

# Re-defining the Independent Film Value Chain

A paper by Peter Bloore

## Introduction:

An industry value chain or system could be summarized as a connected series of activities, that combine to create and deliver a product (or value) to customers. These activities could include research and development, manufacturing, packaging, marketing, and distribution.

Strictly speaking, a value chain represents those activities as carried out within a single company, and a value system represents those activities being carried out by a series of different businesses or freelancers, acting together to create and deliver the product. The value chain and system has already been applied by business academics and consultants in various sectors, including for example the automobile industry and food processing and retail sector (Lynch 2006, pg 203-6). It can also be applied to the film industry.

In the US studio system a film is often developed, produced, distributed and exploited without leaving a single integrated company or consortium: a simple corporate value chain. This is also the case with a small number of international studio-style companies.<sup>1</sup> However the independent feature film production and distribution sector (the prevalent model outside America) is a value system business, in that a feature film is not made and delivered to its final audience by a single company. Instead there is a chain of companies, businesses, and freelancers, all working on different elements of the production and exploitation process, and adding value in different ways along the chain. Furthermore once the film is exploited, the money handed over by the consumer (whether it be in return for a cinema ticket, DVD purchase or online download) is subject to various revenue shares or commissions as it passes back through the chain, which then complicates the revenue flow.

There has recently been a rise of interest in the analytical concepts of the film value chain and value system, as a result of changes in the economies of film financing and distribution which threaten the existing business models (for example technological convergence, the decline of DVD sales and the projected rise of digital downloads). A key part of competitive business strategy involves aligning an organisation with its strategic environment (Porter 1985), so it is therefore vital for those running businesses in the film industry to fully understand the value chain they are working in. This context makes this paper both timely and relevant.

Despite the recent use of the “film value chain” as a concept by writers, consultants and lecturers in the UK, there have been few attempts to accurately codify the chain and explore its complexity, especially within the independent sector. The aim of this paper is to provide a workable diagram to define the current customary independent film value chain and system, for use as a teaching aid and as a tool for further analysis of the strategic challenges and opportunities facing companies in this sector. It is not the aim of this paper to look at potential future models for the value chain.

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<sup>1</sup> Examples in France are Pathe, Studio Canal, UGC, and Gaumont. Other international examples include Japan’s Shochiku and Australia’s Village Roadshow.

## Literature review: the origins of the value chain concept

The term “value chain” was codified in 1985 by Michael Porter, in his influential book “Competitive Advantage: Creating and Sustaining Superior Performance.”<sup>2</sup> He subsequently summarised the value chain as “the set of activities through which a product or service is created and delivered to customers” (Porter 2001, pg 74). Within Porter’s definitions the value chain refers to the activities within a single company, as shown in the diagram below.

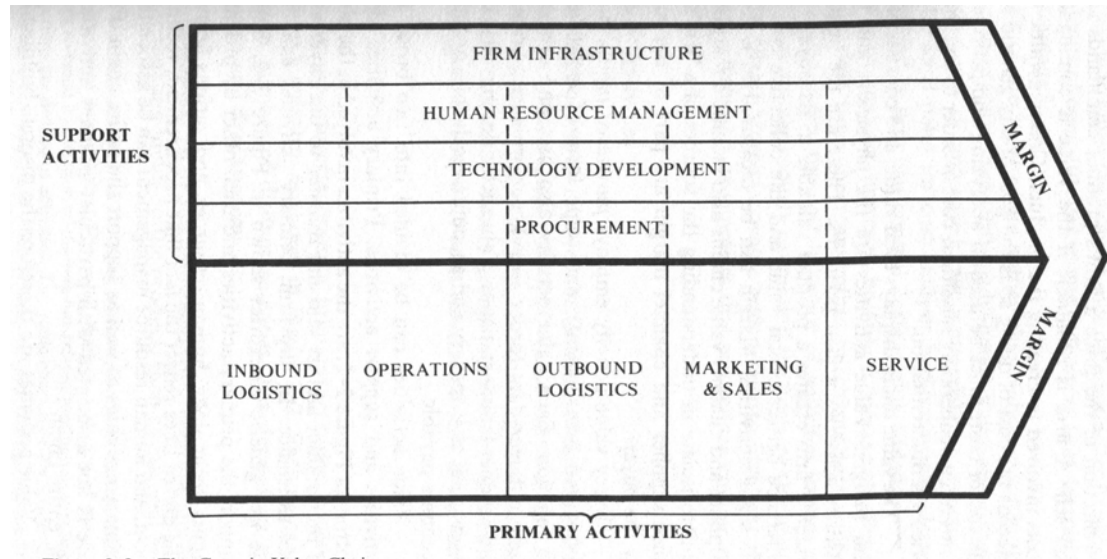


Figure 2-2. The Generic Value Chain

The company value chain is used to help analyse that company’s competitive advantage and strategy within the marketplace (in combination with Porter’s Five Forces, as defined in his earlier book *Competitive Strategy* (1980)). In a later article on the growing power of the internet he summed up the value chain as follows:

“When a company competes in any industry, it performs a number of discrete but interconnected value-creating activities, such as operating a sales force, fabricating a component, or delivering products, and these activities have points of connection with the activities of suppliers, channels, and customers. The value chain is a framework for identifying all these activities and analyzing how they affect both a company's costs and the value delivered to buyers.”  
(Porter 2001 pg 74)

However some products are not created and delivered to the end user by a single company. To accommodate this Porter created the concept of the “value system”, which includes the individual value chains of all the separate companies or players who are co-operating within an industry to deliver a final product. As shown in the

<sup>2</sup> It was developed from existing concepts of business systems being used by the consultants McKinsey and co., and writers like Gluck (1980), Bauron (1981) and Bower (1973); as cited by Porter 1985, pg 36).

diagram below, this could include the suppliers of raw materials, the manufacturers, the distributors (or channels) and the end buyers.

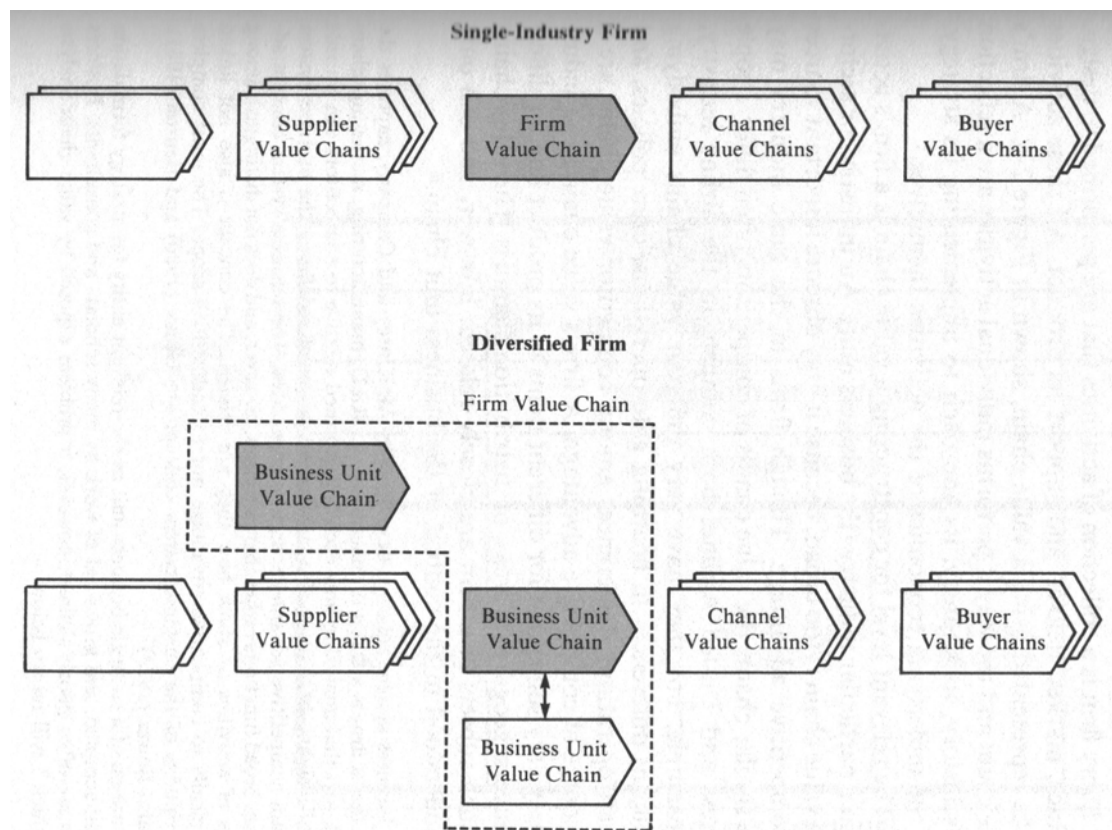


Figure 2-1. The Value System

It is important to note that the value chain concept does not in any way attempt to represent the flow of revenue back through the chain from the exploitation of the product. It is only concerned with value addition during production and distribution.

Porter has also subsequently observed the effects on the value chain of information technology (Porter and Millar 1985) and the internet (Porter 2001), even to the extent that he foresaw the contraction and integration of the value chain and the value system, absorbing the tiers of suppliers, channels, and customers:

“SCM (supply chain management) and CRM (customer relationship management) are starting to merge, as end-to-end applications involving customers, channels, and suppliers link orders to, for example, manufacturing, procurement, and service delivery. Soon to be integrated is product development, which has been largely separate.”

(Porter 2001, Pg 74.)

Perhaps reflecting that integration, writers and academics in the media sector have gradually dispensed with the distinction between the value chain and the value system, and refer to them both as the value chain (encompassing all the separate stages of value addition, whether within one company or several). This is confirmed by one of the more recent books on media strategy, written by Lucy Küng:

“The value chain has been a tool of preference for analysing convergence in the media industry for practitioners, consultants and academics (see for example Tapscott, 1996; Yoffie, 1997; Downes and Mui, 1998). However in the majority of examples it is not used in the “pure form” described above – where individual firm activities are disaggregated and analysed – but rather at industry level as a shorthand means of depicting graphically the various stages by which media products are created and delivered to the end consumer.”

Küng, 2008, page 20.

As a result this paper will follow current media sector usage, and will use the value chain title to apply to all the various stages of product creation and distribution, regardless of whether they are in one company or not.

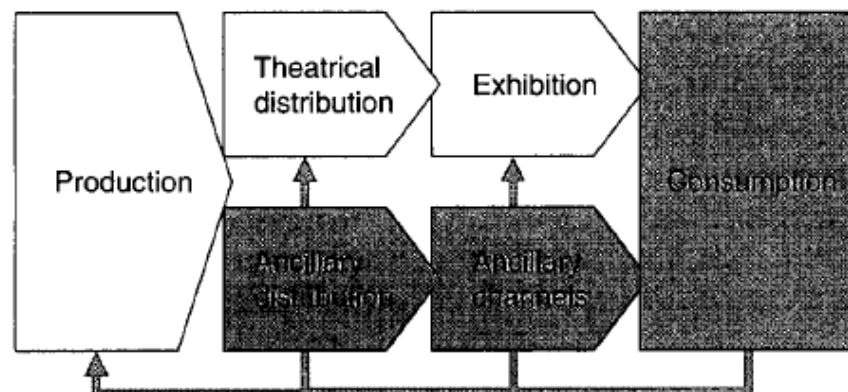
### Literature review: Existing attempts to apply the value chain to the independent feature film industry:

In recent years a number of analysts and academic writers have referred to the relevance of the value chain concept for analysing the feature film industry, including Zerdick et al. (2000); Eliashberg et al. (2006); Lampel et al. (2006); Aris and Bughin (2006); Vogel (2007); Vickery and Hawkins (2008); and Küng (2008). The film value chain was also referred to in academic curricula and marketing literature in the UK (for example Cass Business School 2006, Bournemouth University 2008).

However the value chain models described by the above writers are either not described in detail, or are predominantly concerned with American studio films, rather than independent films.<sup>3</sup> For example, illustrated below is the value chain posited by Eliashberg et al. (2006), which follows the studio model by putting development, financing, and production all into one large value segment called production, and dispensing with international sales and distribution altogether.

**Eliashberg, Elberse, and Leenders: *The Motion Picture Industry***  
Marketing Science 25(6), pp. 638–661, ©2006 INFORMS

**Figure 1 The Value Chain for Motion Pictures**



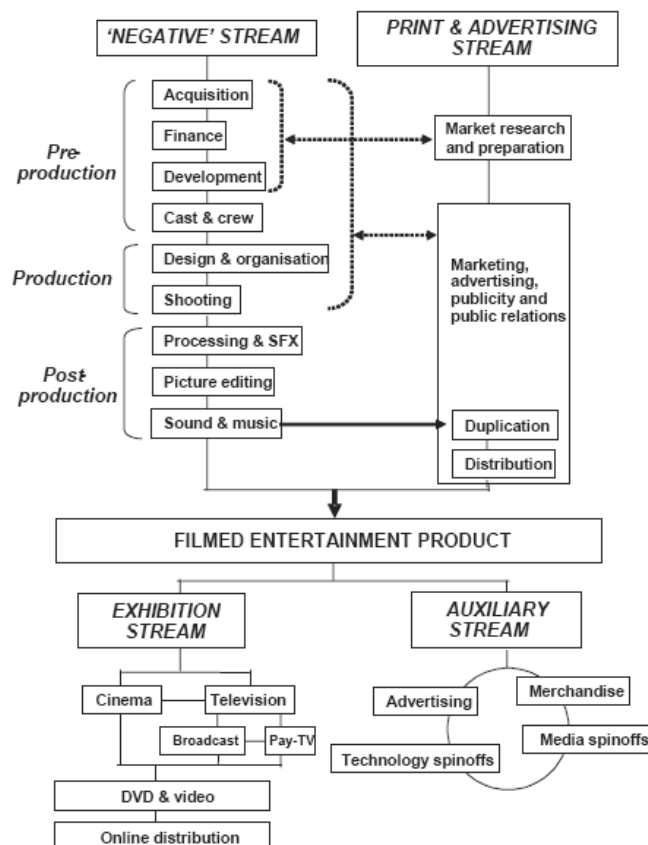
<sup>3</sup> An independent film is “a film that is not a studio picture, and whose development and / or production finance is provided by more than one source” (Davies and Wistreich 2007, pg 8-9, pg 449). It has also been defined as a film “that is developed without ties to a major studio, regardless of where subsequent production and / or distribution financing comes from,” and / or where the producer shares some of the investment risk (Goodell 1998, pg xvii; Vogel 2007, pg 90-91).

In the independent sector, the production segment alone involves a large number of intermediary companies and freelancers, all adding financial and artistic value at different stages, from development financiers to international collection agencies. It could be suggested that not illustrating them in the model over simplifies the situation. Furthermore some of those players are taking fees or commissions off the revenue, so failure to illustrate them does not reflect the complexity of the recoupment process.<sup>4</sup> There is also a question mark over why Eliashberg et al. have chosen to show consumption feeding back into ancillary markets which help feed exhibition (at least in the case of independent films ancillary rights or revenue would be unlikely to financially support exhibition or theatrical distribution).

The Eliashberg et al. paper places its emphasis on the American studio industry, dedicating a lot of time to blockbuster marketing, “star power”, sequels, franchises, product placement finance, and spin off merchandising. These are not key issues for the majority of independent films.

Vickery and Hawkins (2008) embraced the complexity of the film value chain, “both in terms of the quantity and diversity of its various segments and in terms of the nature or character of many of these segments.” They accordingly proposed a more complicated Value Chain diagram (based on a TV value chain created by Zerdick et al. (2000)), which does break the production process down further, as shown below:

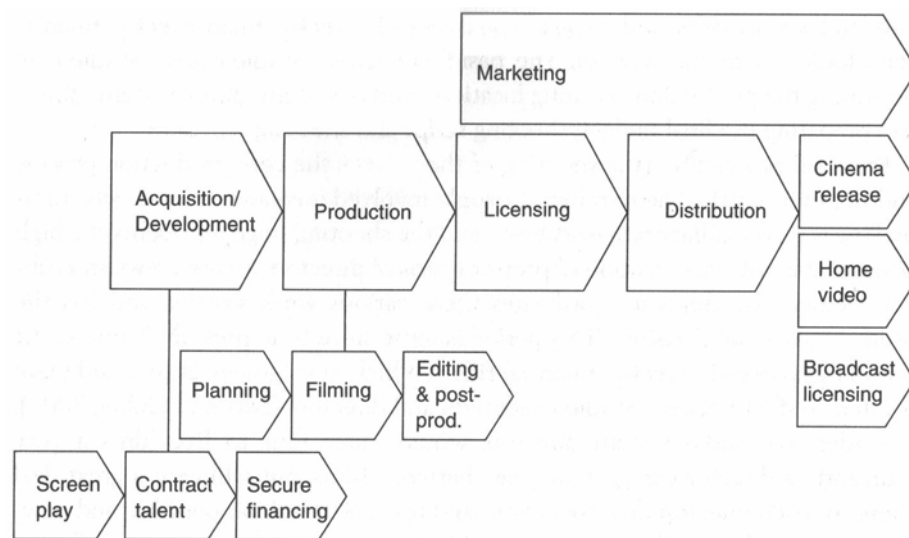
Figure 4.2. The filmed entertainment value chain



<sup>4</sup> Recoupment is a film industry expression meaning “repayment”, usually applying to income from the sales and exploitation of the film which is used to pay off investors in the production budget of the film. (Source: Davies and Wistreich, (2007) pgs 99-101)

However this diagram too is dominated by the studio model. It shows market research taking place at the development and finance stage, and shows prints and advertising spend being incurred at the same time as production. This is more applicable to studios (with in-house marketing departments and subsidiary distribution companies) than independent film companies. Furthermore their textual emphasis on film as a “core intermediate product” to be supplemented by merchandising and other secondary products is again more representative of Hollywood studio franchise movies and blockbusters.

Lucy Küng (2008, pgs 70-73) comes closer to the independent model, especially by breaking down development and production (see the illustration below). It still oversimplifies the process and the number and complexity of the players, especially by avoiding the financing stage in the diagram. However her added distinction between licensing (sales) and actual distribution is a very valuable one.



Above: Value Chain – The Film Industry: Küng et al. 2008, pg 143; and Küng 2008, pg 71.

Finally, Aris and Bughin (2006) explored the value chain in many other media sectors, however they did not explore or define the value chain as it applied to film. Whilst mentioning the wider media sector, it is worth noting that the advent of new business models have also increased the complexity of the value chain, giving rise to concepts like the fragmentation or “unbundling” of the chain (Evans and Wurster 2000). This is a result of a media product or company having multiple suppliers, subsidiary or supportive products, and delivery methods (boosted by convergence, the internet, new mobile media and multi channel television).<sup>5</sup> However this

<sup>5</sup> An example is where a single TV channel (like BBC1) once generated all its own content in-house and delivered it via one medium: the TV set. This was a simple corporate value chain. However it may now receive its content from a mixture of suppliers: including in-house production, external commissions, and acquired completed product. There may be a further blurring of these distinctions by the re-packaging, re-editing or enhancing of bought-in content. This results in a far more complicated value chain. Furthermore the content is no longer a single product, like a TV programme, but may cover multi-platform content including telephone “mobisodes”, interactive competitions, and website content (some of which may be provided by different companies). The external supplier companies

“unbundling” is less applicable to the film value chain, because film still relies on a centrally created single product, albeit distributed in a variety of ways (apart from the separate issue of spin-off merchandising products).

It is also worth noting that none of the above film value chain models pay attention to the role of libraries in returning value to the producer and financier, and the second cycle of exploitation that can result from them (especially considering the potential of Long Tail Theory, as posited by Wired’s Chris Anderson in 2006).

Given these issues regarding existing film value chain models, there is a clear need for a new model of the independent film value chain, which sets out to illustrate the complexity of the independent film sector in more detail; especially by adding the individual players within the segments.

### **The proposed new independent film value chain model in detail:**

This new model is shown on the next page, and was developed by the author through teaching sessions at a number of UK universities at Masters and MBA level. It has incorporated feedback from media business consultants and executives, MBA students and film producers.

#### **Title:**

Film “value chain” has been selected as the title, whereas the term “value system” would be more accurate to Porter’s original usage, since separate companies and freelancers are involved. However, as we have seen, the choice of “value chain” reflects current usage amongst academics and consultants in the media sector.

#### **Design:**

Since Porter (1985) it has been conventional to show the value chain or value system as a series of arrows or lines going from left to right, with the customer or end-user on the right. This is in keeping with the Western European approach to reading and representations of the passage of time. Each segment of the chain as illustrated shows a point where a value is added, usually where an investment is made in the film or its exploitation.

#### **The order of the listing of “players” in each segment:**

Film finance and production is a highly complex and collaborative process. The term “players” has been selected to be able to include the range of private and public organisations and freelance individuals involved. The players named in the boxes have been approximately listed in order of creative power and influence, with the most powerful at the top. This is a subjective judgment and a generalisation, since each film varies substantially. However it is a radical addition to previous models, in that it enables the value chain to be read in terms of creative value and influence, as well as financial value and investment. For example it can be seen that some players, (like the writer, or the producer, or the director) shift in influence during the process, from segment to segment (for example from development to post-production). Note that this order of listing does not reflect their financial input, or their entitlement to levels of income.

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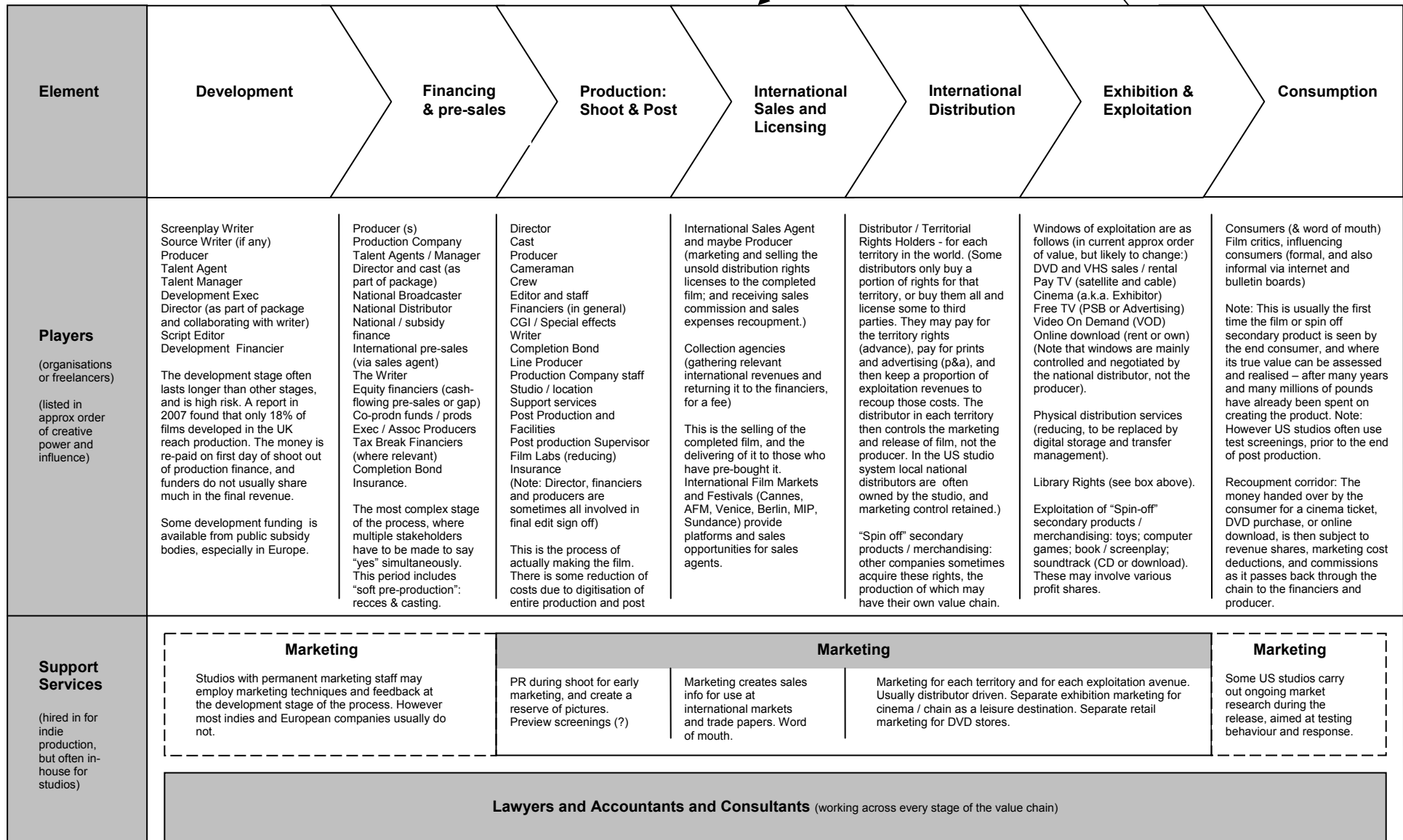
may have their own complex value chains of suppliers and different buyers (for example selling the same programme to different networks around the world or selling DVDs direct to the consumer). Therefore there is no single coherent value chain creating a single product, giving rise to the concepts of the deconstruction or disintermediation or fragmentation or unbundling of the value chain. For a detailed analysis of the distinctions see Küng (2008), pages 20-24.

# The Independent Film Project Value Chain

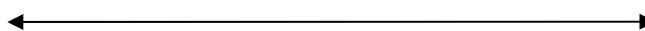
(By activity. Conventional European / US indie, non-studio. © Peter Bloore, 2009)

(Source: Bloore (2009) Re-defining the Independent Film Value Chain)

**Library ("long tail")**  
 Distributor: reissues during first license  
 Producer: sells new license after reversion  
 Producer: remake / sequel (back to start)



Potentially higher risk investment, long period to return



Potentially lower risk investment, closer to consumer



**Development:**

Development is the process of creating or acquiring (through an option) the idea for a film, creating the screenplay (through many drafts), securing development funding for the writer, and initiating the production financing process.

In this chart development has been shown as a separate segment to production. This is because development financing often comes from a different source to production financing (and in Europe often involves public subsidy funds); and because the independence of development can be one of the definitions of an independent film (Vogel 2007). It also reflects the fact that a lot of time is spent in development, and as we have seen it enables the model to show how the creative influence of key players change over the different segments of the production process. This makes the chain more accurate than the simplified model in Eliashberg et al., who chose to combine the production and development activities.

Sometimes development can be said to include packaging the project (by attaching actors and other talent), and budgeting and researching the shoot (recess or soft pre-production). However since this is sometimes also known as “soft pre-production” and often occurs after some part of financing has started, it has been decided to include this latter section of development within the “financing and pre-sales” section. This decision has also been made because there is a shift in power and influence between script development and packaging, in part due to the entry of new collaborators in the chain at this stage, and it was considered important to try to reflect this power shift within the diagram.

It is important to note that the chain as a whole shows very clearly the distance between the development process and the end consumer of the film. As a result marketing departments and distributors very rarely influence the creation of the films they will eventually exploit. This separation can sometimes be said to be one of the weaknesses of independent film-making.

**Financing and pre-sales:**

This is the stage where the film is financed, in the case of independent film often involving a huge range of collaborating businesses, advisors and investors. This is the most complex stage of the process, where the leadership and negotiation qualities of the producer are most vital in ensuring that multiple stakeholders have to be made to say “yes” simultaneously. In investment terms film is perhaps the most expensive of all art forms (with the possible exception of architecture), and each of the investors may bring with them business needs and creative views that can massively affect the completed film. Pre-sales refers to the process where a film is sold, in advance of being made, to some territories in the world, on the strength of the perceived value attached director and cast.

**Production: Shoot and post:**

Quite simply this is the segment where the film is shot and edited. Post production includes the whole editing process, including the addition of computer generated special effects and music. The shoot is usually the point at which the director is most powerful; however this can reduce during the edit and post production process, since the financiers are concerned to protect their investments and get involved in creative decisions. Often the director, financiers and producers are all involved in approving the final edit (who has final sign off is often a closely fought contractual issue).

**International sales and licensing:**

This is the point at which the completed film is then licensed internationally to distributors in each country or group of countries (known as territories). Those distributors pay to receive the film and have the rights to exploit it over a specified period of time. Usually the distributors also agree to return a share of the profits of the distribution of the film back to the original financiers of the film (after their distribution costs and sometimes their advance has been recouped). Therefore (in the independent sector) it is the distributor and not the producer of the film that pays to market it to the final paying audience (further down the chain).

It has been decided in this value chain model to show sales and licensing as a separate segment, because sales agents are neither part of production, nor part of the role of the distributor. Often overlooked by other film value chain models (and indeed some overviews of the film industry), the sales agents add value to the chain; take commissions from the recoupment corridor; and are a crucial part of the business-to-business marketing element of the chain. Including them in the chain helps to illustrate the complexity of recoupment. As we have seen, “pre-sales” (international sales contracted or estimated before production) are often a part of financing production (bank financing can be raised against them), so sales agents are also shown as a player in that segment.

In the studio system many international sales are handled through automatic output deals or foreign distribution is handled by a subsidiary of the studio (reducing the need to show sales agents in the studio model of the value chain).

**International Distribution / Exhibition and Exploitation**

As described above this is the process where the intermediary of the distributor prepares for and delivers the segment of Exhibition and Exploitation in each territory, sometimes selling on portions of the rights. The “windows” (or time-sensitive opportunities of different types of exploitation) could be listed as follows, in order of value to the distributor (rather than the timing of exploitation, which is discussed later in this paper): DVD and VHS sales / rental; Pay TV (satellite and cable); Cinema (a.k.a. the Exhibitor); Free TV (PSB or Advertising); Video On Demand (VOD); and finally Online download (rent or own). Due to changing business models, this order of value will probably soon change, especially as DVD sales decline to be replaced by online download or VOD.

Those not accustomed to the film industry may be surprised to see that cinema box office is not the area of highest value, and indeed it often makes a loss because of the level of marketing cost incurred at this stage. Note that in the independent sector (as opposed to the studio sector) the windows are mainly controlled and negotiated by the national distributor, in negotiation with the exhibitor and other exploitation rights owners, and not the producer.

Note that the exploitation at this stage of “Spin-off” secondary products or merchandising (such as toys; computer games; book / screenplay; soundtrack CD or download) is sometimes carried out at this distribution stage, and might not involve the original film’s producer or financiers (although some profits may go back to them, according to individual deals). These secondary products may involve their own separate value chains and various revenue shares, especially since they are often being sold in different retail outlets to the film itself (for example record shops, toy shops, clothing shops etc). Again the American studio system tries to keep as much control as possible of this stage of the process.

**Consumption / the consumer:**

This paper has chosen to include the consumer as the last segment, which is not always usual practise in value chain diagrams. This is because the consumer is fulfilling two key value-related functions. The first is purchasing the product and allowing financial value to return down the chain (customer consumption). The second, in a way no less important, is that the long term “library” value and reputation of the film is highly influenced by the response of both the general audience (box office figures and word of mouth) and critical voices (including both formal “approved” media critics and informal “unapproved” critics, for example on internet websites or bulletin boards. Even this growth of different types of recognised and influential critical voices results from new technology). In this way the consumer could be argued to be participating and adding value, rather than merely consuming (a viewpoint which would be supported by a variety of writers in modern critical and cultural studies). As Vickery and Hawkins have pointed out:

“The unique economic features of the film and video industries stem from the ‘experience goods’ characteristics of these products, whose market performance depends on complex interactions between psychological, social and cultural factors ... The realisable value of a film is determined largely by intangible assets that have very special characteristics. Consumer perceptions of the personality and talents of individuals associated with a film can play a crucial role in determining the value of the film.”

Vickery and Hawkins (2008) pg 106, pg 59.

**Library Rights:**

This paper has also chosen to include library rights as a separate segment, coming back from the completed “first run” of exploitation of the relevant windows, to re-impact earlier in the value chain. The film can then be re-exploited in two ways. Firstly, for the duration of the distribution license, it can be re-exploited by the distributor (for example a second release of the DVD, perhaps in a collector’s edition). Secondly, once the distribution license expires and the rights revert, the producer may then be able to sell (usually via a sales agent) a further distribution license (to the same distributor or another one) for another period. This is more often as a part of a package of films, rather than as an individual property. A repeat theatrical release is rare, until a significant anniversary of a classic is reached (say 10 or 20 years), however a re-release onto a newly developed technological format has become quite normal.

To some degree the creation of a director’s cut of a film is the result of library rights exploitation. This is because the product is basically remaining the same, and there is no need for a major injection of capital (there may be some re-editing and re-mixing costs, but usually these are minimal; and digital technology is reducing them even further).

Library and re-issue rights are potentially an area of extra value for film and television programmes compared to some other media products (especially newspapers and magazines); partly because of the long shelf life of a successful film and partly because the distribution of the completed product is generally licensed, rather than carried out by the originating company (with the exception of American studio and European mini studio / broadcaster product). In recent years the value of film libraries has risen dramatically, with investors spending billions of dollars purchasing them; despite the fact that “more guesswork and ambiguity appear in the

valuation of film library assets than in perhaps any area relating to the financial economics of the movie business” (Vogel 2007, pg 92). This is due in part to the perceived but unquantifiable potential for earnings to be generated by new format exploitation and future niche markets (through Long Tail Theory). This justifies its inclusion here as a separate segment in the value chain.

A separate section within library rights are the remake or prequel or sequel rights. These are retained by the producer and / or key financiers, and are not granted to distributors. The original writer will also usually benefit, to varying degrees according to the original contract. However this part of library rights leads you back to the very start of the value chain and the development of a new script (even in the case of a remake, which often involves a movement in geographical location). The reason why investors like the concept of remakes and sequels is that there is apparently less risk involved, because the concept has already been tested and the market for the film may be analysed.

### **Risk:**

Generally speaking the earlier (further to the left) you are in the chain (towards development and production) the higher the potential risk for the capital investor, due to the distance in the recoupment chain from the money paid by the consumer (as proposed by Vickery and Hawkins, page 62). However in keeping with Porter’s original theory, the value chain diagram does not attempt to actually show the flow of income and the recoupment corridor.

### **Fragmentation and integration in the film value chain:**

The model clearly demonstrates visually and textually a number of issues and weaknesses in the independent model that film industry insiders have long been aware of. These include the large number of collaborating individuals and organisations; the complexity of the multi-player independent financing process (making it prone to setbacks when even one player drops out); the separation of the producer from the distribution and marketing process; the vacillating power of the writer; and the fact that lawyers and accountants appear to have the most stable jobs in the industry (because they can earn money at every stage of the value chain).

However there is a risk in thinking that co-operation along the chain is inevitable or causal. In a forthcoming book on the independent film industry Angus Finney views that because there are so many co-operating players required to produce a film that the inherently fragmented chain is often on the verge of disintegration, especially at the financing stage:

“The strategic effect of what could be termed a ‘disintegrated model’ is that each element in the chain is heavily dependent on the next player/operator’s partnership and cooperation in order to drive a project forward. A network of varying interacting players have to be attracted, managed and, in many cases, forced into focussing and delivering specific commitments and activities in order for a film project to proceed. The risks are extreme. In addition, the seed idea, and early sunk costs in a concept, idea and writer’s work to produce a realisable screenplay, is six, highly complex stages away from contact with the end-user, the film consumer.” Finney (2009)

To counter this problem, some producers try to establish long term relationships with other finance companies, sales agents, and distributors in the value chain, in order to simplify the financing and production process, either informally (ongoing relationships) or formally (joint ventures, purchases, mergers, output deals).

This ultimately leads to the strategic possibility of vertical or horizontal integration: which is when a company (or consortium) owns players at different points in the value chain. It is therefore able to also earn money at different points – rather than just one point (Lynch 2006, pg 417, 465). The classic film industry example of vertical integration is the way that the Hollywood Studios in the 1920s and 1930s owned the actors, the directors, the production studios, the distribution network and the cinema chains. This meant they controlled the upstream suppliers and the downstream distributors; ensuring massive profits; consistency of product; huge control over how the films were marketed; and high entry barriers for potential competitors (until the 1948 U.S. Supreme Court decision against Paramount Pictures, which prevented all the studios from owning and operating cinema chains, on the principle that it was anti-competitive. It was de-regulated in the 1980s, when the studios again acquired cinemas).<sup>6</sup>

The value chain is useful for demonstrating the advantages of integration, and also for distinguishing between vertical integration (operating in different segments along the value chain, such as owning a production company and a sales agent); and horizontal integration (where a company owns several players in the same segment of the value chain. This is often at the exploitation end of the chain, where one company can own many media outlets showing the same content; for example a DVD label, a TV channel, and a website where films can be downloaded).

However the principle of the two types of integration is the same: the company can earn income at more than one place in the chain. This is particularly relevant in the film industry, where there are different commissions and profit shares in revenue taken by different players in the chain (as we shall see in a moment). The more you can access these different revenue streams, the sooner you can earn money to offset against the expense of production, and the longer you can continue to profit.

A recent film example of integration is the European company PolyGram Filmed Entertainment (Kuhn 2003), which operated across 14 countries and pursued a strategy of owning or having deals in key territories with production companies, sales agents, and distribution companies. Some of this was vertical integration (developing and financing films that could then be sold and distributed in-house), and some of it was horizontal integration (owning PolyGram Specialist Video and part-owning the Sundance TV Channel). The integration strategy enabled distribution marketing departments to be involved in the decision of which films should be greenlit for financing in the first place, thus reducing the distance between the development / production section of the chain, and the exploitation section of the chain. It also entered the library section of the chain by acquiring and exploiting the “third largest post 1948 film catalogue in the world, with approximately 1,500 feature films and 10,000 hours of television programming”.<sup>7</sup> This provided the sales agents with films to sell before the newly produced product came on stream.

However potential downsides of integration include increased overheads; a larger workforce (with all the associated employment costs); the need for different skillsets to operate successfully in the production and distribution sectors; and overall

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<sup>6</sup> Squire, J.E. 2005. *The Movie Business Book*, p113

<sup>7</sup> Kuhn, M. 2002. *One Hundred Films and a Funeral*, p94.

extra managerial complexity (especially if the integrated firm is spread across a number of different geographical locations and time zones). At which point some careful outsourcing could enable an integrated company to become more efficient and cost effective (Mintzberg et al. 2003). The presence of a distribution arm attached to a production company can also lead to the loss of guaranteed money upfront from pre-sales, which would help reduce the financial risk at the production stage (Davies & Wistreich 2007).

### **Retaining talent in the value chain:**

As a result of the multi-player and freelance nature of the production business, producers often find it very difficult to retain key creative talent across many films. This is made worse by the financial power of the studios to lure key talent away to other film projects, especially in America. This increases fragmentation because teams have to be formed anew for each new film, reducing the ability to learn as a group during the process; to build ongoing trust; and to ensure consistency of product. However some producers in the UK have built successful careers out of forming close links with key directors or writers. Examples include producer Rebecca O'Brien, director Ken Loach and writer Paul Laverty; Producer Simon Channing-Williams and director / writer Mike Leigh; producer Andrew Eaton and director Michael Winterbottom; producer Duncan Kenworthy and writer Richard Curtis; producer Andrew Macdonald, writer John Hodge and director Danny Boyle; producer Mark Herbert and director / writer Shane Meadows. In some of these cases the director is integrated into the production company and made a company director, which can help strengthen the relationship.

It could be said that securing an ongoing and close relationship with key creative talent (especially writers and directors) should be the key strategic aim of most independent film producers; because it is the difference between either building a secure business with a track record and a realisable future potential; or making an ad hoc series of individual film productions.

### **The limitations of the film value chain model:**

However any value chain model as applied to the film industry possesses several limitations. These include being unable to represent the importance of reputation and personal relationships; timescale; and, above all, the levels of investment and recoupment at different stages. We shall now look at each of these in turn.

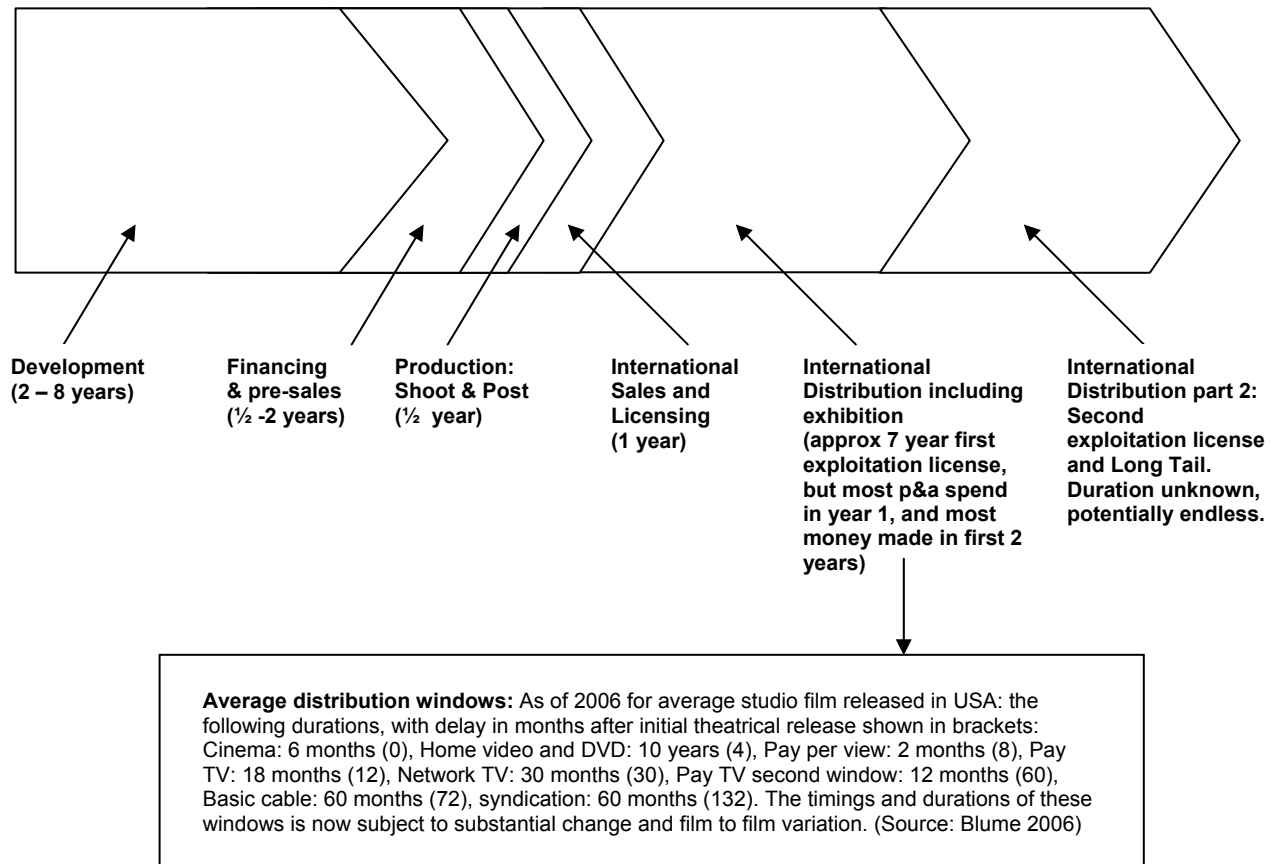
#### **Reputation:**

Value chain models do not show how competitive advantage is gained by those businesses that rely upon branding, softer people skills, specialist knowledge and contacts (Lynch 2006, pg 203-208). This could be said to be particularly true of the film and TV sectors, where great value is placed on experience, trust and personal relationships. Lynch also showed that two competitor companies may be using different suppliers from the value system, or sometimes some of the same suppliers, and therefore it is the way that these suppliers are combined and the value-added by the company itself that provides the differentiation. This is again relevant to the film industry, where similar projects using the same technical crew or talent may result in very different finished films.

### Timescale:

The value chain diagram gives the false impression that the same amount of time and effort is spent in each segment. The diagram on the next page approximates the average time actually spent within each segment (however this is indicative rather than definitive, and every project varies massively). Attempts to transfer this representation to the main model (already containing so much text) proved clumsy and confusing.

Below: An estimation of the film value chain according to timescale: time spent within each segment, as a proportion of total project.



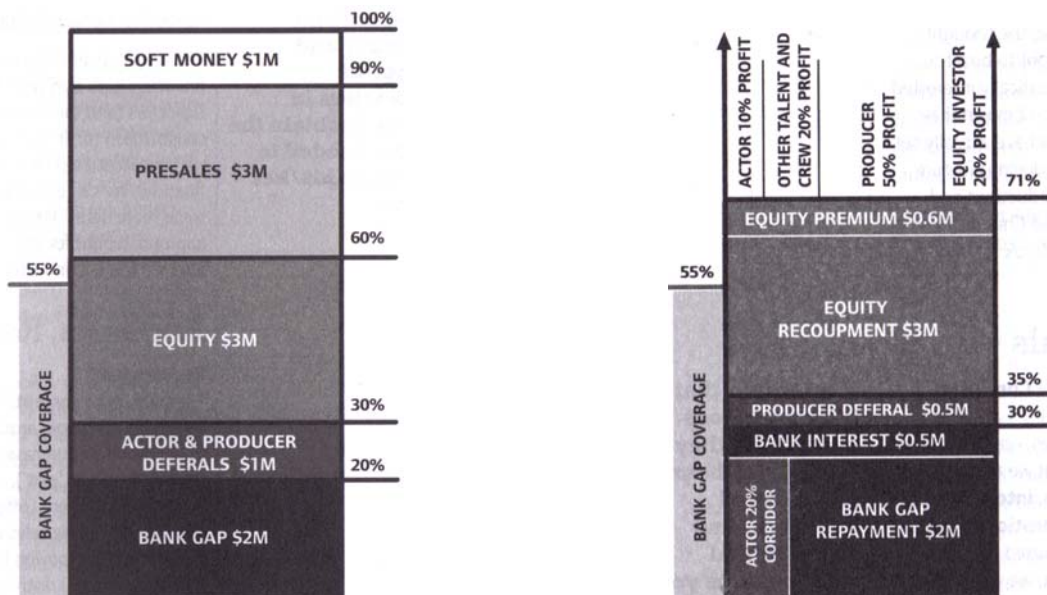
### Levels of investment and recoupment:

The vast majority of investment is during production, which is notably the smallest segment in terms of timescale (see diagram above). However levels of investment in different segments vary so much from film to film that any visual representation of an average would be highly misleading.

Above all, the film value chain as defined in this paper also does not reveal in detail where and how players are earning revenues. This is because not everyone in the value chain receives income in the same way, or even always in one single way. For example some players (like production crew) are paid flat fees upfront, from production budgets, before the product is completed. Some players (like equity financiers) earn income from revenue streams coming from actual sales of the finished product (but only after exhibitors, distributors, and sales agents may have taken their commissions and expenses from that revenue). The timing and levels of these deals vary from film to film.

Other players (like key acting talent, writers and directors) are entitled to receive both: they are paid flat fees during production, but then also share in revenue when certain levels of income are reached and equity investors in primary positions are paid off (they may also receive separate fee deferral payments at some stage during the recoupment schedule). This is a departure from conventional industry value systems, where a supplier company would only be paid a flat fee for providing goods or services, and would not also expect a share of the manufacturing company's profits. This staged introduction of profit shares, sometimes at different moments during the recoupment process, interferes with the clarity of the accounting process and even the long term profitability of the production company or film financier; as well as making the profitability and Return On Investment (ROI) of an individual film much harder to quantify. Furthermore, some players (like sales agents) may receive a percentage commission on selling the film, as well as a repayment of any expenses that they have incurred during the exploitation of the film (for example the sales agent's marketing expenses).

Purely as an illustration of the complexity of this process, one example of a fictional budget and recoupment schedule is shown below. It has been taken from Davies and Wistreich's 2007 book *The Film Finance Handbook*. However even this chart is a necessary simplification, because it shows net income: which is the income after the deduction of sales costs and commissions, distributor's prints and advertising costs, and other commissions (these largely occur to the right of the value chain, before the film financier receives the income). And every film is of course different, according to the negotiation of the individual financing and recoupment structure.



Above: A fictional example of a film budget investment (on the left) and recoupment chart (on the right). Source: Davies and Wistreich (2007), page 100 and page 115.<sup>8</sup>

<sup>8</sup> In the right hand diagram the revenue is "filling up the pot" from the bottom upwards. Davies and Wistreich argue that this fictional film would be regarded as "in profit" once 71% of the budget is recouped (in that equity is paid back and so-called profit shares can start). Therefore the vertical lines



The complexity of film finance therefore makes revenue and recoupment very difficult to illustrate within a value chain diagram. Although this is a drawback of the film value chain model as a teaching and strategic aid, it is only fair to again point out that the value chain and system concept as designed by Michael Porter was not intended to depict or analyse revenue flow; but instead to analyse business strategy, competitive advantage, cost advantage (reducing internal costs in product manufacture by managing internal and external relationships), and buyer value (reducing costs and increasing the perception of value for the buyer) (Porter 1985; pgs 36-52, 62-118, 130-146).

### **Future changes to the film value chain:**

There are a lot of potential changes to the market for feature films and the value chain, as a result of digital technology and convergence: firstly the expected growth of internet downloads and video-on-demand; secondly the reduction of production costs due to the digitisation of the whole film-making process (especially in ultra low budget film-making); thirdly the digitisation of cinema screens, which reduces physical distribution costs and increases the profitability of cinema releases of niche films and back catalogue; fourthly the short-circuiting of the value chain, by producers being able to market and distribute their films directly to the consumer; and finally the suggested long term growth of the niche market via Chris Anderson's Long Tail Theory, as a result of web sales and the growth of internet-based retail aggregators like Amazon and Play.com (although Long Tail Theory is now being questioned by some academics, including Elberse (2008)).

The harder question is how all this change will impact on the value chain. Whilst people may end up paying to view their films in different ways, it has been suggested by some people that the basic economic product of feature film might not be substantially altered by these changes:

“Although the sources and types of costs may be shifting, the overall ratio of investment to return would appear not to be changing. .... it seems likely that overall production levels for feature films and television programming will continue to follow already established output patterns, with production increases likely to come in the form of entirely new types of content, aided by lower cost and higher quality digital content creation and distribution technologies.”

Vickery and Hawkins (2008) pg 106.

However Finney (2009) foresees a far more radical shift, where players in the distribution and exhibition end of the chain may choose to spread back along the chain and become involved in production:

“Ultimately, internet marketing and its growth in sophistication and specific demographic reach, will encourage end-users such as cinema owners and chains, pay-TV operators and even video game operators to enter the production market themselves. A world where these players commission development and feature films which in turn help drive their respective platforms will cut out third party

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above 71% show the subdivision of the remaining “profit.” However some soft money (usually subsidy or public money) might today be expected to recoup at the same time as equity.

distribution completely. The cost of marketing will be borne by the production financier rather than carried over to the distributor.” Finney (2009)

Certainly new devices to play movies are proliferating, including cable set top boxes, games consoles, mobile phones; portable DVD players, computers, and laptops. New methods of transporting them from device to device include high speed home broadband connections, wifi networks, chips, cards, ultra portable hard drives, and new high capacity memory sticks.<sup>9</sup> If Finney is right then providers of the technology could also become involved in generating and delivering content, thus operating at different points along the chain.

At the time of writing, the current economic recession may also have an impact on the speed of future developments and consumer behaviour. Eventually we may even be able to assess whether the claim is true that film is economically contra-cyclical and will thrive in a time of depression (Nardonne 1982; Vogel 2007, pg 74).

### **Conclusions and future research:**

In the current time of dramatic technological and economic change it is hoped that the theoretical tool of the film value chain, as defined in this paper, may be used to provide a valuable insight into the past, present and potential future workings of the film industry. It may be able to inform business strategy and even the investment decisions of newcomers to the sector. It is also hoped that it will act as a stimulus for further debate about the film industry and its business models, including comparison with the value chains in other media and cultural industries.

A further stage in the development of this model may be to attempt some form of visual representation of the correlation that could be made between the value chain and the recoupment corridor / revenue flow. This could result in a diagrammatic film revenue chain, to be seen alongside the value chain. However as we have seen it may be complex and require several variations, for example showing the average film financing structure and recoupment for different budget levels and types of independent film. It is also possible that a different value chain would be posited for ultra low budget and no-budget films (especially when they are self-distributed in the home territory by the producer).

The value chain described in this paper is a snapshot of the independent film industry at this one point in history, and it should therefore be under constant discussion and re-assessment. Further research and debate should be encouraged to try to predict what a future film value chain may look like. However as screenwriter William Goldman once famously observed about the film industry:

“Nobody knows anything... it’s a guess – and, if you’re lucky, an educated one.” (Goldman, 1983)

The same is of course equally true about the future.

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<sup>9</sup> Source: The Economist (2008) Coming soon: Hollywood and the internet, Feb 23<sup>rd</sup> 2008.

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