

'Fighting for your eyeballs - video-on-demand in Australia '

**Prepared by Mariel Beros
Masters by Research Student
School of Business Information Technology
RMIT University, Melbourne**

Abstract

This study examines the impact of new digital technology on film distribution practice by concentrating on the activities of two pioneers in video-on-demand (VOD): one in Canada, one in Australia.

Only the Australian stage of the proposed study has been undertaken at the time of writing. This paper is a working document and concentrates on the operations of TransACT Communications Pty Ltd and its video-on-demand content partner VOD Pty Ltd, which have been offering Australia's first commercial video-on-demand service to subscribers for over a year. They have been competing with traditional tv broadcasters, pay tv services, video and cinema operators for the eyeballs of the citizens of Canberra.

Key Words

Film distribution, Video on Demand, VOD, DSL, fibre to the home, fibre to the curb, cable modem, NVOD, FTTC, FTTH, TransACT Communications Pty Ltd, VOD Pty Ltd.

The Research Project

This study examines the impact of new digital technology on film distribution by concentrating on two case studies in video-on-demand. It focuses on the commercial operations of TransACT Communications Pty Ltd, Canberra and their video-on-demand content partner VOD Pty Ltd, and Rogers Cable Inc, Toronto, pioneers in their respective markets. The specific research problem addressed is how two pioneers in video-on-demand are distributing films via their new digital platforms, and their involvement, if any, in the commissioning and financing of content. Particular attention is paid to the business models and strategies they have chosen to use. Only the Australian stage of the proposed study has been undertaken at the time of writing. It is the subject of this paper.

Video-on-demand is a new digital application that is delivered to the consumer using broadband technology such as a Digital Subscriber Line (DSL), cable modem or fibre to the home/curb (FTTH/FTTC). It allows viewers to select and watch feature films and other programming on their television with the same functionality they currently enjoy when watching a video on a VCR. They can pause, fast forward, rewind, or stop play and watch the selected content as many times as they wish over a specified period, usually 24 hours, for a fee. It is deemed to be the next killer application in entertainment delivery.

A cross-sectional exploratory study was used to identify what the stakeholders set out to achieve and how they pursued their goals, using which business model/s and with what success. An inductive approach using qualitative methods such as semi-structured and in-depth interviews was applied, supported by quantitative methods (subscriber surveys) which were undertaken by the stakeholders themselves. A review of other secondary data including company reports and business plans has also been completed.

The trade press and business strategy consultants writing on new developments in the industry have provided the bulk of literature and theory available on the subject to date. These have primarily been forecasts regarding new business opportunities. Few case studies are currently available. (Cole 2001, Datamonitor 2002, Davies 2002, Groner 2002, Gunther 2000, Jacka 2001, Nwagbogu 2002, PriceWaterhouseCoopers 2001, Sabin 2000, Scheirer et al 2001, Schwartz Butt Kertzer & Courtin 1999, Sweeting 2001, Watson 2001, Wistreich 2001)

Jacka (2001) believes the jury is still out regarding which sector of the industry will benefit most from the proliferation of new digital platforms. She argues that they could well provide opportunities for distribution of new content and hence benefit independent filmmakers, whereas Scheirer (2001), Watson (2001) and Wistreich (2001) tend to support the view that repurposed existing content is likely to provide the bulk of programming for these new platforms. Established players, such as the US studios, who control large libraries of content, appear poised to take advantage of opportunities that arise.

Why all the fuss about Video-on-Demand?

Until recently, the most effective way to distribute a film was to bundle release-date rights according to physical distribution channels, creating a linear release pattern with windows between the various channels to allow maximisation of revenues by delaying the availability of less lucrative formats.

A typical US release schedule is:

theatrical release → non-theatrical release (eg airlines) → home video/dvd → pay-per-view → premium cable TV → network TV → syndicated TV.

A studio film is usually released in the US first, followed by staggered release in other territories around the world. So called 'foreign' territories such as Australia tend to follow the release window pattern of the US release schedule. With the advent of digital delivery of programming and movies, this is set to change. And one of the key drivers of change, will be video-on-demand. (Scheirer, Li, & Gerson, 2001).

Industry analysts believe video-on-demand will not only transform, it will replace the home video industry and change the release-window pattern of major films. Each release window will go global. New business models will emerge. (Cole 2001, Scheirer et al 2001, Watson 2001, Sweeting 2001, Wistreich 2001)

In August 2001, the US studios banded together to form two alliances to distribute their movies over the internet and take advantage of video-on-demand revenues. The first was Movie Fly (now known as Movielink), a joint venture between Warner Bros, MGM, Paramount Pictures, Universal Studios and Sony. (Martins 2001, Stump 2002) Two weeks later Walt Disney Studios and 20th Century Fox launched their own service called Movies.com (Goodridge 2001) In April 2002, Fox announced it was leaving the Movies.com joint venture to pursue other strategies to distribute their films to the broadband audience. (Goodridge 2002).

While the studios have not yet commenced their own commercial video-on-demand services, they are testing the water and have signed limited licence agreements with pioneers in the sector. The structure of the content deals often resemble those used in the television industry where content is bundled and licencees must take library content as well as premium content from the studio. They cannot simply cherry-pick the movies they want. The revenue split also favours the studios and is more lucrative than the terms usually associated with video deals. VOD operators have found the terms increasingly frustrating. Indeed, Intertainer, a leading US player, filed an anti-trust suit against AOL Time Warner, Vivendi Universal and Sony on 24 September alleging price fixing and other anti-competitive behaviour.

Acquisition of premium content from the studios has been one of the key stumbling blocks to the growth of video-on-demand services around the globe, as has the high cost of network access to video-on-demand providers utilising a DSL/ADSL platform to deliver content. Supply side costs have kept video-on-demand providers from achieving a return on investment.

Industry analysts say that to be financially viable, video-on-demand needs to be positioned as part of a bigger package of services, what is known as a quadruple play, in which telephony, high speed internet, broadcast TV, and video-on-demand are offered. The economic model for video-on-demand as a stand-alone service is far weaker. Cable/Pay TV companies are best placed to turn video-on-demand into a paying proposition as for them it is a value added service that provides stickiness that keeps the customer. (Datamonitor 2002, Davies 2002, Watson 2001)

While the studios have been very cautious in their approach to video-on-demand, they cannot ignore it or they risk losing market share to file sharing and piracy as consumers get impatient waiting for movies to be legally available on digital platforms. Video-on-demand is of interest to the studios for three key reasons. It offers them the prospect of delivering content directly to consumers, unlike current video release practices which require them to share revenue with intermediaries such as video rental chains. Secondly, a film's video release contributes about 45 - 65% of total revenue, making it a very lucrative part of the release chain. (Scheirer et al, 2001) Then there is their market share. The US studios dominate film distribution around the world today and they want to maintain their position.

The studios have output deals with local distributors in most territories, who in turn have output deals with cinemas. It is very difficult for independent filmmakers to get access to screens as contractual arrangements for Hollywood product take precedence and few screens and sessions are left for other product. New digital platforms like video-on-demand present both a threat and an opportunity to the studios, and an opportunity for filmmakers to crash the barriers to entry presented by current distribution practice. Video-on-demand has a lot riding on it.

Video-on-demand developments in Australia

TransACT Communications was formed in February 2000 and is owned jointly by Actew, the Australian Capital Territory's utility company, the Telecom Venture Group (TVG), a US backed Hong Kong based investment company, Australian Gas Light, Marconi, Australian Capital Ventures Group, Commonwealth Bank of Australia and the Motor Trades Association of Australia Superannuation Fund.

The company is building an advanced FTTC broadband network to some 100,000 homes across Canberra to provide local residents and businesses with a wide range of services including high speed internet connection, video-on-demand, pay per view and pay TV, mobile and fixed telephone line services. They began rolling out their network in 2001. While rollout is expected to be completed by end 2003, TransACT does not expect to return a profit until late 2004, four years after commencement of the program. (Groner, 2002)

TransACT 's video-on-demand content partner is VOD Pty Ltd. Negotiations are also underway with other potential providers, including Intertainer Asia who are currently offering a VOD service in Hong Kong and Singapore, and undertaking a trial in Beijing. Intertainer Asia is expected to launch on the TransACT network by Christmas.

VOD Pty Ltd is a Sydney based company that is majority owned by the principal shareholders of Civic Video, one of Australia's leading video rental companies which has been operating since 1985. They began their first

commercial deployment of video-on-demand to TransACT customers in March 2001.(Snook 2001) TransACT currently has over 10,000 subscribers with about one-third of the network completed, of which 70% have opted for the package which incorporates video-on-demand.

TransACT's success in telecommunications has inspired other Australian power utility companies to band together and follow suit. They have formed a new consortium called UtilityTel to pursue business opportunities in the sector. If successful, they too may eventually offer VOD. (Clack, 2002).

On the broadband front, Telstra's Chief Executive Officer, Ziggy Switkowski, predicts that in five years time over 2.16 million Australians will have broadband access and there will be 100-150 digital TV channels available. Furthermore, he believes that Foxtel will be well placed in that environment, but according to a Foxtel spokesman, VOD is not even being contemplated at this stage as they simply do not have the capacity to provide such a service.

In February 2002 Telstra announced a \$50 million Broadband Development Fund to accelerate broadband take-up across Australia. (DCITA 2002, Elliott 2002, Pascoe 2002) By September 2001, 52% of all Australian households were connected to the internet, but only about 150,000 had broadband. (NOIE 2002, Jacka 2001)

Curiously, Australia is the only territory in the world that imposes broadband download limits. It makes the establishment of a video-on-demand service using the internet unlikely. And Telstra's high network access costs are proving to be a barrier to potential VOD providers. Their rates are one of the key reasons why leading UK video-on-demand player Video Networks Ltd has not entered the Australian market, despite having spent extensive time and resources on a feasibility study, hiring experienced Australian executives to run the operation and even conducting joint venture negotiations with Telstra. According to a senior Video Networks executive, the negotiations stalled when Telstra realised the commitment required.

Australia's regulator, the Australian Broadcasting Authority (ABA), opened the doors to new telecommunications players in 1997. Prior to that point, utility companies such as TransACT's parent ACTEW could not venture into telecommunications. There are no ABA local content regulations associated with the operation of video-on-demand services in Australia, although there are for free-to-air broadcast and pay TV. (ABA 2002)

Traditionally the financing of independent film and television production in both Australia and Canada has been closely linked with distribution as players downstream, such as film distributors and free to air broadcasters and pay TV operators, have provided equity investment and license fees, which coupled with government subsidy, have been the mainstay of production budgets. Local content regulation has supported this investment, and there's widespread concern in the production community that any relaxation of local content standards will see a substantial drop in local production. (AFC/AFFC

1999, CFTPA 2001, CRTC 2000, Cunningham & Turner 2002, Dillon 2001, Goldsmith Thomas O'Regan & Cunningham 2001)

Sneak Preview: The Australian pioneers in Video-on-Demand

TransACT Communications is one of the few networks in the world that can handle true video-on-demand, according to Geoff Harris, their Manager of Corporate Communications. Their network uses FTTC technology which provides fibre optic cable across the streets, with the last link being copper wire (also known as Very High Bit-Rate Digital Subscriber Line or VDSL technology). FTTC provides users with full interactivity and no bandwidth constraints. Most other outfits like Foxtel and Optus currently only offer near video-on-demand (NVOD) capability due to the bandwidth constraints of their delivery technology. When approached, neither Foxtel nor Optus would comment on their VOD plans.

NVOD differs from video-on-demand in that it doesn't offer full VCR-like functionality. The technique is used in digital satellite and cable services using several channels to transmit a feature film with staggered start times, sometimes as often as every 15 minutes. The selection of films offered is also more restricted than that available on true video-on-demand.

TransACT has passed 30,000 Canberra homes in their broadband rollout to date. Take up has been well over 30% in the 12 months since the service was first made available and has exceeded company expectations. Harris says word of mouth will help to push this figure even higher, as will a new TV advertising campaign that was launched in mid 2002.

All of TransACT's customers have signed up for their telephony package, 90% have opted for high speed data and data access, and 70% (or 4,350 homes) for all three services. Access to video-on-demand is available in their TransTV package, which retails, as a standalone, at \$19.95 per month. For this fee, TransACT provides the customer with a modem and set top box. Customers pay an extra fee for each film they download. TransACT bill the customer monthly for any video-on-demand transactions, and return an agreed part of any such revenue to their video-on-demand content partner, VOD Pty Ltd.

VOD Pty Ltd has been operating a commercial video-on-demand service on the TransACT network for over a year. The company did not require a licence from the Australian Broadcasting Authority as it is a narrowcaster, offering a point-to-point service, so their activities fall outside the jurisdiction of the industry regulator.

VOD Pty Ltd currently has the Australian market to themselves. No one else is offering a true video-on-demand service anywhere in the country, although some companies such as Optus are trialing NVOD. VOD Pty Ltd plans to sustain its first mover advantage by expanding into geographical areas beyond Canberra as soon as possible. They are currently running a video-on-

demand trial on the Western Power network in Perth, and plan to diversify into the delivery of Training on Demand for the corporate sector in the coming year. They are not interested in participating in the production of content and have no plans to invest in this area.

Today the company focuses on its core business of film hire and T commerce, but in the early stages of their existence they did flirt with the idea of providing a full service solution. According to Chief Executive Officer, Tony Aduckiewicz, the idea was quickly abandoned once they factored in the high cost of providing the hardware (network cable, servers, set top boxes) as well as the content and realised that return on investment would be far more difficult to achieve. Aduckiewicz says the company will break even when they reach 30,000 customers. They currently have about 2500 customers on the TransACT network.

By leaving the hardware provision to their network partners and concentrating on the provision of content, VOD Pty Ltd are in a position to enter as many network deals as they wish. The more deals they strike the more profit they make as the costs of content delivery remain fairly static regardless of the number of networks on which they operate.

Their key cost is the content sourced from the Hollywood studios. Then there is the digitisation of the films, their storage on servers and marketing to subscribers. Subscribers are able to download movies or order pizzas through their set top boxes, using VOD Pty Ltd's proprietary menu software. The company developed their own customer management software so that it could be adapted easily to meet their changing needs. The same software is also being used by Optus for their NVOD trial on Sydney's Lower North Shore.

VOD Pty Ltd currently offer TransACT subscribers a menu of some 200 films ranging in price from \$3.95 to \$8.95 per hire. This contrasts greatly with Optus who are offering just 20 films in their NVOD trial. The VOD Pty Ltd menu is refreshed with 6 new films each month and the selection is spread across all genres, including classic and new release Hollywood product, and adult entertainment. They do offer some films from independent filmmakers, but very few.

Tony Aduckiewicz believes a selection of 400 movie titles on their servers will be the optimum number that will satisfy customer needs for depth and stimulate healthy view rates which in turn will lead the business into profitability. This forecast correlates with US practice where providers such as Time Warner provide 400 titles in their video-on-demand services.

Aduckiewicz says VOD Pty Ltd's view rates are four times those achieved by Optus. But Optus sell far more pizzas, mainly due to the bundling of other services in the package. Despite bundling, the Optus NVOD service does not offer the same functionality and convenience to the customer.

The customer management software developed by VOD Pty Ltd allows them to track their customers viewing and T commerce habits and build a profile. Eventually they propose to use this information for personalisation of advertising to each customer, but the company is currently focussing on educating the public in video-on-demand and winning acceptance for the platform. At present they only use their personalisation capacity to remind customers if they have an outstanding library title they have yet to view.

To stimulate view rates, VOD Pty Ltd has drawn on their 25 years of experience in video rental to offer regular 'buy one, get one free' promotions. Subscribers get a free library title (normally \$3.95) with each new release they hire during the quieter trading days from Monday to Wednesday. The subscriber can watch the library film any time during the next month. They have 24 hours in which to view the new release title they select.

VOD Pty Ltd has found that usage trends tend to mirror those of video rentals and use this historical data as a benchmark for their video-on-demand operation. The only exception they have noted is that adult entertainment peaks in the middle of the day, as well as late at night. Churn is currently insignificant as the service is still so new, but the company has budgeted for 3% in the future.

Tony Aduckiewicz believes the company will enjoy more success, and view rates will improve, as their offerings become more current. The terms of their present content deals with the studios are the problem. When VOD Pty Ltd first started trading, their release window was 6 months after that of video, effectively 12 months after a film's theatrical release. But the situation is improving. Today some titles are available just two months after video release. Aduckiewicz is hoping to negotiate for the window to be brought forward to day and date with video. In the US, the video-on-demand window is currently 25% ahead of that for pay-per-view, and immediately follows video. (Sweeting 2001)

Content deals between the US studios and Australian distributors/operators have a standard revenue split: 50/50 for video-on-demand compared to 38/62 for video rental. As usage patterns change and video-on-demand becomes more accepted amongst the general public and video rental wanes, it is likely that the studios will relent and offer better terms for video-on-demand.

Preliminary Findings

The Australian case study presented demonstrates that it is too early in the business cycle to determine what impact video-on-demand is going to have on film distribution practice here. At the moment companies like VOD Pty Ltd are doing their best to establish themselves in the marketplace and fine tune their business models. They are yet to commence active marketing to the general public, but this may change with Intertainer Asia's entry into the Canberra market. Even so, until the companies involved reach critical mass, it

is not likely that their presence is going to have much impact on film distribution.

VOD Pty Ltd is not active in film production or financing, and does not have any plans to expand into this area. Nor does TransACT. It remains to be seen whether any other video-on-demand players that enter the market will become involved in commissioning content or programming seasons of Australian films. Unfortunately, we may have to wait some time to see any developments as Telstra's high network tariffs and the practice of imposing download limits will deter new VOD entrants in the near term. If Utilitytel or some other market entrant gathers enough momentum to challenge Telstra's dominance in the market, then we will see change for the better. Competition will drive network tariffs down, and perhaps see the removal of download limits.

Once it does become attractive for new VOD players to enter the Australian market, and players can see a competitive advantage in providing Australian independent content/films, then it is feasible that they will. After all, local art house cinemas programming independent films thrive along side the mainstream multiplexes. Some also invest in the creation of content. In time, this pattern may be replicated on digital platforms.

Current barriers to entry for independent filmmakers looking for a distribution deal seem set to remain, at least in the short term. The availability of new digital platforms alone is not going to solve the problem. It will take market pressure or government intervention to bring about structural change.

Alternatively, filmmakers frustrated by the present state of affairs may take matters into their own hands and use peer-to-peer networks or form digital distribution co-operatives to make their work available on line, despite the threat of piracy. They may decide that a certain amount of piracy is a small price to pay for the opportunity to reach an audience, indeed, view piracy as a 'marketing expense.' This is not as far-fetched as it seems. File-sharing of music may have damaged sales as the music industry claims, but it appears to have also stimulated the sale of music by independent artists who did not have deals with the major record labels. If this is the case, then the next big hurdle for filmmakers who attempt their own digital distribution, will be how to let the public know where their work is available.

The fight for your eyeballs is still very much in its infancy, but it has begun.

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