

AUSTRALIAN GOVERNMENT'S 2010 REVIEW OF THE INDEPENDENT SCREEN PRODUCTION SECTOR

EXTRACT FROM SCREEN AUSTRALIA SUBMISSION, JULY 2010

Full submission: www.screenaustralia.gov.au/news_and_events/review2010.asp

KEY ISSUES

Screen Australia has identified the following key issues through its consultation with industry and its administration of the Producer Offset.

1. Medium-budget films struggle to be made without Screen Australia funding.

The Producer Offset does not yet assist to generate enough revenue to fund medium-budget feature films without Screen Australia's assistance. This is due to the more complex financing structures of these films and the timing of the introduction of the Producer Offset, which coincided with the global credit crunch and a reduction in Screen Australia's appropriation. Additional funding is required to enable Screen Australia to lift its current funding cap from \$2.5 million and invest in medium-budget films.

2. The Producer Offset doesn't operate effectively for low-budget, one-off documentaries.

While working for documentary series, the Producer Offset is more problematic for low-budget, one-off documentary productions, which may not have sufficient marketplace support to be made without additional funding from Screen Australia. In order to receive the necessary Government support, a company must apply to Screen Australia for direct funding and for provisional and final certification for the Producer Offset, borrow against the Producer Offset to cashflow the production and incur substantial additional finance, administration and legal costs against an average rebate of only \$50,000. A direct payment in the form of a grant could substitute for the Producer Offset payment for one-off documentaries with an overall budget of \$500,000 or less.

Further, the 20 per cent cap on qualifying Australian production expenditure (QAPE) claimed on above-the-line items unfairly impacts on all documentary projects as they have a lower proportion of below-the-line costs compared with drama projects. Given this situation, documentaries could be exempt from the 20 per cent ATL cap.

3. The Producer Offset limits multi-episode projects to 65 episodes.

The Producer Offset for multi-episode non-feature projects is limited to the first 65 episodes rather than a standard unit of time such as hours. This means that programs with shorter episodes hit this limit after far less production activity than programs with longer episodes.

4. There is a lack of support for innovative and entrepreneurial screen projects.

Innovative and entrepreneurial projects, which have low budgets or alternative distribution models, are currently missing out on the support provided to more expensive projects or those with more traditional release strategies. Lowering the \$1 million Qualifying Australian Production Expenditure (QAPE) threshold for feature films to \$500,000 is one means to support innovative and entrepreneurial screen practitioners to bring films to market. Additionally, single-episode program (non-theatrical drama) QAPE thresholds are too high and stymie innovation. Reducing these thresholds will result in more lower-budget, innovative projects being eligible for the relevant Producer Offset. If this were to be combined with increased direct funding support for Australian content on emerging media platforms, this could assist to address the relatively small amounts of Australian content available on these platforms.

5. There is an opportunity to enable the games sector to achieve greater sustainability.

Without greater assistance from Government, Australia will struggle to build a sustainable games sector given the sector's current market structure and inability to retain intellectual property.

A hybrid Location/Producer Offset governed by a modified Significant Australian Content (SAC) test which focuses on the mechanical criteria (development, creative control and source of concept) as opposed to the subject matter of the content (ie settings or characters) could provide opportunities for the games sector to achieve greater sustainability.

Key issues continued overleaf...

PRODUCER OFFSET KEY STATISTICS

Since the inception of the Producer Offset in July 2007, up to 30 June 2010, 406 provisional certificates and 172 final certificates have been issued.

Documentaries make up the largest proportion – 44 per cent of provisionals and 53 per cent of finals.

Around 4 per cent of certificates (both provisional and final) relate to official co-productions.

The 172 final certificates represent \$867 million in total production budgets, \$669 million in total QAPE and \$203 million in total rebate.

Approximately 59 per cent of the final certificates were issued to applicants based in NSW, followed by 23 per cent in Victoria, 9 per cent in Western Australia, 4 per cent in Queensland, 3 per cent in South Australia and 2 per cent in Tasmania.

6. The timing of the acquittal of the Producer Offset affects the liquidity of production businesses.

The Producer Offset is paid via the tax return for the year the project was completed. If a project is completed early in a financial year, the timing of the acquittal of the Producer Offset affects the liquidity of production businesses by delaying repayment of debt. While the Commissioner of Taxation has a discretion to at any time during any year make an assessment of income derived, this discretion has been declined other than in the case of voluntary liquidation of special purpose vehicles (SPVs). Therefore, in order for producers to receive an early payment of the Producer Offset claim, without the need to liquidate, a legislative amendment would be necessary.

7. The integrity of the Significant Australian Content (SAC) test should be preserved.

The SAC test is based on legislation (Division 10BA of the *Income Tax Assessment Act 1936*) that existed prior to the introduction of the Location Offset. The rather broad language in the SAC test suggests that it could be open to interpretation and result in uncertainty. The SAC test is intended to distinguish the Producer Offset from the Location Offset by requiring significant levels of Australian content. The SAC legislation could formally acknowledge the extent to which Australians contribute to the development and creative control of a project and the participation in recoupment or profits from exploitation of a project. Such an acknowledgement would be consistent with Screen Australia's decision-making to date.

8. The definitions of QAPE need to be further considered.

Further consideration needs to be given as to what can and cannot be considered QAPE in order to achieve policy outcomes for Government and Screen Australia, administrative efficiencies for the agency and producers, and reduced compliance costs for industry. Subject to relevant caps, items eligible to be claimed as QAPE could include production insurances and completion bonds, distribution expenses of the production companies, and audit and legal fees.

9. The Australian Bureau of Statistics has indicated it will not be continuing to survey the screen production sector, resulting in a lack of information about the industry.

The Australian Bureau of Statistics has indicated that it will not be continuing its Service Industry Survey (SIS): Television, Film and Video Production and Post-production Services. There is no adequate alternative source of information to inform decision-making.

10. Screen Australia cannot use the Producer Offset data to inform decision-making and agency operations.

Due to tax secrecy laws, Screen Australia has limited ability to use the Producer Offset data to inform the decision-making and operations of the agency and limited ability to inform Government and industry as to particular aspects of its operations and effectiveness.

CHARACTERISTICS OF PRODUCTION BUSINESSES

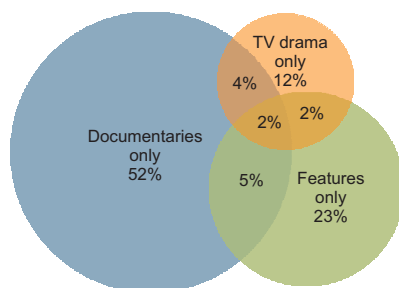
Screen Australia has undertaken new, original research to provide a snapshot of independent documentary and drama screen production businesses in Australia.

This is drawn from an analysis of production credits in the agency's databases and from the *2010 Business Survey* – a survey of production businesses (from the databases) that have made at least one feature film, TV drama or documentary project over the last 10 years.

Based on analysis of Screen Australia's project databases

There are 394 businesses currently active in the production of feature films, TV drama and documentaries in Australia (ie have made at least one title in the last three years).

Most specialise in one type of output, with more than half producing documentaries only.



Based on 2010 Business Survey respondents¹

Around 91 per cent of businesses are likely to be classified by the Australian Tax Office as 'small businesses' (based on income).

The majority (66 per cent) of businesses are structured as limited liability companies, followed by sole traders (24 per cent) and partnerships (7 per cent).

Nearly all businesses are owned by the founder (96 per cent). Family and friends have equity in 13 per cent of businesses, and 10 per cent have some sort of professional private investment.

Just over half are home-based businesses. Around 40 per cent have leased business premises but only 6 per cent have purchased premises.

Just over half of the currently active businesses in the survey are based in NSW, followed by Victoria and Queensland.

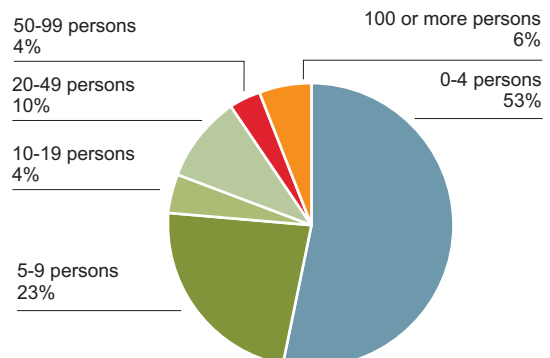
EMPLOYMENT

Labour costs account for around half of the total expenditure of independent screen production businesses.

The majority (64 per cent) of employees are casuals.

Three-quarters of businesses employ less than 10 staff and 10 per cent employ over 50 staff.

Number of employees



1. There were 320 respondents to the survey, although not all respondents answered every question. Proportions are based on responses to particular questions.

ACTIVITIES

For 2009/10, 71 per cent of businesses reported that they had at least one feature in development and 61 per cent were developing at least one documentary/factual project (with an average, in both cases, of three), while 53 per cent of respondents reported at least one documentary in production and 39 per cent at least one feature.

84 per cent of businesses have been involved in income-generating activities other than film and video production: around half of businesses engage in provision of production services, a third in provision of PDV services, and 29 per cent in content distribution or rights management.

18 per cent of respondents indicated some involvement in new media, such as interactive media, games or mobile content.

INCOME

79 per cent of businesses expected to earn less than \$500,000 in revenue in 2009/10, with only 9 per cent anticipating they would earn over \$2 million.

Of businesses reporting a profit in 2009/10, the typical profit margin was 5 to 20 per cent (profit as a percentage of revenue).

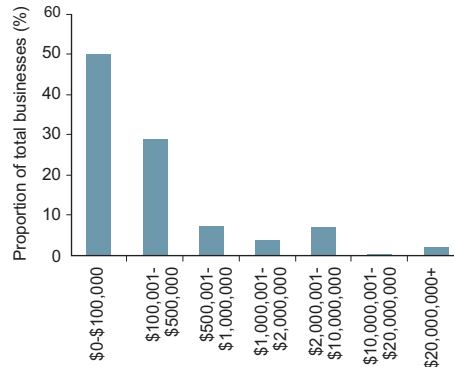
89 per cent have generated income from combinations of sources, predominantly producer fees, royalties, development fees and provision of production services.

Producer fees were the primary source of income for most businesses, averaging 47 per cent of total income.

66 per cent of businesses earn income from royalties, but it's a small proportion of their total income (on average, 16 per cent).

Just over half (56 per cent) of the respondents indicated they had earned some income from overseas (mainly North America and Europe).

Income in 2009/10



INDICATORS OF SUSTAINABILITY

Screen Australia has examined two possible indicators of business sustainability – consistency of production activity and profitability – and analysed the currently active businesses from the 2010 Business Survey displaying these indicators.

A **consistent** business was defined as having a TV series or two or more one-off feature, TV drama or documentary titles in production since 2006/07.²

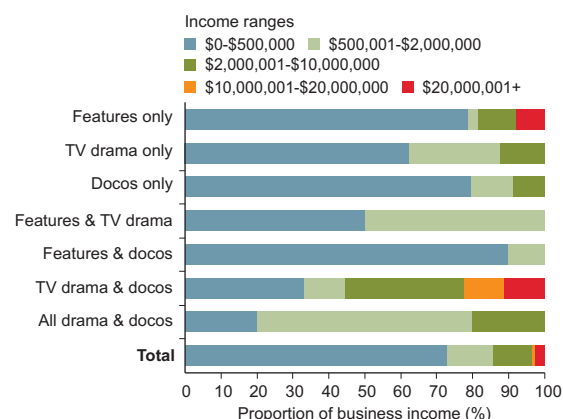
A **profitable** business was one that reported a profit in 2008/09 and/or 2009/10 in the survey.

Based on these definitions:

- 40 per cent of businesses could be defined as consistent
- 56 per cent of businesses could be defined as profitable
- 29 per cent of businesses were both consistent and profitable

A correlation exists between the two indicators. Consistent businesses were more likely to have earned a profit than businesses that had worked intermittently (69 per cent compared to 46 per cent), and profitable businesses were more likely than unprofitable ones to have worked consistently (52 per cent compared to 30 per cent).

Income of currently active businesses in the 2010 Business Survey, by slate composition, 2009/10



Characteristics of consistent and profitable businesses

Compared to businesses categorised as intermittent and unprofitable, those that were consistent and/or profitable shared the following characteristics:

- were more likely to collaborate with other businesses/producers
- tended to engage in more joint ventures
- were more likely to have multiple producers
- were more likely to have slates including more than one production type (documentaries, features, TV drama)
- did not appear to undertake a significantly different range of activities other than content creation, such as provision of production services, PDV, distribution and rights management
- were more likely to be involved in producing new media
- were more likely to earn over \$2 million a year and less likely to earn under \$500,000 a year
- were more likely to earn income from producer fees and royalties, although these sources accounted for similar proportions of total income
- were more likely to have accessed the Producer Offset
- tended to employ more people
- were more likely to have business assets and tools such as a dedicated website, a formal business plan, a board of directors, a line of credit, more than 25 per cent equity in other businesses, annual marketing budget of over \$200,000 (other than project-specific expenditure), and to be based outside of the home
- were more likely to have produced a title that reached \$1 million at the Australian box office and/or one million viewers on free-to-air television in the last five years

Profitable businesses also tended to work with higher budget levels for titles in production in 2009/10, although there seems to be little significant difference in development expenditure.

2. The definition follows that applied to production companies in the 1992 report, *Independent Film and Television Producers: Who's Making What and How They're Surviving*, by Garry Maddox for the Australian Film Commission.

STRATEGIES FOR BUSINESS VIABILITY

Based on responses to the *2010 Business Survey* and an analysis of Screen Australia databases, businesses appear to be engaging in a range of strategies to ensure their long-term viability.

DIVERSITY OF CONTENT

Most drama and documentary businesses specialise in the type of productions they create. Some of these specialist businesses report results that would indicate a degree of viability.

Among the currently active businesses in the survey, the largest proportions of consistent businesses and of profitable businesses are the documentary specialists. However, this is due to the fact they comprise most of the businesses overall.

Businesses that combine types of production are proportionally more likely to have been consistently active in production in the last three years and to have earned a profit in at least one of the last two years.

Businesses that combined documentary with either TV drama or with both features and TV drama were also more likely to be involved in new media production, and to report higher levels of income.

More than half of the businesses that reported involvement with new media (such as interactive media, games or mobile content) showed results indicating a degree of viability, with 52 per cent consistently active in production in the last three years and 65 per cent earning a profit in at least one of the last two years.

This would suggest diversifying across a myriad of content platforms is one strategy associated with viability, including in the area of new media where potential growth and new audience engagement opportunities lie. However, specialisation – allowing proven businesses to charge a 'premium' on their fees, for example.

DIVERSITY OF BUSINESS ACTIVITY

The vast majority (84 per cent) of all respondents to the survey engage in activities other than film and video production. The most common were the provision of production services (51 per cent of businesses), provision of PDV services (30 per cent) and content distribution and rights management (28 per cent).

Of the currently active businesses undertaking these activities, most of those providing production and PDV services reported a profit in one of the last two years (58 and 60 per cent respectively) as did just under half of those in content distribution/rights management (49 per cent).

Most respondents to the survey (89 per cent) reported income from combinations of sources in 2009/10. Production/PDV service fees were the second most significant source of income for production businesses (after producer fees), generating 38 per cent of total income for those businesses. Distribution rights income accounted for 19 per cent of total income for the businesses involved.

Within the sector, there is evidence of companies using vertical integration as an active business strategy, with some PDV companies and distributors expanding into production, and some production companies establishing their own distribution businesses.

COLLABORATION

Producers often work in teams, which can vary from project to project and year to year, with SPVs commonly used for individual projects.

Nearly half (46 per cent) of the 394 currently active businesses in the databases have collaborated with other businesses and/or producers on at least one project in the last five years, including international co-productions. And 23 per cent have multiple producers.

While collaboration was fairly common across all business types, those that combined production types were also proportionally more likely to have collaborated.

Businesses that collaborated were more likely to have worked consistently (52 per cent) and to have recorded a profit (63 per cent) compared to non-collaborative businesses (32 per cent and 50 per cent respectively).

The *2010 Business Survey* results reinforced this tendency towards collaboration, with 33 per cent of respondents joint venturing with domestic partners and 26 per cent with an international partner.

OBSERVATIONS OF SURVEY RESPONDENTS

Respondents to the *2010 Business Survey* were asked to rate factors they saw as significant barriers to the growth of their business or important to its growth, in the opinion of the principal or founder.

Attracting funding or clients, domestically and internationally, were seen as the most important factors influencing future business growth.

Access to an ongoing source of cashflow was seen as the most significant barrier for most businesses.

To what extent are the following factors significant barriers to future growth of this business?

