



Apple, Blu-ray, and the Future of Digital Downloads: What is Apple Really Up To?

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October 28, 2008

When it comes to Blu-ray, few know for certain of Apple's direction (a fact which fuels the number of Blu-ray-related insider leaks and ambiguous public statements). I recall one such disclosure in Q4 2007, a time when the HD-DVD/Blu-ray war in full swing, which noted that Apple was already on board the Blu-ray train and that within 12 months every new Apple notebook would be armed with Blu-ray. Of course, it didn't happen, but Apple has nonetheless made certain to keep the waters muddied. Consider this recent statement by Steve Jobs:

"Blu-ray is a bag of hurt. I don't mean from the consumer point of view. It's great to watch movies, but the licensing is so complex. We're waiting until things settle down, and waiting until Blu-ray takes off before we burden our customers with the cost of licensing."¹

Okay, but what is he *really* saying? Since when is Apple concerned about burdening Mac users with excessive costs? As loyal supporters will admit, there is no such thing as a "cheap" Mac (if there was, it wouldn't be a Mac) and that hasn't stopped consumers from paying the higher prices which Apple commands of its products. To label Blu-ray a "cost issue" is a misnomer, a distraction; in reality, it's about strategic positioning.

Explaining Apple's Blu-ray Predicament

About a year ago I received a copy of an "insider's" document outlining how the various PC vendors were aligning in the high-definition DVD format war. Apple, it seemed, had tossed its support behind Blu-ray and, so I was informed, would have Blu-ray-enabled Macs (both desktop and notebook) on the market by mid-2008, holiday season 2009 at the latest. As is often the case, those within Apple were revealed as less proficient at predicting Apple's future than those of us on the outside!

A lot has changed since that time, for sure. Despite the fact that Blu-ray won the format war, and despite the spin of fanboys and evangelists, Blu-ray player sales have been modest and both retailers and vendors face a tough balancing act during the holiday season. Blu-ray

¹ "Jobs on Blu-ray: A Bag of Hurt," *Gizmodo.com*, October 14, 2008 (<http://gizmodo.com/5063267/jobs-on-blu+ray-a-bag-of-hurt>).

was supposed to generate higher retail prices and improved margins, well above that of traditional DVD players. However, this hope has been dashed by a combination of factors including (a) tough pricing battles with HD-DVD during the 2007 season that led to \$200-\$300 retail pricing levels years before Blu-ray supporters had hoped, and (b) consumer demand being pinched by mounting economic woes. According to TDG's latest research (fielded in mid-October 2008, just two weeks ago), only 9% of adult broadband users "definitely would buy" a new Blu-ray player even if the price was \$200. Competition among Blu-ray retailers and manufacturing will be cutthroat and the winners are likely to be discount retailers such as Wal-Mart and Target selling the \$200-\$300 models, not high-end audio shops selling the \$700-\$900 Blu-ray models. That's not the kind of demand Blu-ray was hoping to see this holiday season.

Apple Rethinking Blu-ray

To date, Blu-ray has failed to impress Apple and Mr. Jobs. Insufficient consumer demand, high levels of satisfaction among traditional DVD users, and mounting pricing pressures will likely keep most consumers away from PCs with extravagant feature sets (at least for this holiday season). But there may be more to Mr. Jobs' comments than meet the eye.

One is reminded of Microsoft's struggle regarding whether or not to embed HD-DVD players into the Xbox 360, a move which would have resulted in disadvantageous pricing at an unfortunate time in the console battles. Despite the fact that Microsoft had a significant stake in the success of HD-DVD, it chose instead to focus its future on digital downloads – of games, music, and movies – to not just the PC but to the game console and living room home entertainment center. Simply stated, Microsoft has announced its intention to "skip" high-definition physical discs and proceed directly to digital downloads (enabled by a Microsoft ecosystem, of course).

Is Apple heading in the same direction? There is significant reason to believe so: (a) it has the leading digital media download property in iTunes; (b) it has a decent living-room platform in Apple TV; and (c) it's eager to stake a claim in the home living room. No doubt, then, that Apple has sown the seeds of a digital download strategy.

Then again, Apple TV has to date been an abject failure, thus delaying Apple's living room strategy. Internet-based digital video downloads to the TV, as Microsoft knows too well, are still five to ten years away from establishing a mainstream presence capable of competing with PayTV operators and maturing on-demand offerings. Not that this matters to Microsoft – it is content to wait, knowing that when this vision finally does come to fruition, it will own a huge part of the value chain. For Microsoft, then, Blu-ray is a relatively unimportant consideration; it can be left to the PC OEMs and CE vendors to determine its fate. The Company's larger vision is squarely focused on digital downloads.

Could Blu-ray be a Catalyst for AppleTV and Apple's Long-Term Living Room Strategy?

So then does Apple see Blu-ray in the same light as Microsoft? Not necessarily. First, unlike Microsoft, Apple is PC vendor – it has to keep up with the latest and greatest PC technology or risk losing market share to competitors who do, meaning Blu-ray has to be a short-term consideration. Second, and more importantly, Blu-ray could have a much greater positive

impact on Apple's living room strategy than anything Microsoft might have up its sleeve. In fact, Blu-ray could be the very catalyst to help grow demand for AppleTV; the perfect 1-2 punch for AppleTV, giving it short-term appeal as a high-def DVD player as well as long-term viability as a next-generation digital media player to deliver Internet TV, movies, and music directly to your home entertainment center. It could offer the best of both worlds! But, as Steve Jobs noted, at what cost?

As with virtually all Over-the-Top digital video boxes, demand has been hindered by high retail prices (especially when judged against an uncertain and relatively novel value proposition). U.S. consumers are accustomed to getting their TV set-top boxes for free (or nearly so), meaning they are by nature less energetic about forking over several hundred dollars for something that does what their existing STB already does – deliver video programming. Then again, if AppleTV was also a Blu-ray player, the platform would serve as a Trojan Horse for next-generation Internet video delivery to the TV, just as Blu-ray players are doing by adding Internet-based video streaming services such as Netflix; just as Sony's PS3 will access The Playstation Network and Home (pending); and just as Microsoft's Xbox 360 taps into Xbox LIVE.

Apple should rethink its Blu-ray strategy, and soon. It's time to reposition AppleTV as a Blu-ray player that also enables media downloads and streams, instead of a next-generation Internet and PC media platform.

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