

## The Risk Game

The Pact/Olsberg report delivers compelling evidence for what producers already know: making ambitious, commercial, award-winning and original independent British films like *The King's Speech* or *Slumdog Millionaire* is currently almost impossible. Yet out of crisis comes opportunity - a one-off chance to reboot a financing system which has, for years, held back Britain's indigenous film industry.

Successive Governments have long recognised the importance of the independent sector. It discovers and nurtures talent. It delivers a skilled workforce, cementing our world class reputation for crews and facilities. It complements the cyclical, dollar-driven nature of the inward investment sector. It makes a significant contribution to GDP and exports and it over-achieves both in terms of reflecting our culture and winning awards. It is increasingly driving efforts to improve diversity and inclusion on both sides of the camera.

Filmmaking is a uniquely risky business. The odds are stacked: tens of thousands of ideas must be developed, thousands of screenplays written and hundreds of films made in order to deliver a few hits. That's not an admission of failure; it's as true in Hollywood as it is in Ealing.

The Hollywood studios just about have the size to play those odds in-house, making enough films, on a big enough scale, for the successes to pay for the failures. But ever-increasing budgets, expensive stars and massive marketing costs force them to look to reliable brands, meaning sequels, franchises and comic books.

The British independent sector plays in a very different space; we give audiences films they haven't seen before and when they succeed they succeed big time, commercially, and critically. But originality equals risk. And mitigating that risk is something that's obsessed the sector for decades. Historically, there have been attempts to incentivise producers, distributors and sales agents to merge their operations and create mini-studios. Those schemes haven't worked because the real strength of this most creative of industries is the passion that comes from independence – the ability to find and champion new ideas.

And so what has evolved, even if it hasn't been fully identified, is a kind of nationwide virtual studio. Thousands of new and established filmmakers compete for limited funds from private and public investors and the economics make sense on a national level – with enough high quality films being made to deliver the hits and pay back the public support many times over.

That's the theory, but the financing model that has evolved alongside that virtual studio has been a problem for many years. It works directly against the special skills of the British industry and ensures that production companies - the engines of creativity - are starved of critical investment, limiting their capacity for growth and global competitiveness. The bad and good news is that the model is now broken. Let's look at what that means.

Independent producers - driven, creative entrepreneurs - are used to piecing their funding together from a patchwork of sources. Eight years ago, Pact worked with the Treasury and BSAC to create the Film Tax Credit ('FTC'), the gold standard for government support schemes, a transparent, abuse-proof mechanism, driving inward investment and repaying its cost many times over.

The FTC provides just under 20% of a production budget if the entire film is made in the UK. That's a vital piece of the financing puzzle. Producers compete for the support of one or more of the public funders - the BFI, BBC Films and Film4. Then they must persuade a UK distributor to put up a substantial guarantee against UK revenues. That's a stiff market test - for the same investment a distributor can buy US films that audiences already know about. Again, originality equals risk - distributors must spend millions marketing a product the audience doesn't yet know it will like.

These elements may provide around 60% of a film's budget. So where does the rest come from? This is where the international market comes in and where all sensible business logic goes out of the door.

While the stars are walking the red carpets of Cannes, Berlin and Toronto, sales agents are in hotel rooms in back-to-back meetings, trying to make 'pre-sales' -

persuading distributors from all over the world to pay good money for as yet unmade films. The 'elements' - script, director, cast - are all they have to go on.

And so, of course, buyers want star names in the films. But the pool of 'bankable' stars is very limited and the recent surge in high end TV drama series and comic book franchises which tie actors up for large chunks of the year has made that situation more challenging. This ought to play to our strengths - British producers are world-beating when it comes to discovering and nurturing new talent. The list of stars and directors who got their breaks in our independent films is huge and disproportionate to the size of our industry. But the international market doesn't know how to value the new: it needs established names to validate the unmade films they're asked to buy.

The Olsberg report demonstrates that the international sales market has virtually collapsed; its value has slumped 50% in five years. That's partly because of the lack of star names and the impact of the global financial crisis, but also because of the new kids on the block. Global SVOD services have disrupted the economics of the distributors who used to buy the independent films. Some streaming services are fully financing films which will only appear in theatres for awards qualification. Or - instead of pre-buying films at script stage - these new players can wait and pay often much higher prices later for the films that succeed. They can overpay because they're fighting to become the pre-eminent streaming platforms for a new generation.

The impact on independent distributors all over the world has been profound. Cinemas won't book films when audiences can access them online from outside their territories, legally or otherwise. TV networks - a key source of downstream income for distributors - hardly show films at all. So as a consequence distributors are going out of business or massively reducing the prices they can pay. So getting 40% of your budget from the international sales market just isn't possible. This constitutes a market failure in the international film financing business and the impact is being felt across all of the key markets. It appears that this is a structural change and not just a cyclical one.

To make matters worse, the massive and welcome success of our inward investment sector is driving up the cost of crews and facilities, so reducing budgets isn't an option if we want to maintain the quality and production values audiences want.

This should actually be a great opportunity for the UK. What has been happening for too long is that the system has forced UK independent producers to sell off all their rights - usually for low prices to international buyers - just in order to get their films made. It was like Henry Ford going to the banks and saying "please, please finance me and you can keep all the profits - I just want to make my cars." Producers were squandering their world-beating talents in order to satisfy the backward-looking or unrealistic casting requirements of nervous buyers. And the proceeds from the hit films were going anywhere but to the production companies that created them in the first place.

Our proposed solution addresses all the issues with a simple increase of the tried and tested FTC, just for films in the £2m - £102m budget range - where our great successes are normally pitched. The initial cost - across the entire industry - will be similar to the support we currently give to a couple of major inward investment TV series, but it will pay for itself many times over. According to the BFI, the FTC generates almost £12.50 for every £1 spent and provides crucial support for UK films and filmmakers. It is a shrewd investment for the UK.

That extra support at production stage will allow producers to roll the dice a few more times, maintain the on-screen production values that audiences want - and retain more rights in their films. This will enable them to access long term revenues streams that can be reinvested in future projects.

The economic logic is clear. One or two additional hits will have a colossal impact. The King's Speech grossed nearly \$400m worldwide, in cinemas alone. As it stands, too little of the revenues from hits like that come back to the UK, or help strengthen the companies that make them. We've already seen how the British TV sector was transformed when they were allowed to hold on to their rights: GDP and export revenues blossomed.

The FTC is, by definition, only spent on British crews, facilities, locations etc. International revenues from successful films are straight export dollars. Domestic revenues contribute to VAT on box office and trigger huge spends across the marketing, advertising and ancillary sectors.

Our proposal is to increase the FTC for films in the £2m - £102m to 40%, with the 80% spending cap removed, in line with the equivalent Australian incentive known as the Producer Offset.

Crucially, to ensure this measure helps to strengthen the UK's independent sector, the enhanced element - the difference between the current 25% and the new 40% level - must be treated as the producer's investment in the film, with the recoupment revenues it generates flowing back to production companies. In line with Pact's commitment to diversity, we further propose that only films which meet the BFI's Diversity Standards qualify for the enhanced FTC. Pact will also explore how a kite-marking system similar to the Producers Guild of America could be introduced to clarify who are the legitimate producers of the films

The position of private investors and sales agents will be improved by these measures - their risk is reduced and more high quality films will be financeable, increasing their opportunity to make fees and roll the dice more often.

The existing equity corridors - advances against profits to reward successful filmmakers - agreed between Pact and BBC Films, Film4 and the BFI must remain in place and should be restated and enhanced in agreement with the public funders, who themselves will benefit from the enhanced FTC.

These measures could constitute a revolution for British production companies. Only the highest quality films will benefit and the increase in production will nurture a whole new generation of diverse British talent on both sides of the camera. Originality equals risk, but in this new world, the odds will be stacked in Britain's favour.