

General policy considerations

Introduction

- 6.1 This chapter will report on the final two items in the terms of reference:
- how Australia’s capabilities in these industries, including in education and training, can be best leveraged to maximise export and investment opportunities;¹ and
 - whether any changes should be made to existing government support programs to ensure they are aligned with the future opportunities and trends in these industries.²
- 6.2 The main conclusion from the Committee in this chapter is a recommendation for the Government to adopt an intellectual property strategy.
- 6.3 The evidence in this inquiry has demonstrated to the Committee that our educational institutions produce talented people who can work at the highest level. In the terms of the four requirements developed by the 1927 Royal Commission, however, the Committee has noted a number of shortfalls.
- The film, animation and special effects industries have often been limited by low budgets (capital), which has hampered content development. Further, assistance is typically aimed at production, rather than distribution.

1 Term of reference (h).

2 Term of reference (g).

- The games industry has regularly traded its intellectual property for development funding (capital).
- 6.4 In order to place the Committee's later comments in context, below is a discussion of current exports and investment and a listing of current support arrangements for the industries. Although this information revisits some facts raised earlier in the report, the purpose is to gather the relevant material for this chapter in one place.

Current exports

- 6.5 The games industry is very much focussed on exports. In 2002 it had a turnover of \$110 million, of which \$100 million was attributed to exports.³
- 6.6 The film industry also demonstrated a significant level of exports. In 2000-01, the total value of film production comprised \$861 million, of which \$608 million was spent in Australia. The \$861 million comprised:
- \$319 million in local productions;
 - \$192 million in co-productions; and
 - \$350 million in foreign productions.⁴
- 6.7 Austrade reported that an apparent trend of Australia exporting less finished film products and instead becoming a location and post-production site for US films.⁵ Of the total pool of 'footloose' US production, Australia and the UK have each secured 6 per cent. The main destination for this work is Canada, which has 80 per cent of the market.⁶
- 6.8 Different sectors within the film industry have a differing export focus. For example, the industry on the Gold Coast is almost entirely based on exports.⁷ By implication, the other main areas of the film industry, Melbourne and Sydney, are more focussed on local production.
- 6.9 These export figures, however, are production related. In relation to film distribution, most revenue on local films is earned from overseas. For example, the Film Finance Corporation (FFC) received 79 per cent of its total recoupment from overseas.

3 Queensland Minister for Innovation and Information Economy, submission no. 36, p. 4.

4 Austrade, submission no. 37, p. 6.

5 *ibid.*, p 5.

6 Cutting Edge Post, submission no. 20, p. 4.

7 Gold Coast City Council, submission no. 53, p. 13.

- 6.10 In terms of intellectual property generally, Australia is very much a net importer. In 1995-96, royalty payments overseas were four times international royalty receipts. In 1994-95, imports of cultural goods were five times the exports.⁸

Current investment

- 6.11 At the time of preparing this report, the most recent figures from the Australian Bureau of Statistics (ABS) for the film industry were for 1999-2000. In that year, the spend on television productions was \$1.3 billion, the spend on commercials was \$243 million, feature films were \$148.6 million and other productions \$84.8 million. The breakdown on the sources of funds for feature films included 20 per cent from the FFC, 13.4 per cent from the private sector in Australia, and 64 per cent from the private sector overseas.⁹
- 6.12 The ABS does not provide a similar analysis for the electronic games industry.¹⁰ However, from the evidence available to the Committee, it appears that the bulk of investment comes in the form of development funding from overseas publishers.¹¹
- 6.13 Investment has flow-on benefits to other parts of the economy. Thirty-seven full time jobs are created for each \$1 million in investment.¹²
- 6.14 With the continuing globalisation of the economy, however, investment funds are becoming more mobile. A considerable amount of Australian equity is going offshore in search of productions that focus on the international market.¹³ The post production of many films made in Australia is being taken back to the US.¹⁴
- 6.15 Not all investment can be put to productive use. The Committee heard that over \$110 million has been invested in new digital production technologies to take advantage of the move to high definition digital television. As noted in Chapter 4, however, the take-up rate of digital television in the community has been slower than expected.¹⁵

8 CREATE Australia, submission no. 46, pp. 2-3.

9 Australian Bureau of Statistics *Film and Video Production and Distribution 1999-2000*, (2001) Catalogue no. 8679.0

10 Film Victoria, submission no. 85, p. 19.

11 The Allen Consulting Group, *Game Industry Development Strategy*, 8 October 2003, p. 17.

12 SBS, submission no. 66, p. 6.

13 Ambience Entertainment et al, submission no. 100, p. 19.

14 Australian National University, submission no. 71, p. 5.

15 Screen Producers Association of Australia, submission no. 33, p. 10.

- 6.16 Similarly, there has been significant investment recently in Australian studios on the east coast. During this inquiry, Serenity Cove in Sydney and Melbourne Docklands were under development.¹⁶ However, the Committee received evidence that there was considerable vacant studio space during the inquiry.¹⁷
- 6.17 As noted in Chapter 4, some industries, such as animation and digital effects, need to continually update their equipment and software.¹⁸

Current government assistance

Taxation measures

- 6.18 A key taxation measure for film is Division 10BA of Part III of the *Income Tax Assessment Act 1936*. Section 124ZAF provides an immediate 100 per cent deduction for money invested in qualifying Australian feature films. The expenditure does not have to be matched to later periods where the income might be earned. To qualify for this deduction, the Minister must certify the film as having significant Australian content. The relevant criteria are listed in section 124ZAD and include the film's subject matter, the place of production, the nationalities and places of residence of key parties, and the sources of finance.
- 6.19 Another tax measure is Division 10B of Part III of the *Income Tax Assessment Act 1936*, which applies to films wholly or substantially made in Australia. This Division allows investors to write off their investment over two years, commencing with the year when the production first started to earn income. Projects that use this Division may not apply for funding from the FFC, although the range of eligible projects is wider than under Division 10BA.¹⁹
- 6.20 Another tax approach has been the Film Licensed Investment Company (FLIC) Scheme, which was established under Division 375 of the *Income Tax Assessment Act 1997* and the *Film Licensed Investment Company Act 1998*. The legislation enabled the Minister to issue up to \$40 million in concessional capital licences to companies. Shareholders who purchased this concessional capital would obtain an immediate 100 per cent

16 Australian Children's Television Foundation, submission no. 29, p. 6.

17 Mrs J. Crombie, South Australian Film Corporation, *Transcript of Evidence*, 30 September 2003, p. 15.

18 Light Knights Productions, submission no. 48, p. 6.

19 Australian Film Commission, *Filming in Australia, Federal Tax Incentives for Film Investment*, http://www.afc.gov.au/filminginaustralia/taxfins/federal/fiapage_56.aspx viewed on 22 April 2004.

deduction if that money was invested in qualifying Australian films. The Scheme, therefore, worked in a similar way to Division 10BA, except that it also allowed investors to diversify their risk.

- 6.21 Two companies, Content Capital Ltd and Macquarie Film Corporation Ltd, received licences. The FLIC Scheme was a pilot and the concession period ended on 30 June 2000.²⁰
- 6.22 A more recent measure is the 12.5 per cent refundable tax offset for film production in Australia, which commenced in September 2001. A film will automatically qualify if it spends more than \$50 million in Australia. If the spend is between \$15 million and \$50 million, then 70 per cent of the total production expenditure must be in Australia.
- 6.23 The tax offset works through calculating 12.5 per cent of the production spend in Australia. The film production company can then reduce its tax bill by this amount. If the offset is higher than the tax bill, then the company receives the remainder as a refund.
- 6.24 The refundable tax offset is available for feature films, telemovies and mini-series, and was extended during the course of this inquiry to high budget television series. Taxpayers may not use any other tax relief or FFC funding in addition to the offset. The legislation implementing the offset is contained in Division 376 of the *Income Tax Assessment Act 1997*.²¹
- 6.25 No comparable arrangements exist for the games industry.

Content regulation

- 6.26 This area of industry support applies principally to television broadcasting. Under section 122 of the *Broadcasting Services Act 1992*, the Australian Broadcasting Authority (ABA) must determine standards to be followed by commercial television licensees. The standards have the status of subordinate legislation. Either House of Parliament may amend a standard under section 128. There is the general *Broadcasting Services (Australian Content) Standard 1999* and also specific standards on advertising and drama on pay television.
- 6.27 Clause 10 of the main standard currently requires licensees to broadcast, during prime time, at least 830 points of Australian drama over a three year period. No less than 250 points can be screened during a year. A

20 *ibid.*

21 Department of Communications, Information Technology and the Arts, *Fact Sheet, Refundable Tax Offset for Film Production in Australia*, viewed on 22 April 2004 at http://www.dcita.gov.au/download/0,2118,4_105255,00.pdf.

program's point score is its duration in hours multiplied by the format factor. To take an example, a feature film that had a licence fee of at least \$150,000 would have a format factor of four. If the film lasts 90 minutes then the licensee would be awarded six content points.

- 6.28 Clause 12 of the standard governs children's programs. Licensees must broadcast at least 96 hours of first release children's drama over a three year period, and at least 25 hours in any year. A feature film at least 80 minutes in length is taken to be three times its actual duration.
- 6.29 Advertising is governed by the Television Program Standard for Australian Content in Advertising (TPS 23), which was one of the Australian Broadcasting Standards carried over by the ABA in 1992. A licensee must ensure that, between 6 am and midnight, 80 per cent of the total advertising time comprises Australian advertisements.²²
- 6.30 The Australian drama content requirements on pay television are governed by sections 103A-103ZJ of the *Broadcasting Services Act 1992*, which were inserted in 1999. The basic requirement is that a holder of a subscription television licence, who provides a drama channel, must spend at least 10 per cent of all program expenditure for that channel on new Australian drama. As required by the Act, this requirement is under review.
- 6.31 No comparable arrangements exist for the games industry.

Support programs

Film, animation and special effects industries

- 6.32 As indicated in the prior section on investment, the film industry receives significant support from government agencies. Figures collected by the Australian Film Commission (AFC) demonstrate this role. In 2001-02, expenditure on Australian features in Australia included 42 per cent of government sourced funding. For the five years up to this period, this figure has stayed within the range of 42-52 per cent. Over the same period, expenditure on Australian television drama included 24 per cent government funding.²³
- 6.33 A number of agencies provide these funds. The FFC takes an investor role in Australian films and recoups a percentage of this money to reinvest in further production. In 2002-03, the Corporation recouped \$15.4 million

22 Australian Broadcasting Authority, *Content regulation, Advertising*, viewed on 21 April 2004 at <http://www.aba.gov.au/tv/content/advertising/index.htm>.

23 Screen Services Association of Victoria, submission no. 28, p. 4.

- and its investment (listed as provision for loss on film investments) was \$56.3 million.²⁴
- 6.34 The AFC is the Australian Government's film development agency. In 2002-03, it issued \$3.3 million in grants and its investment (listed as write-down of assets) was \$7.2 million.²⁵
- 6.35 Australia's public broadcasters also drive much of this production. SBS operates a commissioning division, SBSi, which sources programs from the independent sector. Its budget is now \$8.6 million annually.²⁶ The ABC's drama budget is approximately \$15 million annually.²⁷
- 6.36 The Government also supports documentaries through its National Interest Program. Film Australia's mission is to commission, distribute and manage programs that reflect Australian life. Film Australia's contract with the Government was worth \$6.9 million in 2001-02.²⁸
- 6.37 The film sector also benefits through co-production agreements with other countries. These agreements are usually conducted as memoranda of understanding between agencies or treaties. If productions qualify, they are considered as local productions in both nations and can receive production and market access benefits in both countries. Australia has treaties with the UK, Italy, Germany, Canada, Ireland and Israel. It has memoranda of understanding with France and New Zealand.²⁹
- 6.38 State governments mirror some of the activities of national agencies. For example, in 2002-03, the Pacific Film and Television Commission (PFTC – a Queensland agency) spent \$4.2 million on domestic development and \$2.3 million on incentives.³⁰ State governments also assisted in studio investments in Sydney, Melbourne and the Gold Coast.³¹

24 FFC, *Annual Report 2002-03*, pp. 25 and 52.

25 AFC, *Annual Report 2002-03*, pp. 141 and 142.

26 Senator the Hon. Richard Alston, *Government delivers film industry package*, (media release) viewed on 22 April 2004 at http://www.dcita.gov.au/article/0,,0_1-2_1-3_461-4_16024,00.html.

27 Mr Q. Dempster, *Survival – the challenge for public broadcasting in Australia*, viewed on 22 April 2004 at <http://www.ifj-asia.org/misc/quentin.pdf>, p. 7.

28 Department of Communications, Information Technology and the Arts, *Funding Boost of \$2.7 million for Film Australia* (fact sheet) viewed on 22 April 2004 at http://www.dcita.gov.au/article/0,,0_1-2_1-3_461-4_16020,00.html.

29 Screen Producers Association of Australia, submission no. 33, pp. 15-16.

30 PFTC, *Annual Report 2002-03*, p. 22.

31 Screen Producers Association of Australia, submission no. 33, p. 19

- 6.39 Queensland is not the only state government to provide financial incentives. South Australia provides payroll tax exemptions of 6 per cent to 7 per cent. The eligibility criteria for projects include being wholly or substantially produced within that State and employing South Australian residents. New South Wales provides tax rebates, also of 6 per cent to 7 per cent, through an incentive fund administered by Fox Studios.³²
- 6.40 The Australian, state and territory governments have combined to help fund AusFILM International Inc. This organisation markets Australia internationally as a location for film, television, commercials and similar production. It has a staff of seven and offices in Los Angeles and Sydney.³³ AusFILM also has 70 private sector firms as members, who pay a membership fee of between \$6,000 and \$10,000 annually. The Australian Government provides funding of \$1 million annually³⁴ and Austrade provides in-kind assistance overseas.³⁵
- 6.41 Local governments also participate. For example, the Gold Coast City Council included the film industry in its Economic Development Strategy, liaised with Queensland agencies on industry research, and developed the Pacific Innovation Corridor to encourage broadband infrastructure access.³⁶

Electronic games industry

- 6.42 To date, assistance specifically targeted at the games industry has been generated by state governments. For example, the Victorian Government has:
- developed an industry game plan;
 - spent \$150,000 to attract the Game Developers' Association of Australia (GDAA) to Melbourne;
 - secured the Association's annual conference for Melbourne;
 - spent \$250,000 for Victorian companies to use PlayStation 2 developer kits to develop prototypes of games;
 - commissioned a business plan to establish a cocoon game development studio;

32 Singapore Media Development Authority, *Creative Industries Development Strategy*, September 2002, Annex 4.1, viewed at <http://www.mda.gov.sg/media/industry.html> on 27 April 2004.

33 AusFILM International, submission no. 88, p. 2.

34 Mr I. Robertson, AusFILM International, *Transcript of Evidence*, 4 September 2003, p. 43.

35 Mr L. Downey, Austrade, *Transcript of Evidence*, 8 October 2003, p. 3.

36 Gold Coast City Council, submission no. 53, p. 2.

- examined the feasibility of a motion capture facility in Victoria to enable developers to digitise human movement;
 - been investigating the establishment of a games innovation centre in Melbourne;³⁷ and
 - made further arrangements so Victorian companies could use Xbox developer kits.³⁸
- 6.43 Queensland, which hosts approximately 40 per cent of the games industry, has also assisted its local industry. It provided \$2 million for 80 games scholarships and helped establish the Queensland Games Industry Cluster.³⁹
- 6.44 Governments around Australia have collectively assisted the industry in attending US games conferences. The Australian stand at the Electronic Entertainment Expo in 2003 was supported by the Australian Government and government agencies from Victoria, Queensland, and the ACT, as well as Brisbane City Council.⁴⁰
- 6.45 The AFC runs a number of general interactive media funds, which would be applicable to the games industry. The Commission distributed approximately \$474,000 under these funds in 2002-03. It is not apparent, however, what proportion of these funds went to the games industry.⁴¹

Programs applicable to the entire sector

- 6.46 The one program that appears to be directed to this general sector has been the establishment of the Film Industry Broadband Resources Enterprise Pty Ltd, also known as FIBRE. This organisation was established in November 2001 by a working party of industry representatives and \$650,000 in funding from the Australian Government.
- 6.47 One of FIBRE's roles is to assist firms in the industry negotiate broadband access from telecommunications carriers. Given most firms are SMEs, they are more effective in negotiating with large telecommunications firms if they pool their demand. Evidence presented later in the chapter demonstrates that firms in these industries tend not to collaborate. FIBRE assists these firms 'aggregate their demand'.⁴² The Committee understands

37 Film Victoria, submission no. 85, p. 12.

38 GDAA website, <http://www.gdaa.com.au>.

39 Queensland Minister for Innovation and Information Economy, submission no. 36, pp. 1-3.

40 GDAA, submission no. 54, p. 4.

41 AFC, *Annual Report 2002-03*, pp. 22 and 110-112.

42 FIBRE, submission no. 50, p. 1.

that FIBRE has assisted firms in Port Melbourne and Crows Nest in Sydney negotiate better broadband rates.

- 6.48 The remaining programs are typically federal programs that apply to the economy as a whole. Assistance is usually based on merit selection against proposals from the entire economy.
- 6.49 The first such program is the Export Market Development Grants (EMDG) scheme. Eligible firms are those with an income less than \$30 million. The scheme reimburses a certain percentage of eligible firms' export promotional spending above the first \$15,000. In a firm's first two years, the percentage is 50 per cent. Thereafter, payments are subject to an export performance test and are the smaller of the above figure and a percentage of export earnings. This percentage starts at 40 per cent in year three and reduces to 5 per cent in the seventh and final year.
- 6.50 The maximum grant for the scheme is \$150,000, although this may be reduced if there is high demand from businesses. Initial payments are now capped with the remainder being paid on a pro rata basis from the remaining pool of funds. For example, payments for 2001-02 were capped at \$60,000 and the remainder paid out at 32.84 cents in the dollar.⁴³
- 6.51 Another program is the R&D Start program, which supports research and development. For companies with an annual turnover of less than \$50 million (which comprises much of the games industry), the *Core Start* component can provide up to 50 per cent of project costs. Projects must involve research and development (R&D), but can also include related product development and market research. *Start Plus* applies to companies over the \$50 million threshold, which can receive up to 20 per cent of project costs.
- 6.52 'R&D' is a technical term with a definition that is narrower than 'product development.' R&D must involve innovation, technology transfer into Australia or technical risk.⁴⁴ In the 2004-05 Budget, the Australian Government announced the creation of the Commercial Ready program in 2006-07. The R&D Start program will be merged into this new initiative. Details of the new program will be finalised following consultation.⁴⁵

43 Austrade, *Export Market Development Grants: In Brief*, December 2003, viewed on 22 April 2004 at <http://www.austrade.gov.au/publications/AustradeEMDGInBrief.pdf>.

44 AusIndustry, *Grants for R&D Projects: Customer Information Booklet*, April 2004, viewed on 22 April 2004 at www.ausindustry.gov.au.

45 Department of Industry, Tourism and Resources, *The Commercial Ready Programme*, at http://backingaus.innovation.gov.au/2004/commercial/commercial_ready.htm.

- 6.53 The Australian Government also supports R&D through the Cooperative Research Centres (CRC) program. CRCs are R&D organisations jointly funded by the Australian Government, universities, industry and the CSIRO. There are 71 CRCs in six sectors: environment, agriculture, information technology and communications, mining, medical science, and technology and manufacturing. By linking researchers and industry, the program aims to better focus R&D on use and commercialisation. Federal funding is usually provided on a seven-year basis.⁴⁶
- 6.54 The Committee received evidence about two CRCs that would assist the industries examined in this inquiry.⁴⁷ The more established is the Distributed Systems Technology Centre, which was established in 1992 and received a further seven years' funding in 1999. Its research areas include knowledge and digital resource management, and workflow and collaboration.⁴⁸
- 6.55 The more recent CRC is the Interaction Design Centre, which was established in 2003. This CRC is centrally involved with the industries examined in this inquiry. The Committee received evidence of its field of operation:
- ...the next generation of hardware and software technologies need to be engineered on the basis of the real uses of end users and the new forms of content and new forms of social community group interaction that might emerge as a result of the various ways people access each other online. The centre is about finding the new ways in which we might live, learn, work and play in the digital world—in particular, focused on ways to enhance the way people participate in the digital world as the physical and digital converge.⁴⁹
- 6.56 Being research organisations, the pattern of benefits from CRCs is likely to be diffuse and benefit whole industries, rather than specific firms. Further, the benefits from a particular piece of work at a CRC are likely to be felt in the medium to long term, rather than immediately.

46 Cooperative Research Centres, *About the Programme* viewed on 27 April 2004 at http://www.crc.gov.au/information/about_programme.aspx.

47 University of Technology, Sydney, submission no. 11, p. 2.

48 Distributed Systems Technology Centre, *About DSTC*, viewed on 27 April 2004 at <http://www.dstc.edu.au/aboutdstc/index.html>.

49 Professor J. Jones, Queensland University of Technology, *Transcript of Evidence*, 24 July 2003, pp. 66-67.

Appropriate policy settings

A sector based on fee-for-service or intellectual property?

6.57 Jack Welch, the former CEO of General Electric, stated during a recent visit to Australia that:

...the most successful companies in the future will be those that create intellectual capital.⁵⁰

6.58 The industries examined in this inquiry demonstrate a significant component of fee-for-service work for overseas publishers and producers, instead of generating and capturing the benefits of intellectual capital. In the games industry, there is only one Australian-based publisher. The remainder of firms are developers that are funded by publishers on a project basis.⁵¹ The computer animation industry also saw itself as largely fee-for-service.⁵² As noted earlier in the chapter, the Queensland film production industry focuses on international production and Austrade has noted a growing trend in the Australian film industry towards this type of work.

6.59 Fee-for-service work has a number of risks, including:

- exchange rate movements;
- competition from developing Asian nations such as India and China that have low labour costs; and
- other countries offering their own tax incentives.

6.60 Importantly, many of these risks are outside the control of local firms. The only risk that local firms can themselves manage to any extent is low cost competition from developing nations. The remedy is to outsource production to those areas, which already occurs to some extent.⁵³

6.61 An example of tax incentive risk was the New Zealand Government's announcement of its own tax offset for film production, which also extended to television series. Fiji has offered its own rebates and the Committee heard how South Africa is now beginning to win work that

50 Allanbank International, submission no. 90, p. 2.

51 Mr A. Lancman, GDA, *Transcript of Evidence*, 20 August 2003, pp. 1-2.

52 Mr M. Hollands, Act3 Animation, *Transcript of Evidence*, 28 August 2003, p. 65.

53 Pacific Vision, submission no. 51, p. 3.

previously would have come to Australia.⁵⁴ Cutting Edge Post outlined the prospects of fee-for-service work:

So, while we are seeing the international work increase out of LA, we are also seeing the number of countries that want to get involved in doing that work increase exponentially, which is making it harder and harder for companies in Australia—as innovative as they are, as clever as they are and as capable as they are of delivering the product. Unfortunately, more and more it comes down to the dollar and how cheaply these people can get their films made. From their point of view, they are being driven harder and harder by the studios because there is less and less of a return or there is less money available, so they are having to find more and more innovative ways to make those productions.⁵⁵

- 6.62 On the other hand, it might be preferable for Australian firms to concentrate on developing and exploiting intellectual property, including, but not limited to, locally developed content. The difference in financial return between owning intellectual property and being a fee-for-service provider is illustrated in the following case study from the games industry.
- 6.63 Ratbag Games developed *Dirt Track Racing* (1999) and *Dirt Track Racing Sprint Cars* (2000) for the PC platform. The total development costs were \$370,000, which were advanced to Ratbag by the publisher in return for intellectual property rights. The two titles generated sales of \$4.6 million and, under the contract, Ratbag's return was less than \$800,000. However, if Ratbag had been able to self-fund the games, it probably would have received \$2.4 million.⁵⁶
- 6.64 To take another example from the games industry, its fee-for-service work generates \$100 million of game design exports. This translates, however, to \$750 million in retail sales for overseas publishers.⁵⁷
- 6.65 As noted in Chapter 1, the 1927 Royal Commission identified four key requirements for a film industry, being capital, content, personnel and equipment (that is production), and distribution. All of these, except production, are required to generate suitable returns on intellectual property. The Committee heard in evidence that the US seeks to exploit

54 Mr J. Lee, Cutting Edge Post, *Transcript of Evidence*, 25 July 2003, p. 15.

55 *ibid.*

56 The Allen Consulting Group, *Game Industry Development Strategy*, 8 October 2003, p. 18.

57 GDAA, submission no. 54, p. 8.

intellectual property such as game/film spin-offs, but is happy to outsource fee-for-service work such as production:

This is serial exploitation of IP—intellectual property. It is where the Americans and the entertainment industry in general—but it is dominated by the Americans—are seeing the future. That is where the profits are—from exploitation of IP, not from fee-for-service production. The companies that we deal with—Atari, Midway, Paramount, these kinds of people—do not really care where something is made as long as they are making the profit from the IP. That is the long and short of it.⁵⁸

- 6.66 Since the mid 1990s, culture (supported by copyright protection) became the number one export for the US.⁵⁹ As noted earlier in the chapter, imports in Australia of cultural goods and royalty payments exceed their related exports by at least four to one. Further, the Committee received evidence that production is the high-risk component of the film business, and that profits are generated through distribution.⁶⁰
- 6.67 In light of the above discussion, the Committee has decided to recommend an intellectual property strategy for these industries. The Committee received a number of suggestions in submissions for such a strategy.⁶¹
- 6.68 To be effective, a strategy needs to be underpinned by concrete actions. During the rest of the chapter, this report will examine how effectively the industries subject to this inquiry have used intellectual capital by reference to the four requirements listed by the 1927 Royal Commission. Where appropriate, the report will make recommendations to support the strategy. The Committee's recommendations should not be seen as exhaustive. This inquiry has operated within its terms of reference and there are likely to be matters external to the inquiry that should also be considered.
- 6.69 The former National Office of the Information Economy suggested that any such strategy would be experimental and raised the question of which sectors would be included in such a strategy:

A lot of the innovation policies we have in place at the moment—I am certainly not singling out Australia here; this is common around the world—emerged from an industrial economy which

58 Mr M. Hollands, Act3 Animation, *Transcript of Evidence*, 28 August 2003, p. 66.

59 Mr N. Milan, SBS, *Transcript of Evidence*, 17 September 2003, p. 10.

60 Mr B. Rosen, FFC, *Transcript of Evidence*, 5 November 2003, p. 6.

61 Allbank International, submission no. 90, p. 2, Australian Interactive Media Industry Association, submission 42, p. 14 and Confidential, submission no. 38, p. 6.

was focused on primary and manufacturing production. We still do not really fully understand how to do innovation policy for a service economy. I think that is probably reflected in the way that the digital content is addressed in innovation policy. It is a factor. We have the data to suggest that funding for innovation to the digital content sector is underweight relative to its economic contribution. There are probably many reasons for that; there would be no one reason. But it does open up the question of what an innovation policy for this sector would really look like. The big question is: should we be thinking about innovation in the film sector and innovation in the games sector separately, or should we actually have a more coherent strategy for the entire sector?⁶²

- 6.70 Following the discussion in Chapter 5 on convergence, the Committee is of the view that any such innovation policy should cover all the industries examined in this inquiry. The strength of the links between the industries may vary, but they exist and strengthening them would be to the industries' benefit.

Recommendation 24

- 6.71 **The Committee recommends that the Australian Government develop an intellectual property strategy for the industries subject to this inquiry, addressing the roles of capital, content, and distribution. The strategy should include, but not be limited to, the other recommendations in Chapter 6 that are identified as part of the strategy.**

Developing content that has audience appeal

- 6.72 One of the features of this inquiry has been a divide in the industry between those who argue that the industry is meant to pursue cultural goals, such as pursuing the Australian voice, and those who call for a greater focus on the economic benefits, that is, pursuing Australian business opportunities. As the New South Wales Film and Television Office stated:

The interplay between a local industry, created for a cultural rationale and the "industrial" footloose production (which has an

62 Mr D. Kennedy, former National Office for the Information Economy, *Transcript of Evidence*, 15 October 2003, p. 8.

economic rationale) is a key characteristic of film industries around the world, and applicable to the situation in NSW.⁶³

- 6.73 One example of an organisation that supported the cultural rationale was the Media, Entertainment and Arts Alliance, which quoted the Universal Declaration on Cultural Diversity. This declaration warns against ‘the grave danger of the standardisation of cultures’.⁶⁴ The Tasmanian Government stated that ‘culture is at the core’ of government support for creative audio-visual industries.⁶⁵
- 6.74 A number of business organisations, however, argued that they were limited in their ability to generate a profit, or create content that had wide audience appeal, due to the current cultural policies.⁶⁶ The Committee also received evidence that current cultural policies caused Australia’s best talent to move overseas in search of new challenges and opportunities.⁶⁷
- 6.75 From the evidence in this inquiry, the Committee has decided that there needs to be more focus on audience appeal, especially in the film industry. One straightforward reason is that greater audiences increase the benefits of a project.
- 6.76 Further, it appears that the model of ‘cultural standardisation’ is not compelling. The interplay of cultures could well be more complex. For example, the US does not simply project its culture on the rest of the world. It is also subject to cultural influences from elsewhere.⁶⁸ Hollywood, for instance, was established partially by expatriate Europeans and it continues to be ‘a great importer of everything’.⁶⁹
- 6.77 Further, people from different countries and ethnic groups are likely to view and interpret the same material differently. Therefore, they might be considered to be actively assessing the content using their own culture as a guide.⁷⁰ Finally, domestic culture can be an asset in seeking audiences. Nations have the opportunity to adapt their own cultures for global audiences.⁷¹

63 NSW Film and Television Office, submission no. 56, p. 3.

64 Media, Entertainment and Arts Alliance, submission no. 59, p. 4.

65 Tasmanian Government, submission no. 73, p. 4.

66 BigKidz Entertainment, submission no. 13, p. 9; ASTRA, submission no. 60, p. 3.

67 Allanbank International, submission no. 90, p. 8.

68 *ibid.*

69 Mr J. Bean, ScreenWest, *Transcript of Evidence*, 30 September 2003, pp. 41 and 42.

70 Allanbank International, submission no. 90, p. 9.

71 *ibid.*

- 6.78 As noted earlier in the report, there has been concern expressed recently in the media regarding the profitability and audience appeal of Australian films.
- 6.79 *The Sydney Morning Herald* reported that this lack of success related to quality, rather than culture:
- [Sue] Masters and [Hugh] Mackay don't see the failure of recent Australian movies as part of the same problem as the downturn in television drama. Aussie movies are failing because they are not good enough, not because audiences have a general aversion to them.⁷²
- 6.80 One indicator of whether a film has audience appeal is whether it makes a profit. In the 15 years until 2003, the FFC has invested in 169 feature films, of which only eight had turned a profit. Two more, *Rabbit Proof Fence* and *Lantana*, were expected to also become profitable.⁷³
- 6.81 The Committee regards audience appeal as an important component of delivering benefits from a film or computer game. The link to economic benefits is clear. Further, for two films of equal cultural value, the more popular film will have greater cultural benefits. As the PFTC noted, 'you cannot have a cultural identity if you do not get people seeing the films.'⁷⁴
- 6.82 Although the film industry worldwide is well known for having a large proportion of loss-making projects,⁷⁵ the Committee wished to examine some of the relevant factors that had been raised in evidence and in the public domain as to what might increase the chances of a film's success.

Budgets

- 6.83 The Committee received evidence from a number of sources that small budgets had limited the market appeal of our films. Samson Productions noted:

The low budget "comedy" feature films of which there has been a plethora over the past few years, generally do well at the box office in Australia but do not export. Australian films need to step up into a new league, of more complex, interesting stories and greater production values. This means some films with bigger

72 Anon., 'No great drama, mate', *The Sydney Morning Herald*, 6 September 2003.

73 D. Groves, 'Film funder takes hard look at major revamp', *Variety*, 17 November 2003, viewed at <http://www.keepmedia.com/pubs/Variety> on 10 May 2004.

74 Mr H. Tefay, PFTC, *Transcript of Evidence*, 24 July 2003, p. 56.

75 Ms M. Reid, FFC, *Transcript of Evidence*, 5 November 2003, p. 6.

budgets. But bigger budgets also mean half as many films on the available FFC resources.⁷⁶

- 6.84 During hearings, the FFC made a similar point. In particular, Australia has developed a group of very talented and internationally successful people, including actors, directors and cinematographers. Local budgets, however, are usually too small to deliver these people the kind of work that suits their professional needs. Given that Australian films are competing in a global market, it makes sense to develop films with larger budgets to deliver the production values audiences expect and take advantage of this home-grown expertise.⁷⁷
- 6.85 The Committee received similar evidence in relation to documentaries. Currently, the funding for documentaries generally only permits support for single programs or shorter series. This means they are less attractive to commercial networks, which must spend more per hour in promoting the programs. Good production values are also important.
- 6.86 Audience appeal, however, is possible with documentaries, especially when there is a sufficient budget. As noted earlier in the report, Film Australia reported that its 25-part series, *Our Century*, 'won its slot practically every week that it aired'. *RPA* is another long running documentary and it regularly rates in the top 20 Australian programs.⁷⁸
- 6.87 One comment the Committee would like to make in relation to the size of budgets is that it is to some extent related to the industry's SME structure. If most firms are SMEs, they are going to find it more difficult to put together the required financial backing to ensure large scale commercial success.
- 6.88 The Media Entertainment and Arts Alliance described the life cycle of a typical independent film producer who has a small production company:
- The producer is that company's sole employee for the majority of the time.
 - When finance for a production is secured, approximately ten people might be employed for two months.
 - Employment increases as the shoot date approaches to approximately 50 people for approximately eight weeks.
 - Employment during shooting may peak at over 100 on any single day.
-

76 Samson Productions, submission no. 31, p. 3.

77 Mr B. Rosen, FFC, *Transcript of Evidence*, 5 November 2003, p. 2.

78 Ms S. Connolly, Film Australia, *Transcript of Evidence*, 26 November 2003, pp. 4-5.

- After shooting, employment might drop back to six persons for another four months.
 - Then dropping back to the single producer until the next production.⁷⁹
- 6.89 Later, this report discusses the impact of the SME structure in making it difficult for firms to conduct R&D when they are concentrating on winning the next contract.⁸⁰ Similarly, the view has been expressed that small, independent producers are more likely to take their production fee than further develop a project to improve their chances of making a successful production.
- SPAA is critical of the number of producers rushing films into production simply so they can grab their fee, when those films' screenplays could do with a lot more work.⁸¹
- 6.90 Relating back to the four 'Royal Commission' requirements referred to in paragraph 1.8, the issue of budgets is closely connected to the first requirement, capital.

Scripts

- 6.91 The Committee received evidence that film scripts in Australian films need more development. As noted in the discussion in budgets above, single producers may be tempted to move from the development phase to production to receive their fee earlier, rather than keep developing the script and benefit from a potentially larger commercial return later on.⁸²
- 6.92 The Australian Children's Television Foundation advised that Australian scripts are under developed in comparison with overseas projects:
- A survey of feature films backed by the FFC in the years 1997-1999 showed that an average of only 1.4% of the total budgets was spent on development. This compared with an average of 2% on development in the UK, 5% in Canada and 10% in the USA.⁸³
- 6.93 Other industry figures agree:
- [Sue] Masters says some Australian movie scripts go to the screen "undercooked" – they are not worked on and rewritten as much as the average television drama, and audiences can tell. "The last

79 Media Entertainment and Arts Alliance, submission no. 59, p. 16.

80 University of Technology, Sydney, submission no. 11, p. 3.

81 L. Barber, 'Box-office blues', *The Weekend Australian*, 6-7 September 2003.

82 See also P. Crayford, 'Not enough happy endings', *Australian Financial Review*, 23 August 2003.

83 Australian Children's Television Foundation, submission no. 29, p. 7.

Australian hit movie, *Crackerjack*, might have looked easy,” she says, “but it was the result of years of work by Mick Molloy and others”.⁸⁴

- 6.94 More recently, there have been media reports that attempts to improve script development are resulting in better projects. Programs directed towards this goal include the New Feature Film Writers Scheme in 2002-03, the national residential script workshop program supported by the NSW Film and Television Office and the AFC, SPARK and Film Victoria’s Arista program.⁸⁵
- 6.95 Having a good script relates back to the second of the Royal Commission requirements, namely content. The Committee will consider what action might be taken later in the report.

Commercialisation of Australian intellectual property and content

Film, animation and special effects industries

- 6.96 In light of the concerns expressed about the success of Australian films, the Committee sought evidence at hearings on how firms derived their profits. The FFC commented that ‘the money-making part of the industry is not production; it is distribution.’⁸⁶ Firms in the industry concurred with this view.⁸⁷
- 6.97 As noted earlier in the report, film production is risky because it is difficult to assess and modify a film while it is under production, unlike a computer game. Further, in film production, a company must wear a certain number of losses for each success. Distribution, however, is much less exposed to these risks. If a film is not popular, it is much easier for a distributor to shelve it because they have not made such a significant investment in it as the production company. Further, most distributors manage a large number of films, so they diversify their risks.
- 6.98 The main reason Hollywood distributors produce films is to provide content for their distribution businesses.⁸⁸
- 6.99 The FFC, however, took the view that Australia’s policy settings were production oriented without linking the product to distribution.

84 Anon., ‘No great drama, mate’, *The Sydney Morning Herald*, 6 September 2003.

85 S. Williams, ‘Script to let good times roll’, *The Australian*, 28 April 2004.

86 Ms M. Reid, FFC, *Transcript of Evidence*, 5 November 2003, p. 6.

87 Ambience Entertainment et al, submission no. 100, p. 19.

88 Ms M. Reid, FFC, *Transcript of Evidence*, 5 November 2003, p. 6.

If you look at the industry we are in, whether it is film or television, distribution is the driving force behind it. Even in the UK you can see that Sir Alan Parker, who is head of the Film Council, is saying we have to start changing how we do things and look at distribution, because distributions leads production. What we have here is production pushing distribution. Production is a highly risky area in making a film. You have to look at film making like venture capital. It is like going out to Bass Strait and starting to drill holes and somewhere along the way you are going to find some oil.⁸⁹

6.100 An overview of the industry support in Australia indicates that many of the measures are production focussed. For example, the income tax incentives are production-based. Films that lose money, break even or make a large profit all receive the same accelerated deduction. Payroll tax rebates from state governments are also triggered by production.

6.101 The FFC has attempted to generate a distribution link by requiring producers to have a distribution advance or guarantee for Australia and a sales agent for the rest of the world as a condition for funding.⁹⁰ In evidence, Samson Productions supported the principle behind this approach:

Somebody had to think about this. Somebody else in the market had to think that their film or this piece of television was worth making...⁹¹

And it had to be real commercial money. It had to be a proper exhibitor. It could not be your mum or dad.⁹²

6.102 However, most films are now funded through 'soft money' such as tax funds, government assistance and content requirements. Distributors now only make a small contribution to Australian films and hence they are not at risk.⁹³ Therefore, the Corporation's funding has also tended to be focussed on production.

89 Mr B. Rosen, FFC, *ibid.*, pp. 6-7.

90 FFC, *Investment Guidelines 2003-04*, July 2003, pp. 5-6, viewed on 14 April 2004 at <http://www.ffc.gov.au>.

91 Ms S. Milliken, Samson Productions, *Transcript of Evidence*, 5 September 2003, p. 11.

92 Ms A. Browning, *ibid.*

93 FFC, *Background to Proposed Changes in the FFC's Draft Investment Guidelines 2004-05*, April 2004, p. 2, viewed on 14 April 2004 at <http://www.ffc.gov.au>.

- 6.103 In most industries, the demand of the market place directs what will be produced, also referred to as 'distribution-pull.' Although successive governments have sought to support the industry for a number of reasons, it appears that the measures have overridden the force of market demand to such an extent that the number of unsuccessful films being produced has reached a sufficiently high level to cause concern in the industry and wider community. To be successful, it appears that government policies need to give greater recognition to consumer demands.
- 6.104 Elements of this more sophisticated approach are in content regulation. Clause 10 of the Broadcasting Services (Australian Content) Standard 1999 requires commercial broadcasters to air a certain amount of Australian drama during prime time (5 pm to 11 pm). This period is the commercial broadcasters' key revenue raising opportunity. Hence, the commercial broadcasters have a strong incentive to ensure that the locally produced content they commission is popular. Locally produced content that does not attract a sufficiently large audience share (often 1 million viewers) faces an uncertain future. If the station cancels a show, it is still required to meet its quota and will need to find replacement Australian drama.
- 6.105 The public sector broadcasters, in purchasing and broadcasting local productions, work in a similar way. As broadcasters, they can guarantee distribution for locally commissioned programs.⁹⁴ Further, they are publicly accountable for their ratings to ensure their programs achieve a sufficiently wide audience.
- 6.106 Although the local film industry does not have this level of integration, the film industry in the US does. There, the film industry is vertically integrated with 'production, distribution and exhibition all financing.'⁹⁵
- 6.107 This is, once again, an issue related to the SME structure of the industry. Without sufficient scale, local firms will not be able to develop the necessary vertical integration to link production and distribution. The Committee received evidence to this effect:

Independent producers are a form of entrepreneurial talent, but they're not moguls. The evidence from too many years is clear that our producers are never going to build the companies which will form the basis of a successful film industry. It might work in television – Reg Grundy and Southern Star are two shining examples, but it hasn't worked in film.⁹⁶

94 Ms G. Rowe, SBS, *Transcript of Evidence*, 17 September 2003, p. 10.

95 *ibid.*

96 Ambience Entertainment et al, submission no. 100, p. 17.

- 6.108 The Committee will examine how the Australian Government's feature film agencies might more fully address distribution for these industries within current programs.
- 6.109 The discussion so far indicates that the film industry is having difficulty in securing three of the four Royal Commission requirements. The Committee received evidence in relation to the high quality of Australian production, such as its crews, locations and equipment.⁹⁷ However, there is sufficient evidence to indicate cause for concern in relation to capital, content and distribution.

Games industry

- 6.110 It is valuable to consider the games industry in light of the four Royal Commission requirements. As noted earlier in the chapter, the games industry has often had to trade away its intellectual property in return for development funding, or capital, from publishers. Although this practice allows the companies to stay in business and develop new products, it leads to a significant loss of economic value over the longer term. The Committee would like to present this additional example:

Dark Reign was developed by Auran and published by Activision (one of the largest publishers in the US marketplace). The publishing deal was structured so that Activision provided development funding after they had been presented with an electronic proof of concept. Activision in turn received the copyright to Dark Reign.

Dark Reign subsequently sold 685,000 copies in 58 countries, grossing over US \$12 million for Activision. Auran received less than half the royalty rate it would have received had it been able to self fund the development of Dark Reign.

Due to the market success of Dark Reign, Activision decided to fund the development of a sequel. However, as Auran had no copyright to the title, it was not included in the sequels development and did not receive any royalties from the sale of the sequel.⁹⁸

- 6.111 In other respects, however, the games industry appears to be performing well. As noted earlier in the chapter, of its \$110 million annual turnover, \$100 million is exports. Any industry that is competitive in the world market without government subsidy must be trading off significant

97 Austrade, submission no. 37, p. 5.

98 The Allen Consulting Group, *Game Industry Development Strategy*, 8 October 2003, p. 18.

competitive advantages. Austrade noted that these included low development costs, a high skill level, and content that has ‘a uniqueness that appeals across all cultures.’⁹⁹

6.112 At this stage, it appears that the games industry has secured all of the four Royal Commission requirements except for capital. This arrangement probably explains why it is a profitable industry, but limited in being able to use its creative success to fund further growth.¹⁰⁰

6.113 In order to address these capital issues, the GDAA commissioned the Allen Consulting Group to develop an industry development strategy. This strategy will be considered later in the chapter.

Business skills in the industries

6.114 The industries examined in this inquiry are both artistic and business endeavours. As the FFC stated in evidence:

John Woodward, who is the Chief Executive of the UK Film Council, has said, “As a long forgotten Hollywood wit once said, the trouble with movies as a business is that they’re an art, and the trouble with the movies as an art is that they’re a business”.¹⁰¹

6.115 However, the Committee received a number of comments and submissions arguing that the current level of business skills in the industry needed improving. In particular, the Australian Film Television and Radio School suggested that the lack of collaboration and the SME structure of the industry could be addressed through business education:

I think anyone who looks closely at the digital and content industry can see that it is a very fragmented industry. It is an industry that has very little internal alliance and partnership activity, especially in relation to international markets. It is an industry that is based on individual operators and has very little cooperative enterprise activity. We believe that needs to be addressed. We have plans to create a screen business skills centre at the school, which would be a specialist nationally operating and Commonwealth supported centre, to begin to change the culture of the screen and digital content industry to allow for the talented individuals who are in it to be more sustainable as enterprises, and

99 Austrade, submission no. 37, pp. 14-15.

100 Queensland Game Developers Cluster, submission no. 78, p. 3.

101 Mr B. Rosen, FFC, *Transcript of Evidence*, 5 November 2003, p. 9.

to be able to address the local and international markets from a firmer business base.¹⁰²

- 6.116 Another training institution that recognised the importance of business skills is the Film and Television Institute of Western Australia:

Much of the inquiry, I think, mentions training. Training, in and of itself, I do not believe will achieve results. The training has to be at the front end of what is basically team building in content creation. Traditionally the output or business of training institutions is training. Our output and business is not training, it is actually business development.¹⁰³

- 6.117 The Institute takes an innovative approach to intellectual property. At the start of each cycle, students sign over their intellectual property to the Institute. As the students form teams and work on projects, they then negotiate back their intellectual property from the Institute. The Institute argued that too many schools kept students' intellectual property. This approach gave students a disincentive to do good work at university because the university would retain the benefits.¹⁰⁴

- 6.118 Singapore's Media Development Authority has also recognised the importance of intellectual property. Its recent creative industries development strategy states, 'The acquisition and protection of intellectual property is therefore vital to retaining the value.' The strategy recommends that industry knowledge of intellectual property rights be enhanced.¹⁰⁵

- 6.119 A number of film agencies have recognised the need for business skills in the industry. The NSW Film and Television Office, Film Victoria, the AFC, ScreenWest and the Australian Film Television and Radio School have established the joint venture ENTERPRISE AUSTRALIA. The program involves a media industry management consultancy giving local producers practical guidance on developing sustainable businesses. The aim is to prevent the 'hand to mouth' existence that many independent producers experience.

102 Mr M. Long, Australian Film Television and Radio School, *Transcript of Evidence*, 4 September 2003, p. 22.

103 Mr T. Lubin, Film and Television Institute of Western Australia, *Transcript of Evidence*, 30 September 2003, p. 29.

104 *ibid.*, p. 36.

105 Media Development Authority, *Creative Industries Development Strategy*, September 2002, viewed at <http://www.mda.gov.sg/media/industry.html> on 29 April 2004.

- 6.120 In announcing the program, the Chief Executive of the AFC noted that cash flow problems have led producers to go into production prematurely.¹⁰⁶ This corroborates the Committee's comments in relation to budget development.
- 6.121 The GDAA suggested business development skill seminars for start ups and growing companies.¹⁰⁷ This suggestion effectively amounts to establishing an ENTERPRISE AUSTRALIA program for the games industry. In light of the similarities between the industries examined in this inquiry, and instead of creating a new program, an efficient solution to this matter would be to examine whether the ENTERPRISE AUSTRALIA program could be extended to the games industry.

Recommendation 25

- 6.122 **The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government extend the ENTERPRISE AUSTRALIA to the games industry and provide sufficient resources to cover the extra work.**
- 6.123 Although it fills a gap, ENTERPRISE AUSTRALIA is unlikely to address the wider issue of a general lack of business skills in these industries. A longer term solution would be to incorporate business skills in the initial training for these industries. The Committee received a significant number of comments and suggestions along these lines.¹⁰⁸ The creative industries are known for the volatility of their labour markets. If graduates are not able to secure employment in their chosen field, they will at least have wider employment prospects.
- 6.124 As noted above, a number of educational institutions for these industries have already recognised the importance of these skills. Further, the GDAA has been organising education skills and training roundtables in Queensland and Victoria that focus on that industry's needs in business

106 AFC, *ENTERPRISE AUSTRALIA: Business Strategies for the Independent Producer Inaugural Program Announced*, media release, 24 June 2003, viewed at <http://www.afc.gov.au> on 29 August 2003.

107 GDAA, submission no. 54, p. 19.

108 See for example the Queensland Minister for Innovation and Information Economy, submission no. 36, p. 7; CREATE Australia, submission no. 46, p. 4; NSW Department of State and Regional Development, submission no. 61, p. 1; and JMC Academy, submission no. 69, pp. 2-3.

skills and project management.¹⁰⁹ The Committee would like to see these first steps develop into a comprehensive business skills program for the industries examined in this inquiry.

Recommendation 26

- 6.125 The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government work with education providers and industry to ensure the industries' training courses include a significant business skills component, which should include intellectual property management. One example is the screen business skills centre at the Australian Film Television and Radio School.**

Reform of the Australian Government's feature film agencies

Corporate goals and performance reporting

- 6.126 During the inquiry, the Committee received comment from the PFTC that the FFC and the AFC should re-examine their corporate goals and how they measure their performance:**

Some of the issues facing the industry could be addressed by implementing a more rigorous regime of strategic planning. For example, the corporate plans of the AFC and the FFC do not appear to have quantifiable objectives or, indeed, performance indicators that identify the success or otherwise of specific programs. As you would know, without quantifiable objectives it is extremely difficult to identify inadequacies in particular programs and even more difficult to remodel the program into one that is successful... By way of example, one of the FFC's objectives is to "finance the production of a diverse range of Australian film and television product."

This is more of a description of what that organisation does rather than a quantifiable objective whose outcome can be measured. A new business model would rephrase that objective to read, for example, "to finance the production of a diverse range of

109 Ms E. Richardson, GDA, *Transcript of Evidence*, 20 August 2003, p. 5.

Australian film and television product that generates an average recoupment of at least 35 per cent".¹¹⁰

- 6.127 It should be understood that these agencies do invest in reporting their performance in their annual reports. The FFC's *Annual Report 2002-03* provides an investment overview and recoupment breakdown back to 1988-89. The AFC provides a number of statistics on projects that it has supported going into production and being distributed. The Committee is satisfied that these agencies recognise the importance of this information.¹¹¹
- 6.128 It appears to the Committee, however, that there are a number of ways in which these agencies could improve their corporate goals and performance reporting. For instance, in relation to corporate goals, the PFTC provided the Committee with the following example for the AFC.¹¹²
- 6.129 The Commission's first objective is to 'resource and facilitate the development of outstanding Australian film, television and interactive digital media projects.' The PFTC suggests that this objective will not be effective because it is difficult to quantify and measure. The indicators for this objective are statistics on the number of projects assisted under the relevant programs.¹¹³ The Committee notes that these statistics are inputs rather than effectiveness data. In other words, they focus on resources rather than results.
- 6.130 The PFTC suggests a replacement objective, namely to 'ensure a significant number of quality film, television and interactive media projects are developed that secure production finance and reach a wide audience.' It then suggests the following indicators:
- projects developed by the Commission and which secure production finance achieve at least 10 per cent of the Australian box office and recoup an average of 40 per cent of the cost of production;
 - over a three year period, at least 20 per cent of projects receiving development finance are produced;
 - increase the number of projects developed each year by 10 per cent; and

110 Mr H. Tefay, PFTC, *Transcript of Evidence*, 24 July 2003, p. 55.

111 *ibid.* and FFC and AFC, submission no. 92, pp. 2-3.

112 PFTC, submission no. 89, p. 15.

113 AFC, *Annual Report 2002-03*, p. 22.

- all television projects to secure co-development finance and 20 per cent of feature film projects to secure co-development finance from the market.¹¹⁴
- 6.131 This example usefully demonstrates the principles of measurability. The indicators will enable the industry and the wider community to assess easily the extent to which the agency is performing its role. In discussing performance information and performance indicators, the Auditor-General suggested measurability would assist managers:
- At the highest level, they are a measure which enables managers to monitor progress towards achieving the objective, to indicate if they have been successful or how far away they are from achieving the specified objective.¹¹⁵
- 6.132 Following on from earlier discussion, the Committee considers that the benefits of film industry assistance will be greater if more people see Australian films, both within Australia and overseas. The Committee suggests that the agencies' corporate goals, strategies and indicators should place greater emphasis on distribution of Australian content. As noted earlier, much of the government assistance focuses on 'production-push', rather than 'distribution-pull'.
- 6.133 For example, the AFC publishes limited distribution figures in its annual report. The *Annual Report 2002-03* provides data on the percentage of the films or short features it supports that obtain a theatrical release, or television licence or presale (72.7 per cent in that year).¹¹⁶ Although these productions have the opportunity of attracting an audience and delivering wider cultural benefits, this is not guaranteed. If a film is not popular, for example, it will be discontinued after a week.¹¹⁷ Statistics on the number of people who view assisted projects would be more useful to the community. They would also help the Commission build up a data set to determine which of its programs are effective and why.
- 6.134 The Committee also notes that the Commission's outcome under its portfolio budget statement is focussed on production, rather than distribution. The agency's indicator is:

114 PFTC, submission no. 89, p. 15.

115 Mr P. Barrett, 'Performance Standards and Evaluation,' *Australian Journal of Public Administration*, 56(3), 96-105, September 1997, p. 97.

116 AFC, *Annual Report 2002-03*, p. 66.

117 Mr H. Tefay, PFTC, *Transcript of Evidence*, 24 July 2003, p. 57.

An internationally competitive Australian film and television production industry, which enhances Australia's cultural identity.¹¹⁸

- 6.135 In the sense of meeting its portfolio budget statement outcome, the Commission has been successful. The early parts of this chapter demonstrate that much of the government assistance for the industry has been focussed on production. The Committee, however, finds that the benefits of the industry increase with audience size. This outcome should be amended to have a distribution focus.
- 6.136 In the case of the FFC, it also goes part of the way to providing distribution data because its annual report provides a recoupment breakdown since 1989-90, a list of high-grossing Australian films, and a breakdown in recoupment between Australia (21 per cent) and overseas (79 per cent). It also provides a list of films with a theatrical release.¹¹⁹
- 6.137 A number of improvements, however, could be made to this information. For instance, one of the corporation's objectives is to maximise recoupment.¹²⁰ Given this quasi-commercial role, publishing the level and proportion of investment and the rate of return, both at the agency level and for individual films, would add useful context to how the corporation is meeting this objective.¹²¹
- 6.138 Another comment is that recoupment arrangements vary across films. A dollar of recoupment for one film may indicate a different level of audience for a dollar of recoupment from another film. Audience figures would help readers evaluate the cultural benefits of each project. It should also be noted that the Corporation's objectives do not directly relate to maximising audiences for Australian content. This matter could also be considered.
- 6.139 To be fully effective, key performance indicators and their related targets should have some ownership from the agency involved. The Committee, therefore, does not wish to recommend that the agencies adopt these suggestions precisely. The Committee presents them to assist the film agencies in reviewing their corporate goals and performance information.

118 AFC, *Annual Report 2002-03*, p. 66.

119 FFC, *Annual Report 2002-03*, pp. 25-28 and p. 47.

120 FFC, *About the FFC*, viewed at http://www.ffc.gov.au/about/ffc_int_about.asp on 29 April 2004.

121 Allanbank International, submission no. 57, p. 31.

Recommendation 27

6.140 The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government ensure the feature film agencies' corporate goals and performance information:

- (a) have measurable objectives**
- (b) focus on distribution, audiences and intellectual property, in addition to production**
- (c) for the Film Finance Corporation, include data on investment return and the level and percentage of investment at both the project and agency level.**

Project selection

6.141 The Committee heard a wide range of views on whether the film agencies should be supporting the industry for cultural or commercial reasons. Determining this strategic issue would then feed into project selection. Some of the points of view were:

- success is generated by good content, which in film typically means a good script;¹²²
- for the film industry, cultural and business success are one and the same;¹²³
- the aim of assistance is to tell Australian stories;¹²⁴
- making products overtly Australian is a hindrance in the international market;¹²⁵
- cultural diversity should be protected against globalisation, which is forcing cultures to standardise;¹²⁶ and

122 Professor J. Sabine, Victorian College of the Arts, *Transcript of Evidence*, 28 August 2003, p. 12 and B. Beresford, 'How to choose a film script', *The Australian*, 8 September 2003.

123 PFTC, submission 47, p. 2; Allanbank International, submission no. 90, p. 7; and Ambience Entertainment et al, submission no. 100, p. 6.

124 Ms S. Milliken, Samson Productions, *Transcript of Evidence*, 5 September 2003, p. 12; Mr B. Rosen, FFC, *Transcript of Evidence*, 5 November 2003, p. 9 and Tasmanian Government, submission no. 73, p. 4.

125 Bigkidz Entertainment, submission no. 13, p. 9 and Light Knights Productions, submission no. 48, p. 13.

126 Media Entertainment and Arts Alliance, submission no. 59, p. 4.

- government support should be framed around the basic principle that this activity is an industry, which makes products and employs people.¹²⁷
- 6.142 The Committee would like to pursue the twin goals of making Australian stories and having Australian films develop larger audiences. These goals are not mutually exclusive. The following comparisons demonstrate how successful Australian films and cover many of the same themes, plots and ideas as successful Hollywood films, yet they are still distinctively Australian:
- compare *Lantana* with *The Big Chill*;
 - compare *Shine* with *A Beautiful Mind*;
 - compare *Mad Max* with *Terminator*; and
 - compare *Strictly Ballroom* with *Dirty Dancing*.
- 6.143 The Committee is confident that a good story, told by Australians, will bring significant cultural and economic benefits.
- 6.144 For the FFC to offer funding, a film must receive a provisional certificate that it is a 'qualifying Australian film' under Division 10BA of the *Income Tax Assessment Act 1936*. If a film passes this hurdle, it will tell an Australian story. The next step is to select the projects that are most likely to succeed. Bruce Beresford's comments are instructive:
- Selecting the best scripts is the key. Look at the recent international success of the low budget New Zealand film *Whale Rider* and the British films *Bend it Like Beckham*, *The Full Monty* and *Billy Elliot*.¹²⁸
- 6.145 Austrade made a similar suggestion:
- I think the real issue is we have to keep our creative edge. We have to be open, and creativity is not necessarily about throwing money at things.¹²⁹
- 6.146 The Committee finds that this approach is in line with most, if not all, of the opinions expressed about the rationale of film industry support. Further, seeking to produce the best scripts is consistent with the second Royal Commission requirement of content.
- 6.147 Selecting the best scripts, however, is a challenging task. Bruce Beresford commented that most people who select scripts for investment or
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127 Australian Capital Territory Government, submission no. 77, pp. 10-11.

128 B. Beresford, 'How to choose a film script', *The Australian*, 8 September 2003.

129 Mr L. Downey, Austrade, *Transcript of Evidence*, 8 October 2003, p. 7.

production are 'not capable of recognising good material'.¹³⁰ The Australian Government's feature film agencies will need to collect comprehensive data about their selection processes and the distribution figures of films to enable them to adjust their funding programs over time.

- 6.148 As previously discussed, a number of recent Australian scripts may have been produced before they were ready. Further, the FFC has provided finance on the basis of a distribution guarantee when distributors faced little risk. The Corporation made no assessment of quality; the distribution guarantee acted as a proxy for such assessment. The Australian Screen Directors Association, however, has argued that distributors are not good at picking successful projects at the script stage, but are much better at picking them when they are shown.¹³¹
- 6.149 In evidence, the FFC accepted that it needed to re-examine its funding decisions.¹³² At the time of drafting this report, the Corporation released draft investment guidelines for 2004-05 that include significant changes over the guidelines for 2003-04. The requirement for distribution guarantees is replaced by two categories.
- 6.150 The first category is the market attachment door, which is a more sophisticated version of requiring a distribution guarantee. A minimum of 30 per cent of the production must be guaranteed by genuine market place participants. This can include distribution advances and pre-sales. Further, the Corporation will only contribute a maximum of 40 per cent of the budget and give preference to projects that seek a lower proportion of finance. This approach requires the private sector to demonstrate its faith in the project by having more at stake.¹³³
- 6.151 The second category is the project evaluation door. Projects are evaluated on the following criteria:
- *creative potential*, which includes the creative team's track record and vision for the film, quality of script and proposed cast;
 - *market potential*, which includes the potential to secure distribution in Australia and overseas;
 - *audience potential*, which includes the target audience; and

130 *ibid.*

131 S. Williams, 'Script to let the good times roll', *The Australian*, 28 April 2004.

132 Mr B. Rosen, FFC, *Transcript of Evidence*, 5 November 2003, p. 5.

133 FFC, *Draft Investment Guidelines 2004-05*, pp. 2 and 5-8, viewed on 14 April 2004 at <http://www.ffc.gov.au>.

- *diversity*, which includes a balance of experienced and emerging creative principals, diversity of genre, and including films of artistic and creative merit that have limited commercial potential.

6.152 The Committee commends the FFC for recognising that its processes and outcomes could be improved and seeking to try different approaches. In light of the previous discussion in relation to scripts, the Committee's main comment is that the project evaluation door should place most weight on the script. As Bruce Beresford noted:

Certainly I think it would be more astute from every point of view, including box office, to pick scripts on their merit rather than on some half-baked interpretation of whether or not they fit into some trend. Trying to predict box office performance is invariably disastrous.¹³⁴

- 6.153 Instead of focussing on whether a script will deliver cultural or commercial benefits, the Committee suggests that selecting the best script has the best chance of securing both benefits. After ranking projects by script, the remaining Royal Commission requirements of capital, personnel and equipment, and distribution also appear to be relevant. These criteria are already listed in the FFC's guidelines and the Committee's comments are directed at their weightings.
- 6.154 If a project is a qualifying Australian film and scores highly on these factors, the Committee is confident that the film's likely economic and cultural returns will be maximised.

Recommendation 28

- 6.155 **The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government encourage the Film Finance Corporation to place most weight in its project evaluation door on a project's script initially (in terms of its quality and commercial potential), and secondly on capital, personnel and equipment, and distribution.**
- 6.156 In terms of the process generally, it is important that the Corporation collect data on these new approaches and assess their effectiveness. Although it is often clear if a funding system is effective or not (such as the

134 B. Beresford, 'How to choose a film script', *The Australian*, 8 September 2003.

Corporation's prior distribution link system), data collection and analysis will help the Corporation determine which aspects of the program are more effective and enable fine-tuning.

Recommendation 29

6.157 The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government encourage the Film Finance Corporation to collect data on the results of its new investment guidelines to enable the Corporation to analyse and fine-tune them.

6.158 In order to make the right selections, the FFC needs to have high quality proposals. In the federal sphere, this task is the responsibility of the AFC. In 2002-03, the Commission provided the following funds in relation to film development:

- \$249,000 for script workshops;
- \$132,000 for script and development assessment;
- \$565,000 for general development; and
- \$1.41 million for project development.¹³⁵

6.159 Individual grants often span two years. It appears many of these projects either received funding in the previous year or were to receive additional funding in 2003-04. The Commission supported 139 specific projects under the last two categories, making the projects' average grant \$14,000 in 2002-03. Given that grants often span two years, the average grant would be more than this amount.¹³⁶

6.160 The Committee recognises the Commission's contribution to accountability by listing all fund recipients in the back of its *Annual Report*.

6.161 The size of grants has been recently raised in the media. The Chief Executive of the FFC is credited with making the following argument:

Script development funding...is spread too thinly among too many screenwriters, a product of misplaced Aussie egalitarianism.

135 AFC, *Annual Report 2002-03*, pp. 98-105 and 110.

136 *ibid.*

More needs to be done to identify the more promising scripts at an early stage and support them.¹³⁷

- 6.162 This analysis is consistent with the earlier comments by Bruce Beresford. If a film's success and cultural contribution is built on its script, then the script development process might deliver more results if it produces fewer, better scripts than presently. For instance, a development process that produced a handful of top-quality scripts annually may be sufficient for the feature industry.

Recommendation 30

- 6.163 **The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government encourage the Australian Film Commission to invest more resources into identifying promising scripts (in terms of their quality and commercial potential) and providing them additional support.**

Links to the games industry

- 6.164 As discussed earlier in the report, the Committee has not received evidence of an Australian film being converted to an electronic game. Such serial exploitation of intellectual property delivers significant economic benefits.
- 6.165 In evidence, the Committee heard that Australia is not particularly advanced in this field and that opportunities were often difficult to come by:

We look at the Australian industry and we ask: where is the IP development happening? I look around and I do not really see it happening except in a couple of cases—in the electronic game industry, for example. I am seeing a couple of companies that are seriously looking at developing and exploiting IP in this way, but it is an expensive thing to do because it is like a bet. In fact I was looking at a property that my son told me I should look at. He had read a book by an Australian author called *Across the Nightingale Floor*. I read this book and it is a sword and sorcery fantasy set in medieval Japan—perfect theme for this kind of exploitation. I thought: this is my big chance. I will rip in and put up my hand here. I did some research and I found the agent who was in

137 L. Barber, 'Box-office blues', *The Weekend Australian*, 7 September 2003.

London. The electronic IP rights for the book had been sold prior to publication—and this was a first novel from this particular author. Prior to publication they were sold to Universal in the States for \$US15 million.¹³⁸

- 6.166 As the GDAA has foreshadowed, the film agencies may eventually become more general entertainment agencies.¹³⁹ As noted in Chapter 5, however, the possible extent of convergence is unclear at this stage. Therefore, instead of recommending such an expansion of the film agencies' role in this report, the Committee would prefer to suggest that the film agencies explore, with the games industry, to what extent their programs can encourage Australian industry to serially exploit intellectual property.
- 6.167 One method of encouraging serial exploitation would be to include the broader use of intellectual property as a funding criterion for film development or film finance. Given that it is easier to modify a project during the earlier, planning phases, it would appear that the greatest opportunity to modify content to ensure it supports production in a range of platforms is in the development phase. The AFC, therefore, would have a key role in such a program.
- 6.168 The Committee appreciates that it has already argued that the best chances of delivering a successful film is to develop and finance the production of high quality scripts. The Committee is not stating that a lesser quality script with a cross-platform dimension should receive funding ahead of a high quality script without such an angle. Rather, the Committee's view is that cross-platform content should be encouraged at an early stage of development and that, of two films of otherwise equal merit, the project that has a cross-platform dimension should be preferred.

Recommendation 31

- 6.169 **The Committee recommends that, as part of the intellectual property strategy in recommendation 24, the Australian Government encourage the Australian Film Commission and the Film Finance Corporation to include the serial exploitation of intellectual property in their funding criteria and programs. This review could be done in consultation with the other industries involved in creative intellectual property.**

138 Mr M. Hollands, Act3 Animation, *Transcript of Evidence*, 28 August 2003, p. 66.

139 GDAA, submission no. 54, p. 14.

A creative industry think tank

6.170 A number of organisations during this inquiry raised the need for the establishment of a think tank to collect information about the industries and use the data to promote appropriate policies. Austrade put this view,¹⁴⁰ as did the Queensland University of Technology:

We want to put before you the proposition that one of the ways of organising these very fragmented industry sectors that are characterised by small and medium sized enterprises and lots of microenterprises is to have an industry body with R&D capacity that can get ahead of trends, can sense trends, and produce data that is strategic and leading indicator in its nature, rather than only lag indicator in its nature. On the matter of size and scale, the answer is briefly that we do not know the size and scale of these industries in any comprehensive way. When we do know, it is too late: the industry has moved on. The point that I am making is about the way that lag versus leading indicator data might fit in with an industry body with the R&D capacity to lead with good evidence-based policy advocacy the fortunes of this sector.¹⁴¹

6.171 In Chapter 3, the Committee made recommendations to improve the data on the industries, initially through the AFC and FFC. The GDAA has suggested that these agencies may evolve to also serve the wider entertainment industries, including interactive media.¹⁴² The ultimate long term role of such a think tank will partially depend on how the film and other relevant agencies evolve and the extent to which they provide leading versus lag indicator data.

6.172 Although the Committee can see some benefits in establishing a creative industries' think tank at this stage, the practicalities of such a proposal need to be fully addressed. In the past, three factors have been identified as necessary in establishing an effective think tank:

- *leadership*, which means attracting someone who would be able to win the confidence of the sectors the think tank would wish to influence, that is, politicians, the bureaucracy, business and the unions;
- *high quality scholarship*, because an organisation's effectiveness and reputation would depend on the quality of its work; and

140 Austrade, submission no. 37, p. 7.

141 Professor S. Cunningham, Queensland University of Technology, *Transcript of Evidence*, 24 July 2003, p. 66.

142 GDAA, submission no. 54, p. 14.

- *funding*, to ensure the organisation's energies were directed to its core work, rather than revenue raising.¹⁴³
- 6.173 The Committee is confident that, within academia, industry and the public sector, sufficient skills exist to meet the first two criteria. The key issue is funding. A recent overview of think tanks in Australasia noted a typical annual budget for think tanks between \$100,000 and \$1 million. Because the think tank would be focussed on an industry sector, a realistic budget would be in the lower half of this range. Typical revenue sources for Australasian think tanks are government funding, corporate donations, membership subscriptions, publications, consultancies and project work.¹⁴⁴ Given that most benefits of such a think tank would accrue to the industry, the Committee is of the view that the industry must play a key role in establishing such a think tank. To increase its chances of success, governments could provide seed funding.
- 6.174 One of the key issues that these industries need to address is the prevalence of SMEs. Instead of these firms merging in the short term, an alternative would be to submit this issue for examination by a creative industry think tank.

Recommendation 32

- 6.175 The Committee recommends that the Australian Government liaise with state agencies, the universities and industry to establish a creative industries think tank and provide the new body with seed funding and, further, in-kind support for a period of 5 years.

143 Mr I. Marsh, *An Australian Think Tank?*, p. 53, (1980) NSW University Press Ltd, Kensington.

144 Ms D. Stone 'Dynamics of Think Tank Development in Southeast Asia, Australia, New Zealand, and Papua New Guinea', pp. 401-402 in *Think Tanks and Civil Societies* edited by Mr J. McGann and Mr R. Weaver (2000) Transaction Publishers, New Brunswick.

Fostering production

R&D in the creative industries

Scale of R&D activity

- 6.176 During the inquiry, the Committee received evidence that local firms are undertaking a certain amount of R&D. Cutting Edge Post indicated it was developing five industry based products, which it was hoping to sell internationally.¹⁴⁵ Animal Logic stated that it had received a commercial return on software development and that ‘our R&D and internal software activities have given us a competitive edge’.¹⁴⁶
- 6.177 Overall, however, the Committee did not find evidence of uniform, consistent R&D across the industries. After noting the lead taken by firms such as Animal Logic, the University of Technology, Sydney advised the Committee:

The problem, however, is that the commercial companies involved are still caught in a “cottage industry” pattern of production: they tend to throw all energy into delivering an existing project in order to secure just enough surplus to tide them over until they win the next big commission. They have not managed the economies of scale that allow leeway in logistics, scheduling and budgeting so that they can apply a significant portion of staff and time to venturesome R&D. This is a common problem in an economy the size of Australia’s.¹⁴⁷

- 6.178 Once again, the SME structure of these industries has limited their ability to function in the market place. As stated in Chapter 5, the structure of these industries is largely a matter for them to determine. The Committee’s suggestion for how the industries might themselves address this issue is given in the discussion of an industry ‘think tank’ below.

R&D programs

- 6.179 The Government’s main R&D program that pays firms to undertake R&D is the R&D Start program run by AusIndustry. This program was outlined in the introduction to this chapter. Firms receive up to 50 per cent of their

145 Mr J. Lee, Cutting Edge Post, *Transcript of Evidence*, 25 July 2003, p. 23.

146 Mr Z. Nalbandian, Animal Logic, *Transcript of Evidence*, 4 September 2003, p. 2.

147 University of Technology, Sydney, submission no. 11, p. 3.

project costs, with payments typically ranging between \$100,000 and \$5 million.¹⁴⁸ Micro Forte, a games company, supported the program:

In my opinion, the most powerful single element of assistance has been the R&D Start Program. It has greatly helped companies such as Auran, Beam (now Atari – Melbourne House) and Micro Forte to build unique products and technologies, some of which have attracted the attention of the global industry. While these are my personal observations only, I can say that I believe these companies to have used this assistance well and have propelled their technology and themselves onto the world stage. Today these three companies alone account for over 1/3 of the entire game industry workforce.¹⁴⁹

6.180 The Australian Interactive Media Industry Association also credited the R&D Start program with enabling the development of commercially significant products.¹⁵⁰

6.181 Despite this success, however, the Committee did receive some comments that the R&D Start program's criteria were too limited. Animal Logic noted that, in many cases, its R&D was specific to an individual production and typically did not have a commercial use outside that production.¹⁵¹ The R&D Start program, however, requires applicants to demonstrate the level of national benefit a project will have, including the wider community and Australian industry.¹⁵² The Customer Information Booklet states:

Where possible, you should identify the benefits of your project that will spread beyond your company.¹⁵³

6.182 This requirement for external benefit is consistent with the economic rationale behind government support for R&D. The former Industry Commission explained the argument:

...the fundamental rationale for government intervention remains the "public good" characteristics of knowledge creation – its lack of appropriability [by the firm conducting the research] and wide

148 AusIndustry, *Grants for R&D Projects: Customer Information Booklet*, April 2004, viewed on 22 April 2004 at <http://www.ausindustry.gov.au>.

149 Micro Forte, submission no. 40, p. 1.

150 Mr J. Romney, Australian Interactive Media Industry Association, *Transcript of Evidence*, 5 September 2003, p. 23.

151 Animal Logic, submission no. 83, p. 4.

152 AusIndustry, *Grants for R&D Projects: Customer Information Booklet*, April 2004, p. 11, downloaded on 22 April 2004 from <http://www.ausindustry.gov.au>.

153 *ibid.*, p.13.

applicability – enabling spillovers to society from private investments in R&D.

Where spillovers exist – and empirical work suggests that they are widespread – there is the prospect that not enough R&D will be performed unless government steps in.¹⁵⁴

- 6.183 The Committee, therefore, is reluctant to recommend the removal of the external benefits criterion of the R&D Start program. This analysis may also be relevant to the new Commercial Ready program, which is due to incorporate the R&D Start program in 2006-07.
- 6.184 The GDAA suggested that games should be an identified category within the program to recognise the industry's work in developing innovative software.¹⁵⁵ It appears that grant recipients are determined by merit selection across all industries.¹⁵⁶ A wide merit selection process has the advantage of demonstrating to the community that the Government is seeking to obtain the maximum benefit for public funds. The Committee would not wish to recommend a particular industry fund or grouping because, if implemented, it may weaken the merit aspects of the current process.
- 6.185 The Committee also notes that the program's criteria already refer to innovation, so innovative software development could be supported by the program.
- 6.186 The Association also suggested that R&D deductions should be extended to the whole game software development process. Although taxation matters are outside the terms of reference for this inquiry, the Committee would refer back to the former Industry Commission's comments. If the benefits of a piece of research largely accrue to the firm doing the work, then, in the absence of significant spillover benefits, government assistance may not be warranted.

'Peaks and troughs' in the production cycle

- 6.187 During the inquiry, the Committee received evidence that the local film, animation and special effects industries regularly suffered from a 'boom and bust' cycle. This phenomenon was summarised by the Australian National University:

154 Industry Commission, *Research and Development*, 15 May 1995, report no. 44, v. 1, p. 10.

155 GDAA, submission no. 54, p. 17.

156 No mention is made of particular industry sectors in the *Customer Information Booklet*.

The cyclic nature of the industry means that often there is not enough work to go around; this tends to produce a “boom or bust” effect, where there is either so much work that companies cannot find enough qualified people, or where there is not enough work to keep people employed. This cycle is true of most industries but is exacerbated in the film, TV and commercial work by the project nature of the work. This cycle is the same all over the world but it is made more difficult in Australia due to the small size of the industry.¹⁵⁷

- 6.188 The firms involved in this review placed a high priority on this issue because the industry overall was experiencing a ‘small downturn’ during the inquiry. While local television production was largely steady, there had been a large drop in foreign television production and a small decrease in foreign feature production.¹⁵⁸
- 6.189 It appeared that local firms are usually able to expand production during a boom. Animal Logic noted the example of WETA Digital in New Zealand, which grew from one employee to 400 to complete the visual effects for *Lord of the Rings*.¹⁵⁹ Much of the Tasmanian industry recently grew out of the transfer of people with related skills such as copywriting and photography.¹⁶⁰
- 6.190 There are, however, a number of disadvantages from a downturn, in addition to reduced business. The first is that, due to low cash flow and work levels, firms are less able to keep up with the rapidly improving technologies.¹⁶¹ The second is that local firms are less likely to be able to offer staff work opportunities on large feature films, with the ultimate result that they leave for the US:

Sadly, we cannot offer many [graduates] an opportunity but, hopefully, if he presents an outstanding case to us, we will employ him either on an internship or a traineeship and we will develop his skills and bring him along to a level where we think he is very capable...

But ultimately his dream and his vision—and they all have it—is to work on a feature film; they want on the *Lord of the Rings*, they want to work on *Harry Potter*, they want to work on *The Matrix*. If

157 Australian National University, submission no. 71, p. 5.

158 Mr K. Dalton, AFC, *Transcript of Evidence*, 4 September 2003, p. 59.

159 Mr Z. Nalbandian, Animal Logic, *Transcript of Evidence*, 4 September 2003, p. 7.

160 Ms M. Reynolds, Screen Tasmania Advisory Board, *Transcript of Evidence*, 30 September 2003, p. 21.

161 Samson Productions, submission no. 31, p. 2.

those projects do not exist within our environment they are not going to stay with us; they go. In fact, I lost an animator three weeks ago who had been with me for eight years. He had worked on the Disney film for us and did a fantastic job, really enjoyed the experience and wanted to know where the next film was coming from. There was not one so he has now been employed by Los Angeles based company Digital Domain and he is working over there.¹⁶²

- 6.191 The industry has sought to address this volatility through a number of measures. The first is that it has sought work from overseas. Although this has given the industry some breathing space, the industry is generally of the view that many nations with low labour costs such as China will soon develop the required expertise and compete with Australia for this kind of work.¹⁶³
- 6.192 One activity that is seen as particularly valuable in providing extra work is hosting the production of television series. This sector holds a number of advantages, such as being stable, potentially long term and providing a steady stream of expenditure. The *Farscape* series shot 88 episodes in Australia with local expenditure of \$200 million. Currently, however, there is a lull in this category. The industry has suggested that the 12.5 per cent tax offset be extended to television series.¹⁶⁴ In the 2004 Budget, the Government announced it would extend the tax offset to high budget television series.
- 6.193 The Committee notes that the local industry has been active in seeking new work opportunities to give itself additional work to help overcome the peaks and troughs in the production cycle. The difficulties firms face in handling the volatility in production is partly due to the SME structure of the industry. If firms had greater scale, they would be better able to handle this problem. The Committee also notes that production is the more risky element of the industry. Much better returns can be found in the exploitation of intellectual property.
- 6.194 Given that industry structure is a significant factor in this issue, the industry needs to be a key player in its resolution. The Committee has previously suggested that the Government facilitate the creation of a think tank to give the industry a role in addressing issues such as industry

162 Mr S. Cooper, BEEPS, *Transcript of Evidence*, 25 July 2003, pp. 36-37.

163 Animal Logic, submission no. 102, p. 1 and Ms S. Greenshields, Screen Services Association of Victoria, *Transcript of Evidence*, 28 August 2003, p. 16.

164 Screen Producers Association of Australia, submission no. 33, p. 15.

structure. Volatility of production is a related matter and hence, could also be considered by the think tank.

Recommendation 33

6.195 The Committee recommends that the Department of Communications, Information Technology and the Arts refer the issue of volatility in these industries to the creative industries think tank.

Co-production treaties

- 6.196 As noted earlier, co-production treaties allow a production to be considered a domestic production in two or more countries, allowing that production greater access to finance and distribution. Australia has six treaties (Canada, the UK, Italy, Germany, Ireland and Israel) and two memoranda of understanding that operate to similar effect (France and New Zealand).¹⁶⁵
- 6.197 Most firms in the industry took the view that co-production treaties assisted the industry and more should be done to take advantage of the present treaties and create new ones. A federal review of the program in 2000 found it was providing benefits for Australia.¹⁶⁶
- 6.198 Yoram Gross-EM.TV provided the Committee with an example of the benefits of co-productions. Out of nine animated projects in full production since 1998, three were co-productions made under official arrangements.¹⁶⁷
- 6.199 The submissions raised two main issues in relation to co-production treaties, which will be considered below.

Treaties with developing nations

6.200 Some firms saw particular value in having treaties with developing nations:

The environment in which all these companies operate is undergoing radical change and we can't pretend that our exchange rate and work practices will remain competitive to attract overseas runaway productions...

165 *ibid.*, p. 16.

166 *ibid.* and AusFILM International, submission no. 88, p. 19.

167 Yoram Gross-EM.TV, submission no. 63, p. 4.

The trend won't be reversed – instead it will accelerate with the collapse of traditional trade barriers, as our industry becomes more mobile and as digital production technologies make it far easier to produce films set almost anywhere in the world...

Over time, these new film making countries will build their own film industries as they further develop their own skills. But if we form partnerships with them now, especially within the Asian time zone, we will have a much better chance of supplying services to them – particularly our high-end skills – as their industries mature.¹⁶⁸

- 6.201 Asian cinema is rapidly developing and is now generating international recognition, securing three major prizes at Cannes in May 2004: Best Actor, Best Actress and the runner-up Grand Prize. Although Quentin Tarantino, known for his appreciation of Asian cinema, headed the Cannes jury, the creative development of cinema in Asia is generally acknowledged. As the ABC's website stated:

...neither commercially-driven Hollywood nor artsy Europe appear to be producing as much novel and varied cinematic work as Asia nowadays.¹⁶⁹

- 6.202 Austrade agreed that making contact now with developing nations would generate goodwill for the future:

One of the areas that we should be starting to think more actively about is Australia being a centre for film industry in this region. For example, when films such as *The Lord of the Rings* was made in New Zealand, there was a big drawdown on services from Australia... We can be a source of expertise and services directly from Australia for film industries in the surrounding area. In the future perhaps, we could look to places such as Indonesia, Singapore, Malaysia and other areas as the film industry expands. I think we will have to diversify into Asia. We have already seen strong interest from China. We are working with Vietnam, for example, at the moment. They are interested in training their television technologists in Australia... Those sorts of contacts for the future will be invaluable, because you build the personal relationships that later grow into business.¹⁷⁰

168 Ambience Entertainment et al, submission no. 100, p. 21.

169 ABC, *News Online*, 'Asian films raise Cannes temperatures', viewed on 24 May 2004 at <http://www.abc.net.au/news/indepth/featureitems/s1114057.htm>.

170 Mr L. Downey, Austrade, *Transcript of Evidence*, 8 October 2003, pp. 6-7.

- 6.203 The one organisation that expressed concern about entering into more co-production treaties was the Media Entertainment and Arts Alliance. Its submission listed a number of criteria that it argued should be met before entering into a co-production treaty. These included:
- the two countries have a strong interest in co-producing films together;
 - the two countries have comparable film industries and infrastructure;
 - a public sector entity such as the AFC to oversee and administer the program;
 - reciprocal access to national treatment;
 - comparable benefits for national treatment, so that each country gains by being offered national treatment by the partner country;
 - balance over time of financial and creative participation;
 - broadly comparable conditions of work; and
 - government support for production.
- 6.204 The Alliance's key concerns were that some nations do not provide national treatment for overseas partners' productions and that the scheme might only be used to relocate production to the country with the least favourable employment conditions. The Alliance concluded that the resources used to negotiate these treaties could be better used elsewhere.¹⁷¹
- 6.205 The value of entering into trade relationships with other nations is to take advantage of each other's different skills or needs. An argument that our partner countries in co-productions should be as similar to Australia as possible will reduce the benefits of the program. This argument was put to the Committee in evidence:

What will tend to happen is that you will do in Australia the things that Australia does best and cheapest relative to the rest. So if the post production industry is losing out, it is probably because they are not giving us a good enough deal. I have no sympathy for saying that is the reason not to do treaties. The treaties are required because, unless we help producers like me and others to access international finance, we will have less animation. It is as simple as that.¹⁷²

171 Media Entertainment and Arts Alliance, submission no. 59, p. 13.

172 Mr T. Brooke-Hunt, Pacific Vision, *Transcript of Evidence*, 5 September 2003, p. 36.

- 6.206 Therefore, the considerable differences between the film industries in Australia and Asia suggest considerable benefits in co-productions. Further, the Committee received evidence that Asian nations with low labour costs will soon gain expertise and standard of service similar to that in Australia.¹⁷³ Australia cannot prevent these nations developing this expertise. It can, however, build business by trading with these nations in the short to medium term and so build partnerships for the long term.
- 6.207 In relation to the extent to which other nations may not fully reciprocate in a co-production treaty, the Committee would not wish to recommend that Australia enter a commitment that is clearly not in its interests. The extent to which a treaty meets Australia's interests will depend on the circumstances in each case.
- 6.208 The Committee is of the view that additional co-production treaties with Asian nations should be pursued.

Arrangements with France

- 6.209 The second issue was that the memorandum of understanding with France is not operating effectively. This was a source of concern given that there had been a 'fruitful level of cooperation' between Australia and France in the past.¹⁷⁴
- 6.210 In a submission, Pacific Vision advised the Committee of the key points. The relevant French agency, the CNC, gives Australian co-productions lesser standing than treaty co-productions because they are made under a memorandum of understanding. Hence, Australian expenditure on these projects does not qualify as European and French/Australian co-productions are not eligible for national treatment in France.
- 6.211 Further, the memorandum requires an Australian contribution of 40-80 per cent, but the CNC's policies allow only a maximum of 33 per cent of creative points to be non-European. The CNC has advised its local producers that it will apply the 33 per cent maximum in deciding whether co-productions qualify as European content and CNC funding.
- 6.212 Pacific Vision suggested that, in the short term, the AFC could accept 33 per cent Australian content for French co-productions. In the long term, the Commission could persuade the CNC to change its interpretation of the memorandum or instead negotiate a full treaty.¹⁷⁵

173 Mr M. Hollands, Act3 Animation, *Transcript of Evidence*, 28 August 2003, p. 66.

174 Screen Producers Association of Australia, submission no. 33, p. 16.

175 Pacific Vision, submission no. 95, pp. 1-2.

- 6.213 The Committee agrees that, given the value of the partnership in the past, these implementation issues with the French memorandum of understanding should be addressed.

Recommendation 34

- 6.214 **The Committee recommends that the Australian Film Commission enhance the co-productions program by:**
- (a) negotiating more co-production treaties, including with Asian nations**
 - (b) rectifying the difficulties with the memorandum of understanding with France and, if appropriate, upgrading it to a treaty**
 - (c) supporting an industry mission to France and/or a French mission to Australia to strengthen ties.**

Free trade agreement with the United States

- 6.215 A large number of submissions during the inquiry commented on the possible negative effect a free trade agreement might have on support for the industry.¹⁷⁶ A common argument was that ‘stand still’ provisions that kept current arrangements but prevented Australia implementing new measures in the future would be disadvantageous, given the potential growth in the digital sector.¹⁷⁷
- 6.216 The Committee received a small number of submissions that supported the liberalising of trade in these industries.¹⁷⁸
- 6.217 A draft of the agreement has since been released and, as noted in Chapter 4, is being considered by the Parliament’s Joint Standing Committee on Treaties. The Joint Committee is the primary parliamentary forum for the consideration of the agreement. The Senate has also established its own Select Committee on the Free Trade Agreement between Australia and the United States of America.
- 6.218 This report will limit its comments on the agreement to noting that it has no exemption for programs focussed on the distribution of Australian films. The current exemptions in the document relate to local content and

176 For example, see David Muir, submission no. 39, p. 5; the Media Entertainment and Arts Alliance, submission no. 59, p. 5 and Film Victoria, submission no. 85, p. 9.

177 AFC, submission no. 58, p. 23.

178 For example, see Allbank International, submission no. 90, p. 9.

production. A key message from this report is that much assistance to the industry in the past has been production based, whereas the best returns are in intellectual property, which includes distribution. The Committee's recommendation for an intellectual property strategy may not be completely in harmony with the free trade agreement as it currently stands.

The games industry's development strategy

6.219 On 8 October 2003, the GDAA released its *Game industry development strategy*. The strategy was prepared by the Allen Consulting Group. The main conclusion from the strategy was that the games industry was being constrained by two key factors:

- market distortions that make investment in other parts of the creative content industry more attractive (for example, film tax concessions); and
- imperfect capital markets due to information symmetries and lack of opportunity for risk diversification.¹⁷⁹

6.220 In relation to market distortions, the strategy recommended that the Government extend Division 10BA of the *Income Tax Assessment Act 1936* to the game industry.¹⁸⁰ Tax issues are outside the scope of this inquiry but the Committee could not ignore the apparent groundswell of concern expressed during the inquiry and urges the Government to consider measures that would enable greater equality between treatment of the games and the film industries.

Recommendation 35

6.221 **The Committee recommends that the Australian Government extend Division 10BA of the *Income Tax Assessment Act 1936* to the electronic game industry.**

6.222 In relation to capital markets, representatives of the games industry provided the Committee with evidence of their difficulties:

179 The Allen Consulting Group, *Game industry development strategy*, 8 October 2003, p. xiii.

180 *ibid.*, p. xv.

It is basically just the fact that there are no sophisticated investors out there. By that I mean that they are not familiar with the games industry. They do not know anything about it so they are not aware of what the risks are and therefore are not prepared to invest in it... It is something to just kick-start the investment community, because games are extremely profitable. They are even more profitable if you can finance them yourself. The fact that they are profitable is evidenced by the fact that publishers overseas are quite happy to give Australian developers the money to make these games. What we need to do is get investors and institutions in Australia familiar with the industry...¹⁸¹

- 6.223 The GDAA made similar comments to the Committee.¹⁸²
- 6.224 The industry's strategy proposes a game investment fund to remedy this situation. The fund would have two components, the first being an institutional program. The Government would put out to tender to fund managers two fund licences, with \$20 million in public funds attached to each fund. The private sector would contribute at least \$10 million in matching capital. The managers would invest the funds in the games industry with appropriate returns to investors, the Government and the managers.
- 6.225 The second component of the game investment fund relates to individual pooled funds. These would operate in a similar manner to the FLIC scheme. Investors would purchase an interest in an investment fund to spread their risk and would receive an immediate 100 per cent tax write-off for making the investment.¹⁸³
- 6.226 The game investment fund requires both additional funds and tax changes. As the Committee stated in its background paper to the inquiry, tax and additional public funds are outside the scope of the inquiry. However, the Committee notes the issues raised in evidence to the review and suggests this matter also be considered by Government.
- 6.227 The strategy argues that there is market failure through information asymmetry or that markets are incomplete. It appears that because local investors do not wish to learn about the commercial prospects of the games industry, they are not prepared to make offers of finance.
- 6.228 The Committee does not wish to make any determination on this analysis. One comment might be that games producers currently source finance in

181 Mr G. Siegele, Ratbag Services, *Transcript of Evidence*, 30 September 2003, p. 10.

182 Mr A. Lancman, GDAA, *Transcript of Evidence*, 20 August 2003, p. 10.

183 The Allen Consulting Group, *Game industry development strategy*, 8 October 2003, pp. 32-39.

the world market. The Committee is, however, concerned at the apparent lack of appetite in the local investment community for investing in electronic games.

- 6.229 This lack of financial support is related to the industry's SME structure. If the firms were larger, they would have more financial reserves and would be more likely to be able to fund their own projects. One possibility for these firms is to merge, giving them further economies of scale.
- 6.230 The Committee notes the industry's comment that it needs to 'get investors and institutions in Australia familiar with the industry.'¹⁸⁴ This goal is reasonable. One approach might be to operate investment seminars so that the games industry can present its business models to the investment industry. To be effective, these seminars would need to be properly promoted and be attended by suitably senior personnel.

Recommendation 36

- 6.231 The Committee recommends that the Department of Communications, Information Technology and the Arts facilitate investment seminars for the electronic games industry so that more of the returns from intellectual property be retained by local firms.**

Extending the tax offset to television series

- 6.232 As noted earlier in this chapter, the Committee received a large number of submissions that recommended extending the refundable 12.5 per cent tax offset to the local production of overseas television series. The main benefit of this kind of work is that it tends to be longer term and more stable than feature films.
- 6.233 The most comprehensive case in support of extending the offset was submitted by AusFILM.¹⁸⁵ Large budget television series such as *Farscape* and *The Beastmaster* are typically produced in 12 month blocks. In addition, they have high production values. The production costs for these programs were \$2 million and \$900,000 per episode respectively.¹⁸⁶

184 Mr G. Siegele, Ratbag Services, *Transcript of Evidence*, 30 September 2003, p. 10.

185 AusFILM, appendix A of submission no. 88.

186 *ibid.*, p. 4.

6.234 AusFILM described to the Committee the history behind the exclusion of television series from the tax offset:

There is one glitch...in our offset in that at the time it was introduced the focus was on feature films and there had been something of a crisis as a result of two major feature films not receiving the tax benefits that had been expected for their investors. So there was a need for quite quick decision making and the focus and emphasis was on feature films, and the offset does not extend to series television.¹⁸⁷

6.235 AusFILM's submission also included an economic analysis of introducing the offset. The calculations were based on including:

- television series with a minimum program expenditure of \$1 million per episode and a minimum Australian expenditure of \$15 million per series per annum; and
- bundled telemovies and straight-to-video films where their combined Australian expenditure exceeds \$15 million.

6.236 The estimated economic effects of this proposal are:

- annual Australian expenditure on these production categories of between \$180 million and \$295 million;
- in terms of the federal budget, contributing a net addition of between \$25 million and \$41 million; and
- adding between \$139 million and \$228 million to Australian GDP.¹⁸⁸

6.237 As this proposal is a tax measure, however, it is outside the terms of reference for this inquiry. The Committee presents this background to assist the general debate and is pleased to note the announcement by the Minister for Communications, Information Technology and the Arts on 11 May 2004 that under an extension of the refundable film tax offset scheme, new incentives will be offered for high budget television productions made in Australia. The Committee is pleased that the scheme has been extended to include television series as an eligible format.¹⁸⁹

187 Mr I. Robertson, AusFILM International, *Transcript of Evidence*, 4 September 2003, p. 44.

188 AusFILM, appendix A of submission no. 88, p. 9.

189 The Hon D. Williams (Minister for Communications, Information Technology and the Arts), 2004, *New incentives for television production in Australia*, media release, Parliament House, Canberra, 11 May 2004.

- 6.238 Indeed, bearing in mind the representations made during the course of the inquiry about the need for Government support, the Committee is also pleased that the Minister concluded this announcement with the statement:

The extension of the film tax offset shows the Government is committed to building a local film production industry that can compete in a demanding global environment.¹⁹⁰

Alternative funding approaches and venture capital

- 6.239 Although funding was excluded from the terms of reference, the Committee did receive a number of suggestions, which it has agreed to include by way of information.
- 6.240 One proposal was to place a levy on cinema tickets and use the proceeds to fund additional industry programs.¹⁹¹ France uses this system. The Committee obtained evidence from a number of sources, however, that the overseas film industry and cinema operators would be concerned about increased costs for their businesses.¹⁹²
- 6.241 Mr Muir then suggested to the Committee that an alternative might be to levy a tax on video tape. Germany currently has such a tax, and the aim is to penalise those people who view films through video copies, rather than paying their cinema admission.¹⁹³
- 6.242 The ABC suggested that a licence fee could be imposed to fund public broadcasting. The benefit would be that public broadcasters' funding would become more stable, rather than being affected by the budget position.¹⁹⁴
- 6.243 A possible source of funding for the innovative, start up firms in these industries is venture capital. This type of finance forms an important role in the economy. Larger investors such as banks are reluctant to make relatively small investments such as \$1 million to \$5 million in high-risk firms. Such investments have high transaction costs due to the levels of research required to make an informed decision.¹⁹⁵

190 *ibid.*

191 Complete Post, submission no. 27, p. 4.

192 Mr D. Muir, private capacity, *Transcript of Evidence*, 28 August 2003, p. 54; and Mr K. Dalton, AFC, *Transcript of Evidence*, 4 September 2003, p. 60.

193 Mr D. Muir, private capacity, *Transcript of Evidence*, 28 August 2003, p. 55.

194 Ms S. Levy, ABC, *Transcript of Evidence*, 27 August 2003, p. 14.

195 Industry Commission, *Informal Equity Investment*, Information Paper, April 1997, pp. ix and 1.

- 6.244 Finance plays a key role in firms' ability to innovate. A survey of SMEs found that one of the key impediments to innovation is lack of finance. When firms were asked what assistance they needed to pursue an innovative idea, the most common response was finance. The most common source of finance for innovation was internal funds. Respondents were generally reluctant to give away equity as a means of obtaining finance for innovation.¹⁹⁶
- 6.245 The venture capital sector in Australia continues to grow, but a lack of maturity in this sector has probably worked against the growth industries examined in this inquiry. In the US, where the venture capital industry is most advanced, the two most important criteria for a venture capitalist in assessing a proposal are market attractiveness and product differentiation. An electronic game, for instance, would score highly on these factors because it services a global market and each game is easily differentiated from other games and other forms of entertainment.
- 6.246 In Australia, however, the top two criteria have historically been management capability and the product. An Australian venture capitalist, Christopher Golis, states that this has led to sub-optimal decision making:
- The lack of experience by the early Australian venture capitalists probably led to insufficient time being spent on assessing the growth prospects for the investment and how large the market is for the company's product or service.¹⁹⁷
- 6.247 Finally, it should be noted that only a small percentage of proposals, such as 2 per cent, are accepted by venture capitalists. This figure tends to understate the success rate because any one proposal may be seen by a number of financiers before being accepted, but the deal rate is still low.¹⁹⁸
- 6.248 In this environment, it is easy to see how small, innovative firms in these industries have found it difficult to attract finance, even though they are profitable businesses with growth potential. The Committee trusts that its recommendations that the Government hold a number of investment seminars for the games industry and extend Division 10BA of the *Income Tax Assessment Act 1936* will help address this problem.
- 6.249 Despite these suggestions, it appears that Australian start-ups do not have the same venture capital opportunities as their equivalents overseas, particularly in the US. An analysis of the venture capital industry was

196 Yellow Pages Business Index, *Special Innovation Report: Small and Medium Enterprises*, February 2001, pp. 23, 33 and 35.

197 G. Golis, *Enterprise and Venture Capital*, (1998) 3rd ed., Allen & Unwin, St Leonards, p. 219.

198 *ibid.*

outside the terms of reference of this inquiry and, therefore, the Committee did not pursue it in detail. It appears, however, that such an inquiry in relation to the creative industries could be pursued in the near future.

Recommendation 37

6.250 The Committee recommends that the Australian Government investigate funding models, including international best practice, which will attract venture capital into the creative industries.

Promoting sales

Marketing Australian creative product abroad

Export market development grant scheme

6.251 As noted earlier in the chapter, this scheme reimburses firms for the expenses they generate in developing export markets. Eligible payments include marketing, visits, samples, and participating in trade fairs. AusFILM gave evidence to the Committee that firms found this assistance valuable:

The way that it works in this industry—and I suspect in other industries as well—is the more often we appear in their office space, the more of an impression we make. Obviously, the beauty of the EMDG is that it facilitates more of those trips.

...The last time I was over there I went into Intermedia; they had a script that they had not conceived of coming to Australia, but because I was there in their office, the script went into my hand and I prepared a budget for them. It has not been made here yet, but it put it in their mind. Since then I have received three or four more scripts. You cannot replace actually being there and meeting them in person. I think the EMDG is a great initiative and definitely makes a difference.¹⁹⁹

199 Ms J. Corden, AusFILM International, *Transcript of Evidence*, 4 September 2003, p. 50.

- 6.252 AusFILM also noted that, to be effective in sourcing business from the US, an Australian firm needs to be there twice a year.²⁰⁰
- 6.253 Despite this overall support, the Committee did receive evidence of a number of concerns about the scheme. The first was that the scheme has been capped at \$150 million since 1997. This has meant that payments have been reduced to meet this overall budget. After the first \$60,000, grants for 2001-02 were paid out at 32.84 cents in the dollar. The \$60,000 figure was reduced to \$50,000 in 2002-03.²⁰¹ Although the formal cap on the scheme is officially \$150,000, the effective cap in 2001-02 was approximately \$90,000.
- 6.254 The AusFILM submission noted that firms were caught out for 2001-02 because they had budgeted for a certain level of payment, which did not eventuate. Although the Committee did not have access to the promotional material relevant to that period, it should be noted that the current material refers to the pro-rata system:
- ...you should not plan or make financial commitments which assume you will receive any particular level of second tranche payment for which you provisionally qualify.²⁰²
- 6.255 The Committee is concerned that the official cap is becoming substantially different to the effective cap. The Committee is concerned that this program, which is highly regarded within the industry, is being undermined by insufficient funds to meet demand. One of the Government's targets is to double the number of exporters.²⁰³ In the view of the Committee, it is reasonable to support such a target by the expansion of funds for successful programs.

Recommendation 38

- 6.256 **The Committee recommends that the Australian Government allocate more funds to the Export Market Development Grants Scheme to ensure that firms can receive assistance up to the official cap of \$150,000.**

200 Mr I. Robertson, AusFILM International, *ibid*.

201 Screen Services Association of Victoria, submission no. 28, p. 14 and AusFILM International, submission no. 88, p. 17.

202 Austrade, *Export Market Development Grants: In Brief*, December 2003, p. 3, viewed on 22 April 2004 at <http://www.austrade.gov.au/publications/AustradeEMDGInBrief.pdf>.

203 Austrade, submission no. 37, p. 17.

- 6.257 Another concern expressed to the Committee was that firms needed to have the money up front to undertake the export marketing and were later reimbursed. Light Knights Productions suggested that payments under the scheme be made before firms made the expenditure.²⁰⁴
- 6.258 One of the advantages of the current system is that, because they are spending their own money, firms are likely to only undertake the expenditure after a thorough analysis of its value. If the Government were to provide the money before the expenditure, the Committee is concerned that this initial assessment may be less rigorous. The Committee understands that some firms may have difficulty getting the funds together to finance their export marketing. However, the Committee, on balance, regards it as more important that the incentive remains for all firms to subject their export marketing expenditure to a thorough examination. The Committee, therefore, makes no recommendation for change on this issue.
- 6.259 The Committee received a number of submissions that suggested the time limit for the program should be extended for this industry.²⁰⁵ The arguments were presented by Animal Logic:

Every time a production entity is funded and formed, it brings a different group of people together to manage that mini business of its own. We have to market to the group who are the decision makers on each production. It may be a producer from here, a director from there and a production manager from over there who come together and who are in charge of a \$50 million or \$100 million budget and will make decisions as to where to spend that money. We have to be prepared to market to those people and travel and do what we have to do to build a relationship with them, which may be as a consequence of previous relationships but it is a unique one based on that production. We never get to a point where we have secured a contract with a studio or a producer and it is a revolving door contract that will just keep happening. We have to constantly be travelling and pursuing new relationships—based on old ones but under new entities—to be able to secure projects.²⁰⁶

204 Mr W. Tatters, Light Knights Productions, *Transcript of Evidence*, 24 July 2003, p. 29.

205 Fox Studios Australia, submission no. 75, p. 790; Animal Logic, submission no. 83, p. 4 and AusFILM International, submission no. 88, p. 17.

206 Mr Z. Nalbandian, Animal Logic, *Transcript of Evidence*, 4 September 2003, p. 9.

- 6.260 The argument of these firms is that the scheme is limited to seven years, whereas they are constantly dealing with new companies that require the exporters to build a new relationship. In response to a question on whether such assistance would conclude, Animal Logic responded that this would occur 'When a business is mature'.²⁰⁷
- 6.261 Although firms in these sectors face additional costs in developing new relationships, the Committee would be careful in recommending any open-ended extensions of time limits for the scheme. Determining a business's maturity is an objective and difficult exercise. Given the constantly changing nature of technology and consumers' needs, a business may never be mature. The Committee is more comfortable with the principle that firms will be more efficient and better at meeting consumers' needs in the long run if there is a clear date when they should stand on their own feet.
- 6.262 These firms, however, do have significantly higher costs in needing to redevelop relationships. The Committee, therefore, suggests that the scheme be adapted to the creative industries by amending the current seven year limit which applies to all firms under section 7 of the *Export Market Development Grants Act 1997*. The Committee suggests that this limit be extended to 12 years in the case of the industries examined in this inquiry. To support such a change, the grading of assistance from 50 per cent of eligible costs in year one to 5 per cent in year seven will also need to be amended.

Recommendation 39

- 6.263 **The Committee recommends that the *Export Market Development Grants Act 1997* be amended to extend the current seven year limit on grants to 12 years for the film, animation, special effects and electronic games industries.**
- 6.264 The final issue raised with the Committee about the scheme is that companies within a group might be active in many different markets, but the total grants for that group are capped. Animal Logic argued that it worked in different geographic markets and sold different products such

207 *ibid.*, p. 10.

as visual effects, computer animated feature films, film scanning and recording services, and software solutions.²⁰⁸

- 6.265 Under section 65 of the Act, a group's entitlement is capped at \$250,000. Each individual company's possible total grant is divided by the group's entitlement to give a percentage. This percentage is then applied to \$250,000 to give the maximum possible amount. The Committee understands that the individual grant maximum of \$150,000 would still apply.
- 6.266 The rationale for the group cap appears to be that firms within a group have the opportunity to exchange their expertise in developing exports. Accordingly, the group cap is not unreasonable and there does not appear to be a compelling case for its removal.

The Australian brand

- 6.267 The Committee heard evidence that Australian creative content was yet to develop a suitable, recognised brand in the international market:
- ...Australian games and films are still referred to as quirky. The Americans say, "This is quirky," because the Australians are producing content that they cannot fit into categories. It is called quirky and is often dismissed or marginalised for that reason. In these sectors the industry participants are often thinking very hard about "how to do a wine industry", which is about high levels of coordination, knowing when to collaborate and when to compete, so you collaborate more for overseas and compete within the local market.²⁰⁹
- 6.268 The Queensland University of Technology suggested that, although some industry members were aware of the benefits of using the wine industry as a model, the firms were too isolated from each other and undercapitalised to collaborate. Hence, the University's suggestion of a think tank or similar body. The Government would not run this body and 'crowd out' the private sector, but rather support its development.²¹⁰
- 6.269 Australia already has a positive international image. Austrade stated this included openness, friendly people and beaches.²¹¹ To some extent this could be derived from tourism marketing. Many Australian creative

208 Animal Logic, submission no. 83, p. 4.

209 Professor S. Cunningham, Queensland University of Technology, *Transcript of Evidence*, 24 July 2003, p. 69.

210 *ibid.*, pp. 68-69.

211 Mr L. Downey, Austrade, *Transcript of Evidence*, 8 October 2003, p. 7.

products, however, have taken advantage of and helped build these images.

- 6.270 The Government has recently announced that it will modify Australia's tourism brand from lifestyle to focus on Australian values such as optimism, mateship, inclusiveness and irreverence. As *The Australian* stated:

Australia will sell itself as having "Baz Lurhmann irreverence" rather than Castlemaine slapstick in a \$360 million tourism campaign that aims to rebrand the nation in the eyes of the world.²¹²

- 6.271 The quote recognises how the tourism industry and the creative industries examined in this inquiry have each helped mould the Australian brand. In a similar vein, while promoting a recent Australian film festival in China, actor Bryan Brown described Australian humour as, 'anti-authority, irreverent, dating back to when Australia was a penal colony'.²¹³
- 6.272 The values of brands in the marketplace are well known. They allow firms to charge a premium for their products due to the certainty the brand provides consumers. Further, marketing is made easier as each campaign builds on the last one.
- 6.273 The Committee recognises the value of these strategic insights and agrees that these industries should be assisted in developing the Australian brand internationally. Further, there are clearly synergies between these industries and the tourism sector. Any work on building a national brand in the creative industries should be done in consultation with tourism agencies and tourism industry groups.

Recommendation 40

- 6.274 **The Committee recommends that the Department of Communications, Information Technology and the Arts, in consultation with tourism agencies and tourism industry groups, assist the industries the subject of this inquiry to develop a national brand, either through the proposed think tank or otherwise.**

212 S. Emerson, 'Out with kitsch in Aussie pitch', *The Australian*, 19 May 2004.

213 C. Armitage, 'Larrikins on side with film pirates', *The Australian*, 28 April 2004.

6.275 As noted earlier in the chapter, governments around Australia have assisted the games industry in attending the Electronic Entertainment Expo (E3) in the US. The effectiveness of attending these meetings was demonstrated in submissions:

...I remember how, in the mid 90's Austrade assisted a fledgling Micro Forte and a very small Adelaide based company named Ratbag to gain international exposure by assisting them in attending the Electronic Entertainment Expo in Los Angeles. Without this assistance I would argue, that at least for Micro Forte, we would not be where we are today.²¹⁴

6.276 Micro Forte and Ratbag are now established local games companies.

6.277 In evidence to the Committee, there was universal support for attendance at such conferences, especially among state governments.²¹⁵ Although firms can obtain export market development grants to fund their individual participation, the Committee sees value in a unified Australian presence at these gatherings, especially in relation to building an Australian brand.

6.278 Another suggestion the Committee received in relation to promoting Australian film overseas is to support Australian film festivals, especially in Asia.²¹⁶ This work is already under way to some extent, with Bryan Brown and Sam Neill recently opening the ANZ Bank Australian Film Festival in Beijing.²¹⁷ The Committee sees this promotional work as another part of developing an Australian brand overseas.

Providing a uniform level of service across the industries

6.279 During the inquiry, a number of cases emerged where it appeared that the film industry or some other sector received a certain level of service in export promotion, whereas the games, animation and special effects industries received a lesser level of service.

6.280 One key example was AusFILM. This organisation promotes Australia as a film production location and receives in-kind support from Austrade. During the inquiry, the electronic games industry argued that there

214 Micro Forte, submission no. 40, p. 2.

215 For example, see Queensland Minister for Innovation and Information Economy, submission no. 36, p. 1 and Film Victoria, submission no. 85, p. 18.

216 Ambience Entertainment et al, submission no. 100, p. 22.

217 C. Armitage, 'Larrikins on side with film pirates', *The Australian*, 28 April 2004.

should be an AusGames office in the US to help attract games projects to Australia.²¹⁸

6.281 In evidence, Austrade stated that, 'In principle, I think we would consider it very closely.'²¹⁹ If this proposal was externally funded, Austrade commented, 'we would look very favourably on it.'²²⁰

6.282 A more streamlined approach might be to adapt current arrangements such as AusFILM. Austrade noted there were arguments either way for this proposal:

One of the difficulties of that may be the character of the main parties within AusFILM. The various state film offices are major parties within AusFILM and the membership tends to be focused on the film industry at the moment. So they would need to expand their charter and range of interests to accommodate that. It may actually be easier to set up a special games industry, but I suppose over the last 10 years we have seen massive convergence of the industry and a film and games industry starting to merge and overlap each other.

At the moment within the film industry, I suspect a lot of the membership becomes involved in aspects of gaming, particularly 3D animation and that sort of thing.²²¹

6.283 In evidence, the Committee suggested to AusFILM that it could take on this responsibility. AusFILM stated:

...many of our members have direct or indirect games experience and there are a number of Australian production companies that have produced internationally successful games. So, yes, there is a clear overlap and if the government thought it was appropriate for us to do more in this area we would certainly be very pleased to do so.²²²

6.284 The Committee appreciates there may be some implementation issues in expanding AusFILM's charter and membership. However, given the developing links between the games and film industries, and the opportunity to develop a brand for them, the Committee is of the view that this expansion should be commenced.

218 GDAA, submission no. 54, p. 17 and Aganomis Services, submission no. 64, p. 3.

219 Mr L. Downey, Austrade, *Transcript of Evidence*, 8 October 2003, p. 4.

220 *ibid.*, p. 3.

221 *ibid.*, p. 4.

222 Mr I. Robertson, AusFILM International, *Transcript of Evidence*, 4 September 2003, p. 51.

Recommendation 41

- 6.285 **The Committee recommends that the Department of Communications, Information Technology and the Arts, as a major contributor to AusFILM, negotiate the expansion of AusFILM's role to also include the games industry.**
- 6.286 Another issue raised during the inquiry was Austrade's skill base. The industry identified two particular areas for attention: the digital content sector²²³ and the financing and selling of animation.²²⁴ Further, the Screen Services Association of Victoria suggested there was a general need for Austrade to ensure its Business Development Managers had the appropriate skills and knowledge for the industries examined in this inquiry.
- 6.287 Industry suggested that it might be easier for Austrade to work in more mainstream sectors such as wine, beef and information technology than these fragmented and creative industries.²²⁵
- 6.288 To its credit, Austrade recognised, as one of its future challenges, the need to train staff so they continue to recognise and capture opportunities for the sector.²²⁶

Recommendation 42

- 6.289 **The Committee recommends that Austrade, in consultation with the industries examined in this inquiry, place an emphasis on its relevant skills and knowledge to build up the service it provides.**

Distribution of Australian creative intellectual property

- 6.290 The Committee received some suggestions how government programs might promote the distribution of Australian films. Although taxes and funding levels are outside the scope of the inquiry, they are presented for

223 Australian Interactive Media Industry Association, submission no. 42, p. 12.

224 Mr W. Tatters, Light Knights Productions, *Transcript of Evidence*, 24 July 2003, p. 26 and Mr T. Brooke-Hunt, Pacific Vision, *Transcript of Evidence*, 5 September 2003, p. 29.

225 Australian Interactive Media Industry Association, submission no. 42, p. 12 and Mr W. Tatters, Light Knights Productions, *Transcript of Evidence*, 24 July 2003, p. 26.

226 Austrade, submission no. 37, p. 8.

discussion in light of the importance of distribution to unlocking the gains from intellectual property.

- 6.291 A number of Sydney-based production and post-production companies suggested that any new tax incentives should relate to distribution, in particular linking local and regional production to international distribution.²²⁷
- 6.292 The Committee also received a suggestion that, if a levy of \$10 was placed on each person in Australia, the funds could be used to fund film production and, in return, each individual would receive a book of ten tickets to give them free entry to these films.²²⁸
- 6.293 Although this proposal makes it easier for Australians to see local films, it suffers from the lack of incentive for producers to ensure that a significant number of people see the films they produce.

Bob Baldwin MP
Chair

227 Ambience Entertainment et al, submission no. 100, p. 20.

228 Ms Tamsin Rawady, submission no. 1, p. 1.

