Industry and Innovation ›
Volume 14, 2007 - Issue 4: Hollywood and Beyond: Globalization Of The Film Industry

RESEARCH PAPER

Finance, Policy and Industrial Dynamics—The Rise of Co-productions in the Film Industry

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Pages 421-443 | Published online: 10 Sep 2007

Cite this article https://doi.org/10.1080/13662710701524072

Abstract

This paper explores the growing phenomenon of international co-productions in the film industry. We argue that the rise of co-productions is part of a wider narrative of financial and institutional innovation shaping industrial organization in the film industry. This narrative centres on film finance as a central risk distribution mechanism, and discusses how changes in film support policy, increased tax competition, the search for finance and an abundance of inflowing capital are increasingly driving industrial dynamics in the film industry.

Keywords:

Co-productions finance film industry risk industrial dynamics

Acknowledgements

The research for this article was undertaken with a small grant from the University of Hertfordshire. The authors would like to thank the editor and the two anonymous referees for the constructive and insightful comments during the review process.

Notes

1. Share of total national film production, in numbers of films produced.

2. It is important to distinguish between a co-production and a mere financial participation, in which the “financial partner” participates in the results of exploiting the audio-visual work, without being a co-owner of its constitutive elements (Enrich, 2005; see also Goettler and Leslie, 2005).

3. This was seen recently when the UK terminated its bilateral co-production treaties with Germany, Italy and Norway in favour of the convention. The convention also allows the involvement of co-producers from non-signatory countries as a fourth co-producer (e.g. the USA), provided that their total contribution does not exceed 30 per cent of the total production cost of the film (UK Film Council, 2007).

4. Producing a film in another country for economic (lower costs) or creative (location) reasons.

5. It has to be noted that the categories may be more fluid than the taxonomy suggests, with projects not being made exclusively for one reason, but usually for a combination of creative and economic factors taken into consideration.

6. Taken together, these funds were involved in the production of more than 670 feature films in 2003 which is about three times the number of films released by the majors in the USA. Although this EUR 1.3 billion spent by all funding bodies in Europe is not a small sum, it only marginally exceeds what a single major like Warner Bros spent on its slate of 19 films in 2004—excluding the costs of marketing (Kagan, 2004).

7. For a more detailed account see Eberts and Ilott (1990), Finney (1996a, b) and Moran (1997).

8. Globerman (1983: 77) has commented on the system that it “stands as a monument to irresponsible policy making and comes as close to being a pure taxpayer ‘rip-off’ as one is ever likely to find”.

9. The Film and Television Action Committee.

10. “Below the line” costs refer to the salaries of the non-starring cast members and the technical crew, as well as equipment, studio, travel and catering costs. In contrast to this “Above the line” costs are the costs for creative talent and producers.

11. In order to further reduce the risk for investors, film funds usually invest into a slate of films and not just in a single picture. In contrast to a simple financial stake, equity investors hold a full stake in a film project and are in turn entitled to participate in the exploration of rights associated with the film.

12. In Germany a failure to include such criteria led to the much reported financial drain of German tax money to fund Hollywood films. According to an independent German analyst, in 2004 four out of every five euros (78 per cent) raised through German media funds was channelled into North American-based productions, with only 10 per cent invested in productions in Germany and about 11 per cent in projects within Europe. The total amount of money German media funds raised from private investors was EUR 1.5 billion in 2004 and EUR 1.76 billion in 2003 (Blaney, 2005).

13. “Double dipping” allowed producers to claim tax relief twice on the same movie—once via a production fund, and later via a sale-and-leaseback deal. For films made under Section 48 relief (budgets under $29 billion) “double dipping” could cover 25–40 per cent of the production costs. For bigger budget movies using Section 42, such as the “Harry Potter” franchise or Phantom of the Opera, the value ranged from 15–25 per cent.

14. The European Private Equity & Venture Capital Association defines private equity as a “transformational, value-added, active investment strategy”. In general, private equity can refer to any type of equity investment in an asset, in which the equity is not freely tradable on a public stock market. Investment is usually leveraged with tax credits, and short-term profit oriented. The rapid growth of private equity ($580 billion in total since 2003 (Dow Jones Equity Analyst, 2006)) and its “secretive” business practices (Wachman, 2007) have resulted in a growing public anxiety against this financial industry, with the German socialist party leader Franz Muenterfering famously

accusing private equity investors of asset-stripping and behaving like “swarms of locusts” (Jenkins, 2005).

15. Rather than relying on a single top-or-flop project, equity funds and studios use a portfolio approach to film financing where risk is spread across a slate of films (White, 2005).

16. In the early 1990s the studios diversified into independent film production through acquiring or building independent distribution companies. These “mini-majors” (e.g. New-Line Cinema, Miramax) significantly increased the scope of their spending in the following decade, to meet a growing demand for high budget independent motion pictures (Perren, 2001; Thompson, 2004). The average negative cost of a mini-major peaked in 2003 at an average of $46.9 million, a 154 per cent increase on production budgets since 1999. Films such as Martin Scorscese's $100 million epics Gangs of New York (2002) or The Aviator (2004) reflect how profoundly the image of independent film was changed in this period (Grove, 2005). This growth in the independent sector is in line with a steady expansion of overall studio production budgets that reached an average of $63.8 million in 2003, compared with $36.4 million in 1995, with marketing costs rising in the same period from $17.7 million to $39 million (MPA, 2006a).

17. Insurance-backed securitization introduced institutional investors and in particular large insurance companies to the film industry. However, the failure of these companies to assess their risk accurately led to a series of bankruptcies and court cases and made insurance-backed film financings “one of the major issues facing the insurance industry” (Freshfields Bruckhaus Deringer, 2002: 4). As Phillips (2004) has noted, the London market lost around £2 billion in film financing, and Crédit Lyonnais, once the largest bank in the world went under state administration after it lost roughly $5 billion in film financing deals.

18. To reach international audiences, these films usually have a distribution deal with a major for the USA, and a combination of independent and major distributors internationally, handled by high profile international sales agents.

19. Selective funding schemes award subsidies directly to projects upon meeting certain funding criteria. More focused on artistic and “culturally valuable” film production, selective funding has also been heavily criticized for being highly susceptible to nepotism.

20. Looking at these figures, it appears that the government might as well fund the entire budget of films such as Harry Potter directly, which would at least entitle them to share the rights and the revenues.

21. Tax credits are usually payable on expenditure. However, as producers need the finance upfront, the tax credit is discounted with a financial intermediary or fund.

22. There has been a tremendous growth in private equity capital since 2003, with private equity funds raising more than $225 billion in 2006 alone, and about $580 billion in total since 2003 (Dow Jones Equity Analyst, 2006). This has happened alongside a similar strong growth in the hedge fund industry that has expanded from $240 billion under management in 1998 to approximately $1.4 trillion in 2006 (Russo, 2007).

The decline and fall of the European film industry: sunk costs, market size, and market structure, 1890–1927[1]

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