

CASE 18 The Movie Exhibition Industry: 2011

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The Motion Picture Industry Value Chain

The motion picture industry value chain consists of three stages: studio production, distribution, and—the primary focus here—exhibition. All stages of the value chain are undergoing consolidation.

Studio Production

The studios produce the lifeblood of the industry, the films that are its content. The top six studios produce just 20 percent of all films, but this 20 percent is responsible for over 80 percent of domestic box office receipts (Exhibit 1). Studios are increasingly part of larger corporations, managed as any other profit center. Managing a studio is a challenge as investments are large and a

successful formula elusive. Profitability swings wildly. The cost of bringing a typical feature to market exceeds \$100 million, up 25 percent in five years.¹ Typically, one-third of costs are marketing expenses.

Studios know their core audience: 12- to 24-year-olds. This group purchases nearly 40 percent of theater tickets. Half are “frequent moviegoers” attending at least one movie per month. Profits are driven by the studios’ ability to satisfy this fickle audience. In 2008, two films targeting the core market and based on two successful comic book characters met with wildly different fates.² Paramount’s successful *Iron Man* was produced for \$140 million and grossed \$318 million at the domestic box office. On the other hand, Warner Bros. *Speed Racer*, produced for \$120 million and released the following weekend, was a flop, grossing just \$44 million.

Exhibit 1 Market Share of Film Production 2000–2010

Distributor	2010				2005				2000			
	Rank	Market Share	Total Gross	# Movies	Rank	Market Share	Total Gross	# Movies	Rank	Market Share	Total Gross	# Movies
Warner Bros.	1	18.2%	\$ 1,924	27	1	15.6%	\$1,377	19	3	11.9%	\$ 905	22
Paramount	2	16.2%	\$ 1,715	15	6	9.4%	\$ 832	12	4	10.4%	\$ 791	12
20th Century Fox	3	14.0%	\$ 1,482	17	2	15.3%	\$1,354	18	6	9.5%	\$ 723	13
Disney/Buena Vista	4	13.8%	\$ 1,456	14	4	10.4%	\$ 922	17	1	15.5%	\$1,176	21
Sony/Columbia	5	12.1%	\$ 1,283	18	5	10.4%	\$ 918	24	7	9.0%	\$ 682	29
Universal	6	8.3%	\$ 882	15	3	11.4%	\$1,010	19	2	14.1%	\$1,069	13
Total for leading 6		82.6%	\$ 8,742	106		72.5%	\$6,413	109		70.4%	\$5,346	110
Industry Total			\$10,565	529			\$8,840	547			\$7,661	478
As % of Industry			82.7%	20.0%			72.5%	19.9%			69.8%	23.0%

Source: Data retrieved from Boxofficemojo.com.

Demographic trends are not favorable for the industry. The US population will increase 17 percent by 2025, an increase of 54 million people (Exhibit 2). But the number of 12- to 24-year-olds is expected to increase only nine percent, just four million more potential viewers. Based on current theaters and screens, this is an increase of fewer than 700 additional viewers per theater, roughly 100 per screen.

Distribution

Distributors are the intermediaries between the studios and exhibitors. Distribution entails all steps following a film's artistic completion including marketing, logistics, and administration. Exhibitors negotiate a percentage of gross by the studio or purchase rights to films and profit from the box office receipts. Distributors select and market films to exhibitors, seeking to maximize potential attendees. Distributors coordinate the manufacture and distribution of the film to exhibitors. They also handle collections, audits of attendees, and other administrative tasks. There are over 300 active distributors, but much is done by a few major firms, including divisions of studios. Pixar,

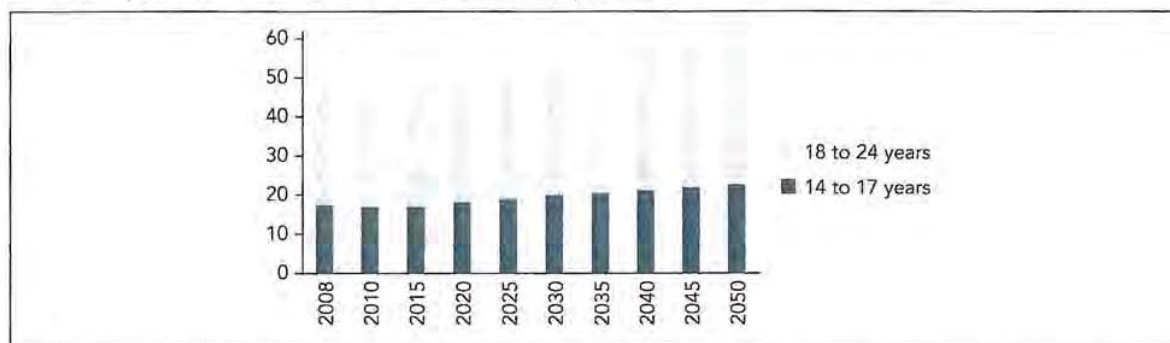
for example, coproduced *Finding Nemo* with Disney and distribution was conducted by Disney's Buena Vista.

Exhibition

Studios historically sought full vertical integration through theater ownership, allowing greater control over audiences and capturing exhibition profits. A common practice was for the studios to use their theater ownership to reduce competition by not showing pictures produced by rivals. This ended in 1948 with the Supreme Court's ruling against the studios in *US v. Paramount Pictures*. Theaters were soon divested, leaving studios and exhibitors to negotiate film access and rental.

Theaters are classified according to the number of screens at one location (Exhibit 3). Single-screen theaters were the standard from the introduction of film through the 80s. They have since rapidly declined in number, replaced by theater complexes. These include miniplexes (two to seven screens), multiplexes (8 to 15 screens), and megaplexes (16 or more screens). The number of theaters decreased more than 20 percent between 2000 and 2010, but the number of screens increased due

Exhibit 2 Population Trend Among 14–17 and 18–24 Age Groups (millions)



Source: US Census.

Exhibit 3 Number of Theaters by Complex Size

	2000	2005	2010	Change		
				2000 to 2005	2005 to 2010	2000 to 2010
Single Screens	2,368	1,723	1,610	-27%	-7%	-32%
Miniplexes (2–7 Screens)	3,170	2,381	1,884	-25%	-21%	-41%
Multiplexes (8–15 Screens)	1,478	1,599	1,683	8%	5%	14%
Megaplexes (16+ Screens)	405	558	645	38%	16%	59%
Total	7,421	6,260	5,817	-16%	-7%	-22%

Sources: Author estimates based on data from Entertainment Industry, 2007 & 2009 Motion Picture Association of America reports, and Mintel Report "Movie Theaters - US - February 2008."

Globe: © Jan Rysavy/Stockphoto.com

Exhibit 4 Exhibition Market Leaders: 2009

Company	Theater Brands	# US Theater Locations	# US Screens	Avg. Screens per Theater
Regal	Regal, United Artists, Edwards	548	6,768	12.4
AMC	AMC, Loews	297	4,513	15.2
Cinemark	Cinemark, Century	294	3,830	13.0
Carmike	Carmike	244	2,277	9.3
Total for leading four		1,383	17,388	12.6
Industry total		6,039	39,717	6.6

Source: SEC Filings & Author estimates.

to growth in megaplexes. Over 10 percent of theaters are now megaplexes and the number of screens is at a historically high level of 39,717.³ Many analysts argue the industry has overbuilt and too many theaters and screens exist to make the business profitable.

The Lead Actors

Declining ticket sales and the increased costs associated with developing megaplexes began a wave of consolidation among exhibitors. Four companies now dominate the industry: Regal, AMC, Cinemark, and Carmike (Exhibit 4). These companies—operating 1,383 theaters in the country (just 23 percent)—control 43 percent of screens. This market share provides these exhibitors with negotiating power for access to films, prices for films and concessions, and greater access to revenues from national advertisers.

There is little differentiation in the offerings of the major theater exhibitors—prices within markets differ little, the same movies are shown at the same times, and the food and services are nearly identical. Competition between theaters often comes down to distance from home, convenience of parking, and proximity to restaurants. Innovations by one theater chain are quickly adopted by others. The chains serve different geographic markets and do so in different ways.⁴ Regal focuses on midsize markets using multiplexes and megaplexes. In 2009, Regal's average ticket price of \$8.15 was the highest among the leaders (Exhibit 5). AMC concentrates on urban areas with megaplexes and on the large population centers such as those in California, Florida, and Texas. Cinemark serves smaller markets, operating as the sole theater chain in over 80 percent of its markets. Cinemark's average ticket price of \$5.46 was the lowest of the majors. Carmike concentrates on small to mid-sized markets, targeting populations of less than 100,000 that have few other entertainment options. Carmike's average ticket price in 2009 was \$6.56 but at \$3.21, their average concession revenue per patron is the highest among the majors.

The differing approaches of these companies are reflected in the cost of fixed assets per screen. These costs result from decisions about how to serve customers, such

as the level of technology and finish of the theater—digital projection and marble floors cost more than traditional projectors and a carpeted lobby.⁵ Despite multi and megaplex facilities, Regal's cost per screen is the highest at \$430,000. Carmike's, the rural operator, is the lowest at just \$206,000. Cinemark is in the middle at \$367,000. Costs for AMC are expected to be near or to exceed that of Regal.

The Business of Exhibition

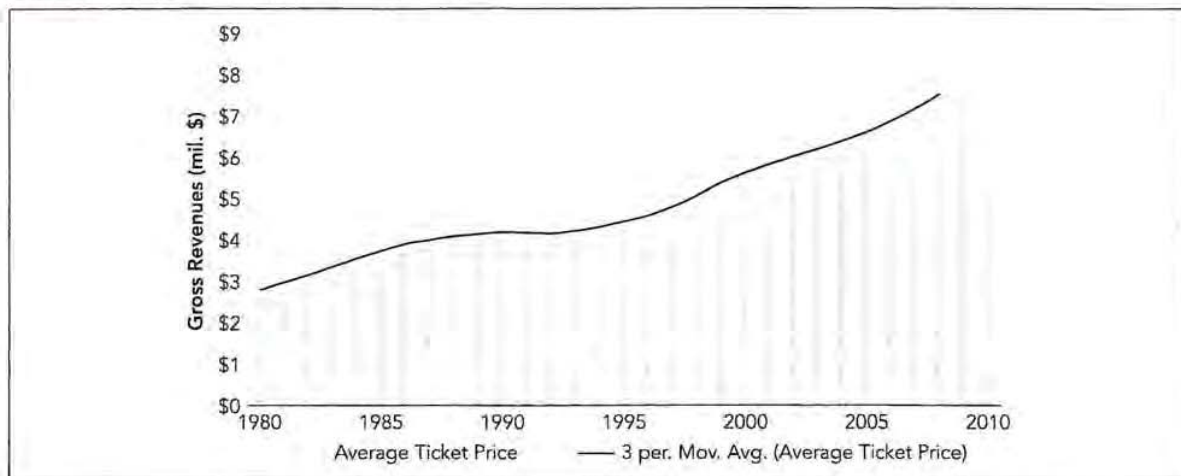
There are three primary sources of revenue for exhibitors: concessions, advertising, and box office receipts. Managers have low discretion: their ability to influence revenues and expenses is limited. Operating margins among exhibitors average a slim 10 percent. This is before significant expenses such as facility and labor costs. The result is marginal or negative net income. Overall, the business of exhibitors is best described as loss leadership on movies: the firms make money selling concessions and selling ads that are shown to patrons who are drawn by the movie.

Concessions

Moviegoers frequently lament the high prices for concessions. In 2009, concessions averaged 30 percent of exhibitor revenues. Direct costs are less than 15 percent of selling price, making concessions the largest source of exhibitor profit. These are influenced by three factors: attendance, pricing, and material costs. The most important is attendance: more attendees leads to greater concession sales. The \$3.75 price point for the large soda is not by accident, but rather the result of market research and profit maximization calculation. Costs are influenced by purchase volume, with larger chains able to negotiate better prices on everything from popcorn and soda pop to cups and napkins.

Advertising

Exhibitors also generate revenue through preshow advertising. Though this constitutes just 5 percent of revenues, it is highly profitable. Mintel reports that advertising revenues among exhibitors are expected to

Exhibit 5 Average Movie Ticket Price, 1980 to 2010

Source: Data retrieved from Boxofficemojo.com.

increase at an annual rate of 10 percent over the coming decade despite audiences' disapproval.⁶ Balancing the revenues from ads with audience tolerance is an ongoing struggle for exhibitors, though not a new one. In the early 70s, one industry executive argued:

It is not a policy of our corporation to use commercial advertising for income on our screen. We are selling the public one item—a particular motion picture—and to use the screen for other purposes detracts from this item.⁷

Box Office Revenues

Ticket sales constitute two-thirds of exhibition business revenues but yield little or no profit. Historically, the power imbalance between studios and exhibitors yielded rental contracts that returned as much as 90 percent of box office revenue to the studios during the initial weeks of a film's release. The split is now closer to 55/45 for large chains. Still, it is common for an exhibitor's portion of ticket revenues to not cover operational costs fully. The record-setting revenues at the box office have been the result of increases in ticket prices that have flowed back to the studios and help cover exhibitors' facilities and debt load.

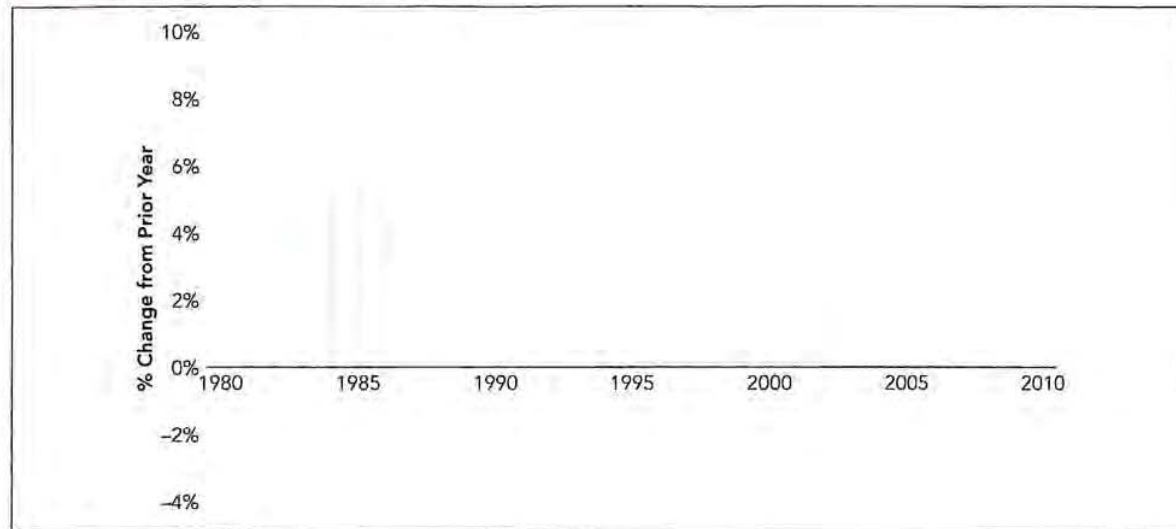
From 2005 to 2009, ticket price increases averaged 3.8 percent per year (Exhibit 6). While these increases set records, an even greater opportunity materialized with the resurgence of 3D. Prior to 2009, a \$1 to \$2 "surcharge" was installed to cover glasses, license fees paid to 3D equipment providers, and to studios in higher rental rates. Following the success of *Avatar*, exhibitors saw the opportunity to use the surcharge as an alternative to ticket price increases. The 3D premium now reaches \$3 to \$5; for IMAX it is \$4 to \$7. Price increases

in March 2010 by AMC, Regal, and Cinemark averaged 8.3 percent nationally on 3D movies, rising from \$13.60 to \$14.73.⁸ In some markets, 3D prices jumped 20 percent.⁹

Recent increases in exhibitor revenues are attributed almost entirely to 3D. In 2005, the box office for 3D was just \$40 million. By 2009, it had risen to \$1.14 billion or 11 percent of all revenues. From 2008 to 2009, 3D receipts grew 375 percent, whereas revenues for non-3D grew less than 1 percent.¹⁰ In addition, these figures may actually under-represent the actual demand for 3D as the rapid expansion in the number of 3D films produced created a bottleneck for the 3D screen space available.¹¹ Longer runs on 3D screens will likely increase the proportion of revenues from 3D. However, Paul Dergarabedian of Hollywood.com cautions that the ticket price increases are not sustainable.

It's what we call a recession-resistant business. Times get tough and people go to the movies because it's the one thing they see as a relative bargain. The minute they cease to see it that way, it's not good for the industry.¹²

AMC may have, intentionally or not, stumbled onto a price cap when several of their New York theaters hit \$20 per ticket for *Shrek* in IMAX 3D at several locations. Amidst a public outcry and unwanted media attention, the chain apologized, citing a pricing error, and reduced prices to \$17 and \$19. This situation suggests there is indeed a cap on the willingness to pay for even this "special" viewing experience. The backlash may make it difficult to raise prices in the near future; any cap on ticket prices is a serious cause for concern for exhibitors as it has been the primary way to increase revenues.

Exhibit 6 Change in Average Ticket Price, 1980 to 2010

Source: Data retrieved from Boxofficemojo.com.

The evidence is mixed that 3D is having a positive impact on exhibitors' bottom lines. This suggests either that the benefits have yet to accrue to exhibitors or are being appropriated by studios. The National Association of Theater Owners (NATO) estimates the savings of digital over film as \$1 billion annually¹³ due to lower production costs of master reels and prints, elimination of shipping, etc. They argue these cost savings will largely accrue to distributors.

By all accounts, revenues per admission have increased, but these are split with studios. At Regal, for example, film rental and advertising costs as a percent of revenues dropped slightly, to 53.3 percent from 54.2 percent for the second quarter 2010 compared to the same period in 2009. Similarly, Carmike's exhibition costs declined slightly as a percent of revenue, from 57.6 percent to 56.8 percent, but other theater operating costs grew from 59.6 percent to 62.9 percent of admissions revenue. In each of these cases, the data reflect substantial increases in ticket prices—and 3D surcharges began in spring 2010. This suggests studios are appropriating a large portion of the revenue increases.

At Regal, this holds true for operating profits as a percent of revenues, which decreased from 12.2 percent in the second quarter 2009 to 9.0 percent in the same quarter in 2010. For Carmike, the net effect was operating income declining significantly, from 8.8 percent of total revenue to 4.1 percent. The overall picture appears similar for Cinemark. Operating income as a percentage of revenues for second quarter 2010 declined from the levels in the same period in 2009, dropping from 14.6 percent to 14.4 percent. While limited to just the first comparative quarter when most price increases and

surcharges went into effect, these trends suggest that, despite substantial investments in digital and 3D, exhibitors may not be able to capitalize on them.

Overall, the exhibitor has limited control over both revenues and profits. Box office receipts are the bulk of revenues, but yield few profits. Attendance allows for profitable sales of concessions and advertisements, but there are significant caps on the volume of concession sales per person, and selling prices seem to have reached a maximum. Advertising remains an attractive avenue for revenues and profits, but audiences loathe it.

The Process of Exhibition

The fundamentals of film exhibition changed little from the introduction of motion pictures to well into the 90s. Historically, each theater received a shipment of physical canisters containing a "release print" from the distributor. Making these prints requires \$20,000–\$30,000 in up-front costs and \$1,000–\$1,500 for each print. Thus, a modern major motion picture opening on 2,500 screens simultaneously requires \$2.50 to \$3.75 million in print costs. This expense is borne by the studios, but paid for by movie attendees. Each release print is actually several reels of 35-mm film that are manually loaded onto projector reels, sequenced, and queued for display by a projector operator. The film passes through a projector that shines intense light through the film, projecting the image through a lens used to focus the image on the screen. A typical projection system costs \$50,000 with one needed for each screen.

In the late 90s, the industry began converting to digital distribution, a format that is now becoming economically viable. Digital cinema involves a high resolu-

tion (4096×2160) digitized image projected onto the screen. The cost of a digital projection system is considerable, averaging \$75,000 per screen. 3D capability can add an additional \$25,000. However, the cost for a digital release print is far lower than traditional film; but these cost savings most directly benefit the studio while, in the meantime, exhibitors pay to convert their theaters. Nevertheless, the number of digital theaters is expanding rapidly. In 2004, there were fewer than 100 in the US. At the end of 2007, 4,702 digital screens had been installed, and by 2009, there were 7,736.

Financing these investments was a significant issue for exhibitors due to the total costs and their weak balance sheets. Two financing avenues were taken by the major theater chains. Forming an agreement with Christie Digital Systems, Carmike went solo with a lease-service approach. Under its 10-year agreement, digital and digital 3D systems are installed with an up-front cost of \$800 per screen. Christie provides equipment service and maintenance amounting to \$2,340 per screen annually. This arrangement effectively puts both the risk and upside with Carmike as fixed costs are increased. Revenues beyond these fixed costs benefit Carmike. Alternately, AMC, Cinemark, and Regal financed the transition through the Digital Cinema Implementation Partners (DCIP) partnership, securing \$660 million in financing to convert nearly 14,000 or over 90 percent of their screens. Each company pays a \$5,000 to \$10,000 per screen conversion charge and subsequent royalty fees of approximately \$0.50 per admission. Conversion of screens ranges from 1,000 screens for Regal to 1,500 for Cinemark.

By the end of 2009, 1,000 screens were being converted to digital every six months. Carmike had converted over 90 percent of its screens to digital. The DCIP firms on average had converted approximately 25 percent of their screens. Plans are in place for the nearly complete conversion to digital among the leading four exhibitors.

To the audience, the most visible aspect of the digital transition is 3D, which went mainstream in 2010. In 2005, just 192 digital 3D capable screens were installed. By 2007, that number more than tripled to 600, reaching 3,378 by the end of 2009. Twenty-two percent of Carmike's screens are 3D capable. The DCIP partners have on average 10 percent of their screens as 3D capable with plans to grow that number to approximately 25 percent. In 2010, 3D screens were responsible for approximately one-third of all box office admissions, generating roughly 40 to 50 percent of all revenues. A study by the International 3D Society reported 3D is responsible for the majority of opening weekend revenues.¹⁴ Of *Avatar's* \$77 million opening weekend, 82 percent was from 3D; for *Alice in Wonderland*, it was 70 percent.

Still, some argue that 3D may be a novelty. The appeal of 3D varies by film, with action and animated

as the leading genres. The long-term trend appears to be downward, to what threshold no one knows (Exhibit 7). "Because the pricing of 3D tickets is now so high, people are becoming more selective about what they see in 3D," said Rich Greenfield, media analyst for BTIG.¹⁵ A focus on 3D may result in more action movies and fewer comedies and dramas, further alienating the non-core audience for movies.¹⁶

The Theater Experience

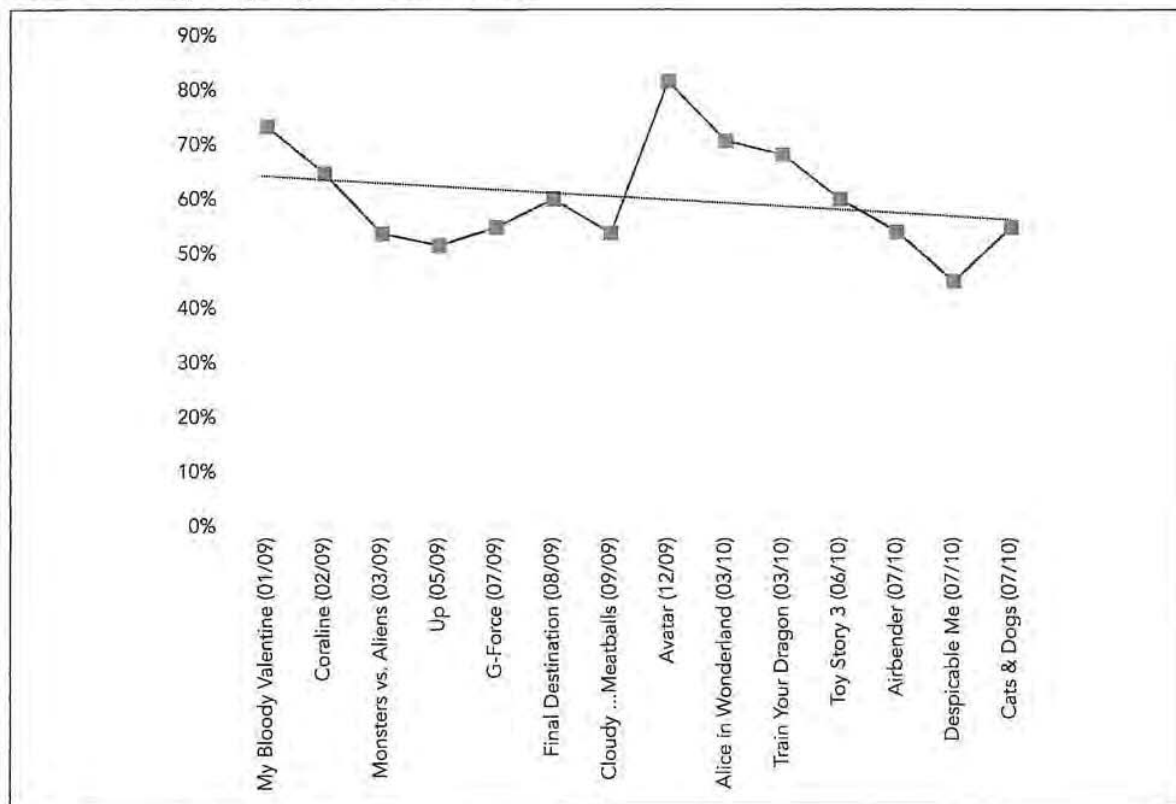
While the industry touts the ongoing transition to digital projection and the latest 3D as the draw for the box office, the allure may be more fundamental. Moviegoers describe the attraction of going to the theater as an "experience" based on: (1) the giant theater screen, (2) the opportunity to be out of the house, (3) not having to wait to see a particular movie on home video, (4) the experience of watching movies with a theatrical sound system, and (5) as a location option for dating.¹⁷

The ability of theaters to provide these benefits beyond what audiences can achieve at home appears to be diminishing. Of the reasons that people go to the movies, only the place aspects—the opportunity to be out of house and as a place for dating—seem immune from substitution. Few teenagers want movie and popcorn with their date at home with mom and dad.

The overall "experience" currently offered by theaters falls short for many. Marketing research firm Mintel reports the reasons for not attending theaters more frequently are largely the result of declining experience. Specific factors include the overall cost, at-home viewing options, interruptions (such as cell phones in the theater), rude patrons, the overall hassle, and ads prior to the show.¹⁸ Patrons report general dismay with the theater experience. A recent *Wall Street Journal* article reported on interruptions ranging from the intrusion of sound tracks in adjacent theaters to cell phones. "The interruptions capped a night of movie going already marred by out-of-order ticketing kiosks and a parade of preshow ads so long that, upon seeing the Coca-Cola polar bears on screen, one customer grumbled: 'This is obscene.'"¹⁹ Recounting bad experiences is a lively topic for bloggers. A typical comment:

I say it has gotten worse. I hate paying \$9.00 for a ticket and the movie is 90–100 minutes long, people talking on the cell phone, the people who work at the theaters look like they are bored, and when you ask them a question, the answer is very rude. I worked as an usher in the late 60s and we had to wear uniforms and white gloves on Friday and Saturday nights, those days are long gone.²⁰

A trip to the local cinemplex can be an eye-opening event for industry insiders. In 2005, Toby Emmerich, New Line Cinema's head of production,

Exhibit 7 Percentage of Opening Weekend Sales from 3D

Source: Data retrieved from Boxofficemojo.com.

faced a not-so-common choice: attending *War of the Worlds* in a theater or in a screening room at actor Jim Carrey's house. Said Emmerich in an *LA Times* article

*I love seeing a movie with a big crowd, but I had no idea how many obnoxious ads I'd have to endure—it really drove me crazy. After sitting through about 15 minutes of ads, I turned to my wife and said, "Maybe we should've gone to Jim Carrey's house after all."*²¹

The unique value proposition offered by movie theaters' large screens, the long wait for DVD release, and advantages of theatrical sound systems also appear to be fading. Increasingly larger television sets, DVD content, and the adoption of high definition (HD) technology are all eroding these advantages. One blogger posts, "Whereas the electronics industry has been innovating to create immersive experiences from the comfort of our own home, the US theater industry has been dragging their feet."²²

Home Viewing Technology

Many home television sets are increasingly large HD sets coupled with inexpensive yet impressive audio systems. In 1997, the screen size of the average television was just

23 inches. Currently, almost all television manufacturers sell LCD televisions with screens 36 inches or larger.²³ Because set size is measured as the diagonal screen size, increases in viewable area are greater than the measurement suggests; in fact, the viewing area of sets doubled from 250 inches² to 550 inches².

The Federal Communications Commission (FCC) requirement that all broadcasters convert to digital broadcasts by 2009 is widely credited with starting a consumer movement to upgrade televisions. Since the 50s, television transmissions were formatted as 480 interlaced vertical lines (480i) of resolution. The new digital format is HD, providing up to 1080 vertical lines of resolution (1080p).²⁴ Three-quarters of all televisions sold since 2006 are HD capable.

As LCD technology became the standard for both computer and television screens, manufacturing costs declined. Wholesale prices for televisions fell 65 percent from the late 90s.²⁵ In 2006, the average television retailed for \$29 per diagonal inch of set size. This is expected to decrease to \$22 within five years.²⁶ Consumers, however, are actually spending more on every television, consistently electing to purchase larger sets to achieve a better viewing experience. Sharp, a leading manufacturer of

televisions, predicts that by 2015 the average screen will reach 60 inches.²⁷

Large-screen televisions, DVD players, and audio and speaker components are commonly packaged as low-cost home theaters. The average DVD player now costs just \$72²⁸ and HD DVD players are beginning to penetrate the market. Retail price wars during the 2008 Christmas season led to HD Blu-Ray players dropping below \$200. These home theater systems offer a movie experience that rivals many theaters, all for \$1,000–\$2,000. Says Mike Gabriel, Sharp's head of marketing and communications, "People can now expect a home cinema experience from their TV. Technology that was once associated with the rich and famous is now accessible to homes across the country."²⁹

Content Expansion

Sales of DVDs have aided the expansion of home theaters and profited the studios. DVD sales have been a primary source of studio profits for more than a decade, but fell precipitously, down 13.3 percent in 2009 on top of an 8.4 percent decline in 2008.³⁰ At \$8.5 billion, 2009's DVD sales equaled 2001 levels; total revenues from DVD sales dropped below that of box office receipts in the US for the first time since 2000.³¹ This decline in DVD sales is due in part to the expanded availability of rentals and pay-per-view, and is at least partially attributable to the studios.

Rentals also serve this market. Netflix grew revenues 85 percent from 2006 to 2009, and it is actively expanding into online streaming. Coinstar's Redbox had over 12,000 rental kiosks offering \$1/night rentals through partnerships with McDonald's (which is also an investor

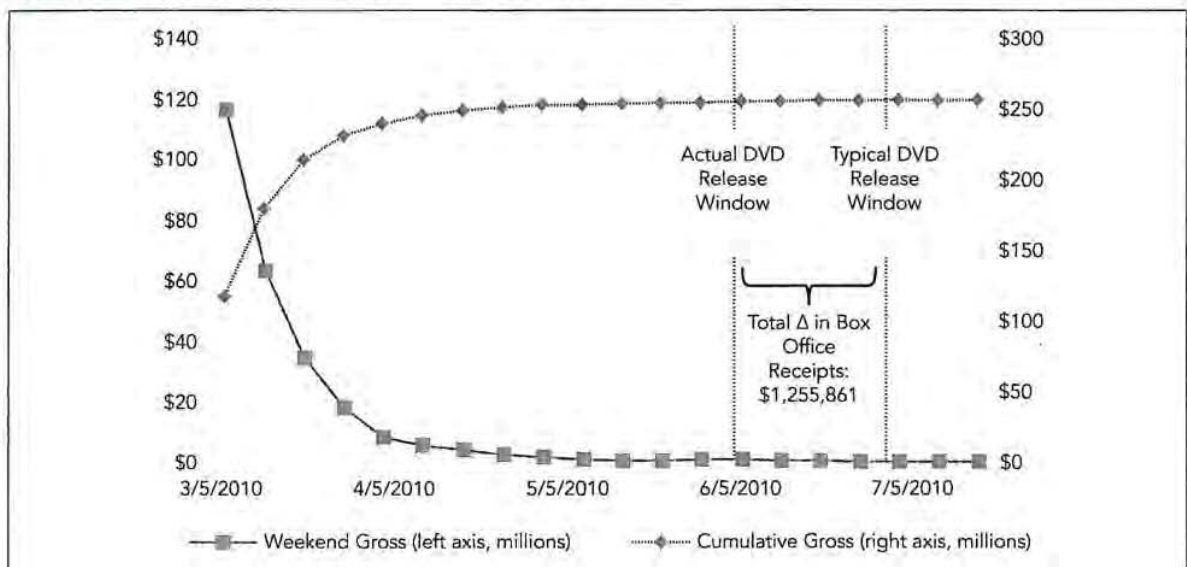
in the company), Walmart, Walgreens, and other retailers even *before* adding kiosks to half of 7-Eleven's national locations.³²

Studios are responding by trying to spur DVD and pay-per-view fees through shorter release windows, actions seemingly incompatible and inconsistent with the drive to increase theater attendance. In 2000, the average window between theatrical release and DVD sales was 5 months, 16 days. In 2009, it was 4 months, 11 days—a 20 percent reduction.³³ Studios are eager to accelerate DVD revenue streams and capitalize on initial marketing expenditures. Arguing in favor of a reduced window, Bob Iger, CEO of Disney, said, "The problem with waiting these days is that we're dealing with a much more competitive marketplace than ever before—there are more choices that people have."³⁴ Theaters may fear complete disintermediation.

The accelerated DVD release of *Alice in Wonderland* in the US (just 88 days after opening and while the film remained in theaters) created great concern among film exhibitors. Exhibitors fear shorter windows deter attendance (Exhibit 8). US theater owners and major Hollywood studios reached an agreement wherein the studios will be able to release one or two movies each year on an accelerated schedule, cutting a month off the traditional four-month DVD release window.³⁵ The *Wall Street Journal* reports,

*Theaters have benefited recently from a boom in box-office receipts, even as studios have suffered from a steep decline in DVD sales. Adjusting the windows is an attempt to maintain the health of both camps, which depend on one another.*³⁶

Exhibit 8 *Alice in Wonderland*: Weekly Domestic Box Office Gross



Source: Data retrieved from Boxoffice Mojo.com.

Hollywood is also seeking to expand direct-to-viewer delivery, avoiding the DVD and capturing revenues directly. Studios won regulatory approval to temporarily block analog outputs on viewers' electronics during pay-per-view movies. While controls for digital outputs are features that are built into modern electronics, viewers with analog equipment could record pay-per-view movies if the regulatory block failed. Studios considered this loophole a security issue. Allowing temporary blockage paves the way for studios to pursue short release windows, offering "premium" pay-per-view opportunities prior to DVD release.

Overall, studios are increasingly seeking to overcome their own lost profits through increased DVD sales and alternative channels to serve the home audience directly. Both are detrimental to exhibitors.

Recession Effects

Beyond the previous attendance drivers mentioned, there is a more ominous one: recession. There has been a long-standing effect between economic recession and depression and movie attendance: as the economy declines, attendance increases. As early as 1911, one observer described movies as a "door of escape, for a few cents, from the realities of life."³⁷ During the depression of the 30s, movie theaters were described as "an acre of seats in a garden of dreams."³⁸ The recession of 2008 saw rapid increases in gas prices, stock market declines, and significant layoffs. One summer movie patron commented, "There's not a whole lot you can do for \$10 anymore."³⁹

The recession of 2008 saw attendance increase 10 to 15 percent over 2007. The air-conditioned comfort of a dark theater and the latest Hollywood release offered a break not just from the summer heat, but from reality. "It's escapism, absolutely. It's probably a subconscious thing, and people don't realize it. But there's just so much going on, with people trying to pay their mortgages and get by. It's an escape for a couple of hours."⁴⁰ However, attendance for 2009 overall was down 4.1 percent. The Motion Picture Association of America (MPAA) routinely touts movies as bargain entertainment. Four tickets to a movie costs under \$27 compared to \$141 for an amusement park or \$261 for a pro football game.⁴¹ This comparison, however, may no longer be relevant as the true substitute may be a home theater and an existing cable subscription.

Possible Alternative Business Models

Under the studio-based film exhibition model, unchanged since the 30s, exhibitors have just two alternative revenue streams: advertising and concessions. Both appear limited in opportunities for increasing revenues and profits.

Advertising, while increasing in amount, threatens to alienate customers. While a 2007 Arbitron survey indicated 63 percent of those 12 and older report they "do not mind the ads they put on before the movie begins,"⁴² other viewers loathe them. Even the industry struggles with the issue. Bob Pisano, president of the MPAA, calls increased advertising or higher concession prices "mutually assured destruction" for both exhibitors and the studios. They "try moviegoers' patience" he argues, "leading them to stay home and rent or, worse, illegally download a film."⁴³

While ticket prices quadrupled, per capita spending on concessions has only doubled since the 70s.⁴⁴ Theater chains have expanded food offerings, some to the point of rivaling mall food courts. The NATO estimates that over 400 theaters now have on-site restaurant or bar service. These theaters appear at odds with the primary demographic market for movies. While the average moviegoer is the teen to 20-something, these theaters seek 35- to 50-year-olds. AMC is experimenting with an in-theater food model to serve this market. Gold Class Cinemas adds a service approach with 40-seat theaters more akin to club lounges than auditoriums, and offers full food and wine service. Tickets, \$20-\$25 per person, are purchased not from a ticket booth but from a concierge. Food sales average near \$20 per person. Some also offer valet parking and childcare to lure customers.⁴⁵ Rob Goldberg, Gold Class Cinema's COO, explains this is part of the appeal saying, "We don't get the teenage crowd."⁴⁶

Keeping patrons coming to the theater and increasing profitability may require a dramatic change for exhibitors. The investment in digital distribution and projection increases both visual quality and operational flexibility, serving as a classic "enabling technology" and opening the door for alternative content. New York Metropolitan Opera's *Live in HD* is an alternative content leader, now entering its fifth season. The series offers opera to audiences where it may not be available locally. Featuring 12 performances on Saturday afternoons, the series is broadcast to more than 500 HD-equipped theaters. Exhibitors continue to experiment with alternative content, mostly for individual sporting events where exhibitors must compete directly with home viewing. Says Jeremy Devine, marketing VP for a Dallas-based theater chain showing the NBA All-Star Game, "I don't care how good your buddy's system is, this is a 52-foot screen. And it's in 3D."⁴⁷

Despite the potential for alternative content, virtually all admissions continue to be for studio movies. The evidence suggests continued problems with profitability under this studio-dominated model. The surge in revenues from 3D does not appear to be increasing profitability.

While exhibitors are, with the exception of Cinemark, predominantly US based, studios are increasingly focusing their attention on the international market where growth is highest. While US revenues grew 20 percent from 2005 to 2009, international revenues grew 35 percent.⁴⁸ Internationally, both attendance and receipts are growing.⁴⁹ Studios' proportional revenues are also further shifting toward international. In 2005, box office receipts totaled \$23 billion with \$14 billion (60 percent) international. By 2009, that increased to two-thirds of the \$30 billion total.⁵⁰ There appear to be opportunities to increase revenues from increased attendance and ticket price increases. In India, for example, last year's 3.3 billion attendees paid an average of just \$0.50.⁵¹ In just that market at current growth rates, the annual volume increase in attendance equals total current US annual admissions.⁵² Among leading US exhibitors, Cinemark has the largest international presence with 130 theaters (1,066 screens) in Mexico and seven in central and South American countries.

Raising the Exhibition Curtain in 2011 and Beyond

Despite a continuing recession, the end of the 2010 season saw an alarming statistic: summer admissions declined 3 percent from 2009 levels, resulting in a decline in both admissions and revenues (Exhibit 9). The increased costs

of going to the theater may be causing audiences to be more selective in the movies they choose to see. Perhaps the escapism of the movies is bumping into a reality of empty wallets. Higher prices are "a very dangerous situation for the movie industry," says Dergarabedian,

*When is too much too much? The demand has been huge, but theater owners should not just think that they can charge whatever they want, because there is a point when people will literally just stop coming because they can't afford it.*⁵³

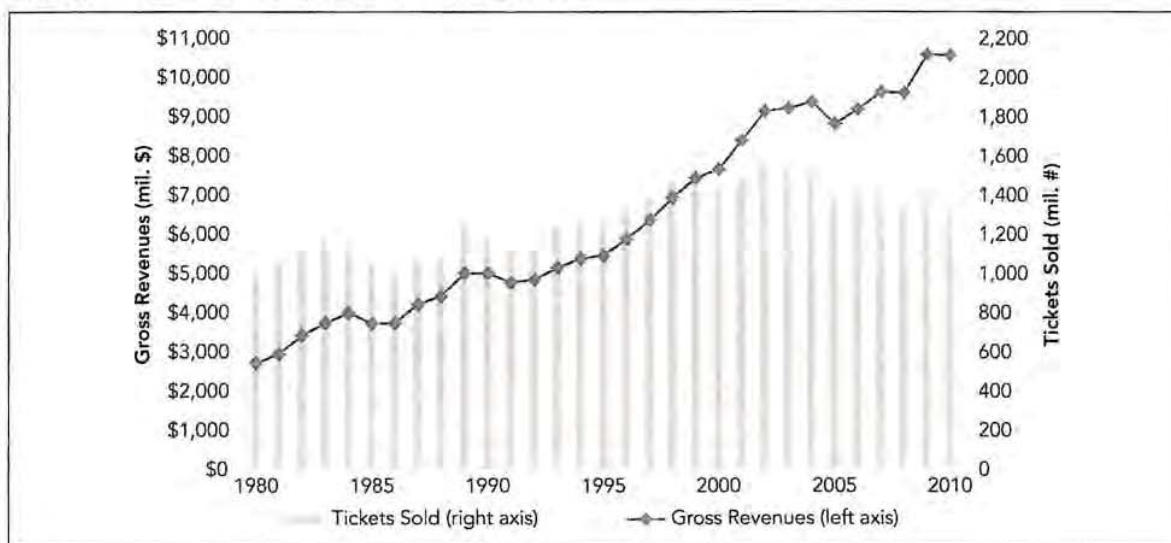
Others explain the decline as a lack of content. Even with expectedly high revenues from big-budget movies, no sleeper hits emerged.

Fitch Ratings summarized the long-term situation:

*[R]evenues and profitability of movie theatres could be increasingly challenged by factors that are largely out of managements' control... [T]he significant degree of operating leverage means that cash flow can be meaningfully affected by moderate top-line declines. These factors and financial policy decisions will remain the main drivers of credit quality over the longer term.*⁵⁴

What can exhibitors do to improve their performance? To reverse the downward trends in attendance? To improve their profitability at a time when the studios, relying on the box office more than ever, are increasingly looking internationally?

Exhibit 9 Domestic Tickets Sold & Box Office Gross 1980 to 2010



Source: Data retrieved from Boxofficemojo.com/yearly.