

# Ten Reasons Digital Cinema Takes Time

by Soren Eilertsen, Ph.D.

*Digital projection, the biggest technology advancement in movie exhibition in half a century, experiences a difficult beginning. Moviegoers show little interest while the complexity and implications confound the movie theatre owners. The movie distributors see economic benefits and want immediate and across-the-board conversion. Although digital projection technology gives the consumer superior picture quality and promises new alternative content, the future comes slowly to most of the world's movie theatres. This paper examines ten reasons Digital Cinema takes time.*

Summary Version  
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## ABOUT THE AUTHOR

As President of Kollner Group, Soren Eilertsen has helped numerous clients in different industries activate and align leadership teams around business results and innovation. Clients praise him for his ability to guide business leaders and teams to insights and new levels of success.

Soren works as a business consultant, educator and leadership coach specializing in strategy and organization development. In this way, he helps clients build effective leadership teams, create winning strategies, and obtain success with change initiatives.

Since establishing Kollner Group in 1999, Soren has helped successfully shape the strategic directions and create exceptional results for numerous for-profit and non-profit businesses. He has worked on world-class endeavors and been fortunate to engage with leaders in great organizations such as American Suzuki, AECOM Design, Nordisk Film Biografer, Rand, Paul Allen's Vulcan, Berry Gordy's Motown Museum Project, UC Health System, Polar Air Cargo, Pacific Coast Producers, and MK Sound.

In the Cinema Industry, Soren has more than fifteen years experience from inside movie theatres and in their executive suites. Prior to founding Kollner Group, Soren headed information technology, human resources, organizational development and strategic planning areas as SVP at Pacific Theatres, a company with theatres and real estate in California and Hawaii. As facilitator of strategy, Soren was instrumental in laying the foundational vision that manifests as Arclight Cinemas today. Since then, he has continued to consult to the cinema industry, including most recently as organizer and facilitator of a newly founded European Cinema CEO Network that involves leading cinema chains.

Combining his education as a psychologist with years in corporate executive roles, Soren takes a unique integral approach that enables him to examine a business from its internal leadership, culture and systems as well as from the external customer, market and business value perspectives.

Visit [www.kollnergroupp.com](http://www.kollnergroupp.com) to find out more about Soren Eilertsen and Kollner Group.

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## INTRODUCTION

Over a decade ago, I wrote an article on digital projection technology for the internal newsletter at Pacific Theatres Corporation. In this, I claimed that the digital projection quality was as good as or better than that of traditional film.

As I write this today, only a fraction of the world's movie theatre screens project from digital technology. Although Sony Electronics and AMC Entertainment recently announced an agreement in principle to convert 4,500 screens to digital projection over the next three years, many circuits install digital movie projection equipment in only key locations and even then in only a few auditoriums. Why is this happening to a technology that has the potential to fundamentally challenge industry paradigms and change the programming in movie theatres?

Digital projection will eventually alter industry paradigms. Many of the current industry conventions around cinema booking and the film rental paid to the movie distributor, spring from the limited number of physical print copies of movies on film. A digital movie can theoretically open in all digital cinemas at the same time without any additional cost to the movie distributor, potentially making studios' desire and pressure to "open big" even greater than today. Digital Cinema allows exhibitors to circumvent the movie distributors and book alternative content with new revenue and differentiation potential in the theatres. This threatens the somewhat arcane industry rules of programming and film rental calculations that presently exist between the exhibitors and distributors.

There is a lot of smoke in the industry around Digital Cinema, and it can be difficult cutting through the fog to the underlying issues. At the moment, distractions such as credit-crunch limited funding are real issues, but the fundamental concern causing exhibitors to slowly convert is simply that the business model equation remains unsolved. If we determined the business value for the exhibitor, these issues would all evaporate. Clearly, the VPF agreements in their current form are not the answer from the viewpoint of the exhibitors.

## TEN REASONS DIGITAL CINEMA TAKES TIME

### I. Contribution by Movie Distributors is Not Large Enough

The original contention for digital technology installation was that movie distributors would obtain all the benefits of a digitized cinema world as the cost of film replication and distribution, for the most part, disappear. Hence, they ought to bear the burden of the significant conversion cost involved with the digital projection equipment installation. The distributors finally came to the table and offered proposals to help compensate for conversion costs through what has become known as "virtual print fees" (VPFs).

To eliminate the need for film prints, distributors need *all* movie theatres converted. Their plan seeks to develop pressure by having a majority of movies theatres converted through the incentives of virtual print fees. Until now, the offering has not made sense from an exhibitor business model perspective.

After suffering initially from wishful thinking that the distributors will fully fund the conversion to Digital Cinema, the exhibitors are now left with the reality of an unworkable business proposition.

## **2. No First-Mover Advantage with Lack of Consumer Interest**

Distributors attempt to create a first-mover advantage for exhibitors by threatening to limit the virtual print fee opportunities to the first adopters. Looking at the long list of exhibitors still on the fence concerning digital conversion, the failure of this strategy becomes obvious. It is difficult to imagine the distributors not engaging in negotiations with many of these theatre owners.

Consumers typically drive technology innovations once they understand and have experienced the benefit. New technology that improves the experience and quality for the consumer can create a first mover advantage by providing the adopter with a differentiation in the market place. Although Digital Cinema provides superior picture quality on the cinema screen, the difference between an image projected by film and a digital image is not great enough to spark consumer interest. Without a clear first mover advantage, theatre owners take a “wait and see” approach.

## **3. Expanding the Content Experience Creates Some Opportunities**

Digital technology further enables a couple of known “dimensional multipliers” that alter the audience experience and thereby create new revenue possibility in the theatre. One is digital 3D and the other is a larger screen format enabled by digital manipulation. Studios are releasing a limited slate of new products in 3D digital format and this has required exhibitors to install at least one digital system in key locations. Some circuits are successfully experimenting with a larger screen format that mimics IMAX – or at least what IMAX has attempted to do in some existing movie theatres with a modified smaller format.

Both of these formats enable a surcharge to the ticket price and this extra revenue justifies the investment in digital technology. However, these initiatives allow the conversion of individual auditoriums but not a wholesale conversion of the entire theatres.

## **4. Alternative Content is the Promise of a Future Paradigm Shift**

The movie is the current content that drives the customer to the cinema. Digital Cinema offers the promise to expand the content beyond movies to alternative content. Several circuits already have regular programming with live transmission of sports and other one-time events as well as off-line retransmission of stage productions such as ballet and comedy. Although showing some signs of success, this has not yet become a great revenue driver.

When new content possibilities have potential to drive serious revenue in the theatres – particularly at times in the week and day when movies don’t drive attendance – then the economic model for Digital Cinema will change. Exactly what that content is and what the impact would be on movie distribution is anyone’s guess. But the potential for differentiation and revenue exists and it requires little lateral thinking to imagine some of the possibilities.

Demonstrating how exhibitors look seriously on these possibilities, AMC recently re-opened an office in Hollywood<sup>1</sup> to investigate alternative content.

**What content is being contemplated?**

- Different versions of the same movie (2D/3D, screen size, rating, language, etc.)
- Real-time sports, concerts, and one-time events
- Off-line retransmission of stage and concert productions
- Opening of “made for television” shows and movies
- Educational seminars for business and other audiences
- Rental to business for product promotion or campaign kickoff

## **5. Battle for Control of Movie Theatre Programming**

Who programs the individual movie theatre auditorium, the exhibitor or the distributor? Does the distributor rent an auditorium from the exhibitor or does the exhibitor license (rent) a movie for programming from the distributor? This is not a trivial question because the answer changes who controls the programming in the theatre.

The industry faces arcane rules for film rental calculations, complicating the shift to alternative content and changes in the method of programming. Distributors and exhibitors negotiate the terms of each movie release, and the rules are generally based on one movie booked in one auditorium for a particular period of time.

Digital projection throws new possibilities and therefore new arguments into the traditional programming battlegrounds. Digital Cinema makes it easier to move the product around in the theatre and also to schedule different movies (or content) in the same auditorium throughout the day. It also becomes easier to mix and match other programming, whether this is advertising, trailers, or alternative content throughout the day. But in practice, distributors attempt to place restrictions through security keys added onto the digital content.

The arcane industry rules and paradigms complicate the move to Digital Cinema and so far the “new ideas” coming forth appears to be firmly based in “old thinking.”

## **6. The Fight to Limit Loss of Independent Locations and Product Diversity**

The distributors’ virtual print fees to offset the digital investment go to theatre circuits playing first-run movies. A large number of theatres are small and independently operated. These small independent circuits – sometimes with just one or a few locations – are in danger of being left out since they cannot afford the sizeable investment. The Digital Cinema investment calculation completely overwhelms these theatres, and without digital, they will not continue to function as

<sup>1</sup> The San Francisco Chronicle reported on April 22, 2009, that AMC Entertainment is re-establishing an office in Hollywood after a four-year absence. New CEO Gerry Lopez said that being closer to Hollywood will strengthen the chain’s relationships with the industry and help it as it looks for new types of programming for its theatres.

a movie theatre in a filmless world. In other words, many of them will close. Even with virtual print fees to independent theatres playing first-run movies, the investment calculation is difficult.

In the United States, NATO started a buying group (CBG – Cinema Buying Group) to assist independent theatre operators. In Europe, governments and industry groups are attempting to intervene to ensure a “fair” conversion where both small and large circuits as well as rural and urban locations have the opportunity to participate in Digital Cinema.

Digital Cinema also threatens the market place balance and the product diversity that the limited number of film copies created. Without this physical barrier, digitized content - in theory - becomes available simultaneously to all movie theatres. When mega-plexes emerged in the early nineties, some predicted that more auditoriums would create increased diversity. Instead, the blockbusters now play on many screens. If the blockbusters become available to all movie theatres at once, will they play the same movies and thereby eliminate some of the diversity that exists today? To protect diversity and their own national film production, some European nations provide digital conversion incentives with attached “demands” for diversity in scheduling.

### **7. The Business Equation Remains Unsolved for Exhibitors**

The exhibitor cannot justify the investment for a full digital conversion from a business cost-benefit perspective even with virtual print fee contributions from the distributor. Alternative content only drives additional revenue to justify the investment in at the most a few auditoriums for the larger location.

Movie exhibition is not a technology-driven business, so investing in technology has not been part of the tradition. Until now, most exhibitors believe that Digital Cinema will complicate their operation and not result in any efficiency that could justify the investment. The operation of digital equipment in theory should make it easier to fully automate and oversee than film projection equipment. However, movie theatres spent the better part of the last century optimizing efficiencies around film projection, so introducing digital technology creates, in reality, a greater initial operating cost. Eventually, the benefit of receiving and projecting digital prints will create efficiency opportunities for the larger movie theatre circuits.

### **8. Immature Technology Not Ready for Prime Time**

We are still in the early age of Digital Cinema and the cycles of evolution come at a rapid speed. The manufacturers continue the race to further evolve digital technology so they can place themselves as the technology leader and obtain “first-mover” advantage seeking to hopefully dominate the market. The question for the exhibitor is two-fold: first, when to jump in and invest in the technology, and second, how to calculate renewal costs when evolution or usage may outdate the system in a few years. The innovations typically come slower once we reach a critical mass of installations.

So far, the technology focus of Digital Cinema has been on the projection equipment, with much less energy spent on the back-office operational aspects. The server side hardware and software

is still in an early stage of evolution. NATO's own digital cinema consultant<sup>2</sup> recently questioned whether the server side technology is ready and if this is the time to invest in Digital Cinema since early adopters will face significant upgrades down the line.

### **9. New Integrator Role Threatens Industry Relations**

Into the mix of everything involved with Digital Cinema comes the third-party integrator who is supposed to distribute digital content to the theatres. Third-party integrators also promise to arrange for the maintenance of equipment. Although integrators play an important role in reducing technological complexity for the parties, they also complicate the business relationship between exhibitor and distributor.

Digital Cinema allows movie theatres to show content developed outside the movie studios, which provides new potential revenue streams for the exhibitor and new industry players in the form of content providers and aggregators. As alternative content opportunities grow, third-party integrators stand to become powerful negotiators between the world of digital video content and the cinemas. Exhibitors question whether a new master of their world is in the making with this new intermediary.

Some equipment manufacturers are taking on the role of integrator and some fear that the current distributors will acquire other integrators over time. This will change industry relations and paradigms; exactly how is still anyone's guess.

### **10. No Easy Money in the Economic Crisis**

Perhaps the economic crisis should have been number one on this list. Let there be no doubt that the freezing of the credit markets caused Digital Cinema to lose momentum and made the already difficult investment calculations even more thorny.

However, the economic crisis provided a welcome respite for all players – and the exhibitors in particular – to stop up and make sure that fundamentals get addressed so that sound business principles drive technology decisions.

## **IN SUMMARY**

My intent with this article was to illustrate the complexity of the issues facing the cinema industry. This complexity currently holds the conversion to Digital Cinema in a gridlock. Digital cinema will continue to grow over the next years, but the quick and broad adoption that some dream about will not happen anytime soon unless generous new incentives are put on the table or alternative content creates radical new possibilities for increased attendance and revenue. A paradigm shift is needed to speed up the conversion.

Technology has a way of challenging and changing industry paradigms. It is a great experience to be part of shaping this transformation, at the same time watching the unfolding from the balcony.

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<sup>2</sup> A February 1, 2009 article posted on the Digital Cinema Report website titled "Is Now the Time to Invest in Digital Cinema?" by Michael Karagosian, who has been NATO's Digital Cinema Technology Consultant