DANTH's FOURTH LUSTRUM DOWNTOWN TRENDS ASSESSMENT 2008
Part 1:

Downtown Movie Theaters Will Be Increasingly In Great Danger

Prepared by
N. David Milder

March 2008

DANTH's FOURTH LUSTRUM DOWNTOWN TRENDS ASSESSMENT 2008
Part 1: Downtown Movie Theaters Will Be Increasingly In Great Danger

A. Our Lustrum Trends Assessments.
For the past 20 years, about every five years (a lustrum) DANTH, Inc. has engaged in a review of the social, economic and political trends that are --- or soon will be-- affecting the health and well-being of downtown, urban neighborhood and Main Street commercial districts. We do this because it is an essential asset when we work on any kind of revitalization strategy for our clients.

Being a curmudgeon, I must also strongly opine that being aware of these trends and their potential effects is an essential component of any district manager's job. Unfortunately it is a job function that too many managers ignore.

The results of DANTH's last trends assessment are available free of charge at:
http://www.danth.com/pdf/trends_3_25_05.pdf

As our current work on trends progresses, I plan to periodically post reports of our findings on our website, www.danth,com, as well as this blog. Besides the subject of this posting, here are some of the topics we've been looking at:

- Time-pressured people continue to be downtowns' best friends
- Retailing is in for much tougher times
- Post-Kelo redevelopment
- Boomers are now seniors and a great market segment for downtowns
- Green redevelopment
- Owners or renters: downtown residential redevelopment
- Downtown crime redux
- Downtown solution trends:
  -- Mixed-use projects
  -- Transit-oriented development, getting more important every day
  -- Place-making
  -- Niche development
- Downtown organizations: a time to alter missions, roles and responsibilities
- The internet and downtown revitalization

Unfortunately, some of the trends DANTH identified suggest that downtowns will soon be confronting major new challenges. DANTH believes that being forewarned enables downtown organizations to be forearmed. Although proven solutions to these emerging threats do not exist, I will try in my blog postings to outline some approaches to finding them, while welcoming other members of the downtown revitalization community to share their solution suggestions.

Below is the first installment.

B. Many Downtown Movie Theaters Are Vulnerable.

For the past 25 years, DANTH has visited about 50 downtowns a year all over the country. Based on those visits, it appears that the cinemas in small and medium-sized downtowns are likely to have several of the following characteristics:

- Be financially marginal
- Show movies that opened at least a month ago in other cinemas
- Have relatively few screens and few seats
- Have a well-worn plant
- Lack stadium seating and comfortable seats
- Have dirty floors and bathrooms
- Often have behaviorally challenged audiences

Many cinemas with these characteristics were closed in the 2000-2001 downturn, but others remain open, though still susceptible to closure. Furthermore, despite their weaknesses, they often remain important as traffic generators, image assets and sources of pride in their downtowns. Their closures would be major setbacks for their downtowns and would require much time and money for recovery.

Countless other movie theaters may be stronger, yet still in danger because just a small drop in the paid attendance can be devastating financially: a mere six percent drop in attendance in 2000-2001 put most of the theater chains into bankruptcy.[1] Revenues based on popcorn and screen ads have definite limits.

In addition, the movie theater business as a whole has been weakening for many years, with some chains closing and others merging to survive. Many older theaters with few screens have closed. For example, according to the National Association of Theater Operators (NATO), the number of "cinema sites" fell from 7,215 in 1996 to 5,543 in 2006, while the number of movie screens over the same period grew from 28,905 to 37,776. The number of admissions grew from 1.34 billion in 1996 to 1.63 billion in 2002, but then declined to 1.45 billion in 2006. The net growth in movie theater admissions between 1996 and 2006 was 8.2%; the USA population during that same period grew 16.2%. Significantly, the decline in admissions from the peak in 2002 of 1.63 billion to the 1.45 billion in 2006, a time when the economy was booming, was 12.4%.

Table 1. Movie Industry First Quarter Revenues 2004 and 2005

	3 Mos 2004		3 Mos 2005		Change $s
SEGMENT	$millions	Percent	$millions	Percent	
VHS	401.5	6.2%	87.8	1.3%	($323.70)
DVD	2659.3	41.1%	3215.9	47.5%	556.4
TV (FREE)	2061.2	31.8%	2150.4	31.8%	89.2
PAY-TV	434.5	6.7%	315.2	4.7%	-119.3
PAY-PER-VIEW	120.7	1.9%	130.5	1.9%	9.8
THEATRICAL	797.1	12.3%	870.2	12.9%	73.1
TOTAL-ALL MEDIA	6,474.50	100.0%	6,769.90	100.0%	295.4

Sources: Source: Motion Picture Assn Worldwide Market Reserach Cited by Edward Jay Epstein, "Hollywood's Death Spiral: The secret numbers tell the story." Slate, Posted Monday, July 25, 2005, at 2:48 PM ET

C. The Fiction Of People "Going To The Movies"

Conventional wisdom holds that we "go to the movies," i.e., that we mostly view films by taking ourselves on outings to movie theaters. However, the truth lies elsewhere. Table 1 above, showing the movie industry's revenue by distribution channel, demonstrates that just slightly more than 12% of its revenues come from movie theaters, while a little less than 88% comes from the numerous distribution channels serving "couch potatoes."

Table 2

By 5-1, Adults Buy More Movie Tickets to Watch at Home Than in Theaters

Estimated number of movies viewed monthly

	"Bought" for home viewing	Bought at theater	Ratio
Mean number of movies viewed per month	3.41	0.66	5.17

PewResearchCenter

Another indication is the title of a May 2006 report by the highly regarded Pew Research Center: "Increasingly, American Prefer Going to the Movies At Home: Home 'ticket sales' dwarf theater attendance 5-1, survey shows."[2] Pew's findings that support the title's assertion are displayed in Table 2.

Many Americans have abandoned movie theater going: 44% of the respondents to Pew's survey reported they never or hardly ever go to a cinema to watch a movie.

Edward Jay Epstein has outlined the historical development of this trend:

> "Back in the 1940s, when studios owned the movie houses and television was not yet available, more than 60 percent of the population went to the movies every week. Today, about 9 percent of the population goes. Just as the movie houses replaced vaudeville houses, home theaters with high-definition television could replace the multiplexes if the death spiral continues."[3]

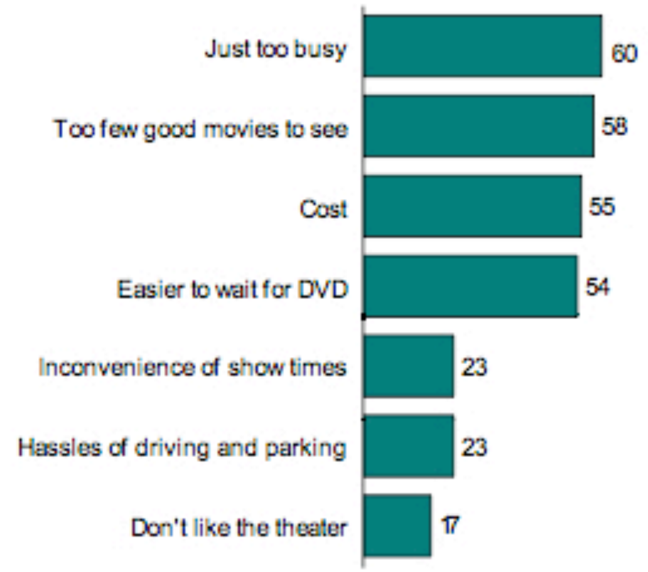
The Pew survey also reported that the preference for home viewing is growing. In 1994 Pew found that 27% of those surveyed preferred going to a theater to watch a movie while 67% opted for watching at home, but in 2006 just 21% preferred the movie theater with 75% wanting to watch a movie at home. This finding suggests that the 9 percent going to cinemas each week may be reduced in the future.

Going out to the movies certainly has become a "special occasion"!

Table 3

Is This a Reason You Don't Go Out to the Movie Theater More Often, or Not?

Percent saying each is a reason they don't go out to the movie theater more often. Among those who go out to the movies



	--Frequency Go Out to Movie Theater--		
	Monthly+	Less than monthly	Hardly ever/ never go out
	%	%	%
Reasons you don't go out to movies more often			
Just too busy	63	57	49
Too few good movies to see	61	56	51
Cost	53	57	54
Easier to wait for DVD	48	58	66
Inconvenience of show times	21	24	27
Hassles of driving and parking	21	24	32
Don't like the theater	16	19	38
Number of respondents	274	323	501

PewResearchCenter

D. The Pivotal Group: Frequent Moviegoers
Among the large group of respondents who hardly ever or never go out to the movies, 87% watch movies at home.

The Pew survey found that movie theater going is most frequent for adults among the young, college educated, and more affluent – teens, unfortunately, were not surveyed. However, it also found that the preference for theater viewing of movies is down most acutely among the young and more affluent-- groups that Pew reported also tend to have more home viewing devices.

Table 4

Even Frequent Theater-Goers Prefer Home-Viewing of Movies

	All Adults	-Frequency Go Out to Movie Theater- Monthly+	Less than monthly	Hardly ever/ never
	%	%	%	%
Favorite way to watch a movie				
Watch at home	75	56	73	87
Go out to a theater	21	40	24	9
Depends on movie (vol.)	2	3	2	1
Don't like movies (vol.)/ Don't know	2	1	1	3
	100	100	100	100
Number of respondents	2,250	541	673	1,028

PewResearchCenter

DANTH believes that pivotal to the future of downtown theaters is the behavior of frequent moviegoers. As can be seen in the lower part of Table 3, the major reasons cited by this group to explain why they do not out to a cinema are associated with time pressures, film selection, and cost – factors that will be brought up again later in this analysis. For example, 63% cited being too busy, 61% mentioned too few good movies, and 53% said cost. Factors that might be associated with the theatrical experience such as they don't like the theater, 16%, and inconvenient show times, 21%, were much less important. Most significantly, Pew reported that even frequent movie theatergoers prefer home viewing of movies, 56%, to going to a cinema, 40% (see Table 4)!

The Pew Report directly addresses the issue of home viewing diverting audience from movie theaters:

> "Are home viewing devices and services eating into the theater-going audience? The Pew findings on this question are mixed. Among people who rarely or never go to the theater, "the ease of waiting for the DVD" is the most oft-cited reason in our survey for not going to the theater more often. But our survey finds that people with more home movie viewing devices and services are also the ones most likely to watch a lot of movies—both in the theater as well as at home. Movie buffs, in short, tend to watch a lot of movies, no matter what the venue. "

Movie buffs do certainly tend to watch a lot of movies, no matter if it's at home or in a cinema. But it is questionable whether the ease of waiting for a DVD is the key variable that will determine whether a significant number of frequent movie-goers will be motivated to do considerably more home viewing and less in the cinemas. More important is the fact that 56% of them (about 14.5% of all adults) already prefer home viewing to theater viewing – they are attitudinally predisposed toward that change! What will push them in that direction? And they account for a heck of a lot more than 14.5% of all movie admissions!

Also relevant here are:

- *The time pressure variable*. Those who are more affluent, in dual-income families and hold higher-level jobs with longer hours continue to feel time pressured and seek convenience. If new film distribution channels to the home – and those not dealing with DVDs are critical here-- are more convenient, then they will likely take more audience from movie theaters
- *The available film library factor*. The failure of many distribution channels to provide a wide choice of easily accessible film titles has been a major drag on increased home viewing.
- *Cost*. Another relevant trend that DANTH has been researching is the decreasing discretionary spending power and reduced real wealth of households in the $50,000/yr to $150,000/yr range. This trend may have a big affect on how films are viewed over the coming five years. As Peter Beronio recently wrote when reviewing an earlier draft of this article:

  > "Two years ago the average family had yet to feel the economic crunch they are feeling today. Many of us in the middle class would still gather up the kids and hit the theater and catch a pizza later. In today's economy that is an $80 to $100 night out for two parents with two kids. With home heating and gasoline costs soaring, investments and houses losing value and families worried about sliding backward, it seems to me that more and more families will opt to go the digital direct HDTV way."

  Americans have been taking $800 billion/yr out of their homes in recent years and spending about $300 billion of it on consumer goods. That is about twice the amount in the recently enacted federal stimulus package aimed at averting a recession. These home piggy banks have closed!
- *Technology Changes.* While DVD sales remain the biggest sales revenue channel for the movie industry, there has been substantial speculation in the media that these sales have leveled off or even begun to decline. At the same time there have been increased attempts to build convenient and very cost-efficient delivery mechanisms to home TVs and PCs via the Internet and many of the cable companies are working to expand their film offering and make them easier to access and view. The young and the affluent, who are most likely both to be moviegoers and buy home film viewing equipment, are open to these new technologies

and potential converts to reduced theater going.

E. The Effects of Movie Industry Actions

Edward Jay Epstein's article in Slate cited above is very important because it raises a point that many downtown leaders may overlook – it may not be consumer behavior or the economy, but the business decisions of the movie studios that eventually force the closures of many downtown movie theaters.

Direct digital home delivery has been long anticipated by many Hollywood studio executives and seen as attractive because of less profit-sharing with theater owners, large reductions in distribution costs and better product delivery because the wear and tear on film would be avoided. It is also seen as a way to grow their audience, i.e., people will watch more films if they are easier and more convenient to access and view.

A strong indication of the importance of direct digital film home distribution in Hollywood these days is the fact that it was a major issue in recent negotiations between the producers association and both the Directors Guild and the Screen Writers Guild. Another indication is the fact that all of the major Hollywood studios have agreed to participate in Apple's new iTunes movie rental offerings, even when some of them continue to have big disagreements with Apple about music distribution.

Within the studios are two management camps: the movie theater wing and the home entertainment group. Epstein argues that their strengths reflects the revenues of their distribution channels, so the home entertainment camp is far more powerful. He also argues that their big point of contention is how long the studios will wait to issue DVDs after a film's theatrical release.[4] Some studio executives argue for both to be released at the same time. First-run theaters would lose an important competitive advantage over the DVDs. This option is widely seen as posing a clear and present danger for movie theater operators. Other studio execs, concerned about keeping the theaters healthy to maintain the industry's mystique and use them as marketing engines to rev up demand in the other sales channels, urge a six-month "window."

With the emergence of direct digital delivery a "second window" problem has emerged: how long a wait after a film's DVD release will there be before the film is available over the cable or Internet? Here the studios are worried about cannibalizing sales from the sales/distribution channel that accounts for 47% of their film revenues. ITunes, for example, has a one month post DVD release date window. David Pogue reports that Vudu gets some of its films at the same time that their DVDs are released[5]

Bottom line: the shorter the release windows are for putting recent films into

Who's Got What? Accessorizing for Home Movie Viewing

Table 5

	Cable/ Satellite	Screen TV*	Premium Channels	DVR/ TiVo	delivery/ Netflix
	%	%	%	%	%
All Adults	81	36	30	17	6
Gender					
Men	80	39	31	18	7
Women	82	33	29	15	6
Race/Ethnicity					
White	82	35	28	16	6
Black	78	43	44	23	6
Hispanic*	70	33	25	11	8
Age					
18-29	74	41	33	16	8
30-49	82	37	33	18	7
50-64	82	34	31	16	6
65+	86	29	18	15	3
Education					
College grad	83	37	30	22	11
Some college	82	36	34	18	6
H.S. grad or less	80	35	28	14	4
Family Income					
$100,000+	91	54	45	31	9
$50K - $100K	85	40	33	20	8
$30K - $50K	80	33	31	16	5
Less than $30K	72	28	19	8	5

Source: Pew Research Center 2006 Report

couch potato-feeding distribution channels and the larger the libraries of older films that the studios make available through these channels, the greater the peril for downtown movie theaters.

F. The Shift To The Digital Distribution Of Movies

1. Brick and Mortar Distribution of DVDs: A Weakening Channel. Brick and mortar chains that rent or sell films on tapes or DVDs have been weakening since 2004 and most are trying to change their business models so they won't disappear. Tower Records has gone out of business. As of February 2008, Blockbuster's stock is trading at around $3.00 a share. It has closed hundreds of stores since 2006 and is busy developing a new business, based on the Netflix model, where customers select the DVDs they want online and the USPS is used to deliver and then return them. Movie Gallery, after filing Chapter 11 and reorganizing, also has switched to online movie rentals and is closing more than 500 Movie Gallery and Hollywood Video stores. DVD sales have declined despite the shortening of the window between theatrical releases and DVD releases.[6]

Brick and mortar movie rental shops are likely to have a high closure rate in downtowns regardless of size. The distribution paradigm has already tipped for them – cable and the Internet are now where it's. According to The Hollywood Reporter, Movie Gallery was "devastated by online competition." [7] An article on TheStreet. Com also attributed Blockbuster's woes to Internet competition: "A quick review of Blockbuster's financial results reveals evidence of an industry under pressure from new means of video distribution, such as the Internet and discounted used-movie sales at Amazon.com. "[8] Both companies are desperately trying to grow an Internet-based hybrid business model in order to survive.

The one brick and mortar DVD retailer that remains not only strong, but the largest in the field is Wal-Mart. Its business is not solely reliant on the sales of DVDs. Few of its competitors can match its bargain prices or its ability to squeeze suppliers to reduce DVD costs. Notably, Wal-Mart has not succeeded in its attempts to develop a viable Internet-based way to sell DVDs. Most downtowns do not welcome Wal-Marts.

High Definition DVDs had been seen as a way to bolster DVD sales. Blu-ray has finally emerged as the winner of the high definition DVD fracas. This technology facilitates an enhanced home viewing experience, but industry experts do not expect unit sales of Blu-ray players to surpass 25% of disc players sold until their prices drop from their current $350 to $400 level to around $200 or $150.[9]

2, Hybrid Model For Renting/Selling DVDs. Hybrid models use the Internet, for customers to select and pay for their DVDs, but non-electronic means – e.g., USPS, UPS, and FedEx -- to deliver them. They do not have the costs of brick and mortar stores, but they are not entirely electronic. Major players using this model are Netflix, Amazon, Blockbuster and Movie Gallery.

In the Pew survey, 6% of adults reported using a mail DVD rental delivery service (see Table 5).

Netflix is an interesting example of this model. In business since 1997, it claims over 7 million subscribers. It offers a good deal of choice, with 90,000 titles in its film library, though its most recent offerings may have been in theatrical release for 19 or 22 weeks or even taken off of the cinema circuit. Netflix claims that it can get a DVD disk to customers within one day of being ordered. However, because of increased competition, Netflix has started to offer subscribers two ways to have film rentals delivered over the Internet: a Watch Instantly service that can stream from a library of 6,000 movies and TV shows to personal computers and a service using a LG "media extender" to directly download films for viewing on a HDTV

For viewers, the DVD mail delivery mode of accessing films offers a good deal of product choice (if not the very latest films), reasonable prices for rentals if the DVD is viewed by more than one person, more convenience than brick and mortar stores, but no immediate gratification – the viewer has to wait for the DVD to be delivered. It also requires planning and pre-consumption actions (ordering). It does not immediately enable "on-demand use", but once the DVD is delivered it can be viewed whenever the owner or renter wants while it is in their possession.

3. Electronic Home Film Delivery Models. There is now an abundance of ways for viewers to electronically both quickly select films they want to watch and have them delivered into their homes. Moreover, the technologies and equipment involved are rapidly changing, a pattern that reflects the substantial interest and investments of technology companies, cable companies and the movie studios.

These electronic film delivery services still vary in:

- Their ease of use
- The equipment they require
- The types of viewing equipment they can deliver the films to, e.g. PC, TV or handheld media device
- The size of their film libraries
- How big a broadband pipe they need to work

All offer:

- Recent movies that probably have been available in theaters and on DVDs for some time, but this may be changing
- On-demand access
- A way to alleviate time pressure issues: one does not have to leave their home to get the film or to view it or to return it
- Reasonable prices, especially when a film is viewed by more than one person
- Greater convenience that brick and mortar stores or mail delivery services

There are many electronic home delivery services. The discussion below centers on those having the greatest potential to capture audience share from traditional movie theaters.

Cable TV: On-Demand Film Viewing. The data in Table 1 indicate that in 2004 and 2005 cable TV paid film viewings were an even smaller revenue source for the film industry than movie theaters.

There are reasons to believe that those revenues might improve somewhat over the next five years. In the "old days" viewing movies on cable TV meant either watching films with a good deal of age on them that were broadcast on the "movie channels" or paying an additional fee and seeing a more recently released film that was broadcast at specific times. Today, cable companies such as Time Warner offer "on-demand" viewing services for many of their programs, which enables the viewer to watch them when there is the time and/or inclination. One no longer has to worry that a Sunday night family gathering might mean missing the latest episode of The Sopranos or Rome. The on-demand service for TV and cable programs is free.

The cable companies also offer the same type of on-demand service for their movie rentals, which obviously still incur rental fees. It is possible to select, load and start watching a film in five minutes or less -- very convenient for the time-pressed.

The FCC has ruled that by 2009 all TV broadcasts will only be in HD format. This will mean that films will be broadcast with a much higher resolution and with an aspect ratio that is or is close to the one that is shown in movie theaters. This will enhance the home film viewing experience.

The Pew survey in 2006 found that 36% of adults already had a flat screen TV in their homes. Only TVs capable of receiving HD broadcasts will be able to view broadcasted programs by 2009. Experts foresee a burst of HDTV sales, especially with their plummeting prices, thin large screens and increased ease of installation and use. Having a home theater environment will be increasingly affordable and increasingly present in American homes. Having these home theaters will probably encourage greater home film viewing

The downside of cable film viewing today is that, with the exception of Comcast, the selection remains as it was 10 years ago: not very large, not firs-run, with few big hits. This is where the DVD mail distributors have a distinct advantage. If cableTV could offer a bigger film selection to complement its very convenient use, reasonable fees and home theater settings, its revenues would take off dramatically. The cable operators have not figured out how to allow their subscribers to access, at the press of a few buttons on their remote controls, thousands of films they can select from. This is particularly strange with Time Warner Cable, which has obvious corporate ties to Warner Brothers Studios and its film vaults. It is also strange because the studios are allowing subscribers to iTunes and Vudu to have much greater access to their films.

Comcast, the biggest cable TV operator, is something of a deviant in the industry, now offering over 1,000 on-demand films a month. It intends to soon increase its on-demand library to 6,000 films, with many being free and half in high definition.[10] In terms of convenience, cost and film selection -- even though its library pales in comparison to Netflix's 90,000 movies -- Comcast seems to have a formula capable of winning some significant market share from movie theaters located within its cable TV viewer sheds. If the other cable companies follow suit, the potential threat to movie theaters will increase commensurately.

Cable already has the infrastructure into most American homes – the wires, the cable boxes, the connections to the TVs. Subscribers already know how to use the system. Meager content has prevented cable TV from having a much, much larger home film audience – and being a much bigger threat to movie theaters. If the content is improved….

Internet Based On-Demand Pay-Per View Film Viewing: Vudu and Apple TV. Both Vudu and Apple TV try to address the following situation as described by David Pogue:

> "Video stores: you have to drive back and forth, and the movie you want might be out of stock. Netflix and Blockbuster by mail: you have to wait a day or two for each movie to arrive. Pay-per-view, video-on-demand, Xbox, iTunes and hotel rooms: puny movie selections. Internet downloads: they arrive on your computer, not your TV."[11]

Vudu hooks up its little black box, which has a large hard drive, to both a TV and to a broadband wire connection and that allows the viewer to chose from its 5,000 films (it plans to have 10,000). The film begins to play almost instantaneously after being selected. Vudu does not connect to a computer. Pogue notes that Vudu, by providing easy access to a film library of that size "comes darned close to putting a video store in your house".[12] Pogue gives Vudu the following overall evaluation: "Instant gratification: A. Selection: B+. Overall movie joy: B+."[13]

The Apple TV film service is very similar. A little white box, called Apple TV, connects to the TV via standard cables. Its built-in Wi-Fi technology, enables Apple TV to connect to the residence's wireless network to download content from the iTunes website. Pogue's overall evaluation of Apple TV is:" Instant gratification: A-. Selection: D. Overall movie joy: B."[14]

Once their boxes are setup to link the TV to their Internet services, neither iTunes nor Vudu have a steep operational learning curve.

Both iTunes's and Vudu's video services will mesh nicely with the HDTV/home movie theater trend.

The young and the affluent, who are the most frequent movie theatergoers, are also the groups most likely to drawn by the technology and design of the iTunes and Vudu systems.

Vudu and apple TV do seem to have the kind of formula that is capable of winning audience share from movie theaters: they have the type of convenience that promises to deal with time pressures, reasonable cost once the black or white boxes are paid for, and the promise of abundant selection. However, their implementation seems to be "in its fumbling, bumbling infancy" mainly because the film selection part of their formula now seems flagging.[15] One may question whether Vudu's 10,000 titles are large enough, especially when Netflix offers 90,000 movies. At this time, Apple's film library is quite small. However, it uniquely has all the major studios signed up so its number of film offerings is expected to soon be larger than Vudu's. Then, there is the question of whether either of them, but especially Apple, can convince the studios to let them rent new movies in a very early distribution window?

A number of very large, successful, tech-savvy corporations are trying to develop Internet-based home film viewing: Amazon, Apple and Microsoft. There also are a number of innovative smaller companies in the field, Tivo and Vudu. The innovation record of four of these firms suggests that they will be working on the problems that now make them fumblers and bumblers in this field and it also gives them a good chance of succeeding. Should that happen, downtown movie theaters would be facing very strong competitors who can threaten their survival.

The success of iTunes in the music industry indicates what can happen in the film industry. The fact that all the major studios signed up so eagerly with Apple TV suggests they indeed have that model in mind.

Another Pew survey done in 2007 found that only 16% of the Internet users said they "watch or download TV shows."[16] However, this Pew report also noted that:

> "Movies and television content are also the province of the young; nearly a third of users ages 18-29 watch or download movies and TV shows, while half as many among those ages 30-49 do so (30% vs. 16%). Just 7% of users age 50 and older say they get movies and television shows online."[17]

This finding suggests that with time the American adult population will become increasingly familiar with and adept at using the Internet to access films. A reasonable inference is that this will increase the user base for Vudu and Apple TV type services, which in turn is likely to mean an undetermined amount of loss of market share by movie theaters.

G. Components Of An Inflection Point.
Reviewing the analysis presented above suggests that important components of an inflection point exist and a loss of 10 percent or more of film viewing market share by movie theaters to home film distribution channels over the next three to seven years is a reasonable expectation:

1. <u>The Exposure of Movie Theaters</u>. As the discussion above has

demonstrated, movie theaters are in an increasingly weakened position because:

- Their hold on adult audiences is small and diminishing
- Even the most frequent movie goers prefer home viewing
- Many theaters have low operating margins based primarily on revenues from concession stands and screen ads
- A relatively modest reduction in paid attendance by a small group of frequent moviegoers could easily erase these meager margins. The frequent movie goers do not have to completely stop visiting movies theaters for the impact to be devastating. This is an important point.
- The frequent movie-goers have demographic characteristics that highly correlate with the use of computers and other electronic home entertainment equipment
- Many theaters lack amenities such as many screens, large screens, first run films, stadium seating, clean restrooms and theaters floors
- Theaters provide a very small revenue stream for the major movie studios. Consequently, the studios are incentivized to make decisions that will help other film distribution channels although they may hurt the theaters

2. Rival Home Film Distribution Channels Are Poised To Grab Market Share. Competing film distribution channels have been improving, many finding formulas that are aimed straight at the three key variables that most impact film viewer behavior --- convenience, film selection and cost:

- On-demand cable TV has great convenience, wide household penetration, competitive prices and indications that some large operators will be offering significantly greater film selections. The introduction of HD broadcasts will also improve product quality and enhance competitive strength
- Apple TV and Vudu have a strong films service formula that could really grab market share if they can offer sufficient film variety. They, too, already offer on-demand convenience and competitive prices. Apple, because of iTunes, has a large amount of household penetration and brand loyalty.
- The competitive strengths of the brick and mortar DVD shops and the mail delivered DVD services versus movie theaters has been improved recently by the growing presence of large HD TVs in American households and the final victory of the Blu-ray HD DVD format.

3. Tipping Point Scenarios. Below are some scenarios under which a tipping point might occur:

- The cable TV and Internet film services improve their film libraries sufficiently to become real competitors with movie theaters.
- Real household incomes erode to the point that the cost of movie consumption grows in importance in consumer decision-making. The cost advantage of home viewing, popcorn, sodas, baby-sitting, etc, is substantial. Given the recent low growth in median household incomes and the soaring costs of medical services, energy, college educations, etc. and the reduced

values of private homes, this scenario is likely to have substantial impact.

- The convenience and comfort of home movie theaters increase to the point that consumers prefer the home viewing experience even more than reported in the 2006 Pew survey. This is occurring now; the question is how big its impact will be.
- The major studios finally go for “simultaneous releases.” In 2006 and 2007 there was a lot of discussion within the major movie studios about releasing films to theaters, cable TV and Internet film services at the same time, with DVDs being released three months later. A major survey of movie audiences in the USA, Japan and Germany, which account for over half of the world’s film market, found that simultaneous releases would enable the studios to increase their revenues by 16%, but cause the revenues of movie theaters to shrink by 40%.[18] More recently there has been some discussion of simultaneous releases for a limited number of films.
- A slow accumulation of impacts from all of the above. This seems the most likely scenario.

H. Implications For Downtowns.

Downtown movie theater closures are bad news because:

- They are usually important downtown assets
- Closed cinemas are usually large, highly visible spaces, occupying considerable frontage and consequently a huge negative for a downtown’s image. It is also usually very hard to re-tenant an empty cinema -- too many stay vacant for numerous years, often for decades. Some of the conversions, e.g., bingo halls and flea markets, are often less than desirable for spaces having prime locations and large size.

Many downtown movie theaters, especially in small and medium-sized communities, will be among the least able to compete with home film services, be they on cable or the Internet. Many also probably have very low operating margins. Chances are that over the next three to seven years they will be attracting fewer patrons and have to work a lot harder to lure them in. Many -- though certainly not all -- of these downtown cinemas will probably be weakened to the point that have to go out of business. If the major studios adopt simultaneous releases of films, then most downtown movie theaters will almost certainly fold.

Modern movie theaters in dense urban areas, with large close-in audience markets and proximity to other attractions, such as retail operations and restaurants that are open into the evening, are more likely to survive. The convenience of multi-purpose trips can motivate people to get out of their homes and move them to the vicinity of the movie theaters, where they can be lured in. Downtown movie theaters will need other strong traffic generators that they can feed off of. A dense close-in population can provide a revenue potential sufficient to finance needed theater improvements and maintenance.

Movie theaters that make film viewing unique (e.g. Imax, 3D) or the night out a special occasion are likely to survive.

Movie theaters that have “special audiences,” e.g., college students in college towns also have a good chance of survival.

Bricks and mortar shops that rent or sell films on tapes or DVDs also are likely to largely disappear in downtowns regardless of size. DANTH has already observed many closures.

I. What Can Be Done Now?

This trend has obvious implications for downtown planning and business recruitment programs. DANTH recommends that downtown organizations should carefully reconsider efforts to attract either shops that rent/sell films or to stimulate the development of new traditional movie theaters.

DANTH also recommends that downtown organizations should immediately start to think about formulating contingency plans for the reuse and/or re-tenanting of the movie theaters in their districts, should they close. One tactic is “shared use,” where movie viewing shares the theater’s space with other functions such as stage plays, concerts, rehearsal space, etc. The Carlisle Theater in downtown Carlisle, PA, is one example of this approach. The Teaneck Economic Development Corporation is now looking into the feasibility of applying that approach to a downtown movie theater. The experience of the Carlisle Theater suggests this approach may not be an easy one.

Downtown organizations should also initiate discussions with local film exhibitors about improving their theaters’ physical plants and the ambience they provide for patrons, e.g., installing stadium seating, having clean restrooms, removing boisterous patrons, etc. Small chains and independent operators are bound to lack the capital to make associated capital improvements and downtown organizations and local economic development corporations will have to decide if they want to provide financial supports, direct or through incentives, for such improvements.

Since George Lucas started to release his latest Star Wars trilogy back around 2002, there has been industry banter about “digital cinema,” where movie theaters would receive films in digital format either by broadband or satellite. Digital cinema enables far better picture and sound quality, 3D formats and other enhancements. “Digital cinema is coming –are you ready?” John Fithian, NATO President asked his membership back in 2005.[19] There have been woefully few implementations since then. Big problems have been cost and the bigger issue of who will pay. Back in 2002 the Wall Street Journal reported:

> "Outfitting one theater screen digitally can take $150,000 to $200,000, and no one has yet figured out how to divvy up the expense for an industrywide shift."[20]

The financial savings (over $2 bilion/yr) go to the studios, but they seem to want the theaters to pay. While the cost may have since fallen to $100,000 per screen or less, the payment issue still remains unresolved. A lot of money is at stake: to update the nation's 37,776 movie screens, at $100,000 a pop, would cost over $3.7 billion.

Unfortunately, many of the weaker downtown theater operators will have neither the inclination nor the capital to make the needed improvements, especially if they face substantially declining markets. For a small theater with three screens, investing $300,000 or even $200,000 for digital cinema may seem entirely chimerical.

Americans continue to feel generally pressured for time, so they want reduced travel times for practically everything. This trend, which increases with household income, is the prime asset of many of the small and medium-sized suburban downtowns that face imminent movie theater closures. The manifestations of time pressures have now gone beyond survey reports: e.g., it has led to a significant decrease in the number of golf players and the closing of a lot of expensively built golf courses; it also, *mon dieu*, led the Metropolitan Opera Company in NYC to cut the length of some operas and reduce intermission times.

More specifically, many Americans feel that they do not have sufficient quality time with their loved ones and are looking for appropriate "special" places out of the home where such quality time can be shared and enjoyed. DANTH believes that the surviving cinemas in small and medium-sized downtowns will somehow meet this consumer need. The Grove, in Los Angeles, provides an example of how this might be done: abutting a large, new multi-screen cinema is a restaurant, The Farm, with an internal open doorway connecting the two. Linking film viewing and dining may foster "special occasion" trips and be a viable strategic response to the convenience and low-cost of home digital movie rentals.

Downtown cinemas might also try to target senior citizens because:

- Members of the very large Baby Boomer generation (78.2 million) are now quickly retiring, but most remain very active. One gerontologist calls them "zoomers" because they are so active and break the conventional wisdom about people of that age behave.[21]
- Senior citizens (over 50) tend to like downtowns, as evidenced by their eagerness to rent or buy the new residential units being built in downtowns

- Seniors still tend to lag in the use of high tech gadgets and many may not feel comfortable downloading and viewing digital movies (see Table 5 above)
- They are the one group that the 2006 Pew survey found had increased its movie going between 1995 and 2006: those in the 50 to 64 age group reporting movie going at least once a month went up from 16% to 21%; in the 65+ age group it went up from 10% to 13%.

The linkage of food and beverages with movie viewing might manifest itself successfully in other ways as well. For example, the convenience and low-cost of streaming or downloading films might also present growth opportunities for downtown eateries and watering holes, much as the sports cable channels gave rise to sports bars.

Downtown entertainment niches have been the bedrocks of many successful revitalization efforts. The declining strength of cinemas will substantially increase the need to develop informal entertainment elements, e.g., skating rinks, outdoor dining, chess tables, model sail boat ponds, etc., to keep these niches robust and alluring. For more information about such entertainments visit:

http://downtown-curmudgeon.blogspot.com/search/label/Entertainment

---

AFTERWORD:

The morning after I finished writing the above article a piece appeared in the New York Times about the movie studios trying to save DVDs, because the staleness of the format and Internet-based viewing have been attriting their sales.[22] I expect that many similar articles will be appearing over the next few years reporting on the changing competitive strengths of the various couch potato home film delivery channels. I strongly doubt that the innovations they report will contradict my contention that traditional downtown movie theaters will be in increasing peril; to the contrary, they will probably confirm it. As a result what I have written about the non-theater film distribution channels may seem outdated a year or two from now, but the danger of increased downtown theater closings will still keep growing.

ENDNOTES

[1] Edward Jay Epstein, "Hollywood's Death Spiral: The secret numbers tell the story." Slate, Posted Monday, July 25, 2005, at 2:48 PM ET. Hereafter cited as Epstein.
[2] Hereafter referred to as Pew Report which will be footnoted only when it is not referenced in the text. The report and the survey dataset it is based upon may be downloaded from the Pew website http://pewresearch.org/
[3] Epstein
[4] "After a movie opens in theaters, it becomes available through other channels in a strict order: (1) hotels and airlines; (2) DVD; (3) pay-per-view television; (4) movie channels like HBO and Starz; (5) TV and everywhere else." David Pogue, "High-Speed Video Store in the Living Room," New York Times, Sept 6, 2007
[5] Ibid.
[6] Eric Bangeman,"Simultaneous DVD, on-demand video releases draw nearer" Ars Technica, January 04, 2006 - 10:44AM CT http://arstechnica.com/news.ars/post/20060104-5892.html
[7] Paul Bond, "Movie Gallery files for Chapter 11: Secures $140 million to manage business, pay bills", Hollywood Reporter; Oct 17, 2007
[8] William Gabrielski, "Screening Blockbuster's Prospects for Success," Street.com, 04/12/06 - 09:25 AM EDT
[9] Saul Hansell, "BitS: Blu-Ray Won the Battle, Now Comes the War" New York Times, February 20, 2008, 5:05 pm downloaded from http://bits.blogs.nytimes.com/
[10] The David Pogue. "State of the Art: The Good, Bad and Ugly of Movie Downloading", NYT, February 21, 2008 downloaded from http://www.nytimes.com/2008/02/21/technology/personaltech/21pogue.html
[11] David Pogue, "State of the Art High-Speed Video Store in the Living Room" New York Times, September 6, 2007
[12] Ibid.
[13] The David Pogue. "State of the Art: The Good, Bad and Ugly of Movie Downloading", New York Times, February 21, 2008 downloaded from http://www.nytimes.com/2008/02/21/technology/personaltech/21pogue.html
[14] Ibid.
[15] Ibid.
[16] Mary Madden, "Online Video: Part 2 What They Watch Online", Pew Internet & American Life Project, July 25, 2007, pp 15-16
[17] Ibid.
[18] Eric Bangeman,"Simultaneous DVD, on-demand video releases draw nearer" Ars Technica, January 04, 2006 - 10:44AM CT http://arstechnica.com/news.ars/post/20060104-5892.html
[19] http://www.natoonline.org/infocus/05augustseptember/prezdesk.htm
20 Anna Wilde Mathews ,"'Star Wars' Forces the Question - Who Will Pay for Digital Cinema?", THE WALL STREET JOURNAL http://faculty.chicagogsb.edu/pradeep.chintagunta/teaching/37400/Session3/readings%20week2%20(sessions%203%20&%204).pdf.
21 http://www.demko.com/zoomers.htm
22 Brooks Barnes and Matt Richtel, "Studios Try to Save the DVD," New York Times, February 25, 2008