Public Consultation launched by the European Commission on the Italian digital cinema tax credits

Answers to the questions raised by the Commission

Cost of installation of a digital projection equipment - Affordability

The amount of 100,000 euro can be considered a fair estimate for the installation cost of a digital projection equipment meeting the requirements of the so called “de facto standard” that the international cinema exhibitors’ community has generally adopted, especially since 2005 when the DCI specs were published.
Obviously this should be considered as an average cost, keeping in mind that first of all installation cost means much more that the purchase of the projector itself and that there are variations linked f.i. to the size of the screen and the extent of the works that are necessary to adapt the projection booth to host the new projector (ventilation is f.i. a major issue as overheating can disrupt the projector functioning).

For comparison of the average cost of 100,000 euro, you may want to see the scheme put in place for the full digitalization of the Norwegian cinema that foresees a global investment prudentially evaluated at the level of 50 million euro for a total of about 420 screens.

Even if it is true that there might be commercial business models too, the Italian state aid can be considered as a component of a more complex financial scheme and/or as an encouragement measure to mobilize additional resources either from private or public sources. See answer no. 2

Commercial business models

The international cinema business usually refers to the VPF (Virtual Print Fee) model adopted in the USA in order to transfer part of the foreseen savings deriving from digital projection from the distributors to the exhibitors in order to partially compensate their investments for the purchase of the new equipment.

In Europe the automatic or almost automatic adoption of the same model has proven to be impossible, as the market conditions are quite different from those of the USA. First of all, the majors control in the US a market share that is nearing 100% whilst in Europe their share is in average about 70%. It doesn't seem realistic that they might be ready to co-finance the European transition to digital to the same extent as in the US. On the other hand the distribution sector in Europe has a very high degree of fragmentation, characterized by the presence of thousands of companies, some of them of very small size and financial capacity. Setting up a business model viable for Europe may require still some time and specific adjustments in every market.
Certainly commercial business models will be more easily accessible for the more profitable cinemas. Bearing in mind that the average market share of the majors mentioned above, it seems unrealistic to imagine that the US industry may contribute to that extent especially in those countries where the share of the domestic movies is , as in Italy, quite significant compared to the average.
As the audience, not easily perceiving the added value of digital projection (f.i. the constant quality of the image), is not ready to pay a more expensive ticket for it, even the more profitable cinemas have to find other sources to recoup their investment, such as 3D projection which, however, implies an additional cost.

Advantage for the tax payer

The conditions set by the Italian aid implies, at least in some cases, the programming of a certain percentage of quality films: this should result in a wider choice and therefore in a benefit for the audience.
The transition to digital made possible to small size cinemas may prevent them from closing down especially when distributors won't be releasing any more 35mm prints (the double channel distribution is generally considered a financial disadvantage to be avoided as much as possible). To maintain cinemas in small towns or rural areas is certainly a long term advantage for the tax payer.
Another collateral but not negligible advantage for the taxpayer, which is not often mentioned, is the reduction of waste deriving from the replacement of film with hard disks and, what is definitely to be encouraged, by satellite or cable distribution.
Destruction of the 35mm prints is today a costly process with a severe impact on the environment.

The destiny of small cinemas

Closing down because of a digital transition implying a process of exclusion instead of inclusion is a real risk for less commercially profitable cinemas (see answer here above). It is difficult to foresee a timeframe: available forecast made a couple of years ago on the spreading of digital projection worldwide indicated 2014 as the year when more than 50% of the commercial screens will be digitized. Updated forecast based on the present situations have been announced: they will certainly be useful to indicate more precisely when the critical threshold of +50% of digital screens will be reached. In fact from then on distribution of 35mm prints will be likely to drop.

One-off State aid

The concern on the fact that the proposed aid may be insufficient seems motivated. On the other hand even if limited this scheme could help digital screens in Italy to reach the critical mass necessary to motivate distributors to make available more film digitally.

Standards

See above the answer mentioning the “de facto standard”. At the moment the definition of standards for digital cinema is in progress. Among the cinema exhibitors’ community the fact that the digital projector should be as versatile as the analog one is a must: they want to be able to show all films (and alternative contents) available on the market by using the same equipment.
In addition to this, cinema exhibition in Europe cannot be commercially viable without US movies (see above the figures on market shares). This implies that exhibitors believe that they cannot avoid DCI specs if they want to show American movies. Therefore their choices for a certain type of technology/standards are not likely to be affected by State aid. Anyway DCI compliant equipment can easily screen other formats such as HD (but not vice versa).

Open digital format

See previous answer. Interoperability of equipment should be the requirement here.

Equipment price

This concern could apply perhaps more to servers than to projectors. DCI compliant projectors have today costs comparable to those that are not DCI compliant but offer high performances (f.i. full HD).

Least profitable cinemas

To reduce the risk for the least profitable cinemas to close down it is essential that tax credits may be used not only in connection with tax on income but with regard to all types of taxes and social charges. In addition to this it should be made clear that this aid is compatible with other types of supports (such as those deriving from local authorities).

Final remarks

A cheaper and more flexible distribution system – as the one that digitalization can provide from a technical point of view – should in principle benefit those movies that have been suffering from the traditional system, more costly, more rigid, less able to react to audience demand and therefore less favourable to movies targeted to niche markets, such as in many cases European films.

The first phase of digitalization in Europe has shown that in many cases the cinemas that were the digitalization pioneers, the so called “eager beavers”, invested in the new technology with the aim of getting a more varied offer, thus catering for the needs of diversified audiences. European distributors seem not to have followed the same path, thus reducing the impact of the new technology on the improvement of the quality of the cinematographic offer to the audience.