

Generating Growth in the Media Industry: Reinventing the Movie Theater Box Office Model

In part four of this series, L.E.K. Consulting (1) outlines innovative ways that casual and social gaming companies are reaching consumers, and (2) spotlights how these successes can be applied to fuel growth in the theatrical exhibition industry.

Movie theater attendance has declined during the past decade due to a decrease in free time and the availability of premium content on home video and over-the-top (OTT) platforms. To compensate, theatrical exhibitors have increased ticket prices and adopted IMAX screens to create premium pricing opportunities. The advent of digital 3D films has also provided theatrical exhibitors with the opportunity to raise ticket prices and differentiate their offerings from home entertainment. Consequently, 3D films have been a major factor in the recent finan-

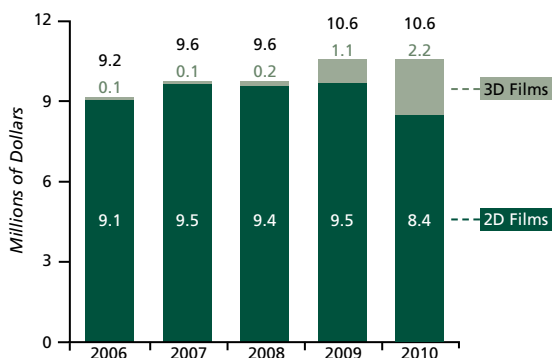
cial success of theaters (see Figure 1). This demand has caused more than a three-fold increase in the number of 3D releases in the U.S. and Canada since 2006.

However, despite the success of 3D films, theater attendance has continued to decline. In its "2010 Theatrical Market Statistics" report, the Motion Picture Association of America (MPAA) states that U.S. and Canada theater admissions are down 15% from a 2002 peak of 1.6 billion. Ticket prices may have also reached a ceiling, and any non-inflationary increase would likely aggravate existing attendance issues. Further complicating matters, theatrical exhibitors' relationships with movie studios have become more strained. Two key issues are:

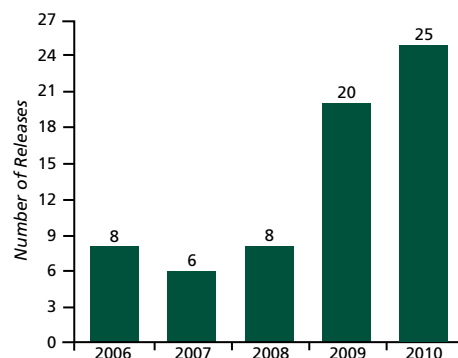
Figure 1

Growth in Digital 3D Theatrical Revenue (2006-10)

U.S./Canada Theatrical Box Office Revenues (2006-10)



U.S./Canada Digital 3D Film Releases (2006-10)



Source: Data from MPAA member studios and IHS Screen Digest regarding 3D box office and release numbers.

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1. Decreased Film Supply: Overall film output has declined from a peak of 633 releases in 2008 to 558 in 2009. As seen in Figure 2, this trend has been driven by a dramatic decrease in independent film releases due to a drop in financing during the recession. Independent (non MPAA members) and major studio subsidiaries decreased their output by approximately 15% between 2008 and 2009. Major studios have also begun focusing more on tentpole features to reduce their financial risk. And L.E.K. sees this trend continuing modestly for the foreseeable future.

2. Shortened Theatrical Windows: Studios are also pushing to reduce the theatrical window by 30- to 60-days in order to move titles to Premium Video-on-Demand more quickly and better support sales of declining home video media, such as DVDs. (Source: *Wall Street Journal*, "The Force of Unity at Cinemacore," 3/28/11.)

Lessons from Social and Casual Gaming

As the novelty of 3D films wears off (and growth is slowing today) and studio strategies work against theaters, exhibitors will need to look to other initiatives to (1) engage customers, (2) increase admissions and (3) drive revenue. Social and casual gaming can provide valuable lessons on how to succeed in this environment:

A. Sell Subscriptions: U.S. theatrical exhibitors can copy some innovators abroad and develop a subscription model for their theaters that provides unlimited access to movie showings.

Similar to the subscription model used by the popular gaming platform World of Warcraft (and similar to Netflix), moviegoers could purchase one-, six- or 12-month pre-paid passes. Subscription models encourage increased attendance, which can raise local market share and per capita revenue.

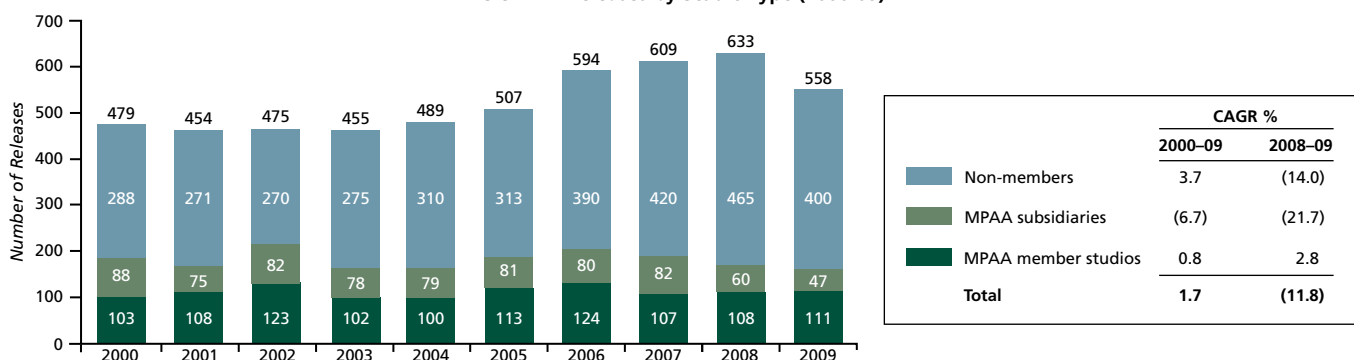
A subscription model creates room for a broad menu of options. A basic subscription may allow unlimited viewings (one per day). Theaters can also roll out tiered subscriptions that they can up-sell to moviegoers, offering additional perks like (1) priority seating for midnight premieres, (2) access to advanced screenings or (3) digital events that offer cast and crew panels. Other subscription packages may be tailored to certain types of films, such as a Family Pack that allows multiple entrants for movies with a G rating.

A key initial selling point would be that the subscription service is for cinephiles and offers them the opportunity to indulge their love of movies. Like other subscription services, it drives attendance (and popcorn sales) by lowering the marginal cost of going to the movies. Ultimately, the subscription service cost structure and offerings can be expanded to target both casual viewers and frequent moviegoers.

B. Get to Know Customers Better: Many social games, such as FarmVille, attract users by offering virtual currency in exchange for participating in advertisers' promotions. This lead-generation model could be applied to enhance existing theater loyalty programs, making them better marketing engines. To have success with this model, discounts and awards must be

Figure 2

U.S. Film Releases by Studio Type (2000-09)



Source: MPAA Theatrical Market Statistics 2009

substantial enough to compel moviegoers to opt-in and provide their personal information.

A recent example of theater chain innovation is AMC's re-vamped loyalty program, AMC Stubs. The program includes improved benefits such as waiving the service fee for online booking sites like Fandango and Movietickets.com, and allows members to track the movies they watch via "virtual stubs" and compile a movie-watching history that can be published on Facebook. While this program will help to keep avid movie fans engaged, it will also provide valuable consumption information that the theater can use to distribute targeted promotions based on the member's location, viewing habits and demographic.

C. Create a Social Environment to Increase Stickiness:

Social games can extend the time a user spends on a social network, increasing the amount of advertising he or she is exposed to – and therefore benefiting both the social network and its advertisers. Similarly, theaters can benefit from increasing moviegoer dwell time. According to Arbitron's 2007 cinema advertising study, frequent moviegoers spent an average of 28 minutes in the theater prior to the start of previews, and infrequent moviegoers spent 24 minutes. Declining attendance means that theaters need to maximize the dwell time of the shrinking audience. Although theaters generate additional revenue by offering attractions such as photo booths and arcade games, these are becoming less of a draw for theaters' key demographic of teenagers and young adults.

Movie theaters should aim to transform from "entertainment centers" to "social centers," providing experiences that encourage viewers to come earlier and stay longer. This strategy could be particularly useful in attracting teens and young adults, who account for 23% of moviegoers and 35% of ticket sales, according to the MPAA, and have been attending fewer movies in recent years. MPAA's theatrical market statistics for 2010 reported that average annual ticket purchases by 12- to 17-year-olds dropped from 7.9 tickets in 2009 to 7.6 in 2010. Ticket purchases by 18- to 24-year-olds fell from 8.4 tickets in 2009 to 7.0 tickets in 2010. Theaters could improve the attendance of this demographic by providing free Wi-Fi in a lounge-like setting that mimics the atmosphere of a coffee shop, or by adding

theaters employing the "living room" concept pioneered by Landmark.

D. Develop Products for Underserved Audiences: A key appeal of social games is that they provide users with an opportunity to participate in a community of people who share some of their interests. A key appeal of social games such as CityVille and Café World is that users can customize their interactions so that only friends can access their network. Theater demographics and viewing habits vary by location, and the ability to customize the content screened in underserved communities would greatly benefit exhibitors.

Unfortunately, today there is a dearth of appropriate niche content for certain locations. There are few Hispanic-oriented films to serve Hispanic communities. Despite the success of "Blindside" and the "Passion of Christ," there are few faith-based films to serve select communities in the Midwest and South. One method of obtaining and distributing these targeted films would be to source them directly instead of renting copies from studios. Regal Cinemas and AMC have already set up a joint venture, Open Road Films, which has placed them in the film distribution business.

Historically, theatrical exhibitors have not been able to make significant changes to their business model due to a power imbalance that favored the movie studios. Now, studios are planning a fundamental change in their distribution model, favoring dissemination through Premium VOD, at potentially great cost to theaters. To counter impending losses, exhibitors should seize the opportunity to use lessons learned from social games to implement fundamental changes in their business model. In the long run, these ideas can improve revenues and exhibitors' negotiating position with studios.

L.E.K. has demonstrated experience helping theatrical exhibitors develop and implement new growth models. For additional insights or further detail on how these ideas can help your business, please contact L.E.K.

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