

COMPETITION IN THE MARKET FOR SWEDISH DISTRIBUTION RIGHTS OF FOREIGN INDEPENDENT FEATURE FILMS

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Abstract

This thesis tests if the popular notion is correct, saying that there are too many companies on the Scandinavian market for distribution rights of foreign independent feature films. This was done through the study of Sweden, Scandinavia's most important market, over the time period 1997-2005. Only the theatrical distributors were studied, and a distinction was made for titles exceeding a production budget of USD 20 million.

In order to ascertain the level of competition the theory from economics on zero economic profit was coupled with the concept of required return on equity, taken from financial theory. In contrast to the popular notion of Scandinavia as being an excessively established market the data for Sweden shows that in 1997-2005 the competition did not result in negative economic profits. On the contrary, data indicates that the profitability increased over the period even though three new companies entered the market.

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Foreword

When doing acquisitions at one of the most recently founded film distribution companies in Scandinavia, Noble Entertainment AB,¹ I heard on numerous accounts people say that this territory nowadays have a remarkable high number of buyers/distributors.² It was also a commonly held view that this competition ruined business for everyone. Bidding wars on the top titles led to overprices being paid, and the stiffened competition for the middle titles forced the distributors into acquiring films that normally would not have been bought, because of their low commercial potential. It is still better to have a film with a low potential to work with than no film at all. Like a machine needs constant refueling the film distributors need new films against which they can amortize their overheads. Additionally, more distributors in a territory mean a higher number of films being distributed. This leads in the end to lower average profits for the distributors as the fight for the film watching consumer intensifies. Higher prices, worse products and less revenue – no wonder that the buyers complained.

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¹ This thesis was written at the end of a sabbatical leave for studies from Noble Entertainment AB in 2006 and early 2007. I was Head of Acquisitions at Noble Entertainment during the two preceding years.

² In the film industry, the terms “distributor” and “buyer” are used synonymously at the markets when film rights are traded. To a film’s producers and sales company, the company that buys the film’s distributional rights represents both a buyer as well as a distribution channel.

1. INTRODUCTION

An equilibrium number of firms in a market is reached, according to microeconomic theory, as the entry of firms rules out economic profit and firms exit the market to avoid losses.³ Economic profits and long-term losses are, in short, eliminated. At a glance the Swedish market for independent film rights seems to contradict this fundamental economic proposition. A commonly held view within the industry is that the Scandinavian market is characterized by too hard competition. This results in overpriced acquisitions, a greater quantity of less commercial titles being bought and, in the end, less profits. And what is more, this does not seem to be only a temporary state since no less than three new Swedish theatrical distributors of independent films have been founded over the last decade while we have not seen any exits.⁴

Indeed, the situation is intriguing from an economic standpoint, but to investigate this market is also of cultural importance. The way in which the market is constituted affects both the supply and the variety of one of our most popular art forms, namely feature films.

The remainder of this thesis will proceed as follows. Section 2 states the aim of the thesis and the scope of the empirical study. A brief introduction to the acquisitions market is given in section 3 followed by a presentation of the distribution market in section 4. These two market descriptions are done in order to give the reader a basic understanding of the markets' characteristics. This knowledge is needed before the literature review and the methodological framework ensues in section 5 and 6, respectively. The empirical study follows in section 7 and, lastly, section 8 concludes.

³ A firm's economic profit is here defined as the difference between its revenue and the return of its inputs when put into their best alternative use, i.e. their opportunity cost.

⁴ NonStop Entertainment AB (henceforth NonStop) was founded in 1999 and started their theatrical distribution the same year, Atlantic Film AB (henceforth Atlantic) was founded in 2002 with their first theatrical release in 2004, and Noble Entertainment AB (henceforth Noble) also started off in 2002 with a theatrical arm in place two years later as well.

2. AIM AND SCOPE

The primary aim of this thesis is to examine the market for the distribution rights of independent foreign feature films in Sweden, and to establish whether it is in a zero economic profit equilibrium. From this one can infer whether or not there are too many companies competing in the market.

The focus of the study will be on the Swedish market. However, Sweden is only a part of the bigger territory Scandinavia for which film rights are most often traded.⁵ But despite this it is still worthwhile to study the Swedish market since Sweden is the main sub-market within Scandinavia.⁶ The largest distribution companies have therefore either their headquarters, or a direct local setup, in Sweden. This makes Sweden an acceptable proxy for the whole of Scandinavia. One must, however, thread carefully when making conclusions for a whole based on only one part.

The traded good in this market is the distribution rights for Sweden of independent foreign feature films. The rights for distributing a film is most often associated with distributing it theatrically in the cinemas, releasing it for the home market on DVD/VHS, and selling broadcasting rights to TV-stations. It should also be noted that other media exist, such as UMD for the Sony PlayStation Portable (PSP), and other showing rights such as airline screenings. However, as these rights usually are bundled together when traded they will also here, for simplicity's sake, be considered as a package. Furthermore, this study will only deal with foreign films, meaning films produced without any Scandinavian involvement such as producer(s) and/or production company. When such ties are present they most often result in a pre-decided distributional pattern that is not the outcome of an open market.

The increased number of distribution companies has first and foremost affected the competition on the titles that the new companies can afford. And since films with high

⁵ Sweden and Scandinavia as film rights territories will be briefly discussed in section 3.

⁶ Sweden usually represents 40-50% of a Scandinavian film right's value and hence also its price tag (Hussain 2007).

production budgets generally are more costly to acquire than films with lower budgets, it follows that the competition has become fiercer primarily on low and medium budgeted films. The empirical study will therefore make a distinction between titles budgeted below USD 20 million and those with a bigger production budget. It is also within this lower segment that we usually find the more quality driven films. Hence, cultural values make it even extra interesting to study the competition here.

For the sake of simplicity companies included in this study will be those who normally acquire films for theatrical distribution. This is a reasonable limitation simply because there is no major buyer of independent films that is solely a distributor for the home market or for TV broadcasting. However, as the DVD/VHS home market and the TV sales are important streams of revenue for the rights holder, these markets will also be presented briefly.

Finally, the study will deal with the time period 1997-2005. Nine years is deemed as a reasonable and manageable time frame to give information on the competitive nature of the market. This means, however, that data from three companies, Atlantic Film, NonStop Entertainment and Noble Entertainment, will be missing for some early years as they entered the market after 1997.

3. THE ACQUISITIONS MARKET

This thesis deals with the market of independent film rights. Independently produced films are films that are not produced by any of the major studios within the Hollywood system.⁷ Unlike the majors, the independents do not have the financial resources needed to handle all stages in a film's development by themselves, and they do not have their own worldwide distribution arms. Hence, the films produced independently are most often collaborations between many producers, and the financing package contains a complex mix of subsidies, funds and private investment. Additionally, they have to

⁷ The terms Hollywood majors and Hollywood studios usually refer to the following companies: Warner Brothers, Universal, MGM, Paramount, 20th Century Fox, DreamWorks, Columbia Pictures and Walt Disney Studios.

attract and find their international distributors through the market mechanism, i.e. by selling the distribution rights to a distributor.

The timing of this transaction largely depends on the specific title. A basic rule is that a film's distribution rights are sold, or *licensed*, early if it is deemed as a low risk investment with high commercial potential.⁸ English language projects in popular genres with star talent connected are often sold on a script only, before the production has begun. More artistic non-English language films are, on the other hand, most often sold after they have been completed and the distributor can reduce risk by seeing, or *screening*, the finished product.

These screenings often take place at certain film markets that are held throughout the year at different places around the world.⁹ The majority of the film markets coincide with an international film festival. The three biggest film festivals for example, i.e. Cannes, Berlin and Toronto, all have film markets connected to them. There are, however, important stand-alone markets as well, like the American Film Market (AFM) in Los Angeles and the specialized TV fair MIPCOM in Cannes.¹⁰ Buyers and sales companies go to these markets where new projects are presented, finished products are screened and film rights are licensed. In the vast majority of sales the price of a certain territory's rights consists of both an upfront payment, a *minimum guarantee* (MG), and of royalties from the distributor's future profits. The exact details regarding the size of the MG and how the future profits will be divided are subject to negotiation, and there is a great variety of outcomes born from the preferences of the negotiating parties and the product's unique risk level. A brief deal memo containing the most crucial elements of

⁸ "Sales" is the term most often used in everyday language within the industry, but "licensing" is the more correct term since the rights for a film are assigned to a distributor in a certain territory for only a limited time period (usually 5-15 years).

⁹ It should be noted, though, that acquisitions are done on a daily basis. Even though the activity is concentrated around the markets, new projects must be tracked and followed, new scripts have to be read, and sometimes recently finished films can be screened on received DVDs.

¹⁰ Formally the AFM is connected to the American Film Institute Festival (AFI FEST), but this link is so weak that it in reality does neither affect the market nor the festival.

the deal is signed, and later a more elaborate contract specifying all the details, the long form contract, is drawn up.¹¹

Sweden is in most cases not a territory for licensing on its own. Sales companies try to bundle small countries together in order to minimize their workload, and this means that Sweden in most transactions only is a part of the license territory Scandinavia. As a general rule it could be said that the Scandinavian countries are only licensed individually on smaller and less commercial titles that do not get much interest from the buyers. When the distributors are not competing for a title the sales company will have to agree on licensing a single country if the distributor just wants to acquire those rights.

4. THE SWEDISH DISTRIBUTION MARKET

The revenues from the acquired distribution rights mainly come from three different revenue streams. These distribution windows are theatrical distribution, DVD/VHS and TV. In the DVD/VHS market a further distinction is made between rental and sell-through, and in the TV market between rights for free TV and pay TV. To provide an understanding of the acquisitions market's revenue side these three windows in the Swedish setting will be presented. Since all major acquisition companies also are theatrical distributors – directly or indirectly – the focus will be on the theatrical market and its participants. But since the home and the TV markets represent important streams of revenue to the acquisition companies these markets will also be presented. In fact, according to Guerpillon (2004) the three windows have roughly the same annual turnover, i.e. around SEK 1.5 billion. According to the same study the theatrical market represents 25% of the revenues from a license for the license owner. Sell-through DVD/VHS is around 40%, rental DVD/VHS is 15% and the revenues from TV sales account for 20%.

¹¹ The deal memo specifies for example what rights that are being licensed, for how long and to what territory. The size of the MG and the royalty splits are also always included. Additionally, other understandings important for the deal could be stated, such as the distributor's commitment to releasing the film theatrically, the minimum budget for the release, etc.

4.1 THE THEATRICAL MARKET

A brief introduction to the theatrical exhibition market is needed in order to understand the changing conditions that the distribution market faces.

4.1.1 THE THEATRICAL EXHIBITION MARKET

The winds of change sweep through the theatrical exhibition market in Sweden at the moment. In 2004 the second largest exhibitor, Sandrew-Metronome Sverige AB, had faced red numbers for an extended period of time and its market share had dropped from 19% in 2001 to 13% in 2003 (Guerpillon 2004). The trend continued in 2004, so on 12 August the owner, Sandrew Metronome AB, sold all stocks to the market leader, SF Bio AB. Due to market concentration concerns the deal was, however, investigated by the Swedish Competition Authority which later, on 25 January 2005, decided to ask the Stockholm City Court to prohibit it. Consequently, on 4 April 2005 SF Bio revoked the offer. On the same day it was announced that the film distributors Atlantic Film AB and Triangelfilm AB, and the production company S/S Fladen Film AB had joined forces and acquired Sandrew Metronome's theatrical chain. It was later named Astoria Cinemas AB.

When 2005 came to an end the deficit from 2004 of SEK 26 million had transformed into a less alarming deficit of SEK 9.35 million (Astoria Cinemas AB 2006). However, in 2006 the good trend was reversed resulting in SF Bio acquiring the chain's 12 theaters outside the Sweden's three biggest cities, i.e. Stockholm, Göteborg and Malmö. In spite of this deal, the threat of bankruptcy was still imminent as the year ended.

Bearing the uncertain future developments in mind the market today could be described in the following way. The market leader is SF Bio AB, with a market share of 52% in 2005. It is now also the only remaining truly nationwide chain with over 200 screens at 24 different localities in the country. Before Astoria Cinemas sold off the 12 theatres to SF Bio it had a market share of 16%. Now it will only operate 10 theatres in the three most profitable cities. HB Svenska Bio Lidingö (henceforth Svenska Bio) is the third largest actor with a 10% market share. The theaters are found in small towns and SF Bio, who owns 50% of Svenska Bio, does not operate in the same towns. Other marginal

cinema operators include Folkets Hus och Parker (3%), Eurostar AB (2%), Riksföreningen Våra Gårdar and Triangelfilm (Svenska Filminstitutet 2006, Konkurrensverket 2005).

If the winds of change are blowing through the theatrical exhibition market and altering the relative strength of its actors, one could also say that these winds are chillingly cold revenue-wise. In 2005 both the number of admissions as well as the net revenue from ticket sales decreased by 12% from the previous year. The number of admissions totaled 14.6 million in 2005 which can be compared to numbers exceeding 18 million between 2001 and 2003. Fact is that 14.6 million admissions with a population exceeding 9 million is one of the lowest numbers ever experienced in Sweden (Svenska Filminstitutet 2006). This drop follows international patterns and often cited explanations include increased illegal downloading, the expansion of the home cinema market and the DVD, and increased competition from other youth spare time interests such as gaming. Preliminary statistics for 2006 indicate an increase by 5% in the number of admissions from the previous year. This increase, however, is to a large extent explained by the huge success of one single film, *Pirates of the Caribbean: Dead Man's Chest* (Dunér 2007).

4.1.2 THE THEATRICAL DISTRIBUTION MARKET

There are around 15 active theatrical distributors in Sweden today. Out of these 15 companies the American majors (Warner, Buena Vista, 20th Century Fox, Universal, Sony Pictures Releasing, and Paramount) represent a considerable market share.¹² The most recent statistics state that it is 65%,¹³ and even though the companies' individual shares are subject to large fluctuations from year to year, due to the impact of individual blockbusters, their combined market share is more stable (Svenska Filminstitutet 2006).

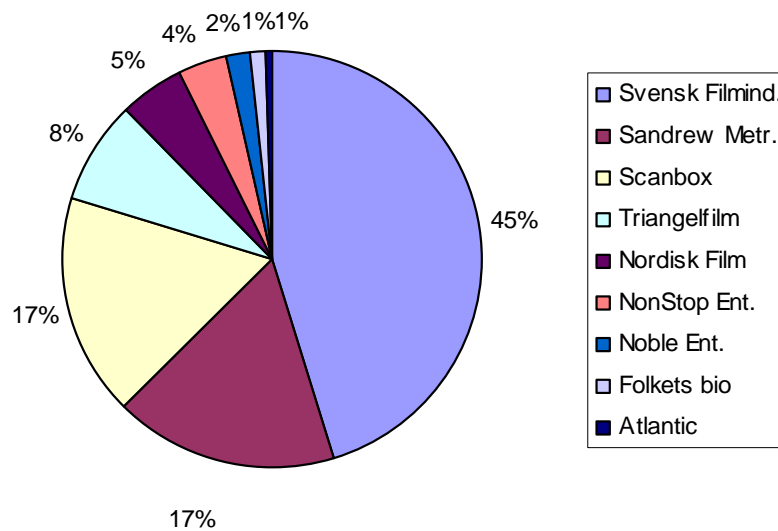
¹² It should be noted, though, that Warner's theatrical releases are distributed by Sandrew Metronome Distribution Sweden AB, and that Columbia Pictures and DreamWorks are distributed by Sony Pictures Releasing.

¹³ This figure of the studios' market share should be somewhat lower if one considers that Sony Pictures Releasing also distributes the independent distributor Nordisk Film's acquisitions. On the whole, however, the difference is marginal.

Some of the remaining distribution companies rely to a larger or to a lesser degree on own productions. Sonet Film AB, for example, did in 2005 only distribute their own or co-produced films while Triangelfilm AB had an emphasis on foreign acquisitions beside their co-productions.

After subtracting the American studio films and the Scandinavian productions, and thereby only measuring the acquisitions market, one finds that Svensk Filmindustri is the market leader with a market share of 45%, followed by Sandrew Metronome (17.3%) and Scanbox (17.1%). Based on the number of admissions three companies represent nearly 80% of the market.

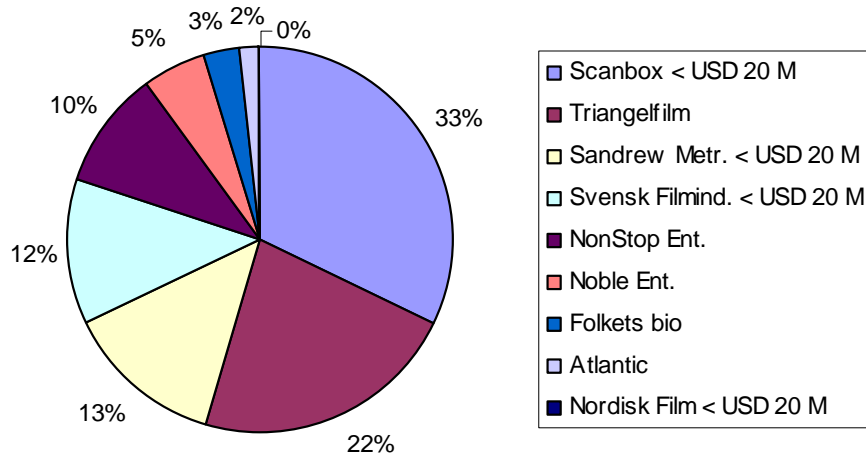
Figure 1. Market shares, based on the number of theatrical admissions in 2005, for the distributors of non-Scandinavian independent feature films.



Source: Raw data from Svenska Filminstitutet (2006). Calculated data is found in Appendix I.

A few of the independent distributors acquire films exceeding the USD 20 million production budget limit. These are the bigger companies, Svensk Filmindustri AB, Nordisk Film AB, Sandrew Metronome Distribution Sverige AB and Scanbox Entertainment Sweden AB. To arrive at the relevant market shares in our market of study these big budget titles should be removed from the data set.

Figure 2. Market shares, based on the number of theatrical admissions in 2005, for the distributors of non-Scandinavian independent feature films with a production budget not exceeding USD 20 million.



Source: Raw data from Svenska Filminstitutet (2006). Calculated data is found in Appendix I.

Now the market becomes more evenly distributed with a number of companies claiming larger market shares. Scanbox's and Triangelfilm's market shares, 33% and 22.2% respectively, are the biggest increases while Svensk Filmindustri (12.3%) and Nordisk Film (0%) have the largest reductions. One should also note that a considerable market share (17%) belongs to the three recently founded theatrical distributors NonStop Entertainment (10%), Noble Entertainment (5.4%) and Atlantic Film (1.7%).

As mentioned the theatrical exhibition market is currently undergoing significant changes. This naturally affects the theatrical distributors since the theatrical market is an important revenue window. After the acquisition of the 12 theatres from Astoria Cinemas, SF Bio is the only nationwide exhibitor and therefore the only option for a distributor wanting a wide release of a film. This will surely affect the distributors' bargaining position when it comes to choosing release dates, premiere theatres and revenue splits. There is a risk that this in the end could result in lower revenues for the distributors.

Another cause for concern is the decreasing numbers of theatrical admissions. Not only does this affect the distribution companies directly through lower ticket revenues, but it

may also affect them indirectly. The trend of decreasing admissions is expected to continue and it causes some people to predict that smaller independent titles will, sooner or later, have to give way for the studios' blockbusters in the competition for theatrical screens (Gradvall 2007). If these predictions are correct the distributors of independent films will have to work harder to secure a theatrical release and, after the premiere, to extend the play dates. If not, the distributor may very well lose one window of revenue which makes it harder to recoup the investment cost, the MG.

4.2 THE DVD/VHS MARKET

The distribution window for the home market is more complex than the theatrical window. On the one hand we have fewer large distributors since the theatrical distributors often cooperate in this window. Scandinavia is a very costly territory distribution-wise as it consists of four countries with different languages, laws, etc.¹⁴ Moreover, the individual countries are regionally disperse adding further costs to sales and distribution. To mitigate these fixed costs some of the distributors simply put their releases into the same sales basket. The exact market shares of the distributors are not available, but estimations show that Svensk Filmindustri is the market leader, followed by Nordisk Film, Sandrew Metronome and the majors (Guerpillon 2004).

On the other hand we have a multitude of retailers. Sell-through DVDs can today be picked up at the local grocery store, the gas station, as well as at the large warehouse and ordered over the internet. The closest thing to nationwide retailers we get in Sweden are the so called *racking companies* that pick out the top titles of the month and then distribute those. The customers of this service include a large number of smaller retailers, or bigger companies with other core competences than film, for example gas station chains. Important racking companies include the giant Bonver Videodata AB, Musikservice Sweden AB and Next Stop Distribution AB. The internet retailers could also be regarded as nationwide chains. In 2003 internet represented 35% of the sell-through market, and this share should today be even greater with a rising trend. The

¹⁴ Finland is most often seen as part of Scandinavia, beside Sweden, Denmark and Norway, when it comes to licensing.

biggest internet retailers are CDON AB, Ginza Musik AB and Discshop Svenska Näthandel AB. One should also mention Homecenter AB, the biggest mail order company in the Nordic countries that also is successful in e-retailing (Guerpillon 2004).

The home market is of paramount importance to the acquisition companies. Since most films do not break even in the theatrical run this is often the window that has to make up for that loss and preferably also recoup the minimum guarantee. Statistics show that the rental market has stagnated and decreased somewhat after its peak in 2003, while the sell-through market has experienced dramatically rising sales since the introduction of the DVD in 1998. The total sales have increased by 400% between 1998 and 2006. The DVD passed the VHS (numbers of units sold) in 2003, and only three years later the VHS was nearly out of the market (Guerpillon 2004, Svenska Filminstitutet 2006). Due to competition and changed pricing strategies, however, these larger quantities do not necessarily equal higher profits. The price of a DVD film has fallen drastically the last two years and this is felt by the distributors who have to adopt large quantity strategies.

4.3 THE TV MARKET

It is estimated that four million Swedish households have access to a TV-receiver. About half of these households receive their transmissions via cable networks, about 30% from terrestrial broadcasts and 20% via satellite (Swedish Radio and TV Authority 2007). The TV market is also experiencing a time of transition right now. Expensive analogue technique is replaced by less expensive digital technique. The digital revolution not only makes it possible to produce television at a lower cost, it also has the bandwidth to carry more channels. In short, more companies can now afford to start TV broadcasts, and there is also room for these broadcasts.

The market expansion and the increased number of channels have increased the demand for content. More channels mean more hours to fill, and since film traditionally is an important part of TV broadcasts this means an increased demand for broadcasting rights of films. Primarily this increased demand is reflected in a greater number of titles being acquired rather than a rise in prices for the existing stock. It should be noted, though, that many of the new TV-channels are specialized and have a niche outside the realm of

fictional entertainment, resulting in the market expansion effects not being fully carried over to the film distributors. It is reasonable to assume that the importance of the TV-window to the distributors will grow over the next few years, even though it is unclear how the development of Web-TV and IP-TV will affect the market.

5. LITERATURE REVIEW

One can make a distinction between structural and non-structural models when presenting the most commonly used research models on competition (Casu & Girardone 2006).¹⁵ In this study, however, a novel finance-economics method will be developed. But to understand why the regularly used models are not employed in this study we need to present them briefly.

The structural models embrace the structure-conduct-performance (SCP) paradigm which, in short, means that for example higher market concentration, i.e. fewer companies with greater market shares, leads to less competition which makes economic profit possible for the companies. In fact, to ensure competition and to protect the consumers, the United States Department of Justice and the Federal Trade Commission rely in their antitrust work on a structural approach using a market concentration index, the Herfindahl-Hirschman index (HHI) (Greco 2000).

The HHI is a widely accepted indicator for market concentration. It is calculated by summing the squared market shares of each company in the market.

Formula 1: The Herfindahl-Hirschman index

$$HHI = \sum_{i=1}^m x_i^2$$

¹⁵ However, the usage of the term “structural models” differs somewhat between researchers. Some researchers use the term to denote the methods proposed by Bresnahan and Panzar & Rosse, which will be presented below and then labeled as “non-structural”. But in order to make a distinction possible between the Herfindahl-Hirschman index and the Concentration Ratio (both presented below) on the one hand, and Bresnahan and Panzar & Rosse on the other, the term “structural” will be used for the former group.

Where:

HHI = the Herfindahl-Hirschman index.

m = Number of firms in the market.

x_i = Market shares of the firms in the market.

The United States Department of Justice considers a market to have a low concentration level if the sum is below 1000 points, to be moderately concentrated if the sum is between 1000-1800 points, and to be concentrated if it is higher than 1800 points (U.S. Department of Justice and the Federal Trade Commission 1997).

The HHI is often criticized for three inherent weaknesses. Firstly, the market share data of every firm in the market is frequently unavailable and this makes the HHI somewhat unreliable to use empirically. Secondly, the HHI points are not as pedagogical and do not have the same intuitive meaning as for example market share statements. Lastly, the HHI is only a market concentration index and doubtful voices have questioned how hard the link between market concentration and market competition really is (Jansen & DeHaan 2003, Casu & Girardone 2006).

Before the United States Department of Justice began using the HHI, the concept of concentration ratios (CR) was employed. Here one estimates the total market share of the n number of largest firms in a market.

Formula 2: Concentration ratio

$$CR_n = \sum_{i=1}^n x_i$$

Where:

CR_n = The concentration ratio of the n largest firms in the market.

n = Number of firms measured.

x_i = Market shares of the measured firms in the market.

Compared to the HHI the CR is looked upon as a cruder tool that, unlike the HHI, does not consider the relative sizes of the firms. However, even though it is a somewhat blunt

tool it gives a quick overview of the market and is easy to apply. These are the reasons why many authorities still rely on it, for example the German Federal Cartel Office. It states that a market is concentrated if the biggest actor has a market share exceeding one third, or if the three biggest actors have at least a 50% market share, or if the five biggest actors control more than two thirds of the market (Matthes *et al.* 2005).

Neither of the two so called structural approaches, CR and the HHI, will be used as instruments evaluating the degree of competition film distribution companies face when acquiring rights for Sweden. Their approach is most useful when evaluating markets where market share is the primary weapon used by the companies to win advantages over their competitors and to extract revenues from their customers. Examples of such industries could be the telecommunications market where the customer base is of paramount importance, and the automotive market where financial muscles for R&D and distribution channels are crucial. This is not the case, however, in the industry studied here. It is not possible for one buyer to outcompete and acquire the distributional rights of a <USD 20 million budget indie only because of a greater market share at home. Furthermore, it is not possible for any market leader to exert market power and to increase profits by altering the price or output policy. Strengths in the acquisitions market are not necessarily based on market shares but rather on other factors. Such factors include a good network of contacts, staying up-to-date on recently announced projects and scouting new ones, being sensitive to trends regarding what is hot and what is not, an instinct for which of the smaller projects that have a potential to be marketed and perceived as bigger than they really are, etc. However, for big-budget films (>USD 20 million) the buyer's financial strength and ability to promote and distribute the film on a large scale will be of importance for the producer and the sales company. Market share will therefore be of importance on these acquisitions (Hussain 2007).

The structural approach has largely been replaced in current research by a non-structural approach that does not focus on market structure and market concentration but on other factors that may affect competitive behavior, such as entry/exit and the

degree of market contestability. Instead of testing for market power and observing market structure the non-structural approach tries to measure the degree of competition directly, by endogenizing market structure and thereby avoiding the problem of one-way causality between concentration and performance inherent in the structural approach (Staikouras & Koutsomanoli-Fillipaki 2006). According to Casu & Girardone (2006) current non-structural research stands on the shoulders of the Lerner index of monopoly power (Lerner 1934), Iwata's measure of competition between oligopolists (Iwata 1974), and tests for competitive conditions in contestable markets (Bresnahan 1982, Panzar & Rosse 1987). Bresnahan and Panzar & Rosse are today the most influential streams of research.

Bresnahan (1982) sets out to measure the degree of market power from linear demand and supply equations. The whole idea is basically to test whether or not a company's marginal revenue deviates from its demand function. If there is a deviation the company exerts market power, and the deviation is measured between 0 (no deviation, i.e. the market is competitive) and 1 (i.e. the market is a perfect cartel). The model is fairly technical and requires the estimation of a simultaneous equation model. The reader interested in these more technical issues is recommended to see Jung & Seldon (1995) and Bresnahan (1989) for straight-forward and very pedagogical readings.

Panzar & Rosse (1987) on the other hand is easier applied and that is one reason why it has become so widely used in recent years, especially in studies of the banking sector. Another reason is that the data needed is more frequently available than the data needed for the Bresnahan approach since it relies on revenues and not on output prices (Mamatzakis *et al.* 2005). What Panzar & Rosse essentially did was to measure market power by observing the extent to which changes in input factor prices affected revenue. Depending on the market structure firms will employ different pricing strategies in response to these cost changes. The sum of the elasticities of the revenue function with respect to the factor prices is reflected in the H-statistic. This measures, in short, the percentage variation of the equilibrium total revenue derived from a one percentage unit change in all input factors used by the firm (Casu & Girardone 2006). In a market

characterized by perfect competition H will be 1, i.e. the change in factor prices will be reflected perfectly in the total revenues. However, when the market is characterized as a monopoly (or a perfectly colluding oligopoly) an increase in input prices will increase marginal costs, which in turn results in lower output and hence reduced total revenue. The H -statistic then becomes 0 or negative. If $0 < H < 1$ we have a monopolistic competitive market where revenues increase less than proportionally to changes in input prices. Even though the Panzar & Rosse model was not intended for it initially, it has also been shown that the magnitude of the values between 0 and 1 reflects the degree of competition in the monopolistic competitive market (Staikouras & Koutsomanoli-Fillipaki 2006).

Both the Bresnahan and the Panzar & Rosse approach pose problems when applied on the market for film distribution rights. Film distribution companies do neither compete with prices nor by adjusting output quantity. While marginal cost and marginal revenue are essential financial tools for the companies, they are not feasible as strategic weapons. Hence both Bresnahan's marginal revenue deviation and Panzar & Rosse's output quantity dependent H will not be as suitable here as in some other industries.

Another problem with the non-structural models in the film acquisition/distribution setting is that they were modeled to study markets that one could suspect have too little competition. Bresnahan was interested in what degree the firms exerted monopoly power and Panzar & Rosse focused on how far away the market was from being competitive. This is hardly surprising since the industry of common interest for them was the banking sector, which is a market most often characterized by only a few large companies. As we have seen, however, the situation in our market is rather different. There does not seem to be any reasons to suspect it to be monopolistic or a perfect cartel. On the contrary one might suspect that there is too harsh competition resulting in negative economic profits. This situation is not included in, and hence not measurable with, the two non-structural models presented above. A test using any of them would therefore most probably only state the obvious – that the market is competitive – and we

would not get any indication of whether or not there are too many companies in the market.

Economic theories concerned with the long-run possibility of too many companies in a market mainly come from the discussion of utility as an alternative goal to profits. To the owner of a company other things than strictly making profits may be of value. This could for example be keeping an old family business and upholding tradition, doing something that is of personal interest, or altruistically working with something that benefits a greater good. These studies are often done through conducting an owner-survey and then linking the results to a hypothesis. A good and very enjoyable example of this methodology is Scott Morton & Podolny's (2002) study of Californian wineries in which they find that the more profit-driven owners produce lower quality wines than utility-driven owners. These latter owners are also less sensitive to revenue decreasing competition. However, since the aim of this thesis is rather to examine the degree of competitiveness than to couple the prevalence of too many companies to certain company and/or market characteristics the utility methodology will not be employed. What is studied here is the degree of competition and not how this competition is affected by owner preferences. This would, however, be an interesting area for future research if the market indeed is found to have too many participants.

6. METHOD AND THEORETICAL FRAMEWORK

The empirical study will not employ any of the structural or non-structural approaches presented above due to the difficulties with fitting them to the acquisitions/distribution market. Neither the method for discerning degrees of competition used by the US state, the HHI, nor the concentration ratios used by the German state can depict a market accurately where market share is not of paramount importance. And neither the Bresnahan nor the Panzar & Rosse approach are suitable since (1) price and quantity are not possible strategic means for the companies, and (2) they are not fitted to situations where one may expect the prevalence of too many companies in a market. Neither will

methods on utility vs. profits be employed since the aim is to examine if there are too many companies on the market and not why this is the case.

Instead a finance-economics (FE) stance will be taken to discern how hard the competition in the acquisitions/distribution market is. By coupling company specific accounting data and financial goals with the zero economic profit condition taken from economics we can infer what the economic reality looks like for the market participants. This method of measuring competition is rarely used and is therefore not described in the literature review above. The method's infrequent use is most probably due to the fact that competitiveness in a given market is next to always only studied when one may expect a lack of competition, and that this results in high costs for society. In such cases characterized by insufficient competition better methods than FE are available. However, when examining markets where one may expect to find too many companies the methodology is less developed. The reason is probably because this state is considered to be temporary and does not inflict any real costs on society. In those rare instances where markets are overcrowded even in the long-run research has focused on the "how come" instead of the "how much". An example of this is the utility discourse described above. However, while the FE approach is something of a less traveled road it is still a intuitively logical and very straightforward way of examining the competitiveness in a market with possibly too many participants. Hopefully future research will develop this method.

The zero economic profit condition states that in a competitive market the economic profits of the participating companies will be zero in the long run. Economic profits are different from accounting profits as the economist includes opportunity cost into the total cost when calculating economic profit, while the accountant does not when calculating accounting profits. The economic profit is, in short, the difference between a firm's revenue and the opportunity cost of its inputs.

Positive economic profits continue to attract new entrants and/or expand production among the existing companies until economic profit is reduced to zero. And when the

market experiences economic losses the firms will exit the market and/or reduce production until the remaining companies reach zero economic profit. In the long-run equilibrium the companies run at their efficient scale, price equals average total costs, and total revenues equal total costs.

To obtain the opportunity cost of capital the Capital Asset Pricing Model (CAPM) will be employed. The CAPM is superior to conventional accounting methods in reaching a reasonable accurate measure of this opportunity cost (Fischer & Kamerschen 2003). Although it is not a perfect measure it is generally accepted as a useful approximation and a good starting point (D'Arcy 1988).¹⁶

By taking into account the risk free rate of return, the return on the market portfolio and the company's specific risk (β), the required rate of return on equity (ROE) of the company can be computed. This required rate of return can then be used as the opportunity cost of capital. The β is the historical covariance of the return of the company's shares and the return of the market portfolio. A value of 0 is the same thing as a risk free investment, a value of 1 means that the shares perform exactly like the market portfolio, and a β exceeding 1 signifies risk. By applying the CAPM on the industry as a whole and not just on one single company the industry's required rate of return/opportunity cost of capital can be estimated. This estimation can then be used to assess if the zero economic profit condition holds for the distributing companies by comparing their annual return on equity¹⁷ with the market's required return.

It should be mentioned that I will only consider the market's general risk premium and not the companies' specific operational or financial risks. These risks differ between the distributors and it is outside the boundaries of this thesis to take their unique risk patterns into account. However, it is reasonable to assume that their risk levels vary in a way that they more or less even out, hence making the importance of the omission less crucial.

¹⁶ See McNulty *et al.* (2002) for a discussion regarding the weaknesses of the CAPM.

¹⁷ The companies' return on equity is here defined as $100 \times (\text{Annual profits or liabilities before tax} \div \text{Shareholders' funds})$.

From this, and with the help of accounting data, it will be possible to conclude whether or not there are too many companies on the market. If the market participants are experiencing negative economic profits this would indicate that there are too many competitors, and positive economic profits would indicate that there are not.

The timeframe of the study will be 1997 to 2005. This nine year period has been chosen since it (1) covers the three most recent entries to the market (NonStop, Atlantic and Noble), (2) the availability of data is good, and (3) it is manageable within the limited frameworks of a Master's thesis. The focus will primarily be on financial results but market entry/exit and variations in market shares will also be considered. This is to examine if changes in the number of participating firms affect market structure. General market statistics from the Swedish Film Institute (SFI), Sveriges Videodistributörers Förening (SVF) and Nordicom will be used.¹⁸ Company specific data comes from the distributors' financial statements and annual reports.

7. EMPIRICAL STUDY OF THE SWEDISH MARKET

To discern whether the acquisition/distribution companies face either positive or negative economic profit their annual return on equity will be compared with the return one should require from their market. If they are experiencing negative economic profits this would indicate that there are too many companies in the market, and positive economic profits would indicate that there are not. The distribution companies are non-traded companies and hence lack the historical covariance statistics with the market portfolio needed to make individual assessments. There are also no comparable companies within the industry to use as proxies. Therefore the CAPM will employ an estimated market beta to obtain the required return on equity for the acquisition/distribution market as a whole.

¹⁸ SFI is a non-profit institute financed largely by the Swedish state, but also by cinema exhibitors, film producers, film distributors and television companies. SVF is the association of Swedish distributors for the home market. Nordicom, finally, is a Nordic cooperation in media and communication research. In Sweden it is located at the Göteborg University.

The basic formulation of the CAPM states that the expected return of an asset is the risk-free rate of return plus the asset's unique risk (β) times the market risk premium.

$$r_e = r_f + \beta(r_m - r_f)$$

Where:

r_e = required rate of return, or cost of equity

r_f = risk-free rate of return

r_m = required return on the market portfolio

$r_m - r_f$ = market risk premium

β = covariance of the return on the asset and the market portfolio

The risk-free rate of return is given by the Swedish 10-year Treasury bond, while the required return on the market portfolio is given by the risk-free interest rate and the historical Swedish market risk premium. This premium has been found to be 4% in recent years (Sandoff *et al.* 2005, Redeye 2006). The risk-free interest rate changes over time, which also affects the required return on the market portfolio since the market risk premium is assumed to be constant. Therefore the required rate of return on equity will be adjusted each year to incorporate the changes in the risk-free interest rate.

The industry β is primarily affected by the fact that the film industry is a high-risk industry. Sawhney & Eliashberg (1996) state that the demand for a movie is highly uncertain since a film is an experimental product¹⁹ that the consumers only can evaluate after having consumed it. Goettler & Leslie (2005, p.232) include the financial risk when they conclude that *"there is no question that financial risk is a primary characteristic of the motion picture industry – demand is notoriously difficult to predict and nearly all costs are incurred before any demand is realized."* De Vany (2004, p. 207) sees the movie industry as a *"business of extremes"* since all major costs are spent in advance and because of the way movie-goers dynamically influence one another. The costs cannot be recouped if the film fails at the box-office and the line between success and failure is very thin due to contagion, i.e. the word-of-mouth effect, in the customer group. De Vany (2004, p. 214)

¹⁹ An experimental product is a product people buy for the experience of it rather than for some utilitarian reason.

also labels the movies as a “*winner-take-all business*” since most films do not recoup their costs and only a small fraction of the films earns the greater majority of the revenues. Other reports that confirm the film industry being a high-risk venture include Hennig-Thurau *et al.* (2003) and Avery (2006).

This riskiness is not only imminent at the production side of the industry but also at the acquisition and distribution side. Since the sales companies can be assumed to be professional and know their markets, a reasonable assumption is that they succeed in distributing the risk from the production side proportionally on to the buyers. When acquiring the rights for a film before the production has finished, a so-called *pre-buy*, the acquiring distributor and the producer more or less face the same risk. And when a finished product is sold the price mechanism adjusts for changes in risk, thereby evening out the risk/reward ratio between the producer and the distributor. Considering this high-risk nature of the acquisition and distribution market a beta of 1.75 will be assumed. Changing this assumption, increasing or decreasing the beta within reasonable limits, will only have minor effects and will not affect the final results of the empirical study.

One problem with the CAPM in our setting is that it does not reflect the whole risk of a non-traded company. Damodaran (2002) shows that adjustments have to be made when it comes to *the lack of diversification* and *the illiquidity problem*.

The owner of a non-traded firm often has his or her whole fortune invested in the company, and hence lacks the possibility of diversifying risk by investing in other companies. And since the CAPM is based on the theory of an efficient market where investors diversify their portfolios one has to adjust the pricing model. This is highly relevant in this study since 75% of the market (see *Figure 2*, above) could be said to be characterized by non-diversified ownership.²⁰ If one wants a more precise company specific estimate a new company beta should be estimated, incorporating the non-

²⁰ Only Sandrew Metronome (13%), Svensk Filmindustri AB (12%) and Nordisk Film (0%) are owned by big finance with diversified portfolios.

diversified element (Damodaran 2002). But for a more general approach a proxy estimate will suffice (Damodaran 2005). Damodaran (2005) argues that an average of 10 percentage points could be added to the cost of equity, and this study will follow his advice by adding 7.5 percentage points (the market share of non-diversified owners times the recommended addition).

When trade with non-traded shares takes place it is connected with high transaction costs. This is, in short, not the efficient market that the CAPM takes for granted and therefore further adjustments have to be made. This illiquidity discount differs between firms and depends on the liquidity of the company's assets, the financial health and the size of the company. It is also affected by the future possibility of going public, and by the control component – i.e. an asset is considered to be more liquid if you control 51% of it than only 49%. Hence, when valuing an illiquid company, its price tag is discounted (Damodaran 2005). It has been argued and shown that the average discount is around 26% for profitable companies with up to USD 5 million in revenue, but it should be pointed out that the discount is only this large if the company is traded with some regularity (Damodaran 2002). Another way of adjusting for illiquidity is to add an illiquidity premium to the company's cost of equity. It is this method that will be used here since this study is more concerned with required returns rather than company valuation. Damodaran (2005) argues that this premium is between 2-4 percentage points depending on the company's revenue, turnover, assets, etc. The mean, 3 percentage points, will therefore be added as an illiquidity premium.

One further adjustment pertinent to this study is caused by the small firm effect. Small companies have historically meant a greater risk as well as higher returns than large publicly traded companies. This effect is said to be a result of the tendency of the CAPM to underestimate the cost of equity in small firms (Beedle 1991). Therefore the estimate of the CAPM should be modified in our case where over 40% of the market (see *Figure 2*, above.) consists of small firms.²¹ I will adjust for this small firm effect by adding 40% out

²¹ The EU definition of small firms is used, i.e. a company with less than 50 employees and an annual turnover not exceeding € 7 million or an annual balance-sheet total not exceeding € 5

of 3.3 percentage points. This latter figure is the mean of currently used estimates (4 percentage points) by professionals (Redeye 2006) and the findings of Barad (2.6 percentage points) referred to by Karlsson (2003). The small firm premium will thus be 1.3 percentage points.

We get the following required return on equity function:

Formula 3

$$r_e = r_f + \beta(r_m - r_f) + P_{nd} + P_{il} + P_{sf}$$

Where:

r_e = required rate of return, or cost of equity

r_f = risk-free rate of return = 3.5%

r_m = required return on the market portfolio = 7.5%

$r_m - r_f$ = market risk premium = 4%

β = covariance of the return on the asset and the market portfolio = 1.75

P_{nd} = non-diversifiable risk premium = 7.5%

P_{il} = illiquidity premium = 3%

P_{sf} = small firm premium = 1.3%

The required return on equity for the Swedish acquisition market of independent films budgeted below USD 20 million is found to be 22.3% given *Formula 3* and a risk-free interest of 3.5% in 2006.

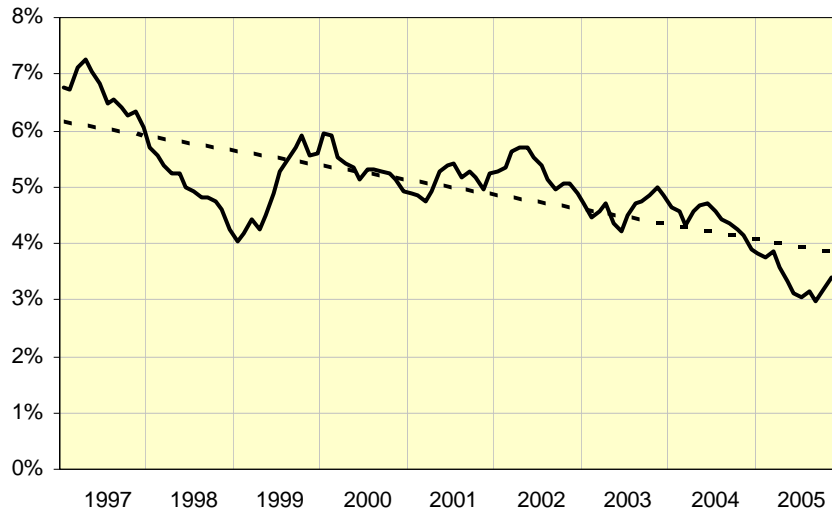
$$r_e = 3.5 + 1.75(4) + 7.5 + 3 + 1.3 = 22.3\%$$

It must be strongly emphasized, however, that this is only a rough estimate. Karlsson (2003) concludes, in his thorough review on ways to value non-traded firms, that there is no perfect method. There are only more or less subjective ways of doing it which relies on judgment rather than objective calculations. Karlsson points out the need for further research in this field given the great uncertainties. Therefore the figure 22.3% should be seen more as a rough, but yet acceptable, estimate than an exact figure.

million. Companies with less than 10 employees are automatically defined as small firms (EU 2003).

The trend of the monthly average risk-free interest rate between 1997 and 2005 has not been constant but has been decreasing as illustrated in *Figure 3*.

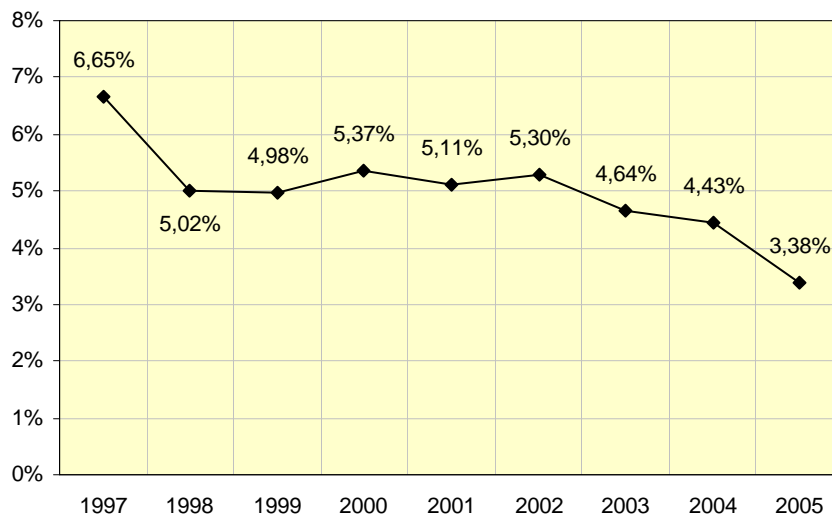
Figure 3. The Swedish 10-year Treasury bond. Monthly average January 1997 to December 2005.



Source: Statistiska Centralbyrån (2007)

To obtain correct yearly estimates of the required return on equity we must adjust for the changes in the risk-free rate. *Figure 4* gives the average annual risk-free rates that will be used when calculating the required return on equity.

Figure 4. The Swedish 10-year Treasury bond. Yearly average 1997-2005.



Source: Statistiska Centralbyrån (2007)

From these yearly averages and *Formula 3* we get the following required returns on equity: 1997 = 25.45%, 1998 = 23.82%, 1999 = 23.78%, 2000 = 24.17%, 2001 = 23.91%, 2002 = 24.10%, 2003 = 23.44%, 2004 = 23.23% and 2005 = 22.18%. We see that the highest required return is 25.45% (1997) and the lowest is 22.18% (2005). Due to the large uncertainties inherent in the model I will allow for some fluctuations and set the required return for the period to a span of 20-30%.

7.1 FINDINGS AND RESULTS: THE SWEDISH DISTRIBUTORS' RETURN ON EQUITY

The volatility of this high-risk “*business of extremes*” that De Vany (2004, p. 207) speaks about is clearly illustrated when graphing the distributors’ return on equity over the period. The values differ greatly between the companies as well as within the companies over the years.²²

Table 1. The Swedish distributors’ ROE (%). Yearly average 1997-2005.

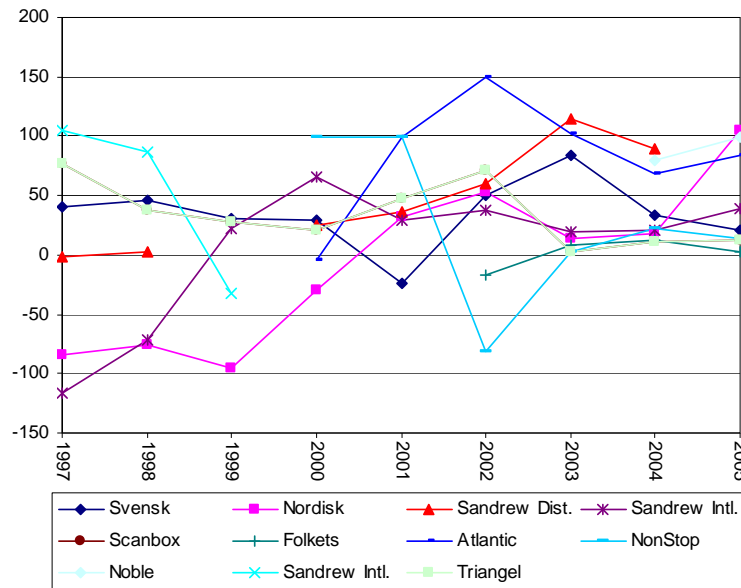
| SHORT NAME | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---------------|-----------|-----------|-----------|-----------|-----------|---------|---------|----------|----------|
| Svensk | 40 | 45,8 | 30,29 | 28,8 | -23,48 | 50,52 | 84 | 33,94 | 21,47 |
| Nordisk | -83,96 | -75,13 | -96,09 | -29,11 | 31,65 | 53,04 | 13,3 | 18,64 | 104,23 |
| Sandrew Dist. | -1,21 | 2,17 | No act. | 24,83 | 35,53 | 59,58 | 114,43 | 89,81 | -572,2 |
| Sandrew Intl. | 104,49 | 86,63 | -33,07 | -4852,33 | 267,75 | 227,16 | 400,00 | -1060,22 | -3244,89 |
| Scanbox | -116,9 | -72,25 | 21,96 | 65,6 | 28,7 | 37,36 | 18,97 | 21,45 | 38,42 |
| Triangel | 77,37 | 37,24 | 27,78 | 20,27 | 47,06 | 70,53 | 2,77 | 11,59 | 12,62 |
| Folkets | Not avail | Not avail | Not avail | Not avail | Not avail | -17,39 | 8,84 | 12,5 | 3,09 |
| Atlantic | No act. | No act. | No act. | -4,94 | 98,8 | 149,27 | 102,06 | 69,08 | 83,75 |
| NonStop | No act. | No act. | No act. | 98,71 | 99,31 | -81,7 | 3,27 | 22,55 | 14,22 |
| Noble | No act. | No act. | No act. | No act. | No act. | -802,75 | -487,04 | 79,78 | 98,74 |

Source: Affärsdata (online database), ORBIS (online database), annual reports.

For the purpose of illustrative clarity extreme figures marked in dark grey above, i.e. observations below -150% and above +150%, have been excluded from *Figure 5* below. This is done in order to depict the volatility of the film industry and also give a hint of the individual companies’ developments. Individual charts for the companies, that are easier to read, can be found in Appendix II.

²² Please note that data on Folkets Bio 1997-2001 is missing making conclusions regarding their returns less reliable. However, as Folkets Bio’s activity is idealistic and not commercial their missing figures will not skew the findings on market returns. Please also note that data for Sandrew Distribution is missing for 1999. This year the company’s activities were done by Sandrew Metronome Sverige AB that also handled the cinema chain.

Figure 5. The Swedish distributors' ROE (%). Yearly average 1997-2005 excluding ROE<-150% and ROE>+150%.



Svensk Filmindustri's return on equity has been relatively steady throughout the period. The years 2003 and 2001 stand out as, respectively, hit and miss years that must be considered normal in the film industry. But on the whole SF has managed to keep things steady, as illustrated by the horizontal trend line.

Nordisk Film has also had a steady development, and as the Danish company has increasingly focused on the Swedish market the returns in Sweden have increased. The trend is steady and positive, without any large fluctuations.

Sandrew Metronome, on the other hand, has experienced some violent fluctuations in both the acquisitions company as well as in the distribution company. Especially the last two years have been extra hard for Sandrew Metronome and it could be assumed that these problems are linked to the severe situation that the concern in general, and the cinema chain in particular, have been experiencing. However, when clearing these few unfortunate years the trend becomes more stable and the distribution company even gets a positive trend that is in line with the industry's predicted required return of equity.

The second Danish company, Scanbox, does exactly like Nordisk Film show a positive trend as the company's presence in Sweden has become increasingly stronger. After two early weaker years, 1997 and 1998, the return on equity has been stable and well in line with the industry's required return.

At first glance, the trend for Triangelfilm does not look as positive as Scanbox's. However, much of this downward trend can be explained by equity accumulation. In fact, only the years 2000 and 2003 were weaker years revenue-wise while 2001 and 2002 were strong years.

Since the primary ambition of Folkets Bio is to bring quality films to the Swedish audience rather than making profits, the return on equity measure should be used with caution. Simply put; an investment in Folkets Bio only needs to generate as much return as to secure the ongoing operations. Hence the required returns become lower. Due to lack of observations one should also be cautious when making conclusions about the upward trend. Most probably this is only the outcome of random chance, and a more appropriate reflection is to view the observations as fitting the company's altruistic and modest revenue goal.

Atlantic Film has delivered healthy returns from the first day when it received its present name in 2002. Between 1999 and 2002 the company was called Aktiebolaget Filmpaket 88/89, and that company's activities were very different from present day Atlantic's. However, data for 2000 and 2001 have been included in Atlantic's dataset to reflect the fact that Atlantic did not begin from scratch in 2002. In the first three years the good returns could be partly explained by a low equity stock. But from 2003 and onwards, when the company had reached a steadier phase in its early development, the explanation is mainly increases in revenues. It should also be pointed out that Atlantic has succeeded in staying at a very high level of returns, beating an investor's required rate of return for the industry.

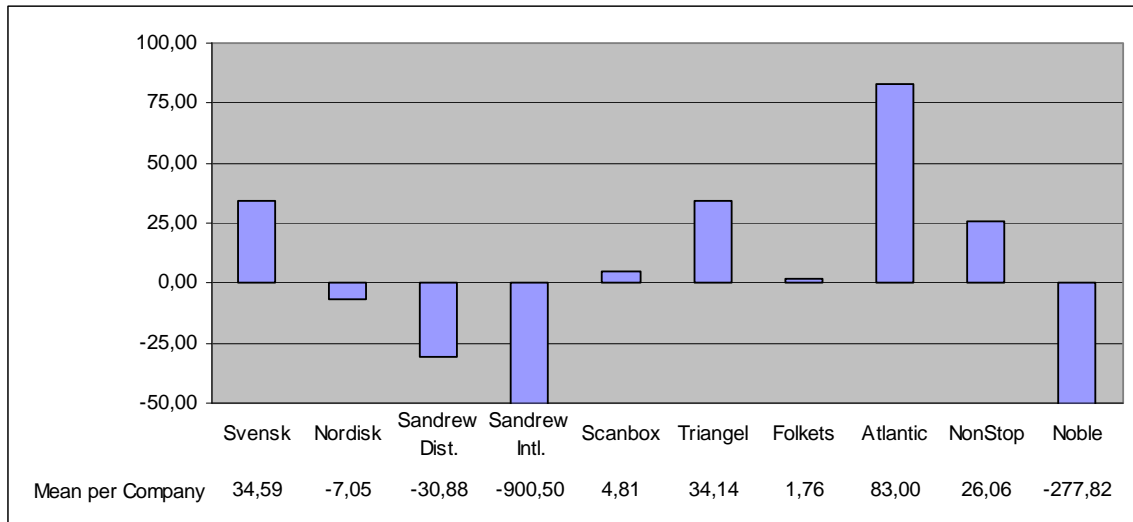
NonStop Entertainment's negative trend is largely due to a small equity stock in the early start-up years which yielded high returns on equity. The conspicuously poor year of 2002 is the accounting outcome of unusually large depreciations. NonStop has continued keeping the revenues, and taxes, down by using aggressive depreciations which have also resulted in low levels on the return of equity. One should therefore be cautious when interpreting NonStop's modest figures.

Finally we have the youngest company, Noble Entertainment. The first two years of its history were characterized by losses and a very small equity stock. Hence the remarkable negative returns on equity. The last two years, on the other hand, have been more positive with increased profits as well as a build-up of equity. Even though these last two years have given seemingly stable high returns it must not be forgotten that the time period is very short and not lends to too far-reaching conclusions. It can easily be argued that Noble Entertainment's high returns is an indication of the high risks associated with new and rapidly expanding enterprises.

7.2 FINDINGS AND RESULTS: THE SWEDISH INDUSTRY AND RETURN ON EQUITY

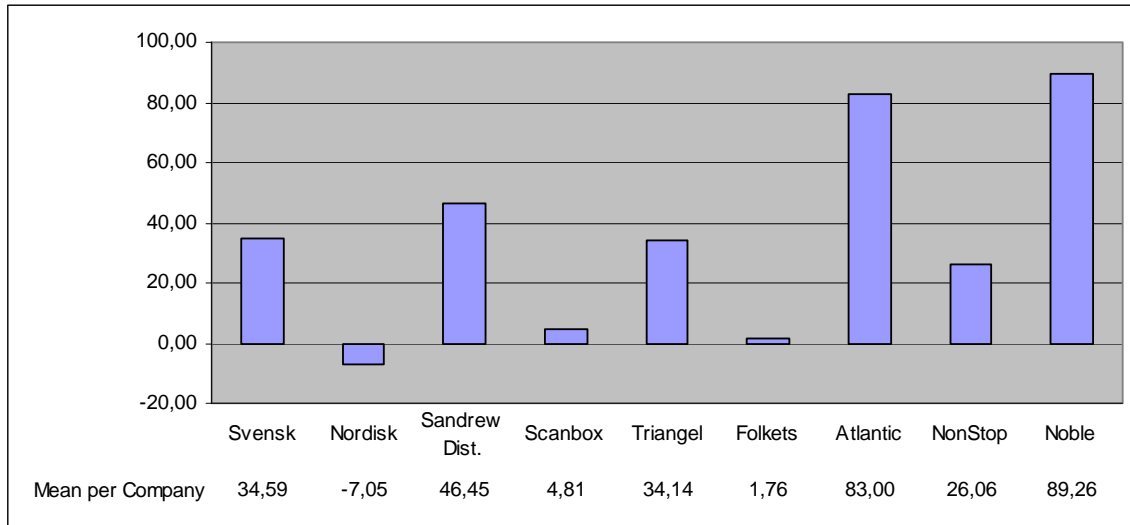
To see if the returns have been satisfactory we need to compare the mean returns over the period for the individual companies with the industry's required return. As concluded above the industry's required return on equity is roughly 20-30%.

Figure 6: Mean ROE (%) per company 1997-2005.



From the above discussion we know that a few extreme years for Sandrew Metronome and Noble Entertainment have had a strong effect on the companies' data. When excluding Noble's upstart years and Sandrew Metronome's recent problems we get a more representative picture of normal conditions.

Figure 7: Mean ROE (%) per company 1997-2005, excluding ROE<-150% and ROE>+150%.

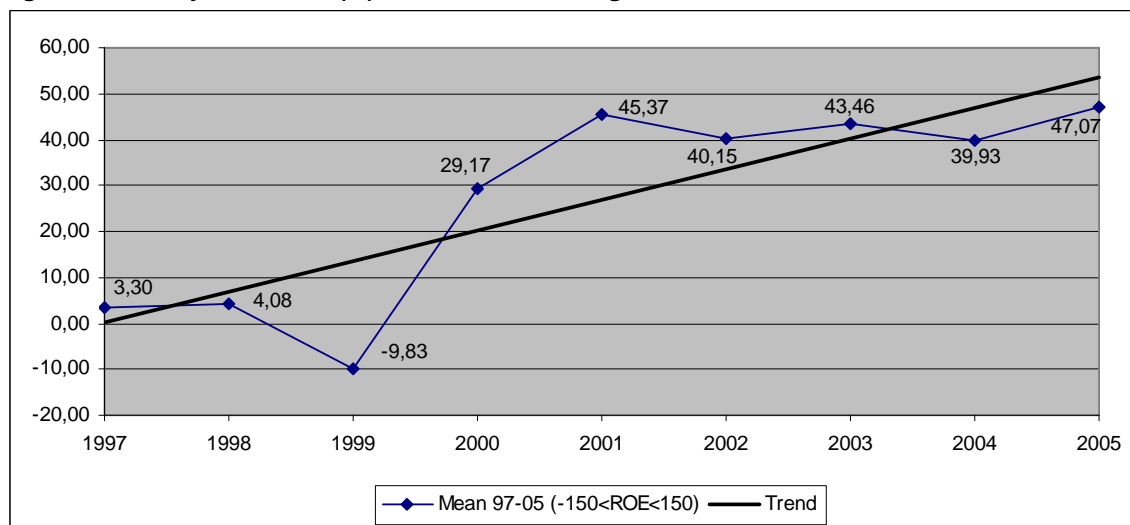


It was stated in the discussion on the distributors' individual performances that Nordisk Film and Scanbox both experienced some weaker years early on in the studied period. Since then, however, they have benefited from a stronger focus on the Swedish market and are now experiencing returns in line with the required rate. The commercial companies that have been firmly established on the Swedish market longer, namely Svensk Filmindustri, Sandrew Metronome and Triangelfilm, all meet the required rate of return over the period – even though Sandrew Metronome's grave problems in the last few years must not be neglected. The three most recently founded distributors, Atlantic Film, NonStop Entertainment and Noble Entertainment are harder to evaluate. Atlantic has constantly beaten the market's required return and this while maintaining good solidity. NonStop is also deemed stable, and their figures have a downward bias due to aggressive depreciation routines. Thus it can be concluded that also NonStop has performed at least as well as one could require. Noble Entertainment has for the last two years, i.e. the only years after the company's painful birth, delivered high returns. However, it remains to be seen if this only is an outcome of the high risks associated with new and rapidly expanding businesses. To sum up, the mean return on equity for

the distributors has over the studied period been in line with, or surpassed the required level for the industry.

The development for the industry as a whole over the period also shows mainly healthy returns. When the industry's annual mean is plotted, after excluding extreme observations, the trend is clearly positive.

Figure 8: Industry mean ROE (%) 1997-2005, excluding ROE<-150% and ROE>+150%.



Even though one should be cautious when interpreting the positive trend, the graph gives a firm indication that the returns of the industry have not suffered due to new companies entering the market. On the contrary, the returns of the industry have increased while the new companies have entered and found their niches.

This is, however, the picture of the whole acquisitions market where no adjustments have been made in order to portray the submarket for titles with a production budget lower than USD 20 million. It could be argued that the positive trend is the result of the older companies' ability to swiftly adjust to new conditions. If the market for smaller titles became excessively established when the three new companies entered the established companies had to shift their focus to markets with less competition, i.e. to big-budget titles. But even though it is tempting to accept an explanation with such positive air of great business intuition it is doubtful if it tells the whole truth. Acquisition

patterns and business strategies do not change overnight, and one should remember that the time period for Atlantic's and Noble's theatrical ventures is merely two years.

Due to the fact that the revenues from individual titles are carefully guarded secrets by most distributors it is not possible to do an exact estimation of the returns on equity only on titles below the USD 20 million mark. But it is possible to get a very rough idea by weighing the company's mean annual return on equity with its market share in this segment. Since this exercise only is aimed at giving an approximation I will use the market shares for just one year, 2005, found in *Figure 2*. As pointed out previously the film industry is highly volatile, which means that market shares vary between the companies from year to year. Hence it should be noted that it is risky to put too much faith in weighted returns based on the market shares in one single year. Another caveat deals with the short time frame. Since Atlantic and Noble only have been releasing films theatrically for two years, 2004 and 2005, it would be misleading to use the 2005 market shares to weigh annual returns before 2004. No conclusions regarding trends should be drawn as a consequence of this short time span.

The weighted industry mean, excluding $ROE < -150\%$ and $ROE > +150\%$, for 2004 is 33.61% and for 2005 30.07%. These returns are clearly below the returns for the complete market but they are still well in line with the required level. The lower numbers are largely due to the omission of Nordisk Film (market share of 0% in 2005).

To sum up, both the data on the return on equity for the individual companies as well as for the industry as a whole indicate that the returns have been satisfactory between 1997 and 2005. A rough measure of the submarket for lower budgeted films tells the same story. Followingly, the proposition that the Swedish market for distribution of independent films is characterized by too many competing companies is ill-supported. In fact, the return levels indicate that there is room for the existing companies on the market, and possibly also room for additional entry.

8. SUMMARY AND FINAL DISCUSSION

The aim of this thesis has been to test if the popular notion is correct, saying that there are too many companies on the Scandinavian market for distribution rights of foreign independent feature films. This was done through the study of Sweden, Scandinavia's most important market, over the time period 1997-2005. Only the theatrical distributors were studied, and a distinction was made for titles exceeding a production budget of USD 20 million.

In order to ascertain the level of competition the theory from economics on zero economic profit was coupled with the concept of required return on equity, taken from financial theory. In contrast to the popular notion of Scandinavia as being an excessively established market the data for Sweden shows that in 1997-2005 the competition did not result in negative economic profits. On the contrary, data indicates that the profitability increased over the period even though three new companies entered the market.

It is natural that one begins to wonder what the reasons are for this misconception regarding the competitiveness of the Swedish market. And even though it has not been the aim of this thesis to venture into such explanations I will try to give some hypotheses in order to facilitate further research. Possible explanations that would be interesting areas for future research include (1) psychological and historically tainted notions, (2) a market expansion and increased demand, and finally (3) the ability of finding one's niche in the three revenue windows of film distribution.

The notions of how things normally are, and used to be, affect the ways we think about new phenomena. Historically Scandinavia has been a market with few distributors competing to acquire the independent films on the market (Pham & Watson 1993).²³ If then suddenly the number of market participants increase by 50% in just a few years it is not surprising if voices lamenting excessive entry could be heard. The response is

²³ Since this survey does not cover any pre-1997 period the question of whether or not this low number of competitors also led to low levels of competition must remain unsaid. Few competitors are not necessarily the same thing as excessive profits – an economic truism excellently exemplified by the rivaling aircraft manufacturers Boeing and Airbus.

psychologically logical and has little to do with actual data on returns and profits. The core question, whether or not the market has room for new entrants, is easily forgotten.

This is in turn connected with the second proposed explanation – that the market has expanded and therefore has room for more participants. The development of the sell-through market has been revolutionized by the DVD, and three times as many units were sold in 2006 than before the introduction of the DVD in 1998 (VideoMonitor 2007). Furthermore, the TV-market has experienced great changes over the last few years with digital broadcasts opening up for new channels. These need to be filled with content, and since feature films by tradition make up a significant part of the broadcasts the demand for films on the small screen has increased. It could be that one focuses too much attention on the theatrical window and forgets the TV- and the home market when commenting on the increased number of distributors. The theatrical release comes first chronologically and is also by tradition considered more prestigious than TV- and DVD sales. It could therefore be assumed that increased competition on the theatrical market gets an unproportional and misleadingly large share of attention.

This leads us to the third proposed explanation why the Scandinavian market often is looked upon as being too competitive while the data suggests otherwise. It is, in short, of great importance to include all three revenue streams when assessing the viability of the distribution market. By finding a niche in any of these three windows a distributor can lessen the competitive pressure and make profits. It is my personal reflection that for example NonStop Entertainment is very good at TV sales, Atlantic Film and Noble Entertainment focus on the DVD market, Triangelfilm, Sandrew Metronome and Folkets Bio emphasize the theatrical window, while Svensk Filmindustri, Nordisk Film and Scanbox have the muscles to manage all three windows.

Additional terrain for further research is how the transformed theatrical landscape will affect feature film distribution. Will the decreased level of competition, resulting from SF Bio's acquisition of Astoria's small town cinemas, affect the conditions of the distributors? Will the supply of films be affected and skewed towards more mainstream

titles with bigger budgets? How dominant will SF Bio become and how will this affect the film industry at large?

Another interesting field of study would be how the rapidly changing TV-market will affect film distribution? In a future where pre-set TV tables increasingly give way to individual choice and personalized tables one could assume that the demand for films would be affected. How is this most likely to change the conditions for the distributors?

Indeed, the film industry is experiencing a phase of rapid change at the moment. The new distribution companies that have recently entered the market are just one sign of this. The development in the coming years will be very interesting to follow and will, most likely, have profound effects on how we will be able to consume one of our most popular art forms.

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APPENDIX I

Market shares in 2005 of the distributors of non-Scandinavian independent feature films.

| COMPANY | ADMISSIONS | MKT. SHARE |
|-----------------|-------------------|-------------------|
| Svensk Filmind. | 844 390 | 45,34% |
| Sandrew Metr. | 321 543 | 17,27% |
| Scanbox | 318 117 | 17,08% |
| Triangelfilm | 150 147 | 8,06% |
| Nordisk Film | 92 477 | 4,97% |
| NonStop Ent. | 67 750 | 3,64% |
| Noble Ent. | 36 431 | 1,96% |
| Folkets bio | 19 815 | 1,06% |
| Atlantic | 11 514 | 0,62% |
| TOTAL | 1 862 184 | 100% |

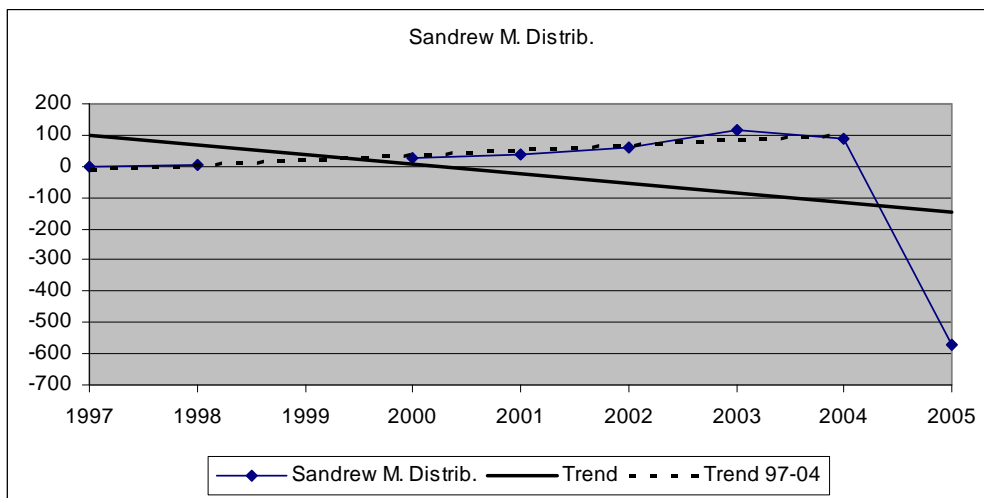
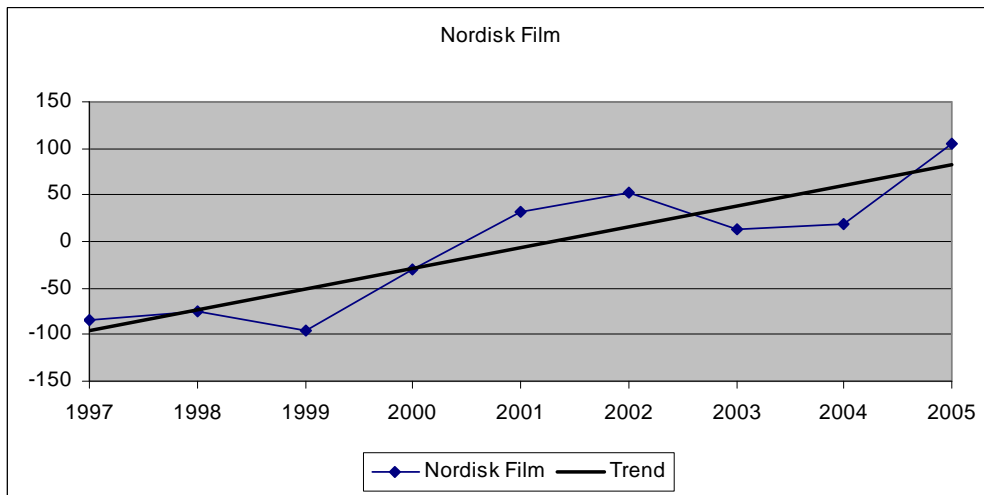
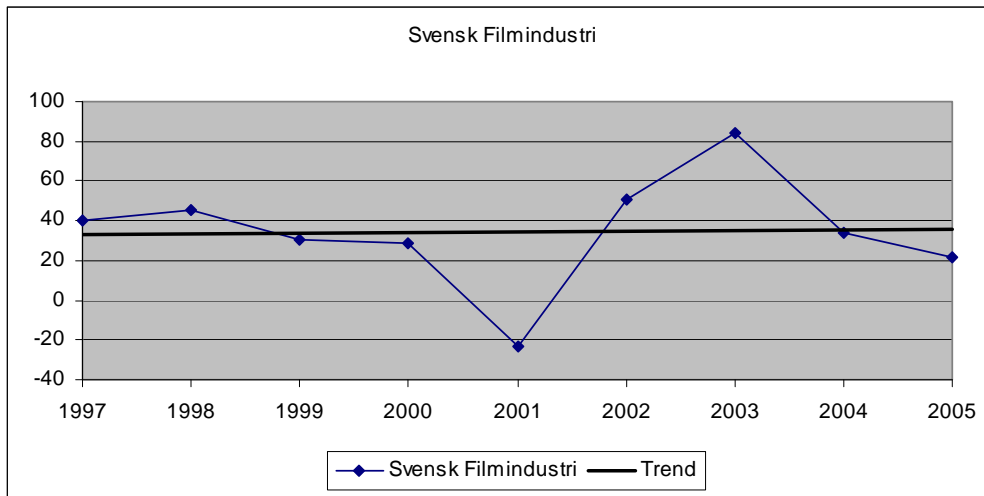
Note: The calculations for the number of admissions are available upon request.

Market shares in 2005 of the distributors of non-Scandinavian independent feature films with a production budget not exceeding USD 20 million.

| COMPANY | ADMISSIONS | MKT. SHARE |
|---------------------------|-------------------|-------------------|
| Scanbox | 218 211 | 32,29% |
| Triangelfilm | 150 147 | 22,22% |
| Sandrew Metr. | 89 139 | 13,19% |
| Svensk Filmind. | 82 808 | 12,25% |
| NonStop Ent. | 67 750 | 10,02% |
| Noble Ent. | 36 431 | 5,39% |
| Folkets bio | 19 815 | 2,93% |
| Atlantic | 11 514 | 1,70% |
| Nordisk Film | 0 | 0,00% |
| TOTAL < 20 MUSD | 675 815 | 100% |

Note: The calculations for the number of admissions are available upon request.

APPENDIX II



- Competition in the Market for Swedish Distribution Rights of Foreign Independent Feature Films -

