THE PENNSYLVANIA STATE UNIVERSITY
SCHREYER HONORS COLLEGE

DEPARTMENT OF ACCOUNTING

ALTERNATIVE METHODS TO FILM FINANCING IN THE 21ST CENTURY: AN EXAMINATION OF CROWDFUNDING

CHELSEA R. BURKA
SPRING 2013

A thesis
submitted in partial fulfillment
of the requirements
for baccalaureate degrees
in Accounting and Advertising and Public Relations
with honors in Accounting

Reviewed and approved* by the following:

Orie E. Barron
Professor in Accounting
Thesis Supervisor & Honors Adviser

Maura E. Shea
Sr. Lecturer in Communications
Faculty Reader

Robert S. Macy
Clinical Associate Professor in Management and Organization
Faculty Reader

* Signatures are on file in the Schreyer Honors College

ABSTRACT

The global motion picture industry encompasses the production, marketing, and distribution of motion pictures to audiences around the world through theatrical and home media entertainment enterprises. Revenue relies on discretionary spending and is highly sensitive to technological changes. It is one of the few industries still dominated by a handful of American studios in terms of infrastructure, financing, marketing and distribution reach. However, the turn of the 21st century brought significant structural changes in terms of discretionary spending and technology that impacted industry profits. Widespread technological adaptations of broadband internet and mobile devices shifted the distribution model away from theatrical and home video sales to streaming movies directly to personal computers and smart devices. The paradigms have changed drastically, yet the major players have not caught up and are becoming increasingly irrelevant. This thesis will explore the shifting landscape and explain my predictions for where the industry is headed. In the next ten to fifteen years, I predict the film industry will see major changes in both the funding of independent films and their distribution. The future of independent film financing will be driven by the growing phenomenon of crowdfunding, whereby consumers of media content actively participate in its creation and production. Crowdfunding platforms such as Kickstarter and IndieGoGo have garnered immense traction and proven a successful fundraising model for creative projects, especially smaller independent films. However, they are still relatively broad in category and do not offer means for exhibition. I predict distribution will be skewed towards direct online streaming to computer and smart devices. As seen in the music industry, I predict there will be a major shift in the prevailing paradigms: from an ownership model to an access model; from an industry dominated by a few monolithic companies who control means of production and distribution, to a more democratized system in which consumers control content creation, and have multiple outlets to access such content.

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

ACKNOWLEDGEMENTS

Like many freshmen, I first arrived at Penn State with more uncertainty than certainty; I was entirely unsure what to major in, which organizations to join, and what career path to pursue. However, I was sure of one thing; I wanted to stand out as a success story. After an incredible journey filled with invaluable experiences, from Wall Street to Silicon Valley, from studies in Milan to the Cannes Film Festival, I am proud of my successes and can confidently say I have reached the point I aspired to five years ago. However, these achievements would not have been possible without the guidance, support, and encouragement of so many people who deserve acknowledgement. For despite my professional accomplishments, I struggled with how to combine my love for the film industry with my experiences in accounting and finance. My honors thesis offered me the opportunity to combine the two, and I would like to thank the Schreyer Honors College for that privilege. By extension, I would like to thank my thesis advisor, Mr. Orie Barron, for his instruction and guidance since my junior year when I was admitted to the Schreyer Honors College, and my two faculty readers Mrs. Maura Shea and Dr. Robert Macy.

I would like to thank The Weinstein Company, specifically Mr. Harvey Weinstein and Mr. Brendan Sweeny, for the opportunity to intern with TWC's International Sales & Acquisition team during the Cannes Film Festival. Those two weeks reignited my passion for the film industry and provided me with a once in a lifetime experience to learn from some of the most brilliant and successful leaders in independent film. Later that summer in 2012, I met Mr. David C. Traub, the executive producer of the upcoming biopic, *Jobs*, in San Francisco at an event called "Hollywood Meets Silicon Valley." Discussions with Mr. Traub provided the basis for my thesis idea, and I am grateful for the time and wisdom he bestowed to me.

For providing research content and continued mentorship, I would like to thank Mr. Todd Supplee, a director at PwC Advisory, and by extension, the PwC Advisory Global Entertainment

Media and Communications group for research that developed my understanding of the motion picture industry. I plan to work with Mr. Supplee on related white papers when I join PwC Advisory this summer as a Management Consulting associate.

I would also like to thank Dr. Robert Macy, my instructor for MGMT 425: New Venture Creation. It was through his class I gained encouragement, guidance, and confirmation of my business proposal. I had never considered myself an entrepreneur until his class. It is probably one of the best courses I've taken at Penn State.

I would like to thank Ms. Robin Stevens, Director of the Smeal College Alumni Career Services & Wall St Boot Camp, and Ms. Lisa Kerchinski, Coordinator of Career Development in the Schreyer Honors College, for their mentorship over the past four years. I met these two wonderful woman at the start of my college career, and I have surely spent countless hours in their office ever since. They took an invested interest in my career aspirations, and I cannot thank them enough for their time, wisdom, and genuine care not only for my career, but for my well being. I hope to return the favor by being an active alumna for both the Smeal College of Business and the Schreyer Honors College.

And of course, I would like to thank my parents, Mr. Tomas Burka and Mrs. Deborah Trialonas, for their unconditional love and support. Since the time I was old enough to go to school, my parents instilled in me a fierce work ethic and the value of education. So much of my success, professionally and personally, is attributed to them.

To my younger sister, Marina Burka, currently a sophomore in the Schreyer Honors College, I hope you follow your dreams as vehemently as I did. I hope you can use your honors thesis as a meaningful way to find solutions for changes in the world you wish to see. Your compassion for those in need is beyond admiration; continue to lead with your heart—it is your true source for success.

Chapter 1

Motion Picture Industry Overview

Introduction

The global motion picture industry encompasses the production, marketing, and distribution of motion pictures to audiences around the world through theatrical and home media entertainment enterprises. Revenue relies on discretionary spending and is highly sensitive to technological changes; as such, the industry can be described as unpredictable, volatile, and in frequent state of transition. However, for those who understand how to manage its ever-evolving flux, it can be extremely lucrative, opportunistic, and thrilling. Since the dawn of the industry in the 1920s, film has characterized and shaped the United States' identity with grandiose dreams and the entrepreneurial spirit. It is one of the few industries still dominated by a handful of American studios in terms of infrastructure, financing, marketing and distribution reach (IBISWorld, 2012).

However, the turn of the 21st century brought significant structural changes in terms of discretionary spending and technology that impacted industry profits. The industry suffered when disposable income dropped due to the Great Recession, primarily in developed markets where more than 60 percent of revenue is derived. Widespread technological adaptations of broadband internet connection and mobile devices shifted the distribution model away from theatrical and home video sales to streaming movies directly to personal computers and smart devices. The paradigms have changed drastically, yet the major players have not caught up and are becoming increasingly irrelevant. Moreover, the growth of developing nations indicates increasing measures of competition and globalization (IBISWorld, 2012).

Fortunately, the industry outlook is bright. The film industry is developing rapidly in emerging economies, especially Brazil, Russia, India and China (BRIC), which will support industry revenue expansion. There is increasing global demand for movie content, supported by rising levels of disposable income in these nations and communication technologies that lower distribution costs (IBISWorld, 2012).

This thesis will explore the shifting landscape and explain my predictions for where the industry is headed. In the next ten to fifteen years, I predict the film industry will see major changes in both the funding of independent films and their distribution. The future of independent film financing will be driven by the growing phenomenon of crowdfunding, whereby consumers of media content actively participate in its creation and production. Crowdfunding platforms such as Kickstarter and IndieGoGo have garnered immense traction and proven a successful fundraising model for creative projects, especially smaller independent films. However, they are still relatively broad in category and do not offer means for exhibition once the film is created. Given the declines in theatrical attendance and home video sales, I predict distribution will be skewed towards direct online streaming to computer and smart devices. As seen in the music industry, I predict there will be a major shift in the prevailing paradigms: from an ownership model to an access model; from an industry dominated by a few monolithic companies who control means of production and distribution, to a more democratized system in which consumers control content creation, and have multiple outlets to access such content.

Chapter 1 provides an industry analysis integral for any reader to have a foundation for understanding the film industry in its present state. Chapter 2 examines the two primary mechanisms of the film industry—production and distribution— with regard to current structural issues compared to that of the music industry, and what changes can be expected based on the patterns witnessed. Chapter 3 explains the history of independent film financing, while Chapter 4 focuses on how private equity and hedge funds have financed films. Chapter 5 examines the role of crowdfunding, while analyzing current competitors Kickstarter and IndieGoGo. My thesis concludes in Chapter 6 with a business plan for a new platform called FlickFunder, which recommends a solution to current problems in both the funding and distribution models for the future of independent films.

Key Drivers of the Film Industry

The key drivers of the global movie production and distribution industry are: Gross Domestic Product (GDP) growth and purchasing power, especially in the BRIC nations; global per capita disposable income; technological changes; and global advertising expenditures (IBISWorld, 2012).

The first of these major economic factors influencing the film industry is GDP growth and purchasing power, and by extension, disposable income. There is a positive correlation between GDP growth (productivity) and purchasing power. Therefore, when productivity is strong, purchasing power increases; this increases demand for industry products. Changes in real household disposable income affect discretionary spending consumers have for entertainment consumption. When disposable income increases, people have more money to spend on items such as movie theater tickets or home entertainment. Therefore, the film industry is highly dependent upon discretionary spending (IBISWorld, 2012).

The Great Recession of 2009 decreased disposable income and productivity, especially in developed nations in North America and Europe, where more than sixty percent of industry revenue is derived. Not surprisingly, the entertainment industry faced declines in sales in the past three to five years as a result. Fortunately, this industry rose in 2012 with the recovering US economy and growing BRIC economies, whose growing middle classes continue to enjoy increasing purchasing power, disposable income, and demand for modern entertainment products.

Technology plays a big role and driving force in the film industry. Technology changes are boosting profitability by cutting both production and distribution costs and offering new revenue streams. On the production side, advances in video equipment and storage (new cameras, instant replay, and editing software) have stimulated demand for movies and sped up the production process. Now, high quality, high-resolution movies can be made for less (IBISWorld, 2012).

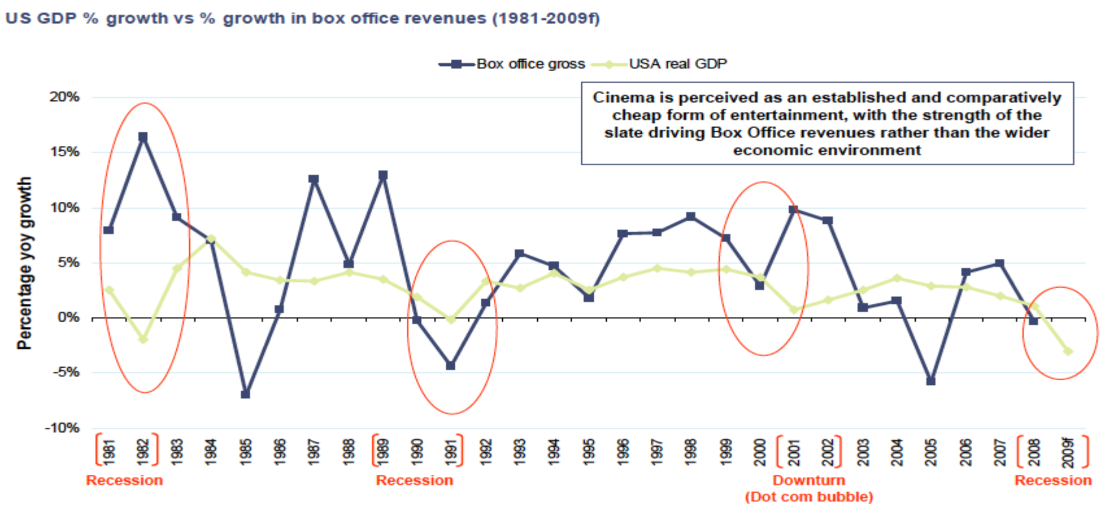
On the distribution side, smart technology and widespread broadband Internet connection is shifting film consumption from the theaters and physical home video (DVDs, Blu-Ray) to online streaming directly to computers, internet-enabled TVs and mobile devices. While 3-D movies stimulated box office and Blu-ray demand, the shift is undeniably towards on-demand streaming due to its convenience, ease of accessibility, and cost-effectiveness. Related to streaming is the driving influence of global advertising expenditure. As movie content continues to be streamed on ad-supported websites, this driver is expected to rise in 2012. According to IBIS World research, these drivers are trending positively, making the film industry a favorable and attractive market (IBISWorld, 2012).

Film Industry: Historic Growth and Future Outlook

Despite the decrease in disposable income from 2007 to 2012 in developed industry markets, industry revenue declined about 0.5% annually on average in the past five years due to advancements in technology, which stimulated demand for movies. Consumer cuts in discretionary power decreased purchase of DVDs, however increases in prices of movie tickets were justified by higher-quality exhibition (IBISWorld, 2012).

As Figure 1-1. US GDP % growth vs. % growth in box office revenues demonstrates, cyclical impacts tend to be low for box office revenue, which have historically not been significantly impacted by economic downturns. Even as consumers cut their spending, cinema is perceived as a relatively inexpensive form of entertainment (PwC, 2009)

Figure 1-1 Source: PwC, 2009, pg. 5



With continuing advancements in technology and growing global demand, the economic conditions look favorable for the entertainment industry over the next five years. Higher GDP growth and lower unemployment will help contribute to a growing household disposable income. Growing demand will stimulate movie production. The general availability of risk capital and finance will improve dramatically, offering more financing opportunities for filmmakers. Overall, revenue is forecast to rise during the next five years at a 2.4% annualized rate to $97.5 billion by 2017, as movie output increases at a moderate rate and demand steadily rises (IBISWorld, 2012).

Profit is a function of revenue less costs. With new revenue streams and lower distribution costs, Industry profits are expected to expand in the next three-five years, from a low of 4 percent profit margin in 2009 to about 4.2 percent in 2012. Profit margins tend to be small because of the large costs associated with producing, marketing, and distributing a film (IBISWorld, 2012). .

The following tables were created based on data from IBISWorld:

Table 1-1: Past 2-5 Year Industry Data

Industry Info	Current Year	Last Year	2-5 yr avg.
Total Revenue	$86.7 billion	$85.5 billion	$87.3 billion
IVA	$23 billion	$22.6 billion	$22.6 billion
Profit Margin	4.2%	4.0%	4.0- 4.5%
Industry Growth Rate	1.4%	-2.7%	-1.3%
Total Employment	853,000	848, 000	850,800

Table 1-2: 2-5 Year Future Outlook

Industry Info	Next Year	5 year (2017)	Avg. Growth
Total Revenue	$89.5 billion	$97.5 billion	2.4%
IVA	$23.5 billion	$25 billion	1.6%
Profit Margin	4.3%	n/a	n/a
Industry Growth Rate	3.2%	.8%	2.4%
Total Employment	860,000	882,000	0.80%

Figure 1-2 graphs the above data. Clearly, global movie production and distribution industry revenue are projected to increase substantially over the next five years.

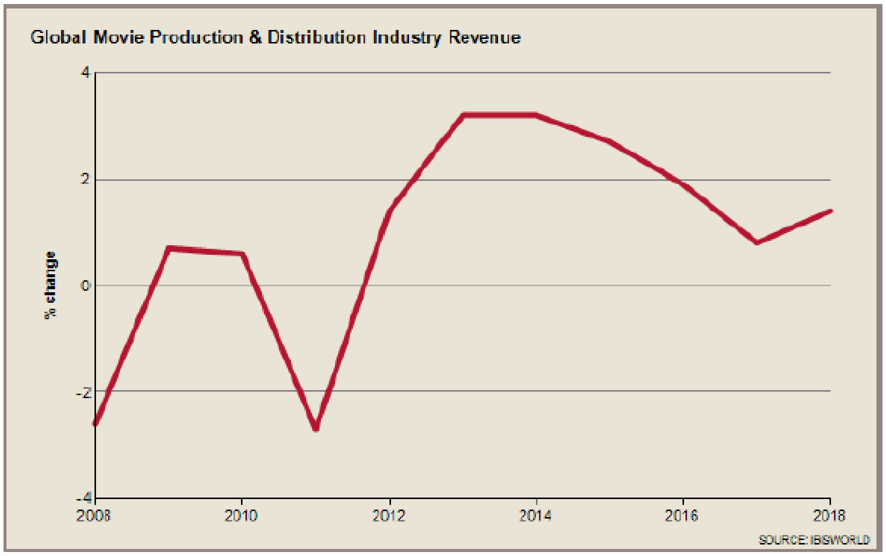


Figure 1-2 Source: IBISWorld, 2012, pg. 8

Industry Outlook: Emerging Trends and Opportunities

"The universe of film is constantly creating and recreating itself as trends emerge and fade, as territories and market react to internal or external forces, and as new technologies supersede older ones," writes C. Foy, Esq., an entertainment attorney in Los Angeles (Foy, 2004).

Indeed, the inherent creative nature of film engenders an entrepreneurial spirit, which has been characteristic of the industry for more than 100 years. With ever-changing audience preferences and desires amidst a fluctuating global environment, there are great opportunities for filmmakers to provide people with new forms of art and entertainment. It is an "eternal source of new opportunity windows to secure a niche, outperform the competition, and invent new franchises, talents or genres," (Foy, 2004).

The latest major change is the digital revolution and social media overhaul driving changes in traditional production and distribution models. While this poses as a threat to the major studio conglomerates, it offers infinite possibilities for new market entrants as new technology levels the playing field and tears down barriers to achieve and capture boundless profit potential. New revenue streams are required to drive growth to secure long-term profitability. The greatest opportunities lie in new online streaming distribution models, and the developments in emerging markets.

In developed markets, cinema attendance and DVD sales have been declining. The growing volume of smart technology and broadband connection has led people to prefer the convenience of online streaming. With this in mind, revenue models can be created around new ad-supported and subscription based revenue streams. Streaming represents the future of movie distribution, yet this has yet to be fully harnessed and commercially exploited (IBISWorld, 2012).

On the production side, advances in video equipment have raised the standards, but fortunately not the costs. This offers opportunities for smaller, independent filmmakers to produce studio-quality movies, even on a lower budget. We are seeing a more level, global playing field, democratized by the Internet and technology, for both producers and distributors of content. The rising middle class in these nations leads to a new population of people with greater discretionary spending to consume entertainment. In terms of volume, cinema attendance is now concentrated in India, with 40 percent of the global total and 3.0 billion admissions in 2009. By comparison, the United States brought in 1.4 billion in attendance, representing a 20 percent market share. A rise in theater establishments and GDP spurts in the developing BRIC nations is estimated to support 1.4% of industry revenue growth. While the United States still dominates the production and distribution infrastructure, clearly there is a trend to invest in developing nations to support the declining revenue from cinema attendance (IBISWorld, 2012).

Industry Outlook: Potential Threats

Just as the ever-changing developments in technology, preference and style provides great opportunity for new, small players in the independent space, this poses a threat for the less adaptable major studios. The industry is increasing in competition, at an increasing rate. However, while barriers to entry are low, the industry is highly concentrated; the four major US studios account for almost 30 percent of all industry revenue due to vertical integration and global distribution arms (IBISWorld, 2012).

One of the main threats is the challenge of free online content. While this is more the case for television, websites such as Hulu have diminished the need to turn to traditional (paid) methods of obtaining entertainment. While websites such as YouTube monitor illegal content, there are countless torrent and free downloading sites which allow users to download movies for free. Naturally, this violates countless copyright protection laws, but the sheer scale of sites and flow over the Internet makes it virtually impossible to eliminate and control entirely. Piracy also threatens online streaming distribution as a pure distribution model. Piracy is being more easily facilitated due to the increase in household broadband connection (IBISWorld, 2012).

Noneconomic characteristics

Despite structural challenges, one of the greatest strengths of the film industry is its extraordinary profit potential. Isn't that why everyone pursues Hollywood, in search for fame and riches? We are brought to the basic rule of finance: there is a positive correlation between risk and return. The film industry is highly volatile and risky, but the upside is the potential reward.

Beyond the economic factors, film is truly a unique art form, an "amalgam" of visual, literary and performing arts, including drama, photography, cinematography, fine arts, music and literature. This amalgam-quality allows for a vast, expansive reach, crossing demographic and geographic borders, and are regarded as one of the most powerful forms of communication. There exists a "collective" perception character and capacity, according to critic Marshall McLuhan, to "unify and re-tribalize" the human race. Films are both cultural and commercial enterprises, and the business of film is acutely impacted by political, social and aesthetic factors and trends. There is a sense of magic and glamour surrounding the film industry, glamourized by Hollywood, which begs for an intangible quality that is arguably, invaluable.

Chapter 2
Production and Distribution Mechanisms: A Look Forward

When we examine the motion picture industry, we can structure the industry into two spheres of activity—production and distribution. Production involves the actual creation of the film, from the inception of an idea to a completed film. Distribution refers to the marketing engine that promotes the movies, and identifies strategic outlets to commercially exploit the movie, from the theater to a home.

The film industry is dominated by a small number of American companies, namely the six major studios and a handful of large independent studios, which are highly vertically integrated with production studios and global distribution arms. This unusual oligopoly structure has persisted since the beginning of Hollywood. For those who are already players in the industry, their dominance of market share, both at home and abroad, plays to their advantage as they are able maintain a strong position even with failures at the box office. Moreover, the major studios monopolize production, distribution, and financing mechanisms because of the high costs involved. However, advances in technology are lowering traditional production and distribution costs, and increases in globalization are increasing industry competition (IBIS World, 2012).

This chapter will examine each of these spheres, discussing current issues, and projecting their look forward given the changes shifting the current production and distribution landscape.

Production

Production consists of five stages: development, packaging, preproduction, principal photography, and post-production. Figure 2-1 outlines the phases in greater detail:

Figure 2-1. The Five Phases of Production (Benedetti, 2002).

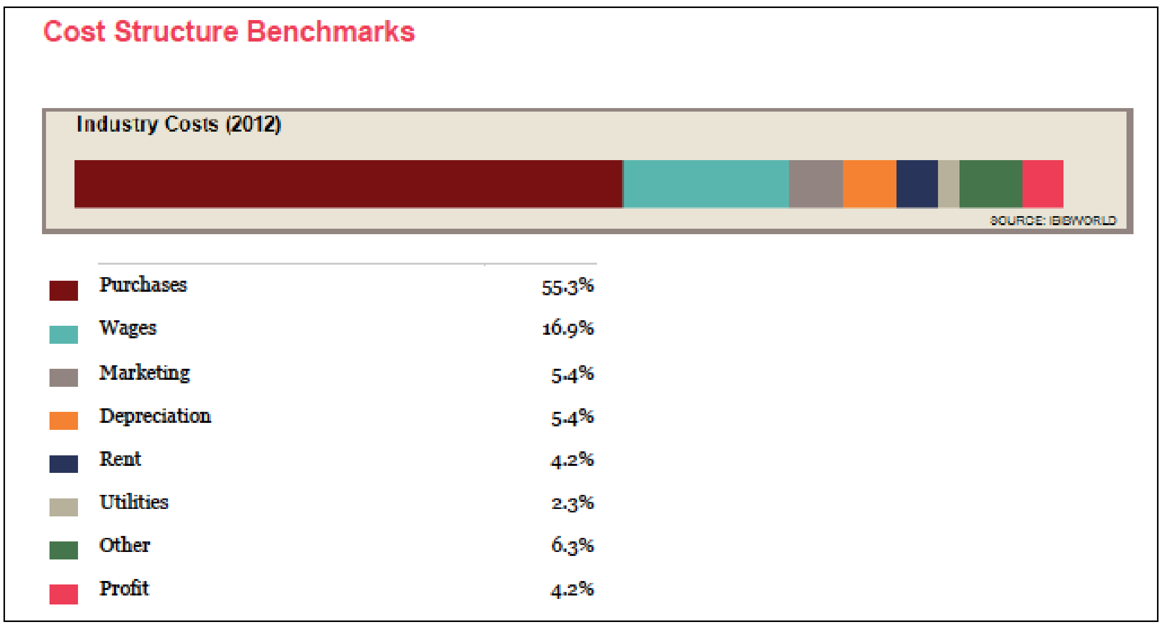
The biggest players, in both the production and distribution spheres, are no doubt the American major studios. The Motion Picture Association of American (MPAA), the trade association representing the six largest Hollywood studios, outlines the “major six” and their parent multinational conglomerates as: The Walt Disney Studios (The Walt Disney Company); Sony Pictures Entertainment (Sony); Paramount Pictures (Viacom); 20th Century Fox (News Corporation); Universal Studios (Comcast); and Warner Bros (Time Warner). These multinational corporations have diverse revenue streams and media interests. Many also provide major television networks: Fox and Fox Networks, Paramount and UPN and CBS; NBC Universal and NBC; Warner Brothers/New Line and WB Network/TNT; and Disney/Miramax and ABC (MPAA, 2013).

Independent studios also play an integral role in the production of films. They are defined in the industry as “well capitalized, going-concern companies and the many individuals who develop and package film projects with little or no staff, and who obtain single picture financing for single purpose production companies, producing each picture separately” (Foy, 2004).

Financing is an essential part of the production process. The major studios fund production projects from current revenues, advance payments, credit facilities with banks, venture capitalists, and public and private offerings. Independent companies finance films from a variety of sources: arrangements with studios, domestic and foreign distributors, banks with entertainment lending sections, private offerings, investors and venture capitalists, private placements, and, occasionally, public offerings (Foy, 2004).

The cost of producing a film, also called the “negative cost,” is extremely high. Negative cost is the term for the cost of actually producing and shooting a film. It does not include distribution and marketing costs; the term comes from the costs of producing everything up until the final “negative”, hence the name. The average cost of a studio movie peaked at $64 million in 2003, an increase of nine percent since the prior year. Few producers outside the major conglomerate studios can afford such costs (PwC, 2009).

Figure 2-2. Cost Structure Benchmarks shows the breakdown of the cost structure benchmarks, as a percentage of revenue (IBISWorld, 2012, pg. 18).



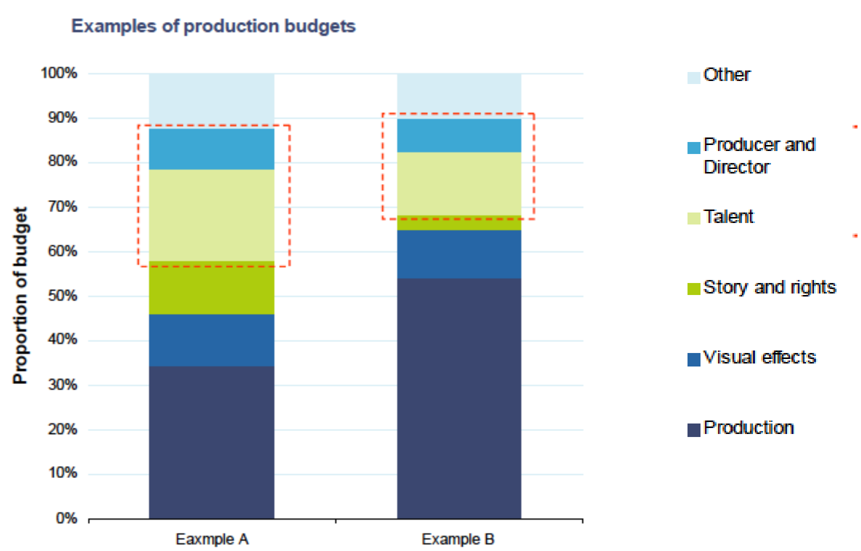
As the figure demonstrates, the cost structure of producing a film leaves little room for large profit margins. Purchases, which account for more than half of total revenue, are the most significant industry cost segment. Purchases include the majority of costs necessary to produce and shoot the film, such as on-set construction, equipment, program rights, and license fees. These costs are high because of the amount of personnel involved in creating a film. High-quality filmmaking requires a unique specialized array of skills and talent. Entertainment attorney C. Foy, Esq. summarizes:

> "Film is both a collaborative art, and a capital and legal intensive business. It requires contributions by artists, pre-production and post-production talent as well as business and legal professionals, all who require extensive fees and salaries for their work."

As Figure 2-2 demonstrates, wages account for the second largest expense, costing about 17 percent of revenue. Because of the high level of technology used in movie production and postproduction editing, this work requires specialized crews who possess both technical and creative skills. Naturally, larger, more complicated films require larger budgets, sets, and staff. Special effects and animation drive up costs, as well. These expenses and budgets ultimately cut into revenues, diminishing profitability.

Indeed, "above the line" personnel account for a large proportion of expenses. As PwC research points out in Figure 2-3, as much as 30 percent of the entire budget can be allowed for producers, directors, and talent (PwC, 2009).

Figure 2-3: Examples of Production Budgets (PwC, 2009, pg 15)

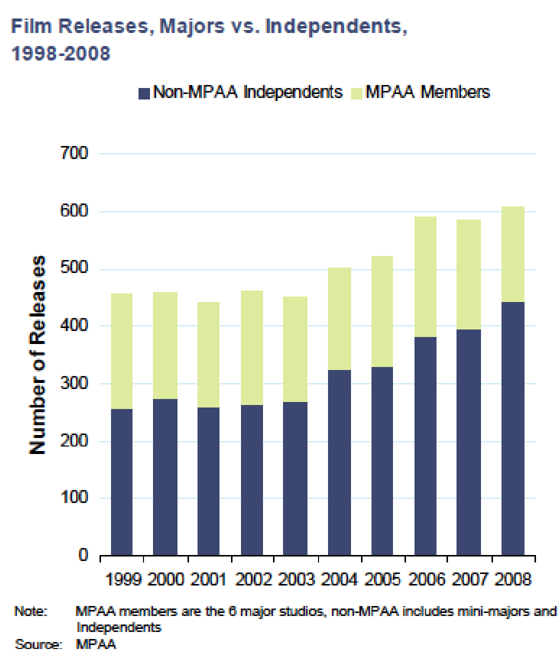


Studios understand star-powered actors or directors add to the potential success of a film, and therefore pay exorbitant salaries for their work.

Traditionally, it was very difficult to obtain funding from sources other than large banks and major studios because of the lack of transparency in forecasting earnings. Films are described as “research and development” products—they cannot be test marketed and therefore the marketplace cannot predict the success of a given film. They are considered high-risk investments because there is no guarantee of payment; in fact, there is often a randomness of pay-off (IBISWorld, 2012).

The Great Recession placed pressure on the studios to lower production costs and alter their product mix. Historically, film production exceeded the number of films actually released. In 2008, the market corrected itself; production was down due to a lack of available credit, writers strikes, and threatened SAG action. Independent movie producers were more heavily impacted by the recession than the majors because of their reliance on outside financial institutions. During the credit crunch, equity was very thin and banks were tight on lending. Moreover, independent studios typically do not have the large budgets and movie libraries to weather cyclical impacts. The major studios survived the recession by focusing on proven franchises and popular blockbusters, and cut costs where possible.

Figure 2-4. Film Release, Majors vs. Independents shows how the reduction in investments significantly impacted the decrease in independent (Non-MPAA) film releases (PwC, 2009, pg 13).



Evidently, there is a currently a large dependency on financial institutions for the production of independent films. Unless lending facilities become less stringent, this model is not sustainable.

Fortunately, changes in technology are driving changes in production costs, and changes in economics are driving new methods for raising the finances for such costs. As mentioned in Chapter 1, advances in technology have sped up the production process and lowered its costs, opening the doors for filmmakers outside the major studios to enter the and succeed in the film industry. No longer does a larger budget translate into larger profits. *Paranormal Activity* (2007) was produced for only $15,000 yet grossed $107 million worldwide, making it the most profitable film of all time, based on return on investment and excluding marketing costs. The film was originally developed as an independent feature; director Oren Peli originally shot the film in just seven days at his home, paid the two actors $500, and did not develop a formal script. While Paramount Pictures eventually acquired the film, this “small” film’s immense success sets a new precedence for the relationship between budget and profit (Paranormal Activity’s Box Office Success, 2009).

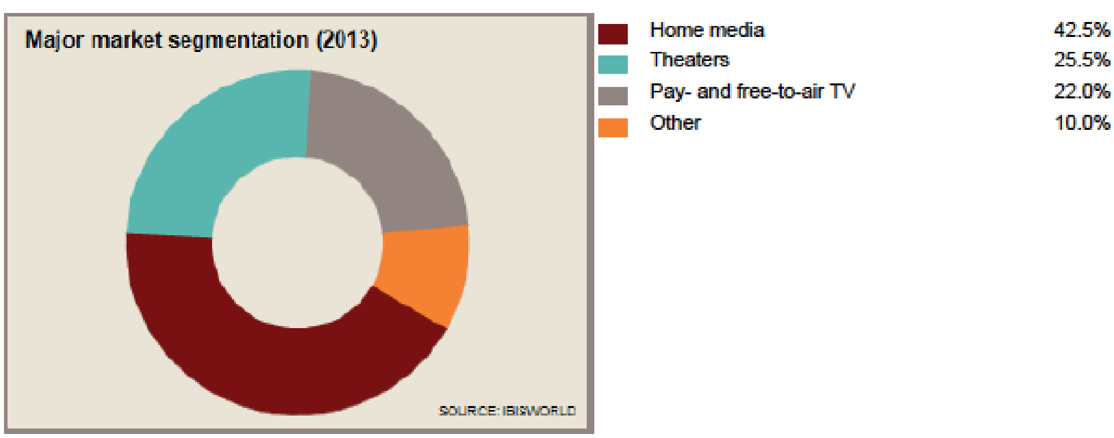
Distribution

If production is the creation of a movie, distribution is the process of commercially exploiting it. Distribution includes marketing (advertising, publicity, and promotion), licensing, and exhibition or broadcast. The following list comprises the primary distribution channels that historically have driven revenue: theatrical distribution (domestic and foreign); home video (VHS, DVD, Blu-ray); subscription pay-television networks (premium cable and satellite channels, pay-per-view); non-pay television (cable and broadcast networks, local channels); and ancillary rights (soundtrack, publishing, merchandise) (Foy, 2004).

As previously discussed, demand for movies are driven by disposable income, publicity and reviews, leisure time, and digital media technology adoption. This is where distribution comes into play; while the film industry cannot control economic drivers such as disposable income, leisure time, production companies can control the level of publicity. Demand for films tends to be greatest when publicity surrounding theatrical exhibition or home video release has been widespread (Kaczanowska, 2012).

Historically speaking, box office revenue accounted for largest part of total revenue, and the financial success of a film was dependent upon successful distribution; reciprocally, successful distribution required substantial investment in costly marketing campaigns for theatrical release. In 2009, about 75 percent of global picture revenue was derived from theatrical distribution and sale of home video. Today, home media has surpassed theaters in terms of market segmentations, at 42.5% and 25.5%, respectively, as shown in Figure 2-5. Major Market Segmentation (IBISWorld, 2012, pg 13).

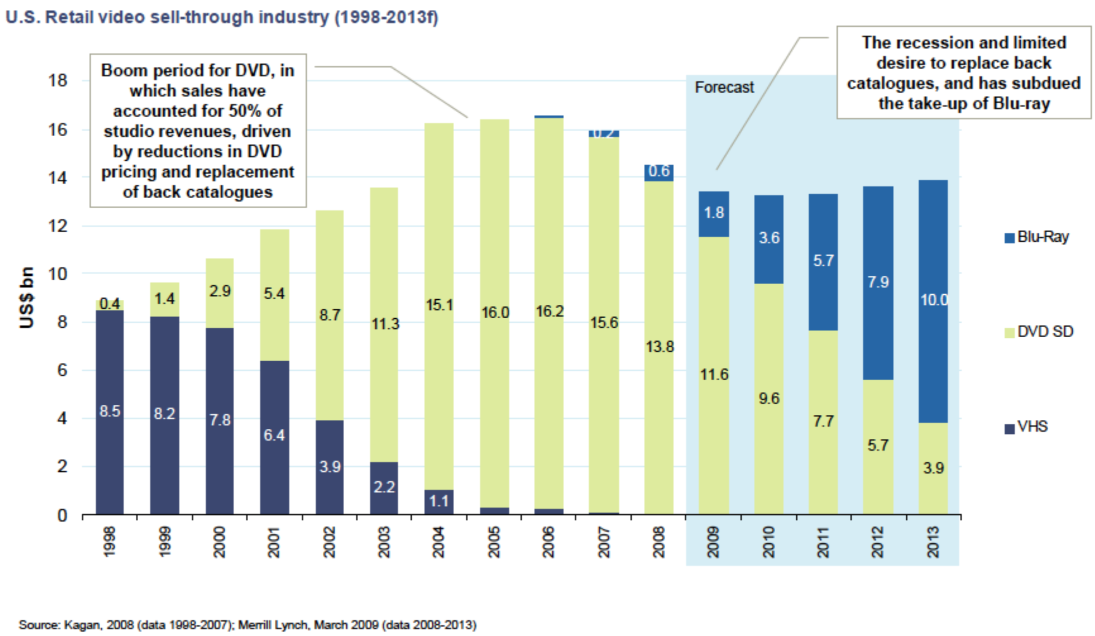
Major Markets



While the box office is no longer the major source of revenue (in 2006, DVD sales accounted for *half* of studio revenue), cinematic release is still an integral part of the distribution process. Movie theaters are the first point of market entry for a new film, and production companies spend a large amount on advertising films to consumers. According to the MPAA, the average marketing cost of a major studio film in 2003 was $39 million, a 30 percent increase from 2002, namely due to surges in television advertisement costs. Today, that number can be as much as or greater than the entire budget for producing the film. Why would production companies spend so much for theatrical distribution? Advertising has been shown to increase audience numbers. Secondly, while box office revenue is declining as a proportion of total industry revenue, box office returns and attendance has actually increased since 2007 in the BRIC nations. Most importantly, the overhaul in theatrical marketing and promotion drives the rest of the revenue streams down the line, ultimately impacting total profit. This has been seen by the increase in home media sales, for such sales reflect a movie's popularity at the box office. The majority of industry revenue today is derived from the sale of DVDs and Blu-ray products. Home media products are gaining popularity due to the increase in household adoption. Consumers prefer their versatility and convenience (Kaczanowska, 2012).

The third and fourth steps in the distribution chain are license fees generated from fee-based networks (subscription pay television, pay-per-view, and video-on-demand) and free-to-air TV networks. License fees are based on how high the potential viewing audience is projected. License fees have increased in the last five years, mostly in developed markets, due to robust growth in cable and satellite audiences. This fees will likely increase with expected cable/satellite technology adoption in developing markets (PwC, 2009).

However, the motion picture industry is facing major structural issues that threaten the current revenue model. DVD sales are declining and Blu-ray adoption will not offset these declines. DVD sales peaked in 2006 at $16.2 billion, which at the time accounted for half of all studio revenue. By 2008, DVD sales dropped 28 percent to $11.6 billion. Forecasted DVD revenues for 2013 are merely $3.9 billion. While an estimated $10 billion in Blu-Ray sales project an estimated $13.9 billion in total revenue for US retail video sales, this is still well below the industry highs of 2006, as seen in Figure 2-6: US Retail video sell through (1998-2013f) (PwC, 2009, pg. 6).



If the largest segment of motion picture industry sales is declining, the development of new revenue streams is critical to drive growth. The popularity of 3D movies and video game franchising has helped support growth in the medium term, but this type of adoption is only appropriate for certain genres. Disney and Dreamworks are leaders in this arena (PwC. 2009).

The most promising new revenue stream is online distribution, referred to as "streaming." Streaming can be applied to both the purchase and rental model. As we have witnessed with the music industry, there was a major paradigm shift from an ownership model to an access model. . The music industry used to be owned by major record labels, which promoted key portfolio artists to the mass market. There was no market segmentation, few product choices (consumers could only purchase entire CD albums), and few distribution outlets. Services such as iTunes and, more recently, Spotify, have revolutionized the suffering music industry by changing the business model. iTunes allowed users to pick and choose individual songs, with the convenience of downloading (for purchase) directly from the iTunes Music Store. Spotify, a commercial music streaming service launched in 2010, disrupted the industry even more when they offered virtually the entire universe of music to consumers, for free, so long as one has an Internet connection. Spotify users can customize their own libraries based on their preferences, and subscribe to their Facebook "friends'" libraries, at absolutely no charge. Unlike illegal services such as Limewire or Napster (no longer in existence), the music is not downloaded- it is accessed through the cloud. Spotify Premium users pay a low fee of $9.99 per month ($120 per year) to have access to the music offline and on the go. According to AppData (www.appdata.com), a leading site that measures the Facebook and mobile app landscape, Spotify ranks as number seven in terms of highest monthly application users (MAU), at more than 25 million MAU in January 2013 (Spotify Appdata, 2013).

The music industry went from selling a few products to a lot of people, to selling a larger number and variety of products with lower volume. The number of potential customers under the curve is actually larger. Now, distribution is easy and the choices are virtually countless. The music industry adapted to the changing business model—in order to stay competitive and relevant to today's consumers, the film industry must do the same.

The online delivery of movies (both rental and purchase) is estimated to increase rapidly over the next 10 years. The growing volume of smart technology and broadband connection has led people to prefer the easy accessibility of online streaming. With this in mind, revenue models can be created around new ad-supported and subscription based revenue streams. Streaming movies online is not only less expensive, but it is also much more convenient. Most consumers do not care about having a physical collection of movies and tend to watch films only once, so there will be an even greater trend towards an access versus purchase model, as seen with the music industry. While the lower cost of online movie purchases could translate into lower revenues, it could also mean lower costs for studios. Online movies are much less expensive for studios to produce due to lower production and delivery costs, and the ability to supply directly to the customer. For example, a studio takes 30 percent of revenue from physical rental, but an astounding 70 percent from Video on Demand (VOD). Therefore, the online purchase model could translate into higher margins for studios (PwC. 2009).

Some industry-wide threats are posed. Once again drawing a parallel to the music industry, the biggest risk is piracy and other forms of illegal downloading. Piracy is being more easily facilitated due to the increase in household broadband connection. Secondly is the threat of increasing competition for the major studios. As previously mentioned, the industry is highly concentrated; the four major US studios account for almost 30 percent of all industry revenue due to vertical integration and global distribution arms. The rules of personal finance are applicable even here: the large studios manage large, diversified portfolios of movies that mitigate losses and other risks. Smaller studios historically have not had the financial resources to create and release as many films each year. However, newly developed technologies that cut both production and distribution costs will help mitigate these risks for smaller production and distribution outlets. The next five to ten years should demonstrate an increase in competition from both developed and developing markets, as economies continue to grow and thrive in the BRIC nations (IBISWorld, 2012).

Streaming represents the future of movie distribution, yet this has yet to be fully harnessed and commercially exploited. This presents a number of opportunities for new market entrants. In summary, the motion picture industry should expect to see a more level, global playing field, democratized by the Internet and technology, for both producers and distributors of content.

Chapter 3

Independent Film Financing: A History

Inherent in every distribution deal is the following truth: (creative) control follows risk, and risk follows financing. In other words, those who take on the financial risk to invest in a film provide capital in exchange for control. Herein lies the fundamental problem of many filmmakers; a producer must often sacrifice creative control in order to obtain funding. Often, this causes dilution of artistic vision.

Independent film financing rose out of the evolution and adaptions from the American feature film industry. Since the dawn of the American film era, motion pictures have been characterized as a large-scale industry dominated by vertically integrated major production and distribution studios.

When the industry was in its infancy in the early twentieth century, independent producers colonized Hollywood as a means of escaping the anti-competitive practices of the Motion Picture Patents Company (MPPC), which held a monopoly in the industry. With the MPPC headquartered on the east coast, the independents established a new film production center in Hollywood, which birthed many of the major studios. Some of the founding names resonate in the industry today: Louis B. Mayer of MGM; William Fox of 20th Century Fox; and the Warner brothers. Ultimately, the MPPC dissolved in 1917, when the Supreme Court ruled it violated the Sherman Antitrust Act protecting a competitive marketplace (Foy, 2004).

In the 1910s, the major independent production companies faced another monopolization battle. When producer-distributor Lasky’s Famous Player’s Co merged with Paramount distribution, the other exhibitors aimed to acquire competing production and distribution houses.

Due to the scale and complexity of these mergers, banking institutions became increasingly involved in the young film industry. Increasing capital requirements for producing the films led to mandated public offerings of the major studios on the New York Stock Exchange. With Wall Street investing vast sums of money into the industry, the studios began to hire official financiers and accountants, who systemized motion picture production. By the end of World War I, the majors were highly vertically integrated and the resulting "Studio System" structure characterized the industry for the next forty years (Foy, 2004).

The 1930s brought a significant technological advancement- the advent of sound. With the vast majority of American film production concentrated in eight studios, this decade was also marked by domination of corporate giants such as the Morgan and Rockefeller groups, who controlled nearly all major sound patents. In the 1940s, B-Studios played an increasingly important role and ultimately migrated to producing television "series" (Foy, 2004).

From inception in the 1900s to the 1940s, early motion pictures were financed by traditional business methods such as commercial loans, credit agreements, bank loans, and security offerings. Because most of the majors also owned their own exhibition channels, they were able to consistently generate income from the box office and replay their financing obligations. With vertical integration, the studios effectively ensured their films, even those with poor income potential, could generate revenue. World War II brought devastation to the growing film industries in Europe, destroying production facilities and theaters. But in the United States, Hollywood continued its economic domination; 100 million people per week paid for a theater ticket (Foy, 2004).

The 1950s and 1960s marked the genesis of modern film finance. The motion picture industry was challenged by three critical changes: the invention of television, which substantially decreased theater revenue by over 50 percent; political investigations of Hollywood that blacklisted many artists; and a series of federal, civic judgments prohibiting studio ownership of theater exhibitions. One of the judgments was the Paramount Consent Decree, which ordered the divesture of ownership in theatrical exhibition enterprises in order to prohibit anti-competitive trade practices. The drastic change in economics and the total vertical integration industry structure led to changes in film financing. Two truths were realized, which hold true to this day. First, increasing collateral requirements is not always feasible or practical for the borrowing producer; a lost loan opportunity equates to a lost income opportunity for the banks. Secondly, the principle threat to loan default was an uncompleted film. In response, two producers in London founded Film Finances, Inc. to be a specialized guarantor. Subsequently, many related businesses were created following this business model (Foy, 2004).

Independent film production was engendered from these industry changes. Independent films flourished in the 1950s, achieving a staggering 30 percent market share in the total film production industry. Another phenomenon of the 1950s and 1960s was the increasing importance of the international market. While both production and distribution had traditionally been centered in America, rising domestic costs moved production overseas to take advantage of lower costs of sets and non-union labor. Moreover, the demand for foreign film increased as US distributors looked to evade the restrictions of the Paramount Consent Decrees. As a result, the number of foreign films in US theaters sometimes was two to three times larger than the number of domestically produced films. The decline of the “star system” and its resulting changes in star compensation also propelled independent studios. In an effort to lower budget costs amidst unfavorable economic, social and political systems, studios abandoned long-term star contracts. Subsequently, stars were compensated differently in terms of individual film profit-sharing. As a result, many movie stars moved away from the major studios and used their celebrity to form their own production companies. Writes C. Foy, Esq**,** “By the end of the 1960s, the film industry transformed from one in which studios “owned” stars, to one in which stars “owned” films” (Foy, 2004).

The developing European film industry shaped changes in style and preference in the US.. The financial and cultural success of “art films” abroad in the 1970s proved independent productions of this genre could be highly profitable. This led to two important events in the evolution of the film industry. First, a new breed of independent filmmaker was created; the producer and director role was combined in an effort to control financing, and subsequently, creative vision. Notorious examples include George Lucas, Roger Corman and Stanley Kubrick. Secondly, the major studios became willing distributors of the newly successful independent and foreign films to supplant declining theatrical revenue (Foy, 2004).

The surge in independent films preempted an important development in film financing—the “interim production loan.” Characterized by: the use of distribution or presale contracts containing minimum guarantee payments for loan collateral; distribution and presale contracts discounted to present value, equating the amount a bank would loan to a producer; and negative pickup. Negative pickup refers to film financing that assures the picture will be completed on time, within budget (Foy, 2004).

The 1970s was also a decade characterized by big-budget, mass-appeal blockbusters, and coupling upward spiraling costs. Production, distribution, and marketing costs increased substantially, also increasing risk. In response, studios trended to merge with large corporate conglomerates to sustain their increased capital requirements. Fortunately for the corporations absorbing the studios, films proved to be extremely profitable in terms of average rate of return (Foy, 2004).

The 1980s were the most lucrative decade for film. The independent film sector developed presale financing and the creation of successful mid-sized independent production-distribution outlets. New Line Cinema and Miramax created a niche brand of films marketed as high-end, lower-quality films, and they proved to be exceptionally talented at acquiring hit movies. To illustrate their success, by 1999 New Line Cinema had achieved almost a ten percent domestic market share, larger than either household names such as MGM or Universal Studios (Foy, 2004).

As discussed earlier, contractual commitments such as negative pickups and presale contracts help independent producers obtain production funding. However, as costs increased, they were no longer a sufficient means to fund the entire budget of a film. They still remain desirable forms of funding for both studios and independents. For studios who supply the negative pickup, it allows them to remove production from their balance sheet. For producers, pickups and presales are desirable as they merely transfer distribution rights, not copyrights. Furthermore, it prevents the "cross collateralizing" of revenues. In the 1980s, presale and pickups increased internationally as producers realized they could presell enough territories so that the total of minimum guarantees exceeded the film's budget—thus creating instant profit. This was not available domestically. Home video exploded in the 1980s with the invention of the VCR and pay television, particularly in Japanese and European markets where a weak US dollar dramatically increased revenue streams. To satisfy growing demand abroad, lower quality "direct to TV" movies produced by "B-studios" gained popularity and acceptance. In this decade, film investing was primarily tax driven. To compete with the ever increasing size and complexity of film production, the 1980s were also characterized by unique film financing vehicles. The first was a public limited partnership (LPS); they were created by Wall Street investors to fund portfolios of films, offered by public major firms such as Merrill Lynch and purchased by smaller investors. They were an attractive investment from a tax point of view; they provided a tax credit and offset passive losses. Investors could purchase films as they were being completed and effectively lease them back to distributors. They could accelerate depreciation and amortization to defer income taxes and other taxes. However, the Tax Reform Act of 1986 included provisions to eliminate these conditions (Foy, 2004).

Non-public limited partnerships or limited liability corporations (LLC) grew in response as a vital private placement method to fund single films and production. While LLCs are subject to the same rules as LPS under the Tax Reform Act, they nonetheless offer investors countless benefits against corporate treatment—limited liability, single taxation, deductibility of losses and special allocations to incomes and losses. Going back to the relationship between financing and creative control, LPS's and LLC's offer an optimal mix; passive investors allow management to maintain control. For this reason, private placement financing remains a vital and utile aspect of modern film finance (Foy, 2004).

The 1990s were characterized by an intense and lucrative evolution in independent film finance and production. The decade brought about economic forces that dynamically altered and impacted the industry. One important marker was the lending freeze by a French bank, Credit Lyonnais Bank Nederlands (CLBN) in 1991. CLBN was the primary maker of single-picture production loans, and a studio finance scandal ceased lending. In response, theatrical revenues for studio films plummeted in Europe, Asia and America. Fortunately, the international surge in demand for art-house and specialty films was accompanied by bolstered ancillary revenue in television and home video, particularly in foreign territories. American studios continued to dominate the overseas markets (Foy, 2004).

With the fall of CLBN, there was a surge in the involvement of insurance companies competing as lenders offering to insure "gap loans." The traditional method of funding a budget through minimum guarantees was no longer sufficient as production and distribution costs increased to keep up with the demand for quality films. Essentially, banks provided gap financing to producers to make up the difference between the total budget and the total minimum guarantees, then insured the loans in the event sales targets were not met. In the past, gap loans were protected by insuring only 20-30 percent of the budge. But gaps widened and banks increased gap loans to as much as 50 percent of film budgets. This increased the risks of loan transactions significantly. Unfortunately, many films did not reach their sales targets domestically or internationally, and the insurance companies were subsequently required to repay the loans. Insurance-backed gap financing has been more rationalized since the height of the market (Foy, 2004).

In the second half of the 1990s, film demand transitioned from art-house and specialty films, which the independents dominated, to major studio films with mega star power and special effects. International demand, in particular, soared. In response, specialty films lost incredible market share and production allocation in studio budgets. Once again, the major studios dominated the scene and oversaturated the market; by the end of the 1990s, it became virtually impossible for small or medium sized independent production companies to obtain theatrical distribution in the US. Only a few large independents survived. The 1990s also witnessed the phenomena of public underwriting in the Neuer Market in Germany. The Neuer market was developed by German distributors who were frustrated by the American domination of the German film market. The sense of frustration was certainly not new to foreign markets frequently sidelined by American movies, but what the Germans did that was so revolutionary was the creation of a public market in tax sheltering vehicles. Essentially, the Neuer market allowed German producers and distributors to raise enormous sums of cash from wealthy private investors. In exchange for their investment, they were offered large tax write-offs for the high production costs (Foy, 2004).

Hollywood quickly caught on. Not before long, the Neuer market film fund was a more attractive means of raising money than the major studio deals offered by Americans. This was in part because the German private investors were more concerned with tax incentives than creative control, allowing the producers to maintain their artistic vision. By the turn of the century, countless Hollywood producers entered into equity or deals with the German film funds. Collectively, this promised astronomical capital and fees, amounting to hundreds of millions of dollars. For example, two large German funds, Helkon and Kinowelt, invested hundreds of millions into independents such as New Line Cinema and Newmarket.

As with anything that seems too good to be true, the Neuer market bubble grew and burst by 2001. Bruce Frumerman of *Finance Alternatives*.com writes, "The funds sprang up like mushrooms, their trading prices soared, and then in 2001 the Neuer Market melted down, a victim of bankruptcies and insider-trading scandals" (Foy, 2004).

The Neuer Market was successful in raising substantial amounts of funding, but in a skeptical manner without fundamental understanding of the deal structure. It had pledged more than $1 billion in production, distribution and rights commitments, yet delivered only a tenth in cash. Once again, producers had to find another strategy to source production capital.

Overconfidence in demand domestically and internationally for high-quality films led to riskier financing arrangements, first with the gap financing and gap insurance lending, and then the enticing German investments. Even after the German market collapsed, a similar alternative emerged—the financing producer. A financing producer brings partial production or distribution equity financing, namely from wealthy American investors. In light of fortunes made through real estate and the dot-com boom, Americans were equally anxious to get involved. This risk-on sentiment characterized film financing for the turn of the century.

Unfortunately, the economy and markets took a turn for the worse with another bubble burst—the dot-com bust. A series of corporate scandals included the Enron case and the Adelphia off-balance sheet financing malfeasance drove bank consolidation and froze lending capital flows. Domestic and overseas box office revenues were down, a consequence of the collapse of the Neuer market. Studios needed to cut risk and costs, without reducing their profits.

Moreover, popular "soft money" (tax-incentive based investments) became less viable as governments revised their tax codes. Tax shelters, tax breaks, labor credits or co-production arrangements are still available, but often involve complex legal issues, ultimately increasing the transaction costs. This is particularly true for co-production arrangements made by foreign territories offering benefits for US companies to film inside their borders (Frumerman, 2007).

In conclusion, the independent studios needed a new revenue model, or at least a new addition to the film financing mix.

Chapter 4

The Role of Private Equity & Hedge Funds in Alternative Film Financing

The turn of the century brought with it a change in the prevailing revenue model. From the beginning of the film industry to the 1990s, films could be financed 80 percent or more by presale agreements. But the trend for high-budget, star driven, franchise-potential pictures, coupled by inflated acquisition rights costs from the Neuer market, increased production and distribution costs significantly. With foreign presale agreements and "soft money" arrangements covering only half of a film's budget, a third ingredient in the financing mix was essential—private equity (Foy, 2004).

Private equity refers to capital provided by investors and funds that make investments into private companies or endeavors. Historically, private equity offers excellent returns, but the funds are extremely illiquid. Because of the large sums of money required and the lock up period is typically five to ten years, the majority of investors are institutional. Most typically, private equity funds are used to conduct leveraged buyouts (LBOs) to purchase distressed companies, improving their status by infusing capital and re-organizing management, and then reselling the company. However, since the 2000s, private equity has become an essential method for procuring independent film financing.

As discussed previously, the 1990s produced numerous real estate moguls and high net worth individuals from the dot-com boom. They were eager and willing to invest huge sums of capital in return for high rates of return. This included high profile entrepreneurs such as Paul Allen of Microsoft, Jeff Skol of eBay, and J.D. Edwards founder Jack Thompson, to name a few. These sophisticated investors understand the principles of successful film financing are analogous to the principles of traditional asset management and portfolio construction. The most basic rule of finance postures a positive relationship between risk and return. Naturally, every investor would love to take as little risk as possible to achieve the greatest possible return. The most effective way to do this is through diversification of portfolio allocation; in other words, never put all your eggs in one basket. Film is one of the most volatile industries; it is advantageous to engage in slate financing, a term of art for financing arrangements that spreads risk across a range of genres (Frumerman, 2007).

In a perfect private equity world, the original equity investors would be returned a multiple on their initial investment, mezzanine investors would receive their interest and principle, and senior debt would be fully serviced with the possibility for another round of financing. The problem is that films are incredibly difficult to value from a financial point of view, as it is impossible to accurately predict earnings at the box office or on home video. Many movies thought to be hits are busts, and smaller films made on a $15,000 budget gross multimillions in theaters (case in point: Paranormal Activity, discussed in chapter 6). Moreover, the confidential nature of industry deals makes it difficult for analysts to even estimate earnings. In reality, if a large scale independent studio produces twelve films a year, about eight will be losses, two will break even, and one will be a smash hit with enough profit to cover the other losses. Since 2004, film financing has recently involved hedge funds, investment banks, private equity funds and other alternative investment sources to fund movies (Frumerman, 2007).

J.P. Morgan, an investment banks, funds 95 percent of all Hollywood films. John W. Miller, a Vice Chairman of JP Morgan Securities, Inc. oversees Corporate Banking Entertainment Industries, where he provides funding for countless box office hits and Oscar-winning titles. His portfolio includes blockbusters such as “The Aviator,” “Million Dollar Baby,” and “Gladiator” and “American Beauty,” all of which were runaway hits at the box office and the Academy Awards (Film Financing: The JP Morgan Way).

Chapter 5

The Role of Crowdfunding in Alternative Film Financing

The intertwining of creative ventures and the need for financial fuel has long since been the plight of the entrepreneur, as well as the independent filmmaker. The substantial capital needed to fund new businesses or films is one of the main restrictions. With the exception of "family and friends" loans, entrepreneurs were formally limited to traditional bank loans or funds from professional investors (angel investors, venture capitalists), which are slim at best. Today, the way entrepreneurial projects are capitalized has been radically changed by a mechanism called "crowdfunding." Crowdfunding offers a revolutionary and advantageous option to finance independent films.

Crowdfunding is the process of soliciting funds from the public to create projects and fund businesses. There are many denominations of the term "crowdfunding", but the type most commonly identified as "regular" crowdfunding is reward-based crowdfunding. In exchange for money, crowdfunders offer rewards to those who pledge. These rewards are typically tied to the project, or are sample of the project. This concept is therefore highly fitting and powerful for artistic projects, such as film (Young, 2013).

Reward-based crowdfunding has revolutionized the film industry for independent filmmakers. No longer do they need to pitch to executives, ultimately compromising on artistic vision in exchange for dollars. Nor do they have to plead with family and friends to help finance the film. While crowdfunding hasn't entirely replaced traditional financing sources, it offers many opportunities and advantages. The genius of crowdfunding is that filmmakers can go right to those who would like to see the movie and offer relevant rewards in return for financing. (Young, 2013).

It is important to note that while this appears as a retail model, a filmmaker is not selling movies via crowdfunding. Donors are providing funding to capitalize the filming process, helping to pay for equipment, travel expenses, talent, and other costs that go into making a small film (Young, 2013).

While crowdfunding should be considered in context with traditional investment instruments, there are compelling advantages to of crowdfunding film projects. The first is that there are minimal upfront financial risks. Typically, there is no cost to placing a campaign on a crowdfunding site. If the campaign is successfully funded, there is another huge advantage other than the funds received- validation of the film concept. By definition, those who pledge money believe in the project and are invested in its success (Young, 2013).

Another primary advantage is protection of the artistic vision and maintenance of100 percent ownership. Unlike traditional financing methods with risk-averse professional investors, banks, or studios that will demand equity ownership or say in the film's artistic direction, crowdfunders essentially solicit donations in exchange for rewards (Young, 2013).

On a closing note, crowdfunding is not to be confused with selling equity. However, with the recent passage of the Jumpstart Our Business Startups Act (JOBS Act, H.R. 3606) on March 22, 2012, it is now legal for small businesses to sell ownership in their companies to nonaccredited investors. This will profoundly change the equity investing landscape in the U.S. (Young, 2013).

Crowdfunding will positively impact the US and global economy. Already, crowdfunding has fueled innovation and brought to life new ideas, products and jobs. Whether through Kickstarter, IndieGoGo, or other platforms, countless projects would not have materialized and succeeded without the interest, publicity, and funding from the crowd. As equity crowdfunding becomes a reality, this industry will boom, new technologies and new paradigms will be created, and they will disrupt the current venture capital and angel investor model.

Crowdfunding Platforms

The four main competitors identified in this space are Kickstarter, IndieGoGo, PeerBackers, and RocketHub.

Pricing Models

Crowdfunding sites use two different types of fee schedules: flexible funding plans and fixed funding plans. With fixed funding plans (also called "all-or-nothing" plans) the creator must pay a percentage of the total funds raised to the crowdfunding platform as a fee. However, money only exchanges hands if the campaign meets its fundraising goal. If the funding goal is not met, the project simply ends. Flexible funding plans allow crowdfunders to collect the funds even if the goal is not met; however, creators typically have to pay a higher fee to compensate.

Competitive Analysis of Crowdfunding Sites: Kickstarter and IndieGoGo

Kickstarter

Kickstarter (*www.kickstarter.com*) is the largest and most popular crowdfunding platform on the web. With their motto, "Fund and Follow Creativity," Kickstarter has catalyzed impressive creative projects. *Inocente*, an independent film by, won the 2013 Oscar for Best Documentary! To date, Kickstarter has launched more than 27,000 projects, and brought about 12,000 projects to successful fundraising completion. More than 30 million people visit Kickstarter, and about $100,000,000 has been pledged thus far.

While Kickstarter seems broad in category, it is limited to creative projects that have a definite start and end date. Creators interested in posting on Kickstarter must apply and be approved by their staff; some 40 percent of submissions are not accepted. The application must clearly demonstrate it is a creative project, with a defined set of rewards for different levels of pledging. All campaigns must have a set a funding goal and time frame. Kickstarter uses the fixed-funding pricing models only; donors can pledge for a project but there is no financial obligation until the monetary goal established by the project creator is met.

Strengths

Aside from being the largest and (currently) most popular crowdfunding site on the web, there are many strengths and advantages to Kickstarter. First is their selective staff filtering of campaign applications. This intense review demands rewards be as close to market value as possible. The Kickstarter staff only approves fund worthy ventures and pushes high incentives, so success rates tend to be relatively high, as high as 46 percent.

Secondly, Kickstarter molds proposals to a proven successful layout. The parameters of running a campaign on Kickstarter are very specific; crowdfunders must create a pitch video, write meaningful descriptions, and send out extensive updates and publicity. Because of its prominence, Kickstarter attracts a lot of funders; the site's high traffic ensures the campaign has the probability to be seen.

Third is Kickstarter's elegant and user-friendly interface. The uniformity is mutually beneficial for crowdfunders and those who wish to pledge. By not having to design their own website, crowdfunders can simply enter their information and focus on their campaign. The site is user friendly and offers a pre-built-in pay system. Many other crowdfunding sites have used Kickstarter's design in building their own websites.

Finally, Kickstarter's "all-or-nothing" pricing model is considered one of its greatest assets to ensure full funding. Once a project reaches a certain threshold both the pledgers and the creators feel a sense of empowerment to reach the goal. Statistically, 90 percent of projects that reach 25 percent funded are eventually fully funded. If the money isn't raised, the project simply ends. Projects without this mindset tend to have a lower success rate

Weaknesses

Crowdfunders who use Kickstarter must pay fees for using their services. Kickstarter takes a five percent cut of fully funded projects. Amazon takes an additional three-five percent cut on top of that. The average profit from a Kickstarter project is 75 percent after rewards, cuts, and other miscellaneous costs.

Some creators have issue with the "all-or-nothing" pricing model. Collection doesn't occur until the end of the campaign, and people often forget they pledged as the duration can last as long as 90 days. Moreover, offline donors are not noted on the website. Conversely, for crowdfunders, the rewards can be costly and time consuming to produce and deliver.

IndieGoGo

IndieGoGo (*www.indiegogo.com*) is the second largest crowdfunding platform. The site was officially launched at the Sundance Film Festival in 2008 with the vision of helping independent filmmakers with fundraising their projects. Shortly after, they partnered with MTV New Media to establish a program whereby new television projects could be crowdfunded, and ultimately acquired by MTV after the pilot was developed. Today, they have expanded into music, charities, small businesses, as well as film. IndieGoGo is very similar to Kickstarter. However, there are two major differences; campaigns do not require staff review, and they offer flexible funding options.

Strengths

Since they are so similar, many of the strengths of IndieGoGo have already been discussed as strengths for Kickstarter. A differentiating strength is that they are friendlier to crowdfunders. IndieGoGo offers a flexible funding program; if the funding goal isn't met, crowdfunders still keep the money (but pay a higher percentage). Applications do not require staff approval, making the process much less stressful and open. Moreover, IndieGoGo focuses on a multitude of markets. While Kickstarter is based solely on creative projects, IndieGoGo has an entrepreneurial and social causes focus, as well.

Weaknesses

IndieGoGo takes a 4% cut, plus an extra 3% for credit card fees for fully funded projects, and takes 9% plus 3% credit card fees for non-fully funded projects. Secondly, IndieGoGo is not known as well publicly and does not have as large of a presence as Kickstarter. They have a smaller base of projects, and even successful projects tend to have a lower amount of total funds raised compared to Kickstarter.

Chapter 6

Business Plan: "FlickFunder"

Product Positioning Statement

For independent filmmakers who are looking to fund their projects through crowdfunding sites, FlickFunder is a crowdfunding website that offers a platform specifically geared towards film projects. Unlike existing crowdfunding sites such as Kickstarter and IndieGoGo, FlickFunder will be differentiated not only in category specificity, but by also offering distribution for completed projects via direct online streaming.

Value Propositions

FlickFunder's business model revolves around providing the independent film community with the means to access a larger audience for raising funds, awareness, and audience. FlickFunder will ultimately help converge large production practices with the independent film industry in an affordable and efficient manner.

Revenue Side

The revenue side of the business model revolves around the customer relationships. FlickFunder will have customers from multiple segments. The first customer grouping is the site's "creators", including filmmakers, producers, writers, and actors. These customers make up the site's interface with their projects and are fueled by passion for film. They will want a large viewing base to increase probability of funding their venture as well as eventually being used as a distribution means.

Low fee deductions from funded projects and a free entry to being uploaded onto the site will entice filmmakers to choose FlickFunder as their means of crowdfunding. To keep the filmmakers on the site, FlickFunder will offer expertise on marketing their film out to possible sponsors as well as facilitating local community involvement into the funding process that will keep the customer from abandoning their project on the site. Successful projects will be the biggest aid in growing this customer base. As filmmakers see reports and hear by word of mouth the successes of the site, more will be willing to put their trust and effort into FlickFunder versus a competitor.

Only fully funded projects will receive the donations. This will help increase success rates of projects. A comparable percentage fee will be subtracted off of the full funded projects similar to that of IndieGoGo. Filmmakers will be able to post their projects for free, promoting an open venue for a diverse variety of films.

The distribution side of FlickFunder will be based on continuing the momentum that the project built on the site. By offering a percentage of allotted raised funds to FlickFunder, filmmakers will have the option to play their films on the site to garner attention in hopes of creating further film awareness. Attracting films to be aired onto the site would help further the success evidence of crowdfunding on FlickFunder. Customers frequenting the site would be allotted 75 free minutes of video viewing per day. After their 75 minutes, users would need to wait until the next day to receive another free allotment of viewing time or would be required to subscribe to a pro account for a fee.

Cost Side

The cost side of the model revolves around the following key creators: filmmakers, producers, writers, and actors. In order to attract such creators to utilize the site, FlickFunder must be regarded as experts in assisting independent groups with production, marketing and distribution of films. These three activities will need to be funded by the revenue discussed below. In order to deliver key activities, FlickFunder will need financial capital, employees, technological capital and office space. To run the site, there will be broadband costs that will increase as site activity increases as well.

Filmmakers will come to the site for aid in marketing their film out to a bigger audience. Money invested in marketing will be needed consistently to promote the site to a larger customer base to attract both filmmakers and funders. In order to create a successful online community, a massive marketing strategy must be utilized to its full potential to build the solid initial base. Through the growing process as revenue continues to stream in, money should be continually reapplied into spreading the brand out to customers and the offer of a better crowdfunding alternative in relation to competitors. Having a solidified brand will have the biggest effect onto the revenue stream. Incentives (reducing FlickFunder's percentage cut off of successful projects) will be given to filmmaker's who can recommend other filmmakers to the site. This will be of use as an additional marketing effort with a slight cost.

Costs are also associated with partnership/investment loss. If successfully funded movies are flops, FlickFunder will suffer a bad image and could result in a decreased customer base. Further costs could come in the form of additional staffing, updating technology, infrastructure, and any licensing.

Physical Distribution

Another leg of the FlickFunder distribution model would be the option for filmmakers to distribute their products theatrically. This would enable the filmmakers to access to a far larger audience (Wide distribution), and be able to have their film show in theaters spanning a large geographic area. In return FlickFunder would take a modest cut of the total box office revenue. This is another area where we may have to evaluate the quality of the films which we distribute else we could be faced with a net loss, however on the flip side if the films fare very well we stand to make the majority of our total revenue in this area alone.

BIBLIOGRAPHY

About Us | Indiegogo. *Indiegogo: An International Crowdfunding Platform to Raise Money*. Retrieved January 30, 2013, from http://www.indiegogo.com/about/our-story

Benedetti, R. L. (2002).*From concept to screen: an overview of film and television production*. Boston: Allyn and Bacon.

C. Foy, Esq. (2004) Motion Picture Industry Overview. *C. Foy, Esq.: Investor Resource Center*. Retrieved October 28, 2012, from http://www.cfoyesq.com/Home_IRC.htm

Film Financing: The JP Morgan Way. *Magazines | Journals | Books and Articles*. Retrieved November 19, 2012, from http://www.iupindia.in/405/AN_Film_Financing_The_JP_Morgan_Way_12.html

Frumerman, B. (2011, February 27). The Skinny On Film Financing: Investors Pull Back The Curtain | FINalternatives.*Hedge Fund and Private Equity News | FINalternatives*. Retrieved September 24, 2012, from http://www.finalternatives.com/node/15656

Global Movie and Production Distribution (2012). In *IBIS World Global Industry Reports* (Vol. 1, pp. 1-34). 1: IBISWorld. Retrieved February 1, 2013, from the IBISWorld Industry Market Research database.

Kaczanowska, Agata. "Movie and Video Production in the US." I(Dec. 2012) In *IBIS World US Industry Reports*. IBISWorld, Web. Retrieved 14 Feb. 2013. <http://clients1.ibisworld.com/reports/us/industry/default.aspx?entid=1245>.

Kaczanowska, Agata. "DVD, Game & Rental in the US." (Dec. 2012) In *IBIS World US Industry Reports*. IBISWorld. Web. Retrieved 14 Feb. 2013. <http://clients1.ibisworld.com/reports/us/industry/default.aspx?entid=1370>.

Le Marché du Film -About. *Le Marché du Film - Festival de Cannes - Du 15 au 24 Mai 2013*. Retrieved February 29, 2013, from http://www.marchedufilm.com/en

Marche du Film Key Figures. (2012, May 27).*Marche du Film- Festival de Cannes*. Retrieved January 2, 2013, from www.marchedufilm.com/uploads/albums/STATISTIQUES_2012.pdf

Motion Picture Association of America History (MPAA). *Motion Picture Association of America Official Website*. Retrieved November 15, 2012, from www.mpaa.org/

Mr. John W. Miller, JP Morgan Film Financing. *Zoom Info- People*. Retrieved November 21, 2012, from www.zoominfo.com/people/Miller_John_820022071.aspx

Paranormal Activity's Box Office Success Story. (2009, December 9). *Movies, TV & Music | POPSUGAR Entertainment*. Retrieved December 10, 2012, from http://www.buzzsugar.com/Biggest-Headline-2009-Paranormal-Activitys-Box-Office-Success-Story-6743452

Supplee, Todd. “Motion Pictures in 2009: Buffeted by the Storm, but still on course.” (June 2009). Pricewaterhouse Coopers Advisory, Entertainment and Media. Retrieved October 11, 2012.

Spotify - Facebook application metrics from AppData..*AppData - Application Analytics for Facebook, iOS and Android*. Retrieved February 29, 2013, from http://www.appdata.com/apps/facebook/174829003346-spotify

What is Kickstarter — Kickstarter. *Kickstarter*. Retrieved January 30, 2013, from http://www.kickstarter.com/hello?ref=footer

Young, Thomas Elliott. The everything guide to crowdfunding. Avon, Mass.: Adams Media, 2013. Print.

ACADEMIC VITA

Chelsea R. Burka

308 W Prospect Ave, State College, PA 16801

Chelsea.Burka@psu.edu | Chelsea.Burka@gmail.com

Education

B.S., Accounting, 2012, The Pennsylvania State University, University Park, PA

B.A., Public Relations, 2012, The Pennsylvania State University, University Park, PA

Honors and Awards

- Valley Magazine's "Cover Girl," 2012
- Smeal College of Business Scholarship for Academic Excellence
- Renaissance Scholarship for Academic Excellence
- President's Freshmen Award for students with a 4.0 GPA

Association Memberships/Activities

- Alpha Kappa Psi, Professional Business Fraternity
- Innoblue Consulting

Professional Experience

- Pricewaterhouse Coopers, Consulting Summer Associate, 2012, San Jose, CA
- The Weinstein Company, International Sales & Acquisitions Intern, 2012, Cannes, France
- Goldman Sachs, Private Wealth Management Summer Analyst, 2011, Los Angeles, CA
- Goldman Sachs, Finance Summer Analyst, 2010, New York, NY

Research Interests

I have broad interests in the convergence of film and finance—essentially, producing. Producing is often referred to as the intersection between art and commerce. Specifically, I am interested in finding alternative solutions for financing films. Given the high costs of producing films, many independent producers default to studios to supply funding, which diminish their creative control. I am interested in exploring ways for filmmakers to produce quality films while maintaining their artistic vision.