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Al Kasper
Portland State University

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A New Studio Era:
How Netflix is Becoming a Threat to the Film Industry

By

Al Kasper

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Dr. Nancy Breaux

Portland State University

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Introduction

Technology has come a long way since the invention of the moving picture. The film industry has been a consistent source of entertainment since the early twentieth century and has evolved alongside public interest and technology. From the beginning, cinema was a large and profitable industry that grew rapidly. Unfortunately, a lack of strong regulations made it easy for larger studios to take over and essentially run the industry for a few decades.

At the beginning of the film industry was a time period known as the Studio Era. This era lasted from the 1920s to the 1950s and was dominated by major motion picture studios. The studios in question were Paramount Pictures, MGM, RKO, Twentieth Century Fox, and Warner Brothers. These studios managed to hold an oligarchial power over other studios due to their antitrust business practices. There were two practices in particular that led to the downfall of the Studio Era: *vertical integration* and *block booking*.

Vertical integration can be defined as when a company owns all stages of production. This business practice is not unheard of in the business world, however, in the film industry, the use of this practice creates little to no competition. The major studios had the resources to own and operate their production, distribution, and exhibition of their films while smaller studios and independent studios struggled to compete. However, “the market control that resulted from bigness as such was not typically considered an offense” (Jacobs, 1983), which left these smaller studios struggling to profit while major competitors controlled most of the market.

A larger concern was block booking. Block booking was a practice that involved theaters purchasing a group (or block) of films to show rather than purchasing them separately. If a theater wanted to purchase a major motion picture, they were also required to purchase and play a set of B films that accompanied the major film. This created an even larger divide between the

major studios and smaller or independent studios. With the ability to buy out a whole theater, there was very little chance for independent productions to be screened to an audience.

Both of these practices got the attention of the Department of Justice and in 1948, a lawsuit was filed against the five major studios for participating in anti-trust business practices. The decision ultimately concluded that the studios could no longer practice block booking and had to divorce from their theater ownerships in order to promote fair competition and a non-monopolistic industry. The *US. versus Paramount Pictures'* decision became known as the Paramount Decrees.

While this decision was made almost 75 years ago, it was repealed in 2019 due to the Department of Justice acknowledging the changes in technology and regulations, firmly believing that there should be no concern for future antitrust practices. Nevertheless, the streaming giant Netflix may prove to be a threat to the current structure of the film industry with or without the Paramount Decrees. This paper hopes to evaluate the future of the film industry in regards to how streaming services are beginning to create a monopolistic industry and the potential to enter a modernized Studio Era.

The Beginning

Netflix has been an industry leader in at-home movie services for over 20 years. Founded in 1997 as a movie rental company, its biggest competitor at the time was Blockbuster, which refused to purchase Netflix despite the offer. Eventually, Netflix changed its service to include a new method of movie renting: the subscription model. This model provided customers with the ability to rent unlimited movies for a monthly subscription price. Blockbuster ultimately filed for bankruptcy, leaving Netflix as the winner of the two rental companies. (Sim, 2016).

In 2007, Netflix switched from a physical movie rental service to an online movie distributor. Works became even more available as customers could rent movies within minutes due to how Netflix “[p]artnered with manufacturers of various consumer electronics products, including video game consoles and Blu-ray Disc players, in order to enable its videos to be streamed over an Internet connection to those devices” (Hosch, 2022). Eventually, Netflix became a globally known service, no longer limited by physical mail; all movies could be streamed through customers’ personal devices connected to the internet.

Netflix released its first Netflix Original content in 2013 with the show *House of Cards*, which had about 2% of all Netflix subscribers watching upon its release (Rawden, 2014). The major streaming service has since created and offered over 2,400 original titles to its subscribers (Hosch, 2022). Netflix’s influence eventually spread to other streaming services such as Hulu and Amazon Prime, both also creating their own productions. “Netflix is aggressively creating original programming, whose global distribution rights Netflix will own outright” (Aguilar and Waldfogel, 2018), which could become a problem for both Hollywood and independent producers alike.

Independent Productions

Independent film studios have historically struggled to compete against larger Hollywood studios. Independent studios were one of the largest groups demanding an end to block booking before the Paramount Decrees, as it denied them access to the most profitable parts of the industry (Jacobs, 1983). There has been consistent favorability in Hollywood studios over independent studios, especially in the distribution portion of the film industry (Gil, 2010) due to

their higher economic power to both produce higher budget films and own the three stages of the film industry.

In an effort to promote more equal competition within the film industry, the Department of Justice managed to ban block booking and end vertical integration with the Paramount Decrees that major studios had taken advantage of. By doing so, the audience had more access to independent and smaller studio productions than before, increasing the audience's choices of films and therefore increasing studio competition.

In the modern day film industry, movie theaters have become less of an attraction, with most customers choosing to stay home and stream movies instead. With competition for theatergoers as a lesser issue, many independent productions now look towards services like Netflix to promote their content to a larger audience. There have been a number of benefits to streaming for independent studios, including that subscribers of Netflix actually rated indie productions higher than blockbusters in early feedback (Zu Tang, 2014). Another benefit for independent studios is that Netflix benefits from the less expensive licensing agreements for independent films given they meet the preferences of the company's subscribers.

Netflix has taken an interesting position related to independent productions. Through the Sundance Film Festival, Netflix began acquiring the rights to multiple indie films that lead to its fifth nomination for an Oscar award (Morrison, 2017). These acts of acquisition beg the question of whether Netflix truly sees potential in independent productions or simply uses them for their own gain (award nominations and clout). Nevertheless, when Netflix decided to submit their own film to the Sundance festival, while the audience laughed at the Netflix logo playing on the screen (Morrison, 2017), independent studios realized a new competitor stood before them. With

the budget and resources that Netflix has available, there becomes less chance for lower-budget indie films to make their name heard. The Cannes Film Festival is an iconic opponent against Netflix, arguing that unless its films are debuted in a theater for a certain amount of time, the major studio cannot enter the competition, allowing space for independent productions to compete without the threat of Netflix to take the glory.

Hollywood Studios and Contract Competitiveness

Hollywood studios are new to being the underdog in the film industry. They have been around for almost a century prior to the conception of streaming services, yet are struggling to keep up with the audience's preferences of staying home to watch their choice of movies. These major studios were originally able to contract with Netflix and have their films available for rent, however, with Netflix changing into its own production studio, these Hollywood studios have serious competition.

From the beginning, Netflix proved to be a threat to Hollywood studios. With Hollywood making most of its money in the early 2000s through movie theater attendance and DVD purchases, the sudden emergence of DVD rental companies proved to be detrimental to their income. Companies like Netflix and Redbox took advantage of the First Sale Doctrine in an effort to undermine the Hollywood studios and be able to rent their titles without proper permission. The doctrine stated, "once a person buys a copyrighted item from the owner, the seller no longer has the right to prevent the seller from reselling it, giving it away, or lending it out" (Sullivan, 2010). This meant that Netflix and Redbox could simply purchase DVDs outright and rent them out to their customers with no legal ramifications.

This potentially unethical business practice did eventually disappear when Netflix turned toward digital content. Currently, according to the Netflix website, the company enters licensing agreements for titles and must remove them from its site once the agreement has expired. The site claims that when considering renewing a licensing agreement, areas to consider are whether the rights are still available, how popular the title is, and the cost of renewing the license. If the company decides that the renewal is not worth the extra costs, they will remove the title. This is considerably different than when they were renting out DVDs to customers. Rather than purchasing a copy outright, Netflix is now forced to consider numerous qualities of a title before offering it to their customers.

How does this impact Hollywood?

These licensing agreements not only limit Netflix and other streaming services to what they are allowed to stream but also encourage studios and streaming companies to make contracts limiting their competition. Netflix itself is particularly interested in gathering exclusive rights to the content that other streaming services want access to (Auigar and Waldfogel, 2018). These rights allow them to be the only source to find certain content, which may attract customers who are specifically seeking those shows or movies. Some production studios are fearful of this tactic in that it may “[give] Netflix too much leverage in future negotiations” (Auigar and Waldfogel, 2018).

Such contracts can already be seen occurring across streaming platforms. In 2011, “Netflix [had]... announced streaming deals with Warner Bros., Universal, Paramount, MGM, Lionsgate, Fox, NBC, ABC, Disney, MTV, and a host of indies” (Smith, 2011). As of 2021, Sony Pictures and Netflix entered an exclusive agreement for five years once the pictures leave

theaters, according to the New York Times. While this limits Sony Pictures' ability to sell off the rights to their films to other streaming services, Netflix now has exclusive rights to Sony Picture films, making their content more diverse and sought after by subscribers.

Other streaming services are following suit. When Disney Plus was established, Disney pulled all of its content from its competition to keep exclusive rights to its content. Amazon Prime Video reached an exclusive deal with the Hollywood studio MGM, according to Business Insider. Many other studios are also using the concept of exclusive content to bring in new subscribers or interested customers to their service. (Clement, et al, 2020).

While these exclusive contracts are beneficial to streaming services by providing unique content, Hollywood studios are taking a hit. By signing these exclusivity agreements, Hollywood studios are forcibly limiting themselves to selling their content to one service. Cons of this type of contracting include limitations in competitive marketing as well as the potential to misvalue content that is signed over (Sanson and Steirer, 2019). Companies like Netflix have the ability to now undermine the competitive market with the appeal of the Paramount Decrees.

Netflix and the End of the Decrees

For nearly ten years, Netflix has stood as its own production studio with consistent movies and TV shows known as Netflix Originals. The first Netflix Original was the show *House of Cards* in 2013. Concerned about the increasing expenses of licensing agreements, Netflix decided to enter the field as a production studio to save the company money and gain control over some of its content (Moore, 2016). Netflix becoming a studio has since encouraged other movie streaming platforms (Hulu, Amazon Prime, etc.) to join in the production portion of

the film industry. Now traditional studios are struggling to compete with the major distributors that push their own content before any other.

Even before the appeal of the Paramount Decrees, Netflix was seen as a threat to the film industry through an attempt to purchase Landmark Theaters ``causing many to wonder if Netflix was even able to buy a theater chain under the ' 'Paramount Decrees''” (Oler, 2020). The company was already a production and distribution powerhouse, and with the purchase of a theater chain, would have landed themselves in a version of the vertical integration system banned in 1948. The company did manage to purchase The Paris in New York, officially breaking the Paramount Decrees before they were appealed.

These acts in defiance of the industry standards and regulations place Netflix as a difficult competitor for Hollywood and independent studios. Not only does Netflix now have the advantage of reintroducing vertical integration, there are other aspects of the company that threaten the competition of traditional studios. Compared to Hollywood and independent studios, Netflix has been positioned to “engage with fans' tastes in ways that the traditional industry cannot” (Burroughs, 2018).

The company has specific algorithms in place to suggest content to subscribers based on previous watched content. Contrary to the old system where movie audiences choose which movie based on marketing and their own interests, Netflix’s algorithm simplifies the movie watcher’s choices by suggesting movies or content that fits into the subscribers preferences. (Hallinan and Strippas, 2016). A concern about this algorithmic switch relative to the film industry itself is the cultural differences that must be accounted for by such a large, global company. Will Netflix Original movies adapt to the censorship laws in certain countries and

create a barrier to accessibility with non censored content, or will Netflix manage to fill the gap between more and less heavily censored countries? With the Paramount Decrees (an American law for the American company) out of the way, Netflix now has the ability to fully integrate their company as production, distribution, and even potentially an exhibitor if they so wish.

The concern regarding the violation of the Paramount Decrees has become more than just a passing thought in recent years. The US Department of Justice repealed the Decrees in November of 2019, determining that both the technological advancements of the film industry and the modern regulations in place would prevent and discourage film studios from violating antitrust laws. The most major change endorsing the repeal for the Department of Justice was the change from theatrical views to streaming.

There are many in the film industry that frown upon the decision to repeal the Paramount Decrees, concerned it could revert back to monopolistic business practices, hurting the whole of the industry rather than supporting it. Dawson Oler wrote that the Department of Justice “[intervened] and [risked] a critical upset of the careful balance already in place” (Oler, 2020) in a long examination of the importance of the Paramount Decrees. Now that Netflix has become vertically integrated (owning one theater and both production and distribution), the resurgence of block booking is expected once the “sunset period” has ended. This “sunset period” refers to a 2 year gap between when the Decrees were appealed and when block booking is set to be legal again (unless action is taken against it). In regards to the return of block booking, it is currently unclear what that will look like and what the effects will be. For now, vertical integration is the only part of the Decrees that has been re-legalised, which in turn will allow studios to purchase theaters and become much more strict on the movies they show.

Conclusion

The end of the Paramount Decree has left an unclear path for the film industry. Created in 1948 to discourage monopolistic business practices, the return of vertical integration and block booking have left the Directors Guild of America and many others worried about the threat that Netflix imposes on traditional studios. A potential new wave Studio Era is to be expected with the return of these practices and the rise of new industry leaders like Netflix, Hulu, and Amazon Prime. Both Hollywood and independent studios are expected to struggle against the global film powerhouse studios that rely on algorithms and push their own content to subscribers. However the end of the Decrees affects the film industry, one thing is clear: the success of online streaming and subscription services will outlast traditional studios.

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