HOME VIDEO IN CANADA

Final Report

Prepared for
Communications Canada

by
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1.0 INTRODUCTION

This section reviews the study objectives and provides an overview of the distribution, wholesaling and retail chain for home video product.

1.1 Study Objectives

NGL Consulting Ltd. was commissioned by Communications Canada to provide an assessment of trends in the Canadian video retail industry and to update Nordicity Group Ltd.'s 1985 "Film/Video Retail Study". The 1985 study surveyed the Canadian video retail sector and examined its role in the production/distribution/exhibition chain of film and video production in Canada.

One important objective of this study is again to assess the role of the Canadian video retail market in terms of its significance to Canadian producers and distributors. Thus, the study provides a useful perspective on the future development of the Canadian film/video industry. It is a first step in responding to the Federal Government's commitment to "improve the distribution of Canada's cultural products in broadcasting, film and video", as outlined in the 1989 Speech from the Throne.

This study provides:

- an assessment of recent trends in the home video industry;
- a detailed examination of the Canadian video retail market, drawing, in part, upon a survey of video retailers conducted for this update;
- an examination of structural changes in the industry, including the relationships among producers, distributors, wholesalers and retailers; and finally,
- an examination of the strategies available to Canadian producers to improve the contribution of the home video market to Canadian rights holders.

The methodology for the study comprises a detailed literature review, interviews with industry experts, case studies of several Canadian productions, and a survey of video retailers in three major Canadian markets based on the questionnaire developed for the 1985 study.

1.2 Overview of the Home Video Market

Consumer spending in Canada on pre-recorded videocassettes, both rental and purchase, is estimated to be between $700 - $800 million in 1988 spread across an estimated 6,000 video retail outlets and an undetermined number of mass merchandisers. The average VCR household rents an estimated 4.1 cassettes per month and purchases an estimated 0.6 cassettes per year.

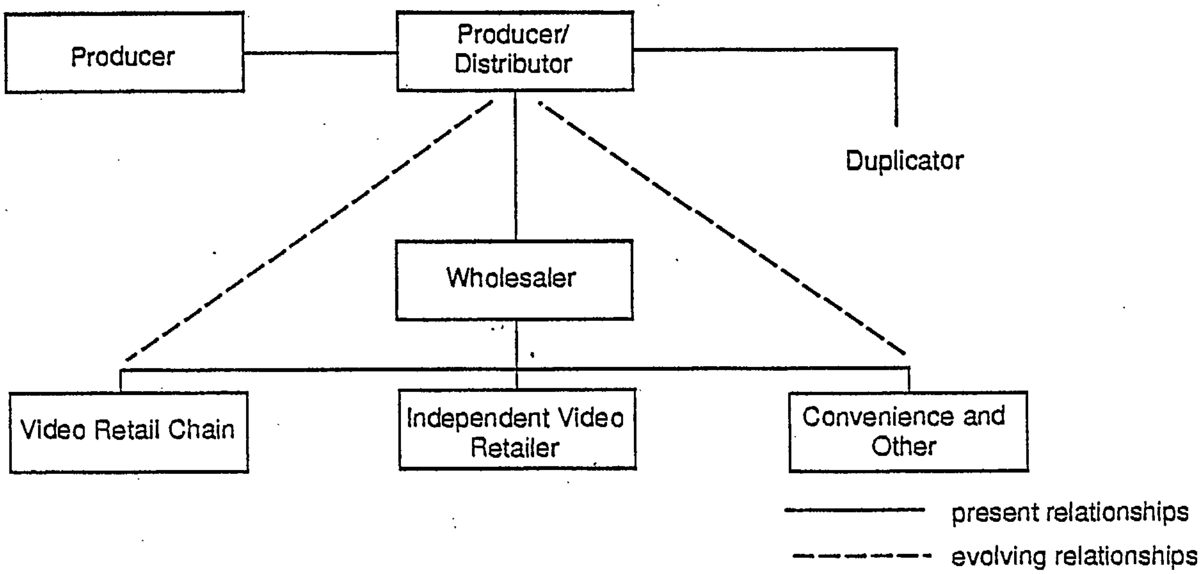
The industry structure in which video retail operates has not dramatically changed since 1985. It can be broken out into three key components:

- **Retailers** - operate in chains or as independent stores; they provide pre-recorded videocassettes for rental and/or sale to VCR owners
- **Wholesalers (sometimes called "distributors")** - act as the distributor to retailers; they buy the packaged cassettes from distributors and re-sell to video retailers
- **Distributors/ Producers (sometimes called "manufacturers")** - control the rights to the video product; they manufacture the videocassettes through duplication and packaging, sell to wholesalers and market to retailers

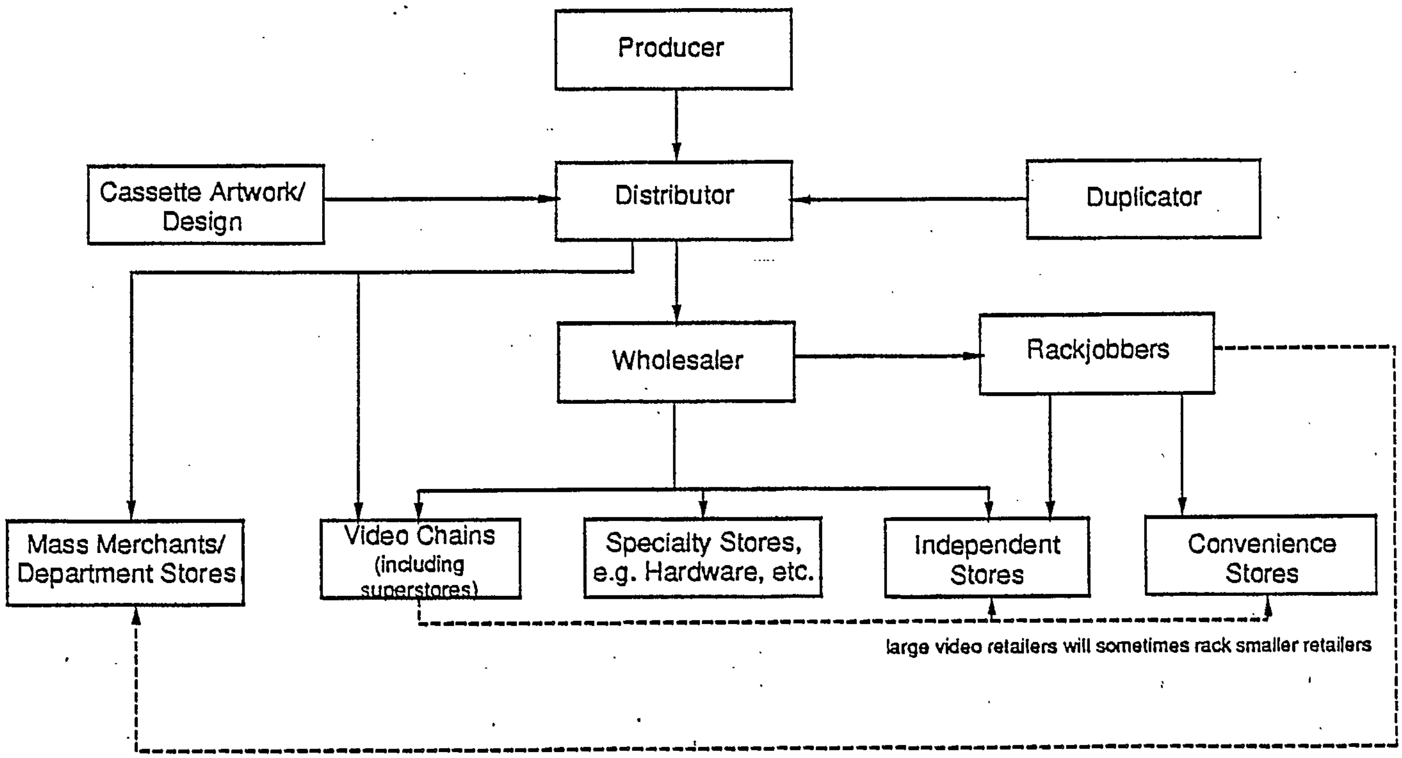
This simple description masks some of the complex interrelationships that have developed among the players since 1985. There are now more alternatives to the consumer in terms of the variety of outlets for video product, i.e. video retail stores, department and record stores, vending machines, etc. Exhibit 1-1 illustrates some of the changes compared to the more simple structure in the mid-80s. It is important to note that these interrelationships are simply typical of distribution arrangements in the video industry, since each deal between manufacturer, distributor and retailer can be quite different.

Exhibit 1-1

1985: Relationships Among Various Players in the Canadian Home Video Market



1989: Relationships Among Various Players in the Canadian Home Video Market



The primary difference from 1985 is the emergence of sell-through, although still a small proportion of total revenues. The chart representing the structure of the video retail industry in 1985 describes a market dominated by video rental. The chart for 1989 is really two markets: the video rental market and the video sell-through market. Some distributors deal directly with mass merchants to provide them with cassettes; wholesalers serve mass merchants as well as video and specialty stores; rack jobbers serve the smaller outlets (some mass merchants are served directly by rack jobbers such as K Mart) often with titles that are less expensive because they have been available to the video market for some time.

In the rental market, major distributors continue to deal with wholesalers who sell cassettes to retailers. One difference now is the presence of the rack jobber who serves the small retail operator and acts as the conduit between the large wholesaler and the small retailer. Another difference lies in the sell-through market, where videos are piggybacked on related existing product lines. For example, music videos are sold in record stores, compact disc's (CD's) are rented in video stores, and children's videos are sold in toy stores.

The video retail market is unique in that it has certain characteristics which are similar to other distribution systems, e.g.:

- Book Distribution: Video retail is like book selling in that both are dealing with the manufacture and physical distribution of product.
- Theatrical Distribution: Video retail is also a "hit" driven business; it uses the same product as cinemas and relies on theatrical distribution for promotion; however, video retail provides more "shelf space", since theatrical is severely limited by the number of available screens.

- Record/CD Distribution: Video retailers, like record stores rely on wholesalers or rack jobbers to supply them with product that has the common characteristic of being played on home players.

- Television Distribution: While the distribution systems are quite dissimilar (e.g. TV has little physical distribution volume) the range of product exhibited on TV is similar to home video.

- Pay-TV Distribution: Video retail is a clear alternative to pay-TV subscription, particularly pay-per-view services; however, pay-TV distribution is more like TV distribution than home video distribution.

Like sound recordings and books, videos are cultural products geared toward home consumption. Consumption can either take the form of rentals or sales, with price as the determining factor. If the price is too high for the consumer (like a recently released title on videocassette), then the market provides that product for rent. If price come down enough videos can be marketed as a product for sale.

Pre-recorded videocassettes cost too much at the beginning compared to movies, so the idea of video rental made sense. Libraries provide the same function for hard cover books. As videos can be priced at $24.95 - $29.95, a sell-through market is possible. However, books are less perishable in perceived value than videos and are thus an easier sell at that price. Correspondingly, since CD's cost relatively more than LPs or tapes, CD rental has become a new distribution approach.

Home video has emerged as a distribution powerhouse in less than a decade. It illustrates the evolving nature of distribution, particularly of electronic image and sound product. Examining how it is structured and what drives it is important to proper understanding of the distribution of cultural product in Canada.

2.0 THE CANADIAN VIDEO RETAIL MARKET

This section examines consumer demand for home entertainment services, VCR penetration and usage characteristics, and provides an estimate of the amount of consumer spending in the Canadian home video market.

2.1 Consumer Demand for Home Entertainment Services

Home video should be examined within the context of consumer demand for home entertainment services. Canadians are now spending more on recreation than in the past. In 1977, Canadians spent $4.4 billion compared to $12.1 billion in 1987. This represents 8.1% average annual <u>real</u> growth (i.e. beyond inflation) in recreational spending over the ten-year period. In the last five years, the average real growth in recreational spending was even higher at 11.8%.

These increases in recreational spending translate into similar increases in home entertainment expenditures, which account for 20% of total recreational expenditures. Home video is a component of home entertainment, which includes basic cable and pay-TV and theatrical admissions (see Exhibit 2-1).

Exhibit 2-1
Estimate of Average Expenditure Per TV Household on Film/Video Entertainment Services for 1986

TV Households (000,000) (Source: Statistics Canada for 1986)	9.204

Total Cable Service Revenues ($000,000) (Source: CCTA for 1986)	- basic service - premium service	$712.0 $160.4
		$872.4
Expenditure/TV HH/Month		**$7.90**

Estimated Total Videocassette Rental/Purchase ($000,000) (Source: NGL Consulting Ltd. for 1986)	$555.0[1]
Expenditure/TV HH/Month	**$5.00**

Theatrical Admissions ($000,000) (Source: Statistics Canada for 1985/86)	$322.8
Expenditure/TV HH/Month	**$2.90**

Total Household Video Entertainment Expenditures for 1986 ($000,000)	$1,750.2
Expenditure/TV HH/Month	**$15.85**

Note: while estimates of cable service revenues and home video revenues are available for 1988, 1985/86 was the latest year available for theatrical admissions. 1986, therefore, was chosen as the year for comparison. Therefore, the final figure of $15.85 per TV household per month understates what the level of expenditure would be today, which would probably be about $20.

1 Estimate for 1986 based on average expenditures per U.S. household on videocassette rental and purchases, Paul Kagan Associates, 1988. Although rental and sell-through patterns are different in Canada and the U.S., the estimate of the Canadian market based on U.S. experience can provide a rough indicator of the size of the market in 1986.

2.2 VCR Penetration in Canada

The Canadian home video market is steadily growing as VCR penetration continues to rise. In 1988, almost all provinces reported over 50% penetration of VCRs in TV households. VCR penetration ranges from 44.2% in Prince Edward Island to 59% in Alberta with an average of 52.8% for Canada. Exhibit 2-2 provides a provincial breakdown of VCR penetration of TV households for 1986 to 1988.

Exhibit 2-2
VCR Penetration of TV Households by Province: 1986 - 1988

	1986	1987	1988
Newfoundland	36.8%	45.5%	50.6%
PEI	28.6%	34.9%	44.2%
Nova Scotia	39.4%	45.8%	52.1%
New Brunswick	32.2%	43.2%	51.9%
Quebec	34.5%	44.1%	49.5%
Ontario	35.6%	46.6%	55.0%
Manitoba	38.6%	48.2%	51.1%
Saskatchewan	31.1%	40.9%	47.9%
Alberta	40.2%	49.2%	59.0%
BC	34.3%	45.1%	51.9%
Canada	**35.6%**	**45.7%**	**52.8%**

Source: Statistics Canada, May, Household Survey.

VCR penetration in Canada has more than doubled since 1985, from 24% to 53% of TV households, but growth is expected to slow as penetration increases. The rapid growth in consumer demand for VCRs is slowing as imports into Canada have declined over the last two years. Imports are estimated at 840,000 units for 1988 which is a considerable decrease from the peak of 1.4 million units in 1986.

However, demand for VCRs is expected to continue to be strong for some time as consumers are now beginning to purchase multiple units for the household and replace older units. According to the Fairfield Group (Video Track: Canada, September, 1988), there are approximately 490,000 Canadian households that own more than one VCR. This represents 10% of Canadian VCR households. With over one quarter of the VCRs in Canadian homes more than 4 years old, VCR replacement purchases will become a major factor. In the U.S., it is estimated that currently over 13% of VCR households are multiple set homes (1988, Paul Kagan Associates), which is expected to increase to 38% by 1996.

VCR penetration is forecast to increase from 53% in 1988 to 70% in 1996, based on growth and maturity rates comparable to the U.S. (see Exhibit 2-3).

Exhibit 2-3
Forecast of VCR Penetration in Canada: 1981 - 1996

	Total Households (000,000)	TV Households (000,000)	Penetration of TVHH's %	New VCR Households (000,000)	Total VCR Households (000,000)	Penetration %
1981	8.063	7.887	97.8%	0.000	0.000	0.0%
1982	8.254	8.101	98.1%	0.168	0.168	2.1%
1983	8.460	8.286	97.9%	0.374	0.542	6.5%
1984	8.857	8.682	98.0%	0.562	1.104	12.7%
1985	9.079	8.930	98.4%	1.021	2.125	23.8%
1986	9.331	9.204	98.6%	1.148	3.273	35.6%
1987	9.556	9.410	98.5%	1.023	4.296	45.7%
1988	9.244	9.112	98.6%	0.513	4.809	52.8%
1989	9.466	9.300	98.2%	0.500	5.309	57.1%
1990	9.688	9.523	98.3%	0.450	5.759	60.5%
1991	9.910	9.743	98.3%	0.400	6.159	63.2%
1992	10.066	9.902	98.4%	0.350	6.509	65.7%
1993	10.223	10.060	98.4%	0.300	6.809	67.7%
1994	10.379	10.215	98.4%	0.250	7.059	69.1%
1995	10.536	10.366	98.4%	0.200	7.259	70.0%
1996	10.692	10.518	98.4%	0.150	7.409	70.4%

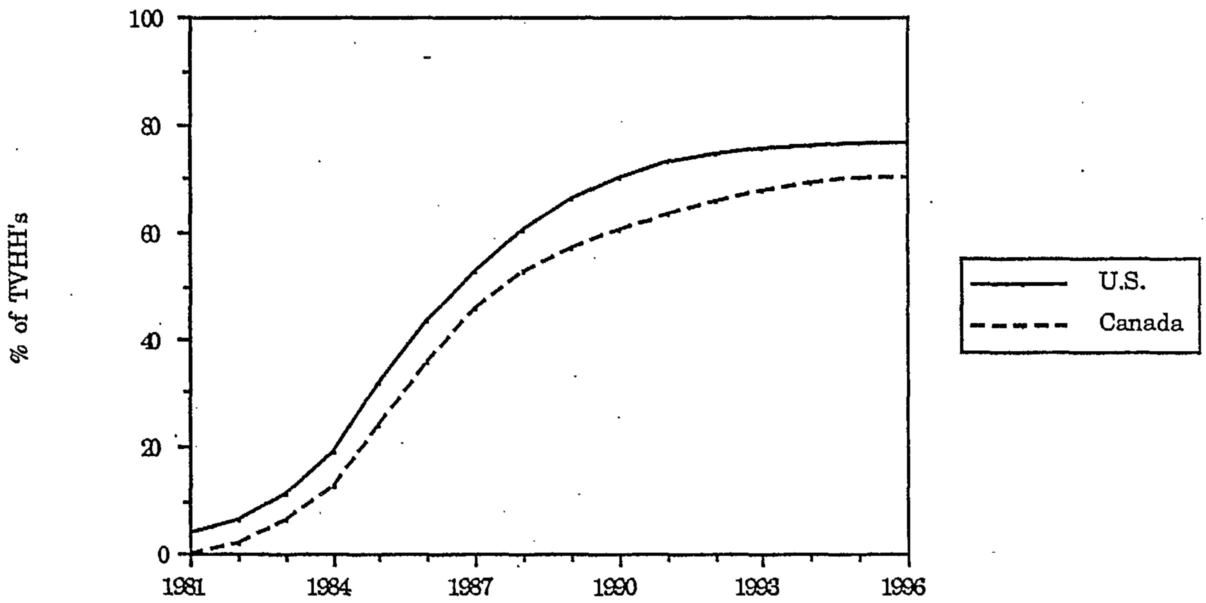
Notes:

- Total Household's: figures to 1988 are from Statistics Canada; figures from 1989 to 1996 are compilation of CMHC forecasts for 1991 and 1996 and NGL estimates for the other years.
- TV Households: figures to 1988 are from Statistics Canada; forecast to 1996 based on a rolling average of TV penetration from 1981 to 1988
- New VCR Households: figures to 1988 are calculated from total; figures to 1996 are NGL estimates
- Total VCR Households: figures to 1988 are from Statistics Canada; figures to 1996 based on addition of new VCR households.

These estimates are roughly comparable with what is expected to occur in the U.S. over the same period. According to Paul Kagan Associates, VCR penetration is expected to rise from 60% in 1988 to 77% in 1996. If we assume that growth in Canada will follow the same pattern, then penetration could rise from 53% in 1988 to 70% in 1996. It is possible that the growth in VCR penetration could be higher so that the gap between

Canada and the U.S. may close up to the 77% level projected for the U.S. Exhibit 3-4 provides a comparison of U.S. forecasts with our own.

Exhibit 2-4
Comparison of Forecasted VCR Penetration in the U.S. and Canada



Notes:

- Paul Kagan Associates, "The VCR Letter", March 8, 1988
- Canadian forecast based on Exhibit 2-3

2.3 VCR Ownership and Usage Characteristics

2.3.1 VCR Penetration by Age and Income

VCRs are more prevalent among higher income groups as illustrated in Exhibit 2-5, below. At all age levels, the highest VCR penetration level is reached at incomes over $55,000. Penetration levels for those 65 years of age and over are consistently below those of other age groups. This is interesting because TV viewing is high in that age category. One could surmise that the physical picking up and dropping off of rented tapes is more of a barrier to that age group than for others.

Exhibit 2-5
Percentage of Households with VCRs in Canada
by Age of Household Head and Income Groups, Spring 1988

	Total by Age Group	Under 35	35 - 44	45 - 54	55 - 64	65+
Under $10,000	19.6	24.4	25.5	23.2	20.4	12.2
$10,000 - $15,000	24.4	37.8	40.2	31.2	23.5	10.8
$15,000 - $20,000	32.7	41.1	40.9	46.2	41.7	18.6
$20,000 - $25,000	42.3	51.0	**57.6**	44.1	35.2	19.0
$25,000 - $30,000	47.3	**56.4**	**55.3**	**55.1**	39.5	21.9
$30,000 - $35,000	**54.1**	**58.8**	**63.1**	**54.1**	45.3	34.4
$35,000 - $45,000	**62.7**	**62.2**	**72.0**	**66.3**	48.0	33.0
$45,000 - $55,000	**67.8**	**71.8**	**73.1**	**71.7**	**60.4**	34.9
$55,000 - $70,000	**73.9**	**74.6**	**80.1**	**74.2**	**63.8**	**55.4**
Over $70,000	**78.8**	**75.7**	**84.7**	**81.4**	**74.0**	51.3
Total by Income Groups	52.0	**56.5**	**67.2**	**63.7**	46.7	20.8

Source: Statistics Canada
Note: Figures in bold are above the national average for 1988 of 52.8%.

Not surprisingly, VCR penetration is highest in the most affluent income groups and the 35 to 55 age groups. According to BBM (Fall 1987), the typical VCR user profile differs from the population in that there is a higher concentration of VCR ownership among:

- younger age groups;
- professionals;
- larger households, and;
- those with pay-TV.

2.3.2 VCR Usage

Consumers purchase VCRs to tape programs off-air and to rent and view pre-recorded videocassettes. In a 1986 report on VCR usage (CBC Research, "VCRs: The Canadian Story", 1986) that was based on special BBM and A.C. Neilsen surveys, viewing of rented cassettes represented 2.1 hours/week, taping of programs off-air represented 2.6 hours/week, and playback of programs taped off-air represented 2 hours/week. This compares to the average of 4.1 hours/week of VCR tuning in Canada by VCR owners (BBM, Fall 1988).

2.3.3 Rental Maturity

The average VCR owner in both Canada and the United States rents four or five cassettes per month, with rental activity dropping with duration of ownership (Video Marketing, 1987).

Kagan projects that with the increase in VCR penetration the number of cassettes rented each month will decline (see Exhibit 2-6).

Exhibit 2-6
Forecast of the Number of Cassettes Rented and Purchased by VCR Households in the U.S.

	Rentals/VCR Household/Year	Purchases/VCR Household/Year
1982	46.8	0.4
1984	54.0	0.8
1986	55.6	1.2
1988	53.8	1.8
1990	52.8	2.3
1992	51.4	2.9
1994	50.0	3.5
1996	48.6	4.1

Source: Paul Kagan Associates , The VCR Letter, March 8, 1988

The typical pattern for new VCR owners is to engage in a lot of rental activity for the first year as they try to view the backlog of films they have always wanted to see. Once that backlog is cleared, the VCR owner is usually only interested in the recent releases and VCR usage subsides. However, it is interesting to note, that after two years of ownership, VCR usage picks up again at the same time as pay-TV subscription increases, which indicates that home taping from pay-TV (or even conventional TV) becomes more prevalent with duration of ownership (see Exhibit 2-7).

Exhibit 2-7
Proportion of Heavy VCR Users Viewing Rented Movies
by Length of VCR Ownership: 1985

Length of VCR Ownership	% of Canadians in VCR Homes
Less Than 6 Months	27%
7 Months - 1 Year	23%
13 Months - 2 Years	16%
25 - Months - 3 Years	21%
More Than 3 Years	22%

Source: CBC Research, VCR's: The Canadian Story", information derived from BBM's VCR Diary Study, 1985

This is confirmed by Canadian retailers and wholesalers; in the early to mid-1980s, VCR owners would rent any new product, including B titles. Now, however, most VCR owners are much more choosy.

2.4 Estimated Size of the Canadian Video Retail Market

Given the scarcity of data, estimating the size of the Canadian video retail market is very problematic. Even defining what constitutes the video retail market poses certain problems. The 1985 Nordicity study based its estimate of the market on a relatively simple video retail environment. The environment today is more complex in terms of the types of outlets involved in the video retail market, particularly in videocassette sell-through.

Our estimate of total consumer spending in the Canadian video retail market ranges from $700 - $800 million for 1988. One rough indicator for estimating the size of the Canadian market is to apply average consumer expenditures on rentals and sales in the U.S. to Canada. Although the markets are different in terms of relative state of development, particularly in sell-through, it does provide one means of making an estimate. U.S. estimates of consumer expenditures per VCR household for videocassette rentals for 1988 are $110 (U.S.) and $28 (U.S.) for cassette sales. Assuming that the expenditure levels for videocassette rentals and sales between Canada and the U.S. are comparable, the Canadian market would be roughly $650 million (Canadian) in rental spending and $165 million (Canadian) in sales for a total of $815 million.

Another way to estimate the size of the video retail market is to use as a base videocassette rentals and sales per month, and then extrapolate to the universe of VCR households in Canada. The market estimate derived in this way is $599 million in rentals and $107 million in sell-through for a total of $706 million. Exhibit 2-8 shows the detailed calculations.

The Fairfield Group in its survey of Canadian VCR households in September, 1988, estimated the size of the Canadian rental market at $1 billion and the sell-through market at $73 million. Fairfield's estimates likely overstate the value of the retail market possibly because the survey was conducted in September, one of the peak periods for videocassette rentals.

As these varying estimates show, it is not possible to obtain a highly accurate estimate of the total market in Canada. Considering the information at hand, our estimate of the amount of consumer spending on videocassette rentals and sales is between $700 - 800 million. The lower number is close to our own calculations (see Exhibit 2-8), with a range to account in part for higher estimates discussed above.

Exhibit 2-8
Estimate of Video Retail Rental and Sell-through Revenues in Canada for 1988

Rental Estimate - 1988		
Number of VCR Households (000,000)	4.809	
Estimated Rentals/VCR HH/Month[1]	4.1	
Total Rental Turns (000,000)	236.6	
Estimated Average Rental Price[2]	$2.53	
Estimated Total Rental Revenues ($000,000)	**$599**	85%
Sell-through Estimate - 1988		
Number of VCR Households (000,000)	4.809	
Estimated Purchases/VCR HH/Year[3]	0.6	
Total Tapes Purchased (000,000)	2.9	
Estimated Average Retail Price/Tape[4]	$37	
Estimated Total Sell-through Revenues ($000,000)	**$107**	15%
Total Consumer Spending ($000,000)	**$706**	100%

Source: NGL Consulting Ltd. , 1989

1 According to BBM, the average amount spent using the VCR by VCR owners each week is 4.1 hours (Fall 1988, 2+); we will assume that half of that time or 2.1 hours/week is spent viewing prerecorded videocassettes (CBC, 1986). We will assume that 90% of that 2.1 hours/week is devoted to rental cassettes and 10% to sell-through. Assuming each cassette is 2 hours in length, this gives us an average of 4.1 tapes rented each month by the average VCR household in Canada. The estimate compares relatively well with U.S. estimates of 4.5 rentals per VCR households per month (PKA, 1988).

2 Our survey of video specialty stores (see below) indicates that the average rental price for a videocassette is $2.92. Since video specialty stores represent an estimated 59% of total rental outlets (see Exhibit 3-1) we will assume that the average rental price for the other types of outlets (convenience and other retailers) is $1.99. The average rental price across all outlets, then is $2.53

3 The Canadian market is estimated to be 18 months behind the U.S. in sell-through (Fairfield, 1988). we could assume that the average number of videocassette purchases pr VCR household in the U.S. in 1986 (i.e. 1.2 purchases per year) represents the level of current activity in Canada; however, we believe that for structural reasons (e.g. higher price points), Canadian sales are only about half the U.S., 0.6 purchases per year.

4 Tapes initially retail for $99.95 and then will drop in price to $29.95 over a period of a year. We will assume that 90% of sell through activity occurs at the $29.95 level and 10% at the 99.95 level, this gives us an average retail price of $37.

3.0 RETAIL STORES AND REVENUE COMPOSITION

This section examines the composition of the video retail market and the estimated share of revenues between the different types of outlets, and provides an overview of developments in video retail market in Quebec.

3.1 Types of Video Outlets and Share of Revenues

The types or variety of outlets dealing in videocassettes, either for rental and/or sale, that are available to consumers have increased since 1985. Dedicated video retail stores still remain the primary outlet for videocassettes to consumers. However, a number of alternative outlets are emerging in Canada, such as department stores, drug stores, record stores, book stores and mail order. Exhibit 3-1 details the composition of rental and sell-through activity in Canada in 1988.

Exhibit 3-1
Share of Rental and Sell-through Revenues by Type of Outlet in Canada - 1988

	Rental Revenues	Sell-through Revenues	Total Revenues
Share of Total Revenues	93.2%	6.8%	100%
Video Specialty Stores	59.0%	45.4%	58.0%
Convenience Stores	23.6%	6.0%	22.4%
Mass Merchants	0.3%	25.2%	2.0%
Direct Mail	0.0%	9.1%	0.6%
Record Stores	0.0%	3.1%	0.2%
Other Retailers	10.8%	11.2%	10.8%
Unknown	6.4%	0.0%	5.9%
Total	100%	100%	100%

Note: figures may not add to 100% due to rounding
Source: Fairfield Group, "Video Track: Canada", September, 1988, complied by NGL Consulting Ltd.

As shown in Exhibit 3-1, Fairfield's estimate of the proportions between rental and sell-through spending in the home video market in Canada in 1988 is 93% for videocassette rentals and 7% for sales. Our estimate (see section 2.4) is 85% for rentals and 15% for sell-through, about double the proportion for sell-through. Whichever is more accurate, both estimates show that the sell-through market in Canada lags behind the U.S.

Exhibit 3-2 provides a comparison with the U.S. in terms of the composition of revenues in the rental and sell-through markets. The breakout by outlet shows a greater amount of specialization in the U.S. between rental and sell-through. Video specialty stores capture the majority of the rental market and mass merchants capture the majority of the sell-through market in the U.S. . In Canada, that degree of specialization has not occurred because the sell-through market in Canada is much less developed.

It is also important to note that in the U.S., sell-through is beginning to represent an important part of the business volume of record stores. According to one Canadian distributor with U.S. ties, sell-through can represent as much as 30-35% of business volume for some record stores. Therefore, while the sell-through market is still dominated by mass merchants, sell-through is becoming more important for other types of specialty outlets like record stores. Video distributors in Canada look forward to increasing interest and commitment at the retail level to expand their sales base.

According to industry experts, the sell-through market in Canada is proportionally behind the U.S. because Canadian mass merchants underestimate the volume potential of sell-through. Wholesalers have apparently not yet made a sufficiently attractive case for sell-through to merchandisers. As well, margins are still a point of negotiation in Canada between wholesalers and merchandisers and business patterns are not yet well established. Finally, the price points in Canada (at

$24.95/$29.95) are higher than the U.S. (at $14.95/$19.95), which is believed to dampen consumer acceptance. However, once business patterns are better established and price points do come down, sell-through in Canada will represent an important area of future growth.

Exhibit 3-2
Estimated Market Share of Outlets in the U.S. Providing Prerecorded Videocassettes for Sale and/or Rental - 1987

	Share of Rental Revenues	Share of Sales Revenues	Share of Total Revenues
Share of Total Revenues	80.7%	19.3%	100%
Video Specialty Stores	77%	28%	68%
Record Stores	11%	5%	10%
Mass Merchants	1%	44%	9%
Convenience Stores	5%	--	4%
Direct Mail	--	15%	3%
Other Retailers	7%	8%	7%
Total	100%	100%	100%

Note: figures may not add to 100% due to rounding
Source: Paul Kagan Associates, The VCR Letter, March 8, 1988

It is estimated that in the U.S. the sell-through market will represent almost 26% of total consumer spending on home video in 1997 (see Exhibit 3-3). This means that sell-through continues to increase share but not in a dramatic way. The rental market is expected to retain its dominant share for the rest of the decade. Thus, even if Canadian distributors and wholesalers become much more effective in marketing to mass merchants, video retail will remain a rental business.

Exhibit 3-3

Estimated Consumer Spending in the Home Video Market in the U.S.

	Total Rental Market	% Share	Total Sale Market	% Share
1982	$603.7	85.3%	$103.2	14.7%
1983	1,064.8	83.0%	218.0	17.0%
1984	1,835.0	82.8%	382.3	17.2%
1985	2,913.7	81.6%	658.2	18.4%
1986	4,094.2	82.8%	853.3	17.2%
1987	4,607.8	80.7%	1,103.3	19.3%
1988	**5,490.6**	**79.7%**	**1,395.0**	**20.3%**
1989	6,360.4	78.6%	1,731.5	21.4%
1990	7,140.4	77.7%	2,050.0	22.3%
1991	7,750.3	76.9%	2,330.1	23.1%
1992	8,179.6	75.8%	2,614.4	24.2%
1993	8,444.3	74.5%	2,893.4	25.5%
1994	8,771.9	73.7%	3,128.6	26.3%
1995	9,157.4	73.4%	3,312.4	26.6%
1996	9,615.7	73.5%	3,466.9	26.5%
1997	**10,051.4**	**74.1%**	**3,505.9**	**25.9%**

Source: Paul Kagan Associates, "The VCR Letter", March 8, 1988.

3.2 Number and Type of Retail Outlets

The Video Dealers Association of Canada (VDAC) estimates that there are some 5,000 - 6,000 active video retail outlets in Canada in 1988. However, there is no comprehensive listing of video retailers in Canada. VDAC's estimate, it is believed, does not take into account some classes of alternative outlets in Canada, e.g. department stores. Distributors indicate that there are some 4,000-5,000 video outlets that are consistent buyers. The total number of outlets (including convenience and variety stores) is probably much higher since those 4,000-5,000 outlets would also rack many smaller outlets. The actual number of outlets is available for some provinces which require registration for licensing purposes.

The VDAC's estimate of 6,000 outlets compares well on a proportional basis with the U.S. For example, Paul Kagan Associates in the U.S. estimates that in 1987 there were 57,500 video retail outlets comprising video specialty stores, convenience stores, record stores and other retail stores. These 57,500 outlets are spread across a universe of 46.25 million VCR households. That represents an average of 804 VCR households per video retail outlet. In Canada, if we assume that there are 6,000 video retail outlets spread across 4.8 million VCR households in 1988, then there are an estimated 802 VCR households per video retail outlet, which is comparable to U.S. estimates for 1987.

For the purpose of this analysis we will assume that those 6,000 outlets represents the universe of stores engaged in the rental of videocassettes, recognizing that the figure probably understates the number of outlets engaged in sell-through. The number of outlets engaged in videocassette sell-through would be difficult to determine, even from compiling wholesaler lists. While wholesalers have accounts with mass merchandisers, the distribution of cassettes usually fits within the merchandisers internal distribution system. Therefore, wholesalers do not know the actual number of outlets to which cassettes are distributed.

Exhibit 3-4 provides a rough estimate of the breakdown by type of video retail store engaged in the rental market in Canada. The estimates are based on U.S. estimates of the average number of VCR households per outlet, by type, assuming that the number of video retail stores and the composition of stores in the U.S. is similar to that in Canada. Given the greater dominance of video specialty stores in the U.S., and the relatively greater importance of convenience stores in Canada (see Exhibits 3-1 and 3-2), further adjustments to these estimates could be made.

Exhibit 3-4
Estimate of the Composition of Video Retail Stores in Canada: 1988

U.S. Estimates for 1987	# Outlets	VCR HH's (000,000)	# VCR HH/ Store
Video Specialty Stores	**25,000**	46.25	1,850
Convenience Stores	**16,000**	46.25	2,890
Other Retail Stores	**16,500**	46.25	2,800
Total	**57,500**	46.25	804

Canada Estimates for 1988	VCR HH's (000,000)	VCR HH/ Store	# Outlets
Video Specialty Stores	4.809		**2,600**
Convenience Stores	4.809		**1,700**
Other Retail Stores	4.809		**1,700**
Total	4.809	804	**6,000**

Source: Paul Kagan Associates, The VCR Letter, March 8, 1988
Statistics Canada
NGL Consulting Ltd.

The estimate of 6,000 video retail outlets today is interesting to compare with Nordicity's 1985 estimates (see Exhibit 3-5). At that time, it was obvious that the growth in stores was declining and that the number of VCR households per store was rising. Moving forward to 1988, that trend can be shown to have continued to the relatively more mature situation today.

Exhibit 3-5
Estimated Number of Video Retail Outlets in Canada Engaged in the Rental Market: 1980 - 1988

	Cumulative Video Outlets	Net New Video Outlets [1]	VCR HH's (000)[2]	% Penetration TVHH's	VCR HH/ Outlet
1980	663	663	n a	n a	n a
1981	1,275	612	n a	n a	n a
1982	2,652	1,377	168	2.1%	63
1983	4,335	1,683	542	6.5%	125
1984	5,100	765	1,104	12.7%	216
1988	6,000		4,809	52.8%	802

Source: Nordicity Group, 1985
NGL Consulting Ltd. , 1989

Industry observers have been predicting that the video retail industry would "shake out", resulting in a greater consolidation of outlets under national franchises whereby the independent and specialty outlets would be squeezed out of the video rental game. According to major video distributors, 12-15% of their videocassette business is done directly with video retail chains. They predict that the level of direct business will increase as the retail industry consolidates and chains increase their presence in the industry. As well, one chain retailer indicated that in the future, the composition of video retail retail outlets will be divided between very large stores (superstores with 8,000+ tapes) and very small stores

1 Source: Nordicity Group to 1984, NGL Consulting to 1988
2 Source: Statistics Canada

(convenience stores with 200+ tapes). The mid-sized outlets will have to expand in order to meet consumer demands for greater selection.

Comparing the 1985 survey results with a recent NGL survey of 50 Canadian video retail stores in three major cities (Toronto, Montreal and Ottawa), the independents have expanded proportionately. In the 1985 survey, the ratio of independent stores to chain stores was 4 to 1; in the 1989 survey, the ratio increased to 6 to 1. This indicates that over the last three to four years, industry consolidation of that kind has not occurred among specialty video stores.

The diversification of outlets is further illustrated in Exhibit 3-6. On a videocassette volume basis, department stores like K-Mart, Sears and Towers in the U.S. have become significant players in the home video market. It is also important to note, that the video retail market in the U.S. is highly fragmented with the largest chain, Erol's, accounting for only 1.7% of total cassette revenues.

Exhibit 3-6
The Top 25 Videocassette Retailers by Volume in the U.S.

	Ranking by Revenue	Market Share	# Stores (Dec. '87)	% Revenues from Rentals
1.	Erol's Inc.	1.73%	147	91%
2.	Wherehouse	1.44%	210	84%
3.	National Video	1.31%	584	95%
4.	7-Eleven	1.09%	4,378	100%
5.	Adventureland	0.95%	421	94%
6.	Sound Warehouse	0.95%	110	85%
7.	West Coast	0.89%	140	95%
8.	**K Mart**	**0.88%**	**2,103**	**0%**
9.	Blockbuster	0.80%	94	95%
10.	**Musicland**	**0.76%**	**524**	**14%**
11.	Major Video	0.75%	87	92%
12.	**Waldenbooks**	**0.61%**	**1,000**	**0%**
13.	Circle K	0.66%	2,600	100%
14.	Zayre	0.63%	362	67%
15.	Towers	0.61%	54	50%
16.	**Wal-Mart**	**0.46%**	**1,135**	**0%**
17.	**Sears**	**0.44%**	**600**	**0%**
18.	Music Plus	0.35%	39	85%
19.	Discount	0.28%	43	80%
20.	RKO/Warner	0.27%	20	38%
21.	Video Library	0.26%	39	92%
22.	Applause	0.26%	49	92%
23.	Palmer	0.24%	85	89%
24.	**Caldor**	**0.21%**	**521**	**0%**
25.	Video Galaxy	0.21%	33	76%

Source: Paul Kagan Associates - The VCR Letter, Sept. 26, 1988.

While there are no comparable figures for Canada, the level of diversification, in terms of the types of outlets in the U.S. involved in the rental and sale of pre-recorded videocassettes, does provide an indicator of how the video retail industry has changed. The level of diversification present in the U.S. probably does not apply to the same extent in Canada because the sell-through market is not as developed in Canada and distribution of feature product tends to be more consolidated in Canada than in the U.S. (e.g. theatrical chains). However, the general trend toward diversification of retail and the greater emphasis on mass merchants in the U.S. is being matched in Canada.

Industry "shakeout", therefore, could represent a variety of changes in the industry. Independents as well as small (i.e. convenience) video retail outlets did not disappear because their particular market niche has been served by the emergence of rack jobbers or small wholesaler. However, increased franchising, the expansion of existing inventories, and the growing presence of mass merchandisers and other alternative outlets will likely be important future developments in the Canadian video retail industry as the home video market matures.

3.3 The Quebec Market

The consumer patterns in Quebec are somewhat different from the rest of Canada. One wholesaler estimated the Quebec market at $175 - 200 million in 1988 in consumer expenditures on videocassette rentals and sales, i.e., about proportional to Quebec's VCR penetration. However, a Toronto-based distributor estimated that 30% of the video retail revenues in Canada from English language videos are generated in Quebec. This can be explained in part by the fact that not all English language films are dubbed into French. In some cases the English version is pre-ordered before the announcement that a French language version is soon to become available. In other cases, there is often a long delay before the release of the French version on videocassette. For example, the French version of Star Trek IV was released two years following its English release. Quebec's continuing efforts - legislative and otherwise - to ensure early French language release may have an impact on French language video sales.

Distribution in Quebec also differs from the rest of Canada because of Quebec's legislation to control video piracy. This affects the distribution of videos in Quebec. As of April 1989 all videocassettes are required to be registered with the Province for a fee of $50 per title and 25¢ per sticker for each additional copy. In order to register the titles, a company must be a Quebec distributor, which is defined as a Quebec-owned and Quebec-operated company. The legislation allows the distributor until March 1991 to obtain stickers for all titles in the store.

The implications for Quebec distributors are that it will no longer be profitable to buy tapes in low volume from outside of Canada. For example, a Quebec distributor will be reluctant to stock up on specialized videos or art films of limited demand if there is a $50 charge per title.[1]

According to some video retailers, Quebec would be more effective in controlling video piracy by reinforcing its enforcement capability rather than registering videos in the manner proposed. The legislation may also lead to instant distributors to be established as middleman between Quebec and non-Quebec distributors.

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1 No attempt has been made to evaluate this legislation and the Quebec Government's perspective was not sought for this study. The material above has largely been obtained through industry interviews.

4.0 STORE OPERATING CHARACTERISTICS

This section provides a review of the video retail survey results which includes a description of store characteristics, the rental and sell-through activity of retailers, composition of business volume of retailers and an overview of their marketing activities. Where possible, comparisons with the results from the 1985 video retail survey are made.

4.1 Retail Survey

In March of '89, NGL conducted a survey of 50 video specialty stores in Montreal (17), Ottawa (17), and Toronto (16) to examine the operating characteristics of video retailers. As well, the results provide us with a point of comparison with the 1985 survey of video retailers (150 respondents). The survey results are not strictly comparable since the March '89 survey did not replicate the sample obtained for the 1985 survey. However, the results do provide indicators of where video retailers are heading.

4.2 Store Characteristics

As stated earlier, there are more independent video stores in Canada than stores that belong to video chains. Independents have increased their share of the total number of stores since the 1985 survey. As well, the number of stores that have been in business more than three years has increased since 1985, which illustrates the relative maturation of the retail industry (see Exhibit 4-1).

Exhibit 4-1
Composition of Video Retail Stores and Number of Years in Business

	% respondents 1985	% respondents 1989
Composition of Outlets		
chain video stores	19%	14%
independent video stores	81%	86%
	100%	100%
Years in Business		
more than three years	26%	74%
one to three years	74%	14%
less than one year		12%
	100%	100%

Source: NGL Consulting Ltd.

In 1985, retailers purchased an average of 1.2 copies of 25 titles per month. In 1989, retailers reported purchasing 1.6 copies of 28 titles per month. The increase in "depth of copy" (i.e., more copies of the same title) can be explained by the proportion of new releases purchased per month. Over three quarters of a retailers' monthly additions are new releases, while less than 20% of the retailers' total inventory consists of new releases. Retailers increase their depth of copy for new releases as the majority of the revenues from a single new release are generated during the first 60-90 days following its release.

Retailers' total inventories have expanded by a factor of 3 or 4 since 1985 (see Exhibit 4-2). At present, the average number of cassettes in a retailer's inventory is 3,141 and the average number of titles is 2,520. The 1985 survey results showed that retailers, on average, were stocking 887 cassettes and 660 titles.

Exhibit 4-2
Video Store Inventory

	1985	1989
average number of cassettes	887*	3,141
average number of titles	660*	2,520

* adjusted from original survey results for video specialty stores only

Source: NGL Consulting Ltd.

Exhibit 4-3 illustrates the increase in the number of titles with 2 to 4 copies in inventory and a decrease in the proportion of titles with only one copy. Canadian video retailers, therefore, have extended inventories to increase their depth of copy, particularly for recent releases. They have also increased the overall size of their inventories to offer consumers a greater breadth of titles.

Exhibit 4-3
Proportion of Titles in a Retailer's Inventory by Number of Copies

	1985	1989
1 copy only	75.6%	67.3%
2 to 4 copies	22.7%	30.3%
5 to 9 copies	1.4%	2.0%
more than 10 copies	0.3%	0.4%
	100%	100%

Source: NGL Consulting Ltd.

Retailers will often sell off surplus copies to other retailers or rack jobbers once that initial rental period of 60-90 days has passed. Titles with one copy only are likely to be "B" titles and "A" titles that are over one year old. Titles with 2 to 4 copies are likely to be "A" titles that are 6 months to one year old. Titles with 5 or more copies will likely be recent "A" titles under 90 days old, as well as "A" titles for sell-through.

4.3 Videocassette Rentals

Exhibit 4-4 illustrates the changes in the video retail business. Total rental volume has increased by 60% from 1985 to 1989, with a slight decrease in volume of rentals during weekends.

Exhibit 4-4
Video Retail Rentals and Sales

	1985	1986
average number of cassettes rented in a week per retailer	588	836
% rental business on weekend	69%	56%

Source: NGL Consulting Ltd.

Changes in rental rates reflect the increasingly competitive market for videocassette rentals. The average weekend rental rate has dropped from $3.29 in 1985 to $3.11 in 1989 which has been somewhat compensated by a rise in the weekday rate from $2.48 to $2.69.

In addition, 42% of respondents reported that they have variable rates for a variety of reasons. The most common rate differentials applied are:

- by product or genre, e.g. new release vs. old release, adult film vs. children's film
- membership vs. non-membership
- promotions offered for multiple rentals, e.g. 2 titles for $5.00 vs. one title for $2.99
- weekday vs. weekend

These rate differentials can also be combined so that there is a differential for weekday vs. weekend, as well as a differential for new release vs. old release.

The most commonly reported differentials are for new releases and children's programmes. Of the respondents who do have differential rates, thirty-six percent charge an average of $3.18 for a new release. An equal number of respondents charge an average of $1.78 for children's titles. When the weekday/weekend differential is applied, the charges for new releases are $2.99 and $3.99, respectively.

Feature films are still the most popular rental product (see Exhibit 4-5), and action/adventure films are still the most popular movie genre. Adult films have declined the most, possibly due to a decline in their availability to consumers. Adult videos may not be regarded as an attractive product by video retailers, particularly in Ontario, because of the public complaints that have prompted police seizures in the past .

Exhibit 4-5
Rental Popularity by Product Type

	1985	1989
feature films	59%	69%
adult films	20%	13%
children's films	15%	12%
music videos	4%	3%
special interest videos	2%	3%
	100%	100%

Source: NGL Consulting Ltd.

Note: comparison is not strictly valid since 1985 figures also contain convenience stores and other retail outlets while 1989 figures are video specialty stores only

4.4 Videocassette Sales

More video specialty retailers are involved in videocassette sell-through and are selling over three times as many cassettes than in 1985.

Exhibit 4-6
Growth in Videocassette Sell-through

	1985	1989
% retailers involved in sell-through	53.2%	62.0%
average number of cassettes sold in a week	1.2	4.1

Source: NGL Consulting Ltd.

It is important to note that the 4.1 cassettes sold per week per video outlet does not represent the universe of activity in the sell-through market. The Fairfield Group estimates that, in Canada, video specialty stores only represent 45% of the total sell through activity while the remaining 55% is spread across a variety of outlets, including department stores, mail order, record stores, etc.

Exhibit 4-7 shows that while feature films are the most popular type of video product in the sell-through market, children's titles represent a significant portion of the total.

Exhibit 4-7
Sales Popularity by Product Type: 1989

Feature Films	51%
Adult Films	7%
Children's Films	25%
Music Videos	9%
Special Interest Videos	8%
Total	100%

Source: NGL Consulting Ltd.

4.5 Seasonal Business Volume

The Christmas season remains the busiest season for video retailers. Over one fifth of their business volume is conducted during this period. While the summer season was reported to be the second busiest season in 1985, the current survey showed a decline in business during that time. Some respondents even reported that the summer was their slow season.

VCR usage generally follows the television season, (CBC Research, "VCRs: The Canadian Story", 1986) with peak activity in the fall and winter and slower activity in the spring and summer. The influence of conventional TV is most notable in Quebec; the introduction of Quatre Saisons, and the heavy competition in new French language programming that ensued, depressed the video retail market in 1987/88. However, rentals and sales apparently climbed in the summer of 1988 in the re-run season and have been steady in 1988/89 as the new TV series enter their second year. Still, the worst video retail evening in Quebec is Thursday when the highly popular Lance et Compte series is aired.

4.6 Composition of Business Volume

While sell-through revenues have been increasing, its contribution to retailers' revenues remains low. In 1985 sell-through was negligible; today it accounts for 6% of the retailer's revenues. Videocassette rentals remain the major source of revenues in video specialty stores. VCR rentals and other video related revenues account for less than than 20% of the video retailer's total revenues.

Exhibit 4-8
Composition of Business Volume for Video Retailers in Canada: 1989

	1985	1989
videocassette rentals	74%	77%
videocassette sales	na	6%
VCR rentals	20%	15%
related equipment sales	6%	2%
Total	100%	100%

Source: NGL Consulting Ltd.

Some video retail stores are also engaged in the rental of product other than pre-recorded videocassettes. For example, some stores are now renting video game cartridges for the Nintendo game system, as well as other game systems. Rentals can run from $2 - 3 per day for cartridges that would cost the consumer about $70. As well, retailers are becoming involved in the rental of CD's. Video retail stores are a natural conduit for this type of software product because retailers can take advantage of the initial high prices on games cartridges and CD's that discourage buyers by offering them for rent. As the VCR market matures, movie rental activity will likely decline; therefore, video specialty retailers will have to take steps to branch out into other product lines.

4.7 Marketing

The increasingly competitive video retail market has resulted in increased spending on advertising for both distributors and retailers. In 1985, a negligible number of video retailers had a budget for advertising. Today, 29% of respondents reporting having allocated an average of 5% of their budget for advertising their store. The most common media used are the newspaper and flyers. These methods are followed by in-store promotions, 2 for 1 coupons and direct mail.

Almost all respondents reported receiving promotional materials from their distributors. The function of these promotional materials is not only to provide retailers with in-store promotion aids but also to advertise distributors product to retailers. Very few retailers were dissatisfied with the product or the service from their distributor. Materials generally provided by distributors included:

- Posters (94% of respondents)
- Floor displays (43% of respondents)
- Counter displays (30% of respondents)
- Flyers (17% of respondents)
- Catalogues (13% of respondents)
- Other Marketing Support, including magazines, pens, T-shirts, discount coupons, trade magazines, sweatshirts, preview tapes, and movie passes

The majority of the video retail store respondents are not involved, nor are they planning to be involved, in new developments in the video industry such as:

- the introduction of vending machines
- the increasing cross promotion between video retail businesses and other businesses that is happening in the United States
- the introduction of home delivery services.

A few have been involved in cross promotion and home delivery services but were not happy with the results.

One major development in the marketing area is the possible establishment of a bi-weekly Canadian household survey on the rental patterns of VCR owners. Such a survey is undertaken in the U.S. and a trial has been organized in Canada by the CMPDA. Data that tracks the rental performance of titles should help distributors to target their advertising and promotional efforts with greater effect.

The proposed bi-weekly survey will begin in July 1989 for a six month trial period. Continuation beyond that time depends upon the participation of the value of the survey to CMPDA members who otherwise would have to rely solely on U.S. market data. Apparently other sponsors of the survey are welcome; it could be of value to Canadian distributors or in support of any Canadian government initiatives to stimulate the marketing of Canadian titles.

5.0 EMERGING TRENDS IN THE HOME VIDEO MARKET

This section provides a review of the emerging trends in the home video industry that affect all levels of the distribution/wholesale/retail chain; included are an assessment of pay-per-transaction, pay-per-view or video on demand, video superstores, video vending machines and recent technological developments such as Super-VHS.

5.1 Pay-Per-Transaction

One of the recent developments in the U.S. has been pay per transaction (PPT). PPT alters the traditional relationship between wholesaler and video retailer in that the wholesaler becomes a partner, in a sense, with the retailer. Under PPT, distributors enter into arrangements with retailers, to provide retailers with a large number of copies of hit titles to help the retailer cover short term demand. In turn, the distributor shares in the rental revenues generated from those copies. In the U.S., National Video is the key proponent of PPT and is currently trying to sign its franchise holders into PPT arrangements with itself as the wholesaler.

The First Sale Doctrine in the U.S. prohibits the studios from sharing in the revenues generated from the subsequent rental or sale of videocassettes by retailers. The studios generate their revenues from the home video market from the one time sale of cassettes to wholesalers, who in turn resell to retailers. PPT maintains that arms length relationship between the studios and the retailers but enables studios to participate more directly in the success of popular titles.

According to an analysis by Video Store, a U.S. trade magazine, PPT holds retailers' gross margins relatively steady (see Exhibit 5-1). Under the existing system, retailers' gross margins can fluctuate widely depending upon the number of rental turns they obtain on a cassette. PPT, therefore, can provide retailers with a certain amount of stability but at the same time it also reduces a retailer's potential to realize higher profits on successful titles.

Exhibit 5-1
Gross Profit Comparison of the Current System vs. PPT in the U.S.

# Turns Rental Life	**100**	**75**	**50**	**40**	**30**	**20**	**10**	**5**
Rental Rate	$2.30	$2.30	$2.30	$2.30	$2.30	$2.30	$2.30	$2.30
Rental Revenues	$230.00	$172.50	$115.00	$92.00	$69.00	$46.00	$23.00	$11.50
Current System								
Total Cost of Goods	$46.25	$46.25	$46.25	$46.25	$46.25	$46.25	$46.25	$46.25
Gross Profit/Tape	$183.75	$126.25	$68.75	$45.75	$22.75	($0.25)	($23.25)	($34.75)
Gross Margin (%)	**80%**	**73%**	**60%**	**50%**	**33%**	**-1%**	**-101%**	**-302%**
PPT System								
Initial Cost	$8.00	$8.00	$8.00	$8.00	$8.00	$8.00	$8.00	$8.00
PPT Payments	$126.50	$94.88	$63.25	$50.60	$37.95	$25.30	$12.65	$6.33
Total Cost of Goods	$134.50	$102.88	$71.25	$58.60	$45.95	$33.30	$20.65	$14.33
Gross Profit/Tape	$95.50	$69.62	$43.75	$33.40	$23.05	$12.70	$2.35	($2.83)
Gross Margin (%)	**42%**	**40%**	**38%**	**36%**	**33%**	**28%**	**10%**	**-25%**

Source: Video Store (U.S.), November, 1987

PPT supporters cite the benefits of the arrangement as:

- providing retailers with more inventory for less up front money
- reducing risk of retailer expenditures on product that does not turn over quickly
- providing retailers with the depth of copy on hit titles to satisfy consumer demand

The detractors of PPT note that the revenue sharing arrangement between the wholesaler and the retailer represents a potential loss of control by the retailers over their own operations. They are apprehensive that studios would increase their percentage of the revenue once retailers are locked into the system. While retailers are able to stock more copies of hit titles under PPT, they also surrender part of their primary profit centre to the wholesaler. One retail expert in Canada, termed PPT as simply an expensive way of financing a video retail operation. Another maintained it was most appropriate for "sick" stores, i.e. those in financial difficulty. Consequently the widespread adoption of PPT will likely only occur if it represents a more profitable arrangement for retailers.

5.2 Pay-Per-View or Video on Demand

Over the last three years in the U.S. pay-per-view (PPV) has become a new window in the release pattern for studio product. The PPV service is offered to addressable cable subscribers by the PPV service provider through the cable operator. The service concept is based on whether a subscriber wishes to view scheduled programming, usually movies and sporting events. Access to the signal is controlled by the cable operator through a host of different ordering technologies. On average, U.S. studios give videocassettes a one month window before the title is released to pay-per-view. Major studios average an 18 day window for home video before releasing to pay-per-view while independent distributors average a window of 27 days. [1] The studios share in the revenues generated by a pay-per-view release, typically 50%, while the revenues generated in home video come from a one time sale to wholesalers.

The home video window is likely to remain ahead of the PPV window in the U.S. for some time since home video represents the larger source of revenue to the studios. The latter are fearful that a title's release to PPV before home video will devalue the home video window and cannibalize revenues from sales to videocassette wholesalers. The role of PPV is

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1 Source: VSDA, Pay-Per-View Report, April, 1988.

viewed as important but subordinate to the existing pay-TV services in the U.S.[1]

Exhibit 5-2 below illustrates that box office successes are more likely to obtain a home video window rather than a pay-per-view window directly after theatrical release. However, release in PPV is still in the experimentation stages, since the studios do not want to jeopardize the revenues to be generated out of that market.

Exhibit 5-2
Comparison of Home Video and Pay-Per-View Windows in the U.S. - 1988
($U.S. millions)

	Gross Theatrical Revenue	Exclusive Video Window
Home Video Release First		
Platoon	$137.0	75 days
Princess Bride	$26.9	63 days
Dirty Dancing	$62.5	35 days
Innerspace	$26.0	35 days
Untouchables	$76.3	29 days
Living Daylights	$50.1	28 days
Cry Freedom	$4.9	23 days
My Life as a Dog	$8.1	11 days
The Big Easy	$17.6	7 days
	Theatrical Revenues	Exclusive PPV Window
PPV Release First		
Pick-Up Artist	$1.1	8 days
Weeds	$1.8	18 days
Born in East LA	$14.5	33 days
The Squeeze	$2.2	35 days
Real Men	$0.5	41 days
Housekeeping	$1.1	43 days

Source: VSDA, Pay-Per-View Report, April, 1988

1 Kagan estimates that cable revenues from pay-TV at $8.2 billion in 1995 vs. $1.9 billion from PPV at that time.

The CRTC issued a call in 1986 for comments on pay-per-view in Canada. Based on the submissions that came out of that call for comments the CRTC did not proceed with a call for applications. [1]

In October '88, the CRTC announced as part of its license renewals for the pay-TV and specialty services, a call for applications for video on demand (VOD) or pay-per-view services. The call for applications noted that proposals would have to take into account the existing pay-TV structure. This has two implications. The first is that if the pay-TV licensees are to be protected from VOD or PPV service offerings, they are likely to be the service providers although perhaps in conjunction with cable operators. The second implication is that, if the pay licensees are not the VOD service providers, then the window position of VOD will likely have to follow that of pay-TV under condition of license.

VOD will only become a significant new window for product if the service offering has extensive penetration of Canadian homes. A conventional PPV service offering would only have a market potential of 400,000 addressable homes in Eastern Canada according to First Choice. Therefore, as a third tier cable discretionary service offering, it will likely rank in importance below existing specialty service and pay-TV services.

The telephone companies are promoting a pure form of VOD via switched fibre directly to the home. There has been a certain amount of experimentation with such a service concept in Canada (by SaskTel), the U.S. (a half dozen trials) and abroad. VOD would be analogous to an electronic video store that could be accessed from the home. Such a service could have a major impact, if widespread, on the existing distribution structure for video product including television and video retail.

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1 See Nordicity Group Ltd., "The Impact of Pay-Per-View on the Independent Canadian Production Industry" Feb. 1987 commissioned by Telefilm Canada.

In a previous report on the U.S. market[1], we estimated that in competition with existing cable service offerings and the video retail market, a video on demand service would be able to generate about $2 - 5 per subscriber per month in its first year growing to $11 - 31 in its fifth year. The wide range reflects two different competitive scenarios: the first is one in which carriers compete with both cable operators and video retailers; the second is one in which carriers compete only with video retailers.

In another study regarding the Canadian market, we estimated that VOD could generate $1 - 2 per month per subscriber in year 1 after launch, rising to about $7 - 10 by year 5. This kind of success would certainly have an impact on video retail, but it remains unclear how video retail would have to change on account of such VOD services.

5.3 Superstores

Typically, the video superstore has 5,000 - 10,000 square feet and stocks 8,000 - 10,000 different titles. The independent video retail outlet is normally only 1,000 square feet and only stocks a few hundred titles. The investment required to build and stock a video superstore can range from $300,000 - $500,000.

The major video superstores in Canada are Jumbo Video, Rogers Video , Giant Video and Major Video. One of the Major Video stores in Toronto is 4,000 square feet and initially stocked 8,500 titles but has since grown to 10,000 - 11,000 titles. There are indications that a battle is now shaping up among those players who have established a presence in video superstores.

The top video retail chains in the U.S. provide an indicator of the trend toward larger inventories. The top five video chains in the U.S. in 1988, (ranked by revenues) are Blockbuster with an average of 9,140 cassettes per store, Erol's with 7,250 cassettes per store, West Coast/National with 3,000

1 See NGL Consulting Ltd., Cost/Profitability of Demand Access Video Information Services, Sept. 1988.

cassettes per store, Major Video with 9,139 cassettes per store and Tower Video with 15,000 cassettes per store.

There are three primary trends in the video retail industry that are fueling the move toward video superstores: (i) increase in the sources of competition; (ii) emphasis on recent releases or "A" titles, and; (iii) increasing importance of leverage on retailers' marketing activities.

5.3.1 Sources of Competition

The composition of the video retail industry has changed substantially since our 1985 study. Consumers continue to have access to pre-recorded videocassettes through traditional video retail outlets. According to our recent survey of the Canadian video retail market, 75% of retailers interviewed had been in business more than three years. While the conventional retailers are long term players, the variety of alternative outlets has increased. Convenience stores (e.g. 7-Eleven, Mac's Milk) have become major players; as well, major department stores , record stores and book stores have become involved in the sale of pre-recorded videocassettes.

The trend toward video superstores represents a strategic response by the conventional video retailer to compete more effectively with the proliferation of alternative outlets by providing a range of titles and the depth-of-copy for "A" titles that the smaller outlets cannot match.

5.3.2 Emphasis on Recent Releases

The bulk of dollar volume of the video retail industry in Canada is generated through the rental and sale of U.S. titles. The major U.S. distributors generate their revenues in the Canadian market through sales to Canadian wholesalers. The U.S. majors are pushing wholesalers towards recent releases or A titles (i.e. a title with a successful theatrical release) because of the higher wholesale prices A titles command.

According to the VSDA's Annual Survey (U.S. 1987) the average number of rentals per title were 111 times for A titles, 65 times for B titles and 39 times for C titles. As well, according to a Fairfield survey (U.S. 1988) A titles represent 77% of monthly inventory purchases by retailers, while B titles represent 18% of inventory purchases, and C titles represent 5%.

As previously noted, the growth in VCR penetration will decline with fewer new VCR owners. Existing VCR owners will rent less, and then only for the recent releases or A titles. The emphasis will move to a more selective renting by consumers.

Video retailers in the U.S., as well as in Canada, are now stocking more copies of A titles than they used to, usually at the expense of their B and C titles. Therefore, while retailers try to solve the depth-of-copy problem (i.e. providing enough copies of A titles to satisfy short-term demand) they increase the breadth-of-selection problem (i.e. fewer titles overall to chose from).

Again, the video superstore is a response to this situation by providing consumers with a large enough inventory to cover off the short term demand on A titles while at the same time providing a much wider range of titles than smaller outlets.

5.3.3 Marketing Leverage

The advent of the superstore brings a new era to video retailing. As there is no product exclusivity for video retailers, the successful retailer must promote other aspects of his operation such as atmosphere and service. Superstores are large enough that they will be able to concentrate a significant amount of resources on advertising and promotion. It has been suggested that the "McDonald's" formula could be applied to superstores, i.e. a differentiation on the basis of service, environment and promotion. As the home video market mature, retailers will be forced to rely more on image promotion since there is no product exclusivity among stores. The superstore that will be in a better position will be the one that leverages its marketing clout.

5.4 Vending Machines

Vending machines have been introduced in Canada and are estimated to hold a 6% share of the market (survey by Video Store Magazine - U.S.). The machines cost between $12,000 and $50,000 and stock from a few hundred cassettes to a thousand. The two largest vending operators are Nelson Vending Technology Ltd. of Toronto and Credit Vending Enterprises in Western Canada. The machines are regarded as a competitive threat to the small retailer because both the small operator and the vending machine offer the roughly the same size and range of product. However, some retailers use the machines to supplement their store hours.

While some retailers have viewed the video vending machines as competitors, there is no evidence to date to support it. In many cases the vending machine serves a niche market. For example, it has been demonstrated that vending machines are most profitable when located at the entrance of a video club that closes at 9 p.m. About 80% of the volume of business is conducted between 9 p.m. and 11:30 p.m. In the United States, vending machines are popular with video store owners as an aid to augment their regular store hours and save on salaries and store overhead.

5.5 Other Retail Trends

As VCR penetration matures and rental activity slows down because of the longevity of VCR ownership, new products will be important for continued growth of video retail operations. Video game cartridges, i.e. Nintendo, and CD's are among the emerging high-priced software products to find an outlet in video retail rental store.

As well, industry observers have noted that the Canadian market is underdeveloped in terms of its sell-through potential. Mass merchandisers have not yet caught onto pre-recorded videocassettes as simply another product line to the extent they have in the U.S. As relationships between manufacturers or wholesalers and mass merchants are established over time and the nature of the "deal" becomes standardized, the sell through market in Canada should grow.

Finally, technological developments could change consumers perceptions of the quality of pre-recorded videocassettes. The new Super-VHS (S-VHS) tape format was developed by JVC and retails for $1,000 and up. In conjunction with a good quality TV set, S-VHS can produce a sharper picture with 420 lines of horizontal resolution as compared with TV's off-air or cable reception of 330 lines.

S-VHS will not have a substantial impact on the home video market until the high quality TV sets come down in price enough to be more widespread in TV households. As well, S-VHS is not compatible with standard VHS; while an S-VHS recorder can play back a standard VHS tape, the new S-VHS tapes cannot be played back on a standard VHS recorder. Manufacturers or distributors are not likely to release titles in S-VHS format until the penetration of S-VHS recorders in homes is well established. Once again we have the "chicken and egg" question, which has sometimes been overcome (e.g. CD's) but not always (e.g. laserdisc's).

The superior picture quality afforded by S-VHS would provide a source of competition to conventional television viewing. Such competition could provide one more impetus for conventional broadcasters to upgrade the transmission and production facilities to accommodate one of the proposed advanced television standards.

5.6 Collective Impact of Trends

The video retail industry is responding to external influences in a variety of ways, i.e. pay-per-transaction, pay-per-view, superstores, vending machines, etc. It is difficult to predict whether any of these trends will win out over each other and how they will change the nature of the video retail business. However, there will probably remain a substantial market for video retailers until the next century when electronic delivery of video on demand may become the standard in terms of the consumption of video product in the home.

6.0 THE VIDEO DISTRIBUTION SYSTEM

Previous sections have described the retail part of the video distribution chain. Here we provide an overview of the distribution chain through an examination of the typical revenue flows for each element of the distribution system, including both videocassette rentals and sell-through . It then focuses on the role of the wholesalers and the existence of vertical integration in distribution. Finally, the section discusses the value of the video market for the distributor (for Canada and the world) and compares the share of net revenues from home video to other sources.

6.1 Revenue Flows in Video Distribution [1]

Video distribution can best be explained by tracing through the mark ups at each stage of distribution. This would show the revenues earned for producer, duplicator, wholesaler, distributor and retailer. Exhibit 6-1 provides a breakdown of typical costs for the two types of videocassette transaction, rental and sell-through. The figures are illustrative only since each deal between producers, distributors, wholesalers and retailers can vary depending upon the circumstances involved. The figures are representative, however, of the proportion of retail revenues (typically $29.95 for a cassette that the retailer sells to consumers and $99.95 for a cassette the wholesaler sell to retailers).

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1 The review of the cost and revenue shares between the different players outlined below is based on discussions with Robert Hamilton Consulting.

Exhibit 6-1
Breakdown of Costs and Revenues for the Average Videocassette for Sell-through and Rental

Cost Structure	Sell-through Cassette	Rental Cassette
Duplicator's Share		
cost of blank tape	$4.00	$5.00
dubbing and packaging	$1.25	$1.75
duplicator's overhead & profit	$1.25	$1.75
Cost to Manufacturer	$6.50	$8.50
Producer's Share (Royalties)	$5.00	$12.00
Distributor's Share[1]		
marketing and promotion costs	$1.25	$2.00
manufacturer's overhead & profit	$4.25	$37.50
Cost to Wholesaler	$17.00	$60.00
Wholesaler's Share		
wholesaler's overhead & profit	$5.10	$15.00
Cost to Retailer	$22.10	$75.00
Retailer's Share		
advertising	$0.25	$0.50
retailer's overhead & profit	$7.60	$24.45
Retail Price	$29.95	$99.95

Source: Robert Hamilton Consulting

1 The distributor is the "manufacturer" who typically gets the video duplicated and packaged.

In order for a retailer to recover the wholesale cost ($75) of a cassette (not including the retailer's overhead), that cassette will have to be rented at least 25 times, assuming an average rental rate of $2.99. According to the Video Software Dealers Association (VSDA) annual survey of retailers for 1987, the average number of times in the U.S. that a tape is rented over its lifetime is 111 times for an A title, 65 times for a B title and 39 times for a C title. Comparable figures for Canada are not available.

The producer and distributor would obviously benefit more from a sale for rental than a sell-through on a one-to-one basis, even if, on a percentage basis, a sell-through is more attractive (see Exhibit 6-2). The producer's share, typically 20% of the wholesale cost is based on a percentage of "first dollar". However, the rental market in effect cannibalizes the sell-through market, since a video sold to retailers for rental to consumers passes through many VCR households. Increased sell-through - or pay-per-transaction - would be more lucrative to the manufacturer and the rights holder.

Exhibit 6-2
Typical Percentage Share Between Players on the Retail Price of a Videocassette

	Sell-through	Rental
Duplicator	21.7%	8.5%
Producer	16.7%	12.0%
Distributor	18.4%	39.5%
Wholesaler	17.0%	15.0%
Retailer	26.2%	25.0%
Total	100%	100%
Final Retail Price	$29.95	$99.95

Source: Robert Hamilton Consulting
Note: The review of the cost and revenue shares between the different players is based on discussions with Robert Hamilton Consulting.

The duplicator's costs comprise the costs of blank cassettes and packaging. The cost of blank cassettes can vary depending upon the quality of the tapes and the amount purchased. Packaging costs include the cost of the cassette case, the jacket cover, and the wrapping. The duplicator's margin is estimated to be about 20% of the total cost of the cassette to the distributor.

The revenues that flow to producers in the form of royalties from the distributor are usually based on a proportion of the price paid to the distributor by the wholesaler for a cassette (i.e. the wholesale net price). Sometimes the proportion may be based on a variable rate depending on the total number of cassettes sold to wholesalers. As well, the producer can usually negotiate an advance against expected revenues from the home video market. The distributor prepays the producer a fixed amount ranging anywhere from 50 - 75% of the producers share of anticipated revenues. This deal is usually made in parallel with theatrical rights. Expected revenues from home video are usually calculated based on the past performance of other similar types of product. While there is no fixed formula, advances will be estimated based on a productions genre, director, key cast and a number of other factors.

For a sell-through cassette, the wholesaler will usually mark up the distributors price by about 25 - 30%, which translates to about 10% of the retail price. Finally, the retailer's mark up on a sell-through cassette represents about 25 - 30% of the retail price.

The breakout of the cost structure of videocassettes between duplicators, producers, distributors, wholesalers and retailers is based on discussions with industry observers and is intended to be representative of typical arrangements in the industry. However, there are a variety of factors and circumstances that can affect the relative share of the retail price between the players. Therefore, these figures should be taken as illustrative only.

6.2 Wholesale Distribution

6.2.1 Wholesalers

The wholesaler, often called a "distributor" in the home video business, serves as the intermediary between the distributor, often called the "manufacturer", as stated earlier, and the retailer. Wholesalers buy packaged videocassettes and resell them directly to retailers. Typically, the wholesaler does not own the distribution rights to the cassettes they sell, nor do they have exclusive distribution agreements with major distributors or studios. There is an exception for French language product, where wholesalers have some exclusive videocassette distribution rights for French language videos from major studios.

Video One and Bellevue Home Entertainment (BHE) represent about 80% of the wholesale industry according to industry interviews. Exhibit 6-3 below is based on our recent survey of video retailers, and indicates the strength of the major Canadian wholesalers in the video retail industry. While vertically integrated, these two major wholesalers operate generally at arms-length from other parts of the video distribution system. For example, Astral Video, a distributor, is linked to BHE, but there is nothing to be gained from restricting its cassette sales to BHE. As well, Video One also has its own marketing arm, Cineglobe.

Both Video One and BHE are owned by companies that also own the main duplicating plants in Canada. However, it is the distributor that arranges for duplication prior to selling to the wholesaler which means there is no direct link between wholesaling and duplication.

Exhibit 6-3
Primary Supplier of Videocassette for
Canadian Video Retailers - 1989

Canadian Wholesaler	Per Cent of Respondents
Videoglobe*	10.8%
Video One	41.3%
Bellevue Home Entertainment	26.1%
Sub-Total	**78.2%**
Other Wholesalers	**21.8%**
Total	100%

* Video One now owns Videoglobe, which operates primarily in Quebec as a wholesaler of French language videocassettes

Source: NGL Consulting Ltd., 1989

6.2.2 Rack Jobbers

There is a segment of wholesalers that has developed into a group known as rack jobbers, a label borrowed from the music industry which better reflects their activities. There are two types of rack jobbers. There are 'new tape' rack jobbers who buy new cassettes (surplus inventory) from wholesalers and resell to small retail operations and 'used tape' rack jobbers who buy used tapes from video retailers and resell to the smaller retailers (for rental) or to mass merchandisers (for sell-through) sometimes on a consignment basis.

Independent or non-franchised video retailers may not be able to justify the initial expense of "A" titles when they are released. Rack jobbers buy videocassettes from wholesalers after the title has passed its peak in consumer demand and the large wholesaler wants to liquidate its stock. The rack jobber can then offer the small video outlet 'A' titles below cost once those titles have passed their peak demand, usually three months after release. As well, rack jobbers can stock sell-through product for mass merchandisers.

6.3 Distributor Functions

The videocassette distributor acquires home video rights from the producer. Exhibit 6-4 lists distributors who are currently active in Canada, representing a mix between distributors and product lines. The distributor may obtain an "all rights"deal for all media (theatrical, pay-TV, home video, etc.), or rights just for home video. The distributor is responsible for manufacturing and promoting the product in all of the relevant geographic territories. This means point-of-purchase displays, advertising in the video trade magazines and other ways of promoting the video product.

Exhibit 6-4
List of Distributors Active in Canada: 1989

Disney	SC/Creswin Inc.
Orion	Anthem Music Video
RCA/Columbia	Vestron Home International
Prism	New World Video
Vid Mark	Life Style Home Video
Alliance Releasing Home Video	A Nelson Entertainment Company
Trans World Entertainment	Warner Home Video
Nova	CBS Fox Video
Coliseum Video	Family Home Entertainment
Academy Home Entertainment	IVE (Canada) Ltd.
Cineam Plus	Paramount
Cineplex Odeon	Republic Pictures Home Video
Astral Video	HBO Video
Cinepix Inc.	Norstar Home Video
Forum	MGM/UA Home Video
MCEG Home Video	Junior Home Video
Nova Home Video	CMV Enterprises
Sony	Playhouse Video
Media Home Entertainment	

Source: CMPDA, 1989

The nature of the deal between producer and distributor varies with each business arrangement. The distributor can carry all of the promotion and advertising costs or they can be shared in some degree with the producer. A 50/50 revenue sharing between producer and distributor for the home video market is only one possible arrangement.

The rights may be for Canada only, North America, world rights, or any combination thereof. It has been common practice, as in the theatrical market, for full North American rights to be sold to a distributor, which means that the purchase of rights for the Canadian market alone is difficult to achieve. Canadian distributors do not have the financial clout to effectively negotiate for North American rights against the major U.S. studios. American distributors acquire Canadian rights as simply an extension of rights for the U.S. market. As a result, the Canadian market has largely become an extension of the U.S. domestic market.

The proposed film and video distribution legislation tabled in the 33rd Parliament by the Minister of Communications would be applicable to video as well as theatrical distribution. The intent would be to permit Canadian-based distributors to acquire Canadian distribution rights. While the Government's proposed legislation on film distribution is an attempt to redress that imbalance, U.S. distributors will still likely control the North American rights to prime international product.

6.4 Vertical Integration of Distribution

Vertical integration is an important element of the video distribution business. The most significant Canadian company that is vertically integrated is Astral Bellevue Pathé, comprising wholly owned or controlled companies, which include the following:

- Astral Films, a distributor for the theatrical market;
- EPS, a distributor of television programming including the pay-TV market with distribution rights to Fox and Columbia;
- Astral Video, a distributor/manufacturer for the home video market;
- First Choice and Premier Choix:TVEC operate movie-based pay-TV channels; First Choice has in conjunction with Superchannel a 50% interest in the new Family Channel (with Disney as a partner); Premier Choix:TVEC owns Canal Famille, a new French language specialty service.

As previously noted, Bellevue Home Entertainment (BHE) and Astral own a major duplicator, Pathé Video. However, it is the distributor/exhibitor (pay-TV for Astral) integration which is important. Horizontal integration in video, theatrical and TV distribution permits the company to acquire all-rights deals and closely coordinate distribution in Canada. Release windows can then be more effectively planned and executed.

Vertical integration in distribution is also a key factor in the distribution chain of foreign product. The primary video products - Hollywood productions - are distributed in Canada mainly through distributors owned by the major studios. Obviously, these production studios act as distributors for their own product and acquire Canadian rights to other video product as well. In view of the differences between them, theatrical distribution and video distribution are conducted as separate operations in Canada as elsewhere in the world. The theatrical distributors' main costs are in "prints and ads" (film prints are for use by theatres while the "ads" is advertising and promotion for the movie). The video distributor has a manufacturing cost (duplication and packaging) as well as advertising and promotion.

In the U.S., of course, home video product is controlled primarily by the major studios. Over the last four years, however, the estimated share of total home video revenues that stem from the majors has apparently been declining (see Exhibit 6-5). The top eight have experienced a collective drop in market share from 84% to 65%. Some of the non-major distributors are increasing their share of the home video market in the U.S. in part by targeting to mass merchants. It is important to note that the figures below are only estimates whose accuracy was questioned by industry experts during the course of the study. They should only be regarded as indicative of certain trends rather than as a comprehensive accounting of studio activity.

Exhibit 6-5
Estimated U.S. Studio Revenue and Market Share for Home Video

	1984	1985	1986	1987
Paramount	12.7%	10.1%	9.7%	11.8%
CBS/Fox	17.0%	14.7%	13.0%	10.8%
Disney	5.6%	5.9%	8.1%	9.1%
Warner	14.6%	9.8%	7.4%	9.0%
RCA/Columbia	11.3%	10.1%	9.5%	8.3%
Vestron	6.4%	10.4%	6.9%	6.1%
MCA	8.8%	6.5%	6.3%	6.1%
MGM/UA	7.6%	8.8%	7.9%	4.0%
Sub-Total	**84.0%**	**76.3%**	**68.8%**	**65.2%**
HBO	4.9%	6.2%	6.7%	6.5%
Heron	1.9%	3.3%	4.2%	5.1%
Lorimar	1.6%	2.6%	4.4%	4.3%
Nelson	5.3%	4.2%	3.2%	3.6%
New World	0.0%	2.6%	2.8%	3.0%
IVE	0.0%	2.6%	1.9%	2.4%
Other Independents	2.5%	2.3%	8.1%	9.8%
Sub-Total	**16.0%**	**23.7%**	**31.2%**	**34.8%**
Total (%)	100%	100%	100%	100%
Total ($ million)	$754	$1,535	$2,160	$2,338

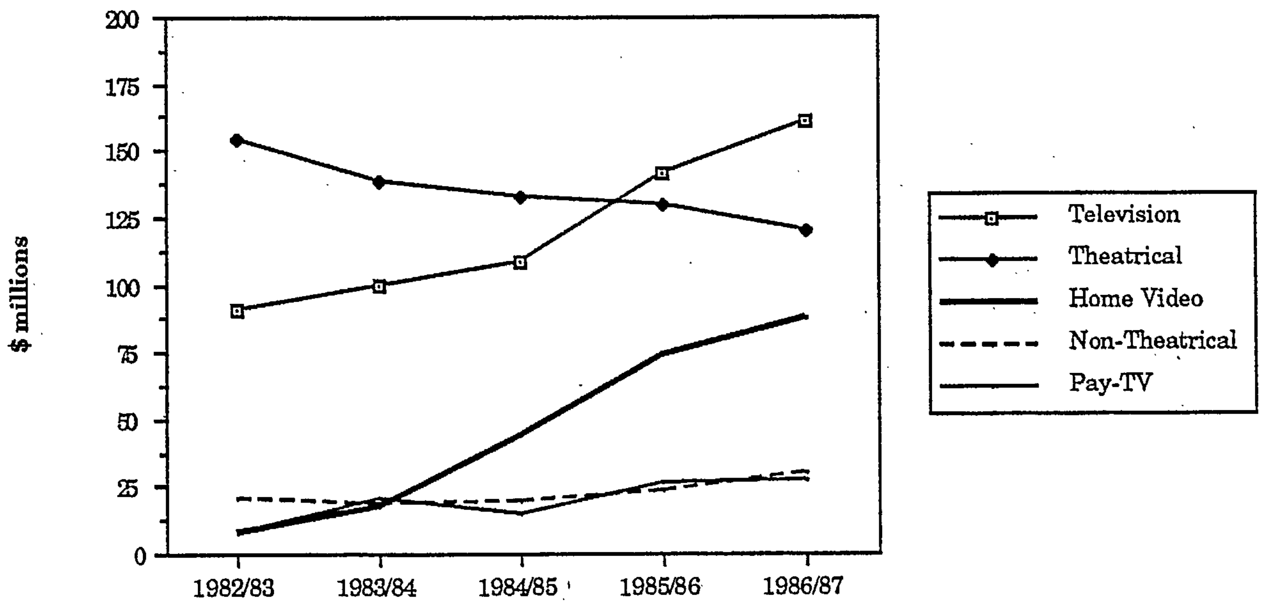
Source: Paul Kagan Associates, The VCR Letter, Jan. 26, 1988

6.5 Value of Home Video Market for Distributors

The home video market in Canada represents a significant source of revenue for distributors operating in Canada. From 1982, the home video market has grown in importance from an estimated 3% of distributors total revenues to 20% in 1987. Theatrical revenues have declined in importance as a per cent of the total from 55% to 28% over the same period while pay-TV and conventional television have increased slightly and non-theatrical has been relatively stable (see Exhibit 6-6a and 6-6b).

Exhibit 6-6a

Comparison of Distributor Revenues by Market: 1982 - 1987



Source: Statistics Canada

Exhibit 6-6b
Detailed Table

	1982	1983	1984	1985/86	1986/87
Home Video					
revenues ($000,000)	$7.9	$17.8	$43.6	$73.8	$87.8[1]
share (%)	2.8%	6.0%	13.7%	18.7%	20.6%
Theatrical					
revenues ($000,000)	$154.6	$138.8	$132.5	$129.4	$120.3
share (%)	54.8%	47.1%	41.6%	32.8%	28.2%
Pay TV					
revenues ($000,000)	$7.9	$20.1	$14.9	$26.3	$27.2
share (%)	2.8%	6.8%	4.7%	6.7%	6.4%
Television					
revenues ($000,000)	$91.2	$99.4	$108.1	$141.2	$161.3
share (%)	32.3%	33.8%	33.9%	35.8%	37.8%
Non-Theatrical					
revenues ($000,000)	$20.4	$18.3	$19.4	$23.7	$30.4
share (%)	7.2%	6.2%	6.1%	6.0%	7.1%
Total					
revenues ($000,000)	$282.0	$294.4	$318.5	$394.4	$427.0
share (%)	100%	100%	100%	100%	100%

Source: Statistics Canada

1 Statistics Canada survey has changed for 1986/87, wholesaler revenues are excluded from the home video market total while they are present in the historical figures. For this run, wholesaler revenues were added back in to the total to provide figures that are historically comparable.

6.5.1 Value of Canadian Product in the Home Video Market

The revenues generated from Canadian product in the Canadian home video market pales compared to foreign product as would be expected. Foreign product, mainly U.S. titles, accounted for 93% (1985/86) of distributors revenues while Canadian product accounted for only 7%. However, Canadian product has managed to capture a larger slice of the market, 7% in 1986 vs. 3% in 1983 (see Exhibit 6-7). Although no figures are available for the current year 1988/89, it is realistic to assume that given the larger portion of revenues accounted for by Canadian product, that that trend should be continuing.

Exhibit 6-7
Distributor Revenues for Canadian and Foreign Home Video Product
($ millions)

	1983	1984	1985/86
Canadian Product	$0.589	$0.890	$5.130
% Share	**3.3%**	**2.0%**	**7.0%**
Foreign Product	$17.195	$42.688	$68.631
% Share	96.7%	98.0%	93.0%
Total	$17.784	$43.578	$73.761
% Share	100%	100%	100%

Source: Statistics Canada
Note: figures for 1986/87 not yet available

Revenues generated for distributors in Canada by Canadian product is low in all of the major markets, not just in home video (see Exhibit 6-8). In the theatrical market, for example, Canadian product only represents 3.1% of distributors' revenues in that market. The only solace for Canadian producers is that their share of the video market is double their revenues from theatrical release. This reflects the relatively greater access to video retail distribution to the limited amount of screen space in Canada.

Exhibit 6-8
Distributors' Revenues by Market and by Product: 1985/86

($000,000)

	Canadian Product		Foreign Product		Total
Market	Revenues	% Share	Revenues	% Share	Revenues
Home Video	$5.1	7.0%	$68.6	**93.0%**	$73.8
Theatrical	$4.0	3.1%	$125.4	**96.9%**	$129.4
Television	$8.4	6.0%	$132.8	**94.0%**	$141.2
Pay-TV/Spcty	$4.7	17.9%	$21.6	**82.1%**	$26.3
Non-Theatrical	$5.7	23.8%	$18.1	**76.2%**	$23.8
All Markets	$27.9	7.0%	$366.6	**93.0%**	$394.5

Source: Statistics Canada

7.0 PROGRAM RIGHTS HOLDERS AND THE HOME VIDEO MARKET

This section examines the importance of the home video market to program rights holders. It provides an overview of home video's place in the various release patterns for feature films. As well, it reviews the value of the Canadian home video market to Canadian and foreign rights' holders as well as the international market for Canadian rights' holders. Finally, it examines the importance of home video in relation to other revenue sources, such as theatrical, pay-TV and conventional TV.

7.1 Feature Film Release Patterns

Film and video production and distribution has become a more complex business as new distribution outlets have developed. This has led to the creation of release patterns that seek to maximize the return to the producer. Careful planning and management of releases in each of the "windows" of market opportunity is becoming required practice for well-run production companies in Canada and abroad.

There are many release patterns for feature film product, but four merit specific attention: the classic release window; a U.S. release scenario involving pay-per-view, and simultaneous release of theatrical and home video; and a special Canadian variant where broadcasting rights are pre-eminent . They are summarized in Exhibit 7-1 and described briefly in turn.

Exhibit 7-1

Comparison of Release Patterns for feature Film Product

Pattern	Window				
Classic Release Pattern	Months 1-3 Theatrical	Months 3-6 Home Video	Months 6-12 Pay-TV		Beyond 12 TV & Syndication
PPV/Home Video Variant	Months 1-3 Theatrical	Months 3-4 PPV	Months 4-6 Home Video	Months 6-12 Pay-TV	Beyond 12 TV & Syndication
Theatrical/Home Video Concurrent	Months 1-6 Theatrical/Home Video		Months 6-12 Pay-TV		Beyond 12 TV & Syndication

It is important to note that the length of the windows described above are illustrative only. Every release pattern will have its own variations. The intent is to provide an indication of the major differences between the three release patterns.

Source: NGL Consulting Ltd. , based on interviews with producers and distributors

7.1.1 Classic Release Sequence

In the early '80s, films were released to the video market well after theatrical release and often after release to pay television. By 1984, home video had asserted its importance and gained second place in a release sequence that is now the "classic" approach. The theatrical window is usually about 1 to 3 months. The home video window, usually 3 - 6 months, follows the theatrical window. Ideally, product in the home video window will follow theatrical release by 3 months for popular titles, and 6 months for others. Some producers prefer even longer video windows of 9 months.

7.1.2 Pay-Per-View Variant

One of the key developments in the U.S. has been the introduction of pay-per-view which has introduced a new window in the release pattern of feature film product. Home video still maintains window priority over pay-per-view in the U.S. because the home video market represents a larger source of revenue to the studios than does pay-per-view. However, studios have been experimenting with day-and-date pay-per-view release with home video and in some cases have released product to pay-per-view before home video. However, on average,the studios give videocassettes a one month window before the title is released to pay-per-view. Major studios average an 18 day window while independent distributors average a 27 day window (VSDA, Pay-Per-View Report, April 1988).

7.1.3 Simultaneous Theatrical/Home Video Release

Some feature films are released to home video simultaneously with theatrical exhibition. This usually a signal that the film is "not viable" for a theatrical run. Sometimes theatrical release is nominal and is intended only to promote the feature for the home video market, e.g., one week in the theatres and then directly to home video.

7.1.4 Canadian Variant

There is a Canadian variant of the release pattern for productions that include major financial participation of a broadcaster. Given the difficulties of obtaining production financing, many lower budget Canadian feature productions, by necessity, have a significant television component; this may be either in the form of license fees and/or equity participation. The window sequence for a production can be altered at the insistence of the broadcasting participant in view of the level of the latter's participation in a production. For example, the CBC was a major participant in the Telefilm-assisted feature *My American Cousin*. The production obtained a limited theatrical release and then went to network television, before home video and pay-TV. Release on pay-TV or conventional TV prior to home video can reduce the value of the home video window to producers because it provides mass exposure of a product before these other markets have been fully exploited. However, broadcasters maintain they can maximize a products promotional value if it is released to conventional TV prior to home video or pay-TV.

7.2 Value of the Home Video Market to Producers

The worldwide home video market is expected to become an even more important source of revenue to the producer. According to an estimate by Disney, the worldwide home video market is estimated to climb from 16% of total wholesale revenues flowing to U.S. producers in 1982 to 41% in 1990 (see Exhibit 7-2). Correspondingly, the theatrical market has dropped from its position of dominance in the late '70s, as have network and syndication revenues. Pay-per-view is expected to grow in importance, but is a small per cent of the total revenues that flow to producers.

Exhibit 7-2
Producers' Gross Receipts from Wholesale Revenue: 1978 - 1990

	1978	1982	1986	1988 Est.	1990 Est.
Worldwide Video	**0.0%**	**16.3%**	**39.4%**	**38.6%**	**41.2%**
Worldwide Theatrical	80.2%	55.9%	40.1%	43.5%	41.0%
Pay-TV	3.0%	13.9%	10.8%	9.5%	9.0%
Network/Syndication	16.8%	13.9%	9.6%	7.8%	6.8%
Pay-Per-View	0.0%	0.0%	0.1%	0.6%	2.0%
Total	100%	100%	100%	100%	100%
Total Revenue ($B)	$2.432	$3.445	$6.240	$6.735	$7.700

Source: Walt Disney Company, 1987

7.2.1 Value of the Canadian Home Video Market to Foreign Rights Holders

While the North American market accounts for almost 65% of world home video revenues to the studio ($2.3 billion), foreign markets grew on average three times as fast as the North American market. Paul Kagan Associates, estimates that the Canadian market in 1987 was worth $136 million in revenues ($U.S.) to U.S. suppliers, ranking third behind the U.K., at $167 million and Japan, at $203 million (see Exhibit 7-3). The next size markets, in terms of total revenues generated to the suppliers, after the United States are Japan, the United Kingdom, Canada, Germany, Australia, Spain, France, Italy and Sweden.

The Canadian home video market may have surpassed theatrical distribution as a source of revenue to the U.S. studios. While section 6.0 provided 1985/86 StatsCan figures showing the theatrical market as still more important, one industry expert estimated that U.S. distributors now expect to generate 40% of their Canadian revenues in the theatrical market and 60% in the home video market.[1]

This same source estimated roughly that there are five million videocassettes or units in the Canadian home video market, representing the bulk of the available product. One million of those units are believed to be sold to consumers and the other four million to retailers for rental. Assuming typical sales prices for sell-through and rental use, the Canadian home video market generates about $30 million in sell-through revenue and $400 million in rental revenues on those units (see Exhibit 7-4). Based on the revenue splits discussed earlier (see section 6-1), the distributors share of those revenues would amount to over $160 million. Accounting for some non-U.S. revenue, this is close to the Kagan estimate of the value of the Canadian market to U.S. distributors, i.e., $136 million (1987) as previously noted.

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1 Discussions with CMPDA

Exhibit 7-3
Revenue to U.S. Program Rights Holders from the Worldwide Home Video Market: 1987

($U.S millions)

Market	U.S. Supplier Revenue: 1987	% Share
United States	**$2,337.1**	**61.1%**
1. Japan	$202.8	5.3%
2. United Kingdom	$166.8	4.4%
3. Canada	$135.6	3.5%
4. Germany	$130.7	3.4%
5. Australia	$87.7	2.3%
6. Spain	$78.0	2.0%
7. France	$76.9	2.0%
8. Italy	$39.8	1.0%
9. Sweden	$36.5	1.0%
10. Norway	$26.6	0.7%
11. Netherlands	$22.2	0.6%
12. Denmark	$17.3	0.5%
13. Argentina	$15.2	0.4%
14. Brazil	$13.6	0.4%
15. Finland	$13.3	0.3%
16. New Zealand	$12.1	0.3%
17. South Africa	$9.9	0.3%
18. Mexico	$9.7	0.3%
19. Greece	$8.9	0.2%
20. Austria	$5.2	0.1%
21. Venezuela	$3.9	0.1%
Top 21 Foreign Markets	**$1,112.7**	**29.1%**
Other Foreign Markets	**$376.1**	**9.8%**
TOTAL WORLDWIDE	**$3,825.9**	**100.0%**

Source: Paul Kagan Associates, The VCR Letter, July 21, 1988

Exhibit 7-4
Revenue Share on an Estimated 5 Million Units in the Canadian Home Video Market: 1989

	Sales	Rentals	Total
# of Units Sold	1,000,000	4,000,000	5,000,000
Revenue Share ($000,000)			
Duplicator	$6.5	$34.0	$40.5
Producer	$5.0	$48.0	$53.0
Distributor	$5.5	$158.0	$163.4
Wholesaler	$5.1	$60.0	$65.1
Retailer	$7.8	$100.0	$107.8
Total	$30.0	$399.8	$429.8

Source: NGL Consulting Ltd.,
Robert Hamilton Consulting,
CMPDA.

A typical "A" title, i.e. high production value movie with international distribution, can expect distribution of 8,000 - 10,000 and up to 30,000 copies for the major hits. At 10,000 copies sold to wholesalers for roughly $60 per copy (see section 6.1), the producer/distributor can gross $600,000, from which manufacturing and promotion costs are deducted (about $100,000) and the distributors overhead and profit (about $375,000). This leaves about $125,000 for the producer. The producer may already have obtained 50-75% of that $120,000 in the form of advances against expected revenues.

A similar product might generate $1 million in rental revenues from theatrical distribution, which could cost $250,000 - 500,000 to launch in "prints and ads" expenditures. Since the video distribution is dependent on theatrical distribution, it is not really possible to separate accurately the net financial return each for each window. However, theatrical and home video are obviously important to the producer and distributor. At the same time the Canadian market cannot be expected to pay a large percentage of the production cost of feature films even if they obtain a reasonably successful theatrical and video distribution.

7.3 Value of the Canadian Home Video Market to Canadian Producers

As in the previous Nordicity study, one focus of research for this report is an update on the value of the video market for Canadian producers or program rights holders. One of the cases examined in 1985 was Rock Demers' *La Guerre des Tuques* or *The Dog Who Stopped the War,* actually the first of the multi-project *Tales for All* series of family feature films. [1] Exhibit 7-5 compares the share of net revenues between markets for the first production with a typical one today, according to an interview with Les Production de la Fête.

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1 The projects are *The Dog Who Stopped the War* (1984), *The Peanut Butter Solution* (1985), *Bach and Broccoli* (1986), *The Young Magician* (1986), *The Great Land of Small* (1987), *Bye Bye Red Riding Hood* (1988), *The Tadpole and the Whale* (1988), and *Summer of the Colt* (1989). The entire series will be 15 films, which are released in both French and English.

Exhibit 7-5
Comparison of Productions by Les Productions de la Fête in 1985
(Le Guerre des Tuques) and a Typical Production Today (1989)

Share of Net Revenues (Distributor/Producer)

	La Guerre des Tuques (1985)*		Typical Production (1989)	
	% Share	$ Revenues	Domestic	Foreign
Theatrical	30%	$215,000	15%	5%
Home Video	20%	$100,000	15%	50%
Pay-TV	15%	$100,000	25%	25%
Conventional TV	20%	$155,000	45%	15%
Other	15%	$89,000	--	5%
Total	100%	$665,000	100%	100%

* includes Canada and foreign

This series has depended very much on the revenues from video rights, particularly foreign (see Exhibit 7-5). A major success for French language video in Canada is only 2,000 copies. This was achieved for most of the *Tales for All* series[1]. As well, foreign markets are more fully exploited, Mr. Demers projected that in the future up to 65% of revenues would be obtained outside of Canada.

English language feature films that have been commercially successful (and critically acclaimed) include the *Grey Fox* reported on in the 1985 study. *Grey Fox* at that time had generated over 30% of its net revenues from home video and almost 50% from theatrical. A rough equivalent is *My American Cousin* (by the same producer as the *Grey Fox*) which was also pre-financed by U.S. video distribution, and has achieved video sales close to a typical "A" title. Although *Dead Ringers* has just entered the video

1 The *Tales for All* series generally did less well comparatively in English Canada. One exception was the 3,500 unit sales (to Dec. 1988) of *Great Land of Small.*

retail market, its theatrical and critical success may also result in a 8,000 - 10,000 copy level of performance.

Another class of production are the genres of action/adventure and horror. This so-called "B" product was typified by Thrill Kill reported on in the 1985 study. It had little theatrical distribution but had successful home video sales. Today it is more difficult to achieve high video sales for a feature film without the exposure of theatrical distribution because VCR owners are no longer mass consumers of "B" product. However, a successful equivalent in today's terms is *The Gate*, an Alliance produced film. Its performance compared to *Thrill Kill* is shown in Exhibit 7-6

Exhibit 7-6
Comparison of Net Revenues Between Markets for Thrill Kill (1985) and The Gate (1989) *

	Thrill Kill (1985)		*The Gate* (1989)**	
	($000)	% Share	($000)	% Share
Theatrical	nil	--	$6,936	63%
Home Video	$708	80%	$3,000	27%
Pay-TV	$36	4%	$1,141	10%
Network TV	na	--	--	--
Non-theatrical	$70	8%	--	--
Syndication	$70	8%	--	--
In-flight	na	--	--	--
Total	$884	100%	$11,081	100%

* net distributor/producer revenues for Canadian and foreign markets

** Figures should be regarded as preliminary since in some cases not all monies have been fully collected nor have some markets been fully exploited.

Another type of Canadian feature is the kind that has important public sector or broadcaster backing and fall into the "Canadian variant" release pattern described earlier. Broadcast exposure, in one expert's opinion, can "garotte" home video distribution. Typical productions of this kind examined in 1985 was *Mario* (a French language NFB production) and more recently *90 Days*, also an NFB production and *Keeping Track* by Malofilm (see Exhibit 7-7).

Exhibit 7-7
Comparison of Net Revenues Between Markets for *Mario* (1985), *90 Days* (1989) and *Keeping Track* (1989)

	Mario (1985)*		*90 Days* (1989)**		*Keeping Track* (1989)*	
	($000)	%	($000)	%	($000)	%
Theatrical	$49	26%	$10	6%	--	--
Home Video	$28	15%	$10	6%	$40	10%
Pay-TV	na	--	$45	26%	$25	7%
Network TV	$50	27%	$75	43%	$290	75%
Non-theatrical	$10	5%	$4	3%	--	--
Syndication	na	--	$30	17%	--	--
In-flight	$50	27%	--	--	$31	8%
Total	$187	100%	$175	100%	$386	100%

* net producer revenues for Canada only
** net producer/distributor revenues for Canada only

Another Canadian feature that may fall into this category is *I've Heard the Mermaids Singing* by Vos Productions. While the feature has not yet exhausted all of its domestic markets, it does illustrate its reliance on pay-TV and conventional TV as a source of revenue (see Exhibit 7-8).

Exhibit 7-8
Comparison of Net Producer Revenues Between Markets in Canada for
I've Heard the Mermaids Singing (1989) *

	($000)	%
Theatrical	$27	10%
Home Video	$30	11%
Pay-TV	$105	39%
Other TV	$105	39%
Total	$267	100%

* represents actual revenues to date and expected future net revenues from the Canadian market

The major example of a Canadian produced dramatic production developed primarily for video distribution was the *Shades of Love* series. Inspired by market research into what was perceived to be an identifiable market niche, Shades of Love (financed by Karl Lorimar of Los Angeles and produced by Astral Films), has apparently not fared as well as anticipated in home video sales. In fact, it is reported that its major distribution outlet in Canada has been pay-TV.

7.3.1 Value of Foreign Markets for Canadian Productions

Sales of foreign video rights can represent an important source of revenue. According to Les Productions La Fête Inc., one foreign distributor purchased the video and TV rights to 15 of its films offering a minimum guarantee of $300,000 for each. As well, presale commitments continue to represent an important source of financing for some Canadian productions. For example, the *Great Land of Small* was made possible through presale commitments to U.S. distributors for the rights in English language territories and Latin America.

Home video rights are very important in foreign markets. For example, Canadian features such as *The Gate* generated over 90% of its net revenues from foreign markets (so far) and home video accounted for almost 30% of that amount. This provides an indicator of the importance of foreign markets, notably home video, to the producer/distributor. As well, *Keeping Track* by Malofilm generated almost three quarters of its net revenues from foreign markets (No breakout of markets for foreign net revenues is available). Producers have indicated that the sale of foreign rights is becoming more important for video than for theatrical rights. It is not unusual for the rights holder to obtain $1 million in revenues from the export of one film's video rights. Finally, many overseas distributors will only buy video rights, and not theatrical rights.

7.3.2 Alternative Video Distribution Systems

The primary focus for the productions discussed above is dramatic product. There is a growing specialization in the types of productions. CBC's Papal Visit sold 45,000 copies as reported on in the 1985 study. More recently, made for video productions like *Boys on the Bus*, a documentary chronicling a season of touring by the Edmonton Oilers sold 12,000 copies in Canada. In another example, a *Guy Lafleur* video was produced and distributed as a promotion in conjunction with sales of Phillips' VCRs; while not as successful in sell-through, it had sponsorship that guaranteed commercial success. Even conventional television provides product for the home video market. For example, CFAC in Calgary, sells copies of its exercise show *It Figures* on videocassette through mail order.

Non-theatrical videos represent a niche market for Canadian rights holders. With the smaller production budgets involved ($60,000 - $100,000), opportunities for recoupment in international markets is larger than for feature films that obtain little theatrical distribution. However, even the non-theatrical home video market can be a hit driven business. For example, while the typical exercise video in the U.S. is successful if it can sell about 30,000 copies, the original Jane Fonda exercise video has sold over 1 million copies to date. Thus, the non-theatrical market is characterized by a great many look-a-likes and only a few winners. Exhibit 7-9 outlines Kagan's estimate of the international sales potential of different genres (other than exercise tapes) in the non-theatrical market.

Exhibit 7-9
Illustrative Sales Figures for Different Non-Theatrical Videos

	Typical	Good	Exceptional
Cooking	10,000	20,000	40,000
Fine Arts	5,000	20,000	30,000
Music Videos	25,000	50,000	75,000
Non-Instructional Sports	30,000	75,000	150,000
Documentary	5,000	15,000	35,000
KidVid	30,000	100,000	250,000

Source: Paul Kagan Associates, The VCR Letter, Sept. 26, 1988

In the non-theatrical market, the key for Canadian producers is keeping production costs low, obtaining adequate promotion and targeting niche markets. Aiming for the international marketplace could be required since the domestic market alone would not be large enough to support even lower budget non-theatrical productions. It is not possible to fully examine the non-theatrical market here; however, the opportunities for Canadian producers and distributors in the non-theatrical market should be explored further.

As the industry matures there will be other experiments with distribution and niches established. For example, BBC in the U.K. through BBC Video World, is now providing compilations of BBC television programming on videocassette available through a mail order subscription basis. As well, Encyclopedia Britannica Films recently announced the creation of a home video division in the U.S. and will launch a line of animated children's videos priced for sell-through in the Fall of 1989.

The evolution of NFB's distribution illustrates how home video can be used for non-theatrical distribution. The NFB is now making agreements with public libraries to stock titles of primary interest to individuals. Some 500 titles (out of 2,000 titles available on video) have been selected as a package in this way. This reduces the need for NFB offices as points of distribution, while at the same time increases the points of public access to NFB product.

8.0 OBSERVATIONS AND CONCLUSIONS

This section reviews changes and future developments in the Canadian video retail industry. It examines some of the dynamics of Canadian production financing and the importance of the home video market to Canadian producers. It reviews the information gaps that exist regarding the Canadian home video market. Finally, it provides an overview of the trade organizations representing the home video industry in Canada.

8.1 The Video Retail Environment

The video retail industry has not changed dramatically since the 1985 study. The concept of the video retail store developed in the early 80s, i.e. rental of pre-recorded videocassettes, primarily movies, has not changed. The composition and complexity of the retail environment, however, has changed. As the growth in new VCR households slows down, the focus of activity should shift away from the video gourmand to the video gourmet. The video retail industry has responded to this development in a variety of ways. Specialty video retailers stock more copies of hit or "A" titles, usually at the expense of their "B" title inventory. As well, video vending machines only address the market for "A" titles. Video superstores, with upwards of 10,000 titles, have emerged in an attempt to capture market share away from specialty video retailers by offering both depth-of-copy and breadth-of-copy. Finally, videocassette rack jobbers have jumped in to serve the smaller retailers, i.e., convenience stores, etc., with less expensive product, including "A" titles.

As the consumption patterns of VCR owners change over time, the industry should change to meet them. For example, the video retail industry is driven by rentals because the product continues to be too expensive ($99.95 for example) to generate widespread sales among consumers. Given the range of product available, there will probably always be a rental industry, but the emergence of the sell-through industry is also important to note. In the U.S. sell-through is predicted to become an important component of retailers' business volume, roughly 25%, within the next 7 years.

As well, pre-recorded videocassettes can be distributed in a variety of ways; rental through video stores is only one means. As alternatives to rental outlets are developed, i.e., mail ordering, mass merchandisers, etc., video retailers may have to focus attention on other types of rental product, such as computer game cartridges and CD's.

A number of corporate strategies are possible over the next several years. Cable operators could move more aggressively into video retail as illustrated by the participation of Rogers and Videotron in the purchase of video retail chains. The development of pay-per-view or video or demand could further the integration between cable operators and pay-TV licensees for services that would likely rely on the same kind of product as video retail. As well, videocassette wholesalers may become more involved in video retail either through direct participation in stores or chains or through arrangements with retailers like pay-per-transaction.

It is difficult to predict how the video retail industry will evolve in the 1990s. There are many influences on the future structure of the video retail industry including marketing and technological innovations that range from superstores to electronically delivered video on demand. The nature of the business, however, has not changed substantially since 1985 nor is it likely to disappear in the next decade. There will probably continue to be a market for the video retail industry, at least until the widespread introduction of an electronically delivered video on demand service some time in the next century.

8.2 Importance of Home Video to Canadian Production

The dynamics of Canadian production financing have not dramatically changed since the 1985 study. For most producers, the Canadian market is still too small to provide them with the financing to cover production costs. Canadian producers, therefore, continue to rely on pre-sale commitments in international markets to make up production financing shortfalls. The Canadian home video market is only one component of an already limited domestic market, and it does not change the economics of production financing. In large part, the Canadian home video market functions as an ancillary market for Canadian producers.

There are Canadian productions that are geared specifically to the home video market, i.e., certain types of "B" titles, how-to and exercise videos. However, financial success in home video is still dependent in large part upon a prior theatrical release. For the most part, access to screen time in Canada is difficult unless a production has international tie ins. That limited access puts a governor on what a Canadian production can earn out of the domestic home video market. As well, consumer preference for recently released "A" titles, mainly international blockbuster movies that have had a theatrical release and are well promoted, still represents the primary revenue vehicle for the video retail industry. For feature film product, then, Canadian producers are in the double bind of having limited access to a theatrical window in Canada and often have to settle for a television window out of sequence with the traditional release pattern of video product. Both factors contribute to inhibit the full exploitation of Canadian product in the home video market.

In the early years of the home video industry, it was thought that home video in Canada might provide an important new market for Canadian productions. While the home video market represents an important revenue source for some kinds of productions, the Canadian home video market today is characterized by the dominance of U.S. product and U.S.-based distributors. That dominance is not likely to change as long as public appetite for U.S. product remains and continues to be fueled by theatrical releases.

At the same time, there are a variety of developments that offer Canadian producers a number of options with regard to the home video market. The composition of the video retail industry is changing to some extent in that there is now a greater variety of outlets for Canadian product. The home video market should become more accessible, i.e. more available shelf space, for certain kinds of Canadian product with the increase in the diversity of outlets.

Furthermore, as the sell-through market matures and more Canadian merchandisers move into videocassettes, there should be a place for non-theatrical Canadian product. The non-theatrical market provides an opportunity for Canadian productions that have already had television exposure, i.e. packaged syndicated television programming. As well, it is important that the market potential of the non-theatrical product be explored and communicated in some way to applicants to the Non-Theatrical Fund in order to increase their understanding of the revenue potential of all markets for non-theatrical product, including the home video market.

The bright spot for Canadian producers is the international market for home video. It provides Canadian producers with a significant revenue and financing potential, either in the form of advances against expected revenues or as an ancillary revenue source. Foreign video markets are often more accessible than foreign theatrical markets, and can dwarf anticipated revenues from Canadian markets collectively.

Thus, foreign markets could provide Canadian producers with the best opportunities both as revenue sources and as sources of financing. Canadian producers therefore, will continue to maximize revenues from foreign markets and link up with international partners to counteract the effects of a small domestic market.

8.3 Scarcity of Information

There is very little information on the Canadian home video market collected on a regular basis. Statistics Canada compiles information on **distributors'** revenues from the home video market, but it runs 1 1/2 - 2 years out of date. As well, there is no survey of Canadian **video retailers** as part of Statistics Canada retail trade statistics.

Video retailers have been captured on an ad hoc basis as part of StatsCan's small business survey for 1986. However, the information that is collected relates to the financial operations of the stores rather than to any aspects concerning inventory, i.e. titles. Research on the Canadian video market, therefore, continues to rely upon information that is available from the U.S., particularly analysis conducted by Paul Kagan Associates and the Fairfield Group. While the markets are roughly comparable in terms of product and composition, there are significant differences between them.

The size of the two markets makes data gathering a different exercise for each. For example, given the small size of the market in Canada, distributors are reluctant to provide detailed information because they regard it as competitive. The larger market in the U.S. makes it easier to gather information that is not considered of competitive importance.

While improvements to StatsCan can be made consideration should be given to setting up detailed annual surveys of the home video industry. This could be done either through outside concerns or directly through an industry association like VDAC. Such data gathering could cover the video retail sector, the VCR household and the video wholesale/distributon sector. The Canadian home video industry is involved in the distribution of cultural product. It is important, therefore, for policy makers to have access to an ongoing source of Canadian information on that industry which can provide input into public policy initiatives relating to the promotion of Canadian product through video retail.

8.4 Industry Organizations

At present, video retailers in Canada are being organized under a national association, the Video Dealers Association of Canada (VDAC). At the same time the U.S. trade association, the Video Software Dealers Association (VSDA), has established a number of regional chapters across the country in Manitoba, Montreal, Ottawa and Southern Ontario.

As a general observation, it would seem important that there be a strong Canadian organization to serve as the focal point for the Canadian video industry. In such an organization there would be a greater tendency for Canadian interests to be represented and Canadian needs served, The home video industry is a multi-hundred million dollar business in Canada, and is a distributor of cultural product. For these reasons, strengthening an industry association would appear to be desirable.