BSAC Business Briefing

China on the Global Media Stage

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This Business Briefing is a short introduction to the business dynamics within China as well as the opportunities emerging internationally from the rapid evolution and global expansion of the major Chinese media and technology groups.

After years of widespread of piracy, particularly in the home video sphere, there is a prevalent assumption in the West that Chinese consumers spend little on media content. In fact, Chinese consumers paid out a staggering $31.4 billion in 2016 to access media content. And this disregards the massive additional media-related revenue streams generated via advertising. Nearly three quarters of this spend was on subscriptions to pay TV and about a fifth went towards purchasing cinema tickets, with the balance spent on paid-for video services delivered online.

Cinema exhibition

China is now the second largest cinema market by gross box office value after the USA, but has now overtaken the USA as the country with the largest number of screens. Last year, an average of 26 new screens were opened every day in China. Despite this rapid growth, there is still considerable scope for further development: China has just 30 screens per million people, as opposed to 125 per million in the USA.

After a decade when box office growth averaged 35% a year, in 2016 Chinese spending on cinema ticket sales slowed to just 3.7% in local currency terms. Explanations for this dramatic slow-down include: general economic weakness; weaker local film releases; as well as a likely government crackdown on box office fraud and misreporting. The growing importance of online ticket selling platforms is also a key factor. To capture market share, several of these platforms had been heavily subsidising their ticket pricing, but this tactic decreased last year as they matured.

Average annual ticket sales in China still work out fewer than one per capita, in comparison to about four per person in the USA, which underlines the potential scope for renewed growth.

Despite the slowdown, the box office benchmark of half a billion dollars for a single film release was exceeded for the first time last year: Stephen Chow's *The Mermaid* generated $525.8m, which was also significantly higher than the number one movie at the US box office, *Finding Dory* ($486m).

In 2016, international movies accounted for 42% of the Chinese box office, a total of $2.7 billion. The overall top ten grossing films included three Disney productions: *Zootopia*, *Captain America: Civil War* and *The Jungle Book*. However, *Zootopia*'s $235.5m tally was considerably lower than the highest ever recorded take for a foreign film in China – *Fast & Furious 7*'s $391m in 2015.

Chinese cinema-goers consistently display different film preferences to their counterparts in Western markets. A case in point is last year's number three-ranked movie: video game spin-off *Warcraft*, made by the US studio Legendary Entertainment, who were recently acquired by the Chinese group Wanda. *Warcraft* grossed $220m in China, almost five times its US tally of $46m. Indeed, it is now relatively common that the Chinese market helps compensate for the under-performance of some international films in their domestic markets.

The Chinese Government applies a strict quota upon the number of foreign films that can be distributed in China on a 25% revenue-sharing basis (as opposed to a flat distribution fee). The current 5-year deal, agreed in 2012, was that 34 films would be allowed access to the Chinese market, of which 14 had to be distributed in 3D or on large format. Other foreign films can be distributed on a flat fee basis. Following recent talks between President Trump and President Xi, there is an expectation that the quota will be enlarged – but this will likely be part of a wider trade negotiation.

There are also a number of other rules and regulations governing the release schedule of foreign films. For instance, the most lucrative slots around national holidays tend to be reserved for Chinese films. Films made under an official co-production agreement will be counted as a Chinese film and eligible to benefit from the 43% revenue share that local films receive. However, to achieve official co-production status, a film must meet strict criteria, including substantial Chinese content within the story and for at least 30% of the staff and crew to be Chinese nationals.

The domestic Chinese film production industry is prolific, but, like many of its European counterparts, struggles to achieve consistent commercial success. There were 772 films made in China last year, but only 43 of these grossed more than $14m in domestic cinemas. Performance of Chinese films overseas is even more challenged. Last year's highest grossing Chinese film, *The Mermaid*, grossed just $3.2m in North America after making $525.8m in China. Moreover, all other international Chinese film releases combined grossed only a little more than *The Mermaid* in all the overseas markets they were distributed in. And this total box office tally of $547m outside China was up 38% on the equivalent performance in 2015.

Pay TV

There are around 300m households in China taking some form of pay TV, mostly via cable. However, this is a market largely closed to Western-owned channel groups. There is a prescribed list of 34 foreign channels licensed to be distributed in China – but strictly only for availability in some hotels, embassy compounds and the like.

Unsurprisingly, local television channels are also strictly regulated. Restrictions on imported programmes on local channels were tightened last year and there is currently a limit of two foreign shows allowed in primetime hours in any 12-month period. These restrictions are likewise applied to TV shows based on foreign formats, such as *The Voice of China*. These now must be approved by the regulator two months before broadcast and only one such programme based on a foreign format can be broadcast on each channel every year – additionally, these cannot be broadcast in prime time during their first year.

Whilst challenging, it has been possible for some Western producers to achieve success in the Chinese TV market. An interesting case in point is *Number One Surprise*, a celebrity driven variety show that was notable for having been made in the USA for a Chinese audience. It was produced by the Tencent-backed company STX Entertainment in partnership with China's XG Entertainment. The show premiered to nearly 300m viewers on Hunan TV – China's second most watched channel – a large audience, even by Chinese standards. This performance was undoubtedly boosted by promotion through Tencent's powerful social media channels.

Online video

The Internet has emerged as a critical foundation of China's fast developing media economy. China is quintessentially a 'mobile-first' nation when it comes to internet usage. Over half the population – 710 million people – use the internet, of whom 93% access the Internet via their smartphones compared to 65% who connect via a PC.

Almost three quarters of Chinese internet users (72%) watch online video, which in numerical terms is a larger audience than the entire population of the European Union. In addition to passive viewing, a remarkable recent trend has been the rapid adoption of live video streaming. The latest official survey indicated that 46% of Internet users (approximately a third of the population) were using live streaming. There is already a thriving economy built around ordinary people that have achieved celebrity status by 'broadcasting' themselves. Most popular are young singers and there are now more than 100 apps that facilitate live streaming. By some estimates, the value of this personal streaming business has collectively reached $3 billion – close to half the size of the entire Chinese cinema box office.

The more 'traditional' Chinese online video market is at an interesting inflection point. Historically it has been almost exclusively advertising funded, but, since 2014, video services paid for directly by consumers have been growing fast and now constitute a significant part of the landscape. The Chinese online video market was worth about $6.5 billion in 2016, with more than 70% of this revenue still being generated from advertising. However, the paid-for part of the market has grown explosively – from $200m in 2014 to over $1.7 billion last year. The total number of subscription video-on-demand (SVoD) subscribers in China is now comparable to the number that Netflix has accumulated globally, albeit with a much lower average revenue per user (ARPU) as pricing plans start at less than $1 per month.

The main players in the Chinese online video market include:

- **Alibaba**, the massive e-commerce player, which spent $5.4 billion on acquiring the leading Chinese online video service, **Youku Tudou**;
- **iQiyi**, owned by leading search engine company **Baidu**;
- **Tencent**, which controls China's most powerful social media platforms WeChat and QQ, and is additionally the leading local games and digital music player;
- **Sohu**, another search engine that also offers online video and other curated content propositions somewhat akin to Yahoo;
- **PPTV**, an online VoD service with a $420m investment from major consumer electronics retail chain Suning; and
- **LeEco**, a new breed of Apple-influenced Chinese device-to-content ecosystem company that markets its LeTV video service in conjunction with its consumer electronics products.

There is a notable absence of any of the big international VoD services from the Chinese market. Although some of these Western players have tried to operate there, all have ultimately been blocked by the local regulator. Apple launched iTunes Movies in China back in September 2015, but was forced to cease operations less than seven months later. Engagement with a local partner is no panacea for success in China: Disney's SVoD service DisneyLife was shut down by authorities in April 2016 after less than five months, despite a multi-year partnership with Alibaba. Marketed via Alibaba's T-Mall shopping service, subscribers had been asked to pay $122 for a Mickey Mouse-shaped set-top box and a one year subscription. Amazon and Netflix have also not found a way to launch their SVoD services in China. While Amazon's Prime retail proposition is available there, the video SVoD component that is bundled elsewhere is lacking. Netflix has spent years trying and failing to find a suitable Chinese organisation to partner with, and has now put any plans for a launch in China on indefinite hiatus.

Chinese content investment

Netflix and Amazon have achieved much of their recent success by investing heavily in exclusive rights to attractive TV shows and movies – and this model is now also playing out in China. Just as in the West, the increasing adoption of the SVoD business model in China is being driven by heavy investments in exclusive content. A case in point is the example of iQiyi, which added 15m new subscriptions to its video service in one year by moving some of its most popular content behind a paywall.

iQiyi produced 30 original series in 2015 (up from 13 the year before) and plans to spend $1.4 billion in 2017 on acquiring and producing content. In addition to having its own iQiyi Pictures movie production arm, the company is investing $305m in a movie slate via Baidu Nuomi Pictures. It has also secured licensing deals with Paramount, Fox, Lionsgate, BBC, NBC and the BFI – the latter to distribute 20 UK independent movies.

Before its acquisition by Alibaba, Youku Tudou was a separately listed company that publicly disclosed some of its programming investments. In Q1 2015 it invested $80m on licensing content and in 2014 spent a total of $164m. They had made partnership deals with several international players, including Disney's Marvel, NBCUniversal and Fremantle. Alibaba itself has spent $806m on a 60% stake in Hong Kong-listed production company ChinaVision; it also has investments in Hehe Pictures and Bona Film (with Tencent), has a $382m stake in Enlight Media and has its own Alibaba Pictures arm with a 17-movie slate. Alibaba has also invested directly in multiple US movie productions, including *Mission Impossible: Rogue Nation*, *Teenage Mutant Ninja Turtles: Out of the Shadows* and *Star Trek Beyond*. Because of this activity, Alibaba's entertainment revenues tripled in Q3 2016 to $585m; however, their losses – $463m – have also been high, in part due to investments in an online cinema ticket selling business.

Tencent has likewise made several investments in production, including into Huayi Brothers, the largest Chinese film studio, but also into the US production company STX. The company has exclusive deals for HBO shows (including *Game of Thrones* and *True Detective*, amongst others), National Geographic, and rights to the first six *Star Wars* movies from Disney.

While the Chinese online video platforms have been actively seeking more international content deals, the government has simultaneously made it harder for Western companies to seize these opportunities. The State Administration of Press, Publication, Radio, Film and Television (SAPPRFT) has clamped down on acquisition of foreign TV & movies by these services with a new cap set at 30% of the total number of titles offered in the previous year. In addition, all shows must be pre-approved and checked for 'healthy content' – effectively ruling out simulcasts. These new restrictions led to several US shows, including *The Good Wife* and *The Big Bang Theory,* dramatically being pulled from schedules in 2015.

Internationalisation

Partly as a response to domestic restrictions, the major Chinese media groups have been accelerating their international investment strategies. I estimate that direct Chinese investments in US TV and film production have so far exceeded $6.5 billion, excluding infrastructure and cinema chain acquisitions. One of the most active investors is Wang Jianlin, the CEO of property-to-entertainment conglomerate Dalian Wanda Group and currently China's richest man. Jianlin is on record as saying that he wants to invest $5-10 billion a year outside of China, with entertainment and sports his top priorities – with the US his first choice target and Europe second. His plans include a multi-billion-dollar fund to invest in productions of all six Hollywood majors. Alibaba also has stated ambitions to invest $7.2 billion in media and entertainment over the next three years

Wanda is already a major global entertainment player and the world's largest cinema exhibitor. Group revenues nearly tripled from 2011 to 2016, from $15.6 billion to $43 billion. Currently controlling more than 12% of global cinema admissions, the group has a publicly avowed target of 20% by 2020. It has spent a total of $6.3 billion on a series of acquisitions, including AMC and Carmike in the US, Hoyts in Australia, Odeon/UCI in Europe and Nordic Cinema in the Nordics. Wanda opened 677 new cinemas with 6,788 screens globally last year, including 1,391 new screens inside China. At the end of 2016, Wanda's global totals were 1,352 cinemas and 14,347 screens.

Jianlin's group is additionally building what is claimed to be the world's largest film studio, for $8.2 billion, on China's northeast coast. Wanda already owns one of China's largest distributors, Wuzhou Film Distribution, and made its first significant move into US production with the January 2016 acquisition of Legendary Entertainment for $3.5 billion. However, the follow-up $1 billion purchase of Dick Clark Productions recently had to be scrapped in the wake of tightening Chinese state controls on capital flows to overseas markets. Similar pressures now threaten to stymie $300m in financing from two Chinese companies, Shanghai Film Group and Hua Hua Media, for a Paramount Pictures movie slate.

Conclusion

China is a large – but complex – media market. It is fostering some of the most dynamic, innovative and connected companies the world has ever seen. From their own particular non-Western starting points, they are carving out new approaches to the 21st century media consumer. Despite fickle and fluctuating State policies towards content and fiscal regulation, there is no doubt that these Chinese groups will play an increasingly important role on the world stage.

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