

Hollywood's enchantment and cursed underbelly

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Abstract

In recent years, the global film industry has been greatly impacted by the COVID-19 pandemic. Unfortunately, the United States and India, the top two countries with the highest number of confirmed cases, have been hit particularly hard. This has resulted in Hollywood and Bollywood, the leaders of the film industry, being greatly affected. However, many may not have noticed that Nigeria's film industry, located in Africa, has been rapidly catching up in the past decade. In fact, it has even achieved an astonishing production value of nearly 6 billion U.S. dollars in recent years, making it the third largest film-producing country in the world, after the United States and India.

In reality, according to the experience of the global film industry leader, Hollywood, at least six to seven out of ten films are critically acclaimed but commercially unsuccessful, with only one film barely breaking even. This harsh market experience, like the curse of Cassandra in Greek mythology, is usually very accurate in predicting outcomes, but most people do not believe it.

This work aims to explore the unique characteristics of the film industry, especially focusing on the Hollywood film industry in the United States, attempting to deconstruct issues such as its unique operational structure, financial accounting, marketing, and the integration of new media portfolios. Finally, this work quotes an interesting perspective from a well-known film playwright, emphasizing that the unique charm of the film industry may lie in the fact that "there is no other business like film that invests a huge amount of money

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to produce a product that cannot guarantee people will buy. Similarly, there is no other business where people, after consuming it, have nothing else except memories.

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1. Fluid Hollywood

The technological innovations of the 20th century have led to a gradual distancing between films and other traditional art forms (Bywater & Sobchack [3]). The first sound film, Talkies, appeared in the late 1920s. In the 1970s, digital animation took film production to a new level, and the audio-visual experiences of films such as Titanic, Terminator 2, The Matrix, and Spider-Man were amazing (Robert & Douglas [27]). Technology has also made film distribution more efficient and refined. Advanced sampling and predictive models can quickly estimate audience numbers and ratings and adjust strategies within one or two days of release. Other technologies, such as broadband video transmission, have also contributed to the personalization of film entertainment. Film innovation also includes economic models. Industries that typically require huge investments are prone to market monopolies, such as steel and automobiles. However, this logic does not apply to films because each film is unique, and even packaging and marketing are tailored specifically to it. Therefore, economic value is different from mass production. In short, films are a monopolistic market that combines many production, distribution, and financial organizations but also relies on various small and specialized independent production companies (Denby [10]). At least in Hollywood, there are many cases of collaboration between small and large companies. Hollywood is like a flux and a paradigm of network economics, constantly aggregating and dividing, including a deal, a film, and a technology (Sedgwick & Pokomy [28]).

1.1 Complex Ecosystem

Before 1920, movie tickets were priced at 70 cents each. With a palace-like atmosphere and elegant music, movie theaters provided a space for people to travel through time and space, where the dream world dissolved the waking world, and the utopian feeling of longing made people move to stay, but unfortunately, this emotional experience was as fleeting as a phantom. (DeSilva [11])

In 1948, the United States' anti-trust law prohibited majors from entering the exhibition (movie theater) market, as independent theaters protested against being treated unfairly, such as the studios monopolizing all film screening channels without open bidding.

However, this market fair competition policy was merely an illusion. Soon after, the effects of distribution and exhibition segregation began to ferment. The studios realized that they did not need to supply new films every week, resulting in a decrease in film supply. As the demand for good movies exceeded the supply, prices skyrocketed beyond what small theaters could afford. At the same time, television began to divide the market, and movie box office revenue rapidly declined. Despite this, as the saying goes, when one door closes, another opens. In recent years, multi-screen chain cinemas have rapidly replaced traditional theaters, and the economic scale of chain cinemas has once again placed exhibition rights in the hands of a few conglomerates. (Waterman [34])

In the United States, after the integration, the mainstream studios formed a situation where six companies dominate the industry, including Disney (Pixar Animation), Sony (Columbia and MGM), Paramount (DreamWorks), Twentieth Century Fox, Warner Bros. (Time Warner), and Universal. Mainstream studios not only produce, finance, and distribute their own films, but also distribute films from independent production companies.

In addition, there are mini-majors that produce and distribute films on a smaller scale, as well as small independent production companies that focus on specific markets but cannot obtain sufficient funds. Occasionally, they also contribute impressive box office results and attract media attention.

Small independent production companies often shoot films for mainstream studios or subcontract for their small distribution companies. New independent production companies often prefer to finance their own productions, rent studios, or sign distribution agreements. Additionally, many independent production companies do not shoot films but sell innovative concepts. (Wyatt [35])

Small independent production companies are often called "states-righters" and often create alternative films that challenge the status quo, including many viewpoints that are suppressed or ignored by conservative mainstream studios or sub-majors.

Perhaps many people are surprised by the complexity of the film industry. On the surface, everything is aimed at ensuring the quality of the films, but in reality, the underlying motive is to ensure that more people

profit. The existence and even explosive growth of small companies seem like a beautiful collaboration in a complex network, but the increasing interdependence also seems to herald the end of an era when alternative choices divergent from the mainstream were provided and a new era of consolidation has begun Jowett & Linton [18].

1.2 *Copyright Exchange*

To describe Hollywood movies, it is more accurate to say that they are a series of contracts rather than a series of films. Although producers are often associated with large, mysterious monsters, they are more like a copyright exchange that integrates financing, production, distribution, and marketing of films (Caves [4]; Zuckerman, Ezra and Tai-Young Kim [37]).

Movie scripts are usually based on existing literary works, concepts, ideas, or real events. The script outline gradually forms a first draft and is eventually finalized. Literary agents who are familiar with recent novels and writers usually help clients prepare script outlines. Producers usually do not accept unfamiliar scripts, but rely on literary agents with a keen eye to recommend them.

If a work is favored, the producer will sign an option agreement. Although the agreement only accounts for a small fraction of the total value, it provides the right to purchase all assets in the future. The option period is usually fixed but negotiable and high-quality works can even be resold immediately, earning the literary agent at least a 10% commission (Wyatt [35]; Yung-Teen Chiu & Chih-Kai Chen [36])

Once a producer selects a specific script, the funding plan is immediately launched. If the producer collaborates with a major studio, the latter often insists on obtaining the rights to sequels, television, and ancillary markets. In any case, the above contracts are beneficial as collateral for financing from financial institutions. In order to obtain financing smoothly, the project plan must provide a detailed story outline, director, producer, filming location, cast lineup, and cost budget. However, financing decisions are often highly subjective and prone to misjudgment; good project plans are often rejected, while bad (green-light) project plans can easily generate profits. For example, *Star Wars* and *Raiders of the Lost Ark*, which became box office hits, were once wandering among many studios before obtaining financing and distribution from Twentieth Century Fox. The script for *Back to the Future* was mercilessly rejected by many studios (Litman [20]; Litman & Ahn [21]).

Professional agents or agencies are also important as they can not only reduce the cost of movie projects but also inject many gossip news into the movie at any time. Ironically, this is often the additional value of the existence of the agency (Chih Kai Chen [6,7,8]).

2. Complicated Fundraising

The average production cost of a film, also known as negative cost, as shown in Table 1, consists of two main elements:

Above-the-line costs refer to the creative costs of the film, including the acquisition of the story rights and screenplay, as well as the related costs of hiring producers, directors, and major cast members, which require the signing of hundreds of contracts.

Below-the-line costs refer to the production costs of the film, including all professional production personnel, temporary actors, transportation and shipping, scenery, and props. For example, shooting locations must be surveyed, rented, and arranged in advance, and if there are any problems, such as inclement weather or the lead actor getting injured, the production cost will skyrocket. Therefore, completion bond insurance is very important for a film. The completion guarantor can fully control the shooting schedule, have the option to decide whether to lend money to the producer, give up or return the financing funds. Interestingly, the higher the production budget, the higher the willingness of the distributor to prepay the rights, which has no direct relationship with the cast and script. (Goldsmith [13])

Although most film production processes have been standardized, the cost of film negative continues to grow rapidly due to varying project requirements and scale efficiencies. For example, in the 1970s, lenient accounting policies led to many famous directors exaggerating their budgets, and low-budget films with big costs became widespread for box office stars, making it easy for anyone to save taxes and obtain financing (Goldstein [14]). However, controlling film production budgets is quite difficult! (Sedgwick & Pokomy [28])

In fact, the most creative aspect of filmmaking is not just on-screen performance but also behind-the-scenes fundraising plans. Film is an interesting tax-saving tool, so it often attracts various sources of funding, including industry players such as production companies, independent distributors, talent agencies, studios, completion funds, broadcasting, cable television, and home entertainment distributors. Financing parties may include banks, insurance companies, and distributors. Investors may

Table 1
Components of Negative Film Costs

Copyright	Pre-production	Shooting	Post-production
Concept Novel Script	Script development Scene design Cast selection Production team Costume design Location scouting Budget	<i>Online costs</i> Producer Director Screenwriter Actor/actress <i>Offline costs</i> Set/scene Props Costumes Crew	Editing Music scoring Opening/ending credits Sound mixing Visual effects Soundtrack

include various public and private hedge funds. For example, in the early 1980s in the United States, the rapid growth of markets such as cable television, junk-bond financing, stock market surges, bubble economies resulting in wealth inflation and excessive lending, led to many hot money pouring into the film industry. However, the investment performance of the film industry has always been poor. In the early 1990s, bank financing restrictions and economic downturns slightly eased the above problems (Nardone [22]). Overall, the various sources of funding and financing for the film industry are as follows, with significant differences:

2.1 Common Stock

Generally speaking, selling common stock is the simplest way for a film producer to raise large amounts of capital with relatively low dividends. However, based on past experience, selling common stock is by no means the easiest financing method for the film industry. Unless the stock market is filled with a speculative atmosphere, raising funds solely through common stock is a time-consuming and energy-consuming process.

The main difficulty lies in the return on investment, as it often takes many years for a film to recover its capital and profits. Even if the film production plan is completed smoothly, the initial assets may have already lost their value. Most investors expect to increase the real value of their investment in the short term. In comparison, although treasury bills and money market funds are unexciting, they are more reliable and secure than investing in the glamorous and illusory film industry.

In fact, it is unlikely for a low-profile startup to directly sell common stock, unless the market is in a bubble and full of speculative atmosphere.

From the perspective of stock market investors, small startup film common stocks lack substantial return on investment.

In recent years, large private equity and hedge fund investors have started collaborating with mainstream studios and well-known independent producers to invest directly in film investment portfolios. These mutual funds provide another option for film financing, instead of just relying on tax savings and limited partnerships. (Chih Kai Chen [7,8])

2.2 Composite Transactions

Common stock is often sold in conjunction with other securities to attract a wider range of investors or to better meet the issuer's financial requirements. For example, in the early 1980s, Telepictures was a television series and feature film production company that specialized in marketing and packaging strategies for TV movies. At that time, the company adopted a strategy of selling equity. Looking back to the early 1980s, Telepictures was first publicly offered by a small underwriting firm in New York. Telepictures owned the rights to over 30 films and 200 hours of TV series in Latin America. The underwriting content at that time totaled 7,000 units, each unit containing 350,000 common shares, 350,000 common share warrants, and \$7 million 20-year convertible subordinated debentures at 13% interest. Overall, Telepictures raised \$6.4 million through stock issuance. In addition, in 1986, the De Laurentiis Entertainment Group was underwritten by a large New York firm, selling \$185 million in common stock and \$65 million in 12.5% senior subordinated notes with a 15-year term. In this case, the well-known producer Dino De Laurentiis donated the Embassy film library and the copyrights to 245 films made in North Carolina as the primary assets of the new company. The main films in the film library include *The Graduate*, *Carnal Knowledge*, and *Romeo and Juliet*. The main concept of the above approach is presale, which means selling film rights to pay-per-view cable TV, home video, and overseas cinemas to ensure even more funding for low-budget film projects. In any case, theoretically, the presale of rights is not unfeasible, but companies that later adopted the same strategy found it difficult to execute in practice. The main reason is that early film production typically faces huge cash flow pressures, unless the film can generate good box office revenue early on. (Chih Kai Chen [6,7,8])

2.3 *Limited Partnership*

Limited partnerships have created many opportunities for investment in the film industry in the past, but they often rely on government assistance to share the risks. Prior to the expansion of the US tax code in 1976, film investment was one of the most interesting tax tools available. Before the amendment, limited partners' limited or non-recourse loans (meaning the lender could not seize all of the borrower's assets in the event of default, and thus the borrower would not be obligated to repay the debt) could offset income losses multiple times from the initial investment amount. Therefore, investors not only enjoyed tax benefits but also the pleasure of investing and sponsoring the film industry (Chih Kai Chen [8]).

This type of agreement is usually done through a purchases or service partnership. For example, in a purchase partnership agreement, an investor would purchase a film for one dollar as the initial payment (usually at an extremely exaggerated price), plus a three-dollar non-recourse loan expected to generate revenue from the film. Although the risk is only one dollar, there is a four-dollar depreciation and investment tax benefit.

Regarding the service partnership agreement, investors are required to first become partners in the production company, rather than simply investing in the film. Through the use of a promissory note, investors can benefit from annual deductions that are several times the amount of their actual investment, making this a highly advantageous tax-saving method for federal taxpayers with a high tax rate of up to 50% (Vogel [33]).

Between 1976 and 1986, the revised tax code only allowed film owners (with strict definitions) to deduct income risks. This amendment specifically stated that investment deductions (if the film was more than 80% produced in the United States, the taxpayer could receive a tax deduction of approximately $6\frac{2}{3}\%$ of the total investment amount) could only be traced back to the film's release date and required investment capitalization, meaning service partnership agreements were no longer allowed.

Regardless, after the tax reform in 1986, many entertainment companies discovered the benefits of investment tax deductions. However, to prevent the use of wages, salaries, interest rates, and dividends to offset income to achieve passive losses from tax shelters, this tax deduction was eventually limited to income from passive activities. In the 1980s, a few

other film partnership structures emerged, most of which occurred in overseas areas.

Although many partnership structures appeared in the 1980s, the original structure was not much different from that of Silver Screen Partners (1983). Strictly speaking, it was not a tax-saving method. For example, HBO (a premium cable television program distributor owned by Time magazine) guaranteed that regardless of how amazing the box office performance was, at least one of the ten films in the financing package would recover all of its production costs (Chih Kai Chen [8]).

However, since only 50% of the film budget is due upon completion of the film, with the remainder to be paid off within five years, HBO not only has a large interest-free loan, but also steady revenue from many new products. For HBO's 50% investment, it still retains exclusive rights to pay TV and broadcast TV, as well as 25% of online TV sales revenue, indicating that the partners heavily rely on theater box office revenue and distribute it through performance bonuses. Later, Silver Screen Partners also adopted a similar partnership structure, but on a larger scale (up to \$4 billion) and to provide financial assistance for Disney films.

Nevertheless, the aforementioned partnership units are not the only type. Securities and Exchange Commission regulates a financing method: Rule D, which refers to a quasi-public fundraising method, for example, independent filmmakers finance small companies and limited partnerships. Rule D allows 35 private investors to purchase the company or partnership unit without being regulated by the 1933 Securities Act. (Vogel [33])

For film studios, the limited partnership financing structure is very attractive. Expanding funds can diversify the use of the film investment portfolio and increase more films to satisfy the thirsty distributors. However, a film may not provide any return to the equity investors, but the studio can at least recover fixed costs (operating expenses) through a specific percentage of rental income from the film.

For individual investors, it is impossible to expect that the partnership structure can provide a higher investment capital return rate. Only a few cases have annual investment returns of over 10% to 15%. However, there are occasional profitable opportunities for participating in the mainstream film studio's production investment portfolio, such as the films *Annie*, *Poltergeist*, *Rocky III*, *Flashdance*, and *Who Framed Roger Rabbit*. Nevertheless, when the box office success of various film investment portfolios, most investors believe that instead of investing through related partnership structures, it is better to invest directly in common stocks of

film studios and distributors (if not considering other reasons, including liquidity), at least they can get better investment returns. (Riding, Alan [25])

2.4 *Financial Loans*

Today, film studios can typically raise funds through debt financing, equity financing, or bank loans based on general business purposes. Therefore, there is great flexibility in financing conditions and structural types, and various corporate assets can be used as collateral.

For example, in recent years, many film studios have used loan securitization, a structure similar to mid-term securities with cars and real estate as collateral. For film industry investors, they can establish paper companies with relatively less equity funds, providing collateral for three-year periods based on the above equity funds and film project values. Subsequently, banks arrange loans, issue commercial papers, and mid-term bonds to raise film production funds. Funds raised in this way can be excluded from the balance sheet, making company profits more attractive and borrowing costs lower. Although ownership will ultimately return to the film studio, risks can be transferred to shareholders (Vogel [33]).

For independent filmmakers, bank loans are not the same. They have little or no collateral other than presale contracts and financing obtained through agreements directly related to film copyrights. Therefore, banks consider films as subsidiary products with potential copyright value. Future screening royalties must not only pay off the loan itself but also pay the loan interest. Banks will also pragmatically measure the loan amount based on different licensing models. In any case, this approach makes loans to independent filmmakers similar to “accounts receivable type” rather than the “standard loan type” of general enterprises using current assets as collateral.

From the perspective of film studios, similar bank loans can avoid high capital costs and strict financial audits while meeting financing needs and artistic perseverance, which are often faced in distribution and financing. In addition, diversified distribution and cross-border and cross-media operations require a great deal of time and effort. Therefore, many filmmakers prefer to invest in creative film ideas (Chih Kai Chen [6, 8]).

2.5 *Private Equity Funds*

In recent years, private equity and hedge funds have become important sources of capital, especially for mainstream production

companies. These funds are composed of retired funds and wealthy individuals who often seek diversified investment targets, including stocks, bonds, and real estate.

These funds, which can reach hundreds of millions of dollars, have the ability to invest in ten to twenty different movies. For production companies, they can provide not only an important source of funding but also greater control over innovation in their work. In fact, production companies can transfer certain risks, including licensing, completion, and film performance. From the perspective of the fund, through diversified investments in multiple films, assuming relatively low risk variability, it can not only obtain returns higher than the average but also reduce overall investment risk.

In practice, movie profits are usually defined as the production company deducting 12% to 15% of distribution costs. Additionally, production companies typically invest in copy and advertising expenses, which are usually deducted before profit distribution. When constructing similar transactions, large investment banks usually provide senior debt instruments that reflect relatively low risk positioning through pricing, and private equity and hedge funds can obtain lower risk positioning. For mezzanine investors, the expected annual return is at least 15%, and the expected shareholder return is at least 20%. In summary, adopting a large movie investment portfolio diversification strategy can reduce the risk exposure of all participants. (Chih Kai Chen [6,8])

In summary, the important issue in movie finance is choosing the production-financing-distribution agreement (PFD), as detailed in Table 2, including:

In-house production/distribution: Production companies or distributors raise funds for production and distribution themselves. Independent producers can be seen as subsidiary organizations of production companies, and production companies usually pay all the regular expenses of subsidiary producers during filming.

Production-financing-distribution agreement: Independent producers submit a complete plan to production companies or distributors, who provide financing for production and distribution.

Negative pickup agreement: The distributor agrees to be responsible for all distribution and production costs once the film is completed, which include the acquisition of the original negative and distribution rights.

Acquisition deals: Distributors bear distribution costs, but production costs are borne by third-party organizations and others.

Table 2
Types of Film Financing

Independent Production and Distribution	Production Financing and Distribution	Negative Pickup	Acquisition Agreement	Rental Distribution Agreement
<i>Sources of Production Funding</i>				
Production Company/ Distributor	Production Company/ Distributor	Lender	Third Party	Third Party
<i>Sources of Prints and Advertising Funding</i>				
Distributor	Distributor	Distributor	Distributor	Non-Distributor
<i>Agreement Time</i>				
Before Production	Before Production	Before Film Completion	After Film Completion	After Film Completion

Rent-a-distributor deals: All production and distribution financing has been borne by third-party organizations and others, and distribution is submitted after production is completed.

From the perspective of mainstream Hollywood production companies, production plans typically use a balanced financing mix to reduce risk. For example, production companies estimate the release of twenty films in one year, of which two are independent productions with full financing, twelve are produced, financed, and distributed agreements with other production companies, and the others are negative pickup or acquisition agreements. (Chih Kai Chen [6,8])

3. Maximizing Audience Reach

Although there may be film industries all over the world, the United States still dominates the global market. This advantage stems from various factors, including historical happenstance, technological developments, ample funding, excellent marketing, and cultural influences. From an economic perspective, today's US film industry dominance is due to (Vogel [33]):

A large domestic market, including population and income, high cinema, television, cable, and video penetration, which is more conducive to offsetting the huge costs (Trumphour [32]). One important reason is that English is the main language, even though Chinese is the largest language globally. However, English is the primary language used in

affluent countries today. In other words, due to differences in style and cultural preferences, English-based film texts can reduce the cultural discount phenomenon that can devalue imported films (Chih-Kai Chen [5]; Ries, Al & Jack Trout [26]).

Nevertheless, despite box office receipts being the primary source of revenue for films, in the mid-1980s, revenue from film-related markets such as broadcasting and cable television began to grow significantly. Even so, queues outside cinemas continue to be long. In fact, box office receipts can be divided into a small number of popular films and a majority of also-ran movies. The former often generates impressive box office receipts in the first three weeks before shifting to the ancillary market, while the latter lacks attraction and goes straight to the ancillary market. Although ancillary markets can increase film profits, they still cannot fill the surging production and distribution costs. Ancillary markets also often have strong substitutes. For example, if a film is shown on cable television before its release, it may result in a decline in broadcast television ratings or the inability to obtain larger rights (Prag & Casavant [24]).

Due to the massive amount of investment in films, the pressure to recover quickly has led to the frequent adoption of simultaneous release strategies, particularly in recent years with the global pandemic. However, price-discriminating continuous release to meet different markets is still the best strategy to maximize revenue, namely, releasing the film in the market with the highest marginal revenue at a specific time, sequentially, starting with cinema, licensed cable television, home video, and broadcast television, etc. Nevertheless, the release order is clearly influenced by the evolution of old and new distribution channels. For example, the internet allows for day-and-date transmission of films worldwide (Chih-Kai Chen [6,8]; Brown [2]).

Overall, in order to capture these ancillary markets, companies often resort to agreements such as cross-shareholding, alliances, and joint ventures, which ultimately lead to more confusion and uncertainty (Hesmondhalgh [16]). Next, we will gradually discuss the relevant issues of box office receipts and the main ancillary markets of films, including home video and subsequent licensing, etc. (Commission of the EC Audiovisual Policy of the European Union [9]; Yung-Teen Chiu & Chih-Kai Chen [36]).

3.1 Average Box Office Is Not Available

"The film drowned in only 15 cm of water!" highlights the fact that the average value of box office is not a useful reference. In other words, the

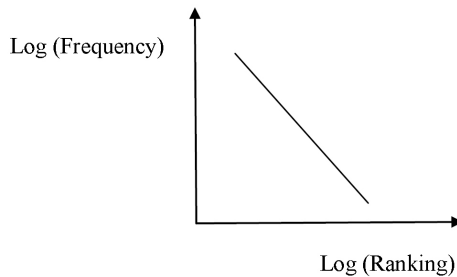


Figure 1
Pareto Principle of movies

film market is one where few are winners and many are losers, and outside investors often play the role of being the first to invest but the last to recover, with high risk! Since filming often involves situations where costs get out of control and skyrocket, just like Parkinson's Law in management, for most mainstream studios, negative film and marketing costs often do not balance with box office and licensing revenue, meaning that there is a huge gap between the two and the average value. (Sochay [29])

In other words, the so-called "average" movie does not exist. The main income of film box office often relies on a few box office hits, as shown in Figure 1, which displays the industrial structure of Pareto Law, applicable to any movie genre, scale or star power. Since each film is unique and faces constantly changing market demands, it is difficult to predict the revenue performance of each movie concretely. On the contrary, big-budget films with high-profile casts often suffer losses, while small-budget films with unknown casts occasionally shine. (Goldstein [14,15]) Table 3 shows the top 20 global box office movies. (Boxofficemojo [1]; The Numbers [30])

In general, because audience preferences often change, movie box office appears to be a non-normal distribution, which means that a few box office hits greatly affect the average value. The same economic model applies to other industries such as TV, books, music, stage plays, and toys and games, where non-normal is the norm. (De Vany & Walls [12]; Postrel [23])

3.2 Riding the Star Effect

In fact, in response to the ever-changing market preferences, A-list celebrities are often a frequent strategy for film producers, as they can

Table 3
Top 20 Global Box Office Films

Movie	Publisher (Release Date)	Box Office (Billions of USD)
Avatar	Fox (2009)	29.23
Avengers: Endgame	Disney (2019)	27.99
Titanic	Paramount (1997)	22.63
STAR WARS: The Force Awakens	Disney (2015)	20.71
Spider-Man: No Way Home	Sony (2021)	19.21
Jurassic World	Universal (2021)	16.71
The Lion King	Disney (2019)	16.63
Avengers	Disney (2019)	15.18
Furious 7	Universal (2019)	15.15
Top Gun: Maverick	Paramount (2022)	14.93
Frozen II	Disney (2022)	14.50
Black Panther	Disney (2018)	13.82
Harry Potter and the Deathly Hallows - Part 2	Warner Bros. (2011)	13.42
Beauty and the Beast	Disney (2017)	12.81
Incredibles 2	Disney (2017)	12.43
Iron Man 3	Disney (2013)	12.14
Despicable Me 2	Universal (2013)	11.59
Captain America: Civil War	Disney (2016)	11.53
Aquaman	Warner Bros. (2018)	11.48
The Lord of the Rings: The Return of the King	New Line (2003)	11.46

bring high investment returns. Although the cost of hiring smaller actors is lower, compared to A-list celebrities who often demand millions of dollars, the risk for producers is actually lower because A-listers can increase box office and other ancillary market revenues. (Kellner [19])

Generally, the contract between the production company and the celebrity is usually just a consensus, such as a deal memo, agreement letter, letter of intent, or term sheet, and there are many professional details that both parties need to address later on. The final contract is often very complex, and potential conflicts can arise at any time, especially when negotiating with large, powerful, and calculating production and

distribution organizations, which can be challenging for artists who value elegance and emotion. Therefore, professionals such as actors, directors, or screenwriters often need the assistance of experts such as agents, lawyers, and accountants. (Chih Kai Chen, [6,8])

In the face of the loose negotiation structure in the film industry, bargaining power or clout is the key. Typically, the influence of newcomers is minimal, while A-listers have tremendous influence. In Hollywood, "you don't get what's fair; you get what you're able to negotiate." Similarly, if the above-mentioned contract is not clear and rigorous enough, many disputes will arise later on. Of course, the best way to handle entertainment disputes is to "try to attract the attention of the mass media!" After all, the film is transparent, and the actors are just ghosts and spirits that attract the audience's attention. In addition, traditional marketing mindset has recently evolved into a concept of utilizing new media combinations, playing a significant role in engaging consumers. In general, although marketing hype cannot save a bad movie, it can definitely make a mediocre performance at the box office shine. (Chen-Yin Liu [5], Wyatt [35])

3.1 *Unethical Manipulation*

After completing the production of a film, the important next steps are marketing and distribution. While the highest ethical standard for film creativity is not being bound by moral constraints, the highest ethical standard for marketing and distribution is hype, hypocrisy, and deceit. Although most film professionals and companies behave ethically in accordance with social norms, there are still many unethical and controversial practices (Chih Kai Chen [6]). For example,

In order to achieve distribution goals such as PR promotion, exhibitors and distributors often distort actual box office figures, manipulate smaller films into becoming must-see titles, or lie to producers about large advertising budgets when in reality it's only regional advertising. Additionally, exhibitors often deceive distributors through unethical behavior, including:

Bicycling: screening a single authorized copy of a film in other theaters or adding additional screenings to obtain illegal box office revenue. For multi-screen theaters, if the predetermined audience size for a particular film is not reached, exhibitors violate the synchronous screening agreement and play other unlicensed but more popular films.

Palming ticket: retaining and then reselling unredeemed movie tickets, as it doesn't affect the movie ticket sales number, so overall box office revenue isn't increased.

Film theft: unauthorized DVD, home video, and website downloads that sharply reduce distributor revenue.

Product splitting: collusion among exhibitors to reduce film bidding competitiveness, which also affects distributor revenue (Vogel [33]).

3.2 *Derivative and Subsidiary*

Markets Prior to the 1980s, film producers of all sizes were primarily focused on how to market their films in cinemas. However, since 1986, the gross domestic wholesale revenue generated by home video (approximately \$2 billion) has surpassed that of cinemas (approximately \$1.6 billion), leading to a complete transformation of the film industry's structure and marketing strategies (Waterman [34]; Yung-Teen Chiu & Chih-Kai Chen [36]).

DVDs and VCRs have become familiar household items worldwide, including in many developed countries such as the United States, Japan, the United Kingdom, France, Germany, Italy, the Netherlands, and Scandinavia. As a result, for many filmmakers, this has undoubtedly become another potentially limitless market (Hoskins, C. et al [17]; Theiler [31]).

In the case of the domestic retail market in the United States, home video sales have grown rapidly to over \$16 billion, with approximately two-thirds coming from pre-recorded film sales or rental income (aimed at consumers). In fact, between 30% and 40% of Hollywood's overall production costs must be amortized through this market revenue. This indicates that both film producers and distributors cannot ignore the marketing of home video (Theiler [31]).

For mainstream studios, the primary marketing decision for the home video market is pricing. Prior to the 1990s, when large retailers no longer participated in revenue-sharing and instead adopted discount pricing strategies, this ultimately resulted in films either being sold at high prices to the rental market or sold at low prices directly to consumers through sell-through. Although the average cost of producing and marketing a film on home video or DVD is roughly less than \$4 per unit, the key decision lies in whether distributors can increase profits from rental income or final sales channels. In recent years, over 50% of American consumers have purchased home video products through final sales channels, with more than half being feature films (Vogel [33]).

However, the market has undergone significant changes since the introduction of DVDs in 1997. With unit costs for each DVD being less

than \$5, subsequent marketing and wholesale prices reaching \$15 have resulted in a profit level almost double that of home video, making film producers more motivated to target the consumer purchase market. In fact, this has always been the primary operating model for music products. Nevertheless, DVDs have clearly eroded the rental pricing model (and revenue sharing model) for home video, which has been in operation for 20 years. The profit structure of DVDs is also more favorable to film producers, who can now control a larger share of the total film revenue compared to exhibitors and retailers in the past.

In the late 1990s, although movie studios and major retailers generally adopted the traditional rental revenue sharing model (used for home video more than DVDs), this model ensured a minimum income for the studios (video rental companies accepted all movies from the studios), with the following rough process: large movie chain rental companies, such as Blockbuster, purchased a single movie from the studio for seven dollars, or one-tenth of the retail price. The initial cut for the studio was about 30-40% of rental income, gradually decreasing to zero within six months. Then, the chain retailers could recoup the money they had invested in buying the movies by selling them as home videos. On average, it enabled rental companies to retain 50-60% of transaction revenue.

However, for evergreen films, such as many Disney animated cartoons, the ultimate sales channel is more favorable than the above revenue model. Anyway, the most likely strategy (before adopting the revenue sharing model) is for the distributor to suggest a higher retail price for home video, making it the main retail item. The selling price for popular A-class home videos is not less than \$89.95, and the distributor can earn \$56.57 in revenue (about 63%). However, the distributor will not be able to participate in the movie rental market, which is an important source of cash flow. (Hoskins et al [17])

If all other conditions remain the same, film studios and distributors (in fact, family video publishers) will choose either the estimated rental quantity multiplied by 63% of the retail price, or the estimated final sales channel quantity multiplied by the wholesale unit price, whichever generates a higher profit. It is evident that marketing strategies aimed at final sales channels are more effective than those targeting rental markets. Generally speaking, distributors must estimate at least seven to eight times higher sales volume than the rental market to demonstrate the superiority of the final sales channel strategy. Similar market forecasts can be observed through standard curves. The curve shows the unit demand for the home video market, which can be estimated based on recent box office sales

performance. Independent film producers also face various challenges. For example, in terms of production financing, Indian film producers prefer to finance through pre-selling (or fractionalizing) rights. The purpose is to find mainstream or sub-mainstream film studios or independent family video publishers as financiers. However, rights fractionalizing is usually not welcomed by large distributors. Additionally, the importance of direct-to-video, which means skipping theatrical release and entering the home video market directly, is becoming increasingly apparent, especially since it can eliminate the huge expenses of theatrical distribution and increase profits.

Finally, all film distributors must seriously face the rapid growth of cable television and internet distribution, especially pay-per-view (PPV) and video on demand (VOD) services. In short, pay-per-view technology will have a serious impact on movie rental chains and will change the release order of certain types of films. (Vogel [33])

In addition, since the early 1970s, there has been a gradual rise in product licensing opportunities for film characters and concepts, with notable examples including *Jaws* and *Star Wars*. Licensed films can drive sequels with the same protagonist, such as James Bond, *Star Wars*, *Jurassic Park*, *Batman*, and *Spider-Man*. Therefore, film studios will pay more attention to the production and marketing of action and children's films, with licensing extending to music products, comics, multimedia, and other interactive formats (DVDs and CD-ROMs), fast food restaurants, and toy stores. For major toy manufacturers, an important product license can bring at least 6-7% of wholesale revenue to the film studio. For example, Disney animation cartoons such as *Beauty and the Beast*, *Aladdin*, *The Lion King*, and Universal's *Jurassic Park* all generated product licensing revenue exceeding 50 million USD. (Chih Kai Chen [7])

4. Conclusion and Discussion

Many people believe that the film industry is attractive and highly profitable, which has attracted the attention of countless investors. However, the taste of success can easily make people forget the pain of failure. For mainstream film studios, their advantage lies in their ability to completely control all stages of the process, from initial financing to distribution and theatrical release. For industry participants, technological development continues to offer various new opportunities and challenges, such as the ubiquitous digital network today being the latest and biggest factor.

This opportunity allows many small or micro enterprises to enter the niche market. Looking at it from a global perspective, investing in film production and distribution requires huge funds, which can easily create a significant barrier to entry and catalyze the industry towards vertical integration. However, for economists, since the production cost of a movie is a sunk cost (compared to the expenditure invested in producing a product previously, subsequent expenditures are relatively small), the key is to maximize the exposure of the film in various screening windows. In other words, facing huge fixed costs and sunk costs, the variable and marginal costs of the film are relatively small, so market size becomes a critical factor in the survival of the film.

In any case, the new media market has greatly reduced many unfavorable factors, and the influx of a large number of newcomers has not led to a decrease in industry investment returns, especially since the attraction cycle of the product no longer exists. In summary, the above factors are only part of the development of the film industry. In recent years, although there has been a trend of large-scale mergers in the global film industry, the financial and economic structure of the film production, distribution, and exhibition industry is still very complex. In any case, it provides investors with a very attractive and favorable investment field.

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