Sony's Blu-Ray Strategy

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Introduction

In 1983, compact disc technology was introduced into the United States revolutionizing the music and movie industries. Both music and movies benefited from the switch to digital which provided great clarity and storage space. "CD quality sound" became the catch phrase to denote quality music recording. As the industry grew, demand increased for better picture quality which meant greater storage capacity. DVDs were introduced to meet this need and were met with great success.

Now in 2007, the Sony Blu-Ray is poised to take over the market as the new standard for the next generation of media disc. The Blu-Ray technology uses a blue laser rather than a red laser (DVD). The shorter wavelength allows Blu-Ray disc to store 25GB of data on each layer compared with DVD's 4.7GB.

It will, however, have to face serious competition from competing standard HDDVD as well as good old fashion DVDs. In this report, we hope to clarify Sony's position in this complex market and analyze what Sony can do to solidify its position. Using 6 forces analysis, as well as current market condition analysis, we concluded that Sony should:

1. Leverage its movie and HDTV advantage to promote Blu-Ray over HDDVD.
2. Offer subsidies for Blu-Ray players to compete with DVD.
3. Obtain more manufacturing support from large Chinese manufacturers.

Sony's Blu-Ray Strategy: Porter Forces Analysis

New Entrants

On the standards side of the market, Blu-Ray and HDDVD have already dominated the high definition media market. Both have had more then a year to develop infrastructure as well as find support from other large corporations in related markets (see Table 1). As a result, it will be unlikely that a new standard could enter the market. Hardware wise, on the other hand, it is still easy to enter the market. Both standards have easy to access websites allowing anyone to apply for a license. Parts to make Blu-Ray and HDDVD players/drives are readily available and can be purchased in large enough quantities to run a production line. Thus we expect to see many new entrants into this side of the market. This may result in a very price competitive market with dozens of Blu-Ray/HDDVD player manufacturers.

Table 1

	Companies Supporting
Blu-Ray	Sony, Panasonic, Philips, LG, Pioneer, Apple
HDDVD	Toshiba, Hitachi, Microsoft, NEC

Buyer Bargaining Power

From Sony's perspective they have three main groups of buyers: licensees, consumers and the major movie studios. The licensees are very numerous and thus do not have much bargaining power. Only the largest manufacturers have bargaining power here. Consumers are more numerous then licensees and don't have any bargaining power. As a whole, consumers can choose to stick with regular DVDs if they find Blu-Ray products to be too expensive, but individually speaking they don't have power. The major movie studios are the only ones with great bargaining power. There are only 12 major studios in all (see Table 2) and each one's support would mean millions of copies of movies released on Blu-Ray disc every year. Thus they are in a great position to bargain with Sony over disc prices. Studio support is currently split in favor of Blu-Ray (see. Table 3).

Table 2: Studio Market Share: (Jan 1. – Dec. 31, 2006)

Rank	Distributor	Market Share	Total Gross	Movies	Tracked 2006 Movies
1	Sony / Columbia	18.6%	$1,710.9	34	27
2	Buena Vista	16.2%	$1,492.6	25	19
3	20th Century Fox	15.2%	$1,398.4	28	24
4	Warner Bros.	11.6%	$1,065.8	27	21
5	Paramount	10.3%	$947.3	19	16
6	Universal	8.9%	$815.2	21	17
7	Lionsgate	3.6%	$331.4	19	17
8	New Line	2.7%	$251.5	13	10
9	Weinstein Company	2.5%	$226.5	15	9
10	MGM/UA	1.8%	$166.8	13	15
11	Fox Searchlight	1.8%	$165.7	16	13
12	Focus Features	1.3%	$118.5	9	7

Table 3. Blu-Ray vs. HDDVD Studio Support

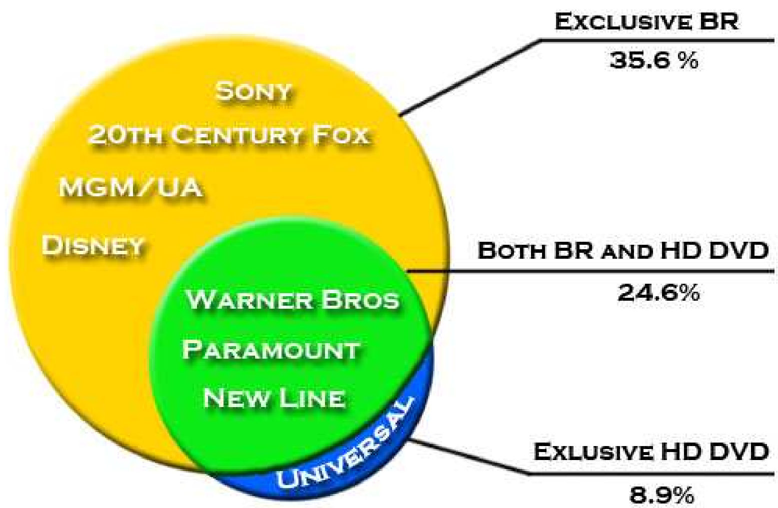
- Exclusive Blu-Ray:
  Sony Pictures, MGM, Disney and 20th Century Fox (18.6%+1.8%+15.2%=**35.6%+**)

- Both Blu-Ray & HDDVD:
  New Line Cinema, Paramount Pictures, and Warner Bros (2.7%+10.3%+11.6%=**24.6%**)

- Exclusive HDDVD:
  Universal Studios (**8.9%**)

  Blu-Ray: 60.2%
  HDDVD: 33.5%

Figure 1. Studio Support Market Share



Supplier Bargaining Power

Sony’s only suppliers are raw materials, plastic, electronic parts (laser) and foundry companies who supply Sony with the parts it needs. These parts are used in a Sony owned company called Sony-NEC Optiarc which produces Blu-Ray drives. These are used by Sony itself to produce Blu-Ray players and also sold to other companies wishing to make Blu-Ray players. With so many suppliers available supplier bargaining power will be quite low. The blue laser used in Blu-Ray drives is perhaps the only exception to this. Supplier power was strong due to a laser shortage in the last summer. However, current supplies seem to have stabilized lessening supplier bargaining power.

Substitute Products

The obvious substitute product for the Blu-Ray is HDDVD. Compared with Blu-Ray, HDDVDs are cheaper to produce, but offer less capacity (see Table 4). Furthermore, HDDVD disc players are also, on average, cheaper then Blu-Ray disc players (see Table 5).

DVDs are another substitute for Blu-Ray. Consumers who don't own an HDTV and/or don't feel HD is worth the extra cost will probably go with normal DVDs. From preliminary data, it seems that both Blu-Ray and HDDVD are selling in comparable quantities making it unclear who will be the winner[1]. As a result, exclusive support for either standard is dwindling. For example, Apple who was an exclusive supporter of Blu-Ray has announced support for HDDVD. Microsoft, who once supported only HDDVD, has also announced support for Blu-Ray products.

Table 4: Blu-Ray vs. HDDVD specifications

	Blu-Ray	HDDVD
Storage Capacity Single Layer	25GB	15GB
Maximum Data Transfer Rate	54.0 Mbit/s	36.55 Mbit/s
Java Support	Yes	No
Single Layer Prices	$11.99	$8.99
Protective Hardcoating	Yes	No

Table 5: Blu-Ray vs. HDDVD disc player prices

Company	**Disc Type**	**Model**	**Price**
Toshiba	HDDVD	HD-A2	$375
Sony	Blu-ray	BDSP1	$759
Samsung	Blu-ray	BD-P1000	$470
Toshiba	HDDVD	XHD-A2	$789
LG	HDDVD/Blu-ray	BH100	$1199
Panasonic	Blu-ray	BMP-BD10	$1148
Philips	Blu-ray	BDP9000	$750

[1]"Finally: VideoScan Releases High-Def Disc Sales Numbers" http://www.highdefdigest.com/news/show/456

Rivalry

On the licensing side of the market, there is little price competition over licenses. Instead, both Sony and Toshiba/Hitachi (joint developers of HDDVD) are competing through marketing. Which ever side is perceived as "winning" will be the side that gets more licensees. On the hardware side, there is heavy competition because anyone with a license can make a HD player. Blu-Ray player manufacturers will compete with not only HDDVD player manufacturers but other Blu-Ray manufacturers as well. Similarly, Blu-Ray companies will also have to contend with DVD player manufacturers. The result is a very price competitive market where disc players and Blu-Ray media may be sold at cost or near cost.

Complements

An obvious complement to Blu-Ray are movies produced by studios and released on Blu-Ray discs. People wishing to view these movies in great HD quality will buy Blu-Ray disc players. High definition televisions are also a complement to Blu-Ray, because it makes no sense to purchase a HD disc player without a proper HDTV to watch movies. It is projected that by the year 2010, 70% of all television sets sold will be HD and 63% of American households will have a HDTV.[2] This makes HDTVs a great complement to Blu-Ray because the "capacity" of the HD disc player market will become very significant. Other complements Blu-Ray are video games (which are released on Blu-Ray disc) and computers (i.e. Sony notebooks with Blu-Ray drives). Video games in particular may play a huge role complementing Blu-Ray because of the PS3. The PS3, sold by Sony, comes with a built-in Blu-Ray player. This makes all of the PS3 owners instant Blu-Ray customers, which could provide the necessary boost Blu-Ray needs to dominate the market.

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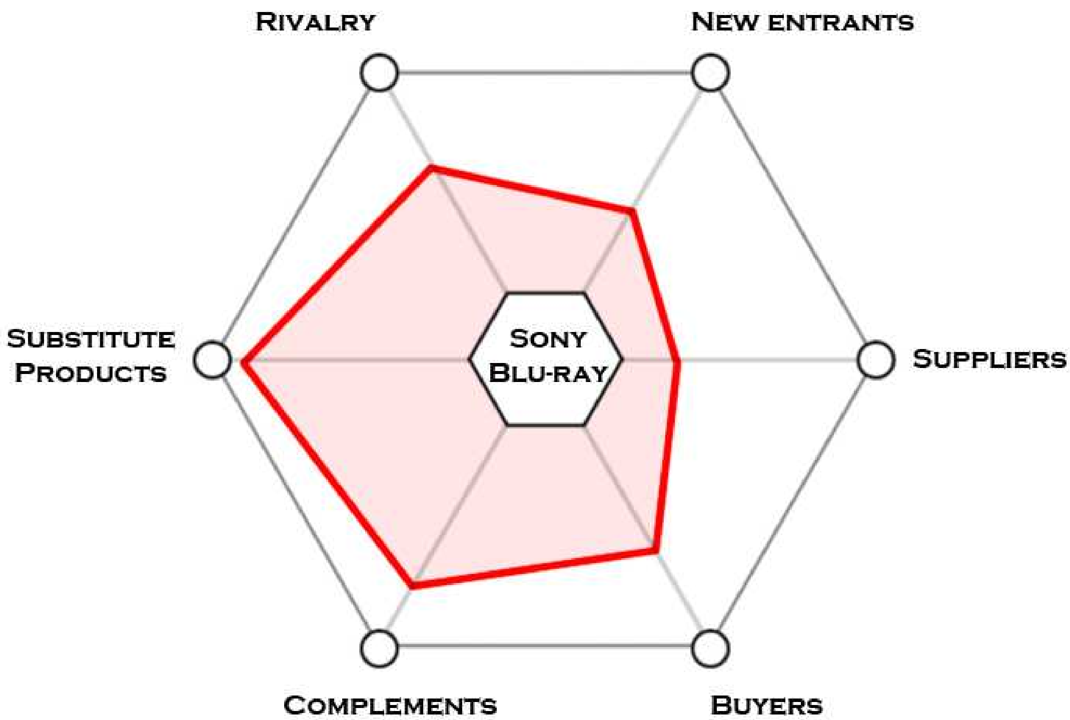
[2] "HDTV Sales in the U.S. Will Constitute 70% of all TV Sales by 2010" http://www.audioholics.com/news/pressreleases/HDTVsalesinUS2010.php

Porter Forces Summary



Points closer to the outside edge indicate stronger power. For example, substitute products are quite powerful in this case because Sony's Blu-Ray is very substitutable (HDDVD, DVD). Thus we recommend that Sony employ aggressive tactics to ensure that Blu-Ray is an attractive option to customers. Sony must also make Blu-Ray less substitutable by leveraging its advantage in movies over HDDVD. This will not, however, have any effect on DVD as DVD will always be the cheaper option. Thus Sony should take advantage of the fact that complements are also quite powerful in the high-def market, particularly HD televisions. Sony already makes HDTVs, which can be used to subsidize Blu-Ray players.

Major Player Profiles

Here we will give a brief description of some of the major players and their roles in the next generation media disc market.

Sony

In the high-def standards market, Sony is the definitely one of the largest and most engaged players. The current Sony strategy is to put all of its eggs in a giant basket called the PlayStation 3. By tying the Blu-Ray inextricably with the PlayStation 3, Sony is betting that sales of the gaming console will drive Blu-Ray's popularity. Conversely, Sony hopes that Blu-Ray's high-definition features can help drive PlayStation 3 sales. Looking at Sony's history, this seems like a great idea. One of the major selling points of the PlayStation 2 was that it could also play DVD movies. In Japan, the leading software title during the launch of the PlayStation 2 was the Matrix.[3]

In fact, from Sony's point of view, this is not a bad idea at all. From Sony's perspective they have two weapons: Blu-Ray and the Cell processor which make the PS3 possible. Why not combine the two into a super weapon to wipe out whatever Microsoft or Toshiba has to offer? Unfortunately, recent news is not good for Sony. Demand for the PlayStation 3 has been weaker then expected.[4] In December, the PS3 was outsold by Nintendo's Wii by over 100,000 units. In Japan, even the PlayStation 2 has outsold the PlayStation 3![5] This obviously does not bode well for Sony.

On the plus side, Sony has had a recent victory in movie studio support over rival standard HDDVD. From Figure 1, we can see that this advantage is quite substantial. Sony itself owns Columbia, one of the largest movie studios around. This guarantees that a substantial amount of the movies made in the future will come in Blu-Ray format - great news for Sony. With the majority of movies coming out in Blu-Ray, Sony may well soon be able to dominate the market. Why buy a HDDVD player when there isn't anything to play on it?

With the PS3, Sony is definitely targeting the high end market. The prices for their Blu-Ray players are also higher then comparable HDDVD offerings from Toshiba and others. The

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[3] "The High-Def Features and Questionable Blu-Ray" http://nintendo.about.com/od/editorials/a/bluray_4.htm
[4] "PS3s in stock show demand may be softening, analyst says" http://news.yahoo.com/s/nm/20070116/tc_nm/videogames_ps3_dc_3
[5] "Japan chooses PS2 over PS3?" http://www.techtree.com/India/News/Japan_Chooses_PS2_over_PS3/551-79033-585.html

question now is: will all this pay off in the future? Can the Blu-Ray become the next major standard with this strategy?

Toshiba

In the high-def market, Toshiba is the primary supporter of HDDVD. As with Sony, Toshiba is making its own HDDVD disc players and licensing technology to other companies. The difference is that Toshiba lacks something comparable to Sony's PlayStation 3 to push HDDVD. Another difference is that Toshiba lacks Sony's overwhelming experience and support in the movie industry. This is not good for Toshiba and HDDVD. Without a comparable quantity of movies, HDDVD has no chance of competing with Blu-Ray.

One great advantage of HDDVD to Blu-Ray is that HDDVD is simply cheaper. It is cheaper to produce HDDVD media disc and it is cheaper to produce HDDVD disc players. To exploit this advantage, Toshiba has opted to be the loss leader in the market in an effort to bring HDDVD to the market faster. For example, it is estimated that Toshiba sells its HD-A1 HDDVD player at $300 under cost.[6] To counter Blu-Ray's PlayStation 3 advantage, Toshiba has turned to Sony's console rival Microsoft. HDDVD is optional on all Microsoft XBOX 360 machines.

From Toshiba's perspective, it is in a race against time because Sony has the advantage in movies. It's only way to win is to force the market to adopt HDDVD through economics. To this end, Toshiba has broken Japanese taboo and licensed it technology to manufacturers in China. The hope is that HDDVD could become the standard once cheap Chinese HDDVD players begin flooding the market. And this is not without reason as many analysts have speculated that DVD became the de-facto standard only when cheap foreign DVD players began to come in.

From past experience, Toshiba has been successful with this strategy. Its flash memory technology, for example, was license to cheap producer Samsung in an effort to dominate the flash memory industry. The bid paid off, as Toshiba memory chips lie in most mp3 players today, but Toshiba lost potential profits to Samsung. The question facing Toshiba is: will this be enough to surmount Sony's movie advantage in the high-def market?

Microsoft

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[6] "Toshiba taking a hit on HD DVD players" http://arstechnica.com/news.ars/post/20060623-7121.html

Microsoft was a major proponent of HDDVD until recently when Windows Vista support for Blu-Ray was announced. Still, Microsoft has publicly stated that the XBOX360 will only support HDDVD. This makes it clear that in the war between Blu-Ray and HDDVD, Microsoft is pulling for HDDVD to win. And this makes sense, because Sony has tied the success of it PlayStation 3 consoles with Blu-Ray. In order to compete with the PS3, Microsoft had to turn to HDDVD as the high-def format for its XBOX360 systems. However, unlike Sony, Microsoft has made this an optional add on to its console.

From Microsoft's perspective, it just wants to win the next generation console war. It wants the XBOX360 to outsell the PlayStation 3. And it does not want to have to pay royalties to Sony for Blu-Ray. Thus it has thrown most of its support behind the more open HDDVD, but has also made preparations in case the Blu-Ray does win (i.e. Windows Vista support). This is typical Microsoft behavior. Meanwhile, the recent strong performance of the XBOX360 should bode well for HDDVD. However there are reports that in Japan the war is all but over in favor of Blu-Ray.

Others

Besides Sony and Toshiba, there are a handful of other major corporations making Blu-Ray and HDDVD disc players. These are pretty much the sheep being led by the shepherds Sony and Toshiba. Some manufacturers such as LG have built dual disc players which support both Blu-Ray and HDDVD. However, these are quite expensive (see Table 5) and are unlikely to substantially impact the market. Some manufacturers, such as Hitachi, are playing both sides. Initially, a major HDDVD supporter, Hitachi has also joined forces with LG to create Blu-Ray drives for the personal computer.[7] Panasonic, an old Sony rival, has started producing Blu-Ray recorders. Basically, most of these corporations don't seem to have strong connections to either Blu-Ray or HDDVD, but are just waiting for the winner.

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[7] "Hitachi-LG Data Storage Develop the Industry's First 4x Blu-ray Disc Drive"
http://www.blurayfreak.com/2006/07/hitachilg_data_.html

What Should Sony Do?

So what should Sony do to ensure Blu-Ray's dominance in the high-def market? Research on the web gives many conflicting reports. Each side says they are winning and analysts are going both ways on this one. However, a recent report shows that both standards are competing quite well with each other. How this will pay out in the coming months is a big question. The war will pit Sony's dominance in movies versus Toshiba's cheap HDDVD drives.

For Sony, it should know that it has the current advantage due to movie studio support. The current market has only a few high def disc players from large corporations. Keeping all else constant, Sony should be able to use its movies to dominate the market. Thus, Sony's main concern is to quickly dominate the market before Toshiba can unleash its cheap HDDVD players onto the market. However, recent news about the PS3 has not been positive. If the Sony PlayStation 3 loses in the market, Sony may very well end up losing the next generation console market as well as the next generation media disc market.

What Sony should realize is that the current Blu-Ray/PS3 strategy is not working. To make it work, Sony needs to more strongly exploit its movie power. Sony does exploit this power to some extent by bundling PS3s with a movie but this is still not enough. It needs to employ more aggressive tactics with its PlayStation 3. For example, Sony could announce PS3s bundled with not yet released on Blu-Ray/DVD movies (i.e. movies that have left the theater, but have not been released to the general public in Blu-Ray/DVD format).

Another major step Sony can take is to use their HDTV products to complement their Blu-Ray players. Sony already offers VAIO notebook computers with built in Blu-Ray drives, why can't they offer HDTVs with built in Blu-Ray players? Or better yet, offer to lower the price for HDTVs if it is bought with a Blu-Ray player (perhaps use a factory rebate system). The high-def market may very well be decided in the next year or so. Quick actions are needed to win the market.

The last step Sony should take is to begin licensing its Blu-Ray to more manufacturers. Sony does offer a license program, but has admitted that the screening process is quite strict to ensure companies don't break Blu-Ray's built in copyright protection system. However, Sony's current strategy could alienate Chinese manufacturers who will turn to HDDVD. Sony has to ensure that at least the major manufacturers in countries like China and Taiwan are building Blu-Ray products. What can occur is a standards split between markets with China supporting HDDVD and Japan and the United States supporting Blu-Ray. HDDVD, with its lax copyright protection and cheapness, is definitely fit for a market like China where copyright protection and royalty payment is shaky at best. If this occurs, you can bet there will be large pirating companies copying movies off of Blu-Ray disc and transferring them onto HDDVD disc to be sold cheaply.

Related to the above is the important fact that this is a highly competitive market where eventually profits will go down. Sony's current strategy resists this by not licensing to too many manufacturers. However, eventually cheap manufacturers will begin producing high-def products and which standard they support will hinge on how greedy Sony is for short-term profits now. Of course, the solution is not to just simply license the technology more. Sony must walk a fine line between getting Blu-Ray technology out into the market cheaply and protecting the rights of supporting movie studios and rental companies such as Netflix and Blockbuster. Perhaps the best way is to court support only from the largest and most reputable manufacturers. At the same time, Sony must leverage its current advantage in movies to promote Blu-Ray as the leading standard over HDDVD. Furthermore, Sony must encourage consumers to switch to Blu-Ray from DVD by subsidizing Blu-Ray players with complements such as HDTV. By using their existing advantages, adding incentives, and being more aware of the market, Sony can woo more consumers and producers to its side, effectively tipping the format war irreversibly in its favor.