Preface

About This Guide

Interactive media, an entirely new form of information and entertainment delivery, permits the user to become an active part of the delivery process. Several industries that are involved in the collection, creation, and distribution of engaging "media rich" content to inform, educate, and entertain are exploring delivery of interactive media, packaged media and electronic networks.

Whether it is called "multimedia," "new media" or "interactive media," the delivery must permit the user to interact either locally or over a remote network. *Emerging Distribution Models for Consumer Interactive Media* focuses on packaged commercial interactive media for consumers, available through retail and other marketing channels. It summarizes the primary distribution issues affecting developers today. It also identifies the issues affecting the delivery of electronic information over online networks.

To understand the industry practices for interactive media, we explored several important industry models. The distribution models include those for videogames, movies (Hollywood), music, software, books, home videos, and television. Of these, the movie, and television distribution models currently pertain to the delivery of entertainment without interactivity and thus are not considered in this guide.

Each of the five industries—videogame, home video, music, book, and computer software—has evolved its own business practices, and distribution patterns. Each has its own terminology, product packaging, legal procedures, and marketing strategies. Each is experiencing new competitive pressures and opportunities, and expanding product offerings and distribution channels. As each industry explores digital media, products, sales, and marketing techniques will merge into the business and distribution model for interactive media.

Focus of the Guide

This guide describes distribution issues from the developer's point of view. Although many developers are also publishers, developers need to know about distributor agreements with publishers and retailer agreements with distributors in order to make sound business decisions.

This guide is divided into three sections: *Strategies for Consumer Title Distribution* written by Joanna Tamer of S.O.S., Inc.; *Interactive Media Distribution Models* written by Robert Aston of Market Vision and S. Swaminathan of Golden Light Imagery; and Appendices A-D.

Section One presents an overview of the current state of distribution of CD-ROM consumer titles and offers guidelines for title developers, publishers, distributors, and retailers in devising their business development, product planning, and distribution strategies.

Section Two defines the common ground of the videogame, home video, music, book, and computer software industries and presents the emerging distribution model for interactive media products.

Section Two will identify successes, failures, and lessons learned for each industry. The discussion will position the reader to understand the longer-range changes resulting from communication technologies that permit the distribution of interactive media. Title design elements and the importance of "content demand" are identified to help developers focus on the important issues in meeting consumer expectations. The last chapter presents guidelines that will concern developers over the next two years. These will help the developer understand the demands of the market and identify steps necessary to ensure a place for them in this rapidly emerging marketplace.

Section Three includes contributor background information, reprints of Digital Media articles, a resource directory of worldwide distributors, sources and supporting documents, and a subject index.

Methodology

Section One contains the observations of S.O.S., Inc., which is involved in the daily development of distribution strategies for interactive media developers, publishers and distributors and retail. Section Two builds on the expertise of publishers and distributors through direct interviews with more than 14 leading publishers and distributors involved in the evolutionary process of establishing the market for interactive products.

Interviews were conducted with industry leaders to gauge the current market for interactive products, to determine emerging patterns of distribution, and to identify distribution and consumer buyer profiles. The interviews provided an industry consensus that validates the workings of each of the five industry models, the emerging interactive media model, and the future possible direction for online delivery and interaction.

This guide reflects the combined experiences of

- publishing companies such as Living Books, Electronic Arts, and DK Publishing
- distributors such as Ingram, Merisel, Baker & Taylor, and Brøderbund
- project consulting experts such as
  - *Market Vision* (understanding interactive media applications, market trends, and distribution issues)
  - *Golden Light Imagery* (understanding the impacts of content on consumers and developers and adding insight into the home video experience)
  - *S.O.S. Inc.* (understanding of interactive media distribution issues)

Section One

Strategies for Consumer Title Distribution

Business Development

Product Planning

Distribution Strategies

Strategies for Success

Produced by
Joanna Tamer, S.O.S. Inc.

While the information represented in the following section is accurate to the best of S.O.S. Inc.'s knowledge, neither S.O.S. Inc. nor Apple Computer, Inc., guarantees its accuracy or assumes any responsibility for any business damages or investment decisions that might result from reliance on it. The information contained in the following chapters on product capabilities, technological acceptance, distribution models, future sales volumes, and future product prices reflects the opinions of S.O.S. Inc. and does not reflect the opinions of any other organization or individual, including but not limited to Apple Computer, Inc.

Section One

Strategies for Consumer Title Distribution

Multimedia developers and publishers operate in a rapidly changing market filled with risk. Although the early pioneering days are nearly over, true market growth is setting in, and a different kind of risk dominates the industry. Until a critical mass of CD-ROM computers was reached in the home market (roughly defined as 10 million units) by year end 1994, simply surviving and producing products for distribution through computer retail, mail order, and bundling was the key to success. Now there is pressure from converging industries, consumer demand for higher production value, and competition from other title developers and publishers for shelf space and distribution partners.

The consumer multimedia industry is a convergence of multiple industries: software, video, audio, and books. Each industry brings a different orientation, language, and deal-making structure to the convergence, often resulting in conflict. At this time (1994), this emerging industry is in flux and major shifts happen every six months. The first shakeout among developers and distributors is already occurring. New funding sources are emerging, but they are difficult to find. There is a lot of hype. Although there is a great deal of information and there are many conferences, uncovering the strategies required to build a successful business venture remains difficult.

Section One offers a window into the world of CD-ROM distribution, a key element for the success of any CD-ROM publishing company. Developers and publishers must understand how to distribute and sell their products through four distinct channels: retail, bundling through original equipment manufacturers (OEM), catalogs, and direct mail. A successful mix includes all of these channels. This section covers basic business development and product-planning strategies, as well as the intricacies of current distribution contracts.

Business Development

Distribution strategy is the basis for all business and product planning. When publishers develop their distribution strategies for retail in the United States, with its tight margins and reserve funds, they find that it leads them directly into their business development strategy and product planning. They understand how little money they have available for product development and for the building of business infrastructure for sales and marketing. To succeed in the emerging industry of CD-ROM title development and publishing publishers must integrate their strategies for business development, product planning, and distribution.

Determine Your Role: Developer, Publisher, or Copublisher

You need to understand the risks and responsibilities of each role (developer, publisher, and copublisher) in the industry. There is little margin for error in this rapidly evolving marketplace. Figure 1 breaks down the roles, risks, and responsibilities of consumer retail distribution.

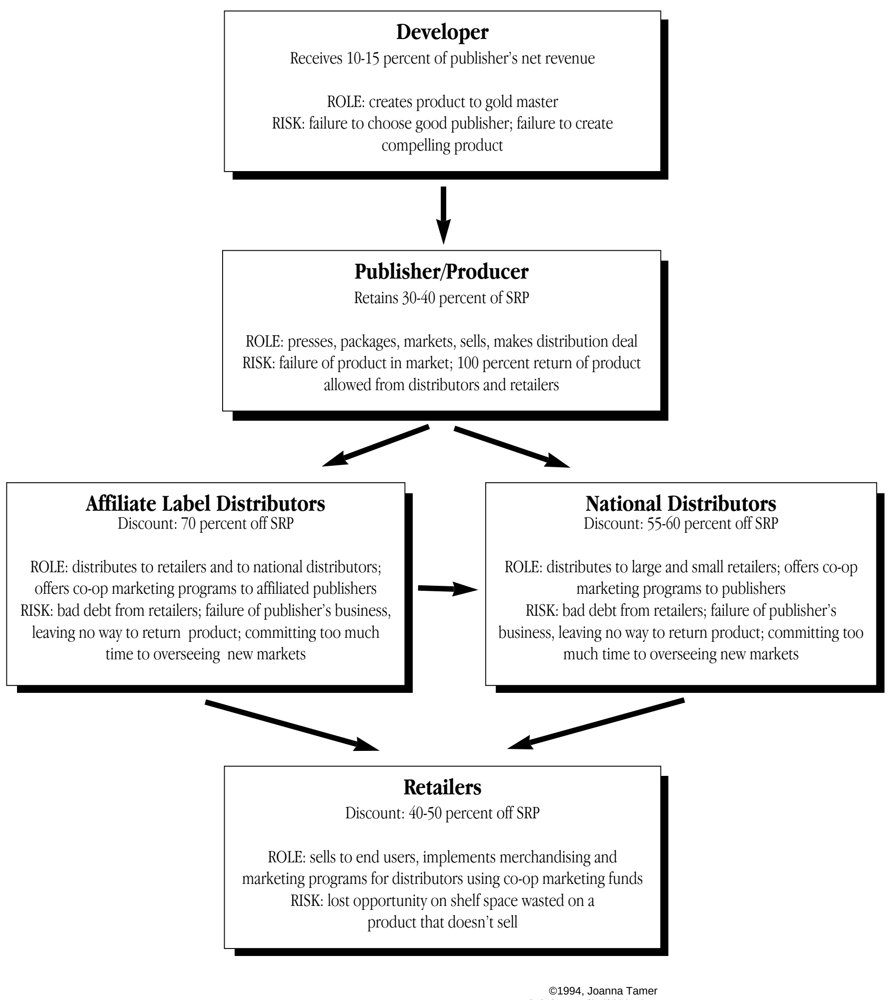

Figure 1. Retail Distribution

A developer's responsibilities include the development of a multimedia title through the gold master, the final CD-ROM disc from which all the others will be copied. The developer looks for a publisher to take the finished product to market, and sometimes to fund its development. The developer risks creating a product that is not compelling to the consumer and choosing the wrong publishing or distribution partner.

A publisher's responsibility is to press and package the disc; to market the product through trade shows, advertising, and public relations; to sell the product through direct channels; and to arrange for its distribution through retail outlets, mail-order catalogs, and OEM deals with other products (hardware, other titles, books, and video and audio products). In a copublishing deal, the developer brings the product to a copublisher, which functions as a publisher but also puts its logo on the product along with the logo of the development house. In many cases the publisher is also the developer. In other cases, the publisher acquires products from developers and brings them to market.

Publishers risk that the product will fail in the market because of failures in product quality; decisions in sales, marketing, pricing, and positioning; choice of distributor; or ability to leverage the distributor's skills or assets. Publishers accept the most risks, since 100 percent of the product in the channel can be returned to them.

The role of any distributor (affiliate label and national) is to warehouse and ship products to retailers and to serve as the "banker" in collecting receivables from major chains and a vast array of smaller, independent retailers. The distributor carries the credit burden, administers the infrastructure for invoicing and collecting receivables from the channel, and pays the publisher 60 days after receipt of goods, although it may take the distributor 90 to 120 days to collect. Distributors risk bad debts from retailers.

Distributors are not responsible for marketing or selling products, although they may provide certain cooperative marketing programs for the use of publishers.

Many affiliate labels are distribution divisions of larger companies that also have publishing divisions. These divisions are managed separately, although the published product is ultimately distributed through the affiliate label division.

Distributors risk selecting publishers that will fail, leaving them with inventory that they cannot return. They might also risk devoting too much time and overhead in "handholding" small publishers, committing too much attention to emerging markets, or carrying too many small retailers that fail to make payments.

Know Your Market

To understand the current consumer market, including its installed base and projected growth, you need to keep up with current market research and competitive analysis information. The installed base of computer-based CD-ROM drives in the home market has been growing exponentially. A January 1992 CES panel on distribution announced that there were 900,000 drives in homes. At the end of 1993, the installed base of computer-based CD-ROM drives in the home was 3.6 million, of which 2.4 million were MPC, according to the Multimedia PC council, and 1.2 million were Macintosh, according to Apple. Projections for the installed base of computer-based CD-ROM drives in the home range from 8.8 million to 10 million by the end of 1994.

Maintain competitive information on the playback installed base, products in your genre, and those similar to your planned release. It is important not to be the third or fourth title similar to other visible titles. Retailers will not tend to take the third product in a given genre (for example, dinosaurs), much less the fourth, unless the publisher or distributor has enough influence with the retailer to obtain shelf space for the product. Shelf space, though growing, is still limited for CD-ROM packaging, and the hundreds of titles released every year are competing for that limited shelf space. For this reason, it is crucial to understand what products are currently on the market targeting what age group in which genre, so that your product does not mimic an existing product.

Understand Your Legal Obligations

Control all legal issues, copyright, and clearances on your content. Make certain that the rights to all materials to be included in your titles have been cleared. Determine who owns the electronic rights, and obtain the rights to republish that content on your multimedia title. Do not assume that any product is in the public domain without verification. It is important to work with an attorney or a rights clearance consultant on these issues.

Obtain proof that any material you include from third parties is truly theirs to license, and obtain a signed agreement clearing you of any liability. Get work-for-hire releases in legal form signed by all contractors. Make certain that the products they develop under the work-for-hire agreements are totally in your control and will carry your copyright for all languages, territories, electronic platforms, and other media (video, books, etc.).

Prepare for rental in the video channel. If you copyright your title as a software product, you will need to gain a separate set of clearances from all creatives involved in order to rent the title through video stores. Video rental (and sell-through) in these stores is one of the few previewing mechanisms available for CD-ROM titles. For this reason, and to reach the video store audience, it is useful to rent titles as long as your title cannot be "completed" or exhausted in the typical rental period of a weekend. Make certain your agreements with contributors to your title allow you to rent the finished title. (See article, "An Interesting Legal Wrinkle: New Media and the Copyright Act" in Appendix B.)

Product Planning

Product planning is critical. It is important to understand what other competitive products are already on the market, their price points and target markets, their distribution strategies, and their success in the marketplace. You should plan a series of products that will reuse your engine (the basic computer code that drives the multimedia program) and template (the programming configuration into which the content is placed for interaction with the engine and graphical user interface).

After determining your business development strategy, identify funding sources; design your engine and template; and create marketing, sales pricing, and distribution plans and production schedules.

Identify Funding Sources

Development projects are generally self-funded, at least through the stage of the first prototype. Some titles are funded the same way independent films are, by small groups of private investors (this is called “titles funding”). Other development houses and publishers are funded with venture capital. It is important, when seeking funding, to have a finished demonstration prototype; a business plan with a strong emphasis on marketing and distribution; and a request for funding that clearly states the amount required, the projected break-even date, the moment you anticipate profitability, and the investors’ projected return on investment. Plan ahead to acquire enough capital to sustain the business through your second and third titles.

Design Engine and Template In Line With Product and Distribution Plans

Design a series of products that reuse the engine and template to amortize the costs of their initial development. Create each series in the same genre with a consistent look and feel for brand-name recognition so that your distributor or publisher can successfully bring the products to market with its focused expertise in your genre. (Most publishers and distributors are not yet broadly experienced across different genres such as games, edutainment, children’s titles, and reference.)

One of your first decisions is whether to build a proprietary engine or to use an off-the-shelf authoring tool and build proprietary extensions that apply to your products. Obviously it costs more initially to develop a proprietary engine than to use standard software. However, owning your own engine can eliminate the need to pay royalties as your products are sold and may give you more control over changes in technology.

Reusing your first engine and template significantly reduces the cost of your second and third titles. Furthermore, publishers and distributors tend to specialize in certain genres of titles, such as children’s, general edutainment and lifestyle, reference and storybook, and games. Building a series of products in the same genre, with a similar “look” derived from the reuse of the engine and template, allows you to place an entire product series with a distributor who understands that market segment. Building a series of titles also establishes an image and reputation for your product label.

Prepare your products for both the United States and international markets[1]. Design the products for internationalization: Design and write the code in those modules of text that need to be translated separate from the codes that control the graphics, animation, and so on. This will allow programmers to pull the "strings" for localizing text, pulling out the modules for translation. Leave 30 to 50 percent more space for expansion into other languages. Avoid American slang and cultural references when planning for distribution into multiple countries.

Create Marketing, Sales, and Pricing Plans

In January 1992 one pioneering CD-ROM title publisher released two titles that taught a lesson in pricing. Anticipating the downward momentum in pricing seen today they released a children's storybook at $29. They priced a content-rich survey of art at $149. Both prices were mistaken: the art survey was too expensive for customers, and the children's book was too cheap for customers to perceive value, or for retailers to make their profit margin.

When the art title was reduced to $99, and the storybook raised to $49, both sold tens of thousands of copies. Today (1994) the art title sells for $49, and the storybook for $29! Remarks one of the publishers, "While you may be a visionary, you had better pay attention to the marketplace!"

It is no longer adequate to release your product into distribution and depend on your distributor's cooperative marketing programs to launch your product, as it was in the pioneering years of multimedia. It is now necessary to develop extensive marketing and sales plans to promote your product through direct sales, retail, OEM deals, mail-order catalogs, and public relations. It is important to commit significant funds for each product's marketing and sales programs, usually 10 to 12 percent of projected sales revenue.

Consider diversifying titles into ancillary products that can be merchandised, such as cartoons, comic books, videotapes, magazines, figurines, and books.

Pricing for titles other than encyclopedias has fallen from a top suggested retail price (SRP) of $129 in 1992 to a top SRP of $49 planned for the Christmas selling season of 1994. "Street prices," the actual cost the end user pays at retail, is generally 15 to 20 percent lower than SRP. Prices will continue to fall, settling ultimately between $19.99 and $49.99, with the majority of products priced at $29 or $39 SRP. Publishers of some titles may attempt a higher price for unique content, and other titles will be priced as low as $9.99.

Become skilled at effective networking. At this time, the multimedia world is open and filled with shared information. It is important for you to know as much about the industry as possible, because it makes major changes and shifts at least twice a year as the market grows and adapts. Join the International Interactive Communications Society (IICS) in your city. Go to major trade shows such as MacWorld, The Consumer Electronics Show, Intermedia, Digital World, New Media Expo, Digital Hollywood, and Multimedia Expo. Meet other publishers and share information with them to climb the learning curve. Read the trade journals: *Digital Media*, *New Media Magazine*, *Wired*, *Morph's Outpost*, *CD-ROM Professional*, and *Multimedia World*.

The publisher's marketing activities are critical to the success of the product. No one is responsible for the marketing except the publisher, which has the greatest risk in assuming 100 percent return privilege from distributors and retailers, who are interested mostly in creating rapid inventory turns and volume sales of the product. If the product does not sell in its initial months, it will be returned, and credibility will be lost among a publisher's partners and in the marketplace. Once a product is released into distribution, and other products are in development, most of a publisher's attention will be consumed with marketing. The true secret of success in selling products in the mass market and the entertainment field is marketing.

[1] For more information on localization, refer to the *Apple Guide to Producing Localized Multimedia* produced by International Contact for the Apple Multimedia Program.

Determine Production Scheduling

As a developer, it is important to build into your financial plans the time and costs for the learning curve of product development in this new technology. Rarely is a first product completed on its anticipated schedule. Missing the Christmas selling season—for which you must ship products to your distributor by the middle of September—can create a serious reduction in revenue for the first year of a product's life, because often more than 40 percent of your year's revenue is generated from October through January.

An average edutainment title (travel, lifestyle, children's learning, art, strategy games, etc.) will sell for at least two years, perhaps longer. The product life of a twitch game (a "shoot-'em-up") is generally 6 to 16 weeks.

When porting a product to another platform, it is important to add to your team someone with extensive experience in that platform, someone who can judge the difficulty of porting and the level of required rewriting.

Most development projects require more time and money than originally planned. The primary steps—content creation or acquisition, integration development, distribution, and marketing—must each be carefully planned for timing, costs, and unexpected overruns. Sometimes those overruns occur because of the time needed to acquire the content, to obtain legal clearances, or to obtain principal photography from a major source. In these cases, the development schedule slips through no fault of the development team.

As a developer, build a team (in-house or with contractors) with enough technical resources to create a series of products on time and on budget. Bring out several products per year after the initial products are completed. As a publisher, build a significant infrastructure for marketing and selling the number of products the development team will produce.

Understand the retail calendar. Products must ship into distribution no later than September 15 to arrive in the stores for the Christmas buying season. Figure 2 depicts the calendar and corresponding events of the consumer market cycle.

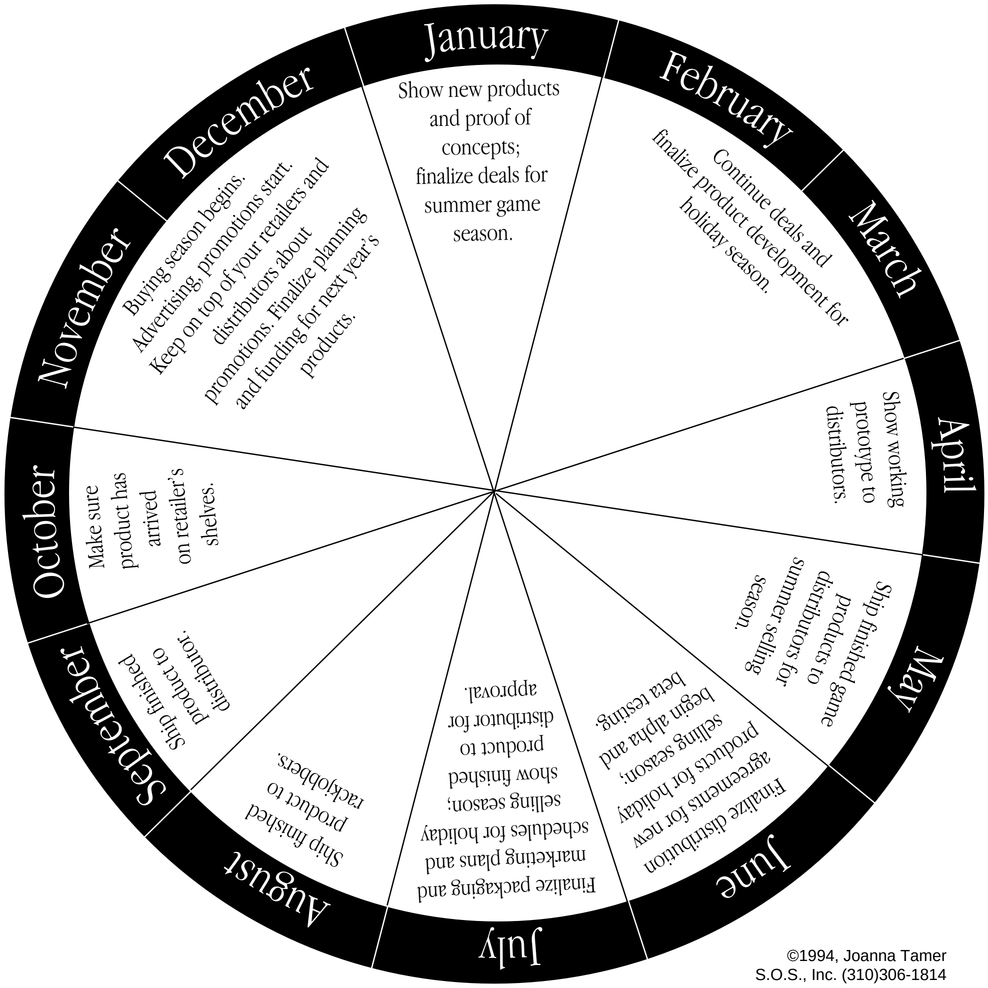

Figure 2. Consumer Market Cycle Calendar

Prior to September 15, product planning should be done by the end of the previous year, product funding should be in place by January, and product development must begin no later than February 1 if you are using an existing engine or template. If you are building a new engine, begin your initial project at least a year before the release date. You should have a prototype ready to show to buyers by April.

As in the film industry, there is a summer release season and a Christmas release season. Often products released in the summer are games and products targeted to children out of school. More general products are released at Christmas time. There are strategies for year-round product releases, but strong marketing programs are put into effect again every fall.

As the market broadens and the channels become more efficient, titles will be released on a year-round basis more like records and books.

Distribution Strategies

Your distribution strategies must work in conjunction with your role as developer or publisher. The size of your business infrastructure, marketing team, and financial resources will determine your ability to choose an affiliate label deal, a copublishing deal, or a national distribution deal. If you are a small developer with a finished product, do not need a significant advance, and would like more flexibility and control in your publishing deal, you may choose a copublishing deal. If you are a company with a significant balance sheet, a series of products or a plan for a series of products, and sufficient cash (at least $100,000) and expertise to launch each product, you can choose a national distributor and retain more of your margin and control. If you are a small or medium-sized publisher and need an advance for pressing and packaging, you might choose an affiliate label deal.

Choose the Right Publisher or Distributor

The choice of your publishing or distribution partner is crucial to the success of your business. It is important that your partners have a proven track record in the consumer multimedia industry, that they be able to return clear sales reports to you, and that their successful track record is focused on the genre of product that you are bringing to market. Try not to bring your first product to a publisher or a distributor who will use it as an entry into the consumer CD-ROM title market. Do not bring a product of one genre to a specialist in another genre. Check references, and investigate the following issues:

- Investigate the publisher's or distributor's track record in your genre. Five major industries will ultimately distribute CD-ROM titles: video games, home video, music, books, and software. Retail channels available to these industries include mass merchants and discounters, the software retail channel, the consumer electronics channel, the office and warehouse channel, superstores, video rental stores, music stores, and bookstores. Your publisher or distributor should be established in most of the channels that you need for your product.

- Evaluate the distributor's sales force, or "feet on the street." It may be critical to your success in retail distribution. Ask the following questions: How many members of the sales force are there? How long have they been with the company? What is the turnover rate? What other product lines do they carry other than the distributor's? How much clout does the distributor have with this sales force? Does the distributor have an exclusive arrangement with this sales force? What channels do they penetrate (software, computer superstores, video, audio, bookstores, mass merchants, department stores, supermarkets)? How highly regarded is the distributor's product line by those sales representatives?

In January 1992 one new publisher with four titles selected a leading affiliate label distributor. Retailers would not accept their products directly, saying they couldn't stock-balance the inventory against only four titles. The affiliate label carried 60 products and offered easy stock-balancing.

By 1994 the affiliate label was carrying over 200 products, and small publishers couldn't gain the affiliate's attention, much less any notice in retail. Sometimes even excellent new products would not reach the shelves.

The publisher, now with more than 14 products, hired a channels marketing specialist to work with the affiliate's sales force, but following the usual sales drop in February after the Christmas shipping season, sales did not return to their expected level. It was clear that the publisher would need to build a sales team to represent the product line directly to retail.

This effort requires a great deal of cash. While looking for a partner with cash to build the direct sales infrastructure, the publisher was acquired (based on its product line and distribution experience), gaining both a channels infrastructure and a good deal of cash.

"Choose your distributor for the programs and advantages it offers, and watch the changes in distribution carefully," says the publisher's CEO.

Demand routine sales reports. There is no way for you to control your destiny in the field without such reporting. Distributors will offer 30-day reports or quarterly reports. Quarterly reports are not adequate for publishers who are responsible for marketing and sales. It is important to receive 30-day reports, and to understand the depth of those reports. Developers may receive quarterly reports with their royalty payments, as they are less directly involved with marketing decisions.

Ask the following questions: What infrastructure is in place to create these reports? If the publisher has an immediate question, how quickly will the distributor respond with an answer from the field? Does it merely track sales per stock-keeping unit (the SKU or part number)? Does it track sales per SKU per retail chain? Does it report sales per SKU per chain per store location? All of these depths of reporting are available from retailers, if the distributor has set up a tracking system and paid the retailers to generate the reports.

- Check references of potential distribution partners. Obtain a list of all of the publishers currently handled by the distributor, and ask for some who have allowed their contracts to lapse. Call as many as you can, including all of the ones who have not renewed their contracts. Ask them about the strengths and weaknesses of this distributor, and particularly determine why a publisher has left the distributor.

- Prepare a distribution strategy that mixes retail, direct mail, bundling, and catalog sales. Retail may account for as much as 70 percent of a title's sales. Macintosh titles are sold more heavily through mail order than through retail channels, while retail is the primary channel for MPC titles. Bundling may return you the smallest payment (perhaps 50 cents or $1 per unit) per product, but tens of thousands of products may be sold. Major distributors who bundle include Software Toolworks and Compton's New Media. Hardware manufacturers who bundle CD-ROM titles include Apple, Creative Labs, Packard Bell, and IBM. Direct selling will bring you the highest margin, and should be considered as a significant element of your distribution strategy. Catalog sales bring a slightly higher margin than retail but are subject to competition from similar products in the same catalog (some of which may be developed by the catalog publisher). Leaders in third-party catalogs sales include Educorp and the warehouse catalogs (PC Warehouse, MacWarehouse, CD-ROM Warehouse).

Negotiate Your Publishing or Distribution Deal

The choice of the deal, like the choice of the publisher or distributor, is specific to your role, skills, and goals. No deal or partnership is the same as any other, and all are highly negotiable. It is important to know which clauses of the contract can be negotiated, and which cannot, a subject that is addressed later in this section.

It is important to get negotiation help when searching for your first publisher or distributor. It is difficult to get above the "noise" of all the other title developers to gain the attention of a publisher or distributor. It can take months of searching, meeting, and negotiating to complete your deal if you do it alone. Distribution contracts are unfriendly and difficult, since they minimize the risk of the distributor. Network among your colleagues to find experts in distribution strategy and multimedia law. Attend seminars at major trade shows and speak to the experts.

The publishing or distribution deal is crucial to the success of the business and must be understood in the beginning of the planning process. There are four different types of publishing and distribution deals: publishing, affiliate label distribution, national distribution, and copublishing (sometimes also known as collaborative or cooperative publishing). The type of publishing and distribution deal chosen will tell you how much money is left from distribution to create and market the product. This information will drive your development strategy, marketing plans, budgets, and funding requests. Although publishing and distribution deals are finalized after the product is completed, it is important to resolve these key issues early in the product planning and development stage.

It is important to remember that all deals are negotiable, and that these guidelines are rough rules-of-thumb.

The publishing deal

The developer who brings the finished product to a publisher will receive about 10 to 15 percent of the product's suggested retail price (SRP) less the cost of goods, which is called "publisher's net revenue". The publisher assumes the risk and responsibility for the success of the product, and the control of its future.

The national distribution deal

To gain the best advantage in their negotiations, publishers should understand the details of retail distribution agreements and their terms and conditions for both affiliate label deals and national distribution.

The national distributors include Baker & Taylor, Ingram, and Merisel. Merisel targets the software channel, while Baker & Taylor specializes in the consumer, education, and library markets. Ingram is more focused on business titles than on the consumer market. Baker & Taylor and Ingram have divisions distributing to the software, audio, video, and bookstore channels, although recently Baker & Taylor reduced the activities of their software division. In general, national distributors offer more margin points but less support. It is wise to understand how to leverage retail distribution before signing with a national distributor.

To release your product through a national distributor (Baker & Taylor, Ingram, or Merisel), a publisher needs about $100,000 per product in market development funds (MDF) to launch and market each product, as well as a marketing and media plan to convince the distributor that the publisher understands its responsibilities in marketing and sales. In this deal the publisher gives away 60 percent of SRP as a margin to the distributor, plus cooperative marketing fees (a private fund set up from a percentage of sales) which range from 5 to 7.5 percent. The distributor withholds a reserve fund, usually 15 to 20 percent of the distributor's invoice amount to the publisher to cover the return of defective or unsuccessful products. National distribution deals tend to last one year and give the distributor right of first refusal for all other products released during the term of the contract.

The affiliate label deal

Affiliate label distributors are the middle tier between the publisher and national distribution. Affiliate label distributors also sell directly to the major retail chains. They specialize in gathering small publishers who do not have the finances or experience to leverage a national distribution deal. They tend to provide more support and attention, thus accelerating the publisher's learning curve. It is important to watch the quality of this support and attention as the affiliate labels grow larger and handle more and more products. At this time (1994), there are many affiliate label programs. A short list includes Electronic Arts, Brøderbund, Compton's New Media, Davidson, Maxis, and new entries from the home video industry such as Trimark and Technology Dynamics Corporation (TDC).

An affiliate label distributor takes a 70 percent margin off SRP and brings your and other small publishers' products directly to the retail market and to national distribution. The contracts require co-op and reserve funds similar to those of the national distributors', but they last two years or longer, tying up all of your products during that time in their right of first refusal .

Copublishing deals

A copublishing deal returns a higher payment to the developer in a simpler structure model in which a distribution fee (usually 60 percent) is subtracted from the SRP. The cost of goods (for pressing and packaging) is then subtracted. The remaining "publisher's net" is divided between the publisher, who is responsible for marketing, and the developer, who is releasing the product to the copublisher. A higher percentage, usually 70 percent, goes to the marketing partner. The logos of both publishers appear on the box and on the screen. This deal generally creates a closer relationship between the copublishers.

The Contract

The developer generally signs the publisher's contract, and the publisher signs the distributor's. Many of the basic terms and conditions of distribution contracts are similar, but there are differences in every contract and differences between the offerings of publishers, affiliate label distributors, and national distributors.

Rights granted

Most boilerplate publishing and distribution contracts ask for the rights to distribute the electronic version of the products listed in the appendix. This must be changed to specify the platforms and operating systems that are currently available. Rights should be granted for the products listed, for example, on Macintosh and MPC computer platforms only.

Because we have so little information about how the set-top box technology and superhighway will be defined in the future, this limitation is essential. What if the leading set-top box is considered a Macintosh or MPC platform someday? Without this specific definition, the publisher is giving the distributor the rights to all its products in any and all electronic forms in which it may publish them.

Rights to ancillary merchandising products, such as T-shirts, figurines, mugs, and so on should be withheld from this agreement and negotiated separately. These merchandising rights can have great value, and they can be offered to licensing specialists (toy companies, audiocassette producers, video producers, etc.) in a separate deal if the CD-ROM is successful.

Rights clearances

It is the developer's responsibility to clear the rights to all content prior to releasing the gold master to the publisher. The publisher's contract will specify that the rights have been cleared by the developer and that the publisher will assume no liability in this regard.

Territory

The first draft of the contract will ask for worldwide rights. At this time (1994) publishers and affiliate label distributors rarely reach any markets beyond the United States or North America. Of the national distributors, Baker & Taylor, through its book publishing division, has only minimal distribution in Europe, while Ingram and Merisel have worldwide distribution channels. Restrict the right to distribute products to those territories where the publisher or distributor has market share. It is always best to retain the distribution rights to international markets until your partner is ready to penetrate them with a localized product and has developed an international strategy. At this time leading international markets include Japan, Germany, France, the U.K. and Australia.

Term of contract

Publishers often ask developers for publishing rights for several years, or until the expiration of the developer's rights to use the products' content.

Most distribution contracts are signed for more than two years: specifically for two Christmas buying seasons (October through January) plus the following first calendar quarter. Often the first draft of the contract asks for three years. This can be negotiated to two years (plus the first quarter), but rarely for less time. National distribution is often signed for one year.

Exclusivity

Publishers expect exclusivity for producing, marketing, promoting, selling, and distributing the developer's product through all sales channels, catalog sales, OEM deals, and direct sales. This is because the publisher is completely responsible for the product's success. Affiliate label distributors demand exclusivity through all retail channels for the product they accept from publishers. This is nonnegotiable. Rights to bundling and catalog sales are negotiable, and direct selling is the responsibility of the publisher.

National distributors do not ask for exclusivity, although they may offer better terms and conditions to receive it if the publisher has enough market development funds to successfully launch the program through distribution at the national level. Somewhat better terms can be gained by granting exclusivity to a national distributor requesting it.

Right of first refusal

Publishers, affiliate label, and national distributors request the right of first refusal on any products that are produced and released to the market during the term of the contract. They generally request a 30-day period in which to evaluate the product and make an offer to the publisher for its distribution rights. The terms of the contract for new product are identical to the terms of the original agreement. This indicates the importance of choosing the best publisher or distributor initially.

This condition is generally nonnegotiable. In recent agreements, contracts have been signed for products in a publisher's particular product line, along with the right of first refusal for other products in that line. As publishers develop more varieties of products and create different product lines, they can seek a distributor suitable to each product line or genre. This is a recent development. All the basic terms and conditions of the contract, including right of first refusal, apply to each product line.

Right of last look

Certain publishing and affiliate label contracts will request the right of last look. In these contracts the right of last look commits you to offer your partner the right to publish or distribute a product after waiving his right of first refusal.

That is, your partner has seen the new product, refused it, and returned it to you to place it with another partner (a new publisher or distributor). Upon finding a new partner and settling those terms and conditions, you are obliged to bring the product and the deal back to your first partner, who can match the current offer and keep the product.

It is unwise to accept this condition, because it hinders your ability to “shop” the product to other partners. This clause is rarely seen in national distribution contracts for new media.

Noncompetition

Certain publishers and affiliate label distributors may agree not to carry products that compete with their partner’s product lines. The larger ones will probably not allow this clause. Certainly the national distributors, with their broad product mix and multiple sources for titles, cannot offer this agreement.

Market development funds for launch

Affiliate label distributors do not necessarily require the publisher to commit market development funds for the launch of the first product. But more and more they favorably view products that have significant launch marketing budgets. National distributors expect a significant MDF fund to accompany a first product release. It is best to have at least $50,000 available for the launch of the first title (its initial three or four months), followed by an equal amount to sustain marketing through the course of the first year. This certainly is expected by national distributors. Co-op marketing funds are insufficient for the marketing of titles, and there are no co-op dollars applied to a first title that has generated no revenue.

Advances

Developers often receive advances from their publishers to support the development of a product. These are advances against future royalty revenue and can range from a few thousand dollars up to $100,000. The advances are to be returned by the developer who does not deliver a finished golden master. The advance is deducted from the royalty revenue once it begins.

An advance on royalties is often available from affiliate label distributors for pressing, packaging, insuring, and shipping the product into the distributor’s warehouse. These advances can reach $50,000. It is not good form to accept the advance to create a marketing budget. It is important to remember that a significant advance may delay a publisher’s royalty revenue from the sales of the product for four to six months. National distributors will rarely even discuss an advance.

Margins

Affiliated label distributors begin negotiating their margins at 70 percent off SRP. National distributors begin negotiations at 60 percent off SRP. These margins are negotiable, based on the amount of money available to launch and market the product. Large companies with significant marketing budgets may begin their negotiations with an affiliate label distributor at 65 percent and drive it lower. The distributor's interest in the product is the key.

The affiliate label distributors require the additional 10 percent because they are the intermediaries selling up to national distribution at 55 percent off SRP and selling directly into retail at 50 percent. Affiliated distributors run their business on the margin differential of 15 percentage points when they sell to national distributors and 20 percentage points when they sell to retail distributors.

Remember that neither level of distributor makes most of its revenue on the margins. Distributors make much of their revenue and profit on the activity of their cooperative marketing programs, in which they offer advertising and promotional programs to all of their partners, minimizing the partners' expense while making a significant profit on each marketing program once the operational overhead and infrastructure are established to deliver such programs.

Co-op marketing funds

The contract for both kinds of distributors calls for a minimum of 5 percent participation in their co-op marketing program. This 5 percent is withheld from the receipts the publisher receives from the distributor (that is, the 30 percent of SRP, which is the publisher's gross receipt from the distributor).

This co-op money is set aside for the publisher to use in marketing and in advertising programs developed by the distributor for "push" marketing, which pushes the product into the retail channels. Co-op programs include space in the distributor's catalogs, direct-mail promotions to retailers, special promotions through retail chains, and the use of space in the distributor's trade show booth.

The 5 percent co-op fund is insufficient to drive the marketing of a multimedia title. A good rule of thumb is to commit 10 to 15 percent of a title's revenue to marketing, advertising, and public relations. The co-op dollars are simply part of this marketing budget. Although the distributor's co-op programs are highly cost-effective, the publisher should not depend entirely on these programs. It is important also to create an independent "pull" marketing plan, which pulls customers into the stores (advertising to customers, in-store specials, discounts, and coupons), as well as direct-mail programs to reach the specialized channels or vertical markets targeted by a publisher's product line.

The returns and defectives fund

Most distributors require a fund to be set aside for returns and defectives. This fund ranges from 10 to 20 percent of the invoice amount received by the publisher from the distributor. The percentages of these funds have been increasing in the last several months, as the distributors seek more safety from the failure of small publishing companies. The negotiation usually settles between 10 and 15 percent.

Some national distributors pay less attention to this clause and instead control their inventory to balance carefully with the accounts payable due from their publishers, never allowing the publisher to become overextended in its payables. This practice places a greater burden on the administrative overhead of the publisher, who may need to ship product to the national distributor on a weekly basis.

Payment terms

Most publishers pay their developers on a quarterly basis, net 60 days. Some larger publishers may pay monthly. If an advance has been given, no payment will be received until the advance has been paid down.

Most distributors pay net 60 days from receipt of goods. After the initial 60 days, payments arrive on a monthly or quarterly basis unless the publisher has received an advance. Publishers will receive monthly statements, but no revenue until the advance has been recovered by the distributor.

Freight and insurance

Generally the publisher pays the freight and insurance to the distributor's dock. The distributor then pays freight out to the retailers. The publisher is responsible for the freight charges generated by returns and defectives and for the freight to return defective products to the distributor's warehouse.

Return privileges

In all cases at all levels of distribution, the distributor has 100 percent return privileges to the publisher. Retailers have 100 percent return privileges to the distributor, and those are passed directly back to the publisher, which is ultimately responsible for the product. This means that the ultimate business risk lies with the publisher. The developer does not incur this risk.

Defective products and products that have not sold through the channel to the consumer are subject to these return privileges. Once the product is returned to the publisher, if it is not stock-balanced (see below) the publisher must absorb the cost of the inventory production and find another channel that will accept the product. Other channels include the computer flea market circuit and certain kinds of software bundles that combine aging products with up to 10 other CD-ROMs as an inexpensive package to the consumer. The product is returned to the publisher's warehouse, and the publisher absorbs the return freight charges and the responsibility for the product.

Stock-balancing

Distributors are allowed to exchange or stock-balance products that are not selling for other products in the publisher's line, usually on a dollar-for-dollar basis. Generally this is a simple clause, since the 100 percent return privilege tends to cover stock-balancing discrepancies.

Price protection

The publisher is obliged to notify the distributor of any price increase or decrease with either 30 or 60 days' notice, and to credit forward to the distributor the difference between a new lower price and the price at which the existing inventory was purchased. The distributor is allowed this price protection on returns from the field up to 60 to 150 days.

This is a fair clause. However, a publisher must be certain that the distributor can verify exactly how many SKUs are in the warehouse and in the field (not yet sold through to customers) before the price decrease goes into effect. With this information the publisher can judge the new value of its inventory and manage cash flow. These issues about infrastructure and inventory control and management are more critical than they at first appear.

Audits

Both developers and publishers have the right to audit the books of their partners. Audits are rarely done without a suspicion of discrepancy. They are generally not allowed more often than once every six months. If a discrepancy is discovered, the mistaken partner's firm is liable for the expense of the audit if the error is above a predetermined percentage, usually 3 or 5 percent. It is standard practice to have the right of audit in a contract in which the revenue or royalty stream is based on sales.

Termination

Termination is generally "for cause" upon a breach of the contract that is not "cured" or corrected within 30 days of notification of the breach. This is common. More important would be the addition of clauses that define the behavior of termination, generally called "effects of termination." If such a clause is not in the contract (usually it is not) it is useful to draft one.

Most developers are not offered exit strategies from their contract with publishers until the end of the term of the agreement. Developers can generally terminate their contracts with publishers for nonperformance or nonpayment, which constitute breaches of the contract. Sometimes developers can receive volume sales commitments from their publishers, but usually that commitment is so low that the publisher would not accept the product if it could not easily sell that volume.

It is best to come to an understanding of how both parties may terminate the agreement (even without a breach) and what behaviors they will agree to follow in that event.

In distribution contracts, the effects of termination clause is generally overlooked in the multimedia industry due to the 100 percent return privilege clause, which protects the distributor in any case. In effect, if the distributor wants to terminate its relationship without any legal constraint because of some problem with the product or the publisher, it can simply slow sales and increase returns. This effectively terminates the contract but still ties the publisher to the agreement.

National distributors generally allow for a 90-day termination clause without breach, as long as their return privileges extend to at least 150 days following termination. Affiliate label agreements, however, make no allowances for termination of the contract before the end of term except for breach. This underscores the seriousness of a publisher's first choice of distributor.

Retail Visibility—The Importance of Packaging and Merchandising

Developers should make certain that their publishers have expertise in packaging and merchandising. Publishers that are not strong in this area should obtain the assistance of packaging and design experts, particularly those who specialize in retail.

Package and merchandise your product for visibility in all channels: retail, catalogs, and direct mail. Coordinate the design of the retail box for use in catalogs and direct mail, where a "thumbnail" or "postage stamp" visual of the front of the box will be used in ads and catalog listings.

Packaging of your product for retail is critical to selling off the shelf. The front of the box must capture the attention of customers from at least 20 feet away and induce them to pick up the box and turn it over to the back panel. The back panel must convince them to buy the product. The spine of the box must capture their attention as effectively as possible, given that "face-up" positioning on the shelf may be rare. Use professional merchandisers to package your product for retail.

As the entertainment channels (video and audio stores) become more active, packaging will shift to fit into their preexisting fixtures, shelves, and racks, so it will resemble the packaging of videocassettes and audio CDs. It is likely that the packaging for CD-ROM products will follow the audio CD trend of smaller packaging down to the size of a jewel case. The "long box" of audio CDs is already obsolete. Audio retailers will not refurnish their stores again to accommodate awkwardly sized multimedia CDs. Video stores prefer a box size similar to those of videocassettes.

Bookstores are beginning to carry CD-ROM titles, often shrink-wrapped with books or inserted inside pockets in the books. It is important to design a compelling sleeve and label for the CD in case a box is not used. This sleeve and label design is also effective when a product is bundled. CD-ROM titles sold in bookstores should fit on bookshelves.

These changing and conflicting demands for box, sleeve, and label design make it critical to work with a packaging specialist who can create a company image for your product lines that will be effective in all these cases.

Last year a well-established publisher released a puzzle title in an innovative, playful box—a movable, cube-shaped package whose panels created a puzzle. The design won Second Place in the national Packaging Council Award, but the product didn't sell.

Other cube packages were selling successfully, but this package did not meet consumers' expectations for design and information. The design interfered with the presentation of screen shots and information about the game. The box was too small to accommodate a jewel case, so the disc had only a sleeve, which made the box deceptively light in weight and perceived value. In the end, the box was shrink-wrapped, so customers couldn't play with the moveable panels anyway!

The publisher finally returned to standard box size and information and added a jewel case to create weight. Now the product is selling very well.

Strategies for Success

Because the distribution agreement is a key element in a CD-ROM title's ultimate success in the marketplace, the developer and publisher must plan carefully and obtain the best contract they can negotiate. Several strategies and tactics will support your success:

- Choose the best publisher or distributor for your product line and genre.
- If you are not a brilliant negotiator, hire one with a history of experience in multimedia contracts. Keep in mind that while attorneys understand licensing agreements that create the product they may know very little about how to manage the product in the marketplace or through distribution.
- Understand the roles of all parties involved, along with their risks and contributions.
- Create your product plan to support your distribution strategy, and keep it in line with the amount of development funds remaining after the creation of your distribution and marketing plans.
- Reuse your engines and templates to create additional product lines, thus amortizing the costs of your initial development.
- Do not go forward without adequate funds to complete your title development; if you are publishing your own titles, have enough capital for effective marketing and distribution.
- Create an aggressive marketing plan that goes beyond retail to include alternative strategies such as direct mail to your installed base, bundling, catalog sales, and niche marketing.
- Develop, or hire someone with, sophistication in all the distribution channels—retail, bundling, catalogs, and direct mail.
- Trust your gut instinct, particularly in your relationships with distributors and other partners, but get references. Courtship is a highly advanced art in multimedia, but follow-through is more important. Talk to publishers who have used the distributors you are considering, and interview them in depth. Do your homework.
- Persevere.

Section Two

Interactive Media Distribution Models

Produced by
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While the information represented in the following section is accurate to the best of Market Vision's knowledge, neither Market Vision nor Apple Computer, Inc., guarantees its accuracy or assumes any responsibility for any business damages or investment decisions that might result from reliance on it. The information contained in the following chapters on product capabilities, technological acceptance, distribution models, future sales volumes, and future product prices reflects the opinions of Market Vision and does not reflect the opinions of any other organization or individual, including but not limited to Apple Computer, Inc.

Chapter 1

Current Distribution Models

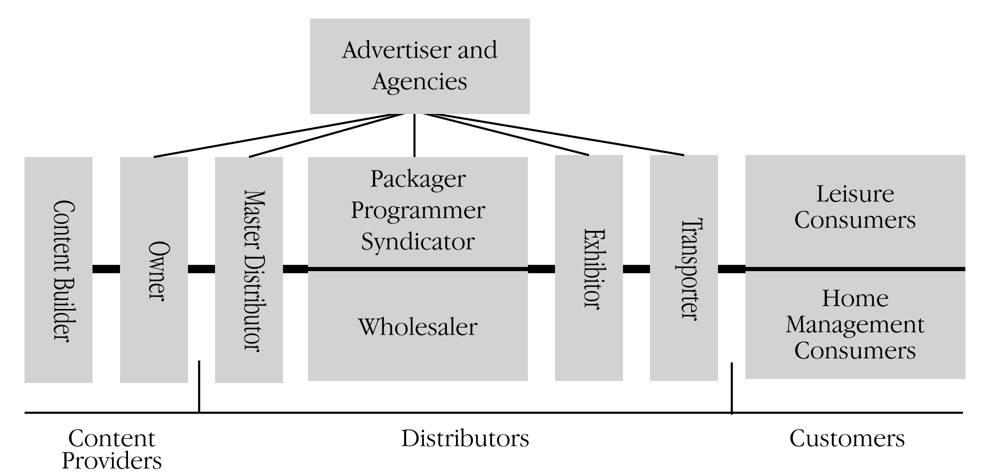
New distribution models are developing for interactive media products. Digital media is becoming the universal standard by which disparate industries based on separate analog standards are finding a common technology. This unification is promoting a marketplace of converging industries.

Emerging industry distribution models permit products to be distributed in more than the one industry that developed them. At one level, for example, microprocessors are permeating everything from washing machines to automobiles and telephones. And at a higher level, music from movie scores is finding its way into videogames.

This guide identifies the elements within the five important distribution channels. The chapters on videogames, home video, book, music, and computer software distribution, discuss issues that affect how various channels will accept interactive media. Chapter 7 describes issues surrounding the creation and delivery of quality content and identifies title design elements to help developers focus on the important issues in meeting consumer expectations. Chapter 8 introduces elements of future electronic distribution channels. The last chapter presents guidelines for developers over the next two years. These will help the developer understand the demands of the market and take the steps necessary to ensure a place for them in this rapidly emerging marketplace.

It is important to understand some underlying distribution structures affecting the industry as a whole. Participants in this distribution structure consist of content builders, wholesalers and packagers, exhibitors, advertisers, and consumers.

As shown in Figure 1-1, the business model is a direct chain between content producer, rights owner, wholesaler, packager, exhibitor, transporter, and customer. Advertisers provide revenue in exchange for product exposure and intersect several points in the business model.



Source: Multimedia Markets and Applications–1994 Annual Forecast, Market Vision

Figure 1-1. Content Distribution Chain

The participants in the creation and delivery of interactive media products and services shown in Figure 1-1 are defined as follows:

- Content providers create information (called software by the entertainment industry). They include artists, writers, programmers, illustrators, and directors. There are three groups of content providers: creators of original works who work independently or "for hire," owners of existing content, and producers who are responsible for assembling the final title.

- Distributors include master distributors, wholesalers, exhibitors, and transporters. Master distributors are at the top of the distribution chain and serve different channels, supplying products to various levels of the path to the consumer. Wholesalers include packagers, programmers, and syndicators. Packagers assemble the content, and make it available to the local distributor (exhibitor). This group may also include duplicators. Programmers assist packagers in assembling different sources of content into a deliverable package. Syndicators create and maintain agreements to increase geographic delivery. Exhibitors are responsible for moving the information and services from content providers to the end user either directly or in association with wholesalers. They are assisted by transporters, who perform the actual delivery. Exhibitors and transporters make up the last step before an interactive media product reaches the customer and thus are directly in contact with customers' expressions of desires and complaints.

- Consumers are the end users for whom the content and services are created.

- Advertisers work to ensure that the members of the distribution chain effectively reach their respective audiences.

Each of the links in the chain plays an important role and shares in a portion of the end-user expenditures and profits. Value chains are diagrams that permit revenue flows in and out of each step in the delivery process to be understood. This helps identify the forces and size of the market components.

Market size depends on the cooperative efforts of all members of the value chain. Understanding the dynamics of value chains makes it possible to model the economics. Value chain models also help clarify market conditions by identifying market shares and revenue flow.

Content providers include both creators and owners who hold the copyrights. Both have a special role to play in the creation and delivery of interactive media content. Table 1-1 illustrates the diversity of content providers. This list continues to grow as owners of content see potential revenues through new packaging and distribution opportunities. The model for distributing this content is in a very early stage of development with portions of each of the five industries contributing experience in the form of market distribution trials.

Content Builders	Companies
Creators	
Authors & scriptwriters	Writer's Guild
Illustration artists & photographers	—
Magazine publishers	*MacWorld*, *Time*
Motion picture industry	Disney Studios, Lucas Films
Videogames industry	Nintendo, Sega, NEC, 3DO, Electronic Arts
Content Owners	
Graphics clip libraries	3G Graphics, ArtBeats, Dynamic Graphics, FM Waves, G&G Designs/Comm.
Film archives	WPA Film Library
Music industry	Bertelsmann Music Group, Sony Music, Creative Support Services, DeskTop Music, Digiffects, Drooling Dog Productions, FirstCom, Music House, Gefen Systems, Killer Tracks, Contemporary Acoustic, CDManhattan Music Data Company, and, Opcode Systems
Photography stock agencies	Eastman Kodak, Comstock, DeskTop Photo, and Image Bank
Repackagers	
Book publishers	McGraw-Hill, HarperCollins, Simon & Schuster, Applied Optical Media, and Matra Hachette
Broadcast television	ABC, NBC, TBS, Discovery Channel, WNET, and Children's Television Workshop
Cable industry	Time Warner
Newspaper publishers	Tribune Company and New York Times

Source: Compiled by Market Vision

Table 1-1. Leading Content Builders and Owners

Artists, writers, musicians, cinematographers, videographers, and other production specialists are combining efforts with computer specialists and subject area experts to form teams for the creation of interactive media projects. The "renaissance" team approach balances technical and artistic skills with subject understanding.

Owners of large archives have a valuable resource and offer opportunities for content creators if copyright licensing can be made easy and affordable. The interactive media production can make use of content licensed from a wide variety of sources, such as museums, news services, public archives, clip art libraries, photography stock houses, clip media, music, and sound libraries, video archives, film archives, and 3D special effects.

Repackagers include traditional print publishers, such as Time Warner, McGraw-Hill, and the *Wall Street Journal*. These companies are investigating new forms of electronic distribution. Suppliers of educational software are also moving to adopt interactive media delivery approaches.

Industries that are well trained in the collection, creation, and use of media are the best candidates to contribute to the development of interactive media. These divide into entertainment, information, instruction, videogames, and media publishing. Each has a wealth of content and talent to contribute.

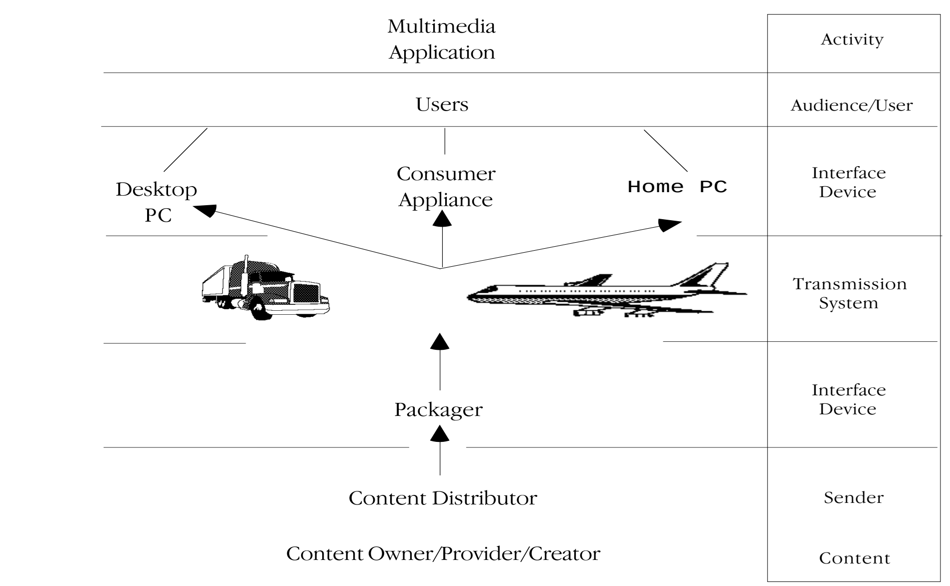
Digital media will enable many new applications and delivery options. Digital media can be delivered in packages designed for retail shelf display and effective use in the home. Electronic delivery is now evolving over computer networks, such as Internet, Prodigy, and America Online, or communications networks, such as public switched telephone networks (PSTN), cable television, or wireless satellite.

Publishing on optical media, specifically CD-ROM discs, has profoundly impacted the design, production, and distribution of information. Early demonstration, such as *Newsweek Interactive*, *MacWorld Magazine Interactive*, and *NBC DeskTop News* have proved the economics of electronic publishing. The cable and telephone companies are also conducting trials to make print, image, film, and video archives available for viewer selection. Though some of these trials may not be successful in the near-term, they will provide valuable insights into the desires of consumers.

Packaged Media Distribution

Digital media can be delivered in packages designed for retail shelf display and effective use in the home. Today physically packaged media, such as CD-ROM and floppy disks are primarily distributed through the existing channels for computer products. These channels are responsible for moving goods and services, adding value along the way through system integration, repackaging, and customer support. The major channels include manufacturer direct, system integrators, value-added-resellers (VARs), value-added-distributors (VADs), mail order, and retail outlets.

The retail channel is a complex interconnection of distribution from several industries. As shown in Figure 1-2, packaged media are delivered through traditional transportation means. Packaging issues, such as standard package size, spine description, and use of color determine the success of the consumer product sales.



Source: Multimedia Markets and Applications—1994 Annual Forecast, Market Vision

Figure 1-2. Delivery of Packaged Media Content

Potential buyers are affected by these design items and actual placement on the shelf. Channel participants consist of a wide variety of outlets, including

- retail outlets like Sears Roebuck and Company
- consumer electronics firms that market video, audio, cellular, and other consumer electronics equipment, such as The Good Guys and Circuit City
- computer dealers, franchisers, and superstores, such as CompUSA
- home video rental stores like Blockbuster Video
- phone stores, such as the AT&T Phone Store
- bookstores, such as Doubleday and Barnes & Noble

Supporting consumer retail channels is a new group of participants called "interactive media" distributors. Traditional distributors in each of the five industries are now exploring business opportunities involving interactive media products. Each is expanding its focus with new staff expertise, and, in many cases, forming new divisions for interactive media products.

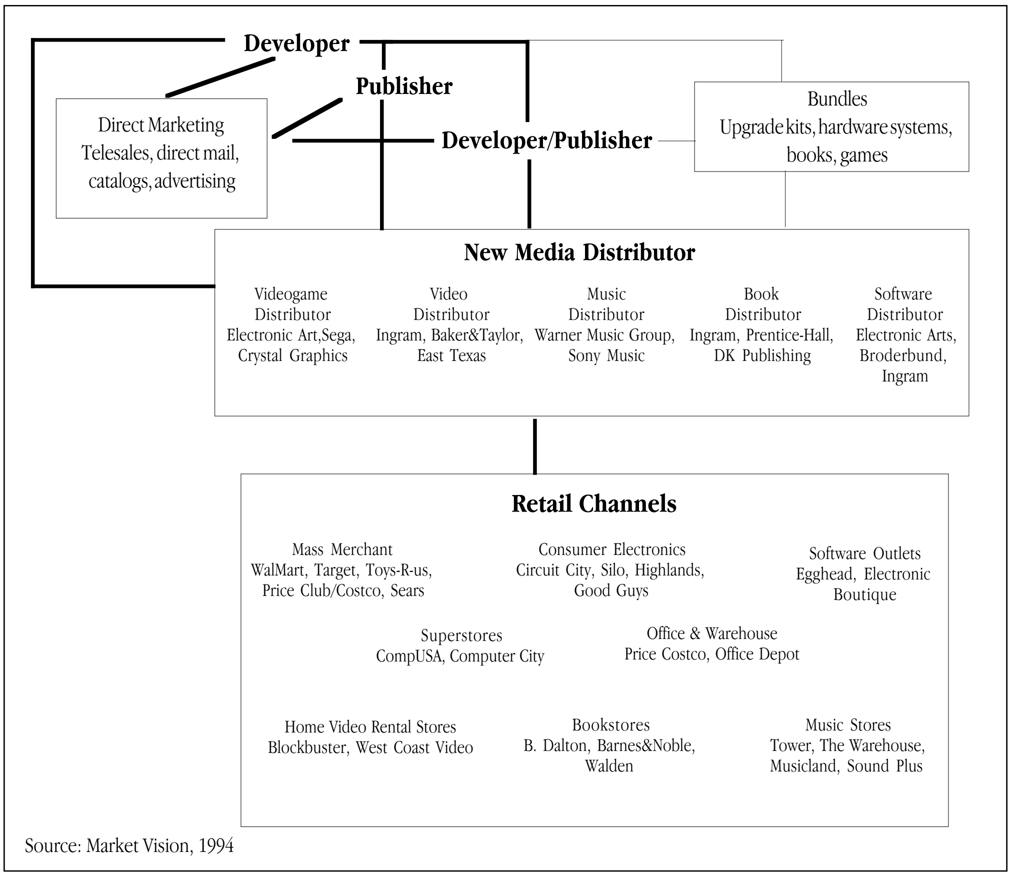


Figure 1-3. Consumer Retail Distribution Channels

As shown in Figure 1-3, interactive media distributors include participants from the videogame, home video, music, book, and computer software industries. Each of these five industries is using its resources to expand current product offerings to include interactive media products and to explore opportunities to cross over into other consumer markets.

A principal problem inhibiting market growth is the confused nature of the media formats and types of players. As the "packaged media" standards struggle of the 1990s is resolved, one universal digital standard will evolve so that digital information can be read on any playback device. Only then will the free exchange of information extend from the printed page to the display screen.

Table 1-2 shows the revenues associated with portions of the value chain in the distribution channel. Only major classes of products are included; the actual size of the industry can be much larger if ancillary products, performance art, and other royalties are included.

Estimated Revenue ($ Billions)	1993	1994	1995	1996	1997
Videogames					
Retail	3.86	4.63	5.56	6.67	8.00
Wholesale	2.70	3.24	3.89	4.67	5.60
Publisher	1.74	2.08	2.50	3.00	3.60
Home Video					
Cassette sales	3.98	4.52	5.02	5.36	5.74
Cassette rentals	8.80	9.59	10.26	10.87	11.51
Wholesale	4.80	5.14	5.50	5.88	6.29
Publisher	3.30	3.53	3.78	4.04	4.33
Books					
Retail	7.58	8.13	8.61	9.06	9.55
Wholesale	6.06	6.50	6.88	7.25	7.64
Publisher	10.73	11.85	12.72	13.45	14.22
Music					
Retail	9.11	9.69	10.19	10.62	11.08
Wholesale	5.45	5.80	6.10	6.36	6.63
Publisher	4.11	4.37	4.59	4.79	5.00
Consumer Software					
Retail	8.66	10.73	13.20	16.20	19.45
Wholesale	6.75	8.37	10.30	12.64	15.17
Developer & publisher	7.56	9.19	11.08	13.38	15.86
Total Consumer Spending	95.90	107.40	120.20	134.20	149.70

Source: MAST, 1993 estimates

Table 1-2. U.S. Consumer Revenue Forecast

Retail sales are currently organized into three principal forms of distribution: traditional computer software outlets, mass-market outlets, and superstores. Indirect sales of software using mail-order catalogs or direct mail campaigns bypass traditional retail outlets. Bundles, which are offered by hardware manufactures with new products or upgrade kits to provide promotional incentives and increase brand recognition, offer another packaging and sales strategy.

The retail channel for packaged media is structured along the following lines:

- Traditional computer software outlets include such national chains as Babbage's; Egghead; and Software Etc. They have provided modest outlets for CD-ROM products since their emergence but are likely to grow in importance.
- Mass-market software outlets have moved to take advantage of sell-through (sale of videotapes) opportunities. Computer and videogame household penetration has increased. The leaders include video chains, such as Blockbuster; bookstores, such as Crown and Barnes & Noble; and record stores, such as Tower and J&R Records.
- Superstores are emerging as traditional computer and consumer electronics retailers begin to refashion themselves as both hardware and software outlets. Among the leaders of this trend are such computer retailers as Tandy/Radio Shack, CompUSA, and PC Warehouse, and such consumer electronics retailers as Circuit City and The Good Guys.

The retail channel dominates sell-through—that is sale of products to consumers—of packaged goods, be it toothpaste, videogames, or home videos. For the near term, sell-through will account for the majority share of interactive media title distribution. Direct marketers will take advantage of the highly focused appeal of individual titles and aggressively pursue retail through direct-to-home sales initiatives. Targeted niche marketing is an important technique to reach highly selective early adopters, especially when price discounting, and other incentives are offered.

Electronic Online Distribution

Electronic online distribution encompasses the delivery over networks of both packaged media and interactive services.

Online delivery will drive the adoption of global standards, permitting the open exchange of digital information without requiring the user to have knowledge of the delivery mechanism. When this is accomplished, a new level of productivity and creativity will exist.

Digital communications over local and wide area networks (LAN and WAN), wireless networks, cable television, and the PSTN (a two-way, point-to-point system carrying the bulk of personal communications undertaken at a distance)—make possible cost-effective electronic distribution of interactive media content. Each method of electronic communications will contend for rights to distribute interactive media programming.

As shown in Figure 1-4, several transmission systems, which are the physical methods of distribution, are available to move content from the builders to the various consumer platforms. The electronic delivery of content will afford an opportunity for all five industries to eliminate the problems of media format associated with packaged media.

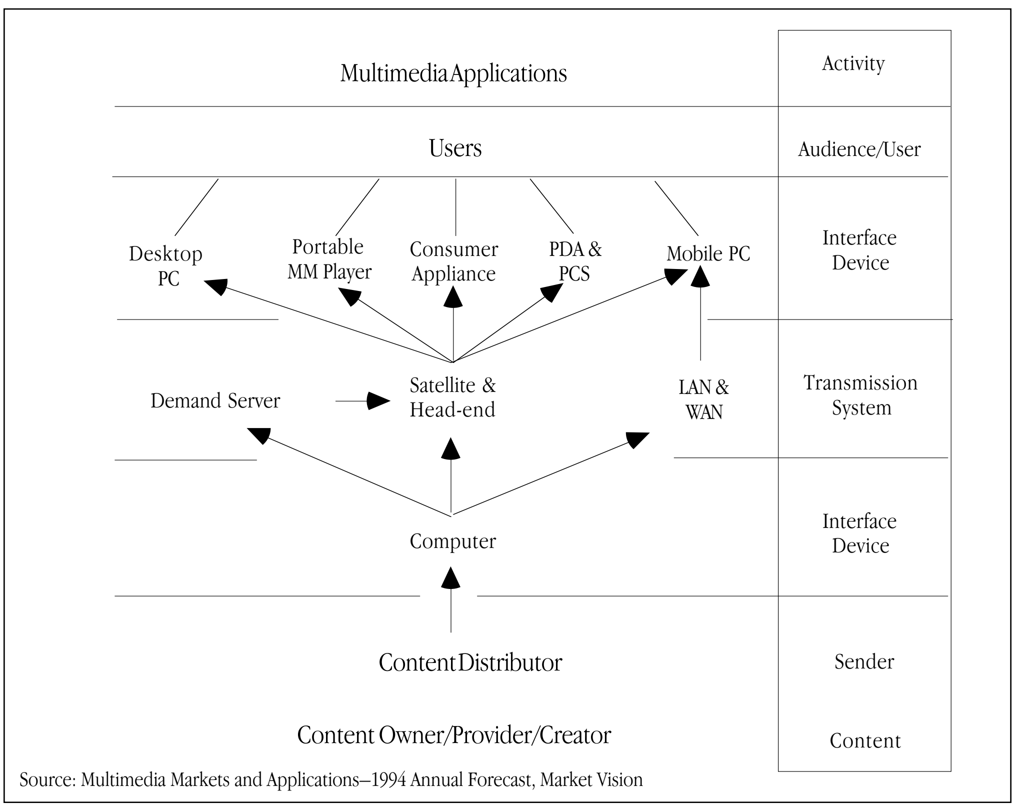


Figure 1-4. Electronic Delivery of Content

Chapter 2

Videogame Distribution Model

Videogames have evolved from the early days of hand-held Pong and *PacMan* into a sophisticated multibillion dollar industry that brings together the cutting edge of high technology, the creative and marketing power of Hollywood, the global conduits of the communications industry, and the economic resources of the financial community. Together they are forming strategic partnerships to explore the vast opportunities the videogame industry presents.

The videogame industry is rapidly growing and changing. This chapter examines how the current videogame distribution channel is changing to accommodate its growth. As fortunes shift and new platforms and media types and formats emerge, it is important to understand the impact this maturing process is having on developers and the existing distribution channels. This impact will afford developers the broadest opportunities in the rapidly growing consumer market.

Videogame Developers

The primary content delivered as videogames is high-action entertainment—such as "fly-shoot-kill" action, problem-solving through exploration, and sports—targeted at preteen and teenage boys. The videogames market has been led until recently by Nintendo with proprietary hardware and software. In 1993 Sega captured the lead with the 16-bit Genesis player.

In 1990 Nintendo sold more than 8.5 million hardware units and 60 million to 70 million titles. Nintendo estimates its United States household penetration rate will be as high as 30 percent. SuperNES saw sales up from 6 million units in 1992 to 25 million 16-bit software titles. Game Boy accounted for $995 million in 1992, based on 4 million units of hardware and 25 million game titles.

In 1993 products developed on the Sega platform sold about 7 million videogame players accompanied by 23 million to 25 million titles. By the end of 1993 there was an installed base of 700,000 SegaCD CD-ROM add-ons for Genesis, and about 4 million CD-based games. Sega believes that the critical mass for CD-games developers to have sufficient installed base to become profitable is 2 million players by 1995. With the average cost of CD-based games development reaching $1.5 million per title, nearly seven times that of a 16-bit cartridge game, developers must have "hit content" and a sufficient market size for success.

Types of Media

Videogames have traditionally been delivered on cartridge-based media. In the last three years floppy disks have been used to deliver videogames to personal computers. Both cartridges and floppies are being replaced by CD-ROM and newer cartridge-based technologies. The market, long dominated by 8-bit cartridges and floppy disks, is being systematically taken over by 16-bit cartridges and CD-ROM disks. In early 1995 the market will begin to accommodate a new wave of 32-bit and 64-bit games.

Diskettes are thought by many to be an obsolete type of media, but there still remains a worthwhile business opportunity. The market for diskette-based products has definitely peaked, but there remains a significant number of consumers who use diskette-based products to enable a developer of these products to achieve substantial sales. Combined with lower development costs, floppy-based videogames present an opportunity for a good return on investment. The reduced development costs can offset the decrease in market size.

On the other hand, developers should recognize that floppy-based games are almost certain to be excluded from rental in home video stores because the disks are so easy to copy. Some distributors will not sell floppy-based games for this reason.

Limited shelf space could also adversely affect the future of diskette-based games. There is still an opportunity for low-budget games, but this is not expected to exist for longer than two years due to consumer demand for higher product value. The primary factor for considering floppy disks is that they still represent the highest installed base of users.

Many industry participants expect a dramatic growth in retail floor space allocated to CD-ROM, replacing space now reserved for floppy disk games. Industry experts expect floor space allocated to CD-ROM to double by the end of 1994 and to double again by the end of 1995.

Many publishers will not consider publishing a game on any platform other than CD-ROM or newer technology. They believe the market growth will occur on the newer and more sophisticated platforms. They expect these markets to mature in the next two years and are committing their development and management resources to gain expertise on platforms such as Sony PlayStation, 3DO, and Sega Saturn.

Double-speed and triple-speed drives are increasing their penetration at the expense of single-speed drives. Designing interactive media titles to single-speed specifications as the lowest common denominator could soon become obsolete. Within the next two years, the majority of drives will be double-speed. Market Vision research estimates that by the end of 1994 the number of double-speed or faster drives will reach 52 percent of all drives installed.

The 8-bit videogame cartridge has been almost completely replaced by the 16-bit cartridge. Furthermore, most industry experts agree that the market for 16-bit videogames has already peaked. This was substantiated by a survey of 41 industry executives conducted by Infotainment World, the publisher of *Game Pro* and *Electronic Entertainment* magazines. About half the group believe 16-bit videogames have at least one more good year. Sega, about to launch a $500 million marketing blitz, intends to extend the 16-bit market through March 1995. This indicates that 16-bit videogames will be a market force at the same time as advanced cartridge-based game technologies are introduced.

New platforms will start appearing in the market toward the end of this year. Sega will introduce Genesis 32X in November 1994 to boost the current Genesis and Sega CD-ROM products to 32-bit processing. The emerging 64-bit game technologies are expected to arrive in mid-to late 1995. With a planned price point under $200, the 64-bit machines are expected to penetrate the market rapidly. The introduction of Sega's Saturn, Nintendo's Project Reality, and Sony's PlayStation are currently planned for mid- to late 1995.

Buyer Profile

Within the next year, CD-ROM drive penetration in U.S. households will reach critical mass, which will decrease the influence of economics on the buyer profile. The buyer of the next two years will demand better content than the successes in today's market now indicate. Saturation has occurred within the early adopters of CD-ROM drives. As drive prices fall, they will become more affordable for those with less disposable income.

Once the installed base reaches critical mass, the content of a title will have a stronger influence on buyers. This increased influence of content is expected to occur in the next 12 to 16 months as the successes and failures of the 1994 Christmas season are felt.

Age will emerge as a principle determinant of title design and development. Younger buyers have shown a strong interest in high-action games that provide intense experiences over short periods of time. This younger group will provide a broad-based market demand for videogames. After playing the game a few times they lose interest and go on to another game.

Middle-aged baby boomers will represent the other significant group. Those over the age of 30 are interested in being engaged by a game over a longer period of time. Interactivity is more meaningful to this group. They also enjoy action and adventure, but they prefer a game that will challenge them intellectually. They prefer the adventure of taking several days or weeks to win the game.

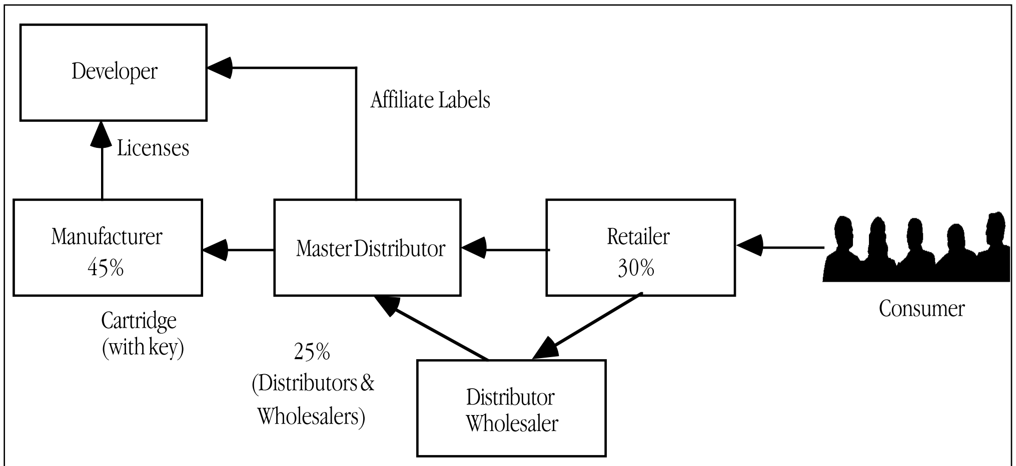
Games that require more time to explore are likely to be more successful in the home video rental market. Consumers will prefer to rent and try a game for several days before deciding to buy it. As the market matures, the demand for better, more varied content will increase. According to Tom Kalinske, president and CEO of Sega of America, "Game rental has become an increasingly important market segment, with estimates at about $1.5 billion a year industrywide. But with nearly one thousand great Genesis and Game Gear software titles available, it's tough keeping an inventory broad and deep enough to satisfy peak demand."

Channel Revenues

Distribution channels for videogames, including floppy disks, cartridges, and CD-ROM, have evolved into a multibillion dollar industry. Two companies control more than 90 percent of its distribution. Because the growth opportunities cross over into other industries, new participants are arriving as the market matures.

Each company has its own distribution network. Nintendo is committed to cartridge-based games, while Sega distributes products through cartridges, CD-ROM, and online channels.

As shown in Figure 2-1, the videogame distribution channel begins with developers and manufacturers. Because Nintendo and Sega currently control the majority of the market, developers obtain their licenses from them to distribute products through the networks these manufacturers each control. Percentages in Figure 2-1 refer to the portion of the consumer revenues retained by each participant. Initially Nintendo dominated and controlled the pricing and distribution policies. As Sega emerged to challenge that position, the distribution dominance shifted but not the policies. As new 32-bit and 64-bit technologies are released, Nintendo and Sega continue to jockey for the leading position.



Note: Percentages refer to the amount of retail revenues retained by each part of the channel.

Source: Market Vision, 1994

Figure 2-1. U.S. Videogame Revenue Streams

Sega and Nintendo are the master distributors for the product, selling directly to large retail accounts like Toys-R-Us, and to wholesale distributors like Ingram, who are emerging as more significant participants in the distribution process as the consumer market expands into other channels like music and home video.

Because they distribute computer software products and video titles through other channels, like software and home video, companies like Ingram and Baker & Taylor are well positioned to supply videogames to their existing customers. As videogames are increasingly influenced by partnerships with Hollywood and represent significant growth opportunities, home video distributors like Ingram and Baker & Taylor will include videogame products to service their retail customers.

As the videogame market expands, some publishers are becoming distributors. Companies like Electronic Arts and Maxis have established their own networks to distribute the products they develop and publish. They have also created affiliate labels, distribution arms established by a publisher to complement their own product lines. Once they have a distribution mechanism in place, they will distribute products for other developers. They often serve as the master distributor for their affiliate label developers.

Retailers, such as Blockbuster and Toys-R-Us are responsible for more than 30 percent of all videogames sold to consumers. Master distributors and wholesale distributors supply their products.

Blockbuster has a direct relationship with Sega to sell cartridges and CD-ROM-based products, and to provide electronic distribution of Sega's games. They also have a direct relationship with Electronic Arts and pay a $3 premium to Electronic Arts for products they offer for rent.

The combined market share of Nintendo and Sega exceeds 95 percent of all distributed videogames. Until 1990 Nintendo controlled over 80 percent of the videogame distribution channel. According to Sega, by 1994 they will account for 54 percent of the market, reducing Nintendo's share to 44 percent. Though the fortunes have shifted between them, they jointly represent the lion's share of the current distribution channel.

As shown in Table 2-1, the top two videogames distributors and retailers comprise 95 percent of the $7 billion industry. The top three retail merchants account for 30.4 percent of the videogame industry.

	Revenue ($ Billions)
Retailer	
Toy-R-Us	1.40
K-Mart	0.43
Wal-Mart	0.30
Distributor	
Nintendo	3.10
Sega	3.80
Electronic Arts	0.42
Acclaim Entertainment	0.29

Source: Market Vision estimates, 1994

Table 2-1. Videogame Industry Revenue for 1993

As the market expands across more retail channels, these emerging distributors will play an increasingly important role in providing developers the broadest possible distribution opportunities for their products.

Channel Successes and Failures

The videogame industry has grown significantly in the last seven years. The early-adopter phase has become saturated. Current research indicates that now broad-based penetration will likely accelerate. This will provide greater opportunities for developers because an increasing number of consumers will purchase more products. It will also place greater demands on their development and business skills as the market becomes crowded with competitors. New platforms are likely to drive development costs up because of increased costs for content licenses, higher-quality graphics, full-motion video, and the participation of Hollywood stars.

Competition will increase, and prices will come down. Margins are likely to get smaller. But increased penetration among consumers and the emergence of new distribution methods will help the market grow. As the industry matures, the consumer will become more sophisticated. And so must the developer.

Looking at some of its past successes and failures illustrates the value of understanding how the videogame industry got to this point and in which direction the future is likely to lead developers and their customers.

Sega's Battle Against Nintendo

By 1990 one out of every three American homes had Nintendo systems. The presence of this company at trade shows, like the Winter Consumer Electronics Show (CES) in Las Vegas, staggered all attendees with its size. With nearly an entire building to itself, Nintendo's dominance in the industry was obvious. Sega entered the market in 1990 on the strength of two titles—*Sonic the Hedgehog* and *The NFL, Starring Joe Montana*—and the introduction of its 16-bit players.

Three factors brought about Sega's ascent in the market. Content, platform superiority (16-bit), and lower cost ($50 less than Nintendo's 16-bit device). This strategy has enabled Sega to capture market share from Nintendo. Today Sega controls 54 percent of the market, and Nintendo's market share has fallen to 44 percent.

Developers today should note the importance that content, platform superiority, and cost have in driving market penetration. The content of Sega's early games was more interesting than the bland content found in most Nintendo titles at the time. The introduction of the 16-bit Sega Genesis gave consumers a platform superior to Nintendo's 8-bit technology. Once Nintendo delivered its 16-bit Nintendo Entertainment System (NES), Sega made certain the Sega Genesis cost $50 less than Nintendo's Super NES.

The lesson seems obvious, but the failure of 3DO to succeed dramatically underscores the need to pay close attention to history. Interest in 3DO's platform is strong, but the price is too high for most consumers (even ones who earn over $50,000 per year). This creates a chain reaction from developers who are reluctant to develop products for such a small consumer base. This was compounded by 3DO's lack of title distribution trategy. They cannot afford to bet on an uncertain future. 3DO's platform superiority has not been enough to overcome its high price tag and lack of available software. It remains to be seen whether 3DO can survive the advent of Sony's PlayStation.

The Emerging Retail Channel

Though significant strides have been made in expanding the distribution channels at a retail level, much work still needs to be done. Retailers like Tower Records are expanding their departments to carry 300 to 400 CD-ROM titles. They attribute lack of success to date mostly to not having dedicated departments in their stores. Tower is planning to change this arrangement throughout the chain by year end. Blockbuster's rental test in the Bay Area is showing some success and has been extended.

Home video is poised this year to make a major commitment to interactive entertainment. Both Sega and Nintendo had major presences at this year's annual Video Software Dealers Association (VSDA) show for the home video industry. Rentrak, a revenue-sharing company that provides videotapes for a small processing fee plus 50 percent of the revenues, enables retailers to increase their "depth-of-copy" (the number of copies ordered of each video title) on a title in an affordable manner. Rentrak has already negotiated a deal with Sega to provide cartridges and CD-ROM products to video retailers. In association with *Game Pro Magazine* they are producing Budget Maker, an online game-forecasting and electronic-buying service that provides retailers with minireviews and ratings on Sega Genesis, Sega CD, and Super Nintendo titles.

Game Rentals Stimulate Sales

Research indicates that game rentals stimulate sales. The debate over the influence of game rentals on sales continues, but the research indicates that 80 percent of Blockbuster's customers prefer to rent a game before making a purchase. Sega estimates that three out of five customers preferred to rent before purchasing. Recent studies by Nintendo showed that 70 percent of games are rented before being purchased. Sega estimates that 40 percent of potential game renters leave the store because the game is out of stock. This depth-of-copy issue is the same kind of problem the home video industry has been struggling with for 14 years. The demand for videogames is up, and the distribution channels need to find a way to meet the demand.

Concern Over Distribution Practices

Some distributors' business practices are being criticized by developers. Distributors like Compton's New Media, which also publishes its own products, are being criticized for giving distribution priority to the titles in which they have a vested interest. This concern is so prevalent that companies like Acclaim have formed affiliate label distribution arms not just for their own products but also to attract developers such as Digital Pictures.

Increased Market Penetration, Record-Breaking Sales and Returns

Personal computer penetration in the home has risen to 31 percent of U.S. households. A recent survey by Computer Intelligence Infocorp reported that 76 percent of that group, roughly 22 million PC owners, use their home PCs for entertainment and games. According to PC Data, interactive sales reached an all-time high last December. This was great news for the industry. Unfortunately it was offset by a product return rate of over 20 percent; according to some estimates it could have been as high as 50 percent, and these numbers do not account for all the bundled software people have discarded. This sends a clear message to developers that the public is becoming more sophisticated and demanding about the content it will accept.

Pay Attention to Content

Once a market reaches critical mass (which is evident here), content becomes a dominating purchasing factor. It happened in the home video industry, and it is happening here as well. Distributors will likely off-load much of this liability onto the developers, resulting in added responsibility written into agreements and maybe even putting aside additional reserves to cover returns. Developers who understand the importance of content and consider it seriously in their product development will have a significant advantage in the expanding marketplace.

Videogame Distribution Profile

Representatives from Electronic Arts and Crystal Dynamics were interviewed for this videogames distribution profile.

Pong, developed by Atari founder Nolan Bushnell and introduced in the early 1980s, was the first electronic videogame. It was soon followed by *PacMan*, then *Ms. PacMan*, *Space Invaders*, and others. From those early beginnings 15 years ago, videogames have evolved into the cartridge games played on either hand-held players or television consoles. Japan based Nintendo and Sega of America are the biggest players in the cartridge videogame arena.

Videogames are now emerging on CD-ROM, usually in the action-adventure category, and lead the field of CD-ROM titles. Acclaim, Crystal Dynamics, and Electronic Arts dominate this area.

The storage capability of the CD-ROM disc, which can hold about 640 megabytes of data, allows developers to combine full-motion video, sound, three-dimensional graphics, and text in the same title. The CD-ROM medium provides developers with more live-action capabilities, and better sound quality than other delivery media.

At first the convergence of multiple media and the teamwork of creative people from several disciplines required to produce sophisticated and complex titles made the Hollywood channel a natural distribution model for interactive media products. Reinforcing this notion is the fact that film companies in recent months have been porting movies from the silver screen to the silicon platter, particularly in the videogame area. For example, a trend is emerging for videogames to feature Hollywood actors, who are filmed against a blue screen so that live-action video sequences can be composited with complex graphics. Mechadeus's *Critical Path* and *Deadalus Encounter* are examples of titles that use this technique.

One aspect of movies-as-games that might not work is that movies rely on storytelling; they have exposition, conflict, and eventually resolution. Videogames, on the other hand, emphasize challenge and mastery and do not necessarily follow a linear development.

The traditional movie channel distribution system is typified by the Hollywood studio system. In the early days, the movie companies hired a stable of creative talent (actors, directors, writers, cinematographers, editors, and so on) who were on staff at the studio rather than being hired on a per-project basis, which is now more the norm. The studio controlled its creative people's careers, particularly those of its actors, as well as its product and profit margins.

Distribution was a key element of the studio system. By controlling distribution, the studio could guarantee its stars exposure. Frequently a studio owned its production facilities and movie theaters. A studio could block out independent movie theater owners (exhibitors) who failed to comply with studio-mandated screening and pricing policies by refusing to rent them "A" movies, or any movies at all. Exhibitors retaliated by creating their own production companies, thereby creating their own products for exhibition.

Today a similar turf war is being fought by videogame producers in the homes of consumers. The camps are the living room (cartridge, set-top boxes) versus the home office (computers with CD-ROM drives). Cartridge consoles, such as the Nintendo and Sega game-playing systems, have long dominated the videogame field, but videogames on CD-ROM, which are playable on the home computer, are gaining a toehold in the larger interactive games market. In fact, games are the fastest growing category of CD-ROM titles. A shift from 16-bit players to 32- and 64-bit players is also in progress. The consensus of industry leaders interviewed for this guide is that 8-bit cartridge games are a dead market, particularly in the home video rental area.

Manufacturers of the new set-top players, such as the Sony-Philips CD-i (compact disc-interactive) system, Panasonic's Interactive Multiplayer (based on technology licensed from 3DO), Atari's Jaguar, and Sony's forthcoming PlayStation are vying to keep videogames in the living room. Also, Microsoft and Sega are working together on the Saturn, an add-on player that will allow users to run their CD-ROM games on a Sega console.

According to leading videogame distributors, the key platform competitors in the videogame channel are Nintendo, Sega, Sony, 3DO, and IBM-compatibles, which offer an open (nonproprietary) development environment. All viable platforms are being represented to some extent, but the ones that promise the most growth are receiving the most robust support from the videogame software companies.

The contemporary videogame channel distribution model borrows from the music industry's affiliate label distribution paradigm and also draws on the conventional movie industry distribution model discussed above.

The affiliate label concept began in the music recording industry where musicians were represented by labels, which usually acted as both publisher and distributor. Small labels often did not have the resources and connections to get their artists' recordings into the retail channel. By joining forces with larger labels, through affiliate label agreements, smaller labels could offer their artists the exposure they needed to become popular.

This affiliate label arrangement was later adopted by the software industry, and now is used extensively by small interactive media title developers to bring their games and other content to market. For example, in the videogame domain, Crystal Dynamics, which has a production division as well as a distribution division, distributes games for P.F.Magic and American Laser. Crystal Dynamics and Electronic Arts are unique in the larger interactive media publishing and distribution community in that they both have a national sales force that sells directly to the retail channel. In fact, Electronic Arts distributes exclusively through its direct sales force, whereas most distributors use manufacturers' representatives.

In a traditional software model, distribution eats up 70 to 80 percent of the sales profit. In the Electronic Arts direct-distribution model, distribution represents 20 to 25 percent of the sales revenue. In addition to employing a direct sales force, Crystal Dynamics reaches an international audience through its relationship with Bertelsman Music Group, which gives the company direct international representation.

When setting up affiliate label agreements, publisher-distributors, such as Crystal Dynamics and Electronic Arts look for companies that have a line of interactive media products, not just a single title, and the capability for the affiliate label (publisher) to sustain a two- to five-year business relationship.

Under the Electronic Arts affiliated label program, the responsibility of the affiliate company (publisher) generally lies in three key areas: developing the product; manufacturing, and delivering the product in a shrink-wrapped form; and marketing the product.

Also, publisher-distributors look for smaller publishers (labels) who have products that will complement rather than compete with their own existing product lines and for exclusive distribution of those affiliate companies' products.

Publisher-distributors, like Crystal Dynamics and Electronic Arts usually accept interactive media products from developers and publishers for review and consideration through affiliate label divisions. Sometimes the divisions are subdivided by specific content areas. Most submission packets also include nondisclosure agreements (NDAs) to provide the developer-publisher some security for its intellectual property rights.

Market Directions

The current market has grown to a fairly large size. The anticipation for future growth is greater than perhaps any other industry has experienced. Global in its potential, with new markets emerging worldwide, the anticipation is great for emerging distribution channels.

The future growth of the videogame industry will be greatly influenced by the home video distribution channel, which affords the best opportunities to achieve the widest possible consumer acceptance of videogames of all the distribution models discussed in this guide. With the opportunity to preview CD-ROM titles by renting before buying and well-established personal rapport between store employees and consumers, home video stores provide a conducive climate for promotion of developers' products.

It is very costly for developers to establish a similar climate in computer software stores, for example. Developers must often underwrite the expenses of direct promotions with retailers, such as hiring in-store personnel to answer questions and providing kiosks for demonstrating the product. These promotional expenses could be too costly for many developers. Furthermore, there is very limited floor space for kiosks in computer stores.

The Future of the Cartridge

Many videogame executives believe that although 16-bit cartridge sales have peaked, there are still good sales opportunities in the existing consumer base. Sega is expected to spend $500 million to prolong the life of 16-bit games, $150 million more than they spent last year. The figure rivals what Hollywood spends in a six-month period promoting feature films.

Infotainment World, the publisher of *Game Pro Magazine*, conducted a recent survey of 41 interactive entertainment executives. Most expect the industry to grow from $12 billion to $25 billion in the next five years, attributing its growth to the continued popularity of games plus new forms of electronic delivery. Almost all agree that 16-bit games are at the top of a curve, yet half the group say they could go for another year. Many executives agree that attention is turning to CD-based games, though they expect 16-bit cartridge-based games to coexist for at least one year, and an equal number believe cartridge-based games will dominate the market.

Dissatisfaction with Distributors

There is a growing concern among publishers and developers that their best interests are not being served by the distribution arm of the videogame industry. Conflict of interest, lack of point-of-purchase (POP) materials, and lack of market development funds add to the growing concern. As a reaction to this state of affairs, hybrid distribution arrangements are surfacing at an accelerated rate. Mergers of smaller regional distributors are beginning. Publishers and developers are forming partnerships. The direction in which this is going is uncertain, but it is clearly an expression of dissatisfaction with current methods of distribution.

Price Cutting

One might argue that increased competition is healthy, but the frenzy with which it is occurring could have harmful long-term effects on the industry. If, for the sake of the deal, developers compromise solid business practices, the industry could find itself establishing conventions that are counterproductive to its growth. This can often happen in a new industry that has no long-standing foundation of accepted guidelines. Amidst the fervor and excitement of new opportunities, unwise short-term decisions are made to gain market share.

The price wars in the early days of the home video industry are an excellent example. From 1984 through 1988, price wars occurred in the home video industry as new retailers lowered their prices to attract customers and to gain market share . These wars set off a wave of low-balling prices, from which the home video industry has never fully recovered. It was impossible for retailers to get a return on their investment by renting movies for 49 cents to 99 cents. In many cases the title would stop renting before the retailer could recover the cost. The public got accustomed to the unrealistically low prices that drove many small retailers out of business. This became a convention that retailers have for the most part been unable to reverse.

Although price cutting has been used in emerging industries as an effective short-term strategy to gain market share, the long-term effects can often minimize revenue potential by keeping prices lower than the market demands. This occurred in the home video industry, and the possibility exists for the same to occur in the videogame industry as many smaller, independent developers compete for market share.

The Changing Distribution Scene

As the videogame industry expands and matures, a broader, more demographically diverse consumer market will offer rich opportunities for developers. At the same time, developers will increasingly compete to have their product distributed.

As new developers emerge and the videogame market expands into other business channels, the existing distribution model will change to accommodate the crossover into these channels. The growing rental market will emphasize timely product release, and bookstores will require easy use of products.

Electronic distribution will create a great demand for product and require existing distribution channels to devise more cost-effective methods of doing business so they can compete with the overhead inherent in electronic distribution.

The market will demand changes in distribution as it grows. The consumer is becoming more discriminating at the same time as competition for shelf space is increasing. Distributors will need to be more cautious with the products they carry and videogame producers will need to be more careful about the games they develop. Though the opportunities are widening at an accelerated rate, the industry will need to become more sophisticated to meet the growing consumer demand.

Mergers

As new players emerge onto the distribution field, mergers are occurring among existing distributors. Existing distribution channels, such as those used by home video, books, and music are overlapping one another. Each is vying for a place within the boundaries of videogame distribution. The merger of smaller distributors, like Microware, L.B. Distributors, and Varnett has made them bigger than Ingram, considered to be the biggest videogame distributor. The increased competition will be healthy for the industry.

Rental Versus Sell-Through

Several videogame developers are undecided about their commitment to the rental market. Electronic Arts is distributing to its direct video rental accounts like Blockbuster and West Coast Entertainment but charges them a $3 premium, in lieu of the royalties they would otherwise have gotten on the sale of the video. To avoid the pirating of discs, Electronic Arts is preventing its distributors from selling its disk-based products, like 3DO titles, to rental dealers. Yet they have signed distribution agreements for the same product with Ingram for sell-through only to video stores.

There are 35,000 video stores in the United States. Recent figures compiled by groups like the Video Buyers Group, which represents 1,300 video stores, reports that in the last year videogame revenues for their members have averaged an increase from 7 percent to 25 percent of their total store revenues. Some distributors, like Video Products Distributors (VPD), are reporting 12 to 15 percent increases in their videogame sales.

The neighborly one-to-one rapport that video stores have with their customers presents a great opportunity to increase the popularity of videogames, and stimulate industry growth.

The Changing Retail Landscape

We can expect to see several new retail faces entering the market. Bookstores are opening their doors to videogame opportunities, but they must overcome two major obstacles. Their sales clerks are not accustomed to selling highly competitive $49 items, even though some books sell for that price, and they need training in the bits and bytes basics of computer software.

The Future Looks Bright

Long-term success of the videogame distribution channel depends on consumers being entertained and engaged with the product on the shelves and on everyone in the value chain making a reasonable profit.

Distributors will need to increase their efficiency and become more consistent with their policies as they prepare to compete with the emergence of electronic delivery.

Recently the Interactive Digital Software Association (IDSA) has endorsed the Electronic Entertainment Exposition (E3) instead of Summer CES for announcing interactive media. Since it is held in April, this is likely to have an impact on development cycles. Thus interactive media must be ready to demonstrate by April each year instead of by June.

Disputes are rising in the IDSA regarding its game-rating plan. With pressure coming from Congress to rate games for home use, the industry is being pressured to implement a plan soon. The official position is to rate games prior to shipment. Some argue this favors videogames over computer software, because computer software is usually published as soon as the development cycle is completed. This makes review prior to shipment impractical for developers.

According to one of the distributors interviewed, return rates of 35 to 45 percent followed last December's record-breaking sales. This dangerously high return rate sends a clear message to the industry. Consumers want to buy, but their tastes are becoming more sophisticated and they prefer meaningful and engaging content.

Developers must negotiate deals carefully and be aware of the different characteristics of each channel. They must also make certain that their contracts protect them in these different situations, both present and future.

Chapter 3

Home Video Distribution Model

In the last 14 years home video has emerged as a major force in the entertainment industry. It has grown from a channel that distributed x-rated movies and third-rate entertainment to the major distribution channel for the motion picture industry. Therefore, one can learn much from its success.

The home video industry is dedicated to providing the rental of electronic entertainment products through 35,000 retail outlets throughout the United States. Over $1.5 billion is already generated through the rental of videogames alone, according to Sega. This is becoming a significant part of the $12 billion home video industry revenues.

This chapter discusses how the home video distribution channel is preparing to include interactive media in its future. Its experience as a fast-maturing, quickly changing market makes it an ideal channel to understand the rapidly growing and fast- changing interactive media market.

In 1994 Disney released *The Return of Jafar* as a home video without first going through theatrical distribution. This confidence in home video has enabled video to grow from to an ancillary market to a primary distribution channel. It has opened the doors to independent producers and created a market for products that would not otherwise exist, as demonstrated by Jane Fonda's fitness videos.

With a network of 35,000 retail outlets accustomed to product promotion and personal one-to-one contact with consumers' entertainment preferences, home video provides an excellent opportunity for interactive media producers to greatly expand the distribution potential of their products. Our research has indicated that the importance of the home video channel in exposing the widest number of consumers to new media cannot be overemphasized.

Home Entertainment Providers

Since the home video industry began in the early 1980s it has been responsible for introducing the consumer to new categories of entertainment. Home entertainment providers have been very successful in distributing their products through home video. Major motion picture studios generate over half their revenues from home video. Providers like Turner and HBO have developed large entertainment divisions as a result of their products being distributed through the home video industry. Independent producers like Jane Fonda, and the celebrity fitness video industry that followed her example, could not have emerged if home video had not been there to promote their products to consumers.

The fitness tape category grew quickly because video stores promoted them on a grassroots basis across the United States. During the early 1980s, independent producers could not afford to distribute their products through conventional motion picture or television distribution channels. Distribution opportunities now exist for independent producers that did not exist before the emergence of the home video industry.

A milieu has been created in the home video industry that enables new categories of products, such as interactive media, to be more easily promoted and introduced to the consumer. For example, expensive kiosks are required to familiarize consumers with interactive media, but they take up precious computer store floor space. In the home video store, a POP poster can stimulate the consumer to ask the clerk if the title is good and then rent it for a few dollars and try it at home. The promotional costs are significantly lower, and the rental generates additional revenue.

The foundation of the home video industry was personalized customer service and convenience. Its cordial and personal atmosphere is very conducive to introducing the public to new kinds of entertainment. Independent movies, music videos, fitness tapes, and 8-bit cartridge games have all deployed product to the home video distribution channel with great success.

Types of Media

Videogames using 8-bit cartridges have been rented steadily in home video outlets for the last four years. Traffic patterns have already been established for consumers to visit home video stores to rent interactive entertainment, such as videogames. As 8-bit cartridges begin to be replaced by 16-bit, the consumer will become more comfortable with emerging technologies and will look to home video stores to lead the way in introducing new types of media.

Companies such as New Leaf Entertainment have begun to introduce videogames on demand at the point of sale. Retailers will be able to provide products as needed without a major up-front investment in inventory. One consideration will be the cost of New Leaf equipment, and any associated licensing fees. As the interactive media market matures in the home video distribution channel, the benefits of installing such equipment should outweigh the costs for many retailers.

The home video store is well positioned to accommodate the growing interest in interactive media. The most likely scenario to occur in home video is for retailers to replace the 15 square feet of shelf space currently dedicated to 8-bit cartridge games with a CD-ROM shelf that can hold up to 400 titles with the jewel boxes placed spine out. Several of the distributors surveyed expressed concern about videogames being copied onto hard disks. For this reason some distributors have indicated that to be included in their catalogs a title must be on CD-ROM to avoid the copying issue.

Copying is highly unlikely to occur with a CD-ROM because it takes up more than 600 megabytes. With the current market price for disk drive space at 50 cents a megabyte, it would cost $300 to copy a $49 game. The high-quality graphics and interactive options CD-ROM affords make for much more engaging entertainment, and the medium is more suitable for the rental market.

Consumers will be able to rent and try new types of media rented as a package with the hardware, like Sega Saturn, Sony PlayStation, and Nintendo's Project Reality. This "try and buy" merchandising method was very successful in contributing to the acceleration of VCR penetration in the home, and will be a major factor enabling consumers to get a hands-on experience before buying. As was learned with the VCR this exposure often led to the purchase of equipment. This will be an excellent way to introduce consumers to new interactive products.

Buyer Profile

As with the videogame market, the home video buyer profile will be divided primarily by age. There will be edutainment games for young children, action-oriented games for teenagers, and more-engaging role-playing games for adults. Within these age groups there will be category preferences.

The home video store is designed to meet the varied preference needs of the family. Displays are arranged by category as well as age group. Almost all video stores have sections dedicated to children's titles, and areas isolated from children, such as adult sections.

Merchandising according to different buyer groups is critical to consumer satisfaction. In addition to the physical arrangement, most video stores have the ability (provided by their computer systems) to prevent children from renting titles with inappropriate content. With this mechanism already in place, the home video distribution channel is already prepared for the arrival of a rating system for videogames. Video stores will be able to accommodate the diverse needs of their customers without any disruption in their normal way of doing business or any additional cost other than inventory and a shelf or two.

Channel Revenues

The home video producer delivers titles to a wholesale distributor, who in turn sup-plies home video products to three main retail groups: major retailers like Block-buster, supermarkets, and small independent retail stores (see Figure 3-1).

Home video products are developed mostly by major motion picture studios, and to a lesser extent by independent producers. They release their products in the home video channel about six months after their theatrical release. A window of time protects the title from being released by other in-home entertainment providers like pay-per-view and cable TV for a period of eight months to one year. This enables the home video channel to maximize the title's rental potential without com-petition from these other markets. Most products are shipped to wholesale distributors on a just-in-time basis, giving them less than one week to turn the product around and ship it to the retailer.

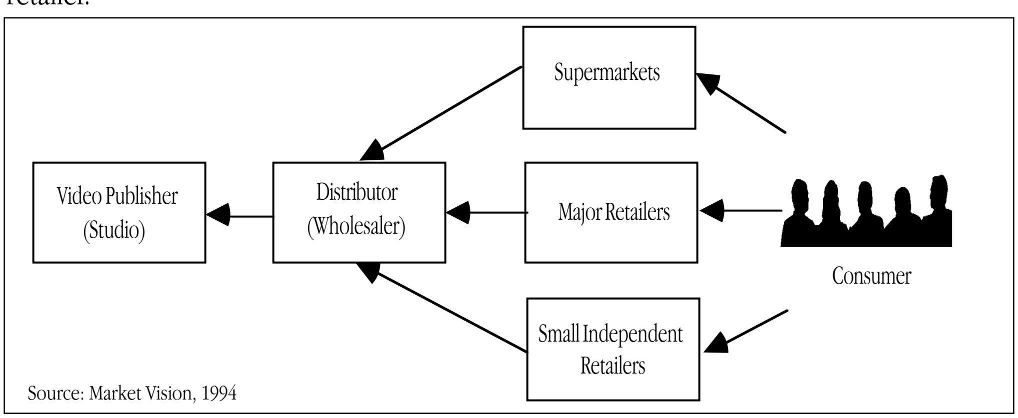


Figure 3-1. U.S. Home Video Revenue Stream

Though the major studios deal with some retailers directly, the majority of their products are shipped to wholesale distributors. There are three major video distributors in the industry: Ingram, Baker & Taylor, and East Texas.

Strict policies are in place to get the product to the distributor by a specific date. The distributors in turn ship the product to the retailer so that it arrives on its predetermined street date. A one-day delay in shipment will cost a retailer hundreds of dollars in unrecoverable rental revenues, as consumers are often already at the store waiting for the movie to arrive from UPS.

Companies like East Texas distribute the majority of their products to Blockbuster. This company has succeeded because it specializes in getting the product shelf-ready cost-effectively. This means they barcode it (each rental copy has its own unique barcode), insert a foam sleeve into the jacket and shrink-wrap it. When a product arrives at Blockbuster it is ready to go right onto the shelf. Conformity to street dates creates anticipation among consumers that has them waiting at the store for the movie to be put on the shelf. It is more cost-effective for East Texas to prepare tapes for Blockbuster than for retailers to do themselves.

To accommodate the need for quick product turnaround to the retailer, regional distributors sprouted up all over the United States to meet these street date commitments. Eventually the regional distributors were consolidated into national distributors, who in turn consolidated, leaving Ingram, Major Video, East Texas, and Baker & Taylor with over 60 percent of the business.

The retail channel is comprised of three main groups. Major retailers, like Blockbuster, and West Coast Video, represent 42 percent. Supermarkets throughout the United States, excepting the West Coast, are a growing part of the market, and small, independent retailers, once the mainstay of the home video industry, are decreasing in numbers as the industry consolidates.

The three main sources of revenue for the home video industry come from rental revenue, sell-through (the sale of videos), and revenue-sharing products owned by distributors like Rentrak.

The home video industry has grown to over $12 billion in revenues. According to Tom Adams of Advanstar Associates, a film and interactive media research consulting firm, video rentals account for 75 percent of total revenues. Because rental stores were slow to respond to the studios' promotion of selling videotapes, the bulk of that business has passed on to mass merchants like Kmart and Price Costco. As the home video retailers began to sell off excess copies of their previously viewed rental inventory, they started to appreciate the value of sell-through, but it was already too late. They do not intend to repeat the same mistake with reference to interactive media, and many retailers have voiced the opinion that they want to sell as well as rent interactive media.

Revenue sharing is becoming a growing part of the home video business. Disney, which is the largest home video provider with over $1.2 billion in revenue, recently announced support for revenue sharing. This adds credibility to the revenue-sharing concept, which has been a much-debated issue in the home video industry so far. Under revenue sharing, a retailer pays a nominal fee of about $12 to $15 to bring a title into the store. The retailer keeps 50 percent of the revenue generated, the distributor keeps 10 percent, and the remainder goes back to the studio. After several weeks the retailer has the option of paying a residual fee, and owning the tape or simply returning it to the distributor. This enables the retailer to stock more copies of a title than if the title were purchased outright.

Rentrak has recently signed an agreement with Sega to provide CD-ROM titles in their revenue-shared catalog. Though it is still a small part of the home video industry, revenue sharing represents a great opportunity for interactive media providers to distribute their products widely.

	Revenue ($ Millions)
Retailers	
Blockbuster Entertainment	1,800
Kmart	257
The Musicland Group	193
WalMart	163
Wherehouse	160
Distributor	
Ingram	572
East Texas Video	528
Major Video	286

Sources: Avandstar Associates, 1994; Estimated North Amer., Video Store Magazine, 1994

Table 3-1. Home Video Industry Revenue for 1993

As shown in Table 3-1, the top three home video distributors comprise 63 percent of the $2.2 billion industry. Overlap between these two distribution channels will grow as products are packaged for consumers.

Channel Successes and Failures

The home video industry has matured faster than any other consumer industry. Today it generates over half the revenue of the motion picture industry. This is the same motion picture industry that fought all the way to the U.S. Supreme Court on the First Sales Doctrine of the Copyright Act to prevent the home video distributors from renting titles.

The main reason for the success of the home video industry was a focus on distribution. In spite of the massive success of theatrical motion picture releases, distribution strategies have been limiting. Little attention was paid to demographics, so some movies failed at certain box offices. Studio marketing executives did not fully understand the importance of demographic marketing strategies.

Home video changed all this. The initial attraction for the consumer was convenience. However, the fundamental cause of its success was bringing movies to a broader demography than theatrical distribution could provide. Fueled by the high- quality performance of home entertainment technology, thousands of neighborhood video stores sprouted up. This wide distribution system helped accelerate its acceptance.

Motion picture executives have recently realized that some movies perform better in the home video channel than in movie theaters. Part of the reason for this is that they looked at their own bottom line, which was greatly increased by the sale of video cassettes. Early on they did not have very accurate information and they paid little attention to rental turn rates, which are the number of weekly rentals for each copy of a title.

The Growth of Distributors

By the early 1980s, studios began to deal directly with larger retailers. By the late 1980s studios lost more than $7 million in inventory to retailers who failed. The studios thought it wiser to spread the risk to distributors and developed tighter guidelines to qualify and select distributors. At this time, large video distributors also introduced product services in direct support of retailers, significantly improving the cost of handling both the studios and the retailers.

A large number of regional and national distributors emerged to serve the growing number of retailers. Because street dates were strictly enforced, it was easier for regional distributors to quickly turn the product to retailers. As the small independent retailer began to disappear, the regional distributors were either bought out by larger distributors or went out of business. Today four main distributors survive: Ingram, West Coast, East Texas, and Baker & Taylor. Further consolidation is taking place.

The Advantages of Rentals

The interactive media industry can learn a tremendous amount from the rental activity of their titles. Just as the motion picture industry was reeducated on distribution and consumer preferences, so the interactive media industry has much to gain from the rental market in addition to hefty revenue potential. They will learn about the longevity of the titles. Much can be gleaned from the rental turn rates. They will find out more about what the public prefers, what works, and what does not from rental performance than from any number of focus groups.

Unlike a movie, which a person is likely to watch only once, a good game is much more engaging. As mentioned above, almost all studies to date indicate that people prefer to rent a game before buying it. A good argument can be made that videogame sales into the home video stores for rental purposes will only enhance the sell-through business.

Just as the theatrical market helps to stimulate the home video market, the home video market is likely to stimulate the videogame market. This could help to stimulate the interactive media industry in general and normalize the sales cycle throughout the year.

Lack of Depth-of-Copy

The extensiveness of the distribution system is the largest single factor in the success of home video. Its primary failure is lack of depth-of-copy and the resulting inability to satisfy the demand for products at the point of sale.

Currently only 25 percent of the public demand is met at the retail level. Home video has brought movies to a wider population base than ever before, but inadequate depth-of-copy has cost the home video and motion picture industries billions of dollars in revenues.

Inadequate depth-of-copy addresses the economics of distribution. The life cycle of titles is not long enough for retailers to buy enough copies to meet the demand for a title. The industry has never been able to provide even 30 percent of the buying public with the movies they want. Revenue sharing can help resolve this issue and should be examined closely as an option by interactive media developers.

Revenue-sharing attempts have met with limited success. Retailers are reluctant to share their revenue figures with others, and the studios have not been overly enthusiastic in their support of the program. Since 1986 estimates have consistently indicated that if the studios embraced revenue sharing their gross margins, as well as retailers' revenue, would increase by over 200 percent.

Home Video Distribution Profile

Representatives from East Texas Home Video, Ingram Micro Entertainment, and Baker & Taylor were interviewed in preparing this home video distribution profile.

The home video channel distribution model is best described as a product rental model. It derives from the phenomenon of distributing Hollywood movies on videocassettes after they have finished their run in the movie theaters, which can range from a few days for a box-office flop, to a few months for a smash hit. Most video store business is in renting movies on videocassettes. Ingram Micro Entertainment, East Texas Home Video, and Merisel are distributors who are bringing interactive media products to market through the conventional home video distribution channel.

Video outlets (the retail channel) range from the large players like Blockbuster to small, independent "mom and pop" shops, and from specialty shops that rent and sell only movie classics or Thai videos to grocery stores that handle only bestsellers. They offer publishers unique expertise in categorizing, displaying (most always face rather than spine out), and merchandising title-oriented entertainment products like videos. This favorable kind of merchandise display is generally not found in computer software stores or superstores.

Interactive media title developers, publishers, and distributors should closely watch what is happening in the home video distribution channel, which is largely a rental channel at the retail level. Rental provides a way for consumers to preview cartridge-based videogames and CD-ROM titles of all kinds. Some distributors, like Ingram Entertainment, offer retailers preselected title assortments to assist retail buyers who are not familiar with the new technology products.

This year experiments in renting CD-ROM content have been conducted by Blockbuster Entertainment; Compton's New Media in conjunction with 20/20 Video (a division of Major Video); and Baker & Taylor. CD-ROM title rentals can lead to CD-ROM sales.

Sega has had success with its 8-bit and 16-bit videogames "selling through" after having first been rented. Cartridge game prices average about $50 each, which is comparable to CD-ROM prices. The rent-to-sell-through formula should be of interest to all who participate in bringing interactive media titles to market.

The question "Is it software or is it content?" is crucial in the rent-to-sell-through formula. Software is sold under a software licensing agreement whereby consumers are licensed to use applications on their computers. CD-ROM titles, on the other hand, are copyrighted as entertainment products, just like books and audio recordings. Some major interactive media publishers who regard CD-ROM titles as software, such as Electronic Arts, resist renting them.

Not all titles are good rental candidates. Titles that have limited hours of interactivity, titles that are easily downloaded to a hard disk (small files 8K to 12K in size, for example), should be withheld from the rental outlet. CD-ROM content such as games and educational and reference works that offer hundreds of hours of interactivity, however, should fare well in the rental domain. Games are especially sought after.

According to an Ingram Micro Entertainment representative, games are particularly good rental candidates because many games cannot be finished in two nights. He said that consumers need up to eight weeks to fully explore a game. Because of that, consumers will rent a game for a couple of nights to see if they like it, and if they like it, they return to buy it.

Securing shelf space at the retail level is an issue that cuts across all distribution channels. It is difficult to resolve unless the title has brand-name recognition or the distributor provides the retailer with a sufficient variety of products to generate a large sales volume. This year an estimated 7,000 to 8,000 titles are available to the consumer, but retailers have limited shelf space. Ingram Entertainment, for example, finds existing space for interactive media products by encouraging its retailers to replace their languishing 8-bit cartridge game sections with CD-ROM title rental sections.

Another in-store merchandising issue is product packaging. Packaging for interactive media products is nonstandard, making its placement on shelves and other types of display furniture unpredictable.

In all but the western region of the United States, grocery stores are one of the fastest growing segments of the home video industry, providing an interesting new retail venue for interactive media titles. In most of the United States, at least half of the grocery stores include video sections. Grocery stores will, however, be somewhat slower to adopt the new products because of their space restrictions. Grocery stores operate at extremely low profit margins (between 1 and 3 percent) and must maximize their limited space. An Ingram Micro Entertainment official noted, however, that those grocery stores that have ventured into CD-ROM sales and rentals have done very well with it.

In the home video channel retailers are used to POP displays, posters, and other in-store promotions. Content publishers might not be accustomed to requests for such materials, especially if they are used to doing business mostly with computer software stores. These kinds of materials are just starting to be supplied to retailers by interactive media title publishers. For example, Compton's New Media has a John Lennon poster available for its *John Lennon: Imagine & Babylon* title. At the distribution level, East Texas Home Video produces a monthly catalog of CD-ROM titles and cartridge games for the retail channel.

One hitch publishers may encounter in distributing their CD-ROM titles through video outlets is the concept of "street dates." Interactive media publishers evolved from the universe of computer hardware and software manufacturing and are more familiar with the concept of a ship date. Video outlets, on the other hand, are used to street dates, a date set by the entertainment distributor on which outlets across the country are guaranteed videocassette copies of a particular movie for rental.

While most distributors make no guarantees and receive none from the retail channel, East Texas Home Video does give some marketing assurances to the publishers it represents. For example, East Texas promises to include the publishers' titles in its monthly catalog and may include a title in the distributor's "starter kit," a selection of 50 to 75 titles provided to retailers to help get them started in the CD-ROM title rental or sales business.

Market Directions

Interest Growing Fast

The interactive media presence at this summer's VSDA annual trade show was very impressive. Companies like Sega and Nintendo made a big splash, as did the interactive arms of all the major studios. In addition 15 to 20 game companies, and distributors exhibited at the show.

35,000 Retail Stores

With videogame rentals becoming a growing, and significant share of video store revenues, it is certain that owners and operators of the 35,000 video stores in the United States are watching closely. Game publishers, who have been divided on the issue of videogame rentals, are paying close attention to the unanimous reports that the vast majority of consumers prefer to rent a game before buying it. The personal atmosphere in video stores is more conducive to game playing than that of mass merchandisers.

A Great Demo Atmosphere

This could be one of the greatest boons to the interactive entertainment industry. Home video will become an excellent benchmark to verify the content value of interactive titles. Unless a title can be entertaining and engaging for several days, it probably will not rent well. The critical issue for interactive entertainment in home video is its rental longevity. Without an engaging and significant content value, a title will not survive. This can serve as a barometer to gauge consumer interest. Conversely, a very involved game might be too complex for the relatively short rental period of a few days, but it could help one decide to purchase the title.

Consumers would feel more comfortable buying an expensive game, like Sega's *Virtual Racing*, which retails for $99, after renting it. It will also be easier to introduce new platforms if consumers can try them out at home before making a purchasing decision. The recent Blockbuster test seems to be supporting this position, with the interest in 3DO being greater than its sales would indicate.

Excellent Synergy

Game rental activity heats up in the summer when kids are out of school. This is good synergy for video stores, whose revenues historically fall off in the summer months. The lack of new releases in the summer could stimulate the sales of more catalog games, added gravy for the game business in video stores' off-season.

Need to Change Product Release Cycle

As the industry grows, the custom of holiday season product release could put a strain on the credit lines and shelf space of retailers and distributors. It will not take much to press the limits of their credit lines. This is happening right now in home video. The upcoming Christmas releases of *Snow White* and *Jurassic Park* on video are pressing the credit limits of both retailers and distributors and holding them back from buying as many copies as they need.

A distributor's line of credit is usually equal to annual sales divided by six, which reflects a 60-day billing cycle. According to the NPD Research Group, 48 percent of all 16- bit game sales in 1993 occurred in the fourth quarter. Combine this with many products released simultaneously and it is not difficult to predict gridlock.

Interactive entertainment publishers have been reluctant to release products outside the holiday season for fear of reduced visibility. As the industry grows, this should be less a concern. Retailers are also likely to apply pressure for a more balanced product release schedule.

Warming Up to Rentals

Home video rental stores provide an important opportunity for videogames and CD-ROM titles. Blockbuster has begun the retail and sell-through program of CD-ROM titles in all of their 52 San Francisco Bay Area stores. The program is supported by Apple Computer, Sega, Philips, and Panasonic for 3DO. Nintendo and Sega cartridges will also we included in the program. Games sell-through will be nationwide by Christmas 1994.

Blockbuster will rent videogame players, such as Sega Genesis CD, Nintendo SuperNES, Panasonic 3DO, Philips CD-i, MPCs, and Apple Macintosh computers with CD-ROM drives. To increase the rental of game titles, the cost of the rental, which includes three titles and a player, is set low at $19.95 for three evenings and $4.33 for each title for two days. This encourages trial by video rental customers, and has been shown to increase store traffic.

Because offering packages of players and titles eliminates bias in platform selection, customer acceptance is based solely on the engaging quality of the content. This is an example of changing the platform distribution methods to increase content sales, and it will test whether content acceptance will drive platform adoption.

There are mixed feelings regarding the rental issue among interactive entertainment distributors. Electronic Arts, for example, charges a $3 premium to its direct video accounts, which include Blockbuster and West Coast Entertainment, in place of rental royalties. At the same time, Electronic Arts is striking deals that prevent distributors from selling their disc-based products like 3DO to rental dealers. They recently signed an agreement with Ingram to distribute their 3DO and CD-ROM products for sell-through only.

A reversal in Nintendo's objection to game rental is likely to have a major impact on the industry. We can expect to see much more cooperation between interactive publishers and the home video industry.

Other distributors are watching this trend and working on ways to adapt it to their product lines. If this approach catches on, it could signal a major step in the direction of the universal game player.

Sell-Through Is Questionable

It remains unclear whether the home video industry will become a viable avenue for the direct sales of interactive entertainment. The industry never warmed up to the idea of sell-through of video titles. It lost a big opportunity after several years of unsuccessful courting by Hollywood to convince them of its potential.

Similar Growing Pains

Among retailers, the home video retailers best understand the consumer from a personal, one-on-one perspective, and they are best suited to raise the familiarity curve with interactive multimedia. The motion picture industry has learned more about consumer preferences from home video than it did from 60 years in the theaters. Interactive media may well get its best education and economic boost from the home video market.

For the next three to four years the home video rental business should become a major catalyst for the growth of interactive entertainment. Much is to be learned from the home video industry, which has already passed through many of the problems now facing the emerging interactive entertainment industry. Experiencing rapid growth, the home video industry has become accustomed to very fast changes in the marketplace. For example, home video was initially believed to be strictly a rental business, but demand for personal copies created a sell-through business amounting to more than $5.6 billion in 1993, according to Video Store Magazine. Home video will adapt best to the interactive entertainment phenomena, perhaps better than any other retail channel.

Chapter 4

Music Distribution Model

Music—and its associated products, including music videos, film scores, and merchandise—has evolved into a complex association of participants, from songwriters, performers, producers, publishers, and distributors to retailers. The music distribution channel and its practices have matured, permitting a wide variety of participants, from independents to large international media conglomerates.

This chapter will explore how the traditional music distribution channel is prepared to accept the addition of interactive media. Lessons learned from years of changing media formats, consumer reactions to changing technologies, and the channel's ability to accept change provides insights that can guide interactive producers, affording the widest possible distribution for their products.

Songwriters, Musicians, and Music Producers

The music industry supports a wide diversity of music projects and products. Songwriters contribute to record albums and motion picture scores. Today little original music is created for interactive media, though this is likely to change.

Music producers, songwriters, singers, and musicians, and now video producers are seeking the widest distribution for their products. This includes not only the original work but also ancillary products such as motion picture scores, retail merchandise, and soon CD-ROM products.

Music and music performances are being packaged in a variety of forms, including feature films and music videos. The latter, which initially were viewed as promotion vehicles, rapidly gained popularity as an independent art form.

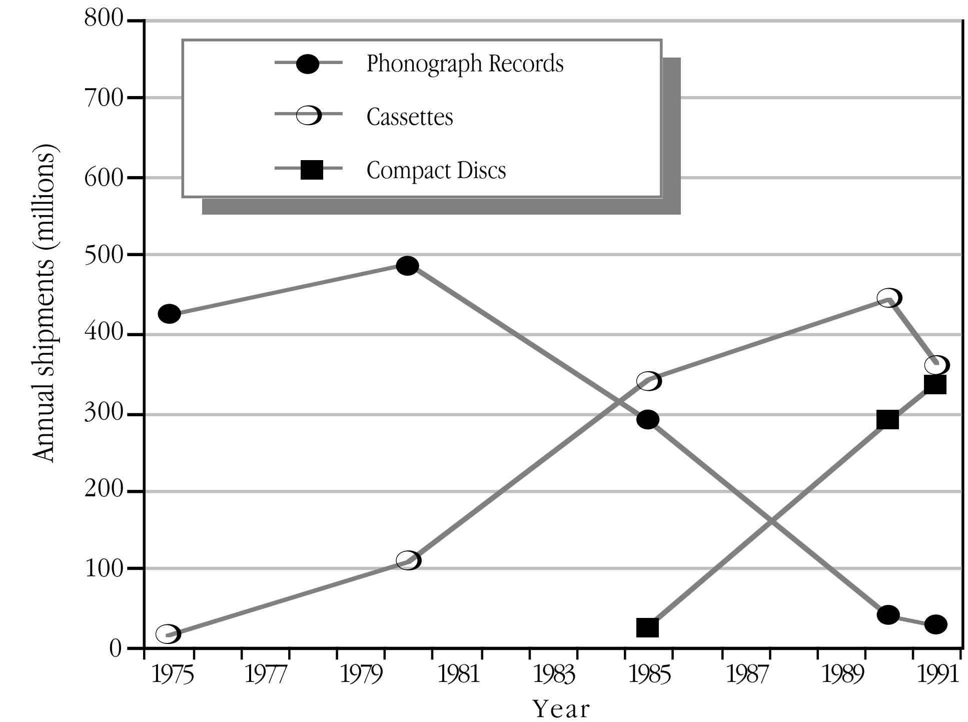
Music distribution channels have evolved to meet the need to distribute records and tapes but have broadened to move other forms of music products as well. Broadcast radio has been viewed as a promotional tool, but new forms of home-delivered records via such cable services as *Digital Music Exchange* (DMX) are now delivering digital music for a $12 monthly fee. Interactive media on CD-ROM combines music videos with other information, such as Interplay Production's *Xplora: Peter Gabriel's Secret World* where end users discover the musician's performances, recording sessions, and music. An insight to the artist's personal life and interests is conveyed via digitized images from personal photo albums.

Another example is ION's premier title, *Jump: The David Bowie Interactive CD-ROM*. *Jump* features real-time video and audio editing and allows the viewer to become a music video director and edit Bowie's *Jump* MTV video in real time and mix a version of the studio song.

Types of Media

Vinyl records have been almost completely replaced, first by tape cassettes, and now by compact discs. As these different formats were adopted, the distribution channel and retail outlets had to adapt to new types of packaging and store displays.

Analysis of the replacement of consumer audio products provides valuable insight into the market dynamics process. As shown in Figure 4-1, after several decades of dominance by the phonograph record, including 78 rpm, 45 rpm singles, and 33⅓ rpm long-playing albums, records were systematically replaced. The decline of analog audiotape is also observed.



Source: Multimedia Markets and Applications–Five-Year Forecast, Market Vision

Figure 4-1. Audio Products Replacement

More important than the changes in physical forms, such as media formats, individual packages, case shippers, store racks, and displays are the changes in promotional strategies. This relates to the design of the printed collateral materials as well as the effectiveness of in-store displays and promotions.

Different demands for dedicated floor space, displays, point-of-sale tracking systems, and security have forced retailers to limit their offerings to two types of products at a time. As new formats, such as the “minidisc,” are introduced, competition for floor space will intensify.

Interactive media packaged in CD-ROM jewel cases have the same space, shelving, and security requirements as audio CDs. This will help ease the problems of adoption by retailers.

Buyer Profile

Although music is appreciated and purchased by a wide spectrum of consumers, music stores have catered to a younger group of buyers. Initial sales of CD-ROM titles with a focus on music have occurred within two groups of buyers. These two groups consist of "popular" and traditional music enthusiasts.

Music videos promoting major artists on MTV and VH1, are becoming multimedia in their own right. As interactive media builds on this growth, a group of somewhat younger buyers, under 25, will emerge to adopt interactive products.

A second and somewhat older group will come from PC users with an interest in more traditional music. Music appreciation software gives this group the ability to explore detailed aspects of various classes of music and composers. This group will also be interested in similar products distributed through retail music stores.

Five years ago half of all record buyers were under the age of 24. Today approximately 60 percent (according to the Recording Industry Association of America) are older than 25, with the fastest-growing segment over the age of 45.

Different target age groups will probably purchase products in quite different channels. More than 40 percent of the audio CDs are purchased by those 24 or younger. This demographic group is not likely to spend large amounts of time in software stores. To reach this age group, interactive music CD-ROM products will need to be available in traditional record stores, such as Tower Records, Musicland, Sam Goody, and The Wherehouse.

The average CD-ROM drive owner, a 35-year-old white male, is more likely to be found browsing the shelves of a computer software store. Titles catering to this interest group will have a higher probability of purchase in computer stores than in music stores since these purchases may well be "impulse buys."

Expanding interactive music products to a mass-market buyer will be more difficult than selling traditional audio-only products, since the purchase decision involves more than playing music at home. Portable uses, hands- and eye-free applications, and background filler uses will not be met by interactive media. So the use of interactive media will be restricted to active participation not passive use.

Channel Revenues

Distribution channels for music products, including tape cassettes, compact discs, and vinyl records, have evolved into a complex collection of participants. These are divided roughly based on their size relating to the volume of product produced or distributed and the popularity of the artists they cover. The channel also supports ancillary products, such as sheet music, retail merchandise, and motion picture music. Although the principal product for interactive producers will be compact disc products, other opportunities will evolve as the channel begins to mature.

As shown in Figure 4-2, the music distribution channel in the United States is divided into major record companies, smaller ones (mini), and much smaller independent labels. Artists, groups, and songwriters sign exclusive contracts with one of these depending on their level of "stardom." Their bargaining power at the time of signing will determine the nature of the deal. Percentages in Figure 4-2 refer to the portion of consumer revenues retained by each participant. These will vary considerably depending on the nature of the relationships and deal-making strengths of the individuals.

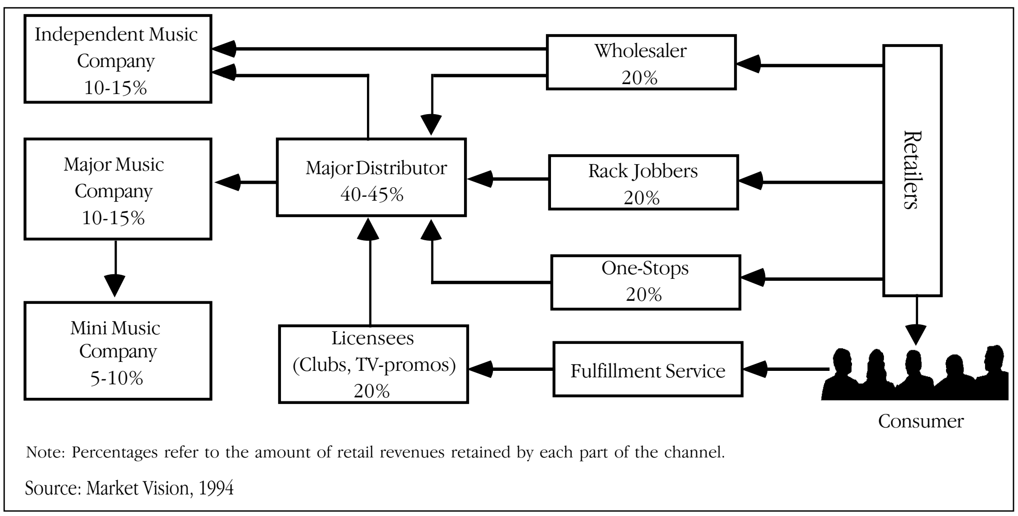


Figure 4-2. U.S. Music Revenue Streams

Major record companies, such as Warner Brothers, MCA, and Sony always distribute through major distributors, some of which were created specifically to serve their needs. There are only six major distributors in the United States: BMG (RCA Records and Arista), CEMA (Capital, EMI-America, Virgin, and Chrysalis), MCA (MCA and Geffen), Polygram (Polygram, A&M, Motown, and Island), Sony Music (Sony, formerly Columbia Records, Epic, and Portrait), and WEA (Warner Bros., Elektra, and Atlantic). These distributors may also carry smaller labels including those of mini music companies and independent record producers.

Independents are record companies that are not owned by a major or mini producer. Many have agreements to distribute on a major distributing company's label. Products are generally released on the independent's own private label.

Some independent record companies distribute their products through independent distributors. They do this to reach specialized markets, such as rap, blue-grass, and Spanish, which are considered too small to get the attention of major distributors. Once the new genre gains wide attention, the majors may pick it up as occurred with rap and hip-hop.

Serving retailers and the customers directly are four groups of transporters and exhibitors, which include wholesalers, rack-jobbers, one-stops, and licensees. Wholesalers provide support for the local distributors (exhibitors). They buy from the major and independent distributors, and sell to retail stores. Rack-jobbers lease floor space from department stores, such as Sears, Kmart, and Target, and maintain their own racks of stock. They pay rent to the store and are responsible for selecting and maintaining the stock.

One-stops cater to small independent music stores and can distribute very small volumes of product. Because the quantities are small, the prices are generally higher, which is acceptable because these stores cater to highly select groups of customers paying for convenience or selection (in many cases for hard-to-get titles and special genres, such as British imports, aerobic music, and comedy albums).

The fourth type of transport is the licensee. Licensees consists of music clubs, TV promotional offers, and foreign distributors. As CD-ROM begins to reach major channels of distribution, TV promotions and clubs will also be interested in carrying these new classes of titles. Distribution outside the United States is through licenses to produce products within individual countries.

As shown in Table 4-1, the top six music retailers comprise 36 percent of the nearly $10 billion industry. Overlap between these music and software distribution channels will grow as products are packaged for consumers.

	Revenue ($ Millions)
Retailers	
Musicland Stores Inc.	933
Tower Records	800
Trans World Entertainment	493
Wherehouse Entertainment	472
Camelot Music	421
Blockbuster Entertainment (music division)	404
Publishers/Distributors	
Warner Music Group	3,330
Sony Music Entertainment (1992)	3,300

Source: Companies filing with SEC and company reprrts.

Table 4-1. Music Industry Revenue for 1993

Channel Successes and Failures

The distribution of music and associated products has been very successful and supports a diversity of opportunities. As the music industry goes beyond traditional music products to promote CD-ROM and other forms of digital media, the channel will face many new and unfamiliar challenges.

Nascent Markets Fuel Price Erosion

Historically price erosion has plagued all interactive media distribution channels. When products are priced too high and over-hyped, the potential exists for consumer disappointment. Signs of this have already been seen with large numbers of CD-ROM products being returned both for defects and for failure to deliver on the promise of a $50 product. This has two effects: price erosion and full discount bins, which flood the market with inferior product.

The average price for CD-ROM products has declined from $50 in 1993 to about $40 in 1994. Further declines in pricing are anticipated, driving the price below $20 by 1996. Several product distribution strategies, such as bundling, are fueling this price cutting and may well accelerate the process.

Product Bundling

Bundling can be an effective distribution strategy if applied judicially for the right reasons. Bundling helps build brand awareness by aligning with high-profile partners and can also be an effective tool extending product life cycles. Bundling will be effective if it is used to enhance product visibility with the customer.

Bundling is more effective as a long term marketing strategy than as a short-term method to increase a product's return on investment. In cases where sequels or succeeding products are coming down the production pipeline, bundling can be a very effective marketing strategy to increase brand awareness among consumers. The possible loss of revenues from bundling can be easily offset by the increased value of brand awareness. Aligning with high profile partners like Apple Computer enhances the credibility of a new brand trying to make a name for itself. The drawbacks of bundling can be minimized by requiring stand-alone shelf copies of the product to be sold alongside the bundled package. In this way if the product is promoted by word of mouth, consumers can also buy the product unbundled at the same retail location.

If misused, bundling can lead to price erosion, channel conflicts, and misconception by customers, which can erode the real value of the product. Bundling of new releases can lead to long-term negative effects. The promise of very large sales numbers motivates content owners to accept lower royalties. However, if the manufacturing cost is a large percentage of the cost per copy in a bundle, the product may become profitable.

Bundling may well delay consumer purchases and give the wrong message to the consumer that the product is not worth much if bundled with inferior products. Most bundles are done with premium titles, often very close to product release. In this case the consumer can become confused, and the result may be a stalled purchase or, worse yet, an alienated potential buyer.

Uncertainty About Copyright Protection

The basis for large revenues that exists in the music industry is the close control of copyrights and other properties. Special organizations, such as ASCAP (American Society of Composers, Authors, and Publishers), and BMI (Broadcast Music Incorporated) have been established to ensure that the creators are adequately compensated for their work. This approach is respected throughout the industry, policed, and reinforced by periodic court tests.

The United States music industry is very concerned about digital recording formats. Since digital music does not degrade when copied and has a longer product life, the music industry stands to lose a lot of revenue by selling a CD instead of a tape that degrades after 100 plays. This is the reason that CDs are more expensive than tapes, even though production costs are lower.

After years of court battles, Digital Audio Tape (DAT) is finally reaching the market, but only for professional applications. Compact disc suppliers lobbied fiercely to hold the new generations of digitally recordable tape products off the market until audio CDs had secured their market position.

The music industry has made a legal case that a certain percentage of blank audio cassettes are used for illegal copying for personal use. This has been partially compensated for by taxing the consumer to pay a royalty to the music industry for the blank cassettes. High-capacity digital storage devices present a new problem, since DATs can be recorded bit for bit from CDs with no degradation in quality. The industry demanded special protocols be implemented in DAT recorders to disable this type of copy. It also demanded that DAT recorders sample at a different frequency than CDs (48k rather than 44.1k). All this has essentially blocked the consumer market for DAT products in the United States.

The next wave will be recordable compact discs, including Sony's mini-disc. These discs are expected to experience similar objections. Much of the fight is centered around the ability to copy digital recordings. This continues to be the important issue, and the battle will escalate as interactive media disseminate "master"-quality products.

Partnerships Are the Rule

The ability to produce a profitable product will require successful partnerships. These must combine content providers with those who have sufficient technical knowledge.

There is currently a perception that the industry is large enough to support high product budgets capable of producing high-margin titles. According to PC Data, out of the top 20 consumer CD-ROM products, the annual gross revenue for the number one title is less than $4 million; revenue drops precipitously to somewhere around $500,000 for products at the lower end of the top 20, while the production cost alone may exceed that annual gross revenue. The handful of titles generating high revenues indicates that the market is still nascent, and that developers must either have deep pockets or strong partners who have deep pockets.

Music Distribution Profile

Representatives from Ebook, New Leaf Entertainment, and Time Warner were interviewed for this music distribution profile.

If 1993 was the year of the CD-ROM, 1994 must be the year of the interactive music CD-ROM, based on newly created music titles available before Christmas from noted artists such as Peter Gabriel, Todd Rundgren, Prince, and David Bowie.

In January 1994, Todd Rundgren, or TR-I (Todd Rundgren-Interactive) as he now calls himself, with his *No World Order*, was the first musician to release an interactive music CD-ROM. Since then several musicians have jumped on the interactive media bandwagon. They include Peter Gabriel with *XPlora 1: Peter Gabriel's Secret World*, which was produced by Brilliant Media. The artist formerly known as Prince has released *Interactive*, produced by Graphix Zone Inc. The Residents' previously released *Freak Show* album has been reissued, and augmented by Cryptic Corporation into a whole new music experience.

Jouissance, in conjunction with Rhino records, is developing music titles that consist of 1960s rock and soul for Christmas 1994 release. And Thomas Dolby has created AVRe (Audio Virtual Reality engine), an authoring tool for creating interactive music CD-ROM discs. ION's Ty Roberts is finalizing an interactive liner note program called OPTION which enhances music-based CDs. OPTION will allow the listener (viewer) to browse at his or her own pace through photos, still or animated graphics, video, lyrics and sound bytes. OPTION significantly augments existing CD liner notes, adding a degree of depth not possible in a 5-inch booklet.

Consumers who buy new interactive music CD-ROM discs may be disappointed when they get home, crack the shrink-wrap, insert their new disc into their CD-ROM player and receive only between four and six full-length songs. The reason for limiting the amount of audio on interactive music CD-ROM discs is a technical one. One full audio compact disc using Red Book, or 16-bit, audio fills up a CD-ROM. To include interactive media tracks, the interactive music CD-ROM developer must limit the amount of audio. In the case of the *Heart: 20 Years of Rock & Roll* disc, the developer chose to include five hours of mono-aural audio, most of it in interviews, and 60-second clips from the Heart discography.

Jouissance's titles, however, will be among the first interactive music CD-ROM discs to target a mainstream audience, offering as much music as a typical CD (10 tracks, more or less), with original graphics and animation, video, liner notes, and obscure interviews playable on Apple Macintosh computers or with a PC CD-ROM.

The traditional model for music distribution begins with an artist-and-repertoire representative from a record label, or a talent scout, "discovering" a musician or group of musicians and signing them to the label. The record label (publisher or publisher-distributor) then pays for recording, pressing, packaging, distributing, and promoting the musicians' audio recording. The larger labels act as the publisher and distributor. Smaller labels publish and represent a recording artist or artists, but usually distribute their music product through an affiliate label arrangement with one of the major labels.

Distribution in the traditional music channel is two-tiered. Large record stores usually purchase music products directly from the major labels to receive volume discounts. Independently owned record stores and small regional chains often go through jobbers, or "one-stops," that stock a wide variety of titles and small labels but do not provide the deep discounts of buying directly from a label.

Industry experts recommend cross-merchandising and cross-promoting interactive music products to the software distribution channel as well as the emerging music distribution channel to reach both audiences. In some ways it is difficult to distinguish the two models because the computer software distribution channel borrows heavily from the traditional music distribution channel. For example, the concept of "gold master" derives from the music industry.

Presently there is no single procedure for licensing a combination of audio CD with interactive media products. For instance, interactive media does not come under compulsory licensing the way audio recording does. The license must be negotiated. "There is no standard deal," commented Terry Schussler of Graymatter Studios at the San Francisco International Film Festival's Interactive Media and Music Showcase in spring 1994.

Mechanical licensing fees of 6.6 cents per title per disc are owed even if a license is not held. Presently a combination of mechanical licensing and synchronization rights constitute interactive media copyrights. When interactive music (music and interactive media) copyright procedures become more standardized, a more precise channel model for interactive music distribution will emerge. For now it remains a mix of the traditional music distribution channel and the computer software distribution channel, which itself borrows heavily from the traditional music distribution channel.

Market Directions

The music retailing business is changing fast, with record stores giving way to multimedia stores selling everything from games to comic books, computer software, greeting cards and CD-ROM titles. Until recently music stores catered primarily to the under-25 age group, but this is changing as retailers expand their offerings to attract a wider age group. Retailers are now targeting families and baby boomers in an attempt to broaden the buyer groups beyond teenagers.

In the last two years Blockbuster Entertainment has built more than 500 music outlets, and it is attempting to dominate the $10 billion industry. Musicland Stores is the top U.S. music retailer with more than 900 stores and is quickly adding Media Play stores supporting interactive media titles. The Media Play stores, which began with 13 stores in 1993, are expected to number more than 180 by 1998 with a shift from mall stores to less expensive strip shopping centers.

Several trials are underway to evaluate the effect of distributing music-related interactive titles through retail music distribution channels. These early attempts will determine the nature and extent of the product that will be released to this channel. Other minor channel opportunities, including cross-merchandising, will be investigated if these major efforts prove fruitful.

Allocation of sufficient floorspace to interactive media and demonstration equipment must occur if initial efforts to promote products are to be effective. If this does not occur, interactive products will predominantly be purchased through computer software stores where the necessary promotional and technical support have been provided.

It is clear that music retailers now realize the importance of cross-merchandising. Drawing customers into the store affords an opportunity to expand their purchasing to include new forms of media, including interactive titles. Although the initial titles promoted will build on the music buyer's interest, it will not take long for music retailers to seize the opportunity to offer a wide range of interactive media titles.

Chapter 5

Book Distribution Model

The distribution channel for books, including hard-bound, paperbacks, magazines, and newspapers, has taken decades to develop into a stable infrastructure. Within this structure dominated by large distributors, such as Ingram, small publishers for specialized markets have flourished. All of these media publishers are exploring new forms of packaging, including audio books, music, video, and CD-ROM. The book industry is waking up to the possibilities of digital media, and are taking initial steps to create and merchandise new forms of publications.

Traditional print publishers, such as Time Warner, McGraw-Hill, and the *Wall Street Journal* are investigating new forms of digital packaged media and electronic distribution. For example, Time Inc. launched several interactive media publications in 1993, including the Time-Life Home Repair titles and six other titles based on the Time-Life series. In addition to traditional publishers becoming interactive media publishers, the distribution channel and bookstores are expanding their offerings beyond books, magazines, greeting cards, and coffee.

Delivered on CD-ROM and floppy disks, interactive media are being applied to the repackaging of traditional sources of media content. Printed books, periodicals, comics, newspapers, sports records, audio books, and many general interest and specific topics areas are being converted to digital media and packaged for both new and existing distribution channels. Both in-house and independent producers contribute to the building of content. The sources of content cover all areas of traditional print media.

This chapter explores how the traditional book distribution channel is prepared to accept the addition of interactive media. Consumer reactions to changing technologies and the channel's ability to accept change provides insights that can help interactive producers achieve the widest possible distribution for their products.

Writers and Producers

The entertainment industry consists of film, video, broadcast, cable, and videogame software. All of these are exploring the repackaging of existing media and digital delivery through book channels. The entertainment industry will approach interactive media from the standpoint of reuse of existing "properties" (footage and characters), while the artistic community will seek to develop an entirely new genre.

The lists of titles and categories for interactive media parallel those of traditional books. Everything from children's books and home improvement to pornography are finding electronic counterparts. The categories generally divide into leisure, information, reference, and instruction.

Because interactive media products will be driven by "engaging" content, book authors who have retained their original rights are in an excellent position to create interactive media works that build on the printed version. Examples include authors and publishers of coffee table books.

Information providers cover both business and consumer topics, such as business news, world news, sports, weather, product information, reference materials, and general interest topics. This diversity of information is now being selectively converted into digital form, and made available through packaged media (CD-ROM) and online data services. Information titles are too numerous to describe here, but they can be simply divided into news and reference.

The list of reference content providers grows daily, with traditional reference book publishers moving into the interactive arena. Some of the more popular Apple Macintosh titles include *Grolier Encyclopedia*, *World Atlas* by Software Toolworks, and National Geographic's *Mammals: Multimedia Encyclopedia*.

Dorling Kindersley is an international publishing group specializing in creation, production, and publication of high-quality illustrated reference works. They publish in over 80 countries in 37 languages and deliver titles to more than 400 publishers worldwide. DK Interactive media, partly owned by Microsoft, is investing heavily in interactive reference works and is releasing five works, including *The Eyewitness Encyclopedia of Science*, *The Ultimate Human Body,* and *The Way Things Work* by David Macaulay.

Good instructional design and effective use of the delivery medium are essential components of interactive media's ability to deliver a powerful learning experience. This demands an in-depth understanding of the subject area and teaching techniques as well as thorough technical knowledge of the different delivery media.

Instructional materials are being developed for several specialized groups of users. These include institutional learning, such as primary and secondary schools (K–12) and universities and colleges, and special education technical training targeted at business, military, and in-home learning. Titles will target specific age groups or will be subject-based. Each of these groups represents vertical markets for instruction providers, and each has special needs.

A highly effective training title, *SimHealth* by Maxis Business Simulation, presents a view of an environment where people can explore, understand, learn, and discuss. The costs to produce custom products are typically $50,000 for the feasibility study, and $300,000 for the final development. The costs for professional productions are increasing, with projects of $500,000 to $1 million becoming common. Projects of this magnitude demand careful planning and project management and a clear understanding of the needs of the consumer.

Types of Media

Bookstores have traditionally distributed a wide variety of publications, including hardbound books, paperbacks, magazines, and newspapers. This channel has also experimented with videotapes but without much success. Audiotape were slow to start in bookstores but are now very successful, and bookstores are allocating more shelf space. Now new forms of media are again attempting to gain shelf space and provide opportunities for browsing customers to expand their selection beyond printed media.

Some book retailers have carried floppy disk products that were packaged for the software industry. For example, Ingram, which distributes to bookstores and libraries, carries CD-ROM and floppy disk products for Windows and Macintosh platforms. Their sales are about two-thirds CD and two-thirds Windows.

Interactive instruction providers are emerging from several areas beyond formal education. Consumer education and “edutainment” titles are reaching the home learning market on CD-ROM and floppy disk. Interactive media educational titles are targeted to several special groups, such as childhood learning, adult self-improvement, language skills, music appreciation, and job training. As with Jostens Learning, titles for home learning complement school programs. Several titles featuring “role-play” are also effective tools.

Today two types of media, floppy disks and CD-ROM, are being packaged with books and also displayed separately. When accompanying books, discs require few additional packaging materials since they are delivered in sleeves. Special packaging and shelf and counter displays may be required.

Buyer Profile

Buyers of books cover all ages and all groups. The initial targets for interactive media are children and adult self-improvement. Because interactive media require platforms for playback, the target buyers must be those with available computers, mostly PC-compatibles running Windows and Macintosh computers. The demographics of CD-ROM owners will drive the types of titles that will initially be released.

One of the largest of these categories is children's topics, which include interactive animated storybooks. Sanctuary Woods's winner of the 1993 Invision Children's Enrichment Award, Brøderbund Software is a leading company that distributes the Living Book series, including *Just Grandma and Me*, *The Tortoise and The Hare,* and *Arthur's Teacher Trouble*. Sound, interaction, and simple animation are provided in a format that encourages exploration. The popular Carmen Sandiego series has sold more than 3.5 million copies and is not only Brøderbund's leading title but also the leader in the children's category. Paramount Interactive's *Busytown* is based on the renowned children's book, *Busy World*, by Richard Scarry. Philips Media publishes a library of family entertainment titles on CD-i. Titles in the library include *Alice in Wonderland*, *A Visit to Sesame Street*, *Berenstein Bears on Their Own*, *Children's Bible Stories,* and *The Best Baby Songs*.

Media titles for book distribution must appeal to traditional bookstore customers, who look for relevant and purposeful content, ease of installation (books can be easily paged through), and a logical interface design (indexing). Most interactive media programs are based on a database of information, such as an encyclopedia on a CD-ROM.

Publishing channels will likely do well with reference topics. Encyclopedias, travel guides, and medical references have already experienced much consumer interest. Interactive textbooks and course support materials are just beginning to be introduced. As this occurs, bookstores and libraries will increase their offerings.

Bookstores are beginning to have success with children's education titles, adult reference, and the group of products loosely described as edutainment.

Channel Revenues

Book distribution is a mature industry that is built on relationships between publishers and retail outlets.

The greatest demand for a new title typically begins about a month or two after it's been released, after the bookstores have sold out of their initial purchases. This is a very different model from that of the software channel. Buying strategies for software are much different, with the initial buy in the thousands of copies. A book distributor's initial buy for new titles is relatively small, because demand lags a month or two behind publication, after which demand for a successful book becomes very steady.

As shown in Figure 5-1, the United States book industry is based on a relatively simple model connecting retailers directly to publishers. Publishers typically go directly to a bookstore. The bookstore buyer places the initial order for a new title directly with the publisher to obtain a better price. When initial orders are sold out, bookstores use distributors for ongoing fulfillment because of their more available inventory and faster delivery.

Percentages in Figure 5-1 refer to the portion of consumer revenues retained by each participant. Authors generally receive 10 to 15 percent of the revenue from a title, while the publisher receives the largest share. Distributors play important roles but account for only about 20 percent of the actual distributed product. Once a deal is concluded between author and publisher, the publishers pays the author an advance against royalties. The publisher is responsible for production, promotions, and insuring distribution with both retail outlets and distributors. The publisher is also responsible for accounting, reporting, and protecting the author's copyright for the work.

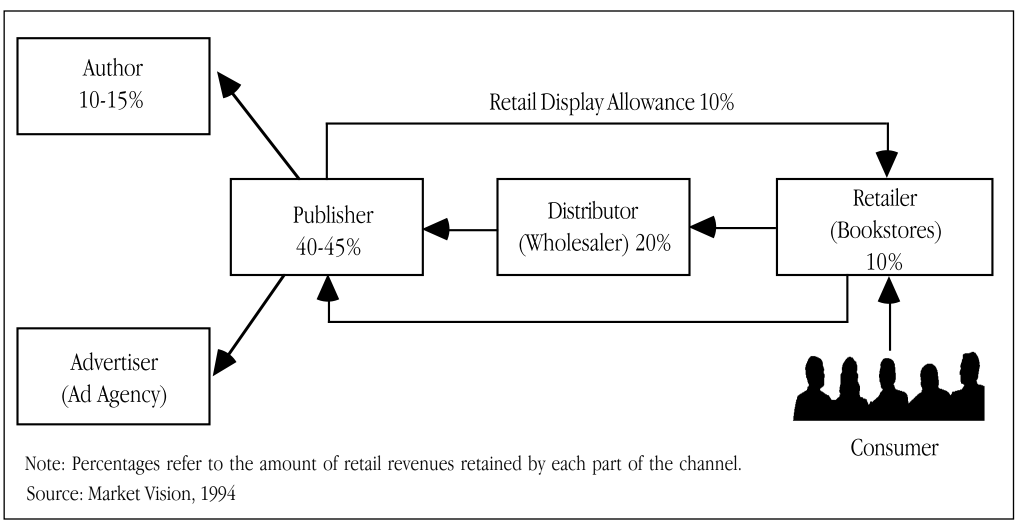


Figure 5-1. U.S. Book Revenue Streams

Revenue for book retailers, publishers and distributors are shown in Table 5-1. According to the Association of American Publishers, book publishing industry sales exceeded $18 billion in 1993. Today, the distribution of CD-ROM products is a very small part of their overall business.

	Revenue ($ Millions)
Retailers	
Barnes & Noble	1,100
Waldenbooks	980
Crown Books	235
Borders Books	184
Books-A-Million	103
Encore Books	65
Publishers/Distributors	
Dun & Bradstreet	4,700
Ingram Inc.	4,000
Harcourt General	3,700
Time Inc.	3,270
Readers Digest Assn.	2,900
McGraw-Hill	2,200

Sources: Adjusted from nine-month revenues, Publisher's Weekly, 1994;
Company reports, revenues reflect more than book publishing.

Table 5-1. Book Industry Revenue for 1993

Brøderbund, an early leader in book distribution of CD-ROM software, currently sells in all of Random House's channels, including superstores, mall stores, mass merchants, consumer electronics stores, warehouse clubs, office clubs, bookstores, and some toy stores. Music stores are not normally outlets for books except for music specialty books.

Ingram takes another approach. It is strictly a demand jobber, meaning that it provides only distribution fulfillment. It stocks products in warehouses and relies on the publishers to generate demand in the marketplace. Ingram also distributes to libraries.

Crown Books has begun a test of the potential opportunity for CD-ROM sales. It is just one of several major book chains investigating expansion of current offerings to include digital media. Several distributors that serve book channels, such as Baker & Taylor and Ingram, are also involved in video and music. Tests are underway in each of these channels. Many of the tests of market potential are expected to yield their first major results during the 1994 Christmas season.

Channel Successes and Failures

Book distribution channels have been very successful for traditional types of publishing works. Several experiments are underway to evaluate whether these channels can accept and support digital media. There are early indications that the channels will be receptive to new forms of merchandise but may have difficulty supporting the highly technical platforms required for playback.

Cross-Merchandising

Bookstores have been successful in expanding their product offerings to include such items as greeting cards. They have also provided an environment conducive to "browsing," where the buyer can sample the product in depth. Some stores provide a coffeehouse atmosphere to enhance this activity and maximize the amount of time potential buyers spend in the store, thus maximizing the possibility that they will purchase other items.

This "try and buy" approach will also be required for interactive media. Stores will have to provide specialized equipment without compromising the librarylike atmosphere. They will need to use special areas, soundproofing, or headphones.

There are three approaches to merchandising CD-ROM products: sold separately, bundled with books, and with accompanying books. Of these, bookstores will employ the first two.

CD-ROM Bundles

A common practice is to bundle books with CD-ROM discs in specially designed back covers. A significant problem with this approach is that the perceived value of a disk bundled with a book is not as high as the book bundled with a disk.

Bundling is a marketing phenomenon that has its roots in the software distribution model and is highly popular in the book channel. Computer book publishers have long included a floppy disk or even a CD-ROM disc with lines of code, utilities, tutorials, or sample graphics files in the back covers of books. There are two ways of looking at bundling: A disc is packaged with a book almost for free, or a book is included with a CD-ROM product almost for free. For example, Living Books includes picture books with its popular children's electronic books.

Whichever way the bundling is approached, the perceived value of either the book or the software will be lessened. For that reason, some publishers will not bundle their products. For example, a Brøderbund spokesperson commented that his company has never been aggressive at bundling, so its products are not cheapened by the time they get to the shelves. Bundling can increase value for the consumer when it appears the CD-ROM adds value to the product.

Although the question of whether a CD-ROM is bundled with a bound book or if it's the other way around may appear to the average consumer to be strictly a matter of semantics, the distinction makes a world of difference to the title developer. A Brøderbund official explained that if it is a book with a CD in the back, the economics do not work, because buyers want it priced as a book with the CD-ROM as gravy—about $9 more than the price of the book alone. The cost of developing the CD-ROM to anything like commercial potential is way beyond what can be covered by $9.00 a copy.

The question of copyright protection for CD-ROM titles also enters into the bundling equation. For instance, booksellers require all books sold through bookstores to be identified by a unique ISBN number; software does not carry the same requirement.

Bundling can account in many cases for half the volume while providing only about 5 percent of the revenue. Only certain types of products, such as large-format coffee table books, will be able to accommodate sufficiently increased prices to provide companion CD-ROM discs.

Employee Training and Technical Support

In addition to supplying good content, interactive products must be extremely easy for standard desktop computers to play back. This applies not only to consumer devices but also to demonstration equipment, such as in-store kiosks, PCs, or videogame players. It is going to be critical that stores have support personnel capable of answering questions not only about the types of titles available but also about the installation and operation of the equipment used to play the products. Customers will be disappointed with the titles if they are difficult to install and use and do not deliver on the title's promises.

Bookstores have mostly provided staff capable of assisting customers in locating specific books either from personal memory or by accessing a textual database (computer index and locator). Consequently the level of technical experience and training of employees is minimal. To merchandise and sell CD-ROM products effectively will require extensive employee training on the types and actual use of the interactive products.

Book Distribution Profile

Representatives from Ingram Micro-Books, (an interactive title distributor), Brøderbund, (a software company), and Living Books, (a publisher) were interviewed for this distribution profile. Living Books is co-owned by Brøderbund and Random House focusing on children's interactive animated storybooks.

Bookstores are expected to become a significant retail channel for interactive media titles by Christmas of 1994. This occurrence seems appropriate given the num-ber of major paper-based book publishers that have entered the interactive media publishing field. They include Random House, HarperCollins, Simon & Schuster, Macmillan, and Dorling Kindersley Publishing.

Entering this niche from the interactive media side are title developers that specialize in creating electronic book products. Some of the major players in this field are Brøderbund (through Living Books, its Random House co-owned subsidiary), EBook, Sony, and The Voyager Co. (through its Expanded Books series).

The traditional book distribution model is similar to the two-tiered music distribution model, except that both large and small booksellers tend to place their initial orders directly with the publisher, sidestepping distributors. In book publishing, distribution accounts for as little as 20 percent of the entire industry, according to some estimates. Living Books follows the traditional book distribution of one of its parent companies, Random House, as well as the software distribution channel of its other parent company, Brøderbund. For secondary orders, bookstores frequently contract jobbers like Ingram Micro, which are similar in function to the "one-stops" of the music distribution channel, carry a wide inventory from many publishers, and can fill a bookstore's order within a couple of days.

At the retailing end of the model, booksellers are a cautious lot and have not embraced new technology products as quickly as similar retail channels in the music and video industries.

Book publishing has long been considered a "gentlemanly" occupation. With the trend over the past two decades of larger publishing houses merging with their competitors and acquiring smaller presses, the publishing industry has lost some of its gentility and has become more traditionally corporate.

Electronic book publishers like Living Books are respecting book publishers' traditions by developing the retail channel slowly, expressing concern that retailers can "sell-through" the interactive media products that they stock. Like other retail outlets, bookstores have limited shelf space for a seemingly infinite number of titles, both in print and on disc. A Living Books spokesperson sees a change in distribution, noting that there are going to be stocking fees for retailers who start selling shelf space by the linear foot. In addition to bookstores, Living Books currently distributes in just about every channel that sells CD-ROM software, including superstores, mall stores, distributors, mass merchants, consumer electronics stores, warehouse clubs, office clubs, and even some toy stores.

Some publisher-distributor concerns include the following:

- Will the retailer used to specializing in one market (books, video, CDs) be able to answer customers' questions about the new products? For example, not all CD-ROM discs are easy to install, and not all hardware is plug-and-play. In fact, in the Windows environment, most PC-clones, CD-ROM drives, sound cards, and speakers (interactive media upgrade kits) are made by third-party vendors, and the components frequently do not work together in harmony. For a computer-oriented user this problem may simply pose a technical challenge, but for the book-oriented end user, hardware wars may create insurmountable obstacles.

  Plug-and-play, a new standard now under development for the PC-compatible platform, allegedly will guarantee that compliant PCs and third-party peripherals, such as interactive media upgrade kits, CD-ROM drives and sound cards will work together without hardware conflicts. Apple's Macintosh computers have never experienced these kinds of incompatibilities.
- Another industry leader worried that when mass merchandisers, such as Kmart, Price Costco, Sears Roebuck & Co., and WalMart, offer electronic books for sale, they will select only the bestselling titles.
- Not having the staff training and knowledge to support the products adequately, both the merchant and customers may have a poor initial experience with interactive media products.
- Software generally has a UPC bar code, whereas books and some related materials receive an EAN bar code, if any. One book distributor recommends putting both bar codes on electronic books and bundled books straightaway. That way the product can be sold through the mass merchandising, consumer, and software retail channels.

  Any book or booklet that is marketed in the book trade is eligible for an ISBN. The distributor usually determines which books need an ISBN. Magazines and other periodicals do not use ISBNs.

- Consumers like to browse in bookstores, often reading substantial parts of a book before eventually buying it. CD-ROM titles likewise require a preview station, either a kiosk or a personal computer with a CD-ROM drive. A noisy kiosk can be disruptive in the normally quiet bookstore atmosphere. Some government agencies that place kiosks in public spaces include headphones in the kiosk design.

  According to Ingram Micro's book division representative, a lot of booksellers want to use kiosks or put a PC in the store and have actual software on it for customers to try. Ingram is now testing in 50 locations around the United States a kiosk it has designed for booksellers to use for demonstrating interactive media titles. Apple Computer is also leading a demonstration project with six multimedia publishers to introduce electronic books to avid book readers.

Apple Computer's Kiosk Project

Apple Computer, Creative Multimedia Corporation, Discis Knowledge Research, Macmillan New Media, Time Warner Interactive, Putnam New Media, and The Voyager Company are testing the sales potential for interactive software in bookstores across the United States and Canada.

The March 21, 1994 *Wall Street Journal* article calls the Apple Kiosk Project "the most ambitious electronic book demonstration project…aimed at winning over avid book vendors to the new technology." The project, known as the "kiosk project," involves four major bookstore chains and four leading independent booksellers in six cities, including: Barnes & Noble, Shakespeare & Company, Tower Books in Denver, The Tattered Cover in Los Angeles, SuperCrown Books in Toronto, Coles Bookstore in Ontario, and Wendell Holmes Bookstore.

Each bookstore will use a kiosk with an Apple Macintosh for CD-ROM titles and an Apple PowerBook for Expanded Books, which are unabridged books on floppy disk. The CD-ROM and Expanded Book titles are provided by the participating publishers. Featured CD-ROM titles in a kiosk include *A Hard Day's Night* from The Voyager Company; *The Family Doctor, 3rd Edition* from the Creative Multimedia Corporation; *HellCab* from Time Warner Interactive Group; *World Tour Golf* from FeatherOut, Inc.; *Peter Rabbit* from Discis Knowledge Research; *Macmillan Children's Dictionary* from Macmillan New Media; and *Big Anthony's Mixed Up Magic* from Putnam New Media. Expanded Books titles include Voyagers' *The Pelican Brief* by John Grisham; *The Complete Hitchhiker's Guide to the Galaxy,* by Douglas Adams; and *Virtual Light* by William Gibson. Macmillan New Media's Expanded Book titles include *All That Remains* by Patricia D. Cornwell and *I Love Boston Guide* by Marilyn J. Appleberg.

Early sales results indicate strong interest on the part of consumers and bookstores. Sales results are showing 60 percent of the purchases coming from CD-ROM titles.

Apple Computer along with The Voyager Company expects this test to provide valuable information on customer interests both in the type of popular titles and the ability of the technology to delivery an engaging and rewarding experience.

Market Directions

A significant opportunity exists for bookstores to sell CD-ROM products as well as their traditional offerings. Publishers from industries outside book publishing are now also interested in distribution to book channels.

In an average week Ingram takes orders for interactive media software from about 250 bookstores out of approximately 35,000 bookstores served. This is a very small percentage of the total account base currently ordering titles, although the number seems to be growing.

Several experiments are under way to test consumer acceptance and determine the best method of packaging, display, and support. The industry is gearing up for a major test for the 1994 Christmas buying season. The results will have a major impact on whether titles are sold with an accompanying book (CD-centric) or as a book with software in the back (book-centric).

The success of marketing CD-ROM titles as books or software will have a significant impact on the pricing of these products. The pricing issues are not resolved today but the added value of a CD-ROM included in a book is not likely to be perceived as more than $10. This is contrasted to selling the product separately for $30 to $40. The consumer will decide whether these products fulfill the perceived value as indicated by acceptance of the price and the level of return activity.

Another issue bookstores may have to address is whether to display "spine out" or "face out." Traditionally they have condensed a large number of titles on the shelf by displaying mostly spines. Bookstores not only will have to allocate floor space to demonstration equipment but also will have to increase the shelf space for face-out displays. This will affect both the number of titles displayed and the competition with printed books for available shelf space.

One of the biggest changes in distribution may well be the growing practice of charging a stocking fee to buy shelf space by the linear foot. Large publishers and distributors will have a significant advantage over small publishers, obtaining the most effective shelf exposure.

Bookstores have evolved into an environment conducive to browsing. Stores that have appropriate demonstration equipment available to customers may be very effective in assuring customer satisfaction. Helping customers evaluate products prior to purchase, if done effectively, will enhance the opportunity to move significant quantities of CD-ROM products through the book distribution channel.

Chapter 6

Computer Software Distribution Model

Beginning with a simple, manufacturer-direct distribution channel, the software industry has expanded to use multiple distribution channels, including consumer retail, mail order, bundling with hardware, and soon electronic distribution. An abundance of programs for businesses and recreation comprise this industry.

Over the relatively short period of 17 years since the beginning of the personal computer industry, a wide variety of applications has evolved for many different platforms. Large text databases and productivity software distribution have accelerated the installation of CD-ROM drives in business and the home. The availability of these drives will accelerate growth of interactive media.

This chapter examines how the software distribution channel is positioned to accept interactive media and accommodate its future growth. With years of experience selling software through various channels, the industry can help guide interactive media developers in the development of new channels. However, the computer industry has not had great success in developing consumer channels. Assistance in this area will have to come from the consumer electronic sectors or from the entertainment industry.

The penetration of computers into United States households has now exceeded 30 percent. This is considered the necessary critical mass to create a consumers' mass market. A recent survey conducted by Times Mirror found that among consumer electronic devices in the home, the PC was valued the highest and would be missed the most. Although a strong resistance still exists among older Americans, younger generations embraced this technology first in the form of videogames, and later for education and business tools.

Productivity software applications, such as word processors, spreadsheets, and databases have reached a level of saturation and sophistication that satisfies most of the users' needs. Thus a slowdown in desktop software sales is inevitable. Microsoft is now witnessing this decrease in revenue growth, recording a 50 percent decrease in 1992 and about 20 percent for fiscal year 1994. Because of this slowdown, the software distribution channel needs a surge of new products, which interactive media can supply.

Software Providers

Software development began in small, independent firms and has grown into large international development corporations. The entrepreneurial spirits of software providers are once again poised for a significant increase in software development.

Creating a spreadsheet is a much different task than developing engaging entertainment software. Consequently, computer software developers will need to combine their skills with those of "subject experts" and storytellers.

Function-Oriented Products

Software providers make a wide variety of products that in most cases are function oriented. Word processor, spreadsheet, database, personal finance, and desktop publishing are some of the leading types of software the industry produces.

Characteristically, the software model is less content oriented than the other business models included in this discussion. The catalyst that unifies the software industry and interactive media is the equipment used by the consumer to operate both kinds of products.

Receptivity to Change

Many consumers will use the same computers for productivity software and CD-ROM-based interactive media. Interactive media may be viewed as additional software for their computers rather than a completely new technology.

Business computer users are accustomed to upgrading their software every nine months. Performance improvements generally outweigh the "bugs" that always accompany upgrades. This is accepted by business users as part of the computer experience, but upgrade bugs will not be tolerated by consumers.

Types of Media

The software industry has traditionally used floppy disks to distribute its products. As the size of software applications has increased, the capacity of floppy disks has not kept pace, leading to the need to supply large numbers of disks per application. Because of the high packaging costs associated with delivering software on large sets of diskettes, the industry has been exploring new ways to distribute its products, including CD-ROM and online delivery.

The software industry has been able to reduce costs of delivering software and online documentation by using high-capacity media. CD-ROM discs, with a 640 megabyte capacity, are beginning to replace floppy disks as the most effective method of software distribution. Silicon Graphics, Sun Microsystems, and others have even found it cost-effective to give away the CD-ROM drive.

CD-ROM also affords software producers the opportunity to market directly to the consumer. Demonstrations of their other products, and in many cases fully operational software with complete documentation, are often included on the disc.

Softkey encryption techniques are now employed to permit customers to preview the program functions and then immediately unlock the software by calling an 800 number for the access code. This method has been used successfully by companies like Adobe™, which includes its entire font library on a CD-ROM, to be ordered as needed. This distribution method greatly reduces packaging costs and leads to improved profitability, and it is beginning to be applied to the sale and delivery of interactive media software.

Buyer Profile

Work at home, small businesses, and consumers are responsible for increasing the number of computers in the home. Personal computers are now used in more than 30 percent of the households in the United States. This is considered a critical mass and the demographic base of buyers has widened; the computer literate population now ranges from young children to seniors.

As more consumers begin to use software, the categories broaden and deepen for different age groups. As the software industry has expanded beyond business software, companies like Microsoft have introduced an entire line of home products under the *Microsoft Home* label. These include productivity and entertainment titles developed especially for home use.

Less mobile senior citizens are learning how to use software provided in their senior citizen centers, and they routinely participate in online entertainment such as bridge tournaments. Edutainment software created by Brøderbund, EBook, Sanctuary Woods, and others are available for children as young as three years of age.

Home computer platforms are popular in medium- and higher-income households. Some households may even have two or more personal computers for different family members. Most of the computer systems going into homes are interactive media–ready, and a significant proportion are already equipped with CD-ROM drives. By the end of 1994 there will be more than 8.8 million computers worldwide with sound capabilities and double-speed CD-ROM drives. More than 2 million of these will be used in the home by consumers. Small business and work-at-home users also account for an additional 1.2 million platforms. Add to this more than 4 million television-attached players, such as CD-i, 3DO, and Sega-CD, and it is clear that consumers are quickly embracing this new technology.

Multimedia-capable computers and upgrade kits with CD-ROM drives are commonly sold into the home with software bundles of four to eight titles. Since most home computer systems are designed for leisure applications, the titles offered tend to include entertainment and information content.

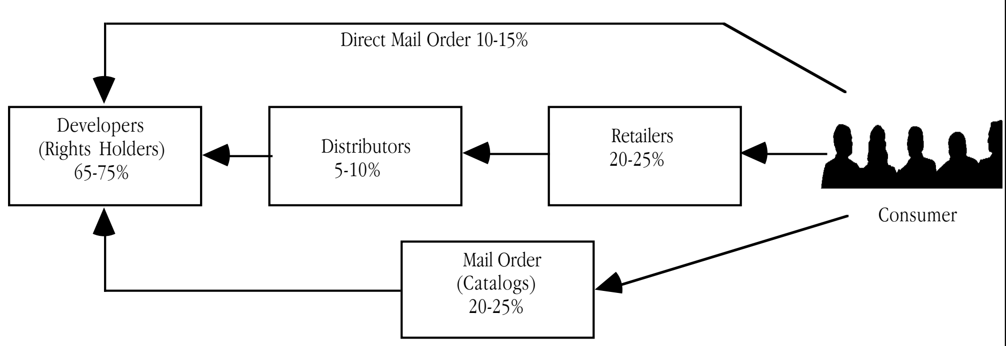
Though middle- and upper-income households are nearly saturated with their first computer systems, many are contemplating the purchase of second systems. At the same time, price-performance ratios have continued to decline, encouraging the adoption of interactive media delivery platforms in lower-income households where videogame and videotape playback are already prevalent.

In addition to the expanded use in the home, the purposes for which computers are used is also changing. A recent survey of 10,000 homes by Computer Intelligence Infocorp asked consumers what they most commonly did with their computers. They found that 76 percent used their computers mostly for entertainment. As the profile of software buyers broadens toward entertainment, a foundation continues to be laid on which interactive media can build a sound future.

Channel Revenues

Software is now distributed through a large variety of manufacturer-direct, retail, and mail-order channels. These include those served directly by the computer industry but also cross over into consumer electronics, office supply, major department stores, discount stores, and a host of specialty stores, now including toy stores.

Figure 6-1 captures the essence of software distribution today. With the advent of personal computers, more than half the product today is moved by the retail distribution channel with the remainder using indirect channels, such as manufacturer representatives and catalogs. Percentages in Figure 6-1 refer to the portion of the consumer revenues retained by each participant. These percentages will vary considerably depending on the nature of the relationships and amount of channel exclusivity.



Note: Percentages refer to the amount of retail revenues retained by each part of the channel.
Source: Market Vision, 1994

Figure 6-1. U.S. Consumer Software Revenue Streams

Software distribution channels were initially designed to support users of hardware in business, education, and government. As the market for in-home use developed, retail outlets began to emerge. These have expanded, as in the case of Fry's Electronics, and CompUSA, which are computer superstores catering to both business users and consumers. These were the most logical starting points for introduction of interactive media products, first with hardware upgrades and now with a wide assortment of titles. For example, Fry's Electronics sell everything from children's titles to adult rated CD-ROM titles, in addition to its traditional software titles for business and personal productivity.

Table 6-1 shows the ten leading computer suppliers, representing 69 percent of the $28 billion computer industry. As shown in Table 6-1, the top 12 consumer electronic retail merchants comprise 57 percent of the $41 billion industry. Overlap between these two distribution channels will grow as products are packaged for consumers.

The distributors deal in both hardware and software with the lions share of their revenue derived from hardware sales. As the crossover of the different retail channels increase their commitment to CD-ROM, a growing number of specialty distributors are emerging to compete for their business.

	Revenue ($ Billions)
Consumer Retailers	
Circuit City	3.24
Radio Shack	2.73
Best Buy	2.54
Sears Roebuck and Co.	2.50
WalMart	2.39
Kmart	2.12
CompUSA	1.73
Target	1.60
Service Merchandise	1.42
Sam's Club	1.12
Office Depot	1.09
Montgomery Ward	1.00
Computer Distributors	
Ingram Micro Inc.	4.00
Merisel	3.00
Arrow Electronics	2.90
Intelligent Electronics	2.60
MicroAge	1.50
Inacom Corp.	1.50
Tech Data	1.50
Datago (Merisel FAB Inc.)	1.00
Pioneer Standard	0.95
Avnet Computer	0.45

Sources: CRN, March 14, 1994; TWICE March 28, 1994

Table 6-1. Computer Industry Revenue for 1993

The retail channels for computer software include the computer superstores such as CompUSA, consumer electronic stores such as Circuit City; major department stores such as Sears and Montgomery Ward; and a variety of discount outlets such as Target, Best Buy, WalMart, and Sam's Club. Other retail outlets for software include Software Etc., Babbage's, and Electronic Boutique. Adding to these are mail-order houses such as CompuAdd, Elek Tek, and Tiger Software. This mixture of outlets affords many opportunities for consumers to "shop" for the product.

Channel Successes and Failures

More than those of other industries, the successes and failures of the software industry will form a basis for interactive media. The software industry has worked hard to earn the loyalty of its customers. To do so it has adopted successful business strategies. The computer industry has not been completely successful within the consumer market, yet recapping lessons learned is worthwhile.

Reduced Pricing

Over the last two years, software pricing has come down drastically. In the case of Borland's Quattro Pro and Paradox, prices have decreased as much as 80 percent. This has enabled companies to sell over a million units, and establish market share in a short period of time. In turn, consumers get a great value, and the distribution channel keeps flowing.

The software industry has been very responsive to environmental concerns, and has redesigned its packaging to minimize paper waste. Standard packaging dimensions have been adopted in many computer superstores, such as Fry's Electronics in the Silicon Valley. Standard packaging dimensions have been proposed by Compton's New Media for mass-merchants such as Kmart where bigger is better especially for "spine-out" displays. The Voyager Company has also proposed a 5 3/8 inch spine standard package. Others such as Disney, IBM and Rocket Sciences have adopted paper jewel cases.

Market Saturation

The success of desktop software has brought about saturation in the marketplace. These successes have been a double-edged sword. The trend is now toward upgrade business rather than new product release. Competition has drastically reduced prices.

The profitability of the software industry, once founded on huge returns from research and development, has diminished significantly. Technical support departments have been a loss leader for many companies. Now software developers are charging for "tech support" and trying to turn these departments into profit centers. This will help offset the reduced revenues from software sales.

Failures

Although the software industry has greatly improved the performance levels of software, the downside of continuous software releases has been systems that are never stable due to frequent upgrading and new bugs replacing old ones. This tends to anger consumers.

After a consumer spends several months getting comfortable with an application another upgrade arrives. Though this instability has been accepted in the software industry, it will not be tolerated in the consumer market. Consumers will not embrace a market until it is stable.

Consumers have distinct attitudes toward upgrades for emerging technologies like the Power PC™ and the Pentium and same-platform product improvement. Upgrades that are made to take advantage of more powerful hardware often give a magnitude of increased performance, and consumers accept this. They are not as tolerant of upgrades for product enhancement.

Piracy Issues

The biggest failure the software industry has faced is the problem of piracy. It has been estimated that more revenue is lost to piracy than is generated legitimately. It is not an easy issue to resolve. Many software developers who have lowered their prices and now derive a good percentage of revenue by charging for technical support believe this shift in the revenue stream may offset some of their losses from piracy.

Platform Compatibility

Cross-platform incompatibility has long plagued the software industry. Consumers want one piece of media to play on their platform of choice. Programs, such as Fractal Design Painter and Adobe Photoshop are identical programs operating on different platforms, in two separate packages. All this redundant software requires additional space on retail shelves and in distributor warehouses for essentially the same product.

Attempts are being made to resolve these issues because the software industry realizes the emerging consumer market will demand this of them. Photo CD, developed by Eastman Kodak, is an example of a good solution to the cross-platform problem. The same disc plays on both Macintosh and IBM-compatible PCs. The emergence of CD-ROM as a new standard could go a long way toward solving this problem. Some developers have solved the problem by writing their code on one platform and then using porting software installed on the disks to load it on a different platform.

Computer Software Distribution Profile

Representatives from Baker & Taylor, Ingram Micro, and Merisel were interviewed for this distribution profile.

Computer software distribution uses a one-tier model, unlike most of the mass-merchandising models (entertainment, music, book, and home video), which are two-tiered. In the software model, the developer is also the rights holder. The software developer sells about 70 percent of its products through distributors. For example, in the software model, the developer may have contact with the end user through direct mail sales, upgrade announcements, and warranty card registrations.

With the addition of CD-ROM consumer products, the computer software industry is now moving toward a two-tier model. This is similar to Brøderbund's approach, in which it acts as a master distributor, and supplies products both to other distributors and directly to the retail channel.

Software is licensed to the end user for use on a computer, and is protected under a software licensing agreement between the developer or the developer-publisher and the consumer. The differences in legal protection between software applications (productivity) and interactive media (entertainment) products can lead to confusion, and misunderstanding on the part of developers, publishers, distributors, and retailers when these products are marketed across channels.

To understand the legal protection issues surrounding software and interactive media products, it is first necessary to clarify the terms *CD-ROM* and *software.* Both words are used somewhat casually within the industry. The noun *CD-ROM,* for instance, is sometimes substituted for more accurate words like *title* or *content.* A CD-ROM disc, like a floppy disk, is a delivery medium. CD-ROM titles and applications, such as word processors, spreadsheet packages, and painting programs, are both computer software. The former provide users with ready-made content, while the latter are used for creation and productivity purposes. To add to the potential confusion, it is possible to buy both content and productivity software delivered on the same disc.

In the entertainment channel distribution models, which feature two-tiered distribution, a developer-publisher will often take its product to an interactive media distributor. Electronic Arts, Compton's New Media, and Brøderbund are the largest affiliate labels as well as retail distributors. The interactive media distributor then takes the product to the master software distributors, such as Baker & Taylor, Ingram-Micro, and Merisel. These larger distributors then take the product into software-only stores, such as Egghead Software, Babbage's, and Software Etc., and computer superstores such as CompUSA.

Mass-merchandisers are accustomed to the book distribution model, where all unsold books may be returned to the publisher or the publisher-distributor for credit. This kind of open return policy is not customary in the software channel, because once the product is opened the diskettes can be copied easily. For this reason software licensing agreements contain a clause that once the shrink-wrapped package is opened the customer owns it, and it is not returnable.

Publishers can get caught between distributors and retailers. The developers and publishers want to keep their products in the retail channel as long as possible. Retailers, on the other hand, want liberal return policies. Retailers who are used to dealing with entertainment products, such as books and videotapes expect 100 percent return policies. Sometimes liberal return policies are abused by the retail channel. Baker & Taylor, for example, which offers retailers a 120-day return policy, has experienced returns of between 35 and 45 percent on CD-ROM products that were bought by retailers.

Merisel has had similar experiences, according to a company spokesperson. Most publishers want to receive money in return for their shipped products sooner than 120 days, which creates a risky situation for distributors. For example, a distributor brings in a product that is then put on retail shelves, and it looks like the product is selling because it's out of the distributor's warehouse for 90 to 120 days. The publisher has been paid, but the products that do not sell come back to the distributor.

There are many demands on publishers, who may not have the initial funds both to develop the product and to support it in the marketplace. The period between the time a developer or publisher places an interactive media title in the retail channel and the time it receives incoming royalties can be long indeed. In the interim, however, retailers rely on publishers to support the interactive media product through co-op advertising, in-store promotional displays, and other forms of product visibility. Product development costs can be anywhere from $50,000 to $500,000, depending on the complexity of the content. After laying out that much cash just to develop the product, not all developers, developer-publishers, or publishers have enough reserves to give the retailers what they need to support the product. This is where forming an association with a distributor's affiliate label can help.

Affiliate labels afford the developer an opportunity to benefit from the major publisher's brand recognition. It helps developers get more extensive distribution for their products than if they self-publish. Affiliate labels provide marketing and packaging assistance and enable a developer to establish brand recognition beyond the first or second product. By distributing through an affiliate label program, the developer's product receives a more focused marketing effort and sometimes derives name recognition from affiliating with a large publisher-distributor, such as Brøderbund or Electronic Arts.

Affiliate label agreements vary from distributor to distributor. For example, Brøderbund's affiliate label program gives developer-publishers a lot of freedom in terms of product packaging and marketing, and the developer-publisher retains its own identity and authorship connection to the product. Brøderbund then acts as the master distributor, using its established connections with consumer-channel distributors like Ingram Micro to get the product into stores such as CompUSA and Egghead Software. Brøderbund's distribution method is a two-tier process. Other distributors, such as Electronic Arts, have nationwide sales forces and distribute directly to the retail channel.

Not all developer-publishers are eligible to become affiliate label partners. Most distributors and publishers will require evidence that their potential business partners have enough resources to manufacture and market the product. Also, in an affiliate label arrangement, a distributor may look more at a product's salability than at the quality of its content.

An alternative to affiliate labels are representative, or "rep," firms. A publisher may retain more of the revenue generated by a new-media product if it chooses to distribute through a rep firm, but rep firms represent many publishers and may not give a particular publisher's product the attention it needs to gain market share.

Market Directions

As the software industry matures, it braces itself for the transition into a consumer market. PC penetration has reached critical mass, and over 75 percent of the consumers use their systems for entertainment and games.

The problems of cross-platform compatibility could be significantly minimized by the adoption of CD-ROM as the preferred type of medium to deliver products. As the purchase of CD-ROM discs is expected to double in 1994 and again in 1995, the installed base will be large enough to accept CD-ROM as the de facto media standard.

The software industry is priming the pump of CD-ROM acceptance, creating a gateway for interactive media. The software industry has been very successful in nurturing consumers into the electronic age and guiding them to the information superhighway. The consumer confidence earned by the software industry will help carry interactive media successfully through the software channel.

Chapter 7

Content Demand

The term *content* is so loosely used in the industry, that its meaning has become vague and under-emphasized. This chapter will clarify what *content* and *content demand* are, and how they are increasing in importance as the interactive media market matures.

When a new industry such as interactive media emerges, it is seeded and driven by those who manufacture the hardware. Early adopters are infatuated with the technology and enjoy using it, without paying much attention to the content of the software they use. After a while the infatuation with the hardware wears off.

At this point, consumers become more concerned with the software they are using than the hardware they are playing it on. This trend increases until the hardware becomes a consumer commodity in the market instead of a novelty. Critical mass is obtained when a product's market penetration reaches maturity, generally when more than 30 percent of the households within a certain geographic region have the product.

Until critical mass is obtained, the market is platform driven. Once a platform's critical mass is reached, the dynamics of the market begin to change, with the consumer becoming more concerned about content. For example, since 1989, Nintendo's market share has dropped from 80 percent to 44 percent because Sega produced a better player for $50 less, and provided more interesting content in its products. In a content-driven market, the consumer becomes increasingly particular and demanding about the kind of content preferred. Thus the consumer's content preferences drive the market, and this is referred to as "content demand."

Changing Dynamics

Over the next two years, we will see a change in the market dynamics that drive successful interactive entertainment. More sophisticated platforms are beginning to emerge, and with them, higher development costs. The early adopter phase is reaching market saturation. The emerging mass-market consumer has less disposable income to spend, and will force prices down from the $40 level to about $30 per title. Increased competition will give the consumer more choices, but it is not likely that they will spend more on interactive entertainment than they do today. They may in fact spend less, as a large number of platform choices tends to stall spending decisions. As a result, consumers will become more discriminating about the kinds of titles they prefer.

The increasing sophistication of consumers combined with an increasing selection of available products will intensify competition, and stimulate a greater demand for higher-quality content. Soon the market will be flooded with poor-quality content at the same time that consumers are becoming more discriminating. This flood of ordinary product will establish a climate where consumers demand higher-quality content that is highly engaging.

The Honeymoon Ends

Consumer are enamored with the novelty of a device for a period of time following the purchase of new and exciting hardware. Usage is at its peak during this honeymoon period. After about a year, the initial excitement wears off, and the consumer spends less time using the hardware. This is when the selection of the titles the consumer spends time with becomes more important.

In an emerging industry, this often comes by surprise since it usually follows a period of acceptance of lower standards. As familiarity with the platform increases, consumers become less enthralled with the technology and begin to care more about substance (content) than platform.

Distribution's Impact on Content

Motion Pictures: The Demographics of Distribution

Since the beginning of home video, motion picture executives have learned a lot about distribution. The success of motion pictures has primarily depended on distribution. Demographic distribution has historically been able to make or break a picture. An example of this was Michael Mann's film, *Manhunter*, which first introduced Dr. Hannibal Lichter. *Manhunter* lasted only a few weeks at the box office. Though it was a brilliant film, preceding *Silence of the Lambs*, its performance at the box office was not good. This high-suspense, intelligent thriller played in all the wrong neighborhoods. When it was released in home video several months later, stores throughout the country could not keep it on the shelves. The turn rates stayed high regardless of the number of copies a store stocked. It maintained that level for several months, making it one of the most profitable videos of the year.

To further substantiate the point, when *Manhunter* was first released to network television, it broke all previous records for a first-run Sunday night movie, and held a captive audience straight through the 11 o'clock news. Its box office failure had nothing to do with content, as studio executives would have liked to believe. They made a major distribution mistake that would have gone undetected had home video not clarified the issue.

Demographics critical to the movie's success drive theater selection, distribution, and ticket sales. Studios often cut back advertising severely if a picture does not perform well in its first few weeks.

Chapter 7

Content Demand

Home Video: The Economics of Distribution

The success of home video stems largely from providing motion picture entertainment to the consumer cheaply and at the consumer's convenience. By 1987 most people lived within a half mile of a video store. Early retailers tended to buy heavily, and then use the excess inventory to open more stores. This trend, combined with increased competition and price wars, soon spread many retailers' resources too thin. As a result, their under-capitalized businesses suffered. They had to pay more attention to the management of their inventories.

With the number of available interactive media titles rapidly increasing, retailers will be more careful which titles they choose to buy. The upcoming 1994 holiday season is expected to see the introduction of 300 interactive media titles. As these titles compete for shelf space, retailers are going to buy titles that have the broadest appeal to their customers.

Conventional retail guidelines dictate that retailers should have enough inventory to satisfy 90 percent of their customers 100 percent of the time. This requires meticulous inventory management. Wavering much from this formula could mean disaster for a retailer. One would likely go out of business satisfying only 80 percent of one's customers.

Although home video rental is now a successful $12 billion dollar industry, it is satisfying only 25 percent of its customers, with the remainder leaving the store without the title they wanted. This is a contradiction because the demand for home entertainment is so great that consumers are willing to overlook an inconvenient of lack of product in home video stores that they would not tolerate in other retail stores, such as hardware and grocery stores.

In order to survive, video retailers have to discover the content preferences of their customers. As the variety of titles expanded, each video retailer had to know which titles to buy, and how many of each were needed to keep customer loyalty. In home video, the success of a title depends on how many copies a retailer has in stock. This is known in the industry as depth-of-copy. Over- or underbuying one or two copies of a title could produce a negative return-on-investment (ROI).

Understanding the kind of content customers will rent within a particular geographic area is a critical factor in the buying decision. For example, a title costs about $70, and will rent for less than $2.50. At that rate it must rent for 30 days just to break even. Most hit titles average 23 to 25 turns (number of rentals) in the first month, and drop off quickly after that. At this rate a title takes six to eight weeks to break even. If retailers purchased sufficient stock to meet the first six weeks' demand, they would go broke. Consumer demand for a title is much greater than a retailer can afford to supply. The retailer really needs to be able to buy the title for less money or on a revenue-shared basis. This would match the economic needs of retailers with consumer demand. But this has never happened. As a result it has cost the industry several billion dollars in lost revenue.

In spite of its huge success, this failure to satisfy more than 25 percent of home video consumers is a major flaw for which distributors, retailers, and consumers have paid a dear price. On one hand, the economics of distribution have helped the home video industry experience phenomenal success, generating over half of the motion picture industry's revenues by providing the convenience of affordable movies to the mass consumer. But, on the other hand, the same economics have restricted that success to only a fraction of what it could be.

Blockbuster understands this very well. That is why it is aggressively pursuing electronic distribution of Sega Games. This will circumvent the depth-of-copy dilemma. As video retailers become more aware of this distribution method, they will embrace it enthusiastically.

In the next 18 months, demographics and economics will play a critical role in the success of interactive media. As mentioned earlier in this chapter, the market dynamics are changing, and the honeymoon phase is ending. With these changes, consumers are becoming more particular about the content they choose for entertainment. The broader the demographic base gets, the more critical content becomes.

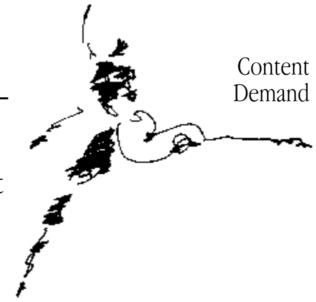
The Half Plate Theory

Give a hungry person a half plate of food and every bit of it will be eaten. You cannot assume that is all the person wanted. Give the person a full plate and it will be consumed with just as much enthusiasm.

Putting poor-quality products into the pipeline will result in a greater demand for quality and meaningful products. The public does not need to express this preference overtly. Following a record-breaking Christmas season, the return of as much as 50 percent of 1993 Christmas interactive entertainment products should have sent a strong signal to the industry: Content is already a big issue and as individual consumer tastes mature consumers will become even more sensitive to content.

According to TFPL, over 5,400 interactive media titles are available. Of that number, 100 (and primarily the top 20) generate 90 percent of the revenue. Because this increasing consumer discrimination is occurring early in the industry's honeymoon with the consumer, it indicates that the interactive media market is maturing faster than expected. Those developers who pay attention to the demand for meaningful content will have a competitive edge.

As the market continues to grow, consumers will prefer some entertainment to none. But those developers providing engaging and meaningful content will stand a much better chance of success.



Products being developed now have an unusual opportunity for extended life once the demand for electronic distribution accelerates in the next three to five years. Product that survive until then will get a second life as they are used to generate the catalog libraries consumers will select from. This will increase the overall ROI of the product. Because of increasing consumer sophistication, products of higher-quality content will be better suited for the electronic libraries. By the time electronic distribution becomes viable, less than 200 of today's existing titles will have content good enough to match consumers' tastes.

Thousands of films preserved in archives became widely available when the home video industry took off. The same demand is likely to arise for the interactive entertainment industry, but there is not nearly the quantity of ready material.

Looking for Meaning

We are living in highly stressful times. We look to entertainment as a way to release tension and relax. The more engaging the entertainment is, the longer the period of release.

Entertainment spans the spectrum from sensory diversion, as seen in movies like *True Lies* and games like *Mortal Combat*, to inspiration, illustrated by films like *Mrs. Doubtfire.* The most successful products usually rest at either end of the spectrum. Studios and publishers perceive less risk, and are more comfortable at the lower end of the spectrum. It is also less challenging creatively to deal with less meaningful content, since it does not require as much thought. The assumption that the public prefers it, simply because they spend money on it, is another illustration of the half plate theory.

As the baby boomer generation gets older, leisure time is becoming a more precious commodity. Consumers are looking for more meaning in their lives. Their interests in entertainment will follow similar lines.

Entertainment that deals with the search for a deeper meaning to life can also be very successful, and, often breaks box office records. It enhances people's enjoyment of the entertainment by helping them deal with the cause of their stress instead of just providing relief from the symptoms.

The movie *Ghost* is an example of a movie that dealt with meaningful issues in a tasteful, entertaining, and profitable manner. The movie dealt with the acceptance of death and was the highest grossing film in 1990, generating over $230 million (*Terminator 2*, came in second).

Meaningful entertainment can help viewers deal with problems and stress. It can add significance to the leisure time the consumer spends being entertained. The more meaningful the entertainment, the more value it has to the consumer.

A recent example is the extraordinary success of *Mrs. Doubtfire*. Its spectacular box office revenues exceeded $220 million, and it stayed in theaters for over 24 weeks, more than twice the industry average. Its performance in home video was even better. It was the most heavily rented title in a single week in home video history. Each store purchased an average of 16 copies, and each copy turned five times in the week. It was single-handedly responsible for raising rental revenues for the home video industry last spring 25 percent over last year's figures, and for lifting sell-through activity 6 percent above the figures for the same time last year.

Let us try to understand the reasons for its success. It dealt with the issue of divorce, which affects almost half the families in America. It addressed the issues of two good and decent people frustrated with an unpleasant situation. It offered a positive solution to a very real and painful problem in a humorous and acceptable manner. It struck a sympathetic cord in the public heart, and as a result experienced record breaking revenues in every distribution channel it used.

People are more interested in reality than fantasy, but the creative community deals more creatively with fantasy. And people like to be entertained but they will prefer to be inspired by a full plate rather than diverted by a half plate.

The Sanctity of the Home

The same criteria used for a successful interactive media product today may not be relevant to products released in two years. The fast action and gratuitous violence common in titles published at this time are mostly directed at the young teenage male, who plays these games in arcades. In the next few years the market will expand into the home, and include girls, women, and men, who will prefer more meaningful and engaging titles. Today's successful titles will not be as widely accepted two years from now.

A similar situation occurred in the home video industry. Adult videos fueled the early interest in home video. Positioning themselves as a "family entertainment" company, Blockbuster refused to carry any adult video in its stores. In an industry that drew nearly 30 percent of its revenues from adult video rentals, many doubted that a video rental store could avoid carrying x-rated titles, but Blockbuster proved them wrong.

A similar trend is now occurring in interactive media as the market grows. Much of the content that is fueling the growth of interactive entertainment today is based on gratuitous violence. This kind of content is likely to be out of favor in a few years as standards of higher-quality content influence the market. The idea that "if it plays well in the arcade it will play in the home" has an inbred flaw: It underestimates the sanctity of the home.

Chapter 7

Content Demand

There are greater concerns today about the negative influence of violent entertainment on our society than there were in the early years of the home video industry. Congress has applied pressure on the videogame industry by telling them that if they do not rate their games for age suitability, the government will.

The International Digital Software Association (IDSA) has developed a five-grade rating system that will appear on packages for the 1994 holiday season. The ratings include EC-early childhood (three years and older), KA-kids to adults (6 years and older), T-teens (13 years and older), M-mature (17 years and older), and AO-adults only (18 years and older). The rating will be displayed on videogame boxes with a brief description of the game's content. Games will be rated by an independent panel of three demographically diverse individuals who are not subject to industry pressure.

It has been shown that people will tolerate lower standards outside the home than inside it. For many successful video arcade games kids play in the malls parents adopt an out-of-sight, out-of-mind attitude. They will not forbid their kids from playing the game outside the home. Bringing the same game into the home is a different matter.

Products that have a broader and deeper appeal are not just going to experience less resistance, their use will be encouraged. As this trend of increasing discrimination begins to pervade the marketplace, these more meaningful titles will experience an extended shelf life.

There will be a growing need for a family-suitable catalog of titles as retailers expand their inventories and begin to promote videogames in bigger, separate departments. Titles having a broader appeal are more likely to be included in the catalog mix.

Distributors are already packaging first-time inventories of interactive entertainment. There will be 75-title starter kits, as well as 400- to 500-title packages. Many of the 35,000 existing video stores will buy starting inventories from the distributors, which could mean the sale of an additional 14 million videogames in the rental market alone. This represents over $420 million in additional revenue for the interactive entertainment industry.

As the penetration of interactive players in United States households continues to grow, the content of titles will become increasingly important to consumers. The recent United States congressional hearings regarding videogame ratings is a strong expression of the importance decency and family-suitable content are going to play when interactive media pervade the home. Consumers will welcome interactive entertainment into their homes, but they will not tolerate the assault of meaningless content that comprises many of today's arcade products.

Chapter 8

New Business Models for Interactive Media

The business and distribution models presented in this guide have clearly identified the cross-over that is occurring between the traditional videogames, home video, music, book publishing, and computer software industries. Digital media, whether or not they employ interactive techniques and frontends, have already dramatically affected the nature of consumer distribution and sales by providing several cross-marketing and promotional opportunities. These changes are based on evolving the existing distribution channels to the delivery of digital media, mostly in packaged forms. At the same time, new business models are evolving that will transcend these traditional models.

This chapter discusses new business models for the distribution of interactive media. These changes in the distribution channel have already begun to be felt but will reach major proportions after 1997, when sufficient online delivery becomes feasible. In the interim several consumer experiments will gauge consumer demand and acceptance. The results of these trials will shape the nature of the user interface, supporting technologies, level of service provided, and pricing structures.

As shown in Figure 8-1, a host of competitive distribution techniques provide viable alternatives to retailing. These include direct broadcasting of television and radio, cable television, online services, and satellite broadcasting. The same digital signal processing that makes possible CD-based interactive media is affecting these other forms of distribution.

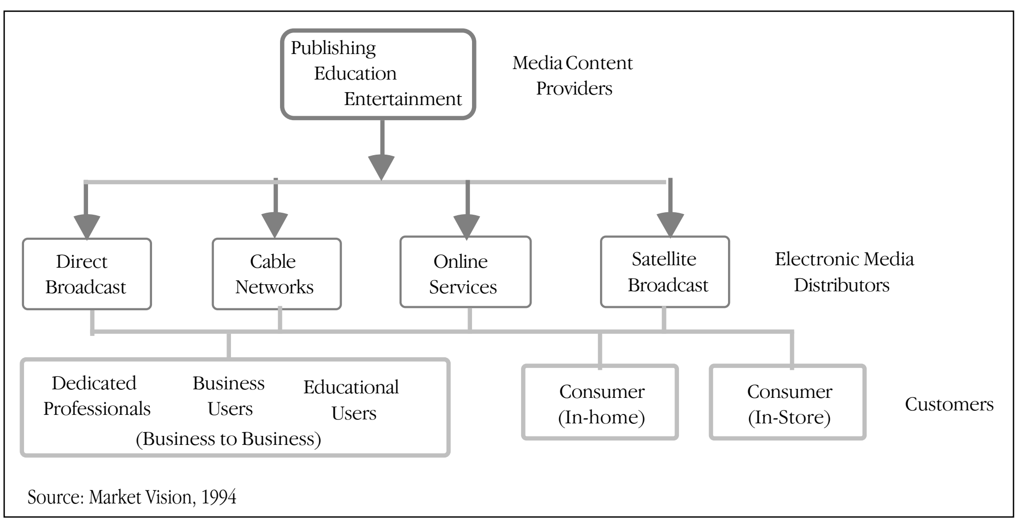


Figure 8-1. Electronic Distribution Channels

Retailing is two distinct experiences: purchasing, which includes shopping and goods acquisition, and the social experience, which remains a popular form of entertainment. They coexist as distinct social and economic functions, but given today's high-pressure marketing efforts, the two activities all too often collide and create consumer disgust. In-home purchasing services are proliferating, as evident from the phenomenal success of catalogs and other forms of direct marketing.

There have been significant increases in capital spending on infrastructure, central offices, and headends (the facilities where the programming signals are actually distributed to customers). Local- and long-line telephone companies are improving signal distribution capabilities, especially for two-way signaling. Cable headends are expanding to permit the transmission of broadband signals, delivery of video by servers, and the collection and processing of customer requests. A small "return channel," permits consumers to respond and request information, products, and services from the headend. As the size of the return channel increases, many advanced services will become possible.

The increase of cable services (e.g., home-shopping channels and pay-per-view), voice services (e.g., 800 and 900 numbers), and online computing networks (e.g., Internet, America Online, Prodigy, and eWorld) are paving the way to new electronic services. Several examples will be discussed in the following sections.

Emerging Distribution Technologies

As illustrated in the previous chapters, much of the market planning for a successful 1994 holiday season has been completed. There is still a little time to affect the products for the 1995 Christmas season. The results of Christmas 1994 will have a greater impact on the products released to the channel after 1995. But more importantly, consumers will voice their acceptance and rejection of products and genres; these reactions will dramatically affect the direction of distribution technologies, many of which are just being developed.

Distribution technologies will evolve along three paths, which are defined as packaged media, online delivery and interactive online. Interactive media, as discussed in earlier chapters, involves the distribution of packaged media with the use of CD-ROM or floppy disks. Online delivery refers to the electronic transfer of packaged media over local- or wide-area networks. Interactive online refers to full two-way (duplex) communications, as with interactive television and interactive services, such as Internet, Prodigy, and America Online.

Expanding on the successes and failures of early packaged media, online methods of distribution will be deployed over the next five years. As telephone and cable companies deploy communication infrastructure, new consumer services will be tested to determine consumer acceptance. Some of these early trials are identified in this guide to suggest to developers what technologies should be monitored and planned for.

New Packaged Media Formats

Single-speed (150 Kbps) drives established the initial standard by which developers had to design products. Due to limitations of speed, access times, and transfer rates, developers were forced to go to extremes to produce products with minimally acceptable quality and performance.

Driven by the need to compete with the high production values the MTV generation and Hollywood filmgoers demand, developers must employ extraordinary techniques to create superior products. An example is Lucas Arts Entertainment, which combines expertise from film and computers to produce special techniques, such as the replication of live actors to fill in crowd scenes, in an attempt to keep production costs down.

In a marketplace of rapidly changing standards and technologies, as with the improvements in CD-ROM drive speeds, compression standards (JPEG, MPEG, and MPEG-2), and authoring tools, developers must be able to adapt to new platforms quickly. As with personal computers, capacity, performance, and costs are constantly improving. Backward compatibility to, for example, slower CD-ROM drives, is a constant consideration if the largest installed base is desired. Title developers will have to anticipate, and adapt to rapidly changing platforms. As we will see later, bandwidth is one of the principal determinants in the delivery of quality content, be it packaged or delivered electronically.

Philips and Sony have finally announced that they are working on other “high-density” formats to support 135-minute feature films on CD-ROM, and to prepare for the emerging MPEG-2 video standard. Two discs are currently required to deliver one full-length movie using MPEG-1 for standard NTSC and PAL television formats. Capacities for MPEG-2 would require as many as six discs. Added to this is a potentially limitless amount of capacity required for the support of ancillary interactive information.

Technology improvements are permitting increased quality, better performance, and a more extensive and richer experience. The key in tracking this moving target is in the proper management of the developer’s assets. Within reason, the developer should create and maintain all properties in the highest resolution possible and maintain code that permits the greatest latitude in adapting the titles to future delivery technologies, including online methods.

Public Telephone Networks

The public switched telephone network (PSTN) is one of the largest investments that society has ever made. There are about one third of a billion access lines worldwide, and the plant is estimated to be worth nearly a trillion dollars. Revenues for the United States communications plant alone total over $100 billion per year.

This two-way, point-to-point system carries the bulk of personal communications undertaken at a distance.

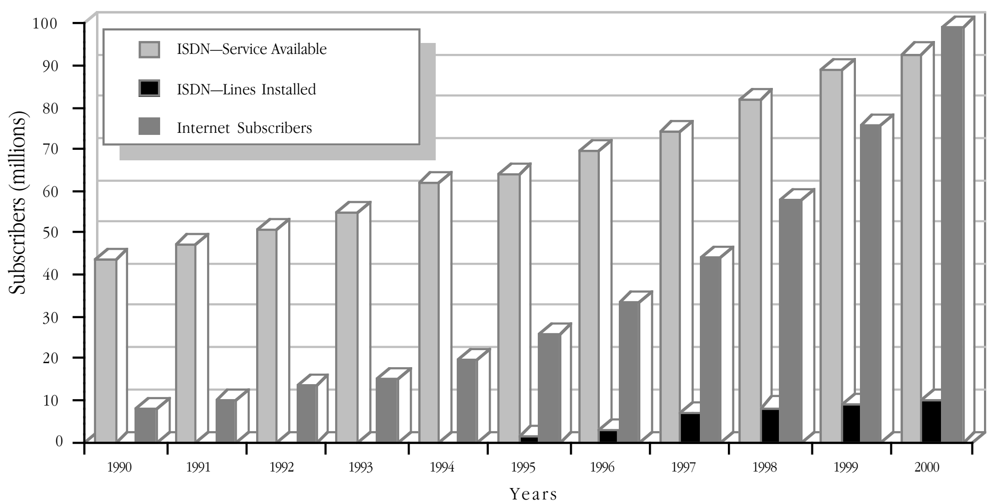
The 100-year-old PSTN embodies a host of deep cultural attitudes. For most of its existence the PSTN has held a monopoly status. This remains true throughout the world except for parts of the U.S. and English systems. Since in most countries PSTN revenues are a major component of the tax base, both labor and government are resisting the move to a market economy. One of PSTN's goals from the beginning was to provide universal service, and that goal has been largely realized. Since the PSTN is a switched service, any two people can contact one another at virtually any two points on the globe. Thus everyone has equal access to the system.

As we move into the interactive media age, these two precepts are coming under attack. Countervailing political forces are working hard to preserve these two properties in the new system.

The PSTN is a hybrid system with a backbone that is being converted to digital but with analog drops to homes. Consequently, when digital data must be sent out over the network, a carrier must be put on the line to hold the digital information. This is accomplished with a device called a modem. The nominal rates on most circuits 40 years ago was about 100 bits per second. Then it went to 1,000, and today it is in the nominal range of 14.4 kilobits per second. But to accomplish serious interactive media applications it will be necessary to increase the bandwidth by at least a factor of ten. To do this will require a complete digital network.

In 1972, the international standards group, CCITT, defined the integrated services digital network (ISDN). This system uses the same digital switches and digital paths within the PSTN to provide a variety of new services. The ISDN concept has been accepted by every telecommunications authority in the world.

By the end of 1993 the estimated number of ISDN lines in use was between 100,000 and 200,000. By the end of 1994, 62 percent of the country will have ISDN service available. As shown in Figure 8-2, Market Vision forecasts that the total number of ISDN lines will reach 10 million by 2000.



Source: Multimedia Markets and Applications–1994 Annual Forecast, Market Vision, 1994

Figure 8-2. Network Growth Through 2000

Figure 8-2 illustrates that narrow band digital switching is now available in over 50 percent of the businesses and homes in the United States. It will reach 90 percent by the year 2000. This capability in the hands of tens of thousands of businesses will provide the basic distribution mechanism for interactive media. The chart also points out that the Internet will feed on these capabilities and help it soar to the 100 million subscriber level by the turn of the century.

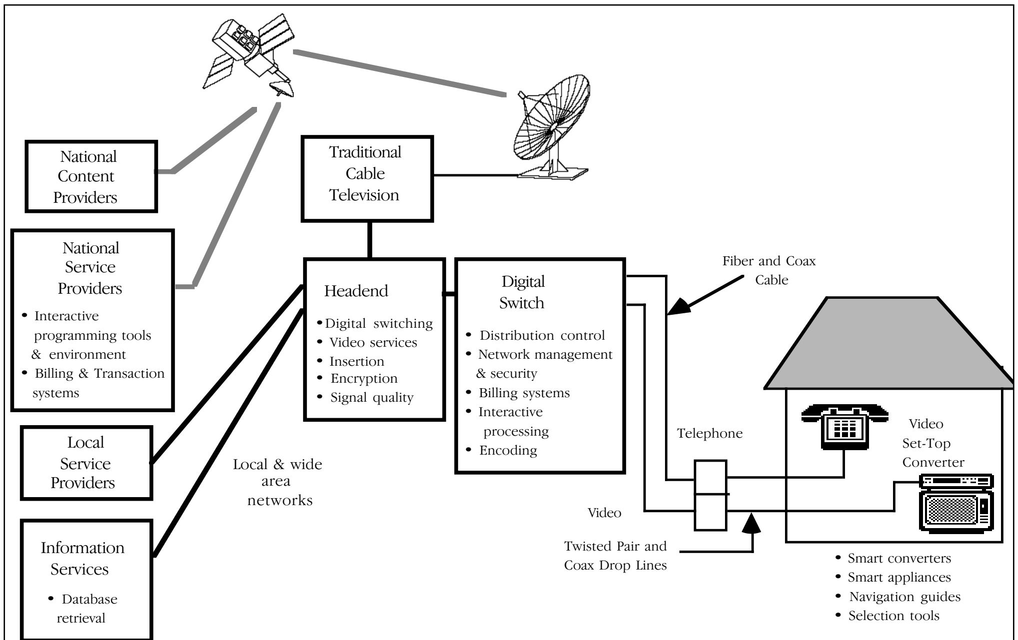
The magnitude of the global communications infrastructure and the extent of changes to permit high bandwidth interactive media services indicates that deployment will take several years. Integrated services are intended to deliver voice, data, and video first to business and then to the home. As the market develops, so will many vertical applications. Business and consumer service trials over the next few years will lead the way to the services of the next century.

Cable-Based Networks

Cable networks are poised to play an important part in the delivery of interactive media content. Clearly we need a high bandwidth transport mechanism into the home. The coaxial cable used by the cable companies is an inexpensive, easy-to-maintain medium that provides nearly a gigabit of bandwidth.

The cable architecture provides a basic transport service that any number of providers could use as a conduit for their information. Customers could then choose which providers they would like to have come into their homes. This is just one of the critical debates going on now that will help shape the national information infrastructure (NII).

As we move to the new cable system (see Figure 8-3), elements of the present system will begin to change. Today it is mostly coaxial cable from the headend antenna (which captures the broadcast signals) to the house. In the future there will be a fiber optic cable from a central office out into various neighborhoods. This fiber will terminate in a network node. The medium from the node to the house will be coaxial cable. Instead of carrying only analog signals as it does today, it will carry a mixture of analog and digital. To decode the digital signals you will need a set-top box (STB). Inside the STB will be decoders that take the digital form of a movie that has been highly compressed and decompress it so that it can be seen on your TV set. With this method movies will be distributed on demand to the home.



Source: Multimedia Markets and Applications–1994 Annual Forecast, Market Vision, 1994

Figure 8-3. Interactive TV System

In some cases services will be delivered via cable or the phone system. Television sets do not have the return channel concept now, but it will be the heart of the interactive television thrust.

Wireless Networks

The overwhelming use of the radio spectrum is for radio and television broadcasts. The medium has traditionally functioned in one direction only, with an active broadcaster, and a passive audience. This is appropriate for some applications but for interactive media applications there must be a return channel. Today that return channel is the PSTN. When home shopping you see the goods that you want to buy on the TV screen. You then get out of your chair, go to the phone, and call in your order. In educational broadcasts, viewers may watch a panel of speakers and then phone queries to the panel.

To get more bandwidth for cellular radio type applications Motorola has proposed a low earth orbiting satellite (LEOS) system. Microsoft and McCaw have announced the development of a LEOS using 840 satellites. Their proposal also ties the satellites to antennae farms that can be hooked up to the PSTN. If all of this works out, they could provide a bandwidth of 2 Mbps, which by the year 2001 will be at the lower end of the bandwidth requirement for many important interactive media applications.

With LAN and enterprise applications demonstrated, several consumer services will also evolve. Metropolitan area networks and interconnected global communications will permit exchange and real-time interaction. Integrated services are intended to deliver voice, data, and video first to businesses and then to the home. As the market develops, so will many vertical applications. Broadcast, broadcatch and videoconferencing services will open new and significant markets.

With the necessary broadband infrastructure in place, a host of service providers can begin to deliver interactive media content to the home and to centralized sites for distribution to consumers. These sites afford an early opportunity to deliver content to retail stores capable of in-store production. Several experiments are underway to demonstrate the technology, and the enhancement of local inventory control, product availability, and customer selection.

Consumer In-Store Delivery

While communication companies are building the necessary transport systems to permit fully digital data communications, local network transport and management problems must be resolved. These include bandwidth management, multiple video videostream synchronization, data contention, data security and authentication, service recovery, and network accounting. Several industry experiments and trials will explore the acceptance and limitations of these proposed technologies.

Some of these experiments include online distribution to retail locations for theaters, home video, and other regional distribution centers. The significance of these experiments is just beginning to be felt, and they await more extensive consumer testing. The examples below help identify the value in providing these services under a more manageable and measurable environment.

Pacific Bell Telephone Delivers Digital Movies

Pacific Bell will use SONET and ATM to deliver movies to theaters. Beginning in 1994, about a dozen theaters in Los Angeles, and another dozen in northern California will receive movies sent directly from the studios to the theaters in digital format. Alcatel will provide the compression and switching hardware. The trial will thoroughly test compression technologies and standard telephone digital switching. If successful, this could lead to home delivery of movies. Movie producers estimate that this approach could dramatically reduce distribution costs, which total about 25 percent of a movie's cost today.

Blockbuster Rents Videogame Players

Blockbuster Video rents videogame players, such as Sega Genesis CD, Nintendo SuperNES, 3DO, Philips CD-i, MPC, and Macintosh computers with CD-ROM drives. To increase the rental of game titles, the cost of the rental, which includes three titles and a player, is set low at $19.95 for three evenings and $4.33 for each title for two days. This encourages trial by video rental customers and has been shown to increase store traffic.

Because this approach eliminates the bias in platform selection, customer acceptance is based solely on the engaging quality of the content. This is an example of changing the platform distribution methods to increase content sales, and it will test whether content acceptance will drive platform adoption.

Other distributors are watching these trends and working on ways to adapt it to their product lines. If this approach catches on, it could signal a major step in the direction of the universal game player.

New Leaf and Blockbuster

New Leaf Entertainment is a joint venture of Blockbuster and IBM to develop and market systems for digital storage, transmission, and reproduction of entertainment software products, such as videogames, music, motion pictures, videos, CD-ROM, and other software publishing.

They have developed a prototype system that stores digital content in a server in their offices and can transmit it over a network to different writing devices capable of creating CD-ROM discs, cassette tapes, and videogame cartridges, and printing collateral materials, such as packaging, installation instructions, and other support materials.

Blockbuster, in conjunction with Sega, will test in-store production and delivery of videogames in 12 stores this summer. The system consists of a game preview kiosk, where consumers preview a specific game. Blank cartridges are reprogrammed, allowing retailers to customize their inventory of rental titles to match consumer demand. It takes about 30 seconds to download the data.

Some games will require the customer to wait to have the software manufactured, and the literature printed and packaged. All the accounting data will be uploaded periodically, and new games will be downloaded periodically.

The business model for in-store systems would employ revenue sharing. Today the publisher sells a game cartridge to a retailer for a flat fee. At that point the publisher is out of the picture and the retailer can rent a cartridge many times. With a revenue-sharing model, inventory does not change hands. The retailer collects the money from the consumer every time a game is rented and returns a certain portion to the publisher.

In the long term, the music distribution channel, with close to 100,000 titles in print today will require a higher-capacity telecommunications network, while an in-store system could easily support the few hundred game titles that are available for the Sega Genesis system.

The infrastructure for the electronic delivery of CD-ROM-based interactive media information will permit two types of delivery: inventory fulfillment and inventory replenishment. With an inventory fulfillment system, one title is transmitted at a time, stored in memory, and reproduced on different types of media, and then the next product is sent. An inventory replenishment system permits overnight copying, which does not require broadband delivery. Shelf space and depth-of-copy become important.

Game rental will become an increasingly important market segment, expected to exceed $1.5 billion worldwide by the end of 1994 according to Sega America. With the ability to program game cartridges at retail locations, retailers and games publishers can maximize their opportunity to put products into customers' hands, and increase overall transactions. The New Leaf test will determine technology feasibility and customer acceptance.

Consumer In-Home Delivery

The excitement surrounding the delivery of electronic services directly into the home is centered around the ability to connect consumers directly to the source of information, products, or the opinions of others. The 30 million Internet explorers represent more than curiosity, as evidenced by the rapid shift in operating philosophy from a medium for intellectual exchange to a conduit for commercial activities.

Delivery into the home involves four classes of platforms, each of which seeks to be the dominant delivery mechanism. Today the principal connection platform beyond the telephone and broadcast (including cable) television is the computer with attached modem. For those reluctant to commit to the training required to use computers, the "set-top box" or advanced cable modem is being promoted. Whether attached to telephone copper lines or to coaxial cable, these advanced modems are connected to television displays employing remote control devices. A third class is a special modem that permits videogame players to be connected over television or cable lines. A fourth class employs wireless cellular telephone communications to specialized platforms, which may be portable with their own television displays.

In a simple world only one of these delivery system would prevail, but this is not the case. The scenario will likely evolve into a complex mixture controlled by user needs and willingness to pay for the delivered service. Within this mixed environment, many opportunities will exist for developers to deliver meaningful content.

Online Consumer Services

Special services, such as Internet, Prodigy, America Online (AOL), and eWorld are beginning to deliver interactive media both in the form of electronically transferred packaged media and as online interactive services. Online services such as Internet have evolved from a conversational network into a host of commercial services.

The basic distribution model is emerging in which international, national, or local service providers distribute products for publishers, and in some cases individual producers. The distributor offers transmission of content, accounting of use, billing, and in some cases collections and disbursement of fees.

The principal equipment necessary for use of these kinds of networks and services is the personal computer with data modem. The full-duplex afforded by this hardware configuration permits the two-way exchange between service provider and customer. This provides the opportunity for all customers to become service providers as well. As opportunities for individuals to become service providers present themselves, the distributors (online service providers) will become more important because of their ability to reach a larger subscriber base.

Interactive Television

The distribution model for interactive TV is similar to that of modem-based networks but differs in the fact that basic services are combined with other forms of entertainment, such as broadcast television, premium cable channels, home shopping, and video on demand (currently delivered as pay-per-view). These are delivered to the television at a greater viewing distance than the "up-close" interaction with a computer screen. In this model the telephone and cable companies act as service providers.

At the heart of this system is the user interface device known as the STB. This device is fashioned after today's cable terminal and remote control but will employ advanced on-screen menu designs. These navigation tools, designed by the service provider, will permit consumers to easily access areas of interest and have some communications, in the form of requests, with the service provider.

The service provider will be responsible for ensuring high-quality content, ease of use, customer support, accounting, security, authentication, billing, and collection. It is likely that billing and collection will be performed by a separate entity. It is also the responsibility of the telephone or cable company (service provider) to maintain the physical connections with the content providers regardless of location to customers (see Figure 8-3).

The basic product the telephone and cable companies are selling is choice. But choice alone will be insufficient unless it is accompanied by personal relevance and high entertainment quality.

It will be the completeness of the broadband communication infrastructure and the access to it that will determine how significantly and quickly this method of distribution gets established and accepted by consumers who are primarily interested in passive entertainment.

Advertising and Local Commercial Insertion

An area sometimes overlooked by developers is the opportunity to produce content for interactive advertising for business. Local insertion of commercials is becoming a commonly accepted practice as both the cost of airtime and production decline. In addition to self-promotion, local commercial insertion can be an important source of projects and revenue.

The Sega Channel

In 1994 Sega, along with Time Warner Interactive and TCI, began testing a new service called The Sega Channel in 1994. Subscribers will buy or rent special hardware and be able to download *Sonic the Hedgehog* or any of the 50 Sega videogames from their cable system. As the videogame experience is a one- to four-player environment, connecting popular videogames over cable will permit a large number of players to compete regardless of geographic location. This will evolve similarly to the specialized modems that plug into Sega Genesis players.

Catapult has developed a specialized modem to connect two or more Sega players over telephone lines and to headend services. Connecting videogames over cable will allow service providers to assess the use of an STB for network gaming with the possibility of replacing the proprietary videogame players with a universal standard—changing the focus from platforms to content.

Interactive media technologies distributed by cable and public telephone network providers will extend existing computing capabilities and create many new markets, such as video-on-demand, home shopping, and personalized news services. The tests conducted on these networks will determine consumer acceptance and will have a significant impact on the direction of the interactive media industry as a whole.

The Future of Electronic Distribution

The current state of development of electronic distribution is characterized by a combination of optimism and confusion. A majority of the publishers and distributors surveyed for this guide were positive about the eventual distribution opportunities but had mixed opinions about the timing of its effective deployment. Some, such as Time Warner Interactive, are aggressively pursuing interactive television technology, business relationships, and consumer reactions to interactive television, while others are taking a wait-and-see approach.

Time Warner Interactive has two studios that develop interactive TV programs, some of which are also CD ROM-based products. They currently have completed 12 programs for interactive TVs and are developing a host of others. They are developing long-term partnerships with the creative community. These relationships will empower developers to access the interactive networks, whether it be Time Warner's Full Service Network (NFS), US West, Bell Atlantic, or TCI.

Ingram, East Texas Video, Baker & Taylor, and Electronic Arts are all closely monitoring the developments surrounding online services and interactive television. Several distributors interviewed expressed concerns about the ability of retailers to produce and delivery quality packaging in the store while the customer waits.

Consumer confusion over platform selection, subsequent stalling of the purchase decision, and, worse yet, consumer rejection are common concerns. But by far the greatest concern is the fear that the distributor will be cut out by the content provider or publisher going directly to the retailer or even consumers.

The future of electronic distribution appears bright, but it should be remembered that shifting the "center of commerce" that has evolved over tens, and in many cases hundreds, of years will not be easy, quick, or inexpensive. With the rudimentary infrastructure in place by about 1998, the first mass-market experiments will point the way to the future of information, entertainment, and communications online delivery. During this period, the actions of today's developers, publishers, and distributors will play a crucial role in molding an engaging experience that will either accelerate or retard deployment and consumer acceptance.

Chapter 9

Developer Guidelines

Developers are faced with a multitude of issues affecting not only the design, financing, and production of a quality title but also a complex collection of marketing, sales, legal, and business issues. Within each area, a small error in judgment could spell significant loss of opportunity and revenues.

The guidelines presented in this section have been identified with the assistance of several of the leading publishers, distributors, and industry experts. Because of the breadth of the topic, recommendations for developers have been summarized in the form of guidelines. Detailed suggestions concerning deal-making, the contract, and business relationships are found in Section One.

Recent changes in product distribution and promotion will most likely have a profound impact on the interactive media titles business. The retail changes occurring today include the following:

Product distribution

- The entry of mass-market retailers (e.g., Blockbuster and Tower Records) and superstores will expand product distribution beyond the traditional forms of specialty retail outlets (e.g., software, home video, videogame, books, music), direct mail, and promotional bundling.
- Entry of high-volume distributors, such as Merisel, and rack-jobbers, such as Handleman, will aggressively expand sell-through reach and challenge leading distributors (e.g., Compton's, Electronic Arts, and Brøderbund).

Product promotion

- Title bundling as a hardware promotional strategy will gradually be eclipsed as title prices decline, except for new product introductions or upgrade kits.
- There will be a gradual shift to a hit-driven, high-volume retailing landscape, with shelf space allocated on the basis of unit "turns," co-op support, and other retailing incentives.
- Major music, video, and book publishers (e.g., Sony, Time Warner Interactive, Polygram, MCA) will dominate shelf space.

All of the distribution models discussed in this guide involve how interactive media title developers get their products (content) to the consumer. Executives from leading companies in each of the five distribution models (videogames, home video, books, software, and music) were interviewed. Their insights into bringing interactive media products to market show consensus on the following points:

- Quality content and high production values are of great importance in creating a successful CD-ROM title or other interactive media product, whether it be distributed on game cartridge or floppy disk.
- The Macintosh and Windows computer platforms are the dominant CD-ROM delivery platforms. Sega and Nintendo dominate the cartridge videogame market, although there is a lot of industry interest in the emerging set-top devices, such as 3DO's Interactive Multiplayer (manufactured by Panasonic).

- Consumers need a way to preview CD-ROM titles. Presently little is done to let potential buyers browse the contents of a disc for which they might spend $30 to $50.
- Retailers generally do not make guarantees to distributors about product placement or sales volume, and distributors, although they frequently provide informational and marketing materials, do not make assurances to publishers about product promotion or placement in the retail channel.
- Publishers and distributors who have brand-name recognition on the consumers' part and large sales volumes are the most sought after by retailers. For example, Living Books, which is jointly owned by Brøderbund and Random House, and Microsoft are actively sought by retailers., because of their visible brand names and larger sales volumes.

Based on the results of interviews with leading publishers, distributors, and marketing consultants, the top ten developer guidelines are identified in Table 9-1.

Guideline	Description
Pay attention to content.	Quality content and high production values are of great importance in creating a successful CD-ROM title or other interative media product, whether it be distributed on game cartridge or floppy disk.
Select a delivery platform.	Macintosh and Windows are the dominant CD-ROM delivery computer platforms. Sega and Nintendo dominate the videogame market. Plan for the emerging players, such as 3DO Interactive Multiplayer and Sony PlayStation. License titles only on platforms that publishers have committed to publish on.
License specific rights.	License only the content that is published in the specific work. Retain rights to content that is not used.
Retain electronic rights.	Do not sign away rights that may provide future royalties in three to four years.
Support try-and-buy.	Provide support, such as kiosks, demonstration systems, and home rentals that permit consumers to preview CD-ROM titles.
Plan new product releases.	Announce the release date and stick to it. Consider strategic product releases at times other than Christmas, such as summer.
Follow good merchandising practices.	Since retailers do not guarantee product placement or sales volume, ensure that the publisher prepares and disseminates retail promotional materials, such as T-shirts, mugs, and posters, for optimum product exposure.
Build product branding.	Seek publishers and distributors who have brand-name recognition.
Design packaging carefully.	The package is the product. Give top priority to packaging that conforms to standard dimensions for warehouse and retail shelf space.
Prioritize distribution.	Develop a distribution strategy and plan. Select primary distribution channels to maximize opportunities for your product that dovetail with their target market, product marketing, and subject area.

Table 9-1. Developer Guidelines

Guidelines specific to the five industries reviewed and electronic distribution are presented in the following sections.

Videogame Distribution

The videogame industry continues to experience explosive growth that provides great opportunities for developers who are quick to respond. As the market accelerates, and distribution channels expand, business and product development errors will be less forgiving.

Guideline	Description
Differentiate products.	Higher development costs will require a more sophisticated marketing plan to penetrate an increasingly crowded market.
Plan demographic targets.	Learn the demographics of your target consumer group. The more mature the group, the more engaging the game should be. Engaging games will rent better in video stores.
Consider minimum system requirements.	Single-speed drives are no longer the lowest common denominator for product design considerations. Double-speed drives are now the current standard.
Encourage game rentals.	Game rentals will stimulate the sales of your product.
Explore all markets.	Floppy disk products still have a market, although they will be excluded from the home video rental channel. Other potential markets include PCMCIA and cartridges.

Table 9-2. Videogame Distribution Guidelines

These guidelines show that developers must plan carefully yet act quickly. A careful analysis of platform, target market, and consumer preferences is critical if videogames are to have a successful launch. Developers must make their products stand out as the market becomes flooded with products. Paying close attention to the content preferred by one’s target consumer group 18 months from now will increase the chances of producing a successful product.

Home Video Distribution

The home video industry is a foremost contender among mature consumer electronics-based entertainment. Because it is centered around consumer electronics and entertainment, it lays the foundation for a better understanding of the emerging interactive media industry.

Guideline	Description
Pursue revenue sharing.	Give serious consideration to revenue sharing as a viable distribution channel strategy.
Support try-and-buy.	This is the most cost-effective way to expose your product to the consumer. Unlike kiosks in software and other retail operations, which will be very costly to implement, the home video rental market will give you better exposure, especially for high-priced games.
Anticipate sophisticated consumers.	Just as you would avoid designing a title in a crowded genre, avoid designing a title without substance. These products are being returned by consumers at alarming rates (as high as 50 percent).
Support product rentals.	Only CD-ROM-based products are likely to rent in the home video channel.
Obtain copyrights.	Determine the method of copyright for your product, either as software or as a book. (See Section One.)
Target distribution.	Understand which channels your products are best suited for. For example, supermarkets are a growing part of the home video market, and they are much more particular about carrying family-suitable content.
Announce and meet street dates.	Commit to deliver your products in a timely manner. Home video releases 100 percent of its products on the announced street date. The anticipation this creates with the consumer is a boost to sales.
Provide POP materials.	Make sure POP materials are provided to retailers, either through your publisher and distributor or by your company directly.
Obtain timely activity reports.	Require weekly or monthly reports at a minimum.
Expand product releases.	Give strong consideration to your product's release cycle. Releasing product throughout the year, rather than just at Christmas, is going to be an increasing trend.

Table 9-3. Home Video Distribution Guidelines

The home video industry is well positioned to accept interactive media. The "try-and-buy" method affords interactive media developers exposure to their products. There are many learning opportunities for developers as they become more familiar with home video, which has already passed through many of the growing pains now facing the interactive media industry.

Music Distribution

The music industry continues to serve as the basis for many of the practices of the software industry, and it has a direct influence on emerging interactive media distribution. Practices relating to copyright protection and cross-merchandising are among the most important contributions from this model.

Guideline	Description
Develop partnerships.	Align with music distributors because music retailers are now diversifying their product offerings.
License selectively.	Prepare for cross-merchandising by protecting properties and licensing only necessary rights.
	Explore music distribution licenses, such as music clubs, TV promotions, and foreign distributors.
Design packaging carefully.	Package especially for the music retailers to attract both the general audience and specific target buyers, such as those over 25.
	Since both music and CD-ROM discs use jewel box packaging, design packaging carefully to differentiate your product while maintaining standard dimensions.
Carefully consider self-publishing.	If you self-publish, be aware of all the hidden costs, such as special promotions, market development funds, and shipping. Most distributors perform only fulfillment, so you may have to handle initial orders yourself.
Target audiences over 25.	Now is a good time to develop products for the over-25 group since retailers are expanding their market appeal.
Cross-merchandising.	Cross-merchandise and cross-promote with the software channel.

Table 9-4. Music Distribution Guidelines

These guidelines show how music retailers are now expanding into age groups that include more than just the MTV-generation. This is a prime time for developers to enter into agreements with music distributors for interactive titles. As this channel matures, there will be other opportunities to distribute ancillary materials, such as posters, T-shirts, travel guides, and other merchandise.

Music publishers of audio CD products will want to cross-merchandise and cross-promote interactive media products from their artists. Many of these publishers may seek distribution agreements in other industries, such as the home video and computer software.

Before digital music delivery over online services, such as Internet and America Online (AOL) becomes possible, promotional clips of new music releases will become popular. One company following this new practice is Warner Music, which offers on AOL newly issued sound clips of material from such artists as Neil Young, Madonna, and the artist previously known as Prince.

Book Distribution

Book publishing is characterized by long-term distribution relationships. Traditional publishers and booksellers are waking up to the possibility of new revenues from interactive media products.

Guideline	Description
Determine the best interactive media titles.	Book channels will do well with reference and children's titles.
Ensure ease of use.	Ensure that your product is self-loading and self-configuring without disruption to other portions of the delivery platform.
Carefully consider CD-ROM bundles.	Bundling CD-ROM discs with books will generate some revenue, but it is only a small part of the total marketing mix.
Plan product roll-out budgets.	Since book distributors are not prepared for product roll-outs, plan and budget to help the publishers perform this function.
Support try-and-buy.	The browsing environment of bookstores is conducive to product previews by buyers. Ensure that support materials are available to permit a rapid "close" of the sale.
Design packaging carefully.	Accommodate packaging for libraries.
Plan to use bar codes.	ISBN numbers are required in all bookstores and must be incorporated into the packaging so that their placement does not conflict with other bar codes.
Provide in-store support.	It is common for the publisher to send experienced demonstrators into bookstores to assist in the introduction of products. Plan for demonstration materials and other in-store aids to support demonstrators. Prepare to support staff training and the need for knowledgeable product support.

Table 9-5. Book Distribution Guidelines

As shown in these guidelines, developers seeking to distribute titles through book channels need to observe many of the standard industry practices, such as library packaging and bar codes. As discussed earlier, the book industry is preparing for the 1994 Christmas season. This will test the rate at which the industry will adopt interactive media products. As there are no insurmountable problems in supporting interactive media within book channels, a successful 1994 Christmas will accelerate developers' activities with book publishers and distributors.

Software Distribution

Software distribution affords many opportunities for interactive media developers. Over 75 percent of consumers use their computers at home for entertainment and games. But the retail channel has yet to develop sophisticated merchandising to promote these products. A formal marketing strategy is necessary to increase consumer awareness of your product.

Guideline	Description
Design packaging carefully.	Differentiate your product through creative package design, yet conform to standard packaging dimensions.
Plan merchandising strategy.	Plan your merchandising well. There is little sophisticated merchandising in the software distribution channel, compared to consumer electronic and entertainment retailers.
Provide retail store support.	Prepare to support computer stores as if they were consumer entertainment centers.
Carefully consider bundling.	Exercise discretion. Bundling can develop brand awareness, but excessive bundling can reduce the viability of your product.

Table 9-6. Software Distribution Guidelines

These guidelines indicate that developers will need to find a way to promote their products directly to the retail channel. It is necessary to find a method to market products as the category grows from a niche-oriented market to a consumer mass-market. Consumers will want to see demonstrations of the products before buying them.

Electronic Distribution

The following guidelines prepare the developer for activities that will begin to present major business opportunities by 1997. The purpose of these guidelines is to alert developers to the attempts of telephone and cable companies to establish a communication infrastructure in support of the delivery of interactive media and services.

Guideline	Description
Deliver packaged media.	Immediate opportunities exist for the delivery of packaged media over data networks. As ISDN and other broadband networks become available, you will be able to deliver hundreds of megabytes of information.
Test in-store delivery.	Get involved in the in-store delivery tests, such as those being conducted by New Leaf Entertainment.
Use online interactive services.	Prepare today to take advantage of online interactive services when available. Begin discussions with service providers, but do not get tied into exclusives. Design today's products with the ability to add "personal relevance." Design for a minimum bandwidth, two-way interactive (return) channel.
Employ local commercial insertion.	Capitalize on the advertising opportunities. Use existing content or develop new titles as the basis for local advertising.

Table 9-7. Electronic Distribution Guidelines

Many of the interactive television trials, company alliances, content licensees, and proposed interactive services are still in an early stage of development. The reversal of billion dollar agreements shows the industry is under tremendous flux. An illustration of this is the announcement by Pacific Telesis to skip the trial stage where ITV services would be evaluated by 1,000 homes in Milpitas, California. They plan to move directly to the commercial deployment of an interactive video network. They will begin to build a statewide network costing more than $16 billion over seven years.

Optimism about this technology and the acceptance of interactive services by consumers is balanced against several delays in trials, deployment plans, and planned company mergers. These digital delivery and interactive services will not reach major deployment until after 1996, with mass-market acceptance occurring much later. From a developer standpoint, projects completed or underway today could become valuable assets as interactive networks are accepted. Your actions today should not preclude the use of properties in future distribution channels.

Conclusion

Interactive media is still evolving as an industry. Current distribution for interactive media products share many similarities with the music, video, software, videogame, and book businesses. Add to this the uncertain influence of the rental industry, and this evolution can lead to confusion and lost fortunes if developers are not aware of changing market conditions early enough to take action.

Being a nascent market, distribution channels for interactive media are only now emerging. As shown in Figure 9-1, the software industry predominates in the distribution of interactive media. Although home video has been renting 8-bit videogames since 1988, videogames have only recently become a significant portion of the rental revenue. Also seen in the figure below is the relatively small contribution today by music and book publishing.

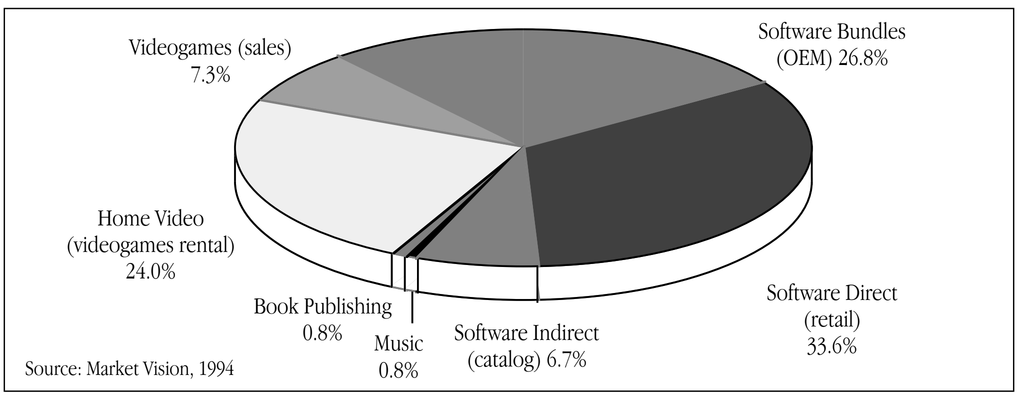


Figure 9-1. Worldwide 1994 Commercial Titles Revenue by Distribution Channel

The distribution pattern estimated for 1994 is expected to change significantly in the next two years. Beyond that, it is even more difficult to forecast the nature of the distribution channel mix. Several factors make this forecast difficult including the following:

- The growing success of the rental market could significantly increase its share of the distribution channel.
- Personal computers in the home have saturated the higher income brackets and are now moving down to lower income groups, forcing a decrease in the cost of players and interactive titles.
- Consumer acceptance of the 300 games released for the 1994 Christmas season will increase the retail channel activity and stimulate commitments by retailers to promote interactive media.
- Interactive music is one of the title areas experiencing growth due to recent success with titles by popular artists, such as Peter Gabriel, Prince, and Bob Dylan and increased activity by superstores like Blockbuster and Musicland.
- If the bookstores' interactive media trials slated for Christmas 1994, including Apple's kiosk project, are successful, retailers will reserve greater amounts of shelf space for electronic books.
- As online delivery of interactive media and full services networks such as Time Warner's FSN become available, the number of distribution options will increase for the overall market.

Given the dynamic nature of this landscape, the many emerging business opportunities will give developers a wider choice in the promotion, sales, and delivery of their products.

A small developer will probably seek private funding. The first model that large developers will adopt is one similar to the venture capital model, in which you develop, manufacture, publish, and sell a product direct to the retailer. Over time that's not going to be the model. Your money is going to have to go into product development, and then a handful of other players will take the product to market. Retailers are going to demand a distribution partner to merchandise the large number of new products that will be introduced. Ultimately the business will get down to marketing and retail distribution.

Master Guideline

Prepare for the unexpected by protecting your intellectual property, managing your assets, and capitalizing on the diverse methods of distribution you have available to you.

Instead of performing all activities, the developer will just develop and arrange with the publisher to distribute the title into the channels. A common mistake is to assume that a title will be able to get the retailers' lion's share. That may be fine for the first year of its release, but if it flops or does not turn well, developers may not be able to obtain additional financial support and development capital to continue.

Retailers are already starting to make decisions for the 1995 Christmas season. The development times of 12 to 15 months, buyer product evaluation and selection, and filling the distribution channel for the Christmas season means that developers must make decisions and commitments about the number and content of titles for the 1995 season by October 1994. The successes and failures recorded during the 1994 Christmas season will affect only design details, not the selection of title topic.

There is too little understanding of true customer demand and willingness to pay to forecast the superhits. But one thing is very clear: In any form of entertainment or information, there's no substitute for a good story or a good author.

Storytelling will ultimately become less dependent on technology. When developers are able to harness the technology, they will return to fundamentally good products with good production values.

Content is ultimately going to drive the market. What is emerging today is a studiolike model, combining elements from the home video, videogames, music, book, and software industries, where production companies are aligned with large publishers and distribution companies that take the responsibility for consumer packaging, marketing, promotion, merchandising, and distribution. Creative people will align themselves with these large publishers and distribution companies to provide both packaged products and online services.

One final note: This guide has focused on the near term within the scope of the 1995 and 1996 Christmas seasons. The explosive ingredients of enthusiasm and confusion, as well as the "glitz" of being in the entertainment business, make for a business environment where the next entrepreneurial innovation could change all the rules of the game. The billions upon billions of dollars at stake for the industry creates an environment of intense competition and associated price wars. One driving fear is that the distribution systems we know today could be imploded to eliminate many "middlemen" and connect the suppliers directly to the consumers electronically. We finish this guide with one last "master" guideline:

> Prepare for the unexpected by protecting your intellectual property, managing your assets, and capitalizing on the diverse methods of distribution you have available to you.

Section Three

Appendices

Appendix A—
Contributor Background

Appendix B—Digital Media,
A Seybold Report—Reprints

Appendix C—Resource Directory of
Worldwide Distributors and Publishers

Appendix D—Sources and
Supporting Documents

Appendix A

Contributor Background

This guide is the result of extensive primary market research conducted for this project and years of investigations performed by the contributing companies. Company backgrounds of the three principal contributors—Market Vision, Golden Light Imagery, and S.O.S. Inc.—follow.

Market Vision

Market Vision is a consulting firm and a publisher of industry research. Our unique value comes from years of experience in multimedia applications and a wide range of experience in strategic market positioning. We have been perfecting skills in market research and strategic product planning since 1982. Based on extensive primary and secondary research and direct application experience, we help our customers understand emerging markets and identify significant business opportunities.

Market Vision principals and associates have a wide range of experience in multimedia, technical product marketing, and strategic market positioning for computer hardware and software products. Our clients are senior executives; sales, marketing, and engineering staff at vendor startup; early stage companies; and corporations. Market Vision principals have been privileged to serve companies such as Apple Computer, Sun Microsystems, Microsoft Corporation, Ampex Corporation, Macromedia, 3M Corporation, and Montgomery Ventures.

Robert Aston founded Market Vision in 1988. He is a pioneer in the formation of market and product strategies for computer hardware and software vendors in computer graphics and multimedia. With an in-depth understanding of market dynamics and a technical background in modeling and simulation, he has provided strategic business and product development planning to companies involved in digital video, magnetic storage product design, object-oriented application development, and three-D and animation software development.

Mr. Aston has founded two leading-edge software companies in computer graphics and desktop publishing. He is the author of *Multimedia Defined*, *Multimedia Applications and Markets—A Five-Year Forecast* and the recently released *Multimedia Applications and Markets—1994 Annual Forecast*. He is a frequent contributor to books and magazines on multimedia, and is coeditor of the recently released Academic Press Professional book entitled *Multimedia—Gateway to the Next Millennium.*

Mr. Aston provides business plan and marketing support. With extensive experience in multimedia, computer graphics, and environmental management, he brings clients the strength of 20 years of computer company business management.

Golden Light Imagery

Golden Light Imagery is a market consulting firm for the interactive media and entertainment industries. Our expertise lies in using a content-based analysis to better understand emerging markets and to forecast future growth of the interactive media entertainment industry. Golden Light also develops interactive CD titles and digital imagery and consults in the motion picture industry based on its expertise in consumer trend analysis.

S. Swaminathan founded Golden Light Imagery in 1990. He has over 12 years' experience in the home video industry, and designed its first fully integrated inventory management system. In conventional inventory management, product history is the constant on which forecasting is based. In the emerging interactive and entertainment industries content is a more accurate foundation on which to forecast consumer preferences.

During the formative years of 1988–1990, when VCR penetration grew from 25 to 75 percent, Mr. Swaminathan advised several major retailers to increase their market shares in the home video industry. Two clients were among the four most profitable video chains in the industry. One rose from a minor player to the fastest growing chain in the industry.

Mr. Swaminathan has lectured and conducted seminars on inventory management for the home video industry throughout the United States and abroad. He has written numerous articles on the subject. He also conducts workshops on digital imagery.

Mr. Swaminathan founded Universal Vision Systems, Inc., a software development company that specialized in inventory management and held upper management consulting positions at Lazor Systems and EBSCO Business Systems. For the last four years he has applied his experience at Golden Light Imagery in a practical way. He has been a visual consultant in the motion picture industry, in productions such as Michael Mann's Emmy-nominated miniseries *Drug Wars*. In addition Golden Light is a developer of CD-ROM titles and digital imagery. Mr. Swaminathan's digital images have appeared in national advertising campaigns; have been profiled at MacWorld, Seybold, and SIGGRAPH conferences; and are currently featured in a Kodak CD-ROM entitled *Art Expo 94.*

S.O.S. Inc.

Joanna Tamer has specialized in distribution and business development strategies for CD-ROM title developers, publishers, distributors, platform manufacturers, and retailers since 1990.

Ms. Tamer has consulted for Apple, Technicolor, Kaleida Labs, Blockbuster, Baker & Taylor, HarperCollins, Time-Life, Propaganda Films, and Broadway Video, among others.

She is a regular speaker or panel chair at most leading trade shows and conferences on new media. Her articles and columns appear regularly in *Digital Media,* and she is currently working on a book with Lonon Smith on the roles and cultures of multimedia, sponsored by the Software Publisher's Association. She is based in Los Angeles and northern California.

Appendix B

Digital Media–A Seybold Report

Appendix B is a selection of reprints addressing distribution and marketing issues for consumer CD-ROM titles, written by Joanna Tamer of S.O.S., Inc., and published by *Digital Media*.

Reprints

New Strategies for Distribution in 1994

Bookstore Channel Emerges

Distribution Planning: 1994

CD-ROM Rental in the Video Channel

Packaging: The Primary Sales Agent

New Multimedia Deal Structures

A Brief Analysis of Bundling Deals

Distribution and The Art of Negotiation

An Interesting Legal Wrinkle

The material in Appendix B, A Seybold Reprint, appeared in *Digital Media: A Seybold Report* (ISSN 1056-7038). The reports are reproduced here exactly as originally published. They have not been abridged, revised, or updated since their first publication. Seybold Publications has prepared this reprint at the request of S.O.S.

Quantity reprints of articles appearing in The Seybold Report may be ordered by contacting Giap Edwards at (610) 565-2480. Seybold Publications reserves the right to alter formatting as space requirements dictate, but no changes can be made in the textual material to be reprinted.

June 8, 1994
Volume 4, Number 1

DIGITAL MEDIA

A Seybold Report

New Strategies For Distribution In 1994

When multimedia publishers take the measure of distribution strategies for retail channels in the U.S., which are defined by tight margin and reserve fund requirements, they'll understand how little money will be left over to actually develop and market a product. This revelation invariably leads publishers directly into business development strategy and product planning, where it's important to manage the dollars available for product development *and* the building of a business infrastructure for sales and marketing. This is the key to ensuring that the company will stay in business while the market grows.

There have been several changes in distribution policy and agreements in the last year, reflecting the growing market and an increase in certain risks. It's best for publishers to start with an understanding of their responsibilities, and those of the distributor.

A Seybold Reprint

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The publisher

Publishers press, package, market and sell product through various sales channels, distribution deals, comarketing and bundling with other partners, selling direct to an installed base of end users, and selling through third-party catalogs.

There have been several changes in distribution policy and agreements in the last year, reflecting the growing market and an increase in certain risks.

The risks a publisher must face are product failures in the market, either because of a lack of quality in the product or through poor decisions in sales, marketing, pricing and positioning, the choice of the wrong distributor, or an inability to take full advantage of the distributor's skills.

Publishers take the greatest risk. They carry the burden of 100 percent return privileges on products from all channels. This is the case because retailers have 100 percent return privileges to the distributor, which are passed directly back to the publishers.

The distributor

National or affiliate label-level distributors order, warehouse and ship product into retail locations. They also serve as the "bankers" in the relationship between publisher and retailer, collecting receivables from major chains and a vast array of smaller, independent retailers. Distributors carry the risk of bad debt from their retailers. They carry the credit burden, administer the infrastructure for invoicing and collecting receivables from the channel and pay the publishers 60 days after receipt of goods — even if it may take the distributors themselves 90 to 120 days to collect.

Distributors also risk selecting a publisher who will fail, leaving them with inventory that they cannot return. The relationship with publishers also involves a lot of time and overhead devoted to "hand-holding" small publishers and investments of attention to emerging markets. Distributors generally try to minimize the cost of hand-holding and market development, but this is a serious balancing act between practicality and indulgence of publishers' or retailers' egos.

Changes in distribution: New risks, new attitudes

Last year, distributors accepted as many products as they could, within reason, so they would have a large inventory to justify their demand for retail shelf space. This year, there are more products available, the market is stronger, and retail shelf space is also growing as retailers reap the rewards of a growing multimedia market. But the result for publishers is, somewhat ironically, a more stringent set of business requirements set by distributors, who are more careful about the products they choose. Many products, even some very good ones, are being turned away because the publishers' business didn't look attractive to distributors.

Last year, several publishers went out of business, leaving distributors with product they could not return. Now distributors are looking for more strength in their publisher partners. Access to retail distribution now requires that a publisher produce during negotiations:

- A strong balance sheet that demonstrates that it will be in business in coming years.
- Excellent product.
- A marketing plan with market development funds committed to the launch of the product. (In the case of some national distribution deals, publishers need to have at least $100,000 in up-front money to market the product during its first year).
- A plan that shows that the publisher will bring more product to the distributor.

Changes in channel strategy: Rising above the noise

Last year, gaining access to retail distribution was the primary marketing and sales goal for publishers, as it gained their products the visibility they needed. Now, even though retail shelf space is increasing, so many more titles are being produced that the "noise" in retail is intensifying. It is more and more difficult for a product to be "heard" above the noise.

Publishers entering the multimedia channels today must assume that perhaps only 60 percent to 70 percent of sales will come from retail. They must create other channel strategies to achieve sales from direct marketing, catalog sales and bundling. It's a good idea to consider hiring a representative firm to penetrate the channels not handled by a distributor, such as mass merchants or the bookstore channel. More money must be devoted to marketing each product, say 50 percent of development costs each year, to build a presence in this growing, noisy market.

Publishers entering the multimedia channels today must assume that perhaps only 60 percent to 70 percent of sales will come from retail.

New contract terms

The contracts for distribution are changing, reflecting the shifts in the marketplace and distribution policy.

Advances. This is a buyer's market, so advances from distributors are generally lower because the distributor's need for product is diminished.

National accounts co-op. A new kind of cooperative advertising fund has appeared: 2.5 percent co-op for national accounts, in addition to the standard 5 percent for general co-op. These funds are generally earmarked for participation in the co-op programs designed by the major retail chains such as Egghead and CompUSA.

Right of last look. Certain affiliate label contracts will request the right of last look for the distributor. Under this clause, after the original affiliate label distributor has seen a new product from a publishing partner, refused it, and returned it to the publisher to place it with another distributor, the publisher is obliged to bring the product and the deal back to the original affiliate label distributor when it has found a new distributor and settled on terms and conditions. At that point, the original distributor can match the current offer and keep the product on its list.

It is unwise for publishers to allow this condition, as it completely hinders the ability to shop a product to other distributors if the current distributor has refused it. This clause is rarely seen in national distribution contracts for new media, but crops up in some affiliate label deals.

The returns/defectives fund. Affiliate label distributors require that a fund be set aside for returns and defective units. This amount, withheld from the publisher by the distributor, is adjusted every six months. Last year, this kind of fund ranged from 10 percent to 15 percent of the invoice amount received by the publisher from the distributor, though negotiators usually settled at 10 percent. The percentages required by these funds have increased in the past several months, as distributors seek more safety from the failure of small publishing companies. Now, the reserve fund is likely to be at least 15 percent, and in many cases 20 percent.

Some national distributors pay less attention to this clause, choosing instead to balance carefully their inventory and accounts payable due from their publishers, never allowing publishers to become overextended in their payables. This means they may order every week or two, keeping their inventory very low, but increasing the publishers' administrative and shipping costs.

Exclusivity. The exclusivity clause in most distribution agreements locks the publisher into the agreement for all products created during the term of the contract. Recently, some publishers have created product lines for different genres of products, releasing only a single product line to a distributor in order to match more closely that distributor's skill set with the genre of product.

Evaluating distribution partners

A publisher building a significant infrastructure for marketing and sales needs as much support from a distribution partner as possible. There are two key issues to consider: sales reporting and the distributor's sales force.

Sales reporting. One of the crucial negotiation points for a publisher hinges on the distributor's ability to respond to the publisher's needs for sales reporting from the field. Questions to ask include: What infrastructure is in place at the distributor to create these reports? If the publisher has an immediate question, how quickly will the distributor respond with an answer from the field? Does the distributor merely track sales per SKU? Does the distributor track sales per SKU per retail chain? Does the distributor report sales per SKU per chain per store location?

All these depths of reporting are available from retailers, but only if the distributor has set up a tracking system and paid the retailers to generate the reports. This investment in reporting is an important feature to look for in a distributor. Publishers cannot control their destiny without such reporting.

Distributors will offer 30-day reports or quarterly reports. Quarterly reports are not adequate. It is important to receive 30-day reports, and to understand the depth of those reports.

Feet on the street. The distributor's sales force, or "feet on the street," may be critical to a publisher's success in retail distribution. How many salespeople does the distributor have? How long have they been with the company? What is the turnover rate of this sales force? What other product lines do they carry other than the distributor's? How much clout does the distributor have with this sales force? Are the salespeople exclusive to the distributor or are they employees? Which channels do they penetrate (software, computer superstores, video, audio, bookstores, mass merchants, department stores, supermarkets)? If the sales force is made up of contractors, the question of how highly the they regard the distributor's product line is especially important.

Getting good help

A publisher should have resources to assist in business planning, distribution strategy and negotiation, and the law. Some of these might be partners or outside consultants, attorneys or agents. The publisher's business plan must include a strong distribution strategy, and product planning that is detailed and tactical. This plan will serve both as the publisher's guide, and to gain credibility when looking for funding for titles or the company.

Publishers should not expect business planning or distribution consultants to be experts in the law. They must have an excellent attorney or agent (or both) specializing in multimedia. A good multimedia attorney will generally have experience in copyright law and content licensing. Agents are most experienced in representing talent. Attorneys are available from both the software and the entertainment industry, and agents work strictly in the entertainment and book publishing arenas.

Attorneys and agents are most useful when negotiating the deals that result in a product, or compensation of the talent that contributes to the product. Attorneys and agents are not usually experienced either in business planning or in bringing the product, when finished, into the distribution channels. They're not trained in the vagaries of distribution.

It is important to obtain assistance from consultants, agents and attorneys when negotiating all levels of all contracts. In Hollywood, artists are never allowed to negotiate their own contracts — it is left to the agent or manager to act as the "bad guy." It's always useful to have representation when two partners are negotiating together against the other team, as it allows more flexibility and can create opportunities to win the negotiation.

The best defense is a good offense

Multimedia publishers are the players most at risk and with the most responsibility and, therefore, should plan carefully. Several strategic and tactical approaches can contribute to the publishers' success:

- Choose the best distributor for a product line; choose the distributor by genre. *(See Vol. 2, No. 9, "Choosing the Best New Media Distributor.")*
- If the publishing company doesn't have brilliant negotiators inhouse, it should hire one with experience in multimedia contracts and distribution deals. It should not rely on attorneys or agents to do this, unless they have demonstrated special skill during negotiations.
- Understand the roles of all parties involved, their risks and contributions. There are no bad guys in a negotiation, but everyone is looking for an advantage.
- Create a distribution plan before seeking funding. A strong, well-funded distribution plan is critical to investors.
- Create a product plan to support the distribution strategy. Make sure that the plan is in line with the amount of development funding remaining, after accounting for the cost of distribution and marketing plans.
- Reuse existing authoring engines and templates to create product lines, thus amortizing initial development costs.
- Don't go forward without adequate funds to complete a launch, both for the development of titles and their marketing and distribution. If the funds aren't available, back off and create a more modest plan that can succeed.

The distributor's sales force, or "feet on the street," may be critical to a publisher's success in retail distribution. How many salespeople does the distributor have? How long have they been with the company? What is the turnover rate of this sales force? What other product lines do they carry other than the distributor's?

- Create an aggressive marketing plan that goes beyond retail to include alternative channel strategies, such as direct mail to an installed base, bundling, catalog selling and niche marketing.
- Hire someone with channel experience to implement your plan to sell through channels.
- Trust gut instincts, particularly in relationships with distributors and other partners. But get references. Courtship is a highly advanced art in multimedia, or any media deal, but follow-through is more important. Talk to publishers who have used the distributors under consideration, interviewing them in depth about the issues that define a successful publisher-distributor relationship. Do the homework that eliminates surprises.

Above all else, persevere.

Joanna Tamer

April 25, 1994
Volume 3, Number 11

DIGITAL MEDIA
A Seybold Report

Bookstore Channel Emerges

Distribution channels for multimedia titles are broadening rapidly as the market grows at a pace even the experts didn't predict. One distribution channel that will be important is bookstores. They will serve as a launch pad for new media titles because bookstores are not intimidating to the ordinary consumer, and because the general public are more comfortable in bookstores than software stores. In addition, bookstores are an arena for teachers and educators looking for learning aides, which will be presented in the classroom, shown to children and recommended to parents. Even if games are the best-selling genre now, home "edutainment" titles are the fastest growing market segment.

Previously in this column we have discussed the multiple channels for titles, including the current software channel and the emergence last fall of the video channel for rental and sell-through. Now, bookstores, the channel for paper-based information services, are emerging as a significant channel for multimedia titles. *(See Vol. 3, No. 7, p. 13, and Vol. 2, No. 5, p. 2.)* The idea of finding a multimedia title in a bookstore is not totally new. A few major book publishers released their first multimedia titles in 1993. But during 1994, the floodgates will open. Nearly all major book publishers, and some niche publishers, will be releasing products in a variety of genres.

The bookstore channel looks as if it will be very active during Christmas 1994 — a year ahead of previous predictions. Retail tests have been initiated by publishers and distributors. In fact, savvy publishers, like the Waite Group and Random House Electronic Publishing, are bundling CD-ROM products with books. New alliances are forming between publishers and content developers. Major book publishers will release a significant volume of product this year, first through established bookstore channels, then in new venues such as software retailers and computer superstores.

New developments

Bookstore chains are looking to Baker & Taylor to help them support the multimedia market, and the distributor expects all the major chains will be distributing CD-ROM titles by this coming Christmas. Brad Grob, the director of business development, new media, at Baker & Taylor Inc., is setting up and rolling out market tests now. Some 20 to 30 stores in a chain will commit a four- to eight-foot section of shelf or floor space to sales of various multimedia titles. The eclectic nature of readers, who typically browse for some time before making a book purchase, lends itself to the introduction of a variety of multimedia genres, including edutainment, literature and reference works. Grob says, "Video and music channels will gravitate more toward games and children's titles, whereas bookstores will create a broader mix."

Another test recently rolled out to selected bookstores dedicated space to a kiosk of Mac-based titles from Voyager, Macmillan New Media and others. The kiosk includes a multimedia Mac running titles as a demonstration.

Random House and Brøderbund Software last year formed a new joint venture, Living Books, combining Random House's expertise in children's book publishing and Brøderbund's expertise in children's multimedia development and publishing. They will share the joint venture's technology, content and channels covering books, video and software.

Bundling: CD-ROMs with books

Multicom, a well-known CD-ROM publisher based in Seattle, Wash., has been bundling its titles with hardcover and high-end paperback books for distribution through bookstores and warehouse clubs. Multicom's "Better Homes and Gardens Healthy Cooking CD Cookbook" is bundled with two high-end paperback books, *Fast Fixin' Diet Recipes* and *Pasta Recipes*. Valued at $72, the bundle is sold for $60 — essentially giving the books away free. "National Parks of America," another Multicom CD, is bundled with the best-selling hardbound book, *National Parks of America*, featuring the photographs of the famed photographer, David Muench.

"The simultaneous release and cross-promotion of the book and our CD-ROM opens additional distribution channels for each product," says Paul Attard, the COO of Multicom. "Having a single disc that supports the two major platforms — MPC and Macintosh — and bundling . . . opens up the traditional book store channel to CD products. Until now, bookstores have been reluctant to introduce CD-ROMs to their customers." Nevertheless, Multicom must bow to the past by offering its titles in three forms: the book, the interactive CD and the combination of the two.

The book publishers' own channel

Random House, HarperCollins, Simon & Schuster and others will look to their own bookstore channels, as well as to the established software channel, to launch products. Bookstores by their very nature will attract a different audience from the software or video channel — look for the music outlets to become the channel for CD bundles with audio and video cassettes. But bookstores have traditionally bridled at the introduction of multimedia titles, since the noise and action of a demonstration station violates the library-like sanctity of aisles of books browsed by thoughtful consumers. New titles from these publishers will drive a wedge into this market by extending the capabilities of the traditional book. Random House's dictionary is easier to search than a paper reference title, as are the various CD-ROM encyclopedias. Non-fiction and literature on a disc is more compact than a book — and can pack a video punch.

The trick will be using the paper book as a familiar point of entry into the multimedia world. By bundling books with discs, as Random House, Multicom and the Waite Group do, the publisher can get around the hidebound beliefs that have prevented multimedia from gaining a foothold on bookstore shelves, next to Shakespeare and other classics. As book publishers bring new products to the retailers who trust them, resistance to the channel will erode.

"In broad terms, like a book, a CD-ROM is content driven and interactive," Bonnie Predd, former senior executive at Waldenbooks, said recently. "Publishers, authors and characters America loves in print and are accustomed to finding only on the shelves of their favorite book shop, are all scrambling to expand the possibilities of their properties by adapting them to the CD-ROM format. The heavy book shopper displays the same demographic characteristics as the early adopters of this new technology—specifically above average in household income and education level," Predd adds.

With the installed base of CD-ROM drives in the home climbing to 4.7 million, and aiming for as many as 10 million by the end of this year, this growing market will demand broader channels to service its interest. Easier access, more varied genre and a comfortable shopping experience will be critical to the growth of the market. We should consider the power of the bookstore channel, which offers all those features, and a large, loyal customer base.

Joanna Tamer

January 31, 1994
Volume 3, Number 8

DIGITAL MEDIA
A Seybold Report

Distribution Planning: 1994

Title development in synch with distribution

More than half of the new media titles sold during a year move through retail channels during the holiday season and the first 60 days of the new year. In order to take advantage of this window of opportunity for next year, new media publishers must begin making 1994 product plans now.

In particular, they must begin the process of establishing a relationship with an appropriate distribution partner. While in years past, the process of finding a distributor was less complicated since there were a limited number of interactive products ready for market, the tables have now turned. There is so much product expected out this year that the publishers must — for the first time — attract and hold the attention of distributors. *(To find out more about choosing the right distributor, see Vol. 2, No. 9, p. 7.)*

The winter Consumer Electronics Show (CES), which was held earlier this month in Las Vegas, is the ideal time to begin initial conversations with prospective distributors — many of whom are in attendance at that show. However, if you missed this year's CES, fear not. You still have a chance to make your 1994 product pitches at some of the spring shows, including Intermedia and NAB's Multimedia World Conference.

Phase I: Presenting products on paper

The product plan, which must be presented at an initial meeting with a prospective distributor, should address products in development for the current year, as well as subsequent titles that will follow as part of a series or as sequels to the new products ready for this year's holiday release.

More than half of the new media titles sold during a year move through retail channels during the holiday season and the first 60 days of the new year.

In addition, the product plan should include the positioning of each title and its target market, the list price, and the packaging of the product at the conceptual level. (Packaging should remain conceptual until a distributor accepts the product and offers input, since he has the power to reject the product if he believes the packaging will hinder its ability to sell.) Although product plans may be treatments or storyboards, they should exhibit the publisher's vision and strategy over the next two to three years.

Phase II: Title development

Once publishers have gathered input from potential distributors on product planning and packaging, they need to get down to actual development. Traditionally, this work takes place during the spring. The goal is to have the product at least 90 percent complete in time for summer CES, held in Chicago in June, so that it can be demonstrated to potential distribution partners.

At the same time that publishers are working on actual production, they should be gathering "boilerplate," or generic, contracts from distributors they have chosen

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to review. Strengths and weaknesses of any potential distributor should be researched: Get in-depth information concerning their contracts, negotiation style, courtship behavior, sales and merchandising performance in the field, and field support such as sales reporting and inventory tracking. (This can be accomplished by talking with publishers who have already aligned themselves with these distributors.) This basic research should bring a publisher's short list of partners down to about three distributors.

Phase III: Finalizing the deal

Typically, contract negotiations begin in earnest in June after final (or close-to-final) products have been presented to prospective distributors. Two or three such meetings should bring one distribution partner to the forefront as a preferred partner.

It is also important to get concrete suggestions on packaging from the distributor of choice in June. In addition, you need to get on your replicator's schedule for mastering and replicating the discs as well as on your designer's schedule for preparing the inserts and packaging.

As we discussed, it is helpful to get a final approval from the distributor before committing funds to final package design. This needs to be done in June or early July, to be ready for a replication and production schedule in August. Remember that replicators are booked year round in advance, and that designers are busy in the early fall.

The art of shipping and selling. Products must be shipped in mid-September in order to arrive on retailers shelves in early October. (If the publisher is also distributing finished goods through rackjobbers such as Handelman's to mass merchants such as Target or Walmart, the finished and packaged product must be shipped to the rackjobbers one month earlier to allow for racking and distribution to retail.)

The September shipping date is critical. Take, for example, one publisher who missed his September date. He pulled extensive strings to have his product shipped from the distributor's warehouse into retail by early November in order to catch the selling season. But early November is often too late, and in this case, the product sat in the retailer's backroom until January. Although the publisher had convinced the distributor to move it into retail during the busiest season, he had no means of convincing the retailer to move it from the backroom to the shelves during its busiest season.

The power of marketing. This scenario points to the usefulness of "feet on the street" or reps committed to handling and merchandising a product at the retail level. To date, field support of this sort is rare among new media publishers.

In addition to marketing representatives promoting wares on the street, publishers must also focus on marketing to the channel and to the customer since product awareness is crucial to its success.

"Push" marketing, a sales technique devised to get products into the retailers' hands, should begin in August. "Pull" marketing, which could include print advertising, direct mail or store promotional mailings, is designed to pull people into retail stores. Pull marketing should be planned in early September, be implemented in October — to promote holiday sales — and continue through February when the holiday buying season begins to slow down, at which point you should already be one month into your 1995 product development cycle!

Joanna Tamer

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December 20, 1993

DIGITAL MEDIA

A Seybold Report

CD-ROM Rental in the Video Channel

A borrowed idea for digital media whose time has come

This holiday buying season has brought us the next major step in creating a mass market for multimedia: CD-ROM titles are now available for rental in leading video stores. In part the shift toward more consumer-oriented distribution for digital media is based on the increase in the installed base of CD-ROM drives and the mass market buzz surrounding interactive media. Basically, it is a borrowed idea whose time has come.

The idea of renting CD-ROM titles originated from the gaming industry's cartridge rental model: More than 60 percent of Sega's game cartridges that are purchased have been rented first. And Sega cartridges are at a similar price point to CD-ROM titles. The interest in testing this model of rental-to-sell-through stimulated Compton's NewMedia, Baker & Taylor and Blockbuster Video to initiate their own extensive pilot programs in video stores.

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Blockbuster establishes trial in Bay area. Blockbuster recently announced an in-depth pilot program in the San Francisco area, demonstrating more than 200 titles from more than 35 publishers on five major platforms in more than 50 stores. Kiosks are being setup to show off the titles, which are being demonstrated by experienced, trained sales personnel. "[We want] to stimulate the multimedia market out there," says Mike van der Kieft, director of business development and manager of new media markets at Blockbuster Entertainment. "We want to create a new business for ourselves, but to do that all participants must be successful. We are trying to create a win/win for all concerned."

Not incidentally, Blockbuster was extremely influential in creating the home video rental market by becoming one of the first chains to rent both VCRs and videos to customers. *(For more on the Blockbuster announcement, please see News story, p. 28.)*

Baker & Taylor, Compton's go nationwide. Baker & Taylor launched a program to rent CD-ROM titles in 100 video stores across the country. This program recommends various product mixes from a list of 300 titles by 20 publishers, including about 100 titles from Compton's NewMedia.

The movement to make CD-ROM titles available for rental in video stores is the first step in targeting the non-technical consumer market.

Compton's, in conjunction with The Major Video Chain, began its own rental program earlier this year, offering a selection of 30 titles to independent video dealers across the country. The number of participating dealers has grown now to 150 "Mom and Pop" stores. In describing the Compton's program, Diane Morgan, executive director of North American sales for the company, says, "Our mission with rental is to inform the average consumer . . . that there is this new technology out there that they have to see. [We are] reaching millions of people who would not go to a computer store."

Previewing multimedia for a new market

Until now, the multimedia market was limited to early adopters who already understood the technology and its potential. These early adopters could purchase software through mail-order catalogs or in software stores or computer superstores.

The movement to make CD-ROM titles available for rental in video stores is the first step in targeting the non-technical consumer market. Brad Grob, group director of market development at Baker & Taylor Software, referred to CD-ROM rental as a "key turning point for multimedia which takes the product beyond the traditional software channels into other channels."

The broader mass market of non-technical users, particularly those seeking entertainment, have had no mechanism for previewing CD-ROM titles. Every other entertainment segment has its previewing mechanism: radios play new music, book review sections tell us about new books, and movies have trailers and coming attractions.

CD-ROM rental could become this previewing mechanism. Visitors to video stores can rent CD-ROM titles in the same way and for the same price that they rent videos. They can buy both in the same store. The mix is extensive and includes all categories of CD-ROM including games, edutainment and reference.

Bonnie Predd, senior vice president of marketing and new business development at Baker & Taylor Software, remarked that "video stores — with their less intimidating and more convenient shops — are uniquely positioned to move CD-ROM into the family market."

Careful strategy required. Not all publishers should offer their products for rental, however. Some titles, however interesting, challenging or useful, may exhaust the user's interest in the course of a weekend. This might be true for a strategy or adventure game, certain story books, or utility products.

If a title is likely to be rented and never purchased, it should become available for rental only at the end of its product life cycle, when the publisher's next title is available for sale (but not for rental).

When releasing an aging title to the rental market, a publisher should add an advertisement or announcement of the new product in the opening screens of the rental product. In this way, the sampling of the publisher's product also offers the renter an opportunity to buy the newest release.

There will most likely be an increase in sampling or trailers of publishers' other products in the titles available through rental programs. It is possible that the rental of CD-ROM titles will offer the first legitimate forum for advertising on CD-ROM discs to the mass market. At first these advertisements will function as the equivalent of "coming attractions" in the cinemas, but later may expand to more aggressive forms of commercial advertising.

The next wave. The rental of CD-ROM titles creates new marketing opportunities on many levels for the expansion of this market, and there is great excitement among the video and software distribution community.

The next wave is under way. As Paul Bader, vice president of sales at Compton's NewMedia, says, "Nothing is more important than the rental of CD-ROM titles for making the new media a mass market product. Rental is critical to its retail success."

Joanna Tamer

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DIGITAL MEDIA
A Seybold Report

Packaging: The Primary Sales Agent

Multimedia titles' distribution is primarily through mail order and retail, and is currently accepted in software stores and computer superstores. As we have discussed in previous columns, the distribution channels for multimedia titles will expand into video and audio stores and ultimately to bookstores during the next couple of years.

This broad-based distribution presents an interesting challenge to publishers of new media titles. They must create an image for their company and product line, and prepare packaging that will be successful across all of these diverse channels. This challenge is sharpened by the understanding that packaging is the primary sales agent for a multimedia title. This is particularly true because there is currently no "preview" mechanism, such as movie trailers or commercials for multimedia titles, and because the current market is so small, it does not justify the cost of full-page advertising.

In recent meetings, I have seen distributors accept a new media title for distribution on the condition that the packaging is reworked to their satisfaction. It is likely the distributor understands the success of packaging in a retail environment better than the publisher, and in this case the suggestion might be supportive and helpful.

However, if it is August or September and the product should be on the shelf in a couple of weeks, a package redesign will delay its release into retail by some six to eight weeks, missing a good portion of the Christmas selling season. Therefore it's probably a good idea to figure out the intricacies of packaging before this critical time.

Jumping off the shelf, and into customers' hands

Packaging must succeed in both retail and catalogs. The package must jump off the shelf into the customer's hands. He must be able to see it, and be attracted to it, in a store cluttered with hundreds of other items.

This same box design becomes the "thumbnail" visual in CD-ROM and software mail-order catalogs. The half-inch or inch-square thumbnail of the box shot becomes the visual for the advertisement in the catalog, placed next to three or four lines of descriptive text.

No standards, no specialists

Furthermore, there is no standard for packaging CD-ROM titles in any of the channels: there is no software box standard and no strict standards in bookstores. The packaging standards for CD audio and for video, stringent in their industries, will ultimately apply to multimedia CD-ROM titles and must be anticipated. This means that publishers must design their boxes to suit four different industries and retail situations, to suit catalog selling, to generate rental interest, and to succeed in all these environments.

The packaging standards for CD audio and for video, stringent in their industries, will ultimately apply to multimedia CD-ROM titles and must be anticipated. This means that publishers must design their boxes to suit four different industries and retail situations.

To complicate matters further, there are very few graphic designers or packaging designers specializing in the new media. Publishers must choose among designers specializing in software, audio, video or book design. And each of them will specialize in their genre, selling off the shelves of those particular kinds of retail or catalog outlets.

Let it be seen

It is important that the title and the publisher be in bold print, vivid enough to be read from 20 feet across the room. The contrast ratio of the title to the rest of the box must enhance this clarity. Therefore the title, any subtitles and the publisher must be large and clearly visible. Most retailers prefer primary colors for their software boxes. However, some software boxes succeed with a black background and black packaging always sells well in video stores.

Compton's New Media has attempted for years to set a standard with its box design, which has a black background, but so far the standard has not been accepted industry-wide. Many publishers prefer the Compton's box size, but vary the design and color.

Publishers should take care with subtitles, so that the name of the product or product line is not confused with its secondary title. It helps to have extensive input from professionals and focus groups if two titles will appear on the box. Sometimes the subtitle is better than the product line name and should be emphasized graphically.

An image for the whole company

It is best to create an identifiable image for the publishing company and for each product line and title in a series. The creation of these various levels of images is best left in the hands of professionals, to allow the images to work together to support the whole.

It is imperative that publishers begin now to plan their company and product-line imaging to succeed across all four industries and their distribution channels. The design must not only sell off the shelf, but off the catalog page in a one-half inch to one inch square format.

These professional designers should specialize in each of the industries that will retail the product: software, audio, video and books. The skills of packaging design for each of these industries is established and quite sophisticated.

The standards for each industry (or lack of them) affect the design. There is much less space on a jewel box or a CD, whether audio or multimedia, than is available on a large box for display on a software store shelf. The standard video box is limited in different ways. Packages designed for bookstores, if larger than the accepted measurements, may find themselves in an oversized book display, in the back cases of the bookstore.

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Although software stores and bookstores are somewhat flexible in the kinds of boxes and packaging they will accept, the audio and the video industries are rigid. This is because their standards apply not simply to retailers' shelf preference, but to the shipping cases, palates in trucks and in the warehouse, and store fixtures that display the items. These industry-wide standards for packing, shipping and shelving will not change for new media. Therefore new media packaging must conform to these standards. And these standards may not be applicable to other channels.

Start now

It is imperative that publishers begin now to plan their company and product-line imaging to succeed across all four industries and their distribution channels. The design must not only sell off the shelf, but off the catalog page in a one-half inch to one inch square format. Product names and subheadings must become memorable and descriptive of the product in only a few words. Copy must be brief and hard- hitting. The product competes for the buyer's attention with hundreds of other items on the shelf and dozens of items on the catalog page.

The 20-second sell

The publisher has 20 seconds of the browser's attention span in which the prospective buyer will pick up the product and read the box, or in which he will stop scanning the catalog long enough to read the description. The multimedia industry is currently devoid of direct sales reps to the end-user, experienced sales people in retail, preview mechanisms and full-page advertising. So the box must do all these jobs, and do it in 20 seconds. The planning for the success of this 20-second sell will take months. It is important to begin now.

Joanna Tamer

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DIGITAL MEDIA

A Seybold Report

New Multimedia Deal Structures

Publishers adopt model of entertainment industry

Multimedia developers to date have followed a software developers' model in the creation and distribution of their product as well as the structuring of their companies. In most cases their product and company development has been self-funded. Product development costs have been minimized, and any profit has been plowed back into the company. Overhead has been kept low. Templates have been designed, and content selected and programmed, to fit into those templates. And since the market has been so small and its future unpredictable, distribution has been concentrated in the traditional computer markets: mail order catalogs and software retail stores.

These strategies have been the best available to ensure the survival of a multimedia publishing company. Now, however, the market is substantiated, and growing. And as the business of multimedia has become more viable, the paradigm for developing, funding and distributing consumer interactive titles has begun to shift from a software paradigm to an entertainment industry paradigm. It is not precisely a film industry model, but a hybrid of the film and record industries, with some elements of the book publishing model thrown in.

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Widespread distribution leads to a Hollywood hybrid deal

Before we can actually understand how development and funding for new media will evolve, we must first look at how the distribution channel is expanding, because it is the widespread distribution of these titles that acts as the catalyst that creates the shift in the business model for interactive media.

Distribution is the linchpin. We are now seeing the adoption of new media in software-only stores, consumer electronic stores and computer superstores. By the end of this year, though, consumers will be able to pick up interactive CDs in video and music retail outlets. Not surprisingly, customers will find music/video titles, interactive movies, film-type documentaries and other interactive media similar to these stores' existing product lines.

The stores will even offer racks of MPC- and Macintosh-based titles for rental before this year is out. Bookstores, as we have said in earlier columns, will be the last holdout, waiting until the 1994 Christmas season before really making a commitment to sell CD-ROM discs.

Expanded channels key to increased funding for titles

In the traditional entertainment industry (books, videos and music) distribution is second in importance only to good original material (the manuscript, the composition or the script). The breadth of distribution represents a product's potential value and indicates its return on investment. Often in the movie industry, for instance, operating and development costs are not recovered until the film reaches foreign or secondary markets such as cable, pay-per-view and video rental.

And it goes like this. This is why the change in funding and development practices for new media is so tightly bound to distribution. As distributors in the entertainment outlets demand more "consumer-oriented" titles, *i.e.*, compelling titles with more video and more music, the cost of production for multimedia developers is going to skyrocket.

This increased cost in production will prohibit the self-funding and isolated authorship that has been so much a part of the existing multimedia development model, and it will in turn initiate the movement toward a film-making model. And yes, you guessed it. Similar to the independent film model, distribution rights for interactive titles will most likely be pre-sold to fund the development of the title.

The end of the $50,000 prototype? At that point (and this is already beginning to happen), titles will be developed with writers, directors, producers, executive producers and agents. "Hyphenates" will work as they do in film: the writer-director, the producer-director, the writer-producer. Executive producers, agents and packaging agents will create deals using talent and name-branding. These packages and deals will be constructed prior to product development, sometimes prior to scripting or storyboarding. And unlike today's new media market, money will change hands *before* a single piece of code is written.

We will see more use of original material, for which royalties will be paid. As full-motion video becomes refined and cost-effective, we will see more use of actors, musicians and writers, all of whom will work under their union contracts. They will expect residuals, royalties or other ongoing payment structures.

The mindset of creating a "box office hit" will take hold, driving decisions about funding potential "A" titles. This shift will take place over the next few years and will solidify once the secondary and international markets provide a significant source of revenue.

Know four industries to build a new one

The new era begins now. We must watch the acquisitions of and investments in the pioneering companies of multimedia. We must track the strategic alliances among leading players in all the industries. We must watch for effective synergy between sister companies such as HarperCollins, Fox and News Corp., or Paramount and Simon & Schuster, or the various divisions within Time Warner.

We must become acquainted with the agents who control the talent, both in Hollywood and New York. We must standardize our distribution agreements and packaging, so that it is as easy to ship a CD-ROM title to software stores, bookstores and audio/video stores as it is to ship the standard video or audio tape. We must learn the language of all four industries, understand their payment and royalty structures, and the cultures that form an acceptable deal in each. We must become acquainted with the guilds that control the talent that will be recruited to make the titles. We must understand their histories, their inter-competitiveness and their power.

It is only in understanding all the dimensions of distribution, production and funding across all the industries touched by multimedia that we will move successfully into the new world of entertainment this technology will create.

Joanna Tamer

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DIGITAL MEDIA
A Seybold Report

A Brief Analysis Of Bundling Deals

Bundling is an alliance between a hardware manufacturer and a software title developer to create increased market demand for both products. A hardware manufacturer, whether of drives, sound boards or other peripherals, offers a bundle of titles, usually three to five, in a mix of categories to create a broad appeal for the package, which consists of the hardware and the multiple titles. This creates a premium or an incentive for the purchaser of the hardware, and creates market awareness for the titles and their developers.

The economics of bundling are interesting: while it will rarely account for more than 20 percent of a developer's sales, it may account for up to 60 percent of the units sold. It is also an effective way to build your installed base; publishers report that the return of registration cards on bundled titles is often as high as 25 percent, since the product is being bought by early adopters who want to be on your mailing list. Given that the volume of units bundled ranges from 10,000 to 100,000 units, generally between 20,000 and 50,000, this is a significant return of information on your installed base.

Gray market danger. There is some danger of gray marketing, the distribution of unauthorized products through alternative channels. For example, it might be that leading mail order companies can buy shrink-wrapped products at bundled prices on the gray market and then sell them for full retail-list price through their catalogs or into their retail channels. Although the bundling contract forbids this, little tracking is done. This opportunity is particularly available for mail order companies that sell both the hardware, peripherals and titles.

It is important to factor in the level of technical support that may be required by so many tens of thousands of titles reaching the market in a short period of time. If the title is in any way support intensive, the developer must consider the increased technical support requirements that this sudden release into the market will generate.

A sliver of SRP. Bundling deals generally bring between 10 and 18 percent of the suggested retail price when the total shrink-wrapped product is delivered. If a master disc is delivered for duplication by the hardware manufacturer, the developer is generally paid between $2 and $5 per unit. A bundle deal is generally for a minimum of 10,000 units over the course of twelve months.

A best-seller, like Icom Simulations' *Sherlock Holmes, Consulting Detective, Volume One*, is reported to have placed 150,000 units in the market on both Mac and MPC platforms. It is guessed that 90 percent of these units were moved through bundling deals. The large volume buyers for bundling deals include Sony, Apple and NEC.

Built into cost of goods. Manufacturers generally have a budget for bundling built into the price of the product or the special promotion they are marketing. They will, for example, build an $80 cost factor into the cost of goods, and will apply this to the acquisition of three or five titles that will be shipped with the product. Then they will look for value: the most interesting titles for the least money. This will allow them to bundle either a highly visible product or more titles in the bundle.

Once an order is placed, say for 20,000 units during a 12-month period, the manufacturer will ask to have the titles shipped in smaller batches. The minimum shipment order initially should be at least 1,000 units, and the reorder number at least 500 units. Otherwise the developer is at a disadvantage in manufacturing planning.

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Approaching a bundle. The savvy developer will negotiate for payment for the total volume, so that the manufacturer does not get the 20,000-unit price, and only order 2,000 units. This negotiation can result in an up-front payment for all the units, which is unlikely, or a higher price per unit for each shipment quantity. In this way the developer fixes the delivery schedule and the pricing "ORO" (on receipt of order). There are three ways to approach bundling: do it yourself (*i.e.*, approach the manufacturer yourself), go to a distributor (either Software Toolworks or Compton's New Media), or wait until the manufacturer comes to you.

In order to build a bundling arrangement in-house, it is important to dedicate a salesperson to build a database of CD-ROM hardware products. There are only about 70 drives on the market, and additionally, sound boards and other peripherals. The salesperson would then contact these companies, solicit their interest, and send a shrink-wrapped product for evaluation. This is a labor-intensive assignment, but it leaves the control and the relationship directly with the developer.

Another alternative is to contact Software Toolworks, which has a special OEM group of several salespeople, or Compton's. Sometimes the manufacturer will come to them to obtain a total bundle of titles already in their warehouses, so that the manufacturer may receive one shipment of five or more titles directly from the distributor's warehouse.

This implies that distribution through these distributors would enhance the opportunity to do bundling through their arrangements with manufacturers. This should be carefully considered, as a developer's choice of distributor is based on many factors other than opportunities for bundling.

The last option is to wait until the manufacturer comes to you for the product. This is likely to occur if the product is a best-seller. Manufacturers will not seek out a product that is niche-specific, but will want to bundle products that have broad appeal.

When to bundle. It is important to understand that bundling is not appropriate until a developer/publisher has multiple products on the market. It is unwise to bundle your first or second product, as this is likely to erode your success in selling the fully priced retail version of the product.

That's because when retailers know it's being bundled, they won't give it precious shelf space at the same time. In addition, distributors know not to try to give a title to retailers if it's being bundled. So there's resistance at both levels. Bundling is also a hindrance to developing a relationship with a new media distributor prior to having several products on the market. The distributor will interpret the bundling as a lost opportunity for his sales of your products.

On the other hand, if you have several products out, say 10 or more, you can "sacrifice" a title into a bundling deal, gaining revenue and further exposure of your company's product line into a uniquely qualified market of first-time buyers of the technology.

Bundling at the end. There has been some discussion in the industry of a strategy for bundling titles that are at the end of their life cycle. This sounds like a good idea, but has rarely been tested, since most titles have not sold through the duration of their life cycle yet. This might be the most appropriate strategy for games, which have a higher "spike" on selling and a quicker decline in their life cycle.

Bundling should be carefully considered as a part of a product's life cycle and distribution strategy. Its benefits should be leveraged to best advantage, and bundling should never be entered into without weighing its impact (successful or not) on the company's financial plans, positioning and total product strategy.

Joanna Tamer

June 23, 1993
Volume 3, Number 1

DIGITAL MEDIA

A Seybold Report

Distribution and The Art of Negotiation

The finer points of distribution and retail for new media

Pricing for the majority of new media titles ranges between $39 and $99. The retail channel is skeptical, if not uninterested, in dedicating valuable shelf space to new media titles. This is slowly changing, and the software stores are stocking more and more product.

The retailer. A key factor in the development of this market is the attitude of the retailer. He is the access to the primary customer. He will take no risk. He demands, and receives, 100 percent return privilege on all products — thus passing the risk back to the distributors of new media (sometimes two tiers of them) who ultimately pass it back to the developer/publisher. *(For more on this, see "Choosing the Best New Media Distributor," Vol. 2, No. 9, p. 7.)*

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The food chain. There are many tiers of distribution between the developer, who may self-publish or take his title to a publisher, and the consumer. The developer/publisher will take his product to a new media distributor. The major players include Electronic Arts, Compton's New Media, Brøderbund and Time Warner Interactive, formerly Warner New Media.

The new media distributor then takes the product into the larger software distributors, the top tier of distribution.

These top-tier distributors include Baker & Taylor Software (formerly known as SoftKat), Ingram-Micro and Merisel. These larger mass-market distributors then move the product into retail, beginning with software-only stores and computer superstores. Later they will move product into the video, audio and bookstore channels.

While selling "up" to the top tier, the new media distributors also sell "around" them, placing the product directly into retail chains, to gain shelf space and to leverage more margin. Major players in the retail market currently include only high-tech stores such as Egghead, Comp USA, Babbages and Software Etc.

Little attention from the retailers. Retailers then assign shelf space for the titles, based on the number of titles they agree to try. This agreement is generally arrived at by a deal that includes 100 percent return and stock-balancing privileges against the floppy-based software carried by that distributor, and some serious marketing dollars from the distributor for the promotion of the CD titles.

At this time, there is generally a single set of shelves, perhaps four shelves by three feet each, dedicated to new media titles. Some leading stores, like Egghead in New York, stock three times this amount. The titles are rarely segmented between Mac and DOS, and some titles publish both platforms on a single disc. There is no retail clarity for the positioning or selling of these products.

In retail outlets that focus on Sega and Nintendo games, new media titles receive secondary or tertiary shelf space positioning. There is rarely a demonstration unit available for the viewing of a title. This is because the market is in its infancy, and because retailers will not give over the four square feet of space required for a kiosk without a financial commitment for the leasing of that space by the publisher or platform vendor.

To date, demo units for new media in retail are rare except in superstores. The first experiments are beginning now by platform developers. The notable exception is Tandy, which is the producer, distributor and retailer of its own product line and affiliated titles.

The retailers' lack of commitment to stocking, marketing and merchandising titles means that the publishers and distributors who are developing this market for their titles must create demand by extensive marketing and "pull-through" programs, to "pull" the customer into the store to buy the product.

A costly proposition with profit built in. These many tiers of distribution cost money, but they function successfully and create a profit because the cost of goods produced is so low (about $1 to press a disc in quantity, and another $1 to package it) in comparison to the amount of data contained on the disc.

At some point soon the conflict of interest inherent in being both a distributor and a publisher, as are Electronic Arts, Brøderbund and others, may become problematic, as the distributor can offer preferential exposure to its own published products.

With these costs of goods in mind, and the knowledge that top-selling entertainment titles may sell 30,000 to 50,000 units a year, mostly through retail and mail-order channels, and that all other categories of successful titles sell 5,000 to 20,000 a year, and the price averages $39 to $69 per title, we can put together a market projection and a plan.

The plan shows that the market is still emerging. Once compelling titles of quality are broadly available, and the price of the hardware and the titles falls even further, the market will grow rapidly. The cost of goods will stay constant, or will fall, and the profit will appear more substantial as the volume of sales grows.

A publishing deal. The new media distributors, who are also publishers, are the pioneers taking the risk to create the market, and they are gathering titles through their own publishing divisions and through their Affiliated Labels divisions.

A developer may bring a title in finished programming form to any of these new media distributors and negotiate a deal for the distributor to publish and distribute it. This means that the developer provides a "one-up," also known as a "gold master" (language borrowed from the record industry), to the new media publisher/distributor.

As the publisher and distributor, then, Electronic Arts or Brøderbund or the others position, market, press, package, merchandise and put into distribution the developer's title. For this publishing deal, the developer will generally receive about 10 cents on the dollar in the form of a royalty payment.

This publishing model is appropriate for small technology businesses that are more focused on programming and development than they are on business development and management. If developers have not created and do not wish to create the business infrastructure to produce, market and sell their product, they should bring the title to a publisher and return to their computers to develop the next one.

At some point soon the conflict of interest inherent in being both a distributor and a publisher, as are Electronic Arts, Brøderbund and others, may become problematic, as the distributor can offer preferential exposure to its own published products. These questions are only now beginning to be raised.

A distribution deal. If the developer is a savvy businessperson as well as a new media artist, he should press, package and produce the title, and commit resources and attention to its marketing and selling. This involves the development of an entire business infrastructure that is separate from the development team.

When a developer/publisher brings a finished, packaged title to a new media distributor, negotiations begin with the distributor's Affiliated Labels division.

Signing an Affiliated Labels agreement with a new media distributor generally means negotiating for two Christmas buying seasons and the subsequent three months until March 31. Sometimes the distributor asks for exclusivity for three Christmas seasons. The deal is exclusive for that distributor into retail. The publisher may leverage mail-order and direct-marketing channels and other channels than retail.

This allows the distributor to launch the product the first year at Christmas, the key buying season, and to carry the product through its initial life cycle to the second season. This term of the contract is rarely negotiable, although one competent developer has succeeded in renegotiating every year in March.

The snake pit of contract language

The initial contract language usually specifies exclusivity for the title and mentions nothing about platforms, thereby covering all CD-ROM hardware. This language must be negotiated out.

Generally the distributor insists on both Macintosh and MPC product exclusivity as a minimal condition, even if only one platform is ready or planned. It is wise to specify that the publisher retains the distribution rights to all other platforms (list them), transmission over cable and satellite downlinks, and any other platform and media now known or yet to be developed. This is generally not a problem since the distributor is only interested in retail distribution at this time.

The new media distributor (Brøderbund, Electronic Arts, etc.) receives a 70 percent profit margin (a 70 percent discount from suggested retail list price) on the product — that is, the publisher is offered 30 cents on the dollar. Sometimes, rarely, this margin is negotiated to 65 percent or 68 percent.

When the new media distributor passes the product up to Baker and Taylor/SoftKat, Ingram-Micro and/or Merisel, they're offered 50 to 60 percentage points. When the product is passed directly to retailers (usually the large chains), they're offered 40 to 50 points. The new media distributor maintains a business on this 10- to 20-point differential, and from the profits of development and participation in cooperative marketing programs with publishers.

More deal points. Notice that if the distributor has 100 percent return privileges (and at this time he always does), the publisher is essentially signing a consignment deal with up-front purchases. The distributor buys a volume of product and stores it in a warehouse. As it sells through, the publisher gets monthly sales reports and a check for the per-unit amount agreed upon in the contract.

Suppose that amount has started with 30 cents on the dollar to the publisher. The publisher then contributes more cents to the distributor's fund in the form of co-op advertising funds and reserves for defective products and returns. The level of these funds is agreed upon during the contract negotiation, and expressed as a percentage off the invoice to the publisher, and is deducted from the payment sent to the publisher from the distributor.

Co-op funds are generally 5 percent of the invoice amount to the publisher; a "reserves" fund can be 10 to 15 percent, again calculated off the invoice amount. If we apply the 5 percent co-op and the 10 percent reserve fund to the 30 cents on the dollar (the publisher's gross invoice amount from the distributor), we are left with 25.5 cents on the dollar for production, packaging and marketing of the product.

So the publisher gets 30 cents less 1.5 cents for co-op less 3.0 cents for reserves, or 25.5 cents per unit. To participate in co-op programs beyond this 5 percent fund, the publisher pays more into the fund (usually in product). If returns exceed the reserve fund, the publisher is responsible for the difference. If the product flops, it can all be returned to the publisher, who is liable for any monies advanced by the distributor for the initial pressing and packaging of the title. The reserve fund is reviewed every six months, and adjusted at that time based on sales and returns figures.

The implications. Although all this may be fair business dealings, it is not clearly spelled out in the contract, especially if read by the uninitiated.

The contract (usually) says the distributor will advance $X to the publisher for a certain volume of units, and will pay $Y to the publisher as they sell through, less returns.

It never mentions that this advance should be listed as a liability on the publisher's balance sheet (which may hinder finding new investment capital for the next product) or that it is due back, rather like an interest-free loan, if the product never sells through. This is assumed in the language of "advance."

Again, as we borrow language and concepts from other industries, certain assumptions are carried in the language, and the agreement is often not clear. It is not the distributor's responsibility to advise the publisher on business decisions, but it is wise for the publisher to understand all this.

The publisher must also handle how these agreements affect cash flow, especially during a first product launch. Suppose the publisher accepts an advance of $50,000 for the company's first title, and uses the money to publish and package the product and deliver it to the distributor. If it is early in the buying season, the publisher may sell enough product to recoup his advance and begin to see revenue coming in.

If the product is launched during a slower season, it may take several more months to see revenue. In the slow seasons (anytime other than September–March), the distributor is unlikely to stock more than a thousand units at a time. So if the product is released in a slow season, advance money will be quite limited.

Marketing programs. The distributor gains a great deal of profit from his cooperative (co-op) advertising programs. These include offering the publishers shared booth space at trade shows, shared advertising space in leading trade journals, participation in direct-mail campaigns, launch announcements and so on. During the initial launch of the product, many of these promotions are offered without charge, to sweeten the contract and to announce the new product for the benefit of both the distributor and the publisher.

After launch, co-op advertising is the most straightforward form of marketing available to the publisher, and most have a charge attached to them. This charge is expressed in dollars but exchanged in product. Actual money rarely changes hands.

But this is not nearly enough. The publisher is responsible for the marketing of the product, and extensive market development is required to gain the attention of the buying public. This is achieved by aggressive promotions such as 3-for-2 sales or "software bundles" of two or three titles at a reduced price, driven through retail and mail-order channels, generally using programs handled by the distributor.

Other promotions include "guerrilla marketing" tactics such as co-marketing with similar but noncompeting products, sharing customer lists, direct mail and so on.

Joanna Tamer

March 29, 1993
Volume 2, Number 10/11

DIGITAL MEDIA
A Seybold Report

An Interesting Legal Wrinkle

New media and the Copyright Act

Is a new media CD-ROM title like a book, a video or a software program? Which parts of the Copyright Act, which governs legal protection for intellectual property in the U.S., apply? Sitting as it does at the intersection of four publishing industries — books, records, film and video, and software — new media publishing contracts and Affiliated Label agreements are modeled on any one of these industries, and borrow language and business practice from the others as needed.

The longer-term legal implications of this mix-and-match method had not been considered until the rather simple marketing idea of rentals surfaced. Recently new media distributors have announced their intentions to provide a limited number of CD-ROM titles for rent through video rental retailers. They are obtaining permission to rent these titles from the copyright owners, and in so doing have opened the door to questions about how to categorize new media products for legal purposes.

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Do you license a title, or buy it?

Some new media titles are copyrighted as software, thus are "licensed" to purchasers for "use" on computers. This is distinctly different from other new media titles, which are simply copyrighted as entertainment products — neither software nor phonographic recordings — and are distributed like any other book or video.

The exclusive rights of the copyright holder apply to entertainment products: he can make the initial sale, reproduce the work, prepare derivative works from the content, distribute copies for sale, and otherwise transfer the ownership of the copyright for the purposes of rental, lease or lending.

With works that are literary, contain music or choreography, or are audio-visual in nature, the copyright holder can further transfer the rights to have the work performed or displayed publicly.

At this point, the First Sale doctrine kicks in. The First Sale doctrine, which is part of the Copyright Act, states that after the initial sale by the copyright holder (if the product is not a sound recording or a software program, in which case other restrictions apply), the buyer can rent or resell the product, but cannot reproduce it or make derivative works from it without permission of the copyright holder.

But you can't rent software. An amendment to the Copyright Act, which applies to sound recordings or computer software programs on tape, disk and other media embodying the program, prohibits the rental of these titles and the gaining of direct or indirect profit from renting, leasing or lending these titles, without express permission of the copyright owner.

However, this prohibition does not extend to a computer program embodied in a machine or a product (for example, a Sega game machine, a talking doll, etc.) that cannot be copied during the ordinary operation or use of the machine or product. The amendment further maintains that this restriction does not apply to a computer program embodied or used in a limited-purpose computer for computer games or other purposes.

Not a book, not a movie in more ways than one

Again, the issue of categories arises. CD-ROM discs cannot be easily copied (yet). So, is a new media CD-ROM title like a book, a video or a software program? So far, distributors seeking rental rights have always obtained a signed authorization, which implies they are treating the title as software, even if it is published (like a book) with only a copyright disclaimer and no software licensing agreement.

Also, many new media titles exist simultaneously as floppy-based software, and the rights to rent, lease or loan are an extension of a previously signed software contract or an Affiliated Label agreement for a new media title.

Caveat to the reader. It is not the purpose of this short article to examine in depth the Copyright Act and its application to new media. My only intent is to raise a warning flag to all players in new media: Now is the time to get your legal act in order.

Through the chaos of merging the film, record, book and software industries, it is critically important that developers and authors, publishers, distributors and retailers understand the blurry edges of legal rights in these new media, and how these rights affect distribution into retailing, rental outlets and libraries.

For example, distributors want to test the formula of "rent-to-sell-through" in retail. The interest in this formula comes from the success of the purchase of previously rented 8- and 16-bit Sega titles: three out of five titles purchased were rented first.

Titles publishers started to argue among themselves about which category the titles belonged to and whether or not they could be rented, and all were correctly citing the Copyright Act to bolster their various arguments.

The price of these games hovers around $49, which matches some CD-ROM titles and which is the price anticipated for most titles within the next year or two. And so the retailers, distributors and publishers are interested in putting out titles for rent, to test the sell-through model experienced by Sega.

Some of the excitement around CD-ROM rentals began at the winter Consumer Electronics Show in January when Compton's NewMedia announced that it would rent selected titles through 20/20 Video.

Dissension arose when a regional sales manager of a new media distributor conducted a small and legal test run of a title, pressing a limited number of special discs marked "for video rental only" and distributed them through a small number of video retailers in a single region.

Following the video rental model in retailing, the titles were rented, and if not returned, the customer's credit card was charged with the suggested retail price — in this case, $99. These CD-ROM titles went out for rental, and, basically, were never seen again.

This was a successful test for the publisher and the distributor, who both were very happy. However, it caused the issues of copyright law, and today's categorization of CD-ROM titles (software versus entertainment products), to come roaring out of the closet.

The rental plans have raised dissension in the industry about the copyright laws that might apply to CD-ROM titles. Titles publishers started to argue among themselves about which category the titles belonged to and whether or not they could be rented, and all were correctly citing the Copyright Act to bolster their various arguments. Some CD-ROM titles are indeed considered software and packaged with an end user license agreement. Thus considered, the end-user never "owns " the product, but only licenses its intellectual property for use on a single machine. Software is not allowed to be rented without the express permission of the copyright holder.

Other titles are correctly packaged and sold as "finished goods" entertainment products, protected by the Copyright Act only as far as the First Sale doctrine applies — in other words, copies can be made as long as they aren't for commercial purposes, and purchased copies can be rented for individual, and not commercial, viewing.

These are recent developments and new questions that are now being raised. Most titles are published with careful copyright protection of the creative materials that contributed to its content, either as "work for hire" or in the transfer of the copyright to the publisher of the title.

With the variety of media used, the copyright of a new media title is actually a complex bundle of copyrights. Distributors, publishers, retailers and copyright attorneys maintain that there was too much else to do to create a market for the new media industry to be concerned with copyright protection at the level of detail that may now be required for rentals, leasing and loaning through libraries. The finer points of law were often lost, or simply not considered.

Finding a path through the Copyright Act

The language and intention of the Copyright Act are clear: to protect the owner and/or creator of intellectual property. But its many amendments are dense with conditions, exceptions and inconsistencies across all four categories of products. It is into this thicket that new media products must descend and find their identity.

This is not a hopeless situation, and if you're an author or developer, here's what you should do if you want to be able to rent out your CD-ROM titles.

- First, make certain that all contributors to the content of your new media title have granted you the broadest possible rights to use their material under the Copyright Act.
- Also make certain that your contributors and creatives understand what they are signing over to you in these rights, and that they have the right to grant to you these rights without infringement of any other party.
- Remember that the inclusion of copyrighted sound recordings in the content of your title may prohibit the entire title from being rented at a future time.
- Publishers and distributors should be careful in the development of their contracts and their marketing programs, especially those that allow for rental of titles and sale of titles to libraries for lending.
- Make certain that the rights you are obtaining have been legally granted all the way back to the creative contributors.

Don't forget, patience is a virtue

Retailers should be patient with the suppliers of their products, while these converging industries sort out their legal practices. Retailers should also be careful that the rights to rent or lease products have been legally obtained.

All players should acknowledge that the intersection of four publishing industries brings forward four distinct cultures and historic business practices and language. Each culture will assume that its language and practices carry certain assumptions of rights and behaviors, but must remember that these cultural assumptions may not be understood by the "foreign" player.

And, speaking of foreign, the U.S. copyright action is not automatically accepted as law in other countries. International issues are even more complex than our own, from the moral rights of France to the country-by-country customization of copyright law applied to each industry.

Learn to think about long-term consequences

The emergence of a new industry and a new market that is the focal point of four other entertainment industries is as exciting as it is chaotic. We must take care in our business dealings, and constantly think ahead. Think ahead to newer media, to new channels that are not understood yet, to technologies not yet invented, to markets and applications not yet imagined. We must leave ourselves the opportunity to expand into directions not yet conceived, and to protect ourselves from restrictions not yet anticipated.

And, of course, just in case, everyone should indemnify everyone else. It's the American way.

Joanna Tamer

The listing of multimedia developers, distributors, publishers, and retailers in Appendix C is for informational purposes only, it is not intended to be comprehensive and constitutes neither an endorsement nor a recommendation. Apple Computer, Inc., assumes no responsibility with regard to the selection, performance, or use of these developers, distributors, publishers, and retailers. Any understandings, agreements, or warranties, take place directly between the developers, distributors, publishers, and retailers and the prospective consumer. Apple Computer, Inc., makes no warranties as to the completeness or accuracy of this list.

Appendix C

Resource Directory of Worldwide Distributors and Publishers[1]

United States

Videogame

Blockbuster Entertainment Co.
One Blockbuster Plaza
200 South Andrews Avenue
Ft. Lauderdale, FL 33301
Tel 305-832-3265
Fax 305-832-3375

Brøderbund (Living Books)
500 Redwood Blvd.
PO Box 6121
Novato, CA 94948-6121
Tel 415-382-4617
Fax 415-382-4582

Compton's New Media
2320 Camino Vida Roble
Carlsbad, CA 92009
Tel 619-929-2500
Fax 619-929-2555

Crystal Dynamics
87 Encina Avenue
Palo Alto, CA
Tel 415-473-3400
Fax 415-473-4310

Electronic Arts
1450 Fashion Island Blvd.
San Mateo, CA 94404-2064
Tel 415-571-7171
Fax 415-570-5137

Interplay Productions
17922 Fitch Avenue
Irvine, CA 92683
Tel 714-553-6655
Fax 714-252-2820

Maxis
Two Theater Square
Orinda, CA 94563
Tel 510-254-9700
Fax 510 253-3736

Ingram Entertainment
1600 E. St. Andrews Pl.
Santa Ana, CA 90275
Tel 714-566-1000
Fax 714-566-7945

Nintendo of America, Inc.
4820 150th Avenue N.E.
Redmond, WA 98052
Tel 206-882-2040
Fax 206-882-3585

Sega of America
130 Shoreline Drive, Suite 200
Redwood City, CA 94065
Tel 415-508-2800
Fax 415-802-3622

[1] Refer to Appendix D—Sources and Supporting Documents for additional developer, distributor, publisher, and retailer directory resources.

Home Video

Baker & Taylor
3850 Royal Avenue
Simi Valley, CA 93063
Tel 805-522- 9800
Fax 805-522-9900

Blockbuster Entertainment Co.
One Blockbuster Plaza
200 South Andrews Avenue
Ft. Lauderdale, FL 33301
Tel 305-832-3265
Fax 305-832-3375

East Texas Distributors
7171 Grand Blvd
Houston, TX 77054
Tel 713-748-2520

Ingram Micro
1600 E. St. Andrews Pl.
Santa Ana, CA 90275
Tel 714-566-1000
Fax 714-566-7945

Major Video Concepts
7998 Georgetown Road
Indianapolis, IN 46268
Tel 800-365-0150

Book

Brøderbund (Living Books)
500 Redwood Blvd.
PO Box 6121
Novato, CA 94948-6121
Tel 415-382-4617 or 4572
Fax 415-382-4582

EBook
32970 Alvarado-Niles Rd. #704
Union City, CA 94587
Tel 510-429-1331
Fax 510-429-1394

Ingram Micro
1600 E. St. Andrews Pl.
Santa Ana, CA 90275
Tel 714-566-1000
Fax 714-566-7945

McGraw-Hill, Inc.
11 West 19th
New York, NY 10011
Tel 212-337-5961

Prentice-Hall, Inc.
Division of Simon & Schuster
270 Sylvan Avenue
Englewood Cliffs, NJ 07632
Tel 201-592-2000

Random House Electronic
Publishing
201 East 50th Street
New York, NY 10022
Tel 212-751-2600
Fax 212-572-8700
AppleLink RANDOMHOUSE

The Voyager Company
578 Broadway, Suite 406
New York, NY 10012
Tel 212-431-5199
Fax 212-431-5799

Music

Atlantic Records
9229 Sunset Blvd.
Los Angeles, CA 90069
Tel 310-205-7439
Fax 310-205-6499

ION
11845 West Olympic Blvd.
Suite 1050
Los Angeles, CA 90064
Tel 310-312-8060
Fax 310-312-8062

New Leaf
350 Fairway Drive
Deerfield Beach, FL 33441
Tel 305-425-4000
Fax 305-425-4026

Sony Electronic Publishing
1800 N. Fruitridge Ave.
Terre Haute, IN 47804
Tel 812-462-8100
Fax 812-466-9125

Time Warner Interactive
2210 W. Olive
Burbank, CA 91506
Tel 818-955-6420 or 9999
Tel 818-955-6499

Software

Educorp
7434 Trade Street
San Diego, CA 92121
Tel 619-536-9999
Fax 619-536-2345

Ingram Micro
1600 E. St. Andrews Pl.
Santa Ana, CA 90275
Tel 714-566-1000
Fax 714-566-7945

Merisel
200 Continental Blvd.
El Segundo, CA 90245
Tel 310-615-3080
Fax 310-615-1263

Microwarehouse
47 Water Street
South Norwalk, CT 06854
Tel 203-854-1700
Fax 203-855-1386

Tiger Software
800 Douglas Entrance
Executive Tower, 7th Floor
Coral Gables, FL 33134
Tel 800-666-2562
Fax 305-529-2990

Software Toolworks, Inc.
60 Leveroni Court
Novato, CA 94949
Tel 415-883-3000
Fax 415-883-3303

Other

Aris Entertainment
310 Washington Blvd., Suite 100
Marina del Rey, CA 90292
Tel 310-821-0234
Fax 310-821-6463

Cambrix Publishing
6269 Variel Avenue, Suite B
Woodland Hills, CA 91367
Tel 818-992-8484
Fax 818-992-8781

IMMediacy
5813A Uplander Way
Culver City, CA 90230
Tel 310-642-4995
Fax 310-642-4998

Multicom Publishing, Inc.
1100 Olive Way, Suite 1250
Seattle, WA 98101
Tel 206-622-5530
Fax 206-622-4380

Trimark Interactive
2644 30th Street
Santa Monica, CA 90405
Tel 310-314-2000
Fax 310-392-8170

Xiphias
Helms Hall
8758 Venice Blvd.
Los Angeles, CA 90034
Tel 310-841-2790
Fax 310-841-2529

Australia

Distributors

Ashton Scholastic Pty Ltd
PO Box 576
Gosford 2250
NSW Australia
Tel 043-283555
Fax 043-233827

Dataflow Computer Services Pty Ltd
PO Box 202
Zetland 2017
NSW Australia
Tel 02-3102020
Fax 02-3192676

Firmware Design Pty Ltd
PO Box 290
Blaxland 2774
NSW Australia
Tel 047-217211
Fax 047-217215

Light Years Ahead Pty Ltd
PO Box 561
Wahroonga 2076
NSW Australia
Tel 02-4776666
Fax 02-4776655

Next for Mac
PO Box 70
Narwee 2209
NSW Australia
Tel 02-5306082
Fax 02-5842042

Oxford Systematics
PO Box 126
Heidelberg 3084
VIC Australia
Tel 03-4599671
Fax 03-4598663

Pacific Advanced Media Studios Pty Ltd
29 Albany Street, Crows Nest
NSW 2065
Australia
Tel 02-4398700
Fax 02-4395486
Internet chris@pams.com.au

PICA Software
487 King St
West Melbourne 3003
VIC Australia
Tel 03-3265255
Fax 03-3266410

Sendel Medical Computerized Tutorials
c/o Dr. Adam Sendel
8 Tarakan Crescent
Northbridge
NSW 2063
Australia

Tech Pacific
1/5-15 Epsom Rd
Rosebery 2018
NSW Australia
Tel 02-6978666
Fax 02-6978670

Techflow Pty Ltd
5/17 Mooramba Rd
Dee Why 2099
NSW Australia
Tel 02-9714311
Fax 02-9823623

Trio Technology Pty Ltd
Suite 3 247 Bayview St
Runnaway Bay 2099
QLD Australia
Tel 075-774411
Fax 075-774455

Try and Byte Pty Ltd
401 Pacific Highway
Artarmon 2064
NSW Australia
Tel 02-9065227
Fax 02-9065605

VideoBytes Pty Ltd
238 Ferrars St
South Melbourne 3205
VIC Australia
Tel 03-6909278
Fax 03-6963885

JAM Software Pty Ltd
3-5 Foster St
Leichhardt 2130
NSW Australia
Tel 02-5500884
Fax 02-5643353

Benelux

(Belgium, Netherlands, and Luxemburg)

Publishers

IPR b.v.
Ambachtsmark 3
Almere
The Netherlands
1335 EA
Tel 31-36-5355204
Fax 31-36-5316688

Lasion Europe bv
Kontichsesteenweg 40
Aartselaar
Belgium
B-2630
Tel 32-3-8770555
Fax 32-3-8878705
AppleLink Lasion.eur

Cart/O/Info nederland
Bezuidenhoutseweg 125
s Gravenhage
The Netherlands
2594 AE
Tel 31-70-3824450
Fax 31-70-3478499
AppleLink HOL0396

Magic Media
Rue Delhasse 21
Brussels
Belgium
B-1060
Tel 32-2-3462365
Fax 32-2-3433279
AppleLink SOON.TO.COME

AVC Rainbow sa
Rue de Lausanne 35
Brussels
Belgium
B-1060
Tel 32-5374400
Fax 32-5372167

Bortiboll Communication B.V.
Printerweg 40
AMERSFOORT
The Netherlands
3821 AB
Tel 31-33-535333
Fax 31-33-535335
AppleLink BORTIBOLL

Distributors

LBC International
PO Box 59
Elst (U)
The Netherlands
3920 DB
Tel 31-83842417
Fax 31-83842430
AppleLink LBC

Borsu International
A. Einsteinweg 4
Lelystad
The Netherlands
8280 AD
Tel 31-32-0072200
Fax: 31-32-0052483
AppleLink HOL0274

Commedia bv
Leidsekade 98
Amsterdam
The Netherlands
1017 PP
Tel 31-20-6231740
Fax 31-20-6380065

France

Distributors

CD R Informatique BP 32
91470 Limours
France
Tel 33 1 64 91 26 76
Fax 33 1 64 91 47 69

Euro-CD
13 Cité Voltaire
75011 Paris
France
Tel 33 1 40 09 80 30
Fax 33 1 43 67 00 38

MicroKey CD World
Avenue des Erables
95400 Villiers le Bel
France
Tel 33 1 39 90 00 30
Fax 33 1 34 29 12 62

Ubi Soft Distributor
28 Rue Armand Carrel
93100 Montreuil
France
Tel 33 1 48 57 65 52
Fax 33 1 48 57 62 91

3ême Vague
23 Rue Etienne Dolet
92240 Malakoff
France
Tel 33 1 47 35 79 29
Fax 33 1 69 28 74 32

dXBank
95 Avenue de Versailles
75016 Paris
France
Tel 33 1 42 15 07 59
Fax 33 1 42 30 53 66

Empreinte Digitale
5 Rue Bassano
75116 Paris
France
Tel 33 1 46 02 64 97

Infogrames Multimédia
84 Rue du 1er mars 1943
69628 Villeurbanne
France
Tel 33 78 03 18 46
Fax 33 78 03 18 40

La Grange Numérique
41 Rue du Môle
78550 Gressey
France
Tel 33 1 34 87 60 34
Fax 33 1 34 87 64 67

La Vague Interactive
50-52 Rue E. Pailleron
75019 Paris
France
Tel 33 1 48 03 31 17
Fax 33 1 48 03 24 94

Lambe Corporation
26 Rue Erlanger
75016 Paris
France
Tel 33 1 46 51 24 77
Fax 33 1 46 51 28 08

Matra-Hachette
11 Chemin du Paradis
91430 Igny
France
Tel 33 1 47 45 94 62

Mediamix
103 Rue de Sèze
69006 Lyon
France
Tel 33 78 24 76 98
Fax 33 72 74 40 13

MK Média
Avenue des Erables
95400 Villiers le Bel
France
Tel 33 1 39 90 00 30
Fax 33 1 34 29 12 62

Montparnasse Multimédia
10 Impasse Robiquet
75006 Paris
France
Tel 33 1 45 48 10 46
Fax 33 1 45 48 94 69

ODA Publisher
7 Avenue de la Cristallerie
92317 Sèvres Cedex
France
Tel 33 1 46 23 38 01

Sony Electronic Publishing
131 avenue de Wagram
75838 Paris Cedex 17
France
Tel 33 1 44 40 64 09
Fax 33 1 44 40 65 31

Germany

PMA Prisma Marketing Agentur
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AppleLink PRISMA.D

Digital World Publishing
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Fax 49 40 68 86 06 661
AppleLink DIGITALWORLD

More Media GmbH
Gasstr. 18, Haus 2
22761 Hamburg
Germany
Fax 49 40 89 97 93 18

Singapore

Pacific Advanced Media Studio (Asia)
Pty Ltd
Raffles City
PO Box 1248
Singapore 9117
Tel 65-440-7448
Fax 65-346-5253
AppleLink higgs.peter
Internet advmedia@singnet.com.sg

Spain

Distributor and Publisher

Mindware
Camps i Fabrés, 3-11 1º8ª
08006 Barcelona
Spain
Tel 343 415 3606
Fax 343 237 9881

Distributor

Axxam (Computer 2000)
Constitución, 1
08960 Sant Just Desvern
Barcelona
Spain
Tel 343 499 9111

DROSOFT S.A.
Moratín, 52 - 4ª Dcha.
28014 Madrid
Spain
Tel 341 429 3835
Fax 341 429 5240

ERBE
Menedez Alvaro, 57
28045 Madrid
Spain
Tel 341 539 9872
Fax 341 528 8363

Publisher

CABCO Interactius S.A.
Masferrer, 20 - 22 - 3r, 5ª
08028 Barcelona
Spain
Tel 343 490 1447
Fax 343 490 9951

D.R. Multimedia S.L.
Julia Sanjuan
Valencia, 333 Atico 2ª
Barcelona 08009
Spain
Tel 343 458 9253
Fax 343 458 9253

Dinamic Multimedia
Victor Ruiz
Ciruelos, 4
San Sebastián De Los Reyes
Madrid 28700
Spain
Tel 341 654 6175
Fax 341 654 7272

Institut Cartografic de Catalunya
Balmes, 209-211
08006 Barcelona
Spain
Tel 343 318 8758

Micronet
María Tubau, 7
Edificio Auge III, 6º
Madrid 28050
Spain
Tel 341 358 9625

Sweden

Publishers

Advice Information Partner AB
Sten Ernerot
Box 4028
S-182 04 Enebyberg
Sweden
Tel 08-7925605
Fax 08-7586869
AppleLink ADVICE

AV-Support
Ola Hjelm
Hornsgatan 156
Stockholm
Sweden
Tel 6581315

Cap Gemini Logic Tech
Roland Lundgren
Box 1544
600 45 Norrköping
Sweden
Tel 30 07 10

CD Förlag
Mats Erwald
Box 3188
103 63 Stockholm
Sweden
Tel 736 5923
Fax 723 1390

CD Makarna
Ann Westfelt
Box 91
191 22 Sollentuna
Sweden
Tel 82 70 88
Fax 08 96 08 46

Datadesign & Multimedia
Peter Lindblom
Box 179
115 22 Stockholm
Sweden
Tel 090-12 46 00
Fax 090-12 46 03

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161 40 Bromma
Sweden
Tel 80 05 03
Fax 80 05 03

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115 22 Stockholm
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Tel 660 93 20
Fax 662 64 67

Nu Media,
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Saltmätargatan 14
113 59, Stockholm
Sweden
Tel 33 77 20
Fax 31 06 07
AppleLink NU.MEDIA

Optisys
Leslie Hardy
Box 11105
161 11 Bromma
Sweden
Tel 08-704 02 85
Fax 08-80 04 70

Optosof
Lennart Fernhed
Box 42
164 93 Kista
Sweden
Tel 08-750 79 50

Projector New Media
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111 27 Stockholm
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Tel 24 58 58
Fax 21 72 85

WM Data
Lasse Hellquist
Box 27030
102 51 Stockholm
Sweden
SW0086
Tel 670 22 12
Fax 670 20 60

United Kingdom

Maris Multimedia Limited
99 Mansell Street
London E1 8AX
United Kingdom
Tel 71 -4881566
Fax 71-702 0534
AppleLink MARIS
CompuServe:100136,2705
Internet:Denis@maris.com

Appendix D

Sources and Supporting Documents

Sources

Alexander Associates
Interactive Update November 30, 1993
Video Retailers Get Serious
New Platforms Demos
38 East 29th Street, 10th Floor
New York, NY 10016
Tel 212-684-2333
Fax 212-684-0291

All You Need to Know About the Music Business, 1994
Donald S. Passman,
Simon & Schuster
Rockfeller Center
1230 Avenue of the Americas
New York, NY 10020

Advanstar Interactive Multimedia Report
Advanstar Associates
Tom Adams, Managing Director
71 West Carmel Valley Road, Suite 205
Carmel Valley, CA 93924
Tel 408-659-3070
Fax 408-659-4330

Crain Communications Inc.
Advertising Age, May 23, 1994
Blockbuster's CD-ROM Crash Course
740 Rush Street
Chicago, Il 60611-2590

Apple Computer, Inc.
AppleLink
Source 1: Developer Support:Selling Into Europe:Distributing Your Product:Main Distributors/ Distribution
Source 2: Worldwide Multimedia:Apple MM Program:Multimedia Services
Source 3: Worldwide Multimedia:Apple MM Program:Redgate Macintosh Registry
Source 3: Worldwide Multimedia:Apple MM Program:Redgate Multimedia
1 Infinite Loop
Cupertino, CA 95014
Tel 408-996-1010

The CD-ROM Directory
TFPL Ltd.
17-18 Britton Street
London EC1M 5NQ
United Kingdom
Tel 44-71-251-5522
Fax 44-71-251-8318

CD-ROMs in Print
Meckler Corporation
Tel 203-226-6967
Fax 203-454-5840

CD-ROM Professional, July/August 1994
Who's Selling Where?
Pemberton Press, Inc.
462 Danbury Road
Wilton, CT 06897-2126
Tel 612-771-9939
Fax 203-761-1444

Dataquest, Inc.
1994—The Year of CD-ROM
1290 Ridder Park Drive
San Jose, CA 95131-2398
Tel 408-437-8000
Fax 408-437-0292

Digital Media—A Seybold Report
P.O. Box 644
Media, PA 19063
Tel 610-565-2480
New Media Magazine
June 1994 Issue

Game Over, How Nintendo Conquered the World, 1994
David Sheff
Vintage Books
Random House, Inc.
New York, NY 10003

Golden Light Imagery
130 Las Colinas Drive, Suite 116
Corralitos, CA 95076
Tel 408-722-3301
Fax 408-722-3302
AOL gld imagery
Internet sswami@cruzio.cem

HyperMedia Communications Inc.
901 Mariner's Island Blvd., Suite 365
San Mateo, CA 94404
Tel 415-573-5170
Fax 415-573-5131

Interactive Media Publications Ltd.
European Multimedia Yearbook 1994
104 St. John Street
London ECIM 4Eh
United Kingdom
Tel 44-71-490-1185
Fax 44-71-490-4706

Interactive Digital Software Assoication
919 18th Street NW, Suite 210
Washington, DC 20006
Tel 202-833-4372
Fax 202-833-4431

The Interactive Multimedia Sourcebook[2]
Templin Bogen Assoicates
507 Howard Street, Suite 200
San Francisco, CA 94105
Tel 415-281-3666
Fax 415-281-3630
EMail: TBA 1944@AOL.COM

LINK Resources Corporation
Interactive Multimedia—The Evolution of Consumer CD-ROM Software Distribution Strategies
79 Fifth Avenue
New York, NY 10003
Tel 212-627-1500
Fax 212-620-3099

Mainstream Multimedia, Applying Multimedia in Business
Roger L. Fetterman and Satish K. Gupta
Van Nostrand Reinhold, 1993
115 Fifth Ave.
New York, NY 10003

Making Money with Multimedia[3]
Addison-Wesley Publishing Company
26 Prince Andrew Place
Don Mills Ontario M3C 2T8
Tel 416-447-5101
Fax 416-447-7755

[2] The SourceBook™ will be available online through America Online in fall 1994, and in print before year end 1994.
[3] *Making Money with Multimedia* will be distributed to Apple Multimedia Program members and subscribers to the Apple Multimedia Information Mailing in the upcoming January 1995 quarterly mailing.

Market Vision
326 Pacheco Ave., Suite 200
Santa Cruz, California 95062-1233
Tel 408-426-4400
Fax 408-426-4411
AppleLink Mkt.Vision
AOL mkt vision

MAST
Roger Fetterman
2245 Laurelei Street
San Jose, CA 95128-1439
Tel 408-984-6213
Fax 408-984-6213

McKinsey & Company Inc.
The McKinsey Quarterly, 1993 No. 3
The Engine of Success in Retailing
555 California Street, Suite 4800
San Francisco, CA 94104
Tel 415-981-0250
Fax 415-954-5200

Multimedia Applications and Markets, 1994 Annual Forecast (through 1998)
Market Vision
326 Pacheco Ave., Suite 20
Santa Cruz, CA 95062
Tel 408-426-4400
Fax 408-426-4411

Multimedia Applications and Markets, A Five-Year Forecast (through 1997)
Market Vision
326 Pacheco Ave., Suite 20
Santa Cruz, CA 95062
Tel 408-426-4400
Fax 408-426-4411

Multimedia CD—An End User Perspective
Market Vision
326 Pacheco Ave., Suite 20
Santa Cruz, CA 95062
Tel 408-426-4400
Fax 408-426-4411

The Multimedia Directory
The Carronade Group
717 S. Cochran Avenue, Suite 9
P.O. Box 36157
Los Angeles, CA 90036
Tel 213-935-7600
Fax 213-939-6705

Multimedia—Gateway to the Next Millennium, 1994
Robert Aston and Joyce Schwarz
Academic Press Professional
955 Massachusetts Avenue
Cambridge, MA 02139
Tel 617-876-3901
Fax 617-661-3608

Optical Publishing Industry Assessment—Sixth Edition 1993
InfoTech
P. O. Box 150
Woodstock, VT 05091-0150
Tel 802-457-1037
Fax 802-457-1038

S.O.S., Inc.
100 Driftwood, Suite #1
Marina del Rey, CA 90292
Tel 310-306-1814
Fax 310-306-4861

Video Software Dealers Association (VSDA)
16530 Ventura Blvd #400
Encino, CA 91436
Tel 818-385-1500

Who Will Distribute Multimedia Products?
Market Vision
Interactive Multimedia News, IMA Trade Journal
August/September 1992
Tel 410-626-1380
Fax 410-263-0590

Leading distributors involved in creating the interactive media market were interviewed. The design of the questionnaire used to perform the direct telephone distributor and publisher interviews was based on a survey of 867 Apple Multimedia Program members. The survey questions for both the Apple Multimedia Program Member Survey and the Interactive Distributor and Publisher Survey are presented in this appendix.

Apple Multimedia Program Member Survey

1. What is your company's primary business activity? (check only one)
   [ ] Developer of content for multimedia projects
   [ ] Developer or supplier of interactive tools
   [ ] Developer of interactive titles
   [ ] Publisher of interactive consumer titles
2. What platform(s) does your company develop for? (check all that apply)
   [ ] Apple Macintosh
   [ ] Windows
   [ ] Other PCs (specify):
   [ ] Workstations (specify):
   [ ] Videogame players (specify):
   [ ] Consumer multimedia players (specify):
   [ ] Portable multimedia players (specify):
3. Who are your primary and secondary markets? (indicate with primary=1 and secondary=2)
   [ ] Full-time professionals (full-time use)
   [ ] Business (part-time use)
   [ ] Education
   [ ] Consumer entertainment
   [ ] Consumer edutainment (instruction)
   [ ] Other (specify):
5. How are you distributing your product? (Check all that apply)
   [ ] Direct
   [ ] Publisher-distributor
   [ ] Distributor
   [ ] OEM bundles
   [ ] Affiliate label programs
   [ ] Mail-order distributor
   [ ] Domestic
   [ ] International
   [ ] Specify other:

6. What is the typical range of copies per title per year you produce, distribute, sell ?
[ ] Less than 10,000 copies
[ ] 10,000 to 50,000 copies
[ ] More than 50,000 copies

7. What industries are your products designed for? (select all that apply)

Entertainment Products
[ ] Adult entertainment
[ ] Adventure and fantasy parks
[ ] Child entertainment
[ ] Consumer videogames
[ ] Electronic photo albums
[ ] Flight simulators
[ ] Interactive books
[ ] Interactive cinema
[ ] Interactive games and puzzles
[ ] Interactive pornography
[ ] Interactive sports
[ ] Interactive TV advertising
[ ] On-screen guides
[ ] Public arcades and games
[ ] Video home movies
[ ] Specify other:

Instruction Products
[ ] Adult self-improvement
[ ] Child learning
[ ] Industrial training
[ ] Music appreciation
[ ] Special group learning
[ ] Specify other:

Information Products
[ ] Home management
[ ] Home shopping
[ ] News services
[ ] Reference materials
[ ] Surrogate travel
[ ] Yellow pages
[ ] Specify other:

8. What are the three most important issues affecting distribution of your products over the next two years?
a.
b.
c.

9. As a developer, prioritize your three primary issues: (enter priority 1, 2, 3, 1=highest)
   [ ] Ability to audit distributor activity
   [ ] Affiliate labels
   [ ] Discount structures and margins
   [ ] Localization for international sales
   [ ] Marketing effectiveness (promotion, co-op, shelf space)
   [ ] Merchandising (packaging, labeling)
   [ ] Minimum quantity guarantees
   [ ] OEM bundles
   [ ] Product return policies
   [ ] Royalty advances
   [ ] Technical support programs
   [ ] Specify other:
10. Do you have any comments or suggestions for a report on distribution?

Interactive Media Distributor and Publisher Survey

General Questions (Software and others)

1. What criteria do you use to select titles or products?
2. Which channels will be important to you over the next 24 months for new media product distribution? (Distribution channels have been designed either to move computer software or consumer products. What channels are you using or tweaking to get CD-ROM hybrids into the hands of consumer?) Do you foresee any new CD-specific channels?
3. What assurances do you require from the retailer channels about product visibility and shelf space, and what assurances do you give developers regarding title promotion and shelf space?
4. Which channels will be important to you over the next 24 months for new media product distribution? (Do you foresee any new channels that are CD-specific?)
5. How are you addressing the issues of online distribution, such as Internet, interactive television or remote gaming networks.
6. Can CD-ROM discs be successfully rented in the same manner as videos and video cartridge games?

Home Video Survey

1. What plans do you have in the next two years to distribute interactive media to the home video rental stores? How big do you think that market will be for you in the next 24 months? (What are your expectations of the market?)
2. What would you consider to be your minimums to make it worthwhile to market videogames into the home video channel?
3. Do you plan to enter this market and when?
4. Will you distribute interactive media differently than videocassettes (based on time sensitivity)?

Videogame
1. Are you going to be emphasizing any particular formats or platforms?
2. What standard distribution guarantees do you provide?
3. What marketing dollar commitments do you make to developers?

Music Survey
1. Do you have intentions of carrying interactive media with other audio titles (i.e shelf space and promotional)?
2. In the future will you handle CD-ROM music videos?
3. How do you view New Leaf as it relates to how music is packaged and distributed in the store?

Book Survey
1. Do you see the bundling of CD-ROM discs with books as a successful way to sell CD-ROM discs?
2. Will retail book stores allocate space to display and demonstrate interactive titles separately, such as kiosks and new shelf space? (How do you mix books and CDs on the same space?)
3. How is the added cost of the CD going to affect book pricing? (An add-on?)

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Emerging Distribution Models for Consumer Interactive Media

Sponsored by Apple Computer, Inc.
Multimedia Business Development Group, New Media Division
for the Apple Multimedia Program

Produced by Robert Aston, S. Swaminathan, and Joanna Tamer

Edited by Dana De Puy Morgan and Vicki Vance

Apple Computer, Inc.

Printed in the United States.
Apple Computer, Inc.
1 Infinite Loop
Cupertino, CA 95014

Simultaneously published in the United States and Canada.

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Printed on Recycled Paper

Welcome to *Emerging Distribution Models for Consumer Interactive Media*!

The year 1993 was an explosive growth period for CD-ROM, driven by the evolution of technology, the building of a critical mass of computer-based CD-ROM drives, and the adoption of multimedia by the consumer market. In 1993 commercial titles accounted for over $6 billion in revenue.

Emerging Distribution Models for Consumer Interactive Media—sponsored by the Apple Multimedia Program—provides insight into current and emerging distribution models, highlighting the correlation of interactive media and traditional publishing models. Converging technologies and industries have created an environment where distribution models are in a constant state of evolution, each having its own set of distinct cultures, business practices, and language.

The 1994 Christmas season marks a pivotal point in the consumer CD-ROM title industry. Consumer demand for CD-ROM titles is rising and will continue to challenge developers to deliver high-quality content, maintain high production values, and control development costs. As high-quality CD-ROM titles reach the market, competition among title developers for shelf space and consumer market share will intensify. In shaping business plans for the 1995 selling season, developers must devise a successful consumer-driven distribution strategy.

*Emerging Distribution Models for Consumer Interactive Medi*a contains invaluable information designed to promote a title developer's success in choosing the appropriate distribution strategy or partner; rising to the expectations of consumers by increasing richness of content; extending title shelf life by creating ancillary products; and expanding in-store merchandising, training, and preview mechanisms.

The ultimate test of a developer's success lies in the marketplace. There the consumers will vote with dollars to select the technology, content, applications, and products that best meet their interests, needs, and budgets. We hope you find *Emerging Distribution Models for Consumer Interactive Media* beneficial and wish you continued success in your multimedia endeavors.

Sincerely,

SSChahil

Satjiv S. Chahil
Vice President and General Manager
New Media Division

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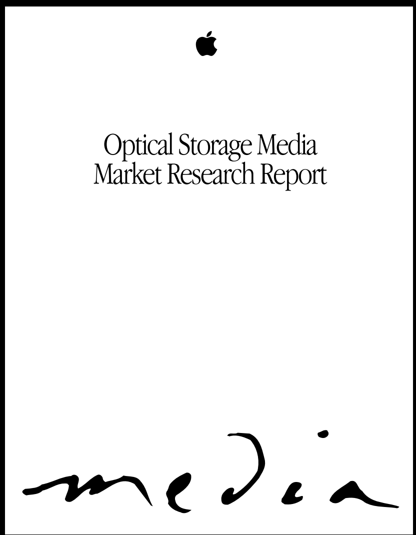
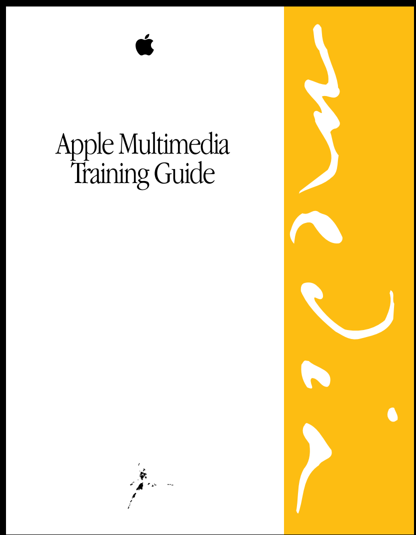
Section One

Section Two

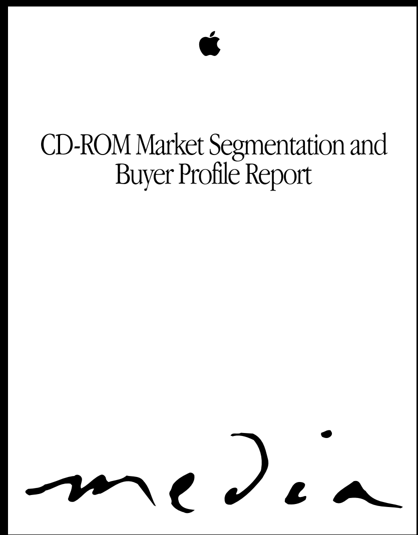
Apple Multimedia Program Directory of Publications



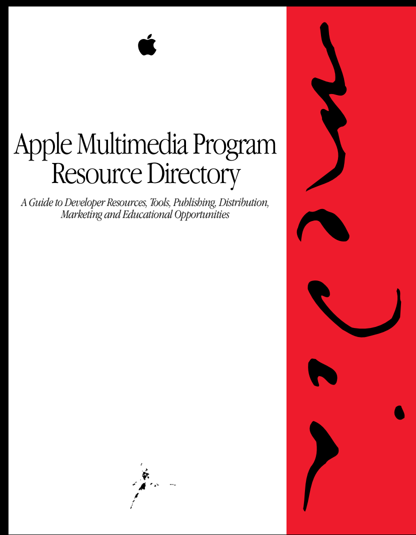
Optical Storage Media Market Research Report
April 1993



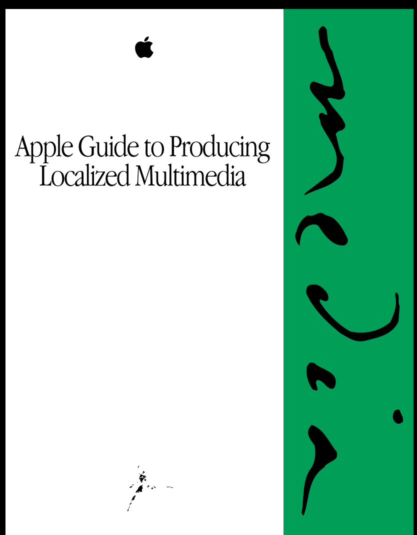
Apple Multimedia Training Guide
July 1993



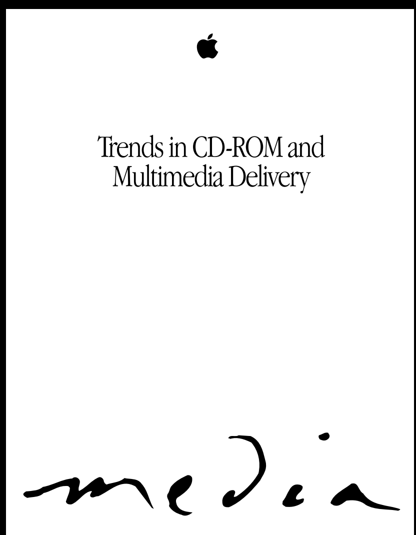
CD-ROM Market Segmentation and Buyer Profile Report
January 1994



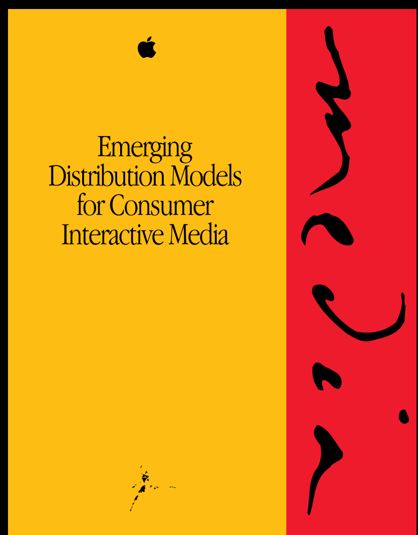
Apple Multimedia Program Resource Directory
April 1994



Apple Guide to Producing Localized Multimedia
April 1994



Trends in CD-ROM and Multimedia Delivery
April 1994



Emerging Distribution Models for Consumer Interactive Media
October 1994