



## DIGITAL PRODUCTION CHALLENGE II

### Introduction on Disruptive Innovation

The German producer Martin Hagemann (Zero Fiction Film GmbH) opened the event stressing the main differences and challenges for film professionals today vs. 7 years ago when the Digital Production Challenge II programme was launched.

The changes brought by the digital technology are not just a technical revolution interfering with our way of making and distributing films but they are a “disruptive innovation”, destroying the business field and business models.

No one can say how we will be working in 10 years. But we are in a process, which is worrying and challenging us, and which does not give us a sustainable living, like it did still 10 years ago. New technologies change our workflows and our distribution models now since more than 20 years,

This is the reason why, even if the DPC workshop is focused on technical challenges, it will also trigger larger discussions especially on the future for the films we produce in Europe and for us, professionals.

But what is a “**disruptive innovation**”? - one of the most used expressions in the last months, when people try to describe, what's about to happen to film, to cinemas. Based on research of the disk drive industry in the 90s (from hard-drives to portable file storage) the term **disruptive innovation** was defined as **an innovation that creates a new market and a new value network and eventually disrupts an existing market and value network**, displacing established market leaders and alliances.

The European Commission's opinion is, that a disruption of the European audiovisual landscape may be on its way, as a result of the increased competition between traditional European audiovisual players and new, **often international, entrants** into the European audiovisual market.

The entrance of these new players, enabled by the Internet and the “**Over-the-Top**” (hereafter “**OTT**”) **distribution** of audiovisual content, increases competition for the **attention of the audience** (relevant for paid entertainment and the advertising market), as content (not only audiovisual content, but entertainment options in general, ranging from music to games to social networks and e-books) is more abundant



and easily accessible. Also, an increased offer of various connected devices multiplies the screens available to audiences, further diverting audiences' attention in this **new multi-screen environment**. Audiences are therefore **no longer "captives" of a single screen with a limited amount of content/entertainment** and audiovisual players are in competition with new entrants to attract and captivate the attention of their audiences.

This shift in paradigm in the audiovisual market from a closed and regulated media environment, where **content was under the control of right-holders**, to an open one that's difficult to regulate, poses challenges to traditional players, who have to adapt to this ongoing transformation in order to secure their market positions and, often, their survival.

Besides the technical change in medium (from analog to digital transfer) a **major shift in content producing** strategy was revealed with the announcement by the streaming platform players that they would start to invest in original movies, for example Netflix in a sequel to "Crouching Tiger, Hidden Dragon" with the Weinstein Company and four movies produced by Adam Sandler, in which he will also star.

Amazon also published the trailer for their first as AMAZON STUDIO produced film by Spike Lee. The announcements are roundly criticised by US theatre exhibitors, who fear for their revenue stream and one could expect a similar reaction from European theatre operators. When Netflix opened with BEASTS OF NO NATIONS by Cary Joji Fukunaga on all there 60 streaming platforms worldwide and tried a day- and-date release in cinemas, the film was boycotted by most of the cinemas worldwide. On one hand a disappointing result of 50.000 admissions in the US box- office, on the other hand – according to Netflix – a #1 in clicks worldwide in the all countries – a success, which could have never been reached with a small 6mio USD indie film on children-soldiers in Africa. The price Netflix paid for the world wide rights: 12mio USD, a good price, never-heard of in the independant distribution sector.

Newest numbers of this year estimate that the three main US SVoD services (Netflix, Amazon and Hulu) will spend USD 6.8 billion on content produced by the main US studios in 2015, an increase of 30% over the content spend of USD 5.2 billion projected for 2014.

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Another shift in **content acquisition strategy** is initiated by the use of “**big data**” by SVoD services in order to identify which shows and movies will interest their subscribers. “Big data” is also used for the production of original content by SVoD services. Netflix, Amazon and Hulu all invest in original content. Even if the investment in original content is still far below the cost of content acquisition through syndication deals (Netflix, for example, spends only 10% of its budget on original programming, an estimated USD 400 million a year), original content is becoming yet another differentiation factor for SVoD services.

At the moment Europe is standing fascinated and frightened in front of this development. Very few global operating companies, not coming from the film- or TV-sector seem to re-invent the whole business, establish themselves as new distributors and hard-ware suppliers, then suddenly as producers and financiers, while the European TV- and Film-Industry is either latched onto consumer unfriendly regulations (distribution windows), is

producing more and more low-budget films or is asking for more public funding (like e.g. the German newspaper publishers do at the moment very strongly). So it looks like, we will be undergoing a heavy disruption of our business, and as producers of documentaries and small budget independent art-house films, we can all feel the blows already for quite a while:

- lower budgets, lower income from international sales.
  - more films each year not only in my territory, but in Europe overall.
- first income from the new platforms, but only accountable are the one-license – deals, not the clicks on various platforms.
- public TV has lost more and more interest in cinema and special content program.

Looking at some of the above mentioned challenge, first **the content**, we have to admit, that what we can see nowadays non-linear and more and more linear TV content, which is completely competitive, with what we might see in a cinema. In fact, we could argue that the best writing and the best character de-



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velopment is generally happening at the moment on stream series, or televisions series– there's better character work and better writing, than we see in most studio movies, specially thinking about the sequel-mania nowadays.

The increased competition for premium content under exclusive licensing deals lead already now to the fragmentation of the offering of premium content. As even early adopters rarely subscribe to more than two SVoD services, the battle for subscribers will intensify and, with it, the battle for exclusive content. The implications of this intensified competition is already drastic for smaller European players. **Hardly no-one in Europe is really able to develop and produce for this global market.**

**So, to sum it up for now: where do we stand:**

**Hollywood** is playing safe, budgets of 200mio USD + marketing budgets of the same amount have to play safe, that's why we see sequels and the same kind of crowd pleasers over and over again. Hollywood has clearly understood, that they have to produce films, which have to be seen in cinemas first, because they are specific genres (like comedies) or because they offer specific high production values (3D, action, etc). But Hollywood has started as well to experiment with the new platform, specially with under-performing films, which appear in the streaming platforms faster and use the marketing input from the cinema release.

**Independent film and challenging content** is more and more exploring the opportunities of the new players, which run their business and tough competition with series-work, vertical told stories. We see more and more actors, directors, writers working for that sector. But this sector is under heavy competition and might be consolidated in the nearby future, leaving 2-3 global players, instead of the now 150 different platforms, we alone know in Europe.



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**Classic TV** is still strong going – in the elder group, but losing dramatically audience in the younger group – as well as the cinemas. More older people go there (you can see it, if you compare programs from 20 years ago and today) but the under – 30 years old ones are staying at home, not watching public TV but the new streaming platforms or are underway on tv, three screens at the same time.

So is there a direct correlation between the rise in quality of home entertainment systems – and content – and the fall in people’s desire to visit the cinema? Will having Netflix or Amazon Instant Video plugged into a super-duper, high-def, 3D wonder box really replace the cinema experience? Perhaps only time will tell for sure, but there’s one key factor that’s worth bearing in mind considering this question.

Until recently, the conventional rules for distributing feature films were largely set around analog technologies with business models based on rigid **window systems and exclusivity**. However, recent advances in digital technologies are changing the way audiences consume media, putting pressure on traditional models for releasing films.

**The main conclusion is**, that audiences now decide – even before a movie opens – whether they will see it in a cinema, or at home.

“There are certain types of films that people really love to see at home, and they’re experiencing a renaissance – documentaries are a perfect example. Documentaries have a very limited theatrical cinema life, but they are exploding on online services such as Netflix and Hulu.”

With these new possibilities for the new audiences, film and moving-image producers and distributors in Europe face a total new world, because film distribution is shifting **from a supply-led to a demand-led market**. In this way, independent producers have now to break away from the rigid singular value chain that dominated the industry, and adopt special, individual release strategies that are tailored to the individual needs of each film.

The logo consists of a series of concentric, slightly irregular blue circles that create a ripple effect, centered on the left side of the page. To the right of this graphic, the text "DIGITAL PRODUCTION" is written in a light blue, uppercase, sans-serif font. Below it, the words "CHALLENGE II" are written in a larger, bold, dark grey, uppercase, sans-serif font.

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As a result of these emerging digital technologies the independent film distribution value chain is being affected by two inter-related movements:

First, a changing relationship with a **new type of consumer** (known as “**active audiences**”); and second, the opportunity to explore new business models that these technologies facilitate.

Therefore, it is arguable, that as a result of the technological impact on the industry, the market will develop in **two directions**: one for the Hollywood studio conglomerates that continue **to use film value chain models** based on traditional mechanisms and the other for independent distributors based around **flexible multiplatform releases** that are tailored for individual films.

But a lot of questions remain:

Do the new models really present a stronger financial return to filmmakers and distributors or are the traditional models, despite the declines, economically more successful? Can new business models work for larger independent films or are they best suited for niche markets?

We cannot answer these questions yet, but there are some tasks, we all, as independent, rather small size players, have to be aware of:

- Rights holders will recognize that **long term licenses** for an emerging medium makes little sense.

**The long tail no longer exists, if it ever had**, production and distribution will be based more on a short term exploitation.

- A new relation between filmmakers, producers and distributors has to be established, with different terms of trade and maybe even experimenting with **direct Distribution**.

- **Concerning CINEMA:**

Independent Exhibitors will get a cut of VOD & Other Ancillary Revenues



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- **Concerning CINEMA:**

Dynamic Pricing in Cinema and in distribution has to follow the consumers needs and availability.

- **Concerning VOD:**

There are now more than **500 video on demand services** available in the EU dedicated mainly or wholly to feature film.

- **Concerning VOD:**

How do we share data ?

- **Concerning the filmmaker:**

To gain attention means to be more recognizable, which in the end means a reduction in creative compromise.

- **Concerning the filmmaker:**

Filmmakers should think about themselves and their films as a **brand** rather than as single film creators.

- Access to much of our greatest **film history** is becoming more limited, which has to be solved.

- Print media continues to die, which asks for the establishment of **new forms of communication** about films: blogs, social media etc.

- **The creative class has allowed themselves to become corrupt and settle for getting their film made**, thinking that is enough. This is the attitude-center of the "**supply led industry**", which our audience does not appreciate anymore. As film is financed in Europe by more than 50% thru public funds, funding mechanisms have to react to that.

But the European audiovisual landscape has seen lately the entry of new players coming from the technology sector for which, in the most cases, audiovisual distribution or production is not their core business. They have the technological know-how to improve user experiences with their services and the reach necessary to profit from economies of scale, thus giving them a competitive advantage over us traditional players, who have still to adapt to these new settings. The audiovisual landscape is changing and market powers are being redistributed, **but fundamentally the audience still desires quality content and entertainment. Players who will** deliver quality content, taking advantage of the distribution enabled by



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the Internet, and at the same time know how to attract the attention of the fragmented audiences will continue to thrive in the future.