# Digital Hollywood: How Internet and Social Media Are Changing the Movie Business

Alejandro Pardo

## 1 Introduction

The history of Hollywood runs in tandem with the history of technological development. The inclusion of sound, followed by that of color, along with the need to adapt to new audiovisual media (first television and then video), are milestones in the history of the largest entertainment factory in the world. Each of these forms of technological development in turn marked a growing pain or turning point at the time of its invention, by which the Hollywood industry was ultimately strengthened. However, the changes over the last decade have been both more fast-paced and more far-reaching than anything that came before. The digital revolution and globalization have transformed the film and TV industry in ways that could never have been foreseen. The big Hollywood studios have been forced to respond to the uncertainty—and potential for profit—prompted by the popularity of the Internet and the success of new digital platforms, especially among young people.

This chapter is an attempt to trace the recent evolution of the present and future challenges the Hollywood industry is facing up in this paradigm shift—from analogical to digital. In order to respond to the complex nature of this phenomenon, I will try to cover, in an exploratory way, a different set of topics, going from the change in consumption habits and the emergence of new virtual markets to the clash of management mentalities, the search for the right business model and a summary of some of the key transformations the entertainment industry is experiencing.

The literature at this respect is quite abundant. On the one hand, some authors have studied the economics of the media and entertainment industries as a whole (Ulin 2009; Vogel 2010) or in the particular case of Hollywood (De Vany 2004; Epstein 2010), not to mention those who have emphasized the impact of globalization and digitalization (Hoskins et al. 1997; Miller et al. 2005; Holt and Perren 2009). On the other, some

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experts have approached the issue of media convergence and new technologies in general (Jenkins 2006; Pavlik and McIntosh 2011) or focused on the consumer (Tapscott 2009) and on the market (Anderson 2006, 2009). On the specific case of the relationship between Hollywood and the Internet, we can also find a series of books published along the last decade, which represent a critical account of the different attitudes the majors studios have had towards new media (Geirland and Sonesh-Kedar 1999; Dekom and Sealey 2003; Lasica 2005; Tryon 2009). On top of that, I am especially relying of the researches done by some scholars on how Internet and the digital economy are changing the current business models and management strategies in the media industry (Stöber 2004; McPhillips and Merlo 2008; Clemons 2009; Vukanovic 2009; Artero 2010) and more particularly in the case of the Hollywood studios (Currah 2006; Perren 2010; Iordanova and Cunningham 2012). Lastly, I am including numerous news and data from trade papers like *Screen Digest*, *Screen Daily* and *Variety*.

What follows is a step forward from previous researches already published (Pardo 2009, 2012).[1] First, I will examine the defining features of the emerging consumer profile and address the most significant elements of the new digital economy, epitomized by the 'long tail market' model. Secondly, I will describe the Hollywood reaction to this new digital scenario and discuss on the business models adopted by major American studios in relation to the online audiovisual market. Thirdly, I will summarize some of the most significant transformations Hollywood is undergoing. Finally I will draw some concluding remarks, which will be necessarily open due to the permanent state of change, innovation and tentativeness of this digital scenario.

## 2 Being or Not Being Digital

In mid-1990s, Nicholas Negroponte announced in his famous book *Being Digital*: "I am convinced that by the year 2005 Americans will spend more hours on the Internet (o whatever is called) than watching network television" (Negroponte 1995, p. 98). Although this prediction has not yet been fulfilled to the letter, the truth of what he argued is likely to be confirmed in the near future. Effectively, as *Newsweek* graphically illustrated in July 2010 under the provocative title of "How the Digital Revolution Changed Our World", the daily time spent in the Internet by the average US citizen has growth from 2.7 h per week to 18 h in the last decade. In addition, the amount of downloads for entertainment content on iTunes surpasses the ten billion figure (*Newsweek* 2010).

Something is changing in our planet. To get just a glimpse of it, let's take a look at the rapid expansion of the 'Apple ecosystem'. Since 2001, the late Steve Jobs'

[1] A preliminary and shorter version of this text was published under the title of "Hollywood and the Digital Revolution: New Consumers, New Markets, New Business Models", in Tribulations numériques du Cinéma et de l'Audiovisuel à l'amorce du 21e siècle, monográfico de Mise Au Point, Cahiers de l'Association Française des Enseignants Chercheurs en Cinéma et Audiovisuel (AFECCAV) [on line], n. 4, 2012. URL: http://map.revues.org/246

company has sold more than 140 million of iPods. Equally, the success of the iPhone first and of the iPad latter has no precedent. The company surpassed the figure of 100 million units sold in the whole world by the end of 2012 in the case of both devices which amount to more than 50 % and 20 % of the company's annual income respectively. As a result, following the market-launch of the iTunes Music Store, the Apple brand has commercialized more than 16 billion songs, over 3 million feature films, and approximately 100 million TV shows since October 2005. On top of that, at the beginning of 2013, Apple Store announced that customers have downloaded over 40 billion apps, with nearly 20 billion in 2012 alone. Despite of being mainly a hardware company, Apple has now over 435 million iTunes accounts with credit cards attached (McBride 2006; Fritz 2007; Screen Digest 2007, 2012; Grover 2008; Hesseldahl 2008a, b; Apple Press Info 2013). This 'iPod/iPhone/iPad generation' epitomizes the new peer group of users whose audiovisual experience is based on all sorts of media platforms and whose profile to a large extent mirrors that of the cinema-going public and those who play videogames. For that very reason, Apple competitors (Microsoft, Samsung, Sony, Google, Amazon, etc.) are trying to catch up the train of the present-and-future technology and to come up with the right business model.

"How will all this revolution affect to the movie business? Some recent market indicators show there is no reason to be worried about. According to Screen Digest, consumer expense on online movies and TV shows in USA doubled from 200 to 400 million dollars between 2008 and 2010—being rental more solid than retail—and reached the 900 million figure at the end of 2011 (ScreenDigest 2009, 2010a, b, 2011c, 2012c). Similarly, revenues from the European online video market were worth of 350 million Euros at the end of 2011, a substantial growth in regard to previous year (ScreenDigest 2011a, 2012b). On top of that, the total online revenues for international territories (outside the US) increased to more than 276 million US dollars in 2010, a 117.5 % rise over 2009 (*Screen Digest* 2011b). Finally, according to the last Deloitte's *State of the Media Democracy* global report (including data for 2011), the number of people opting to stream movies (42 %) is getting closer with those who watch them on DVD, Blu-ray or VHS (51 %). Whereas DVD viewership has scaled down two points over the past 2 years, the number of people who cited streaming as their favorite way to watch a movie increased from 4 to 14 % (Morris 2012a).

Thus, Hollywood is standing at a new digital (and global) crossroad, charted by two basic movements: on one hand, the emergence of a new market for the commercialization of audiovisual products (Internet, digital reproduction devices, smart phones, smart TVs), initially framed under 'the long tail market' tag; and, on the other, the emergence of new type of consumer, known collectively as 'the iPod-' or "the Net-generation" (Tapscott 2009). The two, linked questions set out below sum up the challenges facing the major studios in Hollywood: What new consumer habits define this emerging viewer/audience profile? And, as a consequence, what business model will define the network of relations on the Internet with regard to the commercial practices of the film and TV series industry? Or, in other words, what are the rules governing this new

market? These two questions are closely bound up together; the response to one conditions any response to the other.

## 3 'The Martini Culture' Meets 'The Long Tail' Markets

> The Internet is the most liberating of all mass media developed to date. It is participatory, like swapping stories around a campfire or attending a Renaissance fair. It is not meant solely to push content, in one direction, to a captive audience, the way movies or traditional network television have done. It provides the greatest array of entertainment and information, on any subject, with any degree of formality, on demand. And it is the best and the most trusted source of commercial product information on cost, selection, availability, and suitability, using community content, professional reviews, and peer reviews. (Clemons 2009, p. 17)

This description of the new virtual world drawn by the expansion of the Net reveals a complete new scenario to play the business of entertainment game. The rules have changed as well as the number of key players. Within this game-board, Hollywood studios are trying to make sensible moves.

The Internet has brought with it a new peer group of 'digital natives'. Marketing experts are convinced that this generation of new technology users has now reached a critical mass in numerical terms, and their consumer behavior is markedly different to that which went before. Among others, the following features should be remarked: (a) a more participative and active attitude with respect to audiovisual and entertainment contents (user generated contents); (b) multi-tasking skills; (c) new forms of socializing through virtual communities; (d) a preference for versatility and portability over quality in consumer use ("platform agnostics", in the words of David Denby, the renowned film critic at *The New Yorker* (Denby 2006)); (e) new consumer behavior as a catalyst for the creation of new market niches (low demand, personalized and individually tailored consumption); and (f) unconventional understanding of the free circulation of audiovisual material (piracy).

This matrix of aspects has been distilled into the well-known slogan taken as the motto for the new media scene: "*What* you want, *when* you want, *where* you want and *how* you want". Or, as Michael Gubbins—editor of *Screen Daily*—calls it remembering an iconic advertisement of the 1970s, this is the ultimate expression of 'the Martini culture' in our "ubiquitous leisure society". In regard to this term, he explains:

> It is the sexier big sister of the more prosaic term ICE (information, communication and entertainment) coined in India during the dotcom boom to denote a marriage of information technology and entertainment. And to an extent, both dreams have come true. It is barely impossible to walk 100m in a city in any developed country without seeing the distinctive white earphones of an iPod. Mobile gaming is expanding quickly and telephones have lost their dowdy role as a means of speaking to people, to become portable electronic leisure centers. (Gubbins 2008)

The following question inevitably arises in this context: What rules govern business in this new window of commercial opportunity? Chris Anderson, editor of *Wired*, christened this recently discovered 'gold mine' with the name 'the long tail', a term that has since become common currency (Anderson 2004, 2006). His argument, which soon drew on empirical evidence from an analysis of several companies in the retail sector, runs as follows: commercialization on the Internet is not a marginal market; rather, it is an emerging market whose value is increasing all the time. This argument for Internet commercialization defers to three reasons: (a) the Internet brings together a dispersed and fragmented audience which, as a whole, constitutes a significant market; (b) distribution costs are eliminated and product consumption becomes more personalized and attuned to the demands of these 'digital natives'; and (c) popularity is no longer the key factor in market value; in fact, the Internet is especially apt (and profitable) for the sale of relatively unknown or minority interest products (Anderson 2004, pp. 174–177).

Thus, the emergence of this new virtual market undermines one of the classical laws of consumer goods economics—20 % of products account for 80 % of sales (the Pareto principle). Having analyzed the online services of companies such as Amazon, Netflix and Walmart, Anderson concluded that the proportion of products that contribute to overall profitability in virtual markets might be as high as 98 %. This conclusion does not mean that the most successful titles in conventional distribution channels cease to be so in the virtual world; however, less well-known or minority interest products also become more easily available and are acquired by the fragmented audience(s) of which the virtual market is composed. As a result, a specific catalogue of audiovisual goods may repay on the outlay involved in their production, and marginal profits may rise.

Finally, Anderson outlines three rules to govern this new business model, entirely focused on the consumer's leading role and singularity: (1) availability of a wide range of titles ("make everything available"); (2) competitive pricing in comparison with other distribution channels ("cut the price in half; now lower it"); and (3) personalized consumption ("help me find. . .") (Anderson 2004, pp. 174–177). And he concludes: "The companies that will prosper will be those that switch out of lowest-common-denominator mode and figure out how to address niches" (ibid., p. 177).

However, this theory has been criticized by some well-known scholars. Anita Elberse (Harvard Business School), for example, based on her own empirical research, states that the tail may be long but is equally flat in terms of benefits. In addition, she affirms that compared with heavy users, light users have a disproportionately strong preference for the more popular offerings, while both groups appreciate hit products more than they like those in the tail. As she concludes:

> It is therefore highly disputable that much money can be made in the tail. In sales of both videos and recorded music—in many ways the perfect products to test the long-tail theory—we see that hits are and probably will remain dominant. That is the reality that should inform retailers as they struggle to offer their customers a satisfying assortment cost-efficiently. And it's the unavoidable challenge to producers. The companies that will prosper are the ones most capable of capitalizing on individual best sellers. (Elberse 2008, p. 96)

In my view, both interpretations can be compatible. On the one hand, it is clear that Internet has widened the commercial exploitation for all sorts of products and, therefore, has given opportunity to those considered “marginal” or “obscure”—with no chance of commercial exposure through the conventional windows. On the other, hits will always be hits. They will continue to act as the locomotive for entertainment consumption and will therefore remain as the hard core of the business.

In this regard, after some false starts, a number of the changes to business strategies adopted by Hollywood studios in recent times have attempted to take those principles mentioned above into account. For any key player in the entertainment industry aimed at a ubiquitous leisure society, the challenge is to understand this new scenario, where ‘the Martini culture’ meets ‘the long tail’ markets.

## 4 Hollywood at the Digital Crossroad: A Management Clash?

Contrary to what it could be assumed, Hollywood has been quite reluctant for many years to face up these profound changes. Two insiders as Peter Dekom and Peter Sealy asked in 2003:

> How has Hollywood responded to the huge changes afoot? Unfortunately, no very well so far. First, Hollywood has ignored the facts both inside and outside the industry… [It] has fought to put the technological genie back in the bottle. The Hollywood approach: change must be legislated o litigated to a stop. (Dekom and Sealey 2003, pp. 2–3)

Another expert analyst as Joseph D. Lasica, pointing out at this resistance from the Hollywood majors, assessed in 2005:

> Media companies need to learn to let go. Successful entertainment companies will create new products and pricing schemes, embrace fair use by giving customers flexibility in choosing how they want to view or listen to a work, and give outside innovators the freedom to tinker with and improved existing products. Media companies should embrace their digital destiny, even as their business models suffer short-term dislocation. (Lasica 2005, p. 265)

From inside Hollywood, opposite voices can be heard. Although the majority of studio executives assume the need for change, others get despaired at the slow rhythm of the decision-making process within the huge and bureaucratic corporations. This is the case, for example, of David Wertheimer, former Paramount Digital Entertainment Head and current President of Digital Fox. Few years after abandoning the former studio, he assessed:

> In the studios… you end up doing things that are slow and incredibly safe… In order to move quickly enough, you have to think like a startup—and that means you have to *be* a startup and run like a startup. The studios are always going to be followers rather than leaders. (in Rose 2000)

Why does this fear to change exist? Someone as significant as George Lucas points it out in a very clear way:

> The consortium of rich corporations that used to control this entire medium are now doomed… In some ways we're moving to a world without borders. We are seeing a paradigm change in how movies get made, how they get distributed, and the Internet has pretty much wiped out those borders. Now you can get people around the world to see your film. (in *Screen Daily* 2010)

In other words, what is at stake is the current Hollywood *status quo* as unbeatable oligopoly of production and distribution of branded entertainment content. Executives at the major studios acknowledge that the existing commercial models are in terminal decline. Box-office takings in mid 2000s amounted between 10 and 15 % of total income. The other 85–90 % was generated through the sale of audiovisual products designed for use at home and/or in an individualized way (DVD sales and pay-per-view television). Nevertheless, the digital revolution is also likely to radically transform the market in this regard. The physical copy of the audiovisual product is disappearing, and the existing distribution channels along with it. According to *Screen Digest*, traditional physical rental video spending fell from 51 to 36 % in the United States in 2010, whereas subscription video spending reached as much as 42 %—thanks to Netflix, among others (*Screen Digest* 2011a). Nevertheless, the industry response to this prospect ought to be measured.

Hollywood studio executives have now taken careful note of the rules detailed above. Having been initially resistant—if not openly hostile—to the development of television and video, and thus slow to adapt these new media to their existing business model, the response of such executives to the emergence of new technologies has been markedly different. Nowadays, there is no one reluctant about it—"We have to adapt", said some years ago Barry Meyer, former Chairman and CEO of Warner Bros. Entertainment, "or we'll become dinosaurs" (Denby 2006). And more recently, Mike Dunn, president of Twentieth Century Fox Home Entertainment, stated: "The opportunity in front of us is bigger than it's ever been. We're looking at a renaissance here" (Marich, 2013). However, prudence must rule the progressive incorporation of new business models. As Bob Iger, CEO of The Walt Disney Company and one of the most committed defenders of digital change in Hollywood, explains:

> I have tried to keep two obvious philosophies. First, that our current business not get in the way of adopting new technologies, and, second, that our business belongs to these new platforms. (Swisher 2010)

In other words, the *quid* of the question is how incorporate new business models without killing the most profitable window—home entertainment, which includes DVD, Pay TV and different forms of online video-on-demand (iVoD).

If the Hollywood reaction to the digital scenario shows anything, this is a sort of management clash: the new and challenging versus the old and conservative; or, in other terms, the 'digital' mentality versus the 'analogical' one. This is one of the conclusions deducted by Andrew Currah (2006) after interviewing 150 Hollywood executives. In particular, he summarizes three concluding remarks. First, Hollywood's strategy has been one of preserving the current sequence of commercial windows, rather than exploiting the disruptive power of new technologies (protectionism from oligopoly). In his words, "this has been the case of the collision

between Hollywood (a mature oligopoly overseen by six studios) and the Internet (a decentralized P2P [peer-to-peer] architecture)" (Currah 2006, p. 463). Similarly, Frank Rose, editor of *Wire*, pointed out at the turn of the century: "Hollywood exists to feed the proven bottom line, not to invent the next one" (Rose 2000).

Secondly, we should understand at the same time the main reasons argued by Hollywood executives for their hesitancy. On the one hand, the risk of DVD cannibalization—killing the most profitable window—and the subsequent pressure exercised by big retailers' like Walmart or Blockbuster (until recently, DVD accounted for 55 % of total income). On the other hand, the cost of clearing rights for the Internet (Currah 2006, pp. 455–463).

Thirdly, despite of the fears and reluctances, there is no doubt the future of Internet as window depends on Hollywood involvement (ibid., p. 463). As *Variety* stated at the beginning of this decade,

> Hollywood is suspicious of technology. It always has been. But when it comes to the World Wide Web, it turns out that Hollywood is actually taken over the reigns of Internet entertainment—it just hasn't done it the way everyone thought it would. (Graser 2000, p. 22)

What lies behind this Hollywood management clash, in Michael Gubbins' words, is the collision between two opposing discourses. One is that "the current technology trends are no more than the 'digitisation' of the existing business; just another big step in a series of evolutionary changes in the history of cinema" (Gubbins 2012, p. 70). This approach acknowledges the disruptive power of digitisation in the short term, but understands the immediate future just in terms of replacements or upgrades of existing standards and processes. The other is that "digital represents a wholesale change in consumer attitudes and even taste, based on interactivity and a democratisation of the process of film-making" (ibid., p. 71). This second perspective aims at the real core of the digital revolution, as stated along these pages.

In summary, the new digital scenario is demanding a change of business and management mentality: the old assumptions of limits on creation and access, typical of an economy of content scarcity must open way to the new value drivers of free access, almost infinite variety of products, customized consumption, content aggregators and search engines, typical of an economy of abundance—although with time and expense restrictions.

The move from analogical to digital has been slow and extended in time. At the beginning of the new millennium, the alliance between Hollywood and Silicon Valley became more intense. Technological companies were looking to create Hollywood relationships and a number of industry players moved to 'dot-com' companies. Nevertheless, and it was stated at the moment, "Hollywood's new Web-friendly stance and new deals don't necessarily mean Hollywood understands the ways of the Web" (Graser 2000). In fact, it was more a question of using Internet as a testing laboratory for commercial exploitation or being the first to show (Graser 2000; DiOrio 2000). This attitude towards new markets is quite typical in the case of oligopolistic industries, as Currah explains:

> The commercial developments of new markets and technologies often takes place in a bifurcated fashion, particularly in oligopolies. Specifically, it is possible to make a broad distinction between processes of *exploration* and *exploitation* (Tushman & Anderson, 2004). First, the exploration of emerging markets tends to be pioneered by smaller firms, outside the orbit of incumbent firms... Second, a tipping point occurs when emerging markets obtain a critical mass, attracting the interest of incumbents. In a few cases, this process of exploitation might lead to the displacement of incumbents and the ascendance of innovative 'first movers'... In most cases, however, the growth of a new market actually depends upon incumbents given their assets and market power. Generally innovators are more likely to 'sell out' rather than challenge the ruling oligopoly. (Currah 2006, p. 463)

Effectively, the never-ending strategic movements of mergers, acquisitions and alliances that have taken place along this decade exemplify this dynamic: Fox + MySpace, Disney + Pixar + Apple, Blockbuster + MovieLink vs. Walmart + Netflix, Google + You Tube vs. Hulu, Amazon-Unibox + TiVo, etc. These strategic initiatives provide ample evidence of the determination of Hollywood studios not to miss the boat on so-called *gear-media*. The alliance between Hollywood and Silicon Valley is becoming tighter, like the recent appointment of Bob Iger (CEO of Disney) as new member of Apple's board exemplifies (Lawson 2007; Wallenstein 2011a).

## 5 Business Models: What Did Go Wrong, What Should Be Right

For the Hollywood studios—as well as for the rest of the key players in the entertainment industry—the search for the right business model in Internet has become as harder and crucial as the quest for the Philosopher's Stone. As one industry expert assesses,

> Once upon a time... the movie business was about making movies. Nowadays, it is about creating intellectual property that can be licensed in a raft of different markets... The [Hollywood] studios stand to gain even more from huge audience willing to pay to download movies from their libraries... [Therefore], the real issue for Hollywood studios is how they can dig into this potential gold mine without undermining their existing revenue streams. (Epstein 2005)

Apparently, the theoretical principles have been always clear, but reality has widely demonstrated that this new market—this new consumer—has its own rules. Back in 2001, a *Variety* expert stated,

> Advertising, development, syndication and subscription. The seeds have been planted for profitability, but all these business plans are facing a dot-comeuppance. The basic problem? Nobody can quantify or define the type of content people are willing to pay for... Netizens are willing to pay for content if they get something in return that facilitates their Internet experience, and this realization is starting to dawn on traditional entertainment outlets. (Donahue 2001, p. 18)

More recently, some scholars like Eric Clemons explains how the majority of attempts to date to monetize Internet applications targeted at individuals have been based on natural extensions of traditional media or traditional retailing—in

particular, some form of consumer-focused advertising and/or of consumer-focused e-commerce. Nevertheless Internet “is far more powerful than traditional media on one hand, and far more liberating and thus inappropriate as an alternative to traditional media on the other” (Clemons 2009, p. 15). Apart from those business models based on advertising, the two others with more potential are “those that sell some product, experience, content, or service and earn revenues from the sale, and those that provide access to consumers and charge for access” (ibid.). In summary, “selling real things, selling virtual things and selling access” (ibid., p. 19). In this regard, Hollywood studios, as content and service providers, are potentially at the pole position in this new digital scenario.

In addition, other authors like Simon McPhillips and Omar Merlo assess that,

> [t]he fundamental principles of the industry’s business model are not changing. It will still centre on mutually advantageous relationship between media owners, consumers and advertisers. However, what is also evident is that the dynamics contained within the model are radically changing. (McPhillips and Merlo 2008, p. 251)

For this very reason, as a number of industry analysts have pointed out, the future of the film and TV online business model will be dependent on a hybrid financing structure, involving a combination of direct (pay-per-view and subscription) and indirect (advertising and sponsorship) funding (Fritz 2007). The three current business model to consolidate are: (a) *Transactional*: consumers can buy a permanent download (‘download-to-own’, DTO), rent a temporary download or buy temporary access to a stream (VoD rental); (b) *Subscription*: consumers can subscribe to an ‘all-you-can-eat’ rental service offering temporary downloads or streams in return for a single monthly fee (SVoD); and (c) *Ad-supported*: consumers can download or stream titles for free in return for watching video ads within the content (FVoD) (*Screen Digest* 2007, pp. 270–271; Perren 2010, p. 73). Which one would be the most significant in terms of income, is still an open question. Paying for contents and services will experience the most significant growth according to some experts (Clemons 2009, p. 33). Nevertheless, ad-supported formulas will be remain if they can find ways of being unaggressive and naturally embedded in the audiovisual content (McPhillips and Merlo 2008, pp. 250–251).

Surprising though it may seem, Hollywood took a long and hard way to learn the lesson. In fact, the failure of the first business models adopted by the studios in response to the commercial potential of new technologies—CinemaNow, MovieLink and MovieBeam (Disney), the three first websites for downloading movies, launched in 1999, 2002 and 2005 respectively—was attributed to an error at the level of basic principles: if the Internet is to be a new entertainment platform capable of competing with the conventional media (DVD rental and pay-per-view TV) then either the audiovisual experience it offers should be more attractive and user-friendly, and thus sold at a correspondingly higher price, or its products should be sold at prices considerably lower than those of the existing media. Nevertheless, the reality was quite the contrary: high prices for a limited (library) and not very satisfying (downloading problems) viewing experience (Pardo 2009, pp. 77–79). With a wisdom based on common sense, *Billboard* analyst Michael Greeson wrote

an article prophetically titled "Movie Downloads: Why This Model Won't Work"... (Greeson 2006). Effectively, the three of them ceased operations few years later, after being sold out and merged. Only the emergence of the iTunes model—first for music (2001), then for any sort of audiovisual contents (2005)—marked a turning point (Pardo 2009, pp. 81–82). Since then, the iTunes formula of buying a wide variety of music, films and TV shows on a single basis, at a reasonable price and in a very user-friendly way has been an continuous success. According to Clemons,

> Apple's iTunes is the most successful at charging for content, perhaps because the price for an individual song is low enough and the prospects of litigation are now daunting enough to discourage piracy (Clemons 2009, p. 33)

Some *Screen Digest* data illustrate this level of hegemony: Apple reached 63 % of the online movie market share in the first half of 2011, followed in the distance by Microsoft (17 %), Vudu-Walmart (6 %), Amazon (5 %) and Sony-PlayStation (4 %) (*Screen Digest* 2011c).

Nevertheless, there are still some contrasting attitudes inside the Hollywood system. In a very suggesting article, Alisa Perren points out the different strategies the film and TV divisions of media conglomerates have employed in circulating their properties on line. In this regard, she assesses:

> In general, the television divisions... of the media conglomerates (especially the Big Seven [Hollywood studios]) have reacted in a far more proactive manner in terms of their online distribution efforts than have the theatrical motion picture divisions of these same companies (Perren 2010, p. 73)

To illustrate this point, she mentions two productions from the same media conglomerate, News Corporation-20th Century Fox: the TV show *Glee* and the feature film *Wolverine*, both of them released at same time of the year (May 2009). Whereas in the case of the TV show, Fox network used Internet to distribute and promote the program as wide as possible (Fox.com, MySpace, Hulu, iTunes), the film division tried to prevent any circulation of the movie online without success—it was illegally leaked online months before the theatrical release and downloaded more than four million times worldwide, causing a estimated loss of 30 million US dollars in ticket sales (ibid.).

This same author offers some reasons to justify this different mentality. Regarding TV divisions, Internet has a promotional value attached; it helps viewers to stay up; and it enables to compile more precise measurement figures for viewership on multiple platforms (ibid., pp. 73–74). In summary, "placing the content online following a program's initial broadcast marks an effort by the networks to combat viewer erosion" (ibid., p. 73). In the case of the conglomerates film divisions, apart from the piracy risks, their reluctance to place movies online is based on the theater owners' opposition to make any changes in the existing windows sequence; the nature of the film text—its value is somehow diminished; and some others cultural and economic reasons—the cinema going experience and the need to keep the enhanced theatrical standards in the case of blockbuster franchises (ibid., pp. 75–76). As a consequence, until now,

"the first content made available online is mass appeal broadcast fare and highly niche-oriented feature films" (ibid., p. 76).

Among her arguments, Perren doesn't mention the risk of 'cannibalization', although it represents one of the greatest fears for the Hollywood executives, as seen before. Nevertheless, there are some examples that contradict that threat. Perren offers one of them. The movie *Flawles* (2007), a crime drama starring Demi Moore and Michael Kane, coproduced by Magnolia Pictures, earned 1.2 million US dollars at the box office and more than 2 million through video on demand (Perren 2010, p. 76). And even more clear, when *Iron Man* became available on iTunes in September 2008, it sold more than 1 million US dollars in 2.99 US dollars downloads in its first seven days of release—almost pure profit, because of the low cost of delivery. Nevertheless when the same movie was released in DVD, it achieved the 140 million US dollars revenue figure in its first week (Barnes 2008). A similar case was Clint Eastwood's *Gran Torino*, which earned 60 million US dollars from VoD and downloads, against a total box office take of 148 million US dollars (Gubbins 2012, p. 82).

## 6 Towards Digital Consensus?

In fact, it seems that Hollywood has finally come to terms. One revealing fact, for instance, is its corporate presence in one of the most important new technologies forum for the entertainment industry, the Consumer Electronics Show (CES) at Las Vegas, source of big events and important announcements every year. There, the Hollywood studios and other entertainment companies meet hardware and software manufacturers as well as any sort of state-of-the-art technology companies, looking for the latest digital delivery platforms for content distribution and even for potential franchise ideas. And not only the studios are doing so, but also well-known celebrities like Tom Hanks, Justin Timberlake, Barry Sonnenfeld or Will Smith (Graser 2012b; Stanley 2012).

In the 2010 CES edition, a consortium of the major Hollywood studios, retailers, cable operators, hardware manufacturers and rental services (with the exception of Disney and Apple) known as Digital Entertainment Content Ecosystem (DECE), announced the launching of UltraViolet, an online content locker that stores and plays movies and TV shows on a variety of devices.[2] This platform is intended to enable consumers to purchase a film from any provider and store it online in order

[2] DECE is made up of more than 75 members, which pretty much covers most major entertainment suppliers and device manufacturers. Founding members include Best Buy, Netflix, Comcast, Cox Communications, BSkyB, Intel, Microsoft, Cisco, Dell, IBM, HP, Toshiba, Samsung, LG, Nokia, Motorola, Dolby, Adobe and Sonic Solutions. While Fox, Warner Bros., Paramount, Lionsgate and NBC Universal are supporters, Disney is focusing on its similar Disney Studio All Access offering. Apple is also holding out from joining the organization, although it's likely that DECE's companies will create apps that will play UltraViolet content on devices like the iPod, iPhone and iPad.

to view it using any device with Internet connection—computers, smart TVs, cable set-top boxes, Blu-ray players, videogame consoles, smart phones and tablets.

The most significant change is that this new online device really meets the consumption habits and demands of the 'digital natives'. Every single household can create an account for six family members to access their movies and TV shows, and later music, books and other digital content, from retailers, cable operators and streaming services. Up to 12 different devices can be registered—to cover most of the hardware options on the market, being possible up to three streams at a single time. In addition, content can be downloaded and transferred onto physical media, like recordable DVDs, SD cards and flash memory drives.

In words of Mitch Singer, DECE president and chief technology officer of Sony Pictures Entertainment.

> We've tried to emulate consistent consumer behavior [in developing this service]. . . What we found was that consumers were getting content from the Internet for free and burning DVDs for friends or playing it across every device. We looked at what consumers are currently doing and gave them that with UltraViolet (Graser 2011b).

On his part, Thomas Gewecke, president of Warner Brothers Digital Distribution confirms:

> We believe that UltraViolet will provide consumers with an easy-to-use way to buy and watch digital entertainment across multiple devices. . . Making interoperability possible meets a key consumer need and fundamentally improves the digital video experience. With UltraViolet, consumers will be able to purchase a title once and enjoy it anywhere and anytime they wish (Graser 2010).

Three years since its launch, UltraViolet is still at the takeoff phase. On the one hand, it is still only available in a few English-speaking countries (US, UK and Canada, and hopefully it will reach Ireland, Australia and New Zealand in 2013). On the other, its title library is still limited. On top of that, the process of loading films is still less than optimal and the promise of being able to watch your film on any device is one that hasn't completely been fulfilled yet due to different DRM formats. Those early-stage problems have led some analysts to remain skeptical about this digital locker's long-term success. One strategic innovation consultant assesses.

> I'm not convinced UltraViolet is the silver bullet studios are looking for. At the end of the day, a customer is looking to purchase a piece of content and have it run right out of the gate on virtually any device.. . . Studios, to their credit, are intent on embracing the digital revolution, but they need to be as flexible as possible and keep it as simple as possible. From the customer's perspective, convenience and comfort win (Morris 2013).

In any case, Hollywood is ready for UltraViolet service to go mainstream. By the end of 2012, this platform had achieved nearly 9 million accounts, according to the Digital Entertainment Group. Nevertheless, home entertainment executives at the studios calculate it would need at least 20 million accounts to be considered consolidated (ibid).

Meanwhile, Disney—the only self-excluded studio in this venture—, after some false starts (Disney Studio All Access, Disney Movies Online) is developing its own online window named Disney Movies Anywhere (Graser 2012a). In addition, the Mouse firm announced a new rental deal with YouTube. The Google-owned video online platform offers Disney films for rental on its website, ranging from 1 to 4 US dollars depending on whether they are library titles or releases timed day and date with the home-video window. This rental deal is just a step forward in the increasing cooperation between the two companies, whose strategic plans include a co-branded channel with original programming that would reside both on YouTube and Disney.com (Kaufman 2012; Wallenstein 2011b). On its part, Apple is also out of UltraViolet, confident is its power as leader in the online movie market so far. As these two cases illustrates, the dilemma here is whether joining efforts in a single-platform and dilute your own brand power or betting for a different platform trusting in the your brand market appeal. The *quid* of the question, of course, relies on the consumers' acceptance of a variety of digital lockers to access the entertainment contents they want.

Finally, it is worthy of mention the support that some Hollywood big stars are granting to some online initiatives. This is the case of Tom Hanks and Justin Timberlake—to name just two examples. The former attended the 2012 CES edition to present his upcoming digital production, *Electric City*, a 20-episode animated series, coproduced by his company Playtone together with Reliance Entertainment and Yahoo (Wallenstein 2012). Also in this same CES edition, singer and actor Justin Timberlake, one of the MySpace's investors, announced the teaming between Panasonic and MySpace for the rollout of the social network's new social TV experiment (Morris 2012b).

## 7 The Future Is Now: Movie Business in Digital Hollywood

The previous pages reveal the profound transformation the Hollywood industry is undergoing due to the digital revolution. Some of the authors I have been quoting offer right diagnoses and make thoughtful propositions in this regard. McPhillips & Merlo, for instance, underline how value chain is decoupling, new strategies must be consumer-centric, and business models more 'equitable' between consumer's and advertisers' interests (2008, pp. 251–252). On his part, Clemons, concluding his research on how to monetize Internet and websites, assesses that "community content recommendations, social search, and contextual mobile advertising" provide "value for users, as long as they are trusted". And he adds: "the greater the monetization of each, the less trusted it may become, and the more subject it may be to deliberate manipulation" (2009, p. 33). In his study about strategic management of new media, Vukanovic analyze the five most successful international conglomerates—four of them including Hollywood studios—and identifies six factors to explain the successful growth of them: cross-media content distribution leveraging and repurposing, innovation management, vertical integration, vertical expansion, media diversification, and large number of shareholders (2009, pp. 82–87). Finally, after offering a comparative study of Hulu's and Youtube's business models, Artero warns that "the corner stone will lie with the

capacity of these new models to contribute not just traffic, relevance or users, but revenue" (2010, p. 122).

Taking into account all these contributions, as well as the challenges mentioned in the previous sections of this chapter, I would like to summarize in five points some of the most significant transformations the Hollywood studios are facing to get adapted to the new digital scenario:

1. *Customized consumption*: As explained before, the new generation of tech savvy consumers (the 'digital natives') demands a personalized way to enjoy online entertainment contents—music, movies, TV shows, videogames—which means complete freedom of choice, flexibility and portability. This 'Martini Culture' meeting the 'long tail' markets requires the right targeting, pricing and technological infrastructure (broadband) strategies. In other words, "media convergence has empowered consumers... the imperative is to develop consumer-centric strategies and keep innovating" (McPhillips and Merlo 2008, p. 251). Initiatives like UltraViolet show a change of mentality by the Hollywood studios, in their effort to accommodated to these new consumption habits. One question to be determined here is how to keep the competitive market power of the different brands whereas using common digital platforms (either the mentioned UltraViolet, iTunes or Amazon).
2. *Redefining the windows sequence*: This profound transformation in consuming entertainment—consumers' new habits and disappearance of the physical copy—is definitely changing the current sequence of commercial windows. On the one hand, the time period of exclusivity is narrowing in order to avoid market competition and piracy effects; on the other, customized consumption obliges to design simultaneous release strategies—product availability in several windows at the same time with price discrimination (Ulin 2009, pp. 33–36). Recent examples are *Margin Call*, simultaneously released on theatrical and VoD, and *Abduction*, released at the same time on DVD and social networks—both Lionsgate productions (Goldsmith 2012a). As a consequence, the distribution sector as we know it is condemned to disappear or be dramatically transformed—into online content aggregators, for instance. Physical copies will be soon no longer existing, and 'virtual markets' will end up as the preferred option—as the iCloud option launched by Apple and Google (Morris 2011). Nevertheless, it must be remarked, as some industry analysts do, that cloud computing ecosystems will demand "new behaviors and attitudes about ownership, discovery, value of storage, offline media use, joint ownership, commoditization of services, competing with freemium business models, and licensing of content across blossoming new platforms..." (Johnson 2012, p. 2).
3. *Content is still king but needs adaptation*: "Paying for content and services may be the area that experiences the most growth" (Clemons 2009, p. 33). Despite recent advances in technology, creativity is still the cornerstone of the audiovisual industry. No matter how fast technology is evolving or how dramatically distribution is changing, "if you have a great story to tell, it will work on any delivery system", affirmed Michael Eisner few years ago (in Tartaglione-Vialatte 2008). Nevertheless, this new market physiognomy is leading to a polarization of entertainment contents:

on the one hand, the big-budget Hollywood blockbusters, with high production values, especially design for a 3D cinema experience; on the other, the small and target-specific niche films, aimed directly at home entertainment. This polarization also explains the need to create ‘event-movies’ based on franchises and brand-entertainment content in order to feed a regular market (Ulin 2009, pp. 18–29; Finney 2010, pp. 15–16). Finally, fiction and entertainment contents must be developed since its first stage for a multimedia and interactive consumption. From this perspective, the keys to develop successful contents are related to its capability to be multiplatform distributed and customized by the consumer—i.e., interactive options, potential to create a prestigious brand and capacity to tell an original ‘transmedia’ story (Jenkins 2006).

4. *In search for the right business model*: After many failures and few successes, the search for the right online business model—how to monetize the power of Internet and of social networks—is still a pending issue. What remains clear is that it will include the combination of hybrid formulas, including direct payment, paid subscription and advertising or sponsorship. The successful business model should guarantee two key issues: first, the possibility of customized consumption; second, competitive prices—good price-quality (or consumer’s experience) relation (McPhillips and Merlo 2008; Clemons 2009; Pardo 2009). If some of the latest initiatives launched by Hollywood studios (UltraViolet) really address the first demand, other decisions may be probably wrong. Whereas some experts in online markets defend the predominance of free content and looking for alternative ways of making money out of internet exposure (Anderson 2009), Hollywood studios are thinking in offering select films to rent for 30 US dollars around 60 days after their theatrical release (Graser 2011a). So far, consumers prefer subscription VoD (such as Netflix), where movie deals are a relatively low-profit proposition for studios—It’s estimated that profit for major studio movies is seven times higher in transactional VoD 25 times higher in electronic sell-through. It seems that Hollywood is again coming to terms. “What we learned from all our consumer research is that the product needs to be in hi-def[ignition] and under 15 US dollars to be relevant”, says Mike Dunn, president of Twentieth Century Fox Home Entertainment (Marich 2013).
5. *Internet and social networks have become the key ‘agora’ of our time*: Viral marketing and the need to feed the vast array of fandom ‘cyber-initiatives’ are key tools in creating awareness about any movie or TV show nowadays. ‘Digital natives’ have a high participatory attitude as well as a self-conscience of peer group. We are living in an era of personalized services and recommendations, where social networks (MySpace, Facebook, Twitter) have become the most efficient forums to promote any sort of product or event (Gubbins 2012, pp. 74–75). Hollywood has been much more diligent at this point, taking advantage of these virtual and social marketing mechanisms, not only for building up franchise power (*Lord of the Rings*, *Harry Potter* or any adaptation of comic superheroes), but also to transform low budget independent movies (*The Blair Witch Project*, *Cloverfield* or *Paranormal Activity*) into worldwide blockbusters (Mueller 2007; Wessels 2011; Kaplan and Haenlein 2011). Social networks have become the most efficient forums to

promote any sort of product or event. And even more, they are being tested as a window per se for commercial exploitation, as the recent case of *Abduction*, released by Lionsgate via Facebook, exemplifies (Goldsmith 2012a).

## Conclusion: From Reluctance to Prudent Embrace

The previous pages shows how Hollywood has progressively gone from a reluctant attitude to a prudent embrace of new technologies. Nevertheless, as some authors state,

> there will be no revolution or "industry stampede", as many observers have predicted. Rather, the industry will experience an evolution as the old and new models first learn to co-exist, until they ultimately converge. (McPhillips and Merlo 2008, p. 237)

Effectively, 'convergence' is a fashionable word in this new environment (Jenkins 2006; Pavlik and McIntosh 2011), and somehow marks the aim of this last Hollywood evolution. If anything is clear at the present moment, is that this paradigm shift has no way back. According to McPhillips and Merlo (2008), following Stöber's theory about what defines media evolution (2004), there are three stages to be gradually covered: *invention*, *innovation* and *institutionalization*:

> Media convergence is driving the evolution, and the change will prove profound and permanent. The invention and innovation phases of the transition are complete. We now appear to be in the institutionalization phase... Inevitably, there will be a period of adjustment as large players consolidate and specialist firms define their niches. (McPhillips and Merlo 2008, p. 251)

Unquestionably, Hollywood majors belong to those "large players". Their executives are therefore facing the most challenging transformation in the whole history of the entertainment industry. The digital revolution is shaking the traditional-conservative business models (analogical) and new options are emerging with unavoidable impetus (the online ones). The discussion is open: access vs. content, franchises over distribution channel, free vs. pay/premium content (or mixed ones), user-generated-content vs. professional works, etc.

There are some hopeful facts. Firstly, the consolidation of an emerging market—consumer expense on online movies & TV series has doubled in the last year both in USA and in Western Europe, and it is steadily increasing in the whole world. Secondly, the consensus achieved by most of the Hollywood studios, to create a consumer-centered platform (UltraViolet), much more in the lines of the iTunes model. And finally, the entry of new players and new forms of synergies and competition—Hollywood alliances with Google-You Tube, Hulu, Apple TV, TiVo, Walmart-Vudu, Amazon-Unibox, MySpace-Panasonic, etc.; the transformation of distributors into search engines or content aggregators; of retailers into 'e-tailers' (Netflix, Blockbuster, Amazon, Best Buy or Walmart) and even beyond—into pay TV channels, like Netflix, or movie studios, like Amazon (Cohen 2010).

At the same time, uncertainties are still there. Hollywood studios won't abandon their reluctance to widely license their content to online services in the short term. As said, they may be willing to embrace new technologies but without 'cannibalizing' their so far most profitable windows (cable TV and

DVD). Nevertheless, as main content providers, they own the key for the digital change. Recent ups-and-downs of successful online platforms like Netflix and Hulu, together with their strategic moves, show up to what point content is still king (Goldsmith 2012b, c; Wallenstein 2011c). Paraphrasing *Screen Digest*:

> If the movie industry is to build an online business, major content owners must emulate their counterparts in TV by loosening their grip on content and experimenting with services and business models. Until they do, online services will continue to represent a nominal revenue stream for the movie business. (*Screen Digest* 2010a)

As it can be noticed, the Hollywood studios are still taking positions on the digital game board, but no one exactly knows which rules will be definitely applied and who will success in offering the golden formula to win the consumer's confidence. And meanwhile, the grounds the Hollywood majors are walking on are far from being solid, as one *Variety* analyst points out:

> To say the digital distribution industry is in flux would be an understatement. As a result of this instability, roles shift, allies become competitors and competitors join forces... In an environment of brands competing to build out their platforms, competition is likely to win out over cooperation in the near term. (Kaufman 2012)

For this very reason, studio executives are not going to sit idly anymore. As one industry consultant from Price-Waterhouse-Coopers stated after attending the 2013 CES edition, I've seen a lot more willingness to try different business models in the past year alone than in the previous five years. The studios are starting to move faster and experiment. And that's key (Marich, 2013).

Welcome to Digital Hollywood.

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