SEATTLE POST-INTELLIGENCER

Movie rentals are moving increasingly to TV, Internet

Friday, November 16, 2007
Last updated 7:35 a.m. PT

By ANDREA JAMES
P-I REPORTER

By the end of this year, Netflix, the startup company that took on video-rental giant Blockbuster and changed the way Americans rent movies, will have at least 7.3 million subscribers.

Seattleites who pay for the service get their DVDs from a non-descript site that sits at the end of a row of warehouses south of Tacoma. About 300,000 DVDs leave the space each week.

The California-based company has a secret behind the frosted windows of its Tacoma plant -- a technological one that, if known, would allow competitors to process the volume of DVDs that Netflix does, and deliver movie rentals by U.S. mail within 24 hours. The proprietary technology allows the company to read a bar code for rental return, determine if that DVD has an order that day and to ship the disc.

The most striking feature of the warehouse (which the Seattle P-I saw in an exclusive tour) is its sparseness. There are no librarylike stacks of videos, no robotic arms dropping discs into bins. Just workers at tables stuffing envelopes, a few computers, rolling carts and shelves, lunch tables and proprietary machines that handle the rest. About 26 million of Netflix's DVDs are stored at customers' homes, or are in transit. The remaining 20 million are kept in a California warehouse.

But in 10 years, the videos won't be stored in a physical location. And the company's primary business model, and the technology it depends upon, will approach obsolescence. The movie rental industry is moving from the corner rental store -- which is still popular for some folks -- to DVD by mail, to video download by Internet, to the king of convenience: video on demand.

In the past 3 1/2 years, for example, Comcast's growth for on-demand video has jumped from fewer than 1 million
Movie rentals are moving increasingly to TV, Internet views per month to 15.4 million in Washington state, spokesman Steve Kipp said.

"It's grown significantly and it keeps growing month over month," he said. "If you look at the generation below age 30, they've completely embraced on-demand. My daughter who's 12 has no concept whatsoever of appointment television."

**Video rentals popular**

Netflix's competitors are struggling to resuscitate dying business models -- Blockbuster is losing money and the second-largest chain, Movie Gallery Inc., has filed for Chapter 11 bankruptcy protection. Movie Gallery owns Hollywood Video.

Yet, home video rentals are still the most popular way that Americans rent movies. Home video spending in 2006 exceeded $24 billion, with $8.5 billion of that on rentals, according to the Entertainment Merchants Association.

A major demographic shift -- more women working -- combined with technology-induced demands for speed mean that Americans increasingly don't have time to drop off video rentals, said Eugene Fram, a marketing professor at the Rochester Institute of Technology.

Eliminating late fees alone won't cut it -- time is so precious that companies that offer the most convenience will prosper.

"Currently, Netflix seems to do the best job with its ease of receiving and returning films," Fram said. "However, technology is leading to other approaches to the business, which can even impact Netflix. This is because the consumer has an obligation to accept and to return the films. These are 'responsibilities' that time-compressed families will want to shed."

Tom Paine, owner of six Puget Sound-area suburban video rental stores called DVD NOW or Video Factory, is feeling the pinch.

"We're in a period of change. I think there's a lot of diverse opportunities for people to find entertainment and to find ways to spend their leisure time now," said Paine, who sits on the national board of the Entertainment Merchants Association.

He opened two stores in the past three years, in Redmond and Duvall, even while big chains were closing shops.

Location is his biggest strategy -- which is really just another word for convenience.

"If you have a place down at the corner, and I'm on that corner, then I have a good location," he said. "I can serve you and all the neighbors."

The Internet challenges his business in other ways besides offering video downloads -- it gives people something to do other than rent movies.

"Whereas somebody would have rented a movie in the past and spent a couple of hours watching it, now that person is on the Internet chatting or exploring," he said. "People are still renting. (But) there's fewer people renting and those that are renting are renting less."

It appears that even pornography can't save the rental stores, Paine said.

"That business is being displaced really rapidly with the Internet," said Paine, who sells adult videos at one of his shops.

**Movie rentals on TV**

Luckily for Paine and his counterparts, Internet movie downloads make up only a fraction of the national video
Movie rentals are moving increasingly to TV, Internet rental market, according to the Entertainment Merchants Association. Public chain video stores have 43 percent of the market, followed by independent video stores at 39 percent. Online rentals account for just 16 percent.

Customers, it appears, still like to watch videos on the television screen.

While video on demand remains limited -- Comcast offers just under 10,000 titles compared with Netflix's 90,000 -- the rental store or DVD-by-mail will remain a top choice.

Amazon.com's Unbox service was released in September 2006 to bring movies to the personal computer. This summer it partnered with TiVo Inc., allowing movies to be downloaded to a customer's digital video recorder.

Netflix, which already offers 5,000 titles for the personal computer, plans to expand its service to television in 2008. The company was born adaptable, said communications Vice President Steve Swasey.

"That's why we named the company Netflix, not DVDs by Mail."

**Back at Netflix**

Forty people work at the local Netflix facility, stuffing at least 650 DVDs per hour into red envelopes: Stuff the disc, flip the envelope, strip the sticker, seal the flap, and stack it. Repeat. They wear red Netflix logo T-shirts and their hands work fast.

A wall poster encourages them to meet the 650-per-hour goal. (Netflix Chief Executive Reed Hastings can stuff only 360 per hour.)

"America's taste in movies is broad and vast," said Swasey, grabbing a handful of DVDs that had been ordered in the Puget Sound region that day. His hand included two copies of "Fantastic Four," one copy of "Emma" and -- one of the most popular nationwide that day -- "Transformers."

The Tacoma location is one of 47 hubs; nationwide, the company ships 1.6 million DVDs per day. The space opened a month ago, the third iteration in Tacoma since March 2002.

Christi Lewis, a supervisor from Puyallup, arrives at about 4:45 a.m. and begins bringing in the mail. She eats lunch around 9:30 a.m. She's worked for Netflix for six years, when the hub was only four people.

Her standard is to mail out movies in a method worthy of delivery to CEO Hastings' mother.

"The Tacoma site is the best," she said. "We're a very tightly bonded crew."

---

*P-I reporter Andrea James can be reached at 206-448-8124 or andreajames@seattlepi.com.*

© 1998-2007 Seattle Post-Intelligencer