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Internet TV and the Global Flow of Filmed Entertainment

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IT'S BEEN NOW ABOUT NINETY YEARS that American films and video media have predominated globally, and despite many efforts, despite many government-supplied francs, marks, and now euros, despite various restrictive rules and regulations going all the way back to the 1920s, not all that much has changed. Yes, there is always some hopeful news every year—some film or reality TV series that has been successful, some production company that lights the imagination—but somehow this hopeful news has not diminished the basic dominance of Hollywood.

In 1998, of the forty most successful movies worldwide in terms of box office, Hollywood films constituted the top thirty-nine. Britain's *The Full Monty* was number 40. In 2004, of the fifty highest-grossing films worldwide, forty-seven were American. In 2009, of the fifty highest-grossing films worldwide, forty-nine were American.[1]

This is not a supply issue. Whereas the United States produced 520 theatrical films in 2008, the European Union produced 1,145 films, while Japan and China produced 418 and 400 films, respectively, that year.[2]

Yet in 2008, European films had a 28 percent share in the European Union, whereas U.S. movies had a share of 63 percent.[3] Even in France, the world's first movie nation, audience share for domestic productions dropped below one-third of total theater audiences.[4] The share of British movies in their domestic market was 31 percent[5] in 2008, and German films had 27 percent[6] of their domestic market.

At the same time, the global audience for European films has declined. In the 1960s and '70s, there were decent-sized audiences for quality European films. Truffaut, Godard, Fellini, Antonioni, Bergman, Fassbinder, Pasolini, Wertmüller, Richardson, and Tanner were icons. But the audience for such films has been steadily graying. In 2002, French films' total box office in the United States was an anemic $36 million for the films of a country that makes about 200 films a year. In 2008, French films' total ticket sales on the North American market including francophone Quebec were 14.2 million,[7] which translates to approximately $30 million in the U.S. market.

The worldwide dominance of Hollywood has been especially hard for Europeans to take. For several centuries, culture had been flowing largely in one direction: out of Europe, and into the rest of the world. Then, before World War I, the flow reversed direction for the young and populist medium film. Around the world, audiences flocked to American movies. European cultural elites promoted government protectionism. Already in the 1920s, Germany's near-monopoly producer Ufa advocated the protection of "European films" and established European cartel collaboration together with the French film trade association, in a rare alliance across the Rhine. Various restrictive contractual arrangements were agreed upon with other countries, supplemented by import quotas enacted by governments.

Today, various forms of film protectionism abound. In Canada, the government subsidizes film production directly, and 60 percent of the TV schedule must consist of Canadian content, an indirect regulate subsidy. In Australia, government money makes up around 37 percent of overall investment, plus the lost tax revenues from a 100 percent tax deduction for film investments.

In Europe, Brussels provided in 2002 subsidies of $850 million for films that generated box office revenues of around $400 million. More recently, the EU media program was budgeted at €755 million over seven years.[8] In 2008, according to the European Commission, the twenty-seven member states spent about €1.6 billion in direct support of films each year.[9] Some

European countries provide subsidies for more than 50 percent of a film's budget.[10] And on top of that, there are generous tax shelters for rich investors to entice film production. In addition, there is substantial support for production through public service TV, whose budgets derive from a substantial quasi-tax. In Germany this compulsory levy amounts to about €18 per month per TV household.[11] Germany's public ARD network service TV in 2008 invested €190 million in the production of theatrical films.[12] Furthermore, there are ceilings on TV's showing of non-European (e.g., U.S.) productions.

But even with all of these generous direct and indirect subsidies, non-Hollywood films are rarely an international success. Domestic films are watched in Europe by about 20–30 percent of audiences. But those audiences rarely watch the films of neighboring countries. European films, outside their national market, got only 8 percent of audiences in other European countries in 2006, and 7 percent in 2007. They got a worldwide audience share of less than 5 percent.[13]

Why has Hollywood's dominance occurred? And what are the implications for the next generation of film distribution, over the Internet? Many cultural observers, whether abroad or in American academe, rail about "American cultural imperialism" as a substitute for an analysis, or they invoke, tautologically, the symptoms as cause, such as dominance over "distribution channels" or over "intellectual property rights." "Cultural imperialism" is a term vague enough to project onto a lot of inkblots, from those of the left to those of the right, but historically Hollywood was dominant already before World War I, before America's ascendance to a superpower status.

Hollywood's success is remarkable insofar as it is, by far, the high-cost producer. It has also been astonishingly lacking in foresight and vision. At almost every juncture, Hollywood misjudged the future and fumbled its own actions. It fought television, then pay-cable, and then home video. In each case, the technology it unsuccessfully tried to suppress soon turned out to be hugely profitable to itself. But despite high cost and low vision, Hollywood rides high in the saddle.

Vilification does not provide the kind of understanding that is the precondition for successful remedial action. If ninety years of well-financed, politically well-supported, and benignly reported efforts have failed to dislodge Hollywood, maybe something is wrong with the underlying analysis of the problem.

To analyze this, we start with the most frequent explanations, which turn out to be impressive. From there, we will proceed to stronger explanations.

Market Size

For a time, Europeans attributed the problem of Hollywood's strength to the destructions of war. But those wars happened a long time ago. Another explanation was the large size of the American market. But actually, more films per capita are made in the United States than in many countries, which mean that they divide up the domestic audiences into narrower slices.

The domestic population per feature film produced in 2008 in the United States is 593,000, whereas it is 435,000 in Europe, a modest difference that cannot explain the disproportionate dominance of American films. And, in any event, in a global economy, the size of the home market is not the determinative factor. Otherwise, Swiss watches or Belgian chocolates, hailing from small markets, would never make it internationally. One could even argue that the more a film can support itself in a big domestic market, the less it must try to enter foreign markets in order to survive. India's film industry is an example.

A related explanation is that of English as the global lingua franca. True, but most people watch films dubbed or subtitled, and it's not more expensive to do that from Italian into Spanish than from English into Spanish.

Dumping

Another frequent explanation is that because American films are already produced and paid for by American audiences and then dumped cheaply onto the world market, displacing domestic films would require expensive production. This argument confuses sunk cost with new-project costs. By this logic, nobody would ever buy a car because taking a taxi is always cheaper. For this dumping argument to hold water, one must also assume that Hollywood does not factor foreign markets into its production decisions, while at the same time foreign producers do not export to other countries and must subsist on domestic revenues alone.

Distribution

Another frequent explanation is that Hollywood distribution companies are vertically integrated and favor their own content and suppress that of others. Such advantages of joining distribution with content production are also stressed by empire-building American CEOs and by investment bankers in search of deals, and these are commonly called "synergies." One must observe that film-oriented firms which engrossed themselves by M&As (mergers and acquisitions) have been splitting or tottering: Viacom, Vivendi, Kirch, Time-Warner, Disney, and GE/NBC-Universal. All had well-publicized dysfunctionalities and were barely able to contain their centrifugalism. In economic terms, for vertically integrated firms, discrimination in favor of one's own product is sensible only as long as that product is not inferior. It rarely makes sense for a distribution organization to push its own inferior films into theaters and to reject other producers' potential blockbusters. Ultimately, the market power of Hollywood distributors depends on their access to attractive films, not vice versa.

Popular Culture

In many countries, films are controlled by directors and their artistic vision. Popularity with audiences is not a goal in itself and can even be a source of unease about "selling out." Celebrated French film *auteur* Jean-Luc Godard expressed his attitude: "Who is the enemy? The audience!" In contrast, in America films are controlled by commercially minded producers and distributors. This dichotomy is of long standing. Already in the early nineteenth century, Alexis de Tocqueville, commenting on American culture, observed:

> In aristocracies a few great pictures are produced; in democratic countries a vast number of insignificant ones. In the former, statues are raised in bronze; in the latter, they are modeled in plaster.[14]

This distinction between popular culture and high culture has been commented upon frequently by less sympathetic observers than de Tocqueville. It became a comforting notion that it was the uncompromising integrity of European filmmakers which limited their popularity, in contrast to Hollywood's pandering. But actually, most European (and Japanese, Korean, Indian, Mexican, Brazilian, Egyptian, and Chinese) films are not artsy at all. Those films outside the public TV axis are mostly commercially oriented and have adopted Hollywood's style elements. They are typically produced by big and established domestic media firms, often centered on commercial TV operations. In Italy, Berlusconi; in Germany, Bertelsmann. In France, Vivendi. In Brazil, Globo; in Mexico, Televisa. In Japan, Shoshiko and Toho. All try to be popular in their home markets. Most of their films never reach American audiences, and usually deservedly so.

Conversely, statistical studies have shown that Hollywood producers seem to accept somewhat lower profit margins in order to be associated with "edgy" projects that enhance their prestige.[15] They want not just the money success but also the prestige success. And on top of that, American independent film production is alive and vibrant. For the 2008 Sundance Film Festival, the mecca of American indies, there were 3,624 feature-length submissions, 10 percent more than the year before.[16] This is the pool of Hollywood's next generation of talent. Thus, the self-image of culture versus commerce might be comforting, but it is not really an explanation.

If so, what is? To me, the main success factor for content production is the efficiency of Hollywood.

Productivity

This seems counterintuitive. Hollywood movies are vastly more expensive than European or Indian ones. To produce a film in Hollywood costs about ten times as much as in Europe, and fifty times as much as in India. The budget for two minutes of a Hollywood film pays for an entire feature film in India.

TABLE 3.1. *Film Productivity*

	Investment/ Film	# of Films	Worldwide Tickets/ Film (mil)	Worldwide Tickets/$ Invest	Overall Rev/ Investment
US	70	543	5.5	0.61	1.27
Europe	7.5	752	0.6	0.08	(.08)
India	1.5	843	3.5	2.3	1.19

But Hollywood is more productive. That may be a bit surprising given its high costs. But it all depends on how one defines the product. Table 3.1, prepared by the author with 2006 figures, compares costs and revenues, and shows this in its first column. A Hollywood film costs on average $70 million to produce, versus $7.5 million per film in Europe and $1.5 million in India. But if one defines the product as “tickets sold,” then Hollywood is almost eight times more productive than European producers. ($0.61 versus 0.08 tickets per dollar investment). India’s Bollywood, on the other hand, generates four times more tickets per dollar than Hollywood. But even that gap vanishes when one looks at overall revenues generated. Now, given the disparity in ticket prices, Hollywood has a slight advantage over India (1.27 versus 1.19), whereas European films have, on average, a *negative* return.

Lower Risk

Most other production centers have a weak financing structure to generate investment for movies. In contrast, Hollywood has established numerous ways of raising funds. Efficiency is gained by superior risk reduction strategy: portfolio diversification. Film projects are enormously risky. Eighty percent of films, it is said, lose money. Hollywood has managed to create a portfolio of investments, each with certain riskiness, that achieve a lower risk than any individual part of the portfolio. A studio pools many risky projects, making its aggregate cash flow reasonably safe for the lenders. And this in turn facilitates investments in film projects. In contrast, missing in Europe and other production centers are strong financing structures to invest significant capital into movies. In India, a good part of film financing, for a long time, was through organized crime cartels that liked its glamour and money-laundering potential. European films rely on the public TV system and on direct governmental support. This tends to require a greater emphasis on national culture and hence often reduces global appeal.

Industry Structure

Perhaps the most powerful advantage of Hollywood is the structure of its industry. Most people think of Hollywood as six major studios and two or three mini-majors. And that was the way it was up until the 1950s, when studios were vertically integrated mass producers. But when TV emerged, it forced Hollywood to "re-engineer" itself earlier than other industries. One strategy was to create high-end products in terms of production budgets. But, just as important, the major film studios radically lowered overhead costs by shifting to a project-based structure. Most of the actual production is done not by the handful of studio companies but by hundreds of small independent production companies, which in turn use thousands of specialized firms, with tens of thousands of specialized freelancers. The six major studios provide back-office support for production teams, coordinate advertising, and provide financing and distribution.

More than two-thirds of the Los Angeles–based film industry's workers are freelancers or work for tiny companies. Collectively, they create an industry structure of project-based ad hoc organizations with low fixed costs. The result is an industry characterized by two factors:

- oligopolistic distribution
- competitive creation

The remarkable thing about this structure is that it did not emerge by design or strategy. Rather, it was a case of organizational Darwinism. The relentlessly competitive and risky nature of each film project led to the emergence of such a structure.

The significance of such a model of the project-oriented, almost "virtual" production firm is that it is perhaps the forerunner for many business firms and industries in general. It is an organizational model that integrates creativity with business in a way that functions better than anyone else's model. It is decentralized, networked, virtual, freelance, global, and disaggregated (not integrated), and it draws on diverse creativity. It combines the creativity of small organizations with the economies of scale of large ones.

We can see similar developments reaching consumer electronics, IT, and automotive industries. Specialist firms do the design. Others produce the components. Still others assemble. Still others do the marketing. The major firms then are mainly becoming integrators of the specialist firms and the branders of the final products. This might be, for many industries, the business model of the future.

It would not be the first time that media have led the way for a general business transformation. The printing press pioneered the industrial mass-production system. Today, the film industry model, created in the Darwinian process described, is a forerunner for the next stage, the postindustrial production system and economy.

And now, a new medium is knocking—film over the Internet—and the question is how it will affect this system. Will it be a multicultural richness of many national sources, or will it be just more of the same old Hollywood?

The knee-jerk response to this question is to invoke the usual platitudes. Anybody can enter. You can't tell who's a dog on the Internet. The Long Tail. The Internet community, staunchly internationalist and multicultural by outlook and background, does not want to face the very question of whether it contributes to the further ascendancy of American mass culture.

How then does Internet distribution affect this system? Will it enable other production centers to thrive? To answer this question, we need to look at the same economics of content production and distribution, as they relate to the Internet.

True, Internet film content includes a lot of low-budget, experimental, and user-generated production. At the same time, the high-speed Internet enables much more than standard, linear, and cheap video. Internet film will create content that goes far beyond conventional TV and film: specialized, archived, interactive, asynchronous, immersive, 3-D, multimedia, and globally delivered. Such content requires many additional technical features beyond just video. After some initial low-budget amateur period, providers of Internet film will have to offer content of high technical and design features.

To produce such interactive content is expensive. It requires creativity, lots of programmers, significant testing, and many new versions. It might be a bit like "Dungeons and Dragons" meets "Baywatch" meets "Survivor" meets Harry Potter. Such content exhibits strong economies of scale on the content production side, and network externalities on the demand side. Both favor content providers that can come up with big budgets, can diversify risk, distribute also over multiple other platforms, create product tie-ins, and establish global user communities.

Even for nonpremium programs—such as creative small productions, or sex shows and games—where the absolute production costs are lower, the economic advantages of a large user base still apply.

At the same time, the distribution costs for films over the Internet are high, because the individualization of transmission requires significantly larger transmission resources. Individualization requires transmission capacity that is at least forty times higher than that of a cable channel. It is a common mistake to argue that as transmission is becoming cheaper, it will overcome such a gap. But technological progress leads transmission cost to drop just as much for cable TV distribution as it does for Internet distribution. The relative cost of shared (synchronous) transmission is still much lower than that of nonshared, asynchronous transmission. What the drop in cost means, however, is that the impact of distance becomes much lower. National TV and film lose the protection of distance, and satellite and cable TV lose the protection of limited spectrum on licensing.

Thus, both content and distribution costs for Internet film are high, but distance-insensitive. Therefore, commercial Internet video can function economically best as a premium medium or a specialized medium, delivered globally.

These characteristics favor American companies when Internet distribution emerges as a mass medium. The United States has a large base of an Internet community; significant hardware and software entrepreneurial energy barely contained by the recent downturn; a financial system that provides risk capital; big content-producing companies with worldwide distribution and with experience in reaching popular audiences; talent in content creativity and technology from all over the world; efficient geographic clusters in production and technology; the cultural prowess of the world's superpower; language; a diverse culture; and a university system that generates technology and entrepreneurship. Thus, the medium of Internet film distribution combines the strengths of U.S. firms in entertainment content, in Internet, and in e-transactions. Add to that economies of scale, and scope, and nothing on the horizon can match it.

The broadband Internet means that programs can be distributed globally, at relatively low cost. People in Peru, Panama, and Portugal can select, click, and download. The protection of distance is thus giving way. And the content itself exhibits strong economies of scale. This means that the content of Hollywood, adapted for interactivity, can be all over the world.

Many of these specific factors are also available elsewhere, but probably nowhere quite in such combination. On the other hand, the United States lacks the supportive mechanism of public TV that exists in Europe and Japan for quality content.

Companies and public service organizations from other countries will also participate either domestically without much global reach or as global players who will provide basically American-style commercial content to the world, like British ITV sitcoms, Dutch Endemol reality shows, and the Italian "spaghetti Westerns" of the past. There will also be opportunities for other producers to create and distribute specialized programs for niche and general audiences. And those needs could be met by providers from other countries. And there will also be a community-based, collaborative production environment of user-generated and wiki-style low-budget content.

But the main audience will still be attached to big-budget, technically sophisticated productions that combine Hollywood glitz, Silicon Valley tech, and New York finance. And that means that Hollywood will be even stronger, because it now has a more direct relation with global audiences. It does not have to go through the intermediaries of TV networks and pass through the regulation of governments. It has the ability to fine-tune prices. And it can deploy in its network of specialists also the talent and creativity from everywhere—animators from Japan; special effects software in India; postproduction in Shanghai; venture finance in London;

advertising companies in New York. Thus, Hollywood will become, even more than before, the entertainment content integrator to the world.

A century of history should teach us some lessons. Artistic creativity is not enough. The only way for other countries' film industries to attract the attention of global audiences is for them to resort to managerial responses rather than to find comfort in cultural criticism and political protectionism.

Notes

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