Principles by IUCG:

Forecasting Film Industry Disruptions

INDUSTRY OVERVIEW

What is the Film Industry?

The Film Industry is comprised of the institutions involved in producing and distributing film, as well as movie theaters, subscription services, and cable television networks.[1]

Market Size

Domestic revenues are expected to grow in the upcoming years, but at a decreasing rate. As the number of theater goers decreases, traditional revenue streams are in jeopardy. Developing markets abroad are able to draw upon volume increases across all revenue streams, however, in the more mature US market, raising prices on services is becoming an increasingly common practice to ensure growth.

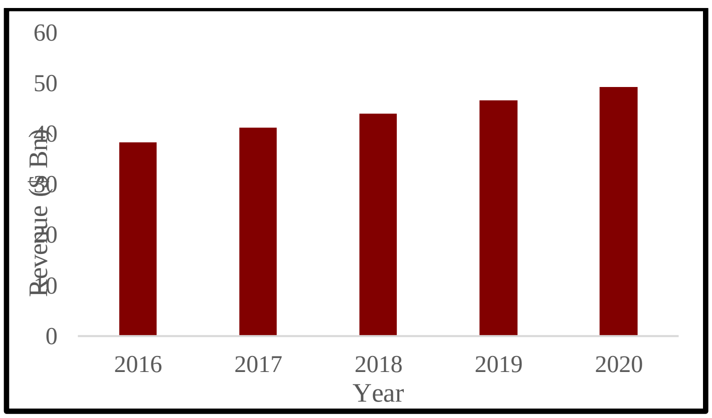


Figure 1. Past and Projected Film Industry Revenues[2]

Tiers Involved

Production Studios

Content is created in owned or rented studios and on location around the world. Studios are responsible for casting, editing, set production and much more.

Distributors

Responsible for marketing of content, setting release windows, and the production and distribution of physical media (DVD, Blue-Ray).

Theaters, Streaming Services, etc.

Theaters show a film for the first several months of its release. Streaming services then bring content to consumers' devices via the internet. Both operate under licensing.

PRODUCTION

The Big 6

Key players in the American production market include Warner Bros Pictures (19.6%), The Walt Disney Company (17.7% Market Share), NBCUniversal Inc. (16% Market Share), 21st Century Fox (12.6% Market Share), Paramount (4.9%), and Sony Pictures (9%). The combined earnings of these 6 companies accounted for 82.6% of all earnings in 2016 in North America. These companies create many of the popular franchises such as *Marvel*, *Star Wars*, *Harry Potter* which are have been box office hits and created a cult following of fans. [3]

It is important to note that the composition of the Big 6 is to change shortly, with the recent announcement that Disney will buy 21st Century Fox for $52.4 billion. This consolidation is representative of what will likely occur in coming years throughout the industry. Disney gains production capabilities, content variety for its streaming platforms, controlling shares of Hulu and cost-saving advantages, all value-adding measures that will cement future success for the company. [4]

Market Share

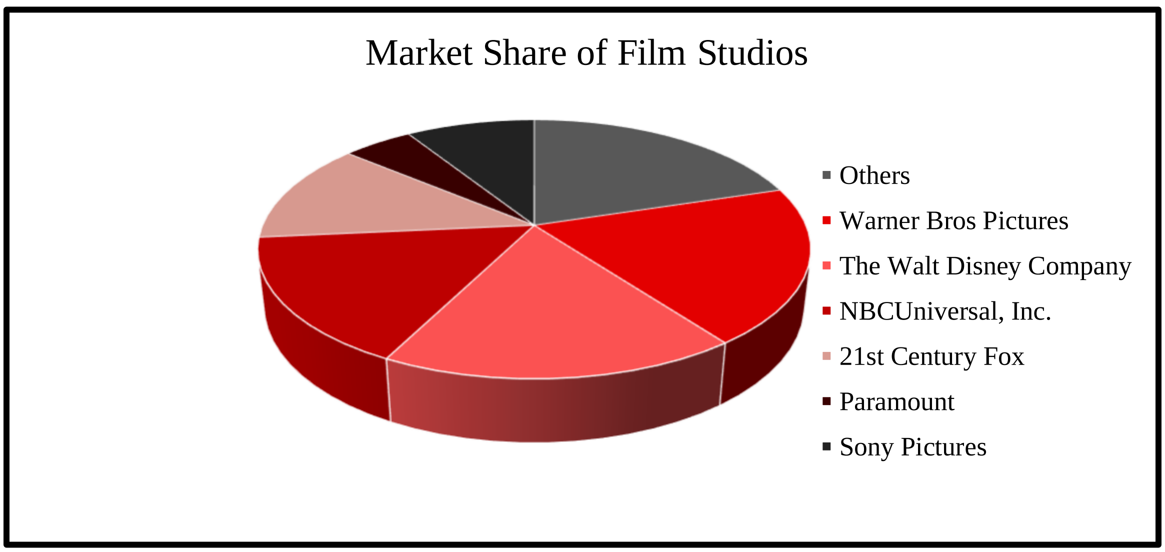


Figure 2. Combined Market Share of Big Six [5]

Production Costs

Much of a film's costs are purchase costs, which are everything involved in the production of a film. Profits are 10% of the total revenue and are split between the production studios and distributors. To maximize these marginal profits, production studios spend an equivalent of 50% of their total costs on print and advertising marketing, which significantly impacts how a film is received at the box office.

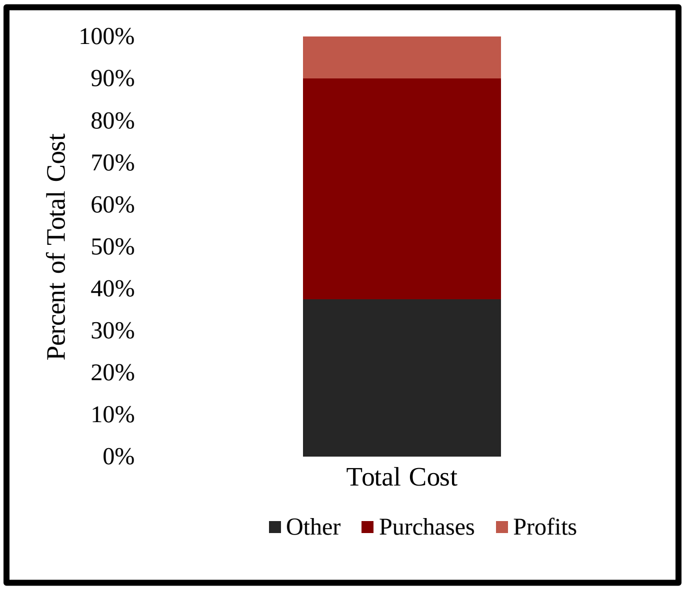


Figure 3. Allocation of Total Cost [6]

Changes in Production Strategies

Creating a film has become very simple because production equipment has become affordable and knowledge about production techniques is abundant. People can now create successful films with iPhones and internet tutorials which has given rise to the trend in microbudget films which are produced with budgets well under $10 million and do not have the ability to be marketed commercially. These films are garnering the attention of streaming services which can provide a platform to showcase the films to a largescale audience unlike the typical limited theatre release available to films of this caliber.

Because streaming services can provide a large variety of films conveniently, many viewers are waiting to watch the film on the available service rather than visit theatres. To combat the decreasing population of cinema goers, large scale productions by the Big 6 are focusing on franchise films such as Avengers which are more likely to become box office hits and bring in revenues via merchandising on top of their primary source of revenue, ticket sales. While this practice is proving to be profitable, large production studios run the risk of alienating moviegoers seeking to pay for and watch more original content, forcing them to rely more heavily on streamed viewing. As such, it is not in the studios' best interest to only rely on this new approach, if they wish to capitalize on the 40,000-domestic theater screen capacity. Thus, a straddling approach of releasing large, franchised films and low budget, original content is a competitive strength.

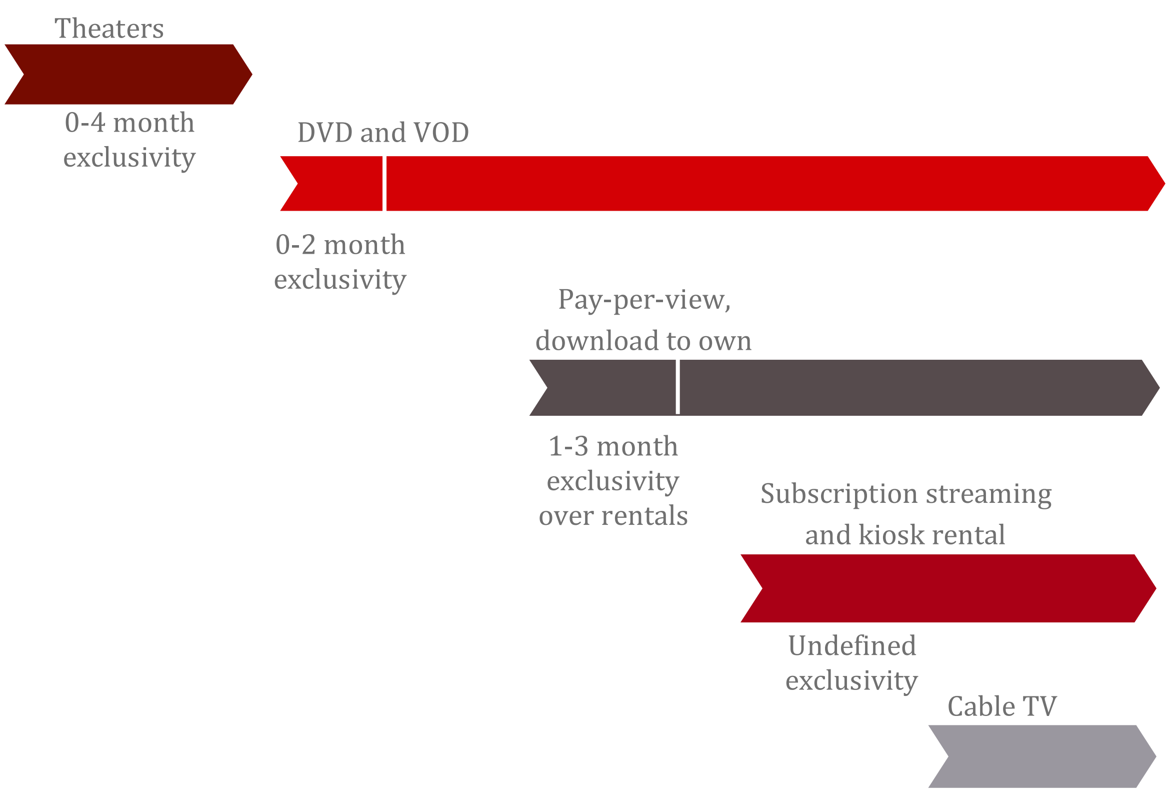
DISTRIBUTION

Release Windows:

Release windowing, or the exclusive licensing of content to specific viewing mediums at pre-determined intervals, exists to maximize the revenue earning potential across each channel by staggering their exclusivity. Traditionally, theaters have the first exclusive rights to show a film for about 120 days before films can be purchased on video-on-demand or DVD's, the first two months of which are exclusive. Eventually, availability trickles down to the final streaming and cable distribution channels. The whole process can take up to two years. [7]

With the proliferation of microbudget films and new distribution methods, this traditional windowing process must change. Large production studios and distributors will need to leverage their partnerships, offering content to consumers through multiple mediums at once, but maintaining staggered cost structuring. This compromise will allow producers and distributors to maintain the usefulness of their respective revenue streams, while catering to consumer demands, that if not met, would likely lead to increases in piracy.

Traditional Release Windowing:



STREAMING SERVICES

Competitive Viewing Platforms

Streaming services provide viewers with convenience, cost-savings, and variety. People do not have to schedule a time to visit the movies and have access to almost 8000 film titles. Additionally, Netflix subscribers can save almost $170 yearly with by using their service instead of visiting the theatres. As a result, Netflix has become an ever-increasing part of the film distribution system, cornering much of the streaming market. [8]

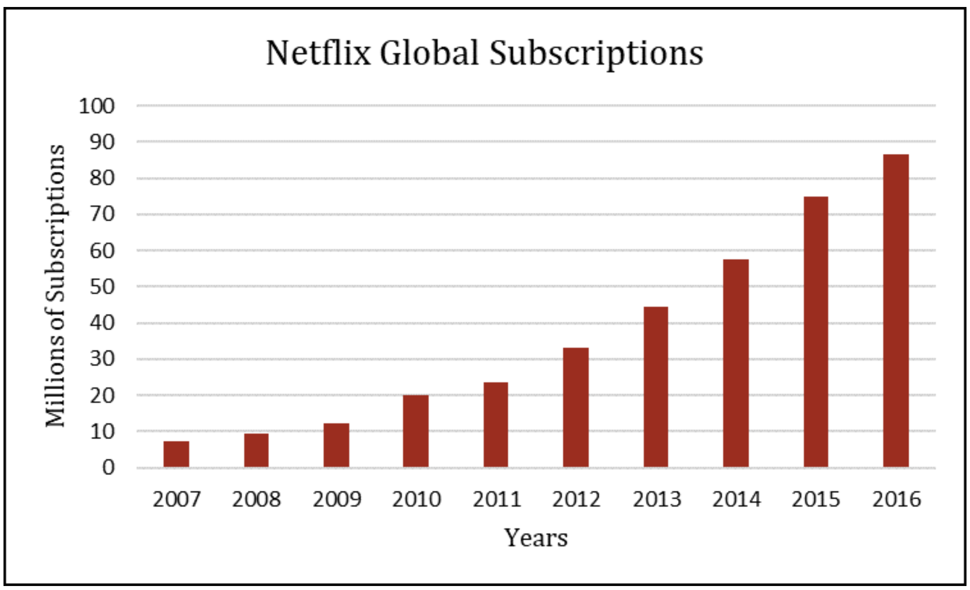


Figure 4. Netflix Global Subscriptions [9]

Netflix has created trust with their audiences to provide all the latest films in addition obscure titles. Their platform and strategies have established themselves as leaders in streaming. In this way, they have captured an ever-growing base of viewers and are replacing the traditional film viewing platform with something that is better suited to the lifestyles of this generation.

Competitive Film Production

Using its advantage as the industry leader in streaming services, Netflix has begun working on original content called Netflix Originals. Recently, it has spent $6 billion per year on buying content for their service but are focusing on establishing themselves as content creators as the company's focus shifts to exclusive content. This is an intelligent progression for Netflix because many large studios, like Disney are removing their titles from the streaming service. [10, 11]

Netflix has been very successful with original television shows and their current progress looks promising as well. They have an estimated 90 films set to release in 2018, which would impact the film industry even more given that Netflix can bypass release windows.

In light of these market trends, large production companies must compete effectively to establish a significant presence in the streaming domain. It is thus in their best interest to consolidate resources along the supply chain, potentially continuing the trend of significant mergers, such that varied content, distributed at a competitive cost, will entice consumers to use their services in addition to or instead of current market leaders such as Netflix.

OUTLOOK

Technology has been the single greatest disruptive force in the long-mature movie industry. As viewer habits change due to new distribution methods, traditional industry leaders will have to respond efficiently in mitigating costs and addressing new entrants to the market. With the rise of companies such as Netflix, production companies will have to capitalize on the success of their big budget movies to compete with the rise of high-volume, niche film production. Additionally, investing in both market segments could further solidify their competitiveness. While their large films will help maintain high theater visitation, their use will have to be combined with an emphasis on high quality in-theater experience and an aversion to large price increases. This will require cost-staggering across other release mediums. That is to say, that there will have to be a compromise between the exclusivity inherent in current release windowing and the ability for streaming services to provide content that bypasses other viewing mediums.

To reemphasize, movie theaters, as a viewing option, are certainly here to stay. However, their health comes down to cost and value. With the rise companies such as MoviePass, which allows subscribers to pay a monthly fee of $9.95 to watch any movie that the company has ticket access to (most popular movies), both the market willingness to regularly visit theaters and the demand for lower prices have been made clear. Given this potential, and the above-mentioned need for release window compromises, theater bundles with streaming services may become advantageous. Theaters and subscription-based streaming services, likely to be the two main ways of viewing film, can thus partner, maximizing the experience delivered by theaters and the convenience offered by streaming. For example, a Netflix subscriber soon may only have to pay a several-dollar fee to watch a movie in theaters that might come to Netflix a few months after, if companies form reciprocal agreements. Whether or not this exact scenario is manifested or not, the strength of this theme remains; the rigidity of past release-windowing will give way to more fluid release scheduling and new cost structures to accommodate this change.[12]

What will also make bundling and other such practices more likely is further consolidation in the industry as leaders in production, distribution, and streaming shore up their competitive advantages. The potential AT&T merger with Time Warner and Disney's similar acquisition of Fox's entertainment business show that in this increasingly competitive market, only the most effective firms will remain. As they aggregate existing content, production capabilities, distribution means, advertising muscle, and much more, these super-competitors will be in close contention to give consumers the ultimate entertainment experiences. Disney has already shown that it will be one such giant, since it will soon own roughly 30% of the domestic production market, have control of a competitive streaming service (Hulu), and will branch out into the international market with its shares in Sky TV. Consolidation will thus allow these super-competing firms to become better integrated and give consumers the kinds of competitive pricing and content variety they want. [4]

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