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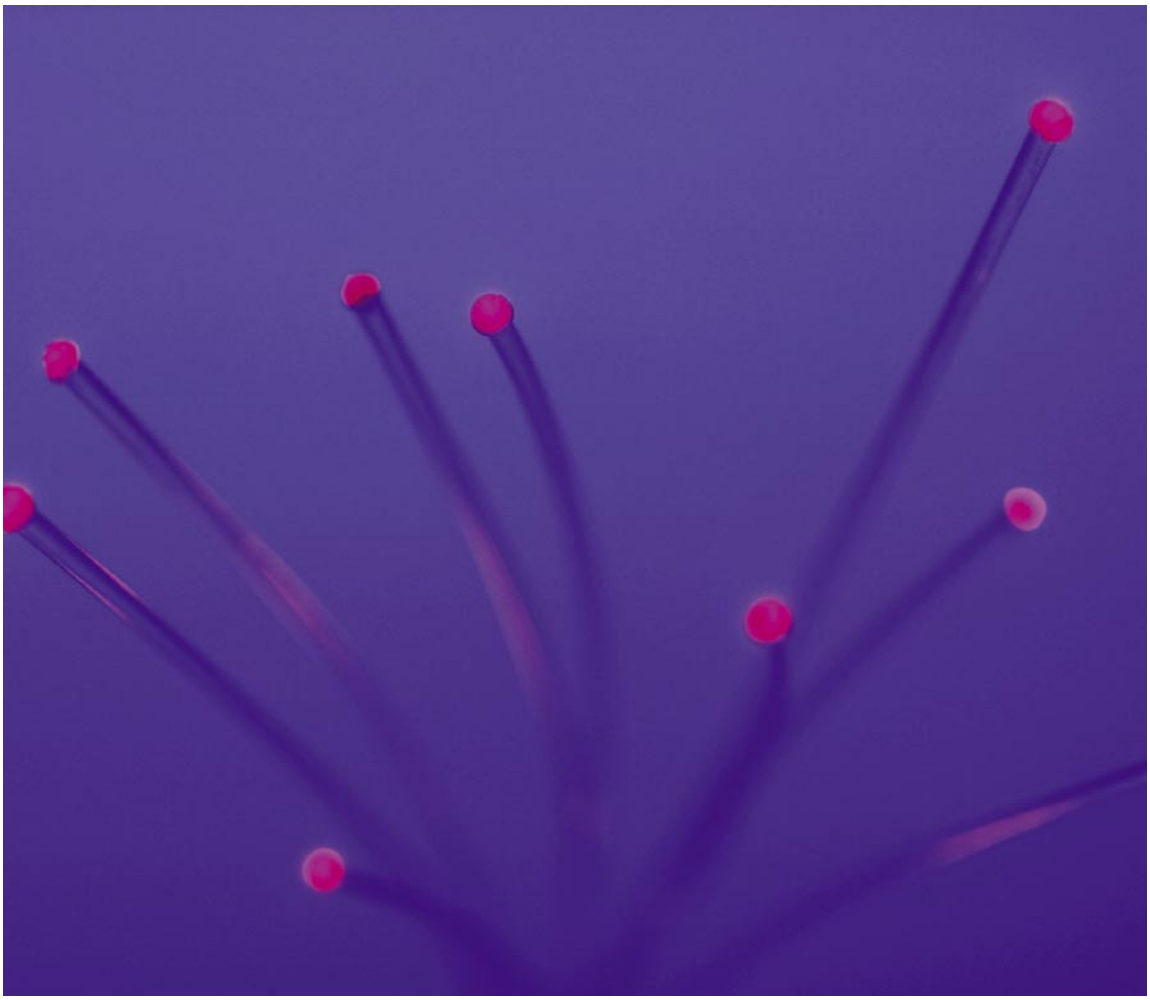
That's (Digital) Entertainment



by Kevin Carton

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The entertainment and media industry tends to be on the cutting edge of technological developments—in fact, it has often been a catalyst in the use and adoption of new technology. Remember when albums gave way to audiocassettes, and then ceded shelf space to CDs? Now DVDs, satellite television, video games and downloaded music are shaping the way we spend our leisure time.

This continual pushing of the technological envelope, and the new formats that have resulted, have expanded the entertainment and media market. But how long can growth continue, given the perils of digitisation: product piracy, illegal downloading, etc? We also have to factor in the negative effects of the war on terrorism; military action in Afghanistan; and the war in Iraq—plus the decline in consumer confidence brought about by an unprecedented series of corporate financial scandals, rising unemployment and a redirecting of investment capital away from consumer products and into the defense sector.

THE DUPLICATION MADE POSSIBLE BY DIGITAL TECHNOLOGY MEANS THAT ENTERTAINMENT AND MEDIA COMPANIES OFTEN FIND THEMSELVES COMPETING WITH THEIR OWN PRODUCTS.

The effects of all these changes are systematically analysed in the fourth annual edition of PricewaterhouseCoopers' Entertainment and Media Outlook: 2003-2007, NORTH AMERICA, a leading entertainment and media industry forecast that provides in-depth analyses and five-year growth projections for 14 industry segments in the U.S. and Canada—as well as a global overview of the U.S., Europe, Middle East, Africa, Asia-Pacific, Latin America and Canada.

Based on his work for the Outlook, author Kevin Carton—Global Leader of PricewaterhouseCoopers' Entertainment & Media Practice—looks at one particularly dynamic and fast-growing phenomenon: the digitisation of virtually every media and entertainment format. Clearly, the results of that transformation will be far-reaching and profound. Our writer explains why.

By 2010, virtually all entertainment and media will be in a digital format. But, while it has many advantages, digitisation has opened a virtual Pandora's Box of issues that challenge, and threaten, industry business models in unprecedented ways. Digitisation's chief disadvantage, from an industry point of view, is that it creates virtually unlimited opportunities for unauthorised usage, enabling perfect copies to be made in less time, with little effort, and lower costs.

Digitisation also allows content to be altered in ways that can seriously compromise a brand and violate performers' image rights. What's more, the rapid expansion of broadband Internet access will aggravate those problems by making it possible to transmit digital files ever faster and more easily.

Hollywood at Home

The duplication made possible by digital technology means that entertainment and media companies often find themselves competing with their own products. But this is nothing new: In the movie industry, for example, many Hollywood studios fought bitterly against cable television—even calling for legislation to prevent it. They fought the same battle against home video, arguing that providing uncut, unedited commercial-free movies in the home—at a far lower cost than in theaters—would erode their core business.

As it turned out, home video and pay cable became major revenue streams for studios without cutting into theatrical attendance. The basic product may be the same, but people perceive the experience of going to see a film in a theater as different from watching the same movie at home. Going to the movies has a social aspect that differentiates it from home viewing. In addition, Dolby sound, the large screen and other innovations enhance the theatrical experience. DVDs represent another advancement in home viewing, and once again, movie attendance has grown along with DVD penetration.

FILE SHARING ALSO REFLECTS THE WIDELY-HELD CONSUMER PERCEPTION THAT TRADITIONAL CHANNELS DO NOT OFFER VALUE FOR MONEY.

Life After Napster

The recorded music industry, on the other hand, has not experienced a similar growth, but is beset by unauthorised usage. It now is possible to download virtually any song for free, and to burn those songs onto a CD for the cost of a blank recordable compact disc (CD-R).

While worldwide music sales in 2002 dropped to their lowest level since 1993, the category still generated $31 billion in consumer spending, demonstrating that buying and owning albums retains its appeal. For many consumers, it is still preferable to, and more convenient than, searching out, downloading and burning individual tracks onto a CD-R. However, the recorded music industry is realising (1) that this is not necessarily the case for younger audiences, and (2) that format, cost and convenience play important roles in turning around their business.

The popularity of Internet file-sharing indicates that younger people like listening to, acquiring and sharing music online, and music companies have responded by introducing their own licensed digital distribution services. While these services are clearly a "work in progress," they have become substantially more consumer-friendly during the past year, with more liberal download policies and lower prices for individual tracks.

On the other hand, file sharing also reflects the widely-held consumer perception that traditional channels do not offer value for money. The success of price-discounting lends credence to that view. According to the

PricewaterhouseCoopers Entertainment and Media Outlook: 2003-2007, in India, for example, CD price reductions of 40% or more have led to double-digit unit sales gains. Music companies also have boosted unit sales of catalog product by discounting those items. This pattern suggests that, at the right price, consumers will buy music through legitimate channels—even when lower cost or free options are available.

However, the industry also has stepped up its enforcement initiatives around the world: seizures of pirated product have increased dramatically, Napster has been put out of business, and other file-sharing services have been sued. Enforcement efforts will never eliminate piracy or free file-sharing, but they can make doing business more difficult for both pirates and the consumers of illegal product. No surprise then, that authorised alternatives are looking more attractive to music fans.

Next-Generation Technologies

Our research suggests that while the Internet access, home video, television distribution and video game markets are maturing, next-generation technologies will be needed to spur growth. Superior technologies—such as broadband Internet access and high-definition television—will certainly strengthen those sectors, but sharp declines in older formats will dampen market expansion.

IF THE E&M INDUSTRY AS A WHOLE HAS LEARNED ANYTHING FROM THE DISRUPTION OF DIGITAL TECHNOLOGY, IT IS THAT CREATING A LARGE BODY OF UNPROTECTED DIGITAL PRODUCT SHOULD BE AVOIDED AT ALL COST.

Broadband Internet access is growing in every region of the world, spurred by expanded availability and by applications—such as online video games and digital films—that require high-speed connectivity. However, as Internet penetration nears maturity in the United States, Canada and Western Europe, new broadband subscribers in those regions will come largely from current dial-up subscribers, significantly reducing dial-up access revenues. Overall, Internet access spending, which has grown at high-double-digit annual rates, will drop to mid-single-digit growth by 2007.

The television distribution market also is making the switch to digital. The growth of direct broadcast satellite (DBS) households continues unabated. Digital cable—which grew because it was able to attract a large number of "early adopters"—has been leveling off, largely as a result of the resistance among remaining analog subscribers to high-priced digital packages. By offering lower prices, free dishes and easy access to major market local stations, DBS is now poaching cable subscribers at rates which will see an 8.4% compound annual increase in satellite households in the U.S. by 2007.

On the video games front, however, three new technologies will drive the market: new console hardware, online gaming and wireless gaming. And while these areas will grow at the expense of personal computer games, the momentum generated by multiple technologies will enable video games

to surpass Internet access as the fastest-growing overall consumer category worldwide during the next five years.

Lessons Learned

If the entertainment and media industry as a whole has learned anything from the disruption of digital technology, it is that creating a large body of unprotected digital product should be avoided at all cost.

To that end, industry players have worked to develop copy protection software standards. Introducing authorised online distribution channels early on may make it more difficult for unauthorised services to become established in other segments besides music.

There is an inherent tension, however, between maintaining security for digital content and making that content appealing to consumers. After all, consumers have legitimate reasons to copy digital files, including portability, as well as backup protection in case of computer failure. Certain copying restrictions have made digital distribution more cumbersome for consumers, but each new iteration shows improvement.

UNLESS COMPANIES ENHANCE THE VALUE-PRICE PROPOSITION, THEIR SALES WILL DECLINE AS DIGITAL TECHNOLOGY PROLIFERATES.

Another critical issue is price. Consumers' behavior shows a willingness to buy digital files—if they're less expensive than the physical product. Publishers, for instance, are meeting with considerable resistance when electronic books are sold online at prices equal to, or higher than, their print counterparts. The filmed entertainment industry is introducing movie downloads over the Internet at prices comparable to home video rentals, but it remains to be seen whether this business model—which relies on broadband Internet access—will take off.

The passivity of consumers when it comes to entertainment—"I want to sit back and be entertained"—nevertheless creates opportunities for suppliers: If the value-price equation is appropriate, consumers have shown that they'll purchase licensed product. Added convenience, ease of use or superior product content can improve the value side, while discounts or bundled products—such as a combined CD/DVD package—can improve the price side. But unless companies enhance the value-price proposition, their sales will decline as digital technology proliferates.

The Shape of Things to Come

The global entertainment and media industry has begun to recover from the 2001 downturn, but growth prospects still remain modest. According to the U.S. Commerce Department, gross domestic product (GDP) grew at a 2.4 annual percentage rate during the second quarter of 2003, a whole percentage point beyond the moribund 1.4% rate seen during the first quarter.

That is obviously good news, especially since a large portion of this second-quarter growth was the result of a healthy 3.3% increase in consumer spending, which, since it makes up more than two-thirds of the U.S. economy, cannot help but have a positive effect in the entertainment and media markets.

In fact, a number of entertainment and media segments are growing rapidly, spurred by new technology. DVD sales, for instance, are propelling the home video market, and, according to PwC's *Outlook*, spending on video games will grow at double-digit rates over the next three to five years.

It is too early to say whether the economy is in full recovery, but the prospects for the entertainment and media markets look promising. And, clearly, the digital distribution of content is here to stay, with new business models being developed continually to make it appealing to consumers and profitable for the industry.

THE DIGITAL DISTRIBUTION OF CONTENT IS HERE TO STAY, WITH NEW BUSINESS MODELS BEING DEVELOPED CONTINUALLY TO MAKE IT APPEALING TO CONSUMERS AND PROFITABLE FOR THE INDUSTRY.

Kevin Carton *is global leader of PricewaterhouseCoopers' Entertainment & Media Practice, based in New York City.*

Kevin advises entertainment and media clients worldwide on strategies to succeed in the rapidly changing environment surrounding the content, information and communications industries. He has served numerous Fortune 500 clients and multinational companies and has extensive experience consulting on mergers and acquisitions as well as post-merger integration of companies acquired. Kevin's clients have included AOL Time Warner, CBS/Viacom and the Associated Press among others.

As host of PwC Convergence Summits in the US, Europe, Asia and South Africa, Kevin has discussed business challenges and opportunities with industry leaders in those markets, and shared the findings of PwC's annual Entertainment and Media Outlook forecast. He is a member of The Museum of Television & Radio's International Council, and earned both his BA and MBA degrees from Rutgers University.

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