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How Does the Film Industry Actually Make Money?

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I've been trying to come to terms with two seemingly irreconcilable facts. First, "Men in Black 3" has made more than $550 million worldwide. Second, while a representative from the parent company of Columbia Pictures told me that the movie is now "in the win column," it seemed until recently as if Columbia might actually *lose* money on it. How could that be? It's not so complicated. Its production costs were close to $250 million; worldwide marketing most likely added at least that much; and a big chunk of the ticket sales go to theaters and distributors.

There must be an easier way to make money. For the cost of "Men in Black 3," for instance, the studio could have become one of the world's largest venture-capital funds, thereby owning a piece of hundreds of promising start-ups. Instead, it purchased the rights to a piece of intellectual property, paid a fortune for a big star and has no definitive idea why its movie didn't make a huge profit. Why is anyone in the film industry?

All business requires guessing, but future predilections of moviegoers are especially opaque. If a large company wants to introduce a new car, it can at least base its predictions, in part, on factors like where oil prices are headed. Movie executives, on the other hand, come up with a host of new theories each summer about what audiences want — 3-D tent poles, 2-D tent poles, vampires, comics, board games and so on — then, sometimes over the course of a weekend, ricochet toward a new theory. Will the tepid economics of "Men in Black 3" spell trouble for "The Amazing Spider-Man," this holiday weekend's big release? Who knows.

Unlike other decades-old industries, Hollywood not only has a hard time forecasting, but it also has difficulty analyzing past results. Why was "The Hunger Games" such a big hit? Because it had a built-in audience? Because it starred Jennifer Lawrence? Because it was released around spring break? The business is filled with analysts who claim to have predictive powers, but the fact that a vast majority of films fail to break even proves that nobody knows anything for sure.

Making matters more complicated is that the industry is filled with professionals — starting with the lowliest junior agents — adept at explaining why *they* were responsible for a project's success. This self-mythologizing has real economic impact. Most major brands spend lots of money ensuring that people have a positive association with them, but most people don't even notice which studio made which movie. (Disney and its Pixar subsidiary are notable exceptions, "John Carter" notwithstanding.) In fact, movie studios are much better at helping brands they don't own — certain stars, directors, producers and source material, like "The Hunger Games" — capture a huge chunk of the money.

The reason a majority of movie studios still turn a profit most years is that they have found ways to, as they say, monetize the ancillary stream by selling pay-TV and overseas rights, creating tie-in video games, amusement-park rides and so forth. And the big hits, rare as they may be, pay for a lot of flops. Still, the profits are not huge. Matthew Lieberman, a director at PricewaterhouseCoopers, expects growth over the coming years to be somewhere around 0.6 percent.

Hollywood is, somewhat surprisingly, a remarkably stable industry. Over the past 80 years or so, its basic model — in which financiers in New York lend money to creative people in Los Angeles — has been largely unaltered. Partly as a result, today's biggest studios — Columbia, Disney, Paramount, Warner Brothers, Universal, 20th Century Fox — have been on top since at least the 1950s. This stability is initially puzzling because movie studios don't have many assets. Worse, every one of their projects is a short-term collaboration between a bunch of independent agents.

A modern studio's main asset, however, is its ability to put together these disparate elements. They know how to get Tom Cruise to do a film, how to get it into theaters around the country and whom to call to set up a junket in Doha. They also know the industry's language of power, with its ever-changing rules about which stars, restaurants and scripts are cool and which are not. It's the stuff of easy parody, but it's worth billions.

Another reason these studios remain at the top is that for most entrepreneurs, taking them on isn't worth the risks. (Even big hits often take years — sometimes a full decade — to break even.) "If I'm sitting on $2 billion, will I invest in a Hollywood studio?" asks Anita Elberse, a Harvard Business School professor who studies the entertainment industry. "Many other industries have a higher return on investment." Billionaires like Anil Ambani, who is a partner in Steven Spielberg's DreamWorks Studios, presumably invest because the glamour helps them with their other businesses.

People have predicted the demise of the film industry since the dawn of TV and, later, the appearance of VHS, cable and digital piracy. But Fabrizio Perretti, a management professor at the Università Bocconi in Italy, says that Hollywood is now actually destroying itself. Because it's harder to get financing and audiences, companies are competing to make bigger, costlier films while eliminating risk, which is why ever-more movies are based on existing intellectual property. Eighteen of the all-time 100 top-grossing movies (adjusted for inflation) were sequels, and more than half of those were released since 2000.

Predictability might win the weekend, Perretti says, but it could eventually make people weary. Meanwhile, Lieberman, from PricewaterhouseCoopers, sees significant growth in another entertainment business that's constantly experimenting with different models, distribution methods and ways of telling stories. Maybe TV is finally going to kill movies after all.

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