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Gross misunderstanding :What journalists miss about the movie business

By Edward Jay Epstein Nov 1, 2012

The vast preponderance of news reporting about Hollywood concerns the weekly box-office race. It is

offered free to the media every Sunday afternoon by Nielsen edi at a low point in its news cycle, packaged with punning headlines and quotes by industry sources, so it can be reported as if it were a high-stakes horse race. In fact, it is, to borrow Daniel Boorstin' s concept, a weekly pseudo-event whose sole purpose is to garner media attention.

Once upon a time, six decades ago, such box-office numbers were critical to the fortunes of Hollywood. The major studios then owned most of the large theater chains and made virtually all of their profits from ticket sales at their own theaters. But as of the late 1940s, antitrust rulings forced the Hollywood studios to divest their theaters, and the theater business evolved into multiplex chains that the studios did not control. As television, home video, pay cable, dvds, and now streaming have become ubiquitous in American homes, the studios have radically changed their business model, moving their profit centers from the large to the small screen, making the box-office race less relevant. Even the numbers themselves are misleading. The reported "grosses" are not those of the studios but the projected sales of tickets at the movie houses in the US and Canada (which is counted by Hollywood as part of the US). Whatever the amount actually is, movie houses remit about 50 percent to the movie distributor, which then deducts, off the top, its out-of-pocket of costs, which includes advertising, prints, insurance, local taxes, and other logistical expenses. For an average big-studio movie, these costs now amount to about \$40 million—so, just to stay in the black, a movie needs \$74 million in ticket sales. Many films don' t make that much, and even those that do, may not be profitable. For example, Disney, which hailed as a great success the nearly a quarter-billion-dollar "gross" of its movie *Gone In 60 Seconds* (released in 2000), wound up with only \$11.6 million from theaters, and since the movie cost \$103.3 million to make, its theatrical run ended up in the red. This is not uncommon. Most Hollywood movies nowadays actually lose money at the American box office and make it from ancillary markets. Meanwhile, the outcome of the box-office race has little

importance to theater owners these days, because each of the major multiplex chains books all of the studios' wide-release movies. Their only concern is the total number of people who show up and how much popcorn, candy, and soda they buy, since that's where their real profit comes from. In numerical terms, the movie-going audience has been shrinking since 1948.

The studios focus on the cumulative revenue their movies take in over many platforms, including both domestic and foreign movie houses, dvd stores, pay-TV output deals, and TV licensing. Even though its ancillary benchmarks can be higher when a movie is No. 1 at the box office, the film can fare very badly in its cumulative results. Consider, for example, Paramount's 2005 film *Sahara* (and here I should disclose that I served as an expert witness in a lawsuit involving its finances). Although it was No. 1 at the opening-weekend box office, it is one of the biggest money-losers in history. Based on a Clive Cussler best seller, the adventure film cost \$160 million to produce and \$81 million to distribute, and wound up losing \$78.3 million. On the other hand, some movies that finish at the bottom of the weekly pile, such as Woody Allen's *Midnight in Paris*, Wes Anderson's *Moonrise Kingdom*, and Darren Aronofsky's *Black Swan*, can ultimately take in more money than movies that finish ahead of them. It certainly helps to be first on a weekend, but not all weekends are equally valuable. There are holiday weekends that can produce as much as ten times the revenue as those in the slack season (when teenagers return to school). A Fourth of July second- or third-place movie can take in far more than a first-place finisher in October, since the total pie is so much larger. And films that open in the summer, no matter where they finish, will also earn more than fall films

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from Christmas dvd sales—due to the usual four-to-five-month embargo on the release of movies on dvd, summer films become fresh product on the market at holiday time. Even in the era of global marketing campaigns, US box office does not necessarily affect foreign revenues, which now are more important than the domestic take. For major movies, such as *Avatar*, more than 70 percent of the theatrical revenue is now earned overseas.

Nor does the box-office race provide an accurate measure of popular taste, since it lumps together movies that open on thousands of screens with those that choose to open on a few dozen screens, hoping to build gradually, benefitting from good reviews and strong word-of-mouth. Consider, for example, *Moonrise Kingdom*, which on May 25, 2012, opened in only four theaters in two cities, and finished in 15th place, while *Men in Black 3*, which was first, was booked on 4,248 screens. Indeed, when studio marketing departments want to know the actual audience appeal of a movie they track the per-screen average, the drop-off between Friday night (when there is no word-of-mouth) and Sunday, and the percentage drop after the first and second week. *MIB3* was all

but dead after three weeks, while Moonrise Kingdom moved to 924 theaters, and was still drawing audiences in late September, the nineteenth week of its run.

What a box-office victory actually measures is the breadth of the opening and the efficacy of the studio's marketing arm: In other words, based on a barrage of 30-second TV commercials containing snippets of the film, which most moviegoers will have seen an average seven times that week, how many people will show up on Friday night? This is a job the studios do amazingly well, but it has little to say about the intrinsic appeal of the movie.

To be sure, the race produces bragging rights every week for the winning studio's marketing department, which then exploit the "No. 1" title in newspaper ads (for which studios spend, on average, about \$4 million per title). And of course the publicity derived from this game further enhances the studios' revenue.

But why does the media play along in the promotion? Generally, it is the only "news" available in the entertainment news cycle surrounding the opening. Any real digging into the economics of a movie takes considerable time, since the studios tightly seal all relevant information, such as the terms of distribution deals, financing, subsidies, and stars' compensation, through Non-Disclosure Agreements. Even extras at times must sign ndas (as I found out when I was an extra in Wall Street: Money Never Sleeps). By the time the economic picture becomes clear, if indeed it ever does, the news value of the project has faded.

At the same time, the media's fixation on the box-office race diverts its attention from the ongoing transformation of Hollywood's business. It neglects the reality that today, the six major studios get less than 20 percent of their total revenue from showing their films in American movie houses. Most of their money comes from another, nearly invisible source: licensing their intellectual properties. Each studio has a vast library of thousands of movies, animated shorts, and TV series it licenses out to worldwide cable networks, pay-per-view TV, and broadcast television. A top executive

at Time Warner recently did the math for me, demonstrating that between 85 and 90 percent of its entertainment earnings comes from licensing its movie and TV titles to television; it is more or less the same story at the four other largest studios. (Paramount because it ceded its television production arm to CBS when they split, is the only major studio without a television production arm.) The reason that licensing is so immensely profitable is that studios do not have to pay advertising, print, or logistical costs, as they do when distributing a movie to theaters. Almost all money received—except for residuals paid to actors' and others' guild pension plans—goes to the bottom line. The same is true with the new business of licensing products to Internet companies, such as Hulu, Netflix, Apple's iTunes Store, and Amazon, for streaming. The continued cranking of this money machine

depends on the studios' retaining absolute control over these intellectual properties—a requisite that, given the threat of digital piracy, is reshaping strategies for how they release movies. The studios' entire system of "windows," in which a film's pay-off is optimized by delaying for many months its release on video, pay television, and other platforms, for example, may have to be compressed, if not entirely abandoned, to counter this threat. There is also new urgency to studios' international diplomacy, since minimizing the availability of pirated copies requires the assistance of governments.

No matter what political opinions their movie stars espouse, the corporate executives behind the scenes now must play nicely with those in power.

The screenwriter William Goldman famously explained the economics of Hollywood this way: Nobody knows anything. By focusing on the box-office race that is spoon-fed to them each week, journalists may entertain their audiences, but they are missing the real story. By neglecting the changing economics of Hollywood—and the politics that flow from it—they leave their audience, much like a movie audience, in the dark about what is really shaping Hollywood

As ever,

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