

Hollywood Hoo-ha

By Jonathan Landreth for *China Economic Quarterly*, Sept 2017

Chinese investors have developed a taste for Hollywood, but their buying spree has drawn more scrutiny than tangible benefits. With their wings clipped by new foreign investment rules, their focus will turn back to their home market.

Hollywood movies have long been the greatest calling card of the American Dream. As China rises, it stands to reason that its wealthy and powerful should wish to project a dream of their own, first at home and then around the world. They are spending billions of dollars on pushing China's soft power beyond its borders, but with decidedly mixed results. For a group of ambitious billionaires and media companies, the movie industry has become a lucrative, yet also troublesome, piece of the Chinese Dream.

The biggest problem for China's wannabe movie moguls is that movies work best as international dream-makers when state interference is light. Players in the Chinese film industry are fighting an uphill battle with regulators in Beijing to be allowed to make films that stand a chance of spreading Chinese cultural influence globally. Meanwhile, investors who built out the nation's movie theaters are clamoring for more popular American movies to screen in order to recoup their outlay.

To this end, they have engaged in a buying spree in Hollywood. So far, their venture has raised more eyebrows than tangible benefits. Chinese films fare poorly in the US, still the world's biggest market. And observers back home are questioning the viability of some of these high-profile investments, especially as Beijing tightens controls on outward investment. Domestically, however, the market has grown quickly, offering a healthy fallback for China's large entertainment conglomerates, even as they begin to reconsider their international ambitions.

A tame but booming market

China's recent movie frenzy emerged in the wake of the Beijing Olympics in 2008, when the government encouraged media makers to promote a new image of China around the world. As the bull market in Chinese stocks crashed and fizzled, forward-looking investors turned instead to the movies. Chinese filmmakers knew that creativity and telling a good story, not Communist Party moralizing, were the key to attracting cinemagoers. They were skeptical about Beijing's "Going Out" propaganda, especially as so few movies from China had any track record of success abroad, least of all those that carried ham-fisted CCP messaging. But other players such as Wang Jianlin, CEO of real estate giant Dalian Wanda Group, spotted a business opportunity.

Listening to government concerns about overheated housing markets, Wang found that Wanda could acquire lengthy leases on land for shopping malls at affordable prices. Malls also fitted Beijing's plan to help China shift to a consumer economy. Their anchor tenants were multiplex theaters, which developers hoped would draw wealthy consumers to see 3-D IMAX Hollywood movies for RMB100 a pop. After the film they could buy shoes and a handbag next door, and celebrate with a meal in a mall restaurant. The strategy was a sound one, as gross cinema ticket sales almost doubled from US\$3.6bn in 2013 to US\$6.6bn in 2016. The number of China's movie

screens also grew exponentially, from a mere 5,630 in 2007—just one screen for roughly a quarter of a million people—to 41,179 by the end of 2016.

In spite of tight controls on release dates and unofficial “blackout” periods that bar imports to protect domestic releases during holidays, Hollywood films averaged 40% of ticket sales from 2012 to 2016. This success came even though China’s state-run distributors are limited to showing just 34 Hollywood films per year. These are imported on a revenue-sharing basis that, much to the dismay of the Motion Picture Association and the US Trade Representative’s Office, pays Hollywood studios a paltry 25% of each film’s revenue. While the roughly 280 movies made in China in 2016 grossed an average of US\$14mn, the revenue-sharing films flown in from Los Angeles grossed about US\$80mn each. China’s box office should soon surpass North America’s, making China the world’s largest cinema market.

Heading to Hollywood

The billionaires backing the industry have long understood the potential of Hollywood in China. Five years ago they began directly funding the six major Hollywood studios to make big pictures for a domestic audience. Wanda’s Wang was the most conspicuous of the Chinese moneymen arriving in Los Angeles. In 2012 he splashed out US\$2.6bn on AMC, the US’s largest theater chain, and plowed millions more into a string of movies made by US studios. Then, in 2016, he purchased the struggling mini-major Legendary for US\$3.5bn.

Wanda was not alone in this venture. Hollywood films were also funded by Chinese e-commerce giant Alibaba, gaming-and-messaging behemoth Tencent, and mainland movie producer and distributor LeVision Pictures. Beijing-based production company Huayi Brothers opened offices in Beverly Hills, while its local counterpart Bona Films sold shares on Nasdaq and took investment from Rupert Murdoch. One of China’s most active outward investing conglomerates, Shanghai’s Fosun, backed a former Warner Brothers executive to form a brand new outfit called Studio8. All these Chinese companies and more signed deals to work with partners in California.

Hollywood quickly developed a taste for Chinese money. Studios expected big budget movies such as *Avatar* to sell well, if not better, in China than at home. As China put butts in seats, Hollywood salivated. Big films from LA studios—such as *Arrival*, *Gravity* and *Transformers IV*, to name but a few—began boasting plots that seemed obviously adapted to please Chinese audiences. By adding Chinese stars and plot lines, such as *Gravity*’s favorable portrayal of China’s space program, the studios hoped to gain a greater share of the Chinese box office.

Such developments raised eyebrows both among Chinese regulators and members of the US Congress. Democrats were concerned about a potential rise in Chinese-style censorship affecting Hollywood screenplays, while Republicans sounded off about the threat of Chinese investment to national security. A California congressman accused Wanda of shipping local jobs to China after *The Great Wall*, a bilingual war epic starring A-lister Matt Damon, was made largely in the Chinese port city of Qingdao. In September 2016, another congressman called for a crackdown against Wang and suggested putting China’s Hollywood buying spree under a review by the Committee on Foreign Investment in the United States (CFIUS). Democrat Chuck Schumer, a long-term and notorious China basher, quickly joined in.

The CFIUS complaint has not yet come before the Senate. Nor has Peter Navarro, Trump's China economics czar, said what, if anything, he plans to do. Yet, despite this uncertainty, many Hollywood insiders believe the China dance is here to stay. They hope that Chinese players may, for the moment, shrewdly take two steps back for each step forward. They reason that Chinese moguls and studios have invested too much time and money simply to skip away.

Killing the golden geese

Such an assumption might be misguided. Even after a decade of double digit box office growth ending in 2015, many of the loans from Chinese state banks to build the shopping malls and multiplexes still have not been paid off. China's economic slowdown threatens both developers' ability to pay for massive infrastructure and Hollywood studios' ability to make flashy, expensive films. As many Chinese movie fans opt instead for new subscription streaming services at home—or fall back on old habits such as pirated discs and illegal downloads—box office growth in China has stagnated since 2016.

What's more, the disappointment of *The Great Wall*—featuring one of Hollywood's biggest stars and directed by China's top director, Zhang Yimou—taught producers on both sides of the Pacific to exercise greater caution with movies touted to work in both markets. As Chinese ticket sales slow, and players on both sides learn from their mistakes, co-productions may begin to promote smaller, cheaper films. Besides, China has learned to make big splashy movies of its own. In July 2017 the neo-nationalist thriller *Wolf Warrior 2* opened to extraordinary success, grossing US\$810mn in just over a month to become the most successful film ever in China.

Hollywood studios, meanwhile, will probably have to turn to new sources of funding for their largest productions. Beijing has begun clipping the wings of China's most fervent Hollywood investors, fearing that massive loans taken out by the likes of Wanda's Wang and Jia Yueting, CEO of the conglomerate LeEco that owns LeVision Pictures, will not be paid back. By the summer of 2017, rumors were circulating that Wang Jianlin—who this summer dropped a US\$1bn bid for Dick Clark Productions, killing his image as the golden goose of China's entertainment industry and its outsized global ambitions—was barred from leaving China. Then Jia Yueting had his assets frozen by Chinese banks. Starved of cash flow, both Wanda and LeEco have since backed away from funding new Hollywood studio projects, and China's Recon Holdings was off-again-on-again with a proposed US\$100mn acquisition of Millennium Films.

In August 2017, the crackdown became official when the government announced new outward investment restrictions making it harder to splash huge sums on foreign entertainment deals. Financial regulators ordered China's biggest banks to stop loaning money to fuel what they called "irrational" investments abroad. About one-quarter of Hollywood films currently in production are backed by Chinese money, which means that the funding will not dry up for the next three years or so. But the Chinese gold rush appears to be over.

Back to basics, back to China

Seen in a positive light, Beijing's crackdown on outbound investment represents a move to protect state banks from issuing risky loans that threaten to turn sour. It rightly wants to prevent Chinese depositors from overpaying for foreign assets, and to stop moguls from fleecing ordinary Chinese investors for funds to fuel speculative acquisitions. The upshot is that movie studios on both sides

of the Pacific must get smarter and get back to basics. That means no more using film budgets to move dumb money out of China.

Initially, the focus in China could soon shift back to importing films. Rumors are circulating that the quota of 34 foreign films per year could soon double, while the 25% share of box-office revenue taken by US distributors could edge closer to the international average of 40%. This would allow Wang, Jia and other big investors to shore up their infrastructure investments at home by filling more cinema seats. Such a move may also encourage Hollywood to put more energy into producing genre films popular with Chinese audiences, or even making films in Chinese. The rise in the import cap is necessary to prevent movie theaters from closing as millions of consumers instead stream videos on demand.

Even then, competition from streamed internet content will be tough. The number of viewers watching films via the likes of Baidu's iQiYi, Alibaba's Youku Tudou and Tencent Video surged to 75mn in 2016, more than triple the 22mn in 2015. Although all of China's streaming services continue to lose money, in time they (like Netflix and Amazon) may learn how to turn a profit. One crucial advantage they have over movie theaters is that, despite regular crackdowns, the Chinese web is still more loosely regulated. Much of the content available online would never get anywhere near a movie theater.

In the long run, though, the popularity of streaming on demand may actually help rather than destroy the movie industry, by improving the quality of films shown in the cinema. Because most industry players now agree they must curtail their dependence on big imports with limited relevance to local audiences, Chinese writers and producers have begun to use the internet as a cheaper tool for experimenting with different types of content. If this eventually produces big-budget movies better suited to local audiences, the Chinese movie industry could yet find itself in rude health, even as the grand foreign ambitions of China's movie moguls fall by the wayside.