Western Europe: the industry overview

Buoyant DVD market now worth more than VHS

DVD is now officially the most popular video format in Europe. In 2002, consumer spending on DVD in Western Europe overtook consumer spending on VHS for the first time. It has taken barely five years since DVD was officially launched in Europe for it to dominate the sector – a phenomenal achievement.

The video market in Western Europe continued to show healthy signs of growth in 2002 as spending on buying and renting VHS and DVD units grew by 26.7 per cent to Euro 11.2bn. In dollar values this represents growth of 33 per cent to $10.5bn. Distributor revenues from video software in Western Europe also grew by over a quarter to Euro 6.2bn.

Consumer spending in key Central European territories (Croatia, Czech Republic, Hungary and Poland) reached Euro 140m by the end of 2002, an increase of over eight per cent on the previous year.

The five largest European video markets, UK, France, Germany, Italy and Spain, accounted for almost four out of every five euros spent by consumers on video (78 per cent) in Western Europe. The lion's share of this was generated by the top three territories, which between them had two-thirds of the market. The UK claimed a massive 36.2 per cent of the pie, France 18.4 per cent and Germany 12.5 per cent.

Of the 21 European territories analysed in depth in this study only one, Poland, did not record growth. A total of 15 countries recorded an increase in consumer spending of over 20 per cent, while eight recorded growth of more than 30 per cent. In the Netherlands and Norway growth exceeded 60 per cent. Such strong increases were primarily driven by the popularity of DVD.

Of course, spending on DVD software is driven by rapidly rising DVD hardware penetration. By the end of 2002, over 18 per cent of Western European television households had at least one DVD Video player or recorder. This is more than double the figure recorded at the end of 2001 and represents an installed base of nearly 29m DVD Video player/recorders. In the main Central European territories, the penetration rate was just 2.6 per cent by the end of 2002; across the whole of Western and Central Europe it was to 16.5 per cent by the end of 2002.

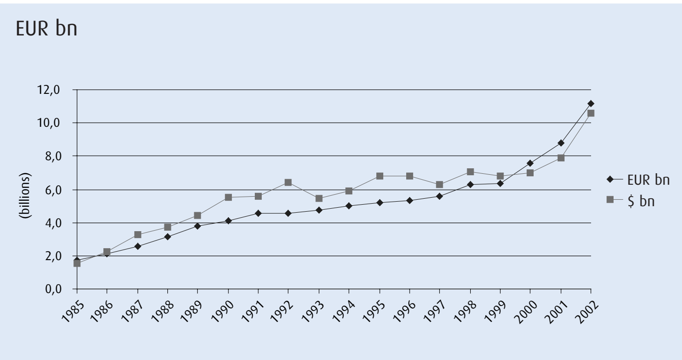
DVD takes centre stage

For the first time, Western European consumers spent more on buying and renting DVDs than VHS cassettes in 2002. This was primarily a retail phenomenon; VHS remained the dominant format in the rental sector in every territory analysed. However, the shift towards DVD at retail level was so significant that by the end of the year overall spending on DVD was more than twice as much as overall spending on VHS.

Further east, however, the pace of growth was more measured. Over two-thirds of consumer spending in the combined territories of Croatia, Czech Republic, Hungary and Poland was on VHS in 2002.

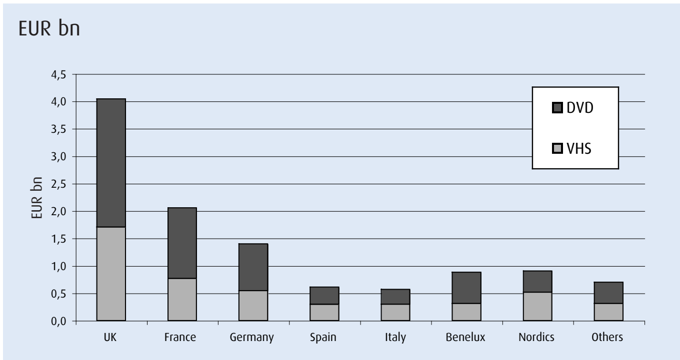
The growth of DVD was good news for video distributors, too. Distributors' revenues from retail DVD in Western Europe overtook those from retail VHS by nearly 50 per cent in 2002. This happened despite the fact that the number of units of VHS and DVDs shipped to consumers was very similar at 254m and 263m units respectively

Total Western European consumer spending on video software 1985-2002



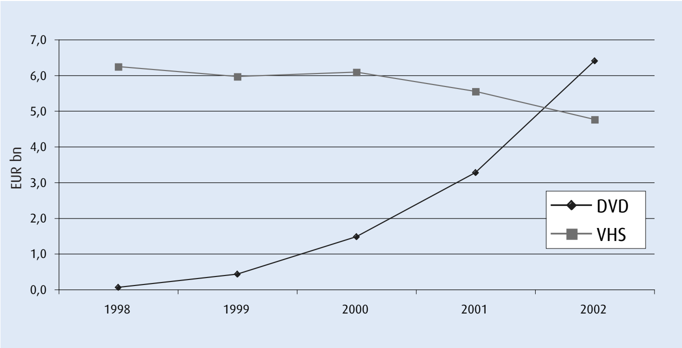
Source: IVF/Screen Digest

Consumer spending in different territories for VHS and DVD 2002



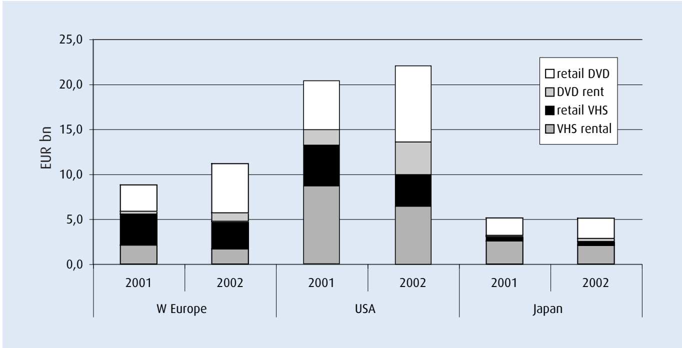
Source: IVF/Screen Digest

Consumer spending on VHS and DVD in Western Europe 1998-2002



Source: IVF/Screen Digest

International consumer spending on video software 2001-2002



Source: Screen Digest/Adams Media Research

and is a reflection of the fact that despite ongoing price reductions, DVDs remain significantly more expensive than VHS cassettes.

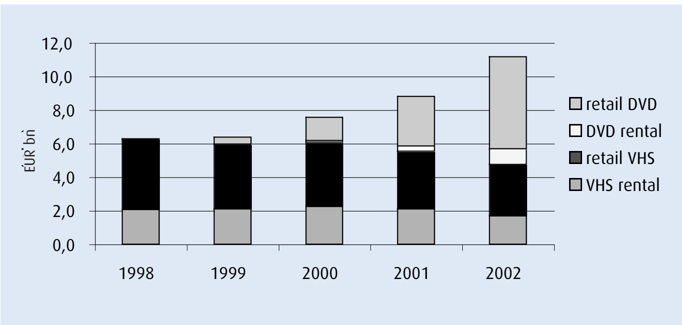
Meanwhile, the rental sector is becoming less and less important to the distributors' bottom line. Although almost a quarter of consumer spending on video software (24 per cent) was channelled through rental stores in 2002, sales to the rental sector accounted for just 15 per cent of distributors' revenue.

This reflects the fact that the very different business models operating in the rental and retail markets mean that distributors receive a much smaller share of consumer spending on rental than they do of retail spending. On average, about 30 per cent of European spending on video rental is returned to the distributors, compared with around 60 per cent of retail spending. Thus as the balance of spending shifts increasingly towards retail, there is a disproportionate shift in the same direction in distributors' revenues.

Extent of cannibalisation becomes clearer

When DVD was first launched many of its supporters claimed that the format was generating incremental business rather than taking over the existing VHS business. Whilst that may have been true in the early days, there is no doubt now that the analogue format is suffering at the hands of DVD. This is particularly clear in the rental sector where, although the number of DVD rental transactions almost trebled compared to the previous year, total rental activity rose by less than one per cent.

Western European consumer spending on video software by sector 1998-2002



Source: IVF/Screen Digest

There are also signs of cannibalisation in the VHS retail market although they are masked by the massive increase in spending driven by DVD. After years of steady growth the European retail VHS market first declined in 1999. By the end of 2002 VHS volume sales were down seven per cent on the previous year – to 243m units. In 2002, however, consumers bought around 249m DVDs, constituting growth of 104 per cent on the previous year.

Consumer spending around the world

Europe was not the only key market where consumer spending on DVD overtook consumer spending on VHS in 2002. The format reached the same benchmark in the US last year, despite the fact that DVD was launched a year earlier in the US (1997) than it was in Western Europe. Furthermore, in Japan, where DVD was officially launched in 1996, consumer spending also tipped in favour of the digital format for the first time in 2002. So why has the shift to DVD happened faster in Europe than in the US or Japan?

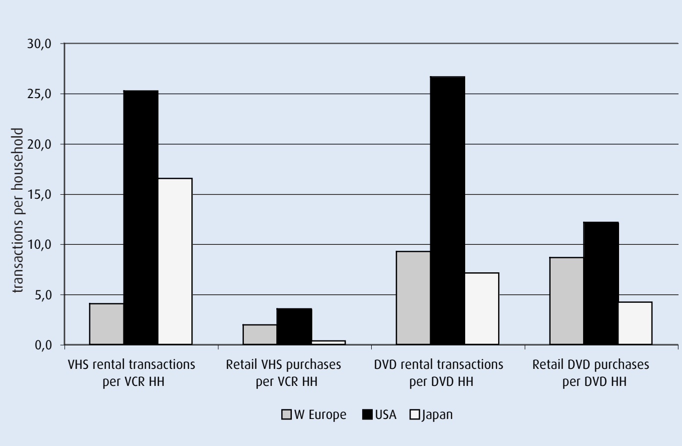
In Japan it is simply the case that a smaller proportion of homes have acquired DVD hardware. Despite its earlier launch, DVD Video player/recorder penetration had reached just 13.3 per cent of Japanese television households by the end of 2002, compared with over 18 per cent in Western Europe. A key reason for this is that Japan lacked a plentiful supply and range of DVD titles during the first few years after launch.

In the US, however, over one third of television households had a DVD Video player and/or recorder by the end of 2002, twice the proportion in Europe. The explanation here lies in the dramatic upturn in interest among European consumers in buying and renting DVDs, compared to their historic levels of VHS activity. Whilst the average American VHS household made over 25 VHS rental transactions in 2002, its European equivalent rented just four times – a ratio of one European rental for every six in the US. However, the average European DVD household rented 9.2 DVDs in 2002 compared with the US average of 26.6 (a ratio of almost 1:3).

On the retail side, two European VHS sales compared with 3.5 US sales, whilst DVD sales were even closer (8.6 European sales compared with 12.1 US sales). As a result, by the end of 2002, the percentage of total consumer spending generated by DVD was higher in Europe (at 57 per cent) than it was in the US or Japan where it constituted 53 per cent and 51 per cent respectively.

Last year was also notable for reaching another industry milestone. Consumers have been spending more on buying and renting

International per household video activity 2002



Source: Screen Digest/Adams Media Research

European and US tie ratios compared 2002

	W Europe	USA	ratio
Average VHS rental transactions per VCR HH	4,0	25,2	1:6.2
Average VHS retail sales per VCR HH	2,0	3,5	1:1.8
Average DVD rental transactions per DVD HH	9,2	26,6	1:2.9
Average DVD retail sales per DVD HH	8,6	12,1	1:1.4

Source: Screen Digest/Adams Media Research

videos than on going to the cinema for over a decade. However, 2002 marked the first year in which consumer spending on DVD alone overtook consumer spending at the box office, both in Europe and in the US.

Software prices continue to fall

The number of retail VHS cassettes and DVDs shipped in Western Europe in 2002 was similar at approximately a quarter of a million of each format. However distributors' revenues from retail DVD in 2002 were nearly twice as high as those from retail VHS. The main reason for this is that the trade price of a DVD is much higher than that of a VHS cassette. The average retail DVD trade price was Euro 13.47 in 2002, while the average trade price of a retail VHS cassette was Euro 7.14.

There are costs related to manufacturing DVDs that do not apply to VHS, such as the compilation or creation of extra material and the expense of authoring. However, the manufacturing costs of a DVD can be significantly lower than those of a VHS cassette and their smaller size can make distribution cheaper. DVD prices are still falling rapidly, due to a combination of aggressive pricing by both distributors and retailers, and the increasing availability of budget-priced releases, but this decline has been accompanied by a reduction of VHS prices too. The average trade price of a retail VHS cassette fell by about six per cent in 2002, while the average trade price of retail DVD fell by approximately 10 per cent, fuelling the increase in DVD retail sales.

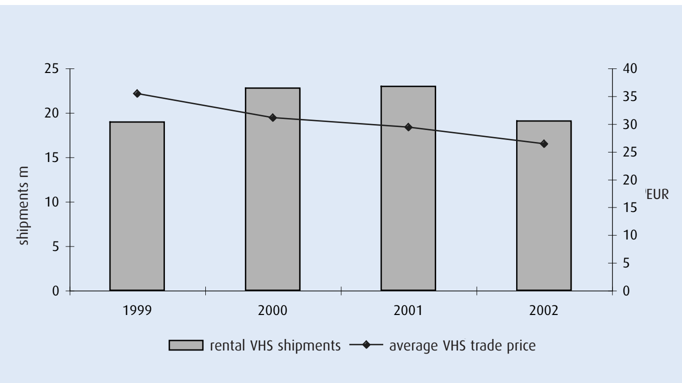
The average trade price of rental VHS software, which has been falling for at least a decade, fell by over 10 per cent in 2002. The fall in prices has been particularly steep in the past three years because of the increased use of copy depth and revenue sharing deals offered to rentailers by distributors. A copy depth deal involves rentailers being offered cheaper-than-usual stock on condition that they increase their usual order. Revenue sharing involves rentailers being offered stock for low (or no) up-front costs in return for sharing the subsequent rental takings with the distributor.

By contrast, the average trade price of rental DVD software has been steadily rising since the launch of the format, reflecting the increasing number of DVDs released for rental at a premium price (in line with VHS rental trade pricing). This issue is intrinsically linked with the issue of DVD rental 'windows'.

Windows – shut or open?

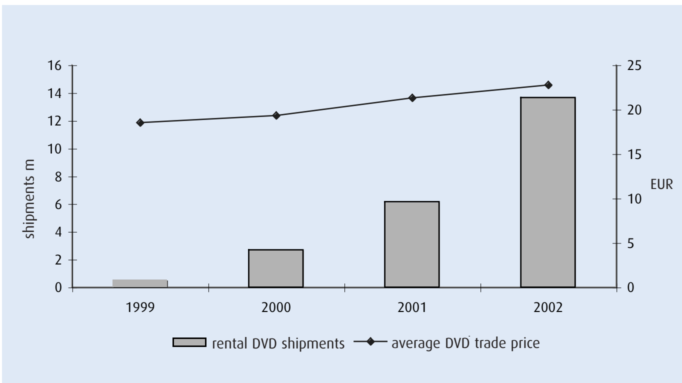
Over the last few years, DVD has brought a fundamental change in the way that distributors release rental and retail video product to the market. Instead of continuing the existing 'video rental window' which applied to most VHS releases, some distributors such as Warner and Columbia, which wanted to boost take-up of DVD, opted instead to release titles on retail DVD 'day and date' with the VHS rental release. As a DVD rental business developed they also permitted the same discs to be rented, as long as this was not

Western European VHS rental trade prices v VHS shipments 1999-2002



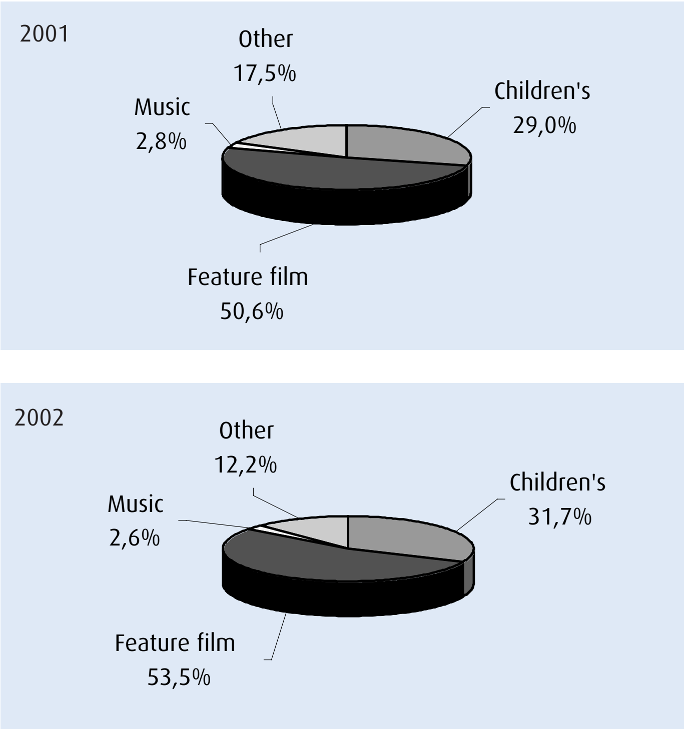
Source: IVF/Screen Digest

Western European DVD rental trade prices v DVD shipments 1999-2002



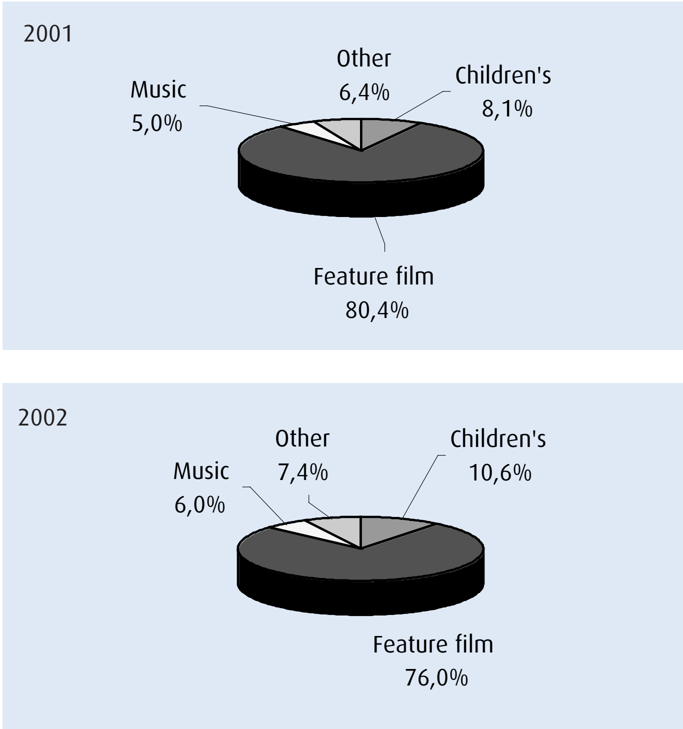
Source: IVF/Screen Digest

Western European retail VHS market by genre



Source: IVF/Screen Digest

Western European retail DVD market by genre



Source: IVF/Screen Digest

prohibited by local regulations. In the case of a prohibition on rental of retail discs, rentailers would pay a premium price for rental discs as they were used to doing for rental VHS cassettes.

However, as the DVD rental sector grew, the distributors were keen to increase their share of revenues from it. Several distributors experimented with DVD rental windows and premium pricing, but others were concerned that delaying the DVD retail release might damage their core DVD retail business.

Maturing DVD market prompts genre shifts

In 2002, the market share claimed by feature films, the dominant genre on DVD, fell from 80.4 per cent to 76 per cent according to Screen Digest analysis of available data. At the same time children's programming increased its share by 2.5 percentage points to 10.6 per cent. The market share of music and 'other genres' - which includes TV series, documentaries and special interest titles such as sport and fitness – rose slightly. The rise in the sale of non-film genres reflects the wider range of titles now available in the European market as a result of the changing demands of a more mainstream audience.

Feature film still dominates the VHS market too and the category grew by about three percentage points in 2002 to 53.5 per cent. Children's titles increased their share by a similar amount to the rise seen in children's programming on the digital format - 2.7 percentage points. The incredible popularity of Warner's first "Harry Potter" title boosted growth in the children's categories on both formats. The rise in this genre would have been even greater but for the fact that the title was categorised as a feature film rather than a children's title in the UK, the largest European video territory.

It is expected that the market share of non-film software will continue to rise as the range of available DVD titles increases. However, feature film will remain the dominant genre category for the foreseeable future.

Cost of piracy

Piracy, including copying of physical products and the creation of pirated copies from screenings, as well as online downloading of material and peer-to-peer file swapping, presents an increasing threat to the film industry. According to the Motion Picture Association, by the end of 2002, the estimated level of piracy was highest in many of the key Central European countries, partly due to their proximity to Russia, which is a major source of pirated material. In each of these territories piracy levels were higher for DVD than VHS, as was the case in all territories in this study except Italy, Greece and Hungary. In Spain and Croatia the levels of piracy were similar on both formats. The fact that DVD piracy levels are higher than VHS piracy levels in most territories reflects the fact that pirated DVD is more profitable.

RETAIL VHS UNITS SOLD

	2002 (m)	2001 (m)	% change
Belgium	6,8	5,8	17,0
Denmark	7,5	7,5	0,0
France	46,8	52,1	-10,2
Germany	28,6	31,7	-9,8
Italy	20,5	21,2	-3,3
Netherlands	13,3	9,5	40,0
Norway	4,1	4,0	2,5
Spain	13,2	13,0	1,8
Sweden	8,4	7,9	5,7
UK	79,0	93,5	-15,5
Western Europe	**242,8**	**261,5**	**-7,1**
Croatia	0,1	0,1	5,1
Hungary	1,4	1,3	7,7
Poland	2,3	2,9	-20,7
Western/Central Europe	**248,2**	**267,2**	**-7,1**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

RETAIL DVD UNITS SOLD

	2002 (m)	2001 (m)	% change
Belgium	8,9	4,9	81,7
Denmark	4,2	1,8	133,4
France	51,8	26,4	96,1
Germany	35,5	18,9	87,8
Italy	10,2	5,3	92,5
Netherlands	13,9	4,9	184,5
Norway	2,8	1,6	75,0
Spain	11,9	6,3	88,8
Sweden	3,9	2,7	43,1
UK	89,9	41,3	117,7
Western Europe	**249,3**	**122,2**	**104,0**
Croatia	0,3	0,0	1087,4
Hungary	0,8	0,4	120,0
Poland	0,7	0,7	2,9
Western/Central Europe	**251,3**	**123,3**	**103,8**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

VHS RENTAL TRANSACTIONS

	2002 (m)	2001 (m)	% change
Belgium	15,6	20,8	-24,9
Denmark	14,1	18,1	-21,8
France	33,7	53,1	-36,6
Germany	79,1	119,3	-33,7
Italy	48,1	54,0	-11,0
Netherlands	30,1	34,9	-13,8
Norway	15,6	14,5	8,1
Spain	64,1	92,4	-30,7
Sweden	17,0	18,3	-7,5
UK	125,3	173,8	-27,9
Western Europe	**501,4**	**667,5**	**-24,9**
Croatia	11,5	11,9	-3,0
Hungary	12,8	14,5	-12,1
Poland	8,4	8,1	3,8
Western/Central Europe	**526,3**	**682,5**	**-22,9**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

DVD RENTAL TRANSACTIONS

	2002 (m)	2001 (m)	% change
Belgium	10,9	4,9	124,1
Denmarkı	5,6	1,9	197,0
France	28,8	9,4	206,9
Germany	51,5	15,0	243,3
Greece	7,0	3,4	105,0
Netherlands	20,5	8,3	147,0
Norway	8,3	2,8	200,0
Spain	23,4	6,8	242,2
Sweden	8,8	2,8	213,3
UK	57,0	24,6	131,9
Western Europe	**266,5**	**96,0**	**177,6**
Croatia	2,3	0,4	426,8
Hungary	0,9	0,3	205,0
Poland	0,5	0,4	32,3
Western/Central Europe	**270,7**	**98,3**	**175,4**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE ANNUAL VHS SALES PER VCR HH

	2002 (m)	2001 (m)	% change
Belgium	2,1	1,8	15,5
Denmark	3,7	3,8	-1,4
France	2,4	2,7	-10,4
Germany	1,1	1,2	-10,6
Italy	1,2	1,3	-6,0
Netherlands	2,2	1,6	39,4
Norway	2,6	2,6	-0,2
Spain	1,4	1,4	-0,3
Sweden	2,6	2,5	1,4
UK	3,4	4,1	-15,4
Western Europe	**2,0**	**2,1**	**-8,3**
Croatia	0,4	0,2	67,2
Hungary	1,0	1,0	-1,1
Poland	0,5	0,6	-15,1
Western/Central Europe	**1,8**	**2,0**	**-8,5**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE ANNUAL DVD SALES PER DVD HH

	2002 (m)	2001 (m)	% change
Belgium	13,1	15,6	-16,2
Denmark	8,7	6,9	26,4
France	9,2	9,1	1,2
Germany	4,5	6,1	-27,5
Italy	7,4	7,6	-1,7
Netherlands	12,2	9,2	32,1
Norway	6,8	8,4	-18,3
Spain	6,8	7,3	-6,2
Sweden	6,8	9,8	-31,4
UK	13,3	13,5	-1,8
Western Europe	**8,6**	**9,3**	**-7,3**
Croatia	0,3	2,0	-86,3
Hungary	4,9	3,7	31,6
Poland	5,5	8,3	-33,5
Western/Central Europe	**8,6**	**9,3**	**-7,7**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE ANNUAL VHS RENTALS PER VCR HH

	2002 (m)	2001 (m)	% change
Belgium	4,8	6,5	-25,8
Denmark	7,0	9,1	-23,0
France	1,7	2,7	-36,8
Germany	2,9	4,5	-34,3
Italy	3,0	3,4	-13,5
Netherlands	5,0	5,8	-14,2
Norway	9,8	9,3	5,3
Spain	6,7	9,8	-32,1
Sweden	5,2	5,9	-11,3
UK	5,4	7,5	-27,8
Western Europe	**4,0**	**5,4**	**-25,8**
Croatia	33,2	43,0	-22,7
Hungary	9,4	1,1	759,4
Poland	0,3	0,2	54,5
Western/Central Europe	**3,9**	**5,2**	**-24,0**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE ANNUAL DVD RENTALS PER DVD HH

	2002 (m)	2001 (m)	% change
Belgium	16,1	15,6	3,4
Denmark	11,7	7,3	60,8
France	5,1	3,2	58,5
Germany	6,5	4,9	32,5
Greece	19,1	21,3	-10,4
Netherlands	17,9	15,6	14,7
Norway	20,2	14,4	40,0
Spain	13,5	7,9	70,0
Sweden	15,3	10,2	50,2
UK	8,4	8,1	4,7
Western Europe	**9,2**	**7,3**	**26,1**
Croatia	4,8	37,6	-87,3
Hungary	6,5	2,9	128,8
Poland	3,1	7,5	-58,3
Western/Central Europe	**9,2**	**7,4**	**24,8**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE CONSUMER PRICE OF RETAIL VHS CASSETTE

	2002 (m)	2001 (m)	% change
Belgium	10,0	11,9	-16,4
Denmark	12,8	12,7	0,8
France	14,0	13,6	3,0
Germany	11,5	12,1	-5,5
Italy	9,8	10,2	-4,6
Netherlands	8,0	8,6	-6,7
Norway	15,2	13,2	15,4
Spain	10,6	9,5	10,6
Sweden	10,2	10,4	-1,5
UK	15,0	15,3	-2,3
Western Europe	**12,6**	**13,2**	**-4,0**
Croatia	12,7	13,0	-2,3
Hungary	8,8	9,7	-9,4
Poland	6,9	6,4	8,0
Western/Central Europe	**12,5**	**13,1**	**-4,0**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE CONSUMER PRICE OF RETAIL DVD

	2002 (m)	2001 (m)	% change
Belgium	21,5	23,9	-10,0
Denmark	22,5	22,4	0,5
France	23,0	26,6	-13,5
Germany	20,1	21,5	-6,7
Italy	19,0	24,4	-22,0
Netherlands	20,4	23,9	-14,7
Norway	21,8	20,1	8,2
Spain	21,2	21,0	0,8
Sweden	18,5	19,4	-4,8
UK	23,1	25,2	-8,2
Western Europe	**21,9**	**24,2**	**-9,1**
Croatia	21,4	21,8	-1,9
Hungary	22,0	23,4	-6,0
Poland	15,8	18,8	-15,9
Western/Central Europe	**21,9**	**24,1**	**-9,2**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE CONSUMER VHS RENTAL PRICE

	2002 (m)	2001 (m)	% change
Belgium	3,0	2,8	7,1
Denmark	4,7	4,0	17,0
France	3,4	3,4	0,0
Germany	2,8	2,6	4,0
Italy	3,3	3,1	6,7
Netherlands	3,0	3,0	1,0
Norway	5,3	4,2	26,0
Spain	2,5	2,0	26,1
Sweden	4,4	4,3	1,0
UK	4,2	4,0	5,1
WesternEurope	**3,4**	**3,1**	**7,3**
Croatia	1,2	1,1	3,3
Hungary	1,6	1,4	14,3
Poland	1,6	1,6	2,1
Western/Central Europe	**3,3**	**3,2**	**5,1**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.

AVERAGE CONSUMER DVD RENTAL PRICE

	2002 (m)	2001 (m)	% change
Belgium	3,0	3,0	0,0
Denmark	4,7	4,3	9,4
France	3,4	3,4	0,0
Germany	2,7	2,4	12,7
Greece	1,5	1,5	0,0
Netherlands	3,0	3,2	-6,0
Norway	6,7	5,6	19,0
Spain	2,5	2,2	15,5
Sweden	4,4	4,3	1,0
UK	4,6	4,2	7,7
Western Europe	**3,5**	**3,3**	**6,1**
Croatia	1,2	1,2	1,9
Hungary	1,9	1,8	2,9
Poland	2,1	2,4	-10,2
Western/Central Europe	**3,5**	**3,2**	**6,5**

Source: IVF/Screen Digest
Note: countries listed above are IVF members. Regional totals include some countries not listed.