintermediation* (Chircu and Kaufmann,1999), as well as alternative outcomes (e.g. *more intermediation* --as new roles for intermediaries emerge from the changed structure, or *re-intermediation*, as traditional industry players have incentives to develop e-commerce capabilities and start competing in electronic markets as well) has emerged. Excellent papers by Mahadevan (2003), using a taxonomy of 12 B2B electronic market structures to examine the impact of market fragmentation, asset specificity and other variables on the ability of a firm to exploit these market structures, and Sen and King (2003), using a game theoretic transaction cost approach to predict degrees of disintermediation are recent examples. The latter note that e-commerce is leading to considerable changes in industry value chains by changing the economics and structure of distribution channels that may result in the demise of intermediaries.

Channel Power and Structure Within the Home Video Distribution Channel

Sims, et al (1977) note that “the presence of appreciable channel control by one firm over another has emerged in those industries which are dominated by a few oligopolistic sellers.” Perhaps no better example of this situation exists than that of Hollywood’s highly successful industrial system, which has functioned well for almost 90 years, with the major studios controlling the industry, within a fairly traditional channel of M-W-R-C.

The major studios in Hollywood (the Majors) powerfully dominate the world film market by controlling distribution channels across the various audio-visual markets (O’Regan, 1992; Puttnam, 1997; Silver and Alpert, 2003). They or their parent companies own the leading domestic and international film, video and television distribution companies as well as the four major American TV networks NBC, ABC, CBS and Fox and also provide the world with much of its TV programming. The Majors derive 80% of a movie’s revenues from the video and television markets (Table 1). In reality, the cinema release of a movie is a brand building exercise to facilitate high demand in the home video and television markets. Revenues from these post-theatrical markets provide the cash flow needed by these media conglomerates to operate and re-invest in new film production.

Research Questions and Method

Given the above, this paper poses two questions of interest to distribution channel researchers:

- (1) What is the likely course of home video distribution given new available digital technology ; in particular, do available trends support (a) disintermediation, (b) more intermediation, or (c) re-intermediation?
- (2) What are the likely effects of new digital technology on channel power within the home video distribution channel?

To examine these questions the authors examined available data and current trends in the home video market, and the channel power dynamics thereof. In particular, we examined past and current data on industry trends and current thinking in this area, as well as data on video rentals, movie revenues across various distribution channels, the ability of channel members to gain or lose power as a result of technological “assets” (Mahadevan,2003) and the like. Comprehensive data on 2003 video industry sales is currently unavailable and has been supplemented with historic industry sales data as required.

Key Findings

The Home Video Market

Sony released Betamax, the world’s first video tape recorder in 1975. At that time, the cinema (theatrical) release was the main source of revenue for a motion picture. Network television was a secondary market and with its introduction, home video became an embryonic ancillary market. (Wasser 2001)

By 2001, the video market, not the theatrical release, provided the single largest revenue stream for Hollywood movies, as shown below in Table 1.

Table 1. Worldwide (non-North American) home video market revenues 2001

Media	Movie revenues	movie revenue mix
Theatrical Revenues	US \$ 5.7 billion	20%
Home Video Revenues	US \$ 12.4 billion	40%
Free TV Revenues	US \$ 9.7 billion	30%
Pay TV Revenues	US \$ 3.2 billion	10%

Source: Hollinger (2002) MPA statistics reported in The Hollywood Reporter at Backstage.com

http://www.backstage.com/backstage/news/article_display.jsp?vnu_content_id=1520789

Trends in Video Rentals and Sales

Table 2 below shows that video cassette rentals and sell-through video cassette sales peaked in 1998-2000 period. DVD was introduced in 1997 and by 2003 both DVD rentals and sell-through surpassed the video cassette market’s peak years. (MPA 2003) Today as video tape approaches its 30th year and the end of its life cycle, DVD is booming. Its popularity is being driven by consumer demand mainly for movies but also for TV series, as well as the novelty of the format as the price of DVD players has dropped dramatically.

Table 2:Trends in Video Rentals and Sales

	Embryonic stage	Peak volumes	2003
VCR penetration into US homes	2 % in 1980		91 %
Video rentals	2 million units rented in 1980	99 million units rented in 2000	53 million units
Sell-through videos		626 million units sold in 1998	240 million units
DVD market size	Only US \$4.6 billion in 1997		US \$14.3 billion
DVD rentals	1.6 million units rented in 1998		111 million units rented in 2003
DVD sell-through	33 million units sold in 1998		985 million units sold in 2003

Sources: MPA 2003; Sporich 2004. Is Digital a Disruptive Technology for the Home Video Market?

Christensen (1997) argues that whilst some innovations are sustaining technologies that improve product performance and service delivery, others are disruptive technologies that can ultimately facilitate the transformation of industry business models and market structures. Additionally he notes that disruptive technologies become dangerous for incumbents when they expand into the value matrix held by the old market – in this case the video rental chains.

Digital technology has redefined book-selling with Amazon.com’s business model at last evolving into a profitable online e-retailer. Digital has also disrupted the music industry which has been in recession for almost four years. Sales are down due to a combination of factors, foremost among them, online piracy initially through Napster et al but also as a result of the recent wide diffusion of CD / DVD burners in home computers and the introduction of mobile MP3 players and Apple’s iPod.

Incumbents Strategic Response to the Threat of Digital in the Movie/Video Industry

In 2001, five major Hollywood studios - Universal, Paramount, MGM/UA, Warner Brothers and Sony / Columbia, announced that they were creating a joint venture to launch a video-on-demand (VOD) service. It would operate over the Internet and enable consumers to download movies to their computer hard drive for a limited period of time on a fee for download basis.

Movielink executives explained that the primary motivation for the Major studios moving quickly to establish a VOD service were worries that the popularity of Napster’s music file sharing software and strategy could also spread to the movie industry and create similar problems for Hollywood on the Web (it has). Their VOD technology would it was hoped, help to limit online video piracy of their movies. (Rich 2001)

A second motivator for the Majors in these ventures was that digital technology enables “the opportunity to establish direct relationships with consumers and collect critical information on them. Building up a list of consumers with known tastes in movies, the studios could then use the web for highly targeted direct marketing pitches.” (Sweeting 2000).

Channel Structure Impact: Disintermediation?

Disintermediation is likely in the home video market because digital is a potentially disruptive technology for the video rental store on two fronts - it strengthens the power of the major studios as distributors at the expense of the video retailer and it empowers the consumer providing greater choice and more flexibility.

With forty per cent of the film industry's revenues coming from the home video market (Table 1) and the fact that revenues would be further boosted by eliminating the video store middleman, the Major studios would seem to have every incentive to increase their revenues via digital distribution. Just as the Nickelodeons disappeared 90 years ago as the movie industry entered its pre-Hollywood shakeout phase, and neighbourhood movie theatres disappeared as TV diffused widely, as "channel captain" the Majors are not adverse to abandoning unprofitable sectors. The future doesn't look healthy for the local video store.

Digital enables the Major studios to directly monitor consumer behaviour and the interactive nature of digital enables the Majors to follow in the footsteps of Amazon.com employing data mining software to make personalized offers to their VOD customers promoting their range of movies along the lines of "other customers who rated this movie favourably also watched..."

Channel differentiation can provide sustainable competitive advantage: "The goal should be to push products down into the lowest cost channel that can deal with them. That's the way to make more profit and often more sales." (Friedman and Furey 2000).

Digital facilitates that scenario through video-on-demand. As Disney Chairman and CEO, Michael Eisner signalled at the time that his company announced its entry into the VOD market, "Downloading movies over the web would offer studios something they'd never had before - no middleman (the video store). Rather than licensing its movies to some third party website operator," Eisner said, "the studio would likely offer download directly from their own sites. Its like a \$2.50 video rental but we keep all the money." (Sweeting 2000)

Digital also empowers consumers at the expense of the video retailer because it eliminates "supply problems". Consumers can access their choice of movie literally on-demand either through interactive television services from their Pay-TV operator or over the Internet via Movielink.com or other providers. Video-on-demand eliminates the need to physically go to the video store and the risk of being disappointed the video you want isn't there because its movies are available 24/7. A key finding of a recent survey of the home video market in North America showed that 47% of respondents "always" (10%) or "often" (37%) left the video store empty handed and that "it was not uncommon for video store renters to settle for a 'second-choice' title because a specifically desired title is not available" (Hoffenberg 2004).

Digital distribution through video-on-demand and interactive TV are sustaining technologies for the Hollywood studios because they improve product performance (picture and sound quality); service delivery (24/7 consumer access) and lower distribution costs through a shorter channel span, less manual handling and potentially more profit from the elimination of the middleman. And digital distribution is likely to become a disruptive technology for the video store and result in disintermediation of the value chain because it empowers consumers offering them greater choice and increased flexibility (any movie, any time). The end result? Disintermediation and the eventual demise of the video rental store, the timing of which, is subject to the rate of diffusion of digital television and broadband into consumer homes.

This is the looming scenario facing the large video chains who must now be monitoring VOD, the diffusion of broadband and the trend in convergence of media with trepidation. With widespread access to video-on-demand, regardless of the delivery method, why would consumers at that point take a trip to rent a movie that might not even be available at the local video store and also have to pay an extra fee if they return it late when they can order their movie of choice via VOD for a fixed fee from the comfort of their own home?

Conclusion

This paper has examined the issue surrounding the potential of digital technology to change channel dynamics, strategy, and structure in the video movie distribution market. While exploratory in nature the data examined suggests that digital technology is already well on the way to changing existing methods and channels of distribution for movie videos, as well as power relationships within this network. It seems likely that the traditional M-W-R-C channel which has existed in this market, will be replaced by a M-W-C or M-C channel, with resulting disintermediation or re-intermediation.

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