# Hedging against disaster:

## Risk and mitigation in the media and entertainment industries

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### Introduction: Theoretical frameworks for risk analysis

Risk is a central aspect of managing business in a market economy, particularly so in the media and entertainment industries. As Harold Vogel writes: "That the movie industry is complex and that it often operates near the edge of chaos in the midst of uncertainty is almost an inescapable inference for anyone who has been even a casual observer of, or participant in, the process of financing, making, and marketing films" (Vogel, 2015: 157-8). Operating in this sector has always been risky but even more so in an era of shifting consumer demand and internet disruption. This article seeks to identify and classify the most likely sources of potential loss and opportunity for firms in the media and entertainment sector. It does so by constructing a typology that categorizes risk in seven types. Combining this classification with an analysis of media firms' most common mitigation strategies for each class of risk, this article demonstrates that risk management is central to the way these businesses operate and has a determining influence on their output.

Among social scientists, economists have probably the most advanced understanding of risk as they have the statistical methods to quantify it, in certain contexts at least (e.g. Klimczak, 2007). However, these same theoretical foundations seem to limit the discipline to the financial aspects of the concept. In media economics, the focus seems to be on the risk exposure – and ways of reducing it or shifting it to third parties – for firms and investors in the film and TV industries (e.g. De Vany and Walls, 2002; Doyle, 2002; Hoskins *et al*., 1997; Picard, 2002; Vogel, 2014).

Creative industries scholars have begun to grapple with the concept of risk. The discipline's approach to risk is broad and inclusive, encompassing risks taken by firms, but also workers, artists, and the audience, in all aspects of the production and reception of cultural products. Some categories of employees are particularly exposed, from stunt performers to war correspondents (Martin, 2012). Risks can be political (a filmmaker facing arrest in an authoritarian state), artistic (a film director blending genres or an actor accepting the role of a paedophile), physical (the stunt performer) or commercial (Hjort, 2012; Naficy, 2012).

The approach taken here focuses on corporate risk, adapting the analytical framework offered by the business management literature. The data is based on firms' annual reports, academic literature and interviews with industry insiders. It covers the media and entertainment sector in general but special attention is given to the world's eight largest media and entertainment corporations (excluding Apple, Alphabet and Microsoft which are primarily based in adjacent industries, Table 1). The international nature of their operations enables them to distribute risk along several territories, but also enhances their exposure to certain risks.

This article adopts the World Bank's definition of risk as 'the possibility of loss' (The World Bank, 2014: 11). Risk, however, is complex and multi-faceted and, as the Bank adds: ‘risk is not all bad ... because taking risks is necessary to pursue opportunity. *Opportunity* is defined as the possibility of gain, thus representing the upside of risk’ (The World Bank, 2014: 11). Across all industrial sectors, it is a necessity for firms to assume certain risks in order to grasp opportunities and grow. Would they opt to avoid too many risks, they would eventually decline and be left at the margins of their industry. Risks cannot be shunned altogether but need to be assessed, owned and controlled by firms in purpose-built management processes.

Table 1: World’s leading eight media conglomerates

| *Company name* | *2014 total revenue (in US$)* | *Remark* |
|---|---|---|
| Comcast | 68.8 billion | Incorporating NBC Universal |
| Walt Disney | 48.8 billion | |
| 21st Century Fox | 28.7 billion | |
| Time Warner | 27.4 billion | |
| CBS Corporation | 13.8 billion | |
| Viacom | 13.8 billion | |
| Bertelsmann | 11.8 billion | Media divisions only |
| Sony Entertainment Pictures | 5.9 billion | A Sony Corporation division |

Sources: annual reports. Note: local currency exchange date: December 2015

## Risk typology in the media and entertainment sector

Most risks – albeit not all – faced by businesses in the media and entertainment industry can be categorized in seven types, as follows: catastrophic, financial, regulatory, technological, intellectual-property (IP) related, value-chain related and commercial. To a large extent, these risks are non-endemic (i.e. not specific to a sector), but their intensity and specificity varies from one industry to another. Financial and regulatory risks are currently particularly acute in banking, while technology and IP-related risks are a matter of immediate concern for many film & TV executives. Likewise, the same risk can have different implications across industries, or firms within the same sector (e.g. IP-related risks differ in their nature and impact for media and pharmaceutical businesses). The following typology is, of course, specific to the media and entertainment industries.

*Global Catastrophic Risks (GCR)*

Global Catastrophic Risks are those that 'might have the potential to inflict serious damage to human well-being on a global scale' (Bostrom and Ćirković, 2008: 1). They cover everything from cosmic hazard, volcanic super-eruptions and pandemics to unintended consequences generated by nuclear weapons, artificial intelligence, nanotechnology and pollution (climate change). Some GCRs are existential and can potentially cause extinction of life on earth (ibid: 4).

Although the threat from supernova explosions and gamma-ray bursts is of extremely low probability (Dar, 2008), not the same can be said of climate change. The World Economic Forum has ranked extreme weather events at the top of global risks in terms of likehood, and second to weapons of mass destruction in terms of impact (World Economic Forum, 2018: 6).

When it comes to pollution, media firms are not innocent bystanders, it is estimated that the sector accounts for two per cent of global carbon emissions, equal to the aviation industry. The carbon footprint of an average hour-long TV show corresponds to eight flights between London and New York (Gannagé-Stewart, 2015). Digital culture generates an enormous amount of e-waste and residential energy use, fueled by electronic devices, is rising rapidly (Miller, 2015). Some media companies, realizing that their activities should not further deteriorate societies' exposure to climate risk, are addressing environmental issues within the framework of Corporate Social Responsibility (CSR) programmes. Walt Disney, for instance, recognizes ‘the consequences and devastating impacts of climate change’ and admits that ‘these challenges demand fundamental changes in the way society, including business, uses natural resources’ (The Walt Disney Company, 2012: 50). Consequently, the firm is working its way through 18 environmental stewardship targets, including achieving zero net direct greenhouse gas emissions, reducing electricity consumption, and sending zero waste to landfills. Other environmental initiatives include reforestation projects in locations around the world from Los Angeles to Inner Mongolia (The Walt Disney Company, 2012: 50, 61). Sony is equally ambitious and its environmental philosophy is based on four principles: curb climate change, conserve natural resources, promote biodiversity and control chemical substances (Sony, 2015).

Although most media firms report CSR activities, they do not show equal commitment to environmental issues. As is the case with other sectors, in the absence of governmental norms, they are free to shape their own sustainability practices (Cowan et al., 2010). There is no industry-wide coordination on the environment in the United States, apart from initiatives undertaken by on-screen talent and production staff who are involved in environmental activism (Story, 2014). In the United Kingdom, the British Academy of Film and Television Arts (BAFTA) founded a consortium of the country’s leading broadcasters and production companies in order ‘to raise the profile of sustainability in the industry, championing sustainable production techniques and freely providing the tools, guidance and direction needed to reduce the impact of moving-image media production on the environment’ (The BAFTA Albert Consortium, 2015).

However, because of the severity and global scope of environmental risks, media firms cannot act efficiently without government guidelines and coordination. It befalls national administrations and international institutions to assess, formulate policy and take action to reduce impact. The United Nations Environment Programme (UNEP) and the 21st session of the Conference of the Parties (COP21) to the United Nations Framework Convention on Climate change in Paris in December 2015 illustrate the importance of inter-governmental collaboration on environmental issues. Within this framework, the International Telecommunication Union (ITU) runs a programme that involves targets, recommendations and global standards, which covers all aspects of the relationship between information and communication technologies, the environment and climate change (ITU, 2016).

*Financial risk*

This paper distinguishes between risks that are connected to global financial markets and those, commercial, that are generated in media production and distribution (see below). Financial risks particularly affect media firms operating across several economies, chiefly among them the sector's conglomerates that operate in 100-plus territories. Fluctuating interest rates affect credit markets and the rate at which these firms are able to borrow money. A recession will lower the levels of liquidity in the global capital markets and limit a business' ability to raise capital on acceptable terms (e.g. News Corp, 2014: 19). Variations in exchange rates for foreign currencies also create uncertainties and firms are particularly vulnerable when they shoot a project abroad. If, for instance, a US-based company producing a film in the UK (and many do because of the facilities and local Film Tax Relief) encounters an appreciating British pound (in this case, the payable currency) against the US dollar (the funding currency), this would add significantly to the budget. A common solution is to reduce or even eliminate exposure to foreign exchange risks using a variety of derivative financial tools such as option contracts or interest rate swap agreements. The latter enables parties to buy or sell a currency at a set price during a specified amount of time (Bulkey, 2015: 37).

*Regulatory risk*

Media and entertainment firms are subject to a wide variety of laws, specifically among those are regulations related to copyright and intellectual property, data protection, user privacy, consumer protection and content regulation. Uncertainties for multinationals are enhanced by the fact that they operate across many jurisdictions. As a general rule, risks are also heightened in countries with opaque and inefficient regulatory procedures. The World Bank states: ‘Clear regulations and simple bureaucratic processes are important in part because they mitigate risks for entrepreneurs, new and experienced alike’ (The World Bank, 2016: 34). In such countries, media firms can be affected by sudden changes in laws and regulations that can have serious consequences for their operations.

In October 2014, for instance, the Russian government passed a law restricting foreign ownership of local media firms to 20 percent, giving them until February 2017 to comply. In the time it took the Russian Parliament to discuss the bill and for President Vladimir Putin to approve it and make it a new law, the share price of Sweden’s Modern Times Group, which had heavily invested in local media, dropped by 20 per cent (Sineischikova, 2015). Forced to comply with these new regulations, the group sold its Russian and international pay-TV channel business to a local private equity firm within a year (Middleton, 2015).

However, regulatory risk does not come solely from quasi-authoritarian regimes with protectionist tendencies. The European Commission's plan for a digital single market represents a threat to copyright owners. Jean-Claude Juncker, the President of the European Commission, has called this project one of his 'top priorities'; its aim is for users to use their mobile phones, download content and access entertainment platforms seamlessly across borders (Juncker, 2014). Whilst European copyright laws are due for an update and consumers may benefit from a single digital union, it presents a fundamental threat to rights holders that sell IP across the continent. In the current copyright configuration they are able to sell licences to broadcasters and platforms on a country-to-country basis, hence maximizing revenue from their IP. However, a digital union would abolish licensing frontiers and make content readily available across Europe, resulting in a considerable loss of income for content providers (Wiseman, 2015).

In the jurisdictions where the views of stakeholders are sought and draft bills are debated in parliaments and the public sphere, regulatory risks can be mitigated by lobbying. Clubbing together in industry lobbies is the most efficient way for media firms to make their voice heard and gain political representation. In the above case, following hard lobbying from the industry, the European Commision has now acknowledged that its 'proposals must "respect the value of rights in the audio-visual industries" and "preserve the financing of EU media and innovative content"' (Maxtone-Smith, 2016).

*Technological risk*

Technology risks are particularly wide in scope. The first source of uncertainties stems from the rapid technological change that continuously opens up the field of possibilities for disrupting business models (e.g. the proliferation of online platforms) and interrupt income streams (e.g. ad-blocking software and devices). As Walt Disney aptly summarizes: 'New technologies affect the demand for our products, the manner in which our products are distributed to consumers, the sources and nature of competing content offerings, the time and manner in which consumers acquire and view some of our entertainment products and the options available to advertisers for reaching their desired audiences' (The Walt Disney Company, 2014: 18).

Disruption caused by the Internet leaves media businesses wondering whether their traditional distribution channels are becoming obsolete while they watch niftier competitors use alternative technologies to distribute and monetize their content. The network is transforming the video ecosystem and the content value chain by enabling the emergence of OTT (over-the-top) content providers. Using different business models (e.g free-to-view versus pay-to-view), the most successful have internationalized rapidly, such as Netflix, which was available to over 100 million subscribers in more than 190 territories by 2017 Netflix, 2017).

Traditional media firms have three options to mitigate this threat, none of them being mutually exclusive. This first is to engage with new technologies and explore new ways of distributing content. For instance, most leading entertainment conglomerates and broadcasters have launched their own on-demand platforms that enhance viewing flexibility and incorporate content and services that go well beyond catch-up TV (e.g. Comcast's Xfinity in the US market, Sky Q in its European markets).

The second alternative for entertainment conglomerates is to acquire firms that threaten their position in the content value chain. Many multi-channel network (MCN) operators that produce and distribute content online (usually via YouTube channels) have integrated larger groups: AwesomenessTV was acquired by DreamWorks, Fullscreen by AT&T and The Chernin Group, YoBoHo by the RTL Group, and the biggest of them all, Maker Studios (55,000 independent creator partners, 7,000 YouTube channels, 5.5 billion monthly video views and 380 million subscribers in February 2015) was acquired by Disney (Smith, 2014: 7-8).

Thirdly, some conglomerates have taken stock of the situation and opted to re-structure their operations accordingly. Both Time Warner and Disney have concentrated their investment in content production as opposed to distribution or aggregation. The former has spun off its cable division and the latter has heavily invested in branded intellectual property. Robert Iger, chairman and CEO of Walt Disney, recently explained that when he took the company's helm, he 'focused pretty heavily on what the world looked like then, and what [he] thought it would look' and it seemed clear to him that 'there would be a proliferation of distribution' which 'would be more and more a commodity' (Iger, 2016). Noticing that Disney's income relied heavily on its media networks, he took the decision to invest in to high quality intellectual property. A key outcome of this strategy was three major acquisitions: Pixar in 2006 (US$7.4 billion), Marvel in 2009 (US$4 billion) and Lucasfilm (US$4.1 billion) in 2012 (see also below; *The Economist*, 2016: 25-28).

Media firms depend on global information systems to conduct their business;

their failure can cause disruption of services, data loss and divulgence of confidential information. Although these breakdowns can be caused by a wide range of factors, from extreme weather to computer viruses, numerous media organizations recognize that 'there has been a rise in the number of cyber-attacks on companies' network and information systems by both state-sponsored and criminal organizations' (News Corp, 2014: 22). Nothing illustrates more the heightened threat of hacking than the attack on Sony. In November 2014, a group of hackers calling themselves 'The Guardians of Peace' began a series of attacks against Sony's IT system. Allegations were made that North Korea sponsored the breach in an act of retaliation for the release of *The Interview*, a comedy featuring a plot to assassinate their leader, Kim Jon-un. The attack crippled Sony's computing networks for a number of days, forcing staff to work with pen and paper, and led to the disclosure of a considerable amount of confidential data and IP loss. The personal files of thousands of Sony employees were released (complete with Social Security numbers), together with emails from Sony executives and Hollywood stars, the most colourful being widely reported in the press. The attack also led to IP loss with five Sony films, (including *Annie*, *Mr Turner* and *To Write Love On Her Arms*), which ended ending up on illegal file-sharing sites, where they were downloaded a million times (BBC News: 2014; Risk Based Security, 2014). According to the FBI, '90% of companies would have been unable to withstand the attack' (Michael Lynton, Sony Pictures CEO, in Harvard Business Review, 2015: 111).

The irony is that Sony was among the best prepared against cyber attack. After a PlayStation data breach in 2011, the firm had put in place robust cyber-risk management processes. Sony established a system whereby 'each Sony Group business unit, subsidiary or affiliated company, and corporate division is expected to review and assess business risks on a regular basis, and to detect, communicate, evaluate and respond to risk in their particular business areas' (Sony, 2014: 40). In addition, risk management was embedded in the governance structure, with the group's corporate executive officer in charge of compliance, and the central Group Risk Office tasked with promoting the establishment and maintaining of risk management systems (ibid.). Sony has since taken additional steps, implementing new cyber-security protocols and enhancing IT infrastructure protection (Havard Business Review: 2015: 113).

Since this attack, Netflix and HBO are among the media firms that had files stolen following hacks into their production servers, and 'cyber security is not at the top of board agendas' (Pennington, 2017: 22). However, as with environmental issues, the severity of cyber-risk is such that firms cannot entirely mitigate them even with governmental support, and the idea that governments and international organizations should be playing a more active role is gathering pace. Neil Fisher, Unisys Vice President of Global Security Solutions, states that 'We have reached a tipping point on cybersecurity [and] it is now a significant threat to a lot of economies. So getting an international agreement on what constitutes normal behaviour is now badly needed' (in Singer and Friedman, 2014: 185). However, there is little agreement on the way to proceed. In 2012, an attempt was made to expand the regulatory powers of the ITU to include the Internet, but the proposal was rejected by a number of governments - and most significantly the United States - on the grounds that it would enable autocratic regimes to control the network (O'Rielly, 2017; Singer and Friedman, 2014: 183-4). Talks about a 'cyber Geneva Convention', similar to the series of treaties that apply in armed conflicts, are also inconclusive at the time of writing (Singer and Friedman, 2014: 185-197).

*Intellectual property-related risk*

IP-related risks are prevalent in the media and entertainment industries. The unauthorized use of IP, which remains rife, constitutes a formidable challenge for media and entertainment firms. Methods of content theft vary and digital technologies have only exacerbated the problem. Recording devices, including mobile phones, can be used to steal films from cinema screens, for the copy to be either distributed online or sold in counterfeit DVDs. Peer-to-peer file sharing websites enable users to exchange pirated content and streaming websites allow them to watch copyrighted content illegally without downloading it (FACT, 2014). The number of these sites, which are difficult to close down, is constantly growing. Despite the Motion Picture Association of America (MPAA) winning an injunction in Canada in November 2015 against Popcorn Time (otherwise known as the ‘Netflix of piracy’ because of its popularity, ease of use and streaming quality), the website is still up and running but in another top-level domain (i.e. popcorn-time.to instead of popcorn-time.io).

Statistics reveal the magnitude of the task faced by media firms. The fifth season of *Game of Thrones* was downloaded via BitTorrent 14.4 million times, a number far exceeding its authorized US viewers, 8.1 million (Ernesto, 2015). Pirated content is also present on legal platforms. YouTube’s owner, Google, receives over two million DCMA (Digital Millennium Copyright Act, a US copyright law) takedown requests *every day* (equal to 1,500 per minute) from copyright owners chasing infringements of their IP rights (Walker, 2015). It is estimated that piracy sites represent up to 24 per cent of the global Internet traffic (Sodoma, 2015).

The loss of income from piracy is difficult to assess but the US government estimates that IP theft costs the US economy some US$300 billion annually (The National Bureau of Asian Research, 2013: 2). In the UK, 30 per cent of the population is involved in 'some form of piracy', costing the industry £500 million a year (Lodderhose, 2014).

The entertainment industry is forced to devote considerable resources to combat IP theft and its response is three-pronged: to educate, lobby and prosecute. The sector has established trade bodies tasked with promoting their IP rights, such as the UK's Federation Against Copyright Theft (FACT) or Creative Future, an American advocacy group that brings together 450 companies and organizations. These bodies run grassroots campaigns in order to educate the public about the risks and implications of content piracy and the damage it does to the creative sector.

Prosecution is becoming a weapon of choice. In addition to the MPAA, the RIAA (Recording Industry Association of America) has recently won a lawsuit against download sites that engage in copyright-infringing activities on a commercial scale (e.g. Ernesto, 2016). In the UK, FACT collaborates with the British police forces in order to arrest and prosecute content thiefs (FACT, 2015).

These organizations also lobby governments, asking law makers to better enforce existing IP protection measures and promote IP rights internationally. The US government itself is at the forefront of this battle as its economy has most to gain from better legal environments and enforcement of IP rights; its own Commission on the Theft of American Intellectual Property recommends the adoption of more effective measures (The National Bureau of Asian Research, 2013: 3-6). The United States bases its bilateral and multilateral initiatives on IP risk assessment that is done on a country-to-country basis, and puts the problematic territories on a priority watch list (Froman, 2015; United States Trade Representative, 2015).

*Value-chain related risk*

As media firms specialize in segments (e.g. film or TV production, distribution) they operate in complex transnational production networks and routinely deal with hundreds of suppliers across borders (Chalaby, 2016a). In particular, content aggregators (broadcasters and entertainment platforms) need to acquire a considerable amount of programmes, which represents their largest single expense. But the risk exists that they may not be able to acquire the content they want on the terms they deem acceptable. Nothing illustrates this issue better than sports rights contracts, whose value has escalated in recent years. When broadcasting rights are renewed – typically every three years –sports federations auction them to the highest bidder and thus may award them to a new party if it outbids the current rights holders. The potential for economic loss is particularly acute when the bidders are pay-TV networks which depend on sports to sustain their subscriber base.  In the UK, Sky Sports was forced to shell out £4.2 billion to retain the broadcasting rights to 126 live Premier League matches from 2016 to 2019, almost double the £2.3 billion it paid for 116 matches per season in the previous three years. Sky was in competition with BT Sports, which secured a smaller package of rights from the Premier League. The market initially thought that Sky had overpaid for these rights and its share price dropped by almost 5 per cent in the days following the contract awards were announced (Rumsby, 2015). BT Sport's threat to Sky was highlighted when the latter lost the UK broadcasting rights of UEFA's Champions League to the newcomer. BT's agreed price, £299 million a season for 350 live matches for a duration of three years far exceeded Sky's own valuation (Gibson, 2013).

The cost of other programming is also on the rise. The local licenses of popular entertainment formats such as *The Voice* or *MasterChef* can be prohibitive once these shows have acquired a track record. With regard to drama, broadcasters used to be the sole purchasers but now have to compete with entertainment platforms, which are investing heavily in original commissions. Today, the largest commissioning budgets are in the hands of online platforms, such as Netflix, which spent US$6.3 billion on programming in 2017 and is planning to bring this sum to US$8 billion in 2018 (Molla, 2018). This is equivalent to what media conglomerates spend on non-sports content: 'Time Warner (US$8 billion), Fox US$8 billion and Disney (US$7 billion)' (Molla, 2018).

Aggregators have been responding to this situation by buying TV content production companies in droves. All3Media, Eyeworks, Nice Entertainment, Twofour and Talpa Media are among the international TV production groups recently acquired by the likes of Liberty Global, Time Warner and ITV (Chalaby, 2016b). Such acquisitions enable content aggregators to diversify their revenue by selling programming to other broadcasters and platforms but it also helps them secure their content supply chain. When these groups cannot find suitable content on the open market, they can always turn to their production units. However, media companies have ceased buying into sports franchises because these investments failed to prevent an escalation of sports programming costs. Sports TV rights are most often negotiated at league level and therefore part ownership of, say, a football club, brings no advantage in rights negotiations.

*Commercial risk*

For the media and entertainment industries, the most fundamental problem resides in the difficulty of predicting consumer tastes and demand. This risk is inherent to cultural production and is the focus of economic analysis (e.g. De Vany and Walls, 2002; Doyle, 2002, Picard, 2002; Vogel, 2014). The history of the sector is a long road of unexpected successes and unforeseen failures. Many of last decade's most celebrated TV shows and formats have been turned down by countless channel commissioners before finding a home. *Survivor*, which was eventually adapted in 43 territories, could not find a broadcaster brave enough to purchase a local licence for years. *Idols*, which also travelled the world and broke ratings records for Fox in the US market throughout most of the 2000s, was turned down (twice) by *all* the US networks (Jones, interview 2010).[1] *Dancing with the Stars*, the international version of BBC's *Strictly Come Dancing*, was also turned down by the US networks. It was passed over twice by Andrea Wong, then ABC's Vice-President of Alternative Programming, before watching a tape of the British show finally convinced her it could work in America (Wong, interview 2014). *Dancing with the Stars* has since surpassed 55 adaptations totalling 300 seasons worldwide.

Many movie projects did not fare better. *Raiders of the Lost Ark*, one of Hollywood's most profitable franchises, was turned down by all the studios before ending up at Paramount, and *Star Wars* was passed on by Universal (Goldman, 1996

[1983]: 40-41). As William Goldman, the Hollywood script-writer, aptly and famously wrote: ‘Nobody knows anything’ (Goldman, 1996: 39).

Media companies, however, have developed techniques to mitigate risks and hedge their bets. First, faced with uncertain demand, they strive to keep a lid on production costs. Film and TV producers usually adopt an executive structure with clear lines of authority and responsibility in order to ensure that the film is delivered on time and on budget, and tend to hire on- and off-screen talent with an established reputation (Epstein, 150-1; von Rimscha, 2009).

Films, and increasingly TV series, are researched and tested. Hollywood has long been a marketing pioneer and employed market research firms such as Gallup since the 1930s. US studios test each aspect of their projects, including advertising strategies, trailers, film titles, on-screen talents’ popularity (and best combinations), appeal to different market segments and territories, and potential box office revenue (Bakker, 2003: 121)

Part of this process includes the test-preview, a well established practice in Hollywood. Films are screened to an audience that is given preview cards and then assembled in focus groups. According to the scores and comments, storylines can be modified and scenes and endings shot again. The new film is tested until scoring positively (Obst, 2013: 89-98). TV series are also piloted with cable tests. An episode is screened on an obscure cable channel to a test audience, who is then interviewed after the broadcast. Again, storylines can be changed to make the programme more appealing to different target audiences (Lituchy, interview 2015).

Film marketing is a sophisticated enterprise and costs have skyrocketed in recent years: they now vary between US$40 million per medium-sized movie and

US$200 million for a summer tentpole, far exceeding, in both cases, production costs (McClintock, 2014). It can be argued that an expensive marketing campaign only raises the profit threshold without reducing commercial risk, but without audience awareness of a film it will undoubtedly lose money for its producers.

Awareness is the initial objective of the advertising campaign, which is achieved through trailers – also tested – and free publicity generated by gossip about the film stars. Publicists plant stories in the media and give journalists vetted access to the celebrities who can talk about anything but other projects they may be working on (Epstein, 2005: 179-182). At a later stage, studios endeavour to grow the film's 'definite interest intensity', which measures viewers' commitment to purchase a ticket (Obst, 2013: 99). Although TV advertising remains an (expensive) must, film studios increasingly mix classic advertising methods with viral campaigns and, whenever possible, involve licensees and merchandisers in the process (Sakoui and Palmeri, 2015).

The age-old hedge against disaster is the use of known on-screen talent because of their public profile. The relationship between stars and box-office success, however, is still a subject of debate and findings vary: while some quantitative studies attach a positive correlation between the two (e.g. Elberse, 2007; Sochay, 1994) others fail to find any connection (Ainslie et al, 2005; De Vany and Walls, 1999; Ravid, 1999).

Film studios employ a host of other methods to mitigate commercial risks: they can sign presales agreements, for which they receive a minimum advance from distributors for rights in a particular territory, they can purchase completion bonds, insurance policies that provide cover in case their project spirals out of control

(Grantham, 2012: 201-202), they can enter co-production arrangements, which require them to split profits but also potential losses or they can transfer some of the risk to the equity investors who have invested in the project (Vogel, 2015: 133). If they operate in Europe they can shift some of the risk to the taxpayer by wheedling out money from film councils. In the TV industry, producers and distributors are on the receiving end of broadcasters' risk-shifting practices: drama, the most expensive genre to produce, is most often deficit-funded, requiring distributors to complete the investment from commissioning broadcasters, and therefore partake in the commercial venture (Nohr interview 2013). However, the most common form of risk mitigation has also become the most visible to consumer: (film) franchising and (TV) formatting.

*Franchises and Formats*

There is little doubt about the benefits of franchises as a successful risk mitigation strategy: 'As relying on cultural familiarity [of 'highly familiar movie concepts'] represents an alternative strategy to reduce uncertainty in investments in motion pictures, a proposition supported by our study, our findings suggest that the concept of cultural familiarity works more successfully than the star power approach to gain audience attention and to generate profit' (Hennig-Thurau et al, 2007: 84).

As a cursory glance at the listings of cinema multiplexes suffice to confirm, cultural familiarity – whether sought after by releasing remakes and adaptations from TV series, books or video games, or developing fully-fledged entertainment franchises – has become Hollywood's risk mitigation strategy of choice. Eight of 2015's top ten worldwide box office hits fall into this category (*Minions* being a spin-off from the *Despicable Me* franchise) (Table 2).

Table 2: 2015 Worldwide Box Office – Top Ten Movies

| *Rank* | *Movie Title* | *Studio* | *Total Gross (in US$ millions)* |
|---|---|---|---|
| 1 | Star Wars: The Force Awakens | Buena Vista | US$2,048.2 |
| 2 | Jurassic World | Universal | US$1,670.4 |
| 3 | Furious 7 | Universal | US$1,516.0 |
| 4 | Avengers: Age of Ultron | Buena Vista | US$1,405.4 |
| 5 | Minions | Universal | US$1,159.4 |
| 6 | Spectre | Sony | US$879.5 |
| 7 | Inside Out | Buena Vista | US$856.8 |
| 8 | Mission: Impossible – Rogue Nation | Paramount | US$682.3 |
| 9 | The Hunger Games: Mockingjay – Part 2 | Lionsgate | US$653.0 |
| 10 | The Martian | Fox | US$624.1 |

Source: Box Office Mojo, 2016

Six more franchises, sequels or adaptations figure in the next top ten most popular films. *Spotlight*, winner of the best picture category at the 88$^{th}$ Academy Awards in February 2016 figures only at 79$^{th}$ position of worldwide box office revenues, standing at US$ 63 million (Box Office Mojo, 2016).

A franchise can be defined as *an ensemble of narratives and characters that can be developed and exploited across company divisions, platforms, territories, and generations*. At the heart of the franchise lies storytelling, which can be *discrete* (stand-alone stories) or *sequential*, as is the case when episodes are structured in a longer narrative arc; most franchises use both narrative forms. The cast of characters needs to be appealing and is led by a hero. Many franchises revolve around heroic journeys that are carefully structured and mimic the themes and patterns of myths and folktales (e.g. the influence of Joseph Campbell on George Lucas) (Yorke, 2015: 53; see also Campbell, 2008 [1949]). A franchise is further defined by its *contours* (number of media platforms it extends to) and *lead medium*: film (*Star Wars*), TV series (*Star Trek*), or video games (*Assassin's Creed*).

Most franchises are well-known brands that come with their own consumer base, lessening the commercial risk and requiring less marketing effort in order to expand to new and younger audiences. Franchises enable rights holders to maximize their IP in many ways. First, conglomerates use franchises to build up synergies among divisions: the movie – if cinema is the lead medium – is accompanied by a host of products that can include video games, TV series, mobile applications, animation, music, books, and theme park attractions. The most popular franchises derive further revenue from licensing and merchandising deals (e.g. fashion retailers who pay for the privilege to access major entertainment brands and print their logos and characters on clothes and accessories). A key principle of franchises, discovered by the Walt Disney company in the 1950s, is that products feed each other to create a virtuous circle of sales: the firm's motion pictures, TV series or publications plug its attraction parks, which in turn lead to further licensed merchandise sales and rekindle interest in other Disney products, and so on and so forth (*The Economist*, 2016: 25-28).

Disney – among the world's most successful content companies with a US$155.5 billion valuation in early March 2018 – is a consistent exponent of this strategy and most of its output consists of re-iterations and developments of established brands (*The Economist*, 2016: 25). In recent years, it has produced 26 movies under the umbrella of Pixar, Marvel and Lucasfilm. Out of these 26 films, 25 were successes that, on average, have earned the company over US$ 760 million in global box office sales, even before being leveraged by Disney's consumer product groups (Iger, 2016).

This strategy is echoed in the TV industry, which has learnt to develop its own franchises: TV formats. A TV format is *the structure of a show that can generate a distinctive narrative and is licensed outside its country of origin in order to be adapted to local audiences* (Chalaby, 2016a: 13). The first TV formats emerged in the 1950s but rose to prominence in the late 1990s, when the TV industry globalized and became more competitive. It developed into a multi-billion dollar industry in the 2000s (FRAPA, 2009: 8-13), and today TV formats are ubiquitous and part of the daily diet of broadcasters' schedules: all game shows (e.g. *The Million Pound Drop*), talent competitions (e.g. *Got Talent*, *The Voice*), factual entertainment (e.g. *Gogglebox*) and reality programmes (e.g. *Big Brother*) are formatted, as are an increasing amount of dramas and comedies (Chalaby, 2016; Moran, 1998; 2013).

Risk management is one of the key drivers of the thriving format trade. The format industry rests on a compelling premise: *the willingness of broadcasters to pay for the privilege of outsourcing risk*. As Ed Waller writes: 'The entire edifice of the international format business relies on some networks taking on high levels of risk so that others further down the line, in other countries, don't have to – but pay for the privilege' (Waller, 2013). Formats are *proofs of concept* because their recipes have been tested elsewhere and their formula is known to be working. Before committing their company, TV buyers peruse ratings data that details the show’s performance in a selection of territories, scheduling scenarios, channels and audiences. Performance in certain countries matters more than others, and they look for ratings on channels similar to theirs. If a show’s ratings performance is internationally consistent, it indicates that the structure of the programme is solid - the proof of concept - and buyers like to think that an adaptation will perform equally well in their territory. A track record does not offer them a guarantee of success but will at least enable them to manage risk (Chalaby, 2016: 12).

## Conclusion: risk and corporate strategy

The risks outlined in this article present the greatest possibilities of loss for the media and entertainment industry but do not exhaust the pitfalls that lie for firms in the sector. Nor could this article review all the mitigation strategies deployed by companies. Their effectiveness is difficult to assess and depends to a large extent on circumstances and the relative exposure of companies. As a whole, there is room for more industry-wide cooperation, especially regarding IP-related risks, cyber-security and climate change. Considering the latter, the corporate sector also needs to cooperate more actively with NGOs and governmental agencies. Risks can be assessed, managed and shifted up or down the value chain but not out-sourced. Insurance policies can mitigate some risk but it does not make it disappear and is no substitute for effective corporate strategy.

This article sought to demonstrate that risk mitigation has become a key driver of corporate strategy in the media and entertainment industries. It can be seen in Walt Disney’s chosen position in the content value chain and in the growth strategy of most media conglomerates. Expanding the scope of a company is a way of insulating it against commercial risk, where many new projects fail, size works to soften the blow from the inevitable failures.

Finally, it is also apparent that risk mitigation has a growing impact on content as film studios have turned to franchises and broadcasters increasingly rely on formats. It is a strategy that can score wins but it comes with potential pitfalls: the unintended consequence of the search for predictability of income is growing predictability of content. Any franchise or format is an exercise in creating excitement and unpredictability within set boundaries (like a sports game played according to set rules). Consumers, however, can easily turn away if the exercise feels too contrived (in the same way that they will lose interest in a sports tie or league if the outcome becomes too predictable). Risk mitigation is a necessity for investors and producers in the media and entertainment industries but it should not overshadow creativity and innovation, which must remain at the heart of media firms’ business models.

**Acknowledgements**

The author would like to express his deep gratitude to all the interviewees for their time and cooperation, and thanks the anonymous reviewers for their constructive criticisms and helpful suggestions.

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(Company names and job titles at time of interview)

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[1] Elisabeth Murdoch, witnessing the *Pop Idol* phenomenon from London, called her father in New York pressing him to acquire the format rights at once. Fox's executive team duly obliged, earning the network a fortune (Rushfield, 2011: 46).