midasinitiative

# 2D OR NOT 2D, WHAT ARE THE QUESTIONS?

## MIDAS Initiative Report into the Animation Industry in Ireland

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# CONTENTS

# 1.0 Introduction

The rapid advancement of technology has made computer animation available to the masses and the animation industry is said to be one of the fastest growing industries worldwide. The demand for animated entertainment has expanded with the increase in broadcasting hours by cable and satellite TV along with the growing popularity of the Internet.

The industry is continually re-inventing itself as it continues to expand and develop, and costs for entry into the market are becoming increasingly low. Architecture and product design in particular are industries that are increasingly using 2D and 3D animation techniques as an integral part of their normal day-to-day activities, albeit at the expense of traditional drawing and modelling techniques.

In the past, animation series and films were aimed at children aged nine and below. In recent years however, TV stations have been producing animation series for teenagers, adults and the whole family. Animation series like The Simpsons and King of the Hill have been successfully aired on primetime TV resulting in a new, wider demographic appeal. The major markets for animation product traditionally include the United States, Canada, Japan, France, Britain and Germany.

*(Source: Research and Markets)*

In the film industry there is a growing movement to make all-CGI feature films – perhaps the single most lucrative application of animation techniques – using existing animation studios, newly formed studios, and a variety of new combinations of the traditional models. The global success of animated features from Dreamworks, Pixar, Disney etc. will surely further the notion that CG features can mean huge box-office profits, helping new developing projects source the required investment.

Three-dimensional graphics, photo-realistic animation, cinematic-quality sound and interactive real-time multiplayer games, have recently become a reality for the evolving games industry, driven by the evolution of gaming middleware and 3D. The technology coming out of the games industry is leading academia and other industries in terms of these types of applications.

Naturally then, as more of these animation-based solutions are produced, it should mean more work for animation companies and effects studios, and it's feasible now for smaller studios to develop content of a quality sufficient to lure customers and investors. Quite where the animation industry in Ireland is placed and how well it is equipped to compete in these markets is the subject for this report, which will examine in greater depth the technological, economic and geographical issues affecting this sector of the digital content industries.

# 2.0 Markets

## 2.1 The Global Market

Globally, animation is one of the most commercially attractive digital media forms or products. The rapid advancement of technology has made computer animation production and delivery more readily available to the masses and the animation industry is one of the fastest growing industries around the world. The most recent Roncarelli Report states that the industry was worth $27.1 billion at the end of 2002 and is forecast to grow to a value of $33 billion by 2008. *(Source: The Roncarelli Report on the Computer Animation Industry, 2003)*

Commercially, animation is easier to sell to both internal and export markets than live action film as it can more readily transcend cultural barriers due to a universal understanding of the visual content as well as the ability of the audio narrative to be easily dubbed into different languages as required, evidenced perhaps by the particularly high concentration of Japanese-originated animation content for children's television broadcast markets worldwide.

Full length animated films, specifically computer generated graphics, have become a particularly hot genre over the past few years. Production of animated movies is at an all-time high, buoyed by high box office returns for CGI movies and the strong DVD market. Admissions to animated movies were 95 million in the USA and 74 million in Europe in 2003.

*(Source: Screen Digest)*

The opportunity for growth in this market is obvious and staggering although the competition for the full length animation film market is extremely intimidating. The largest competitors in this market are currently DreamWorks, Pixar and Disney, all of whom have created some of the largest films in the genre with, accordingly, their stock trading at an all time high. Reports have surfaced that other major players including the likes of Sony and LucasFilm are increasingly getting into the action. Indeed, every one of the major US studios is now said to be involved in producing animation features.

*(Source: InvestorGuide)*

The big question for this relatively new animation market is whether or not the newer, perhaps smaller entrants have the staying power to compete with already-established players in a market where, despite the potential for enormous international success, there may already be sufficient output from the major players to satisfy the market requirements. DreamWorks' own success, for instance, has been rather inconsistent to date, with several large hits like the two Shrek films and Shark Tale, but there have been a number of large flops as well. The company as a whole has actually lost money for three of the last five years.

*(Source: InvestorGuide)*

In respect of the competition for market share, US films captured 88% of European animated admissions in 2003, compared to only 9% for European and 3% for Japanese movies. Particularly, Finding Nemo was the most successful animated film in the last five years, grossing €506 million in the USA and €205 million in Europe.

*(Source: Screen Digest)*

The European animated movie industry has suffered from relatively small budgets and piecemeal distribution strategies compared to its US competitors, although several big- budget European animated films which have enjoyed commercial success worldwide Sprung! The Magic Roundabout, Valiant, the Wallace and Gromit Movie, Asterix and the Vikings and Arthur. Overall, some 81 animated movies were produced and released theatrically in Europe between 1997 and 2003. This compares to only 150 animated films produced in Europe before 1997.

*(Source: Screen Digest)*

In addition to animated feature and television programme production, the market for animation is extending to include CGI special effects, titles and inserts for more traditional live action content.

# 2.0 Markets cont.

Indeed there is an increasing blurring of the traditional differences between what may have been seen as animation per se and these new content production opportunities as each requires essentially the same technology tools and skill sets.

Likewise, animation production is a central component of the burgeoning interactive leisure software market with the visual content for virtually all games products being animated rather than live action-based. The games industry is actually more profitable than all the other digital content industry sectors, including film and television broadcast and is likely to see the strongest future market growth.

Animation industry growth continues to be driven by the many new smaller computer animation companies, taking advantage of the low and reducing financial threshold for market entry. Looking to the immediate future, however, this seemingly unstoppable increase in computing power, as well as the corresponding reduction in computing costs, is enabling more of the global computer animation production output to occur outside of the traditional North American, European and Japanese production centres. This is a pattern that has been increasingly apparent over the past three years, resulting in the growing importance of the outsourced computer animation production market.

*(Source: Digital Vector)*

The global computer animation production industry has therefore become very fragmented of late and now most of the world's small to medium players, perhaps in excess of 4,000 companies, are employed to execute outsourced animation projects from other countries. The major factor behind this shift of computer animation production to the Asia-Pacific region, increasingly being tapped by North American film and television programme producers, continues to be the availability of low cost, powerful computer animation platforms and, especially, much lower labour rates in the Asian and Pacific Rim countries compared to North America and Europe.

*(Source: Digital Vector)*

The low local labour costs means that these countries can offer computer animation production services to American and European producers at very attractive rates. The costs of outsourcing work to countries such as Korea is said to be roughly half that incurred in production houses in the more developed countries. For example, in the Philippines and India, the costs are said to be even lower at around 25–30% of the cost of production in the more developed countries. *(Source: Digital Vector)* However, in addition to the cost competitive advantage, these new production markets also feature the delivery of good international standards of animation skills quality.

This process of globalisation is, of course, an ongoing one and, due to the extremely competitive climate, as well as an ongoing global economic slow-down, some of the US studios have recently laid off many animators and artists in, until recently, their favoured outsource markets. India, in particular, is increasingly emerging as an alternative to Korea, Philippine and Taipei for animation outsourcing and is also emerging as a post-production hub. There is currently a considerable increase in the 2D and 3D animation outsourcing to India.

*(Source: Digital Vector)*

Key to the potential for commercial success of any medium or content form is the methods by which the customer accesses, purchases and enjoys it. The current trends towards individual rather than family viewing, Internet download delivery, electronic payment – and indeed new models of short-term, subscription-based rental instead of ownership of content – are clearly going to affect the ways in which the animation industry will operate in the future.

Successful box office animations can often be particularly successful in the post-theatre home video and DVD markets due to their particular niche audience (children) and whole family appeal. Associated revenues from ancillary activities, e.g. games, toys, merchandising and soundtracks, can often far outweigh the initial box office of the animated film or television programme and this is often the rationale behind a broadcaster's or distributor's initial commissioning of an animated film or television programme.

# 2.0 Markets cont.

These ancillary revenues are increasingly a fundamental part of the projected balance sheet for the film and the relevant intellectual property (IP) issues are usually dealt with at the initial licensing stage of the project. Interestingly however, independent producers are less likely to think about such licensing issues until after securing a media deal. Although cinema success is the benchmark for the main 'blockbuster' animations (Shrek, Toy Story et al) many producers are beginning to investigate the lower cost direct-to-DVD market as a channel for lower budget titles.

The expansion of multi-channel digital television has created opportunities for the development of new animation-specific or niche audience-targeted channels, e.g. Nickelodeon and Cartoon Network. These in turn require new sources of programming material which stimulates the developers and production companies.

The key to successful animation, and indeed with any other digital content form, lies with the strength of the idea and the characterisation. Although both comics and children's books have been historically good sources of content it is now rare to find a famous title that has not already been optioned. The challenge now is to find good stories and ideas that are relevant to society's current tastes, are newly published or are already in the public domain.

In response to, or perhaps a key driver of, the surge in domestic uptake of broadband Internet connectivity, new distribution channels for animated content are beginning to appear with both atomfilms.com and ifilm.com being particularly successful examples of web-based distribution and exhibition companies.

However, as with both the music and games industries, these digital production and distribution technologies are enabling increased piracy and bootlegging of animation content. The protection of the vital IP remains fundamental to the sustainability of the animation industry and yet the very technologies that enable independent distribution threaten the existence of the traditional business models that provided economic sustainability.

Currently, one of the most vibrant markets is that of mobile telephony which is at last beginning to see real consumer interest in 3G broadband capability. Whether as the medium for a piece of art, entertainment or commercial advertising, animation has the potential to capitalise in this new distribution channel, either as film or part of a game product, in much the same way as music has already begun to.

How the market will evolve and how revenues will be shared between producers and distributors is as yet unclear, but it is likely that an opportunity will exist for greater numbers of producers to access a greater number of smaller micro payments from a more fragmented (but larger overall) global audience. However, it is certain that the current industry cartels will continue to try to maintain and protect their existing market dominance by acquiring and perhaps merging with the new technology providers as required.

Another massive technological development in the near future will be the roll-out of high definition (HD) television and with it the simultaneous release of the latest digital entertainment hardware (including consoles such as the PlayStation3, Xbox 360 etc.) that have been designed to fully utilise the technology. These content players will also be equipped for the forthcoming next-generation DVD technologies being developed by a consortium led by Toshiba and a rival in the Sony-designed 'Blu-Ray' format. It is likely however that playback solutions will be compatible with both formats as roll-out commences in 2006.

Already, animation production software is equipped to allow development for the new standards and, as the market uptake becomes ubiquitous, the requirement for development skills and budgets in the animation industry will have to increase accordingly.

### 2.1.1 Financing Animation Production

Funding for animation development remains the single largest barrier to production. Increasingly the costs of even lower budget works far exceed their earning potential in both domestic and international markets combined. Without market profitability the prospects of financial investment, especially for new works by unknown producers, become ever more limited.

# 2.0 Markets cont.

With particular similarity to the film and television sectors, there are three main financial considerations applicable to the animation industry:

1. initial financing of the production and acquisition of rights;
2. marketing and distribution costs - those associated with the exploitation of the content; and
3. costs associated with an outright disposal.

The second and third requirements are effectively cash flow considerations and will generally depend on anticipated returns.

Major sources of finance generally include:

1. license fees
2. co-production
3. sale of intellectual property rights
4. distributors
5. media partnerships
6. corporate investment and tax incentives
7. institutional sources of finance

## Licence Fees

Domestic broadcasters typically pay in the region of 10% towards the production budget, however some commercial broadcasters have been known to stretch this to 30% for certain productions. Many European broadcasters, especially German and Scandinavian, pay higher licence fees towards production budgets.

## Co-production

Co- production for both film and television financing is widespread, and in fact is usually necessary for independent theatrical film financing. With television's more domestic focus, co-production can be a useful tool that gives producers the opportunity to tap international markets and capital. The BBC, for example, has partnered for many years with several US public broadcasting stations and with cable channels such as HBO, Arts & Entertainment or Discovery and is also part of the EBU, a European broad-casting initiative, which, amongst other things, assists in the creation of animated co-production series.

The main reasons for developing co-production agreements include:

- Production costs are too high to be covered by any one organisation. Even if a domestic broadcaster is enthusiastic about a programme, it is often the case that the broadcaster cannot cover the entire cost of its production.
- Co-production utilizes production budgets rather than acquisition; this means the programme can earn more money in distribution.
- Various national and regional programmes, and tax breaks, encourage production through financial incentives. Production subsidiaries, co-production, and government support programmes also benefit from the involvement of private financial institutions.

## Sale of Intellectual Property Rights

Intellectual property allows people to own their creativity and innovation in the same way that they can own physical property. The owner of IP can control and be rewarded for its use, encouraging further innovation and creativity in the long term.

It is therefore imperative that any animation company wishing to develop into a stable, long-term business must be aware of the potential of their own, plus others' IP rights and assets. In fact, an animation company is perhaps worth little or nothing long term without the development and control of its IP.

## Distributors

Reliance on distributors for both production finance and access to broadcast networks has increased significantly in the recent past. This is largely due to the decrease in licence fees from the main broadcasters and the parallel rise in the many specialist channels. As the distribution market fragments however, in response to the audiences' changing consumption patterns and preferences – enabled by the provision of new technologies – there may be more channels

# 2.0 Markets cont.

available that require content. But with these smaller niche audiences there is generally less advertising revenue available to fund productions. It is therefore necessary for producers to sell their projects to a wide number of territories and networks to realise the maximum return.

The scale of a distributor's investment obviously depends on the type of production. Worldwide distributors typically provide a pre-production guarantee, which may cover around 25% of a budget and are remunerated by a commission on international sales of 30-35%. They themselves then collect minimum guarantees from local distributors in return for territorial rights.

An independent producer that makes one or two series a year will find it difficult to attract attention of the major broadcasters and networks, and valuable time and resources could also be lost in identifying and approaching the right buyers. A distributor however, can create a point of sale with a large catalogue of rights (which may have been acquired from various sources) and by using their extensive network of contacts.

## Media Partnerships

One potential solution to the problem of distribution for independent producers has been by way of a media partnership or joint venture that shares the risk factor associated with any animation project that has not got a major studio name attached to it. Media partnerships or formal joint ventures in the animation industry are increasingly seen as an effective way of spreading the inherent risk in animation productions.

Each entity has its own speciality and each speciality concentrates on maximising the exploitation of the overall project by focusing on its own experience and knowledge of the sector. This arrangement both reduces the financial risk involved with large-scale projects and also widens the opportunity to attract funding. In addition, failure in one area would not necessarily prohibit the success of the project itself.

A typical media partnership may consist of:

- production company
- distributor
- merchandiser
- book publisher
- record company
- music publisher
- Internet service provider
- mobile telephone network operator
- content aggregator

## Corporate Investment and Tax Incentives

Corporate investment in animation has been increasing due to both the perceptions of market profitability and the availability of particular tax reliefs to give incentives to corporate investors contemplating the financial backing of animation productions. While perhaps not of great use to independent producers, who often do not have sufficient other taxable profits against which a tax write-off incentive can be set, it can be very useful to high earning individuals.

Types of incentives for investment include:

- sale and leaseback
- deficit finance schemes
- contracted debt schemes
- industry-specific tax incentives (e.g. Section 481)

A particularly important source of subsidy worldwide is undoubtedly found in the form of tax incentives. Most countries now have some form of government -approved facility (with the notable exception of the US) including Section 48 in the UK and Section 481 in Ireland. These programmes can attract domestic and inward investment to a country's film-making by essentially lowering the costs of production in that country and boosting the prospects of return on investment.

Many countries have introduced specific financial incentives to attract film projects and the UK has introduced a new tax credit, effective post July 2005, which will actually increase the level of

# 2.0 Markets cont.

incentive with a higher threshold of expenditure to £20 million and will apply to 100% of the production company's budget. *(Source: BBC)* However, as most countries now have such a scheme, other cost factors – namely labour and material costs – are increasingly helping to make the decision as to the choice of location, evidenced recently by the rise of the eastern European industries at the expense of the UK and Ireland, which had previously been so successful in this regard.

### Institutional Sources of Finance

There are numerous public institutions offering schemes to the film, TV and animation industries sectors, including:

- The Film Council
- The Film Industry Forum
- The British Film Commission
- The Northern Ireland Film and Television Commission
- The Irish Film Board (Bord Scannán na hÉireann)
- European Union

## 2.1.2 Distribution

Distribution is a major barrier to economically sustainable animation production. Without distribution to the markets there can be no possibility of financial success and, increasingly, without prior confirmation of distribution there is little chance of obtaining the necessary production finance.

Distribution is the exciting, dynamic, competitive business of launching and sustaining music, software, films etc. The digital content industries may be product-driven but the distributors' task is to connect the product with the public, to draw the widest possible audience to each individual title and to realise the full potential of the developers' work. However, the distribution sector remains highly polarised, with the top eight companies accounting for over 95% of box office earnings – a picture that is mirrored across the music and leisure software sectors also.

The animation industry worldwide is clearly being affected by an overall reluctance on the part of distributors and broadcasters to commission new work as well as by general economic factors including the recent significant decline in marketing and advertising revenues. Although digital television is creating new niche-specific channels, it is having to do so by dividing the existing advertising, licensing and subscription revenues between a greater number of operators rather than, in the main, developing entirely new and additional sources of revenue with which to finance production.

Clearly there are too few distributors, publishers or aggregators to be able to satisfy the needs for all of the actual or potential developers to competitively bring their works to market – a market that is already saturated with too much product and where only a tiny proportion can ever be sustainable. The local digital content production industries appear to have to either compete for this insufficient and diminishing resource or hope that a new form of commercial publishing and distribution support mechanism can be created to serve their particular interests in the market, in competition with the established giants of the industry.

In the absence of an indigenous distribution and publishing sector, US industry domination flourishes. Fragmented local distribution networks have made it easy for US corporate giants to push their own products at the expense of domestic productions. As the biggest global players, such as Sony, Universal and Microsoft, increasingly move to dominate the content production and distribution industries, opportunities for new market entry will become increasingly difficult.

Self-marketing and publishing for non-US content is also difficult. The cost of advertising on UK or Irish television, which may run into many hundreds of thousands of pounds or more for a package of spots in all regions, is usually prohibitive for most products, given their potential returns. Few campaigns use only TV, but rather a range of integrated media solutions, as distributors strive to get their message to as much of the target audience as possible, as many times as possible. Meaningful competition on this scale is simply not viable.

# 2.0 Markets cont.

## 2.2 The Market in Ireland

### 2.2.1 Market Overview

Despite initial optimism during the 1980s and 90s, Ireland's indigenous animation industry has had a more difficult recent past. Almost overnight, Industrial Development Authority intervention created a vibrant and successful animation industry in Ireland where previously there had been none. Significant financial incentives led to the establishment of international firms like Don Bluth, Fred Wolf and Quateru and projects such as An American Tail and Teenage Mutant Ninja Turtles were true international successes.

Sadly, all of these companies had left by the mid 1990s and the Irish animation industry very nearly collapsed entirely. However, Bluth's earlier alliance with Ballyfermot College to create an international-standard classical animation course, which in turn spawned the more contemporary course at Dun Laoghaire College of Art and Design, had begun to create a talented local workforce that was able to take advantage of the reducing technology costs to continue working, albeit on a much smaller scale.

Currently, details of the size of the indigenous animation industry on the island of Ireland are sketchy as various reports seem to quickly become obsolete as companies enter and leave the market. Our own research however indicates that there may be as many as 65 companies whose primary activities are fully engaged in the development of animation content, employing a total of around 430 members of staff and with a total market value locally in excess of €35 million.

*(Source: MiDAS Primary Research, 2005)*

Recent films by Irish companies Brown Bag and Zanita were Oscar-nominated, proving that (if nothing else) the industry in Ireland is capable of competing on creative and technical standards. However, both films were only available to niche festival and, more recently, web and DVD audiences rather than via film theatre release or television broadcast, so overall profitability from commercial exploitation remains limited.

In addition to those considered to be animation film-makers, there are many more digital media production companies and agencies, most often engaged in providing corporate marketing and advertising solutions, that will include both 2D (e.g. Flash web content) and 3D animation in their range of services. These companies tend to provide marketing services specific to companies within their own geographical location and as such are unlikely to be able to develop significantly or create entirely new wealth for the local economy.

There seems little opportunity either for export development in these corporate services sectors as each territory in Europe, Asia and the US also has a similar supply base of small companies, all of whom are competing just as vigorously to protect domestic market share. Almost all these companies will use the same software products from the mainstream international publishers, e.g. Adobe and Macromedia (who themselves have recently merged to consolidate market domination) and will develop the same core services. In short, there seems to be little opportunity for export-based growth in this market, save for price competition, which needless to say favours the new lower-cost economies over Ireland and does nothing to improve overall sustainability.

Similarly, while the boom in software development emerged from the location to Ireland of major international companies – keen and willing to exploit the high skill levels and relatively low costs of production that were available in the 1980s and 90s – an opportunity for the animation industry might be possible if a global studio were to create offices here to stimulate the work-for-hire sector. The difficulty is, however, that those attractive economic conditions no longer exist and the levels of expertise and quality to be found in Asia and eastern Europe are now at least as high.

In keeping with the international markets, both financing and distribution are particular concerns in Ireland with little in the way of an indigenous infrastructure in place for either issue. The Irish Film Board has specific support for animation including the Frameworks, Short Shorts and Irish Flash programs, the latter being an alliance with the digital media distributor Atom Films. However,

# 2.0 Markets cont.

while most commentators would agree that the Film Board's assistance has helped to raise the standard of animated film production in Ireland, what is now vitally required is a scheme that specifically aids the commercial side of the sector.

The Northern Ireland Film and Television Commission (NIFTC) is able to support up to 90% of the development costs of new animation projects through its Made in Northern Ireland (MINI) lottery-funded programme.

Clearly, while continuing to be an excellent consumer market for the best internationally-developed animated content, the Irish market is not sufficiently supportive of indigenous production. Without increased exposure on local television channels, in cinema theatres or the development and exploitation of new distribution models, e.g. the Internet, mobile downloads and DVD shorts, it is hard to see how the animation industry in Ireland can significantly improve its overall profitability and sustainability in the short term.

## 2.2.2 Capability Analysis

### Skills

It is clear from even the limited international successes of the past that the animation production workforce in Ireland is sufficiently skilled in the development of content to an acceptable, market ready, standard.

There are already a number of specialised university courses and basic animation skills are being taught widely throughout the whole of Ireland at a further and higher education level. Market entry is relatively inexpensive and the basic interests and early activities within the medium are being widely developed at an individual level.

Our own market research has indicated however that there is a relative lack of commercial and work-based experience and it is uncertain how this might be improved, except as an obvious consequence of greater, long-term business exposure. Specific business-related skills too (project management, finance management and procurement, sales and marketing etc.) are said to be in short supply throughout the creative industries as a whole and the recent Enterprise Strategy Group report, Ahead of the Curve, has recommended that the sector needs to recruit over 1,000 additional sales and marketing employees with which to stimulate the required competitive market advantages.

### Production

Again, as with the current skills levels, there does not seem to be a particular problem with the availability of industry-class production capacity. Now almost entirely computer-based, the hardware and software required for the production of animated content is freely available and readily affordable.

In particular sectors of the animation industry, e.g. console games and box office feature films, the production values are generally much higher than those required for television, web, mobile and niche-market DVD projects etc., and may require additional and more expensive equipment. Companies and institutions providing these facilities such as Windmill Lane, Ardmore Studios and the Bright Room, are, however, starting to emerge.

Pre-distribution facilities for some products, like telecine, may still be relatively scarce in Ireland as a whole but, while these are readily available elsewhere in the British Isles, Europe and the US, ongoing distribution changes towards digital delivery are reducing the importance of these older technologies.

### Finance

As has been said earlier, finance – for both the initial production process including tooling, training, recruitment etc., and commercial exploitation including manufacture, distribution, promotion and marketing etc., is in very short supply.

Companies in Ireland traditionally make do with relatively low levels of start-up capital, using their own personal money and informal investment from friends and family. Bank lending is seen as essential but difficult to obtain as the traditional institutions shy away from the high risks attached to the industry. The venture capital and business angels sectors, while much more established in

# 2.0 Markets cont.

the Republic of Ireland than in the North, are still relatively immature compared to other competing markets and are not, in general, being fully utilised.

*(Source: InterTrade Ireland)*

Ireland has enjoyed significant investment in the past from Europe, providing an ongoing commitment to a competitive tax regime to assist the promotion of enterprise and to drive business growth. But imminent changes in EU member state limits will place new restrictions on state aid from enterprise from 2006 onwards making such intervention more difficult and much less certain.

Clearly a new integrated system of access to both the public purse and, more importantly, private investment markets will be needed with which to prime the development of a sustainable, competitive economic environment.

## Distribution and Promotion

As above, the distribution of digital content continues to rest in the hands of a very select group of global giants, all of whom are essentially US owned and based. Whether it is in respect of the delivery of international content to the Irish market at the expense of indigenous product, or the promotion of Irish-originated content to the international markets, the amount of content available to the world's consumers far outweighs the current market capacity for consumption.

Common to most international, non-US, suppliers is the question of how to improve competitive potential. Should Ireland try to develop an alternative distribution and promotional infrastructure with which to try to win back an appropriate market share? Or should we just try harder to compete for the attentions of the current dominating distributors and publishers?

Difficult as the second option might be, the first option is more likely to prove prohibitively expensive, a touch naïve and, almost certainly, doomed to failure.

New tastes for digital delivery via broadband Internet, 3G telephony, DVD etc. might provide an interesting potential for market growth in this area however, although these technologies are still relatively immature and the accompanying business models uncertain.

## Intellectual Property Rights

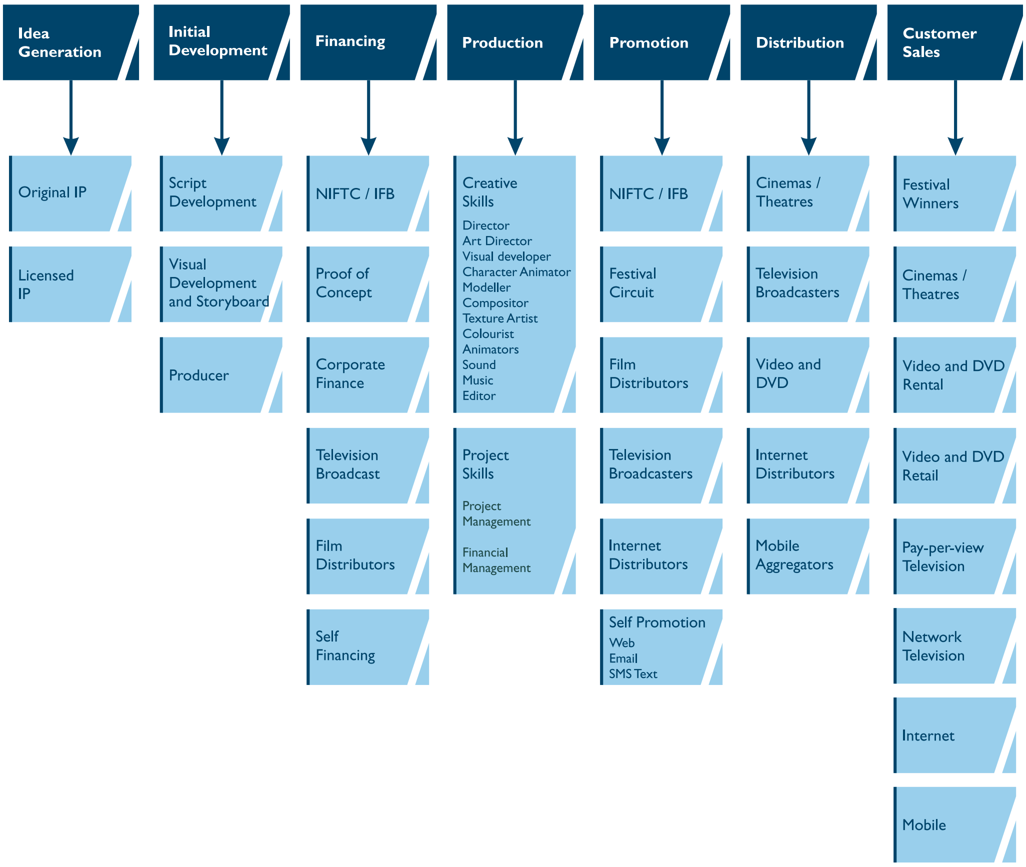
We have discussed earlier the importance of IP development as a sustainable source of income and wealth but almost all of the value of the Irish animation industry is currently created from contractual work-for-hire or from corporate communications services production that creates little or no residual value for either the producer or the economy as a whole.

In common with all sectors of the digital content industries in Ireland, there is currently not nearly enough development of original or owned IP within animation. Ireland is historically considered to be a land of poets and storytellers but we do not appear to be channelling enough of this natural national talent into the creation of sustainably exploitable content development.

While it very definitely more difficult to attract the levels of finance required to develop an entirely new story, treatment or product this is the one area that, if tackled, will provide potential for long-term market growth and economic wealth for the industry.

# 3.0 Key Market Dynamics

## 3.1 Animation Industry Value Chain




### 3.1.1 Idea Generation

The first element within the industry value chain is the origination and generation of the basic project idea. This will typically follow one of two routes, original IP and licensed IP.

#### Original Intellectual Property

Original IP is essentially the development of a brand new creative idea or storyline, including plot and characterisation which can be communicated via the medium of animation. Intellectual property allows people to own their creativity and innovation in the same way that they can own physical property.

Copyrighting the IP gives the content creators the rights enabling them to control the use and economic benefits of their material. It is therefore imperative that any production company wishing to develop into a stable, long-term business must be aware of the potential of developing their own IP rights and assets.

#### Licensed IP

In the absence of original IP there are no set rules as to where an ideal property can be found. The key is the ability to recognise a great idea, from books, comics, history etc. and know how to sell it to the appropriate buyer. With an established storyline and fully developed characters, a producer has almost all the main ingredients necessary to

# 3.0 Key Market Dynamics cont.

create the film, however, it is increasingly rare to find a famous title that has not already been optioned and it is imperative therefore to find good stories that are either newly published or that are already in the public domain.

## 3.1.2 Development and Pre-production

### Script Development

Prior to the commencement of any actual production, the original writer's basic storyline and characterisation should be developed into a coherent script. This will potentially involve the hiring of specialist scriptwriters to revise and enhance the story as well as redraft character dialogue where necessary.

### Visual Development

Visual development too will be required at this early stage to establish the key designs for the animation including styles, colours, backgrounds etc.

The storyboard is a series of simple sketches that help set the pictorial context and flow of the animation. Storyboard development takes the initial layout and translates it with an eye toward enhancing the dramatics of a scene to improve the entertainment and storytelling value.

### Producer

Producers 'manage' the entire production and bring together all the elements to make a project work, such as finance, cast and crew. Some producers are more creative and hands-on, developing the initial concepts and commissioning writers and directors. Others come from a more business-oriented background, such as finance or law. Many projects see two or more producers working together, who bring these different skills to the production. The producer needs to keep track of all finances involved during production and manage the overall project schedule through communications and administrative support.

The term executive producer is a very fluid one, sometimes being a simple credit for being one of the financiers or a 'respect' title for having done something substantial. However, in larger projects, executive producers are generally responsible for the overall project including long-range planning, marketing and budget concerns.

## 3.1.3 Financing Development

Project funding is the primary concern of all production houses. Often a balance has to be reached between immediate finance requirements and retention of rights that will ultimately yield a return over a longer period of time.

There are three main considerations for the animated film industry:

1. initial financing of the production and acquisition of rights;
2. marketing and distribution costs - those associated with the exploitation of the content; and
3. costs associated with an outright disposal.

### NIFTC and IFB

The Northern Ireland Film and Television Commission and the Irish Film Board (Bord Scannán na hÉireann) between them provide the main source of financing for film project development on the island of Ireland.

The Irish Film Board (Bord Scannán na hÉireann) provides loans and equity investment to independent Irish film-makers to assist in the development and production of Irish films. The board also acts in co-operation with other Irish semi-state agencies to improve the marketing, sales and distribution of Irish films and to promote training and development in all areas of filmmaking including animation.

The NIFTC is an integrated agency for the development of the film industry and film culture in Northern Ireland. It provides film and television producers from anywhere in the world with assistance and information they may need when producing in Northern Ireland. It offers loans and grants for a wide a range of areas including development, production and distribution.

### Proof of Concept

In Northern Ireland, Dream Ireland Ltd manages Dreamlab Invest, a proof of concept fund that provides early stage financial assistance for digital media producers to enable the development of their project ideas to a stage where they are suitable for submission to the NIFTC and IFB for development funding.

# 3.0 Key Market Dynamics cont.

This is currently the only activity of its type in Ireland although similar facilities exist in Great Britain.

### Corporate Financing

Corporate investment in film production is an increasingly common and necessary source of funds around the world. Sources of finance include the institutional banks and commercial venture capital companies as well as private business angels.

Investment in film is made attractive due to the continued commitment by both the Irish and British governments to provide industry-based tax relief schemes, namely Section 481 in Ireland (recently extended to 2008) and a new scheme, launched in July 2005, to replace Section 48 in the UK.

Although an established mechanism worldwide, corporate financing for film is still largely uncommon throughout Ireland due to the banks' perceived mistrust of the digital content industries generally and a relatively immature venture capital culture nationally.

### Television Broadcasters

Having an animated film or television programme commissioned by a broadcaster is seen by many as the most financially secure method of project realisation. Opportunities for locally-produced programming by the BBC, UTV, RTE and TG4, are scarce and resources for the screening and performance of Irish films (particularly short and experimental ones) do not yet match the levels of output.

Co-production for both film and television financing is widespread, and in fact is usually necessary for independent theatrical film financing. With television's more domestic focus, co-production can be a useful tool that gives producers the opportunity to tap international markets and capital.

### Film Distributors

Reliance on distributors for both production finance and access to broadcast networks has increased significantly in the recent past. Worldwide distributors typically provide a pre-production guarantee, which may cover around 25% of a budget and are remunerated by a commission on international sales of 30-35%. They themselves then collect minimum guarantees from local distributors in return for territorial rights.

An independent producer that makes one or two animated films a year will find it difficult to attract attention of the major distributors in a sector that remains highly polarised, with the top eight companies accounting for over 50% of all releases worldwide and 95% of box office gross.

*(Source: UKFC)*

### Self-financing

As access and availability of finance is a key issue for animation producers, and indeed all entrepreneurs on the island of Ireland, most producers expect to invest relatively small absolute amounts of their own personal capital into their new business and expect to fund the deficit between their own resources and a combination of banks and financial institutions, government sources, and informal investment from 'family, friends and fools'.

*(Source: The Global Enterprise Monitor, 2003)*

Self-financing is likely to be suitable only for low-budget animated shorts produced on desktop computer systems, although, again there is specific support for these activities readily available from both the NIFTC and the IFB.

## 3.1.4 Production

The animation production process can actually be categorised into two headings: creative skills and project skills.

### Creative Skills

These are the areas of activity concerned with actually creating the film or programme content and include:

- director – the director is the primary storyteller on a project; it is his or her vision that is the guiding force. The director is also responsible for supervising all the work that ends up in the picture.

# 3.0 Key Market Dynamics cont.

- art director – working closely with the producer and director, the art director is involved from the first stages of pre-production through to the end of production and is responsible for the visual look and creative style.
- visual developer – is responsible for the overall look and style of a project under the guidance of the director and art director
- character animator – creates, animates and is responsible for choreography, timing, and acting of characters, objects, or effects
- modeller – builds the 3D models and backgrounds for use by the animators and compositors
- compositor – layers and matches several images, backgrounds characters etc., in a frame to form a scene or scenes
- texture artist – designs and applies textures to models, props and backgrounds
- colourist – applies colour to character models and scenes
- animators
- sound
- music
- editing

### Project Skills

These activities are necessary to facilitate the creative skills, providing the required support and assistance as required:

- project management
- financial management

Although most consideration of the digital content industries tends to focus on the needs and capabilities of the creative personnel, project and financial management skills in particular are said to be in short supply within the sector.

## 3.1.5 Promotion

The role of promotion within the animation industry is to identify the targeted customer segments and communicate the availability of the film and programme content to those prospective customers for potential purchase. Film promotion is, like any other consumer-related marketing communications, enormously expensive and will include a range of media including:

- television
- radio
- print
- direct and interactive marketing
- promotional merchandising
- public relations
- personal selling

### NIFTC and IFB

The Northern Ireland Film and Television Commission and the Irish Film Board (Bord Scannán na hÉireann) again provide the main source of financing and promotional activity to improve the potential for marketing, sales and distribution of Irish films internationally.

### The Festival Circuit

One of the few promotional opportunities for new and inexperienced film makers is the international film festival circuit. By strategically positioning a film in the global marketplace, festivals can help to secure commercial interest in the project, gain critical recognition and provide future project opportunities for producers.

The main Irish film festivals include Dublin, Cork, Galway, Belfast and Derry and are now established and essential features of the domestic industry.

### Film Distributors

Distribution companies, as above, will obviously provide the lead role in the marketing and promotion of animated films that they have helped to produce financially.

# 3.0 Key Market Dynamics cont.

There may be opportunities to attract the interest and support of a major distributor for an independently produced film although this is, again, difficult for many smaller companies.

### Television Broadcasters

Again, having commissioned content from an animation production company, TV broadcasters will actively promote the film or programme, not only to their own domestic audience but also to broadcasting partners in other territories worldwide.

### Internet Distributors

In recent years the Internet has provided opportunities for short animations to reach potentially huge audiences. There are now a number of well-established entertainment sites (e.g. atomfilms.com, ifilm.com) that stream or provide downloads of short films and help promote the film and the producer to a much wider market.

### Self Promotion

While it is unlikely that the individual producer or small independent production company will be able to utilise traditional marketing channels, new interactive digital media solutions are appearing that give a low-cost opportunity for promotion. Viral e-mail or SMS text campaigns might be used to drive potential customers to the producer's own web site where short examples or whole films might be made available for download or streaming. This is made increasingly possible by mass market uptake of broadband DSL and cable Internet connectivity worldwide.

The web site can also be used to capture customer preference details allowing the promoter to instigate and develop mutually valuable relationships with the customer of a long period of time to turn loyal customers into marketing advocates and sources of new, referral business.

Mobile technologies too hold the promise of being able to add to the guerrilla marketer's tool box as 3G and other forthcoming technologies mature and become more commonplace.

## 3.1.6 Distribution

Distribution is concerned with the delivery of the animation content to the customer, how the customer wants to receive it, in the preferred medium, in the right time and at the right price. This is perhaps the most important element in the value chain after the original production process as, without distribution, the customer cannot have the opportunity to see the film and provide payment for the privilege.

### Cinemas and Theatres

Cinema audiences have been on the increase worldwide in recent years and theatre release is still the most crucial factor affecting overall profitability of all film projects with the cinema's exclusive 'window of exhibition'.

There are, however, few opportunities for theatre release for animated films that are not supported financially by the major distribution companies and virtually none for shorts, except for the small, niche exhibitors' clubs. In order to enhance audience understanding and enjoyment of non-blockbuster films and to develop audiences for indigenous and specialised animation long-term, greater support could be given to the distribution and promotion of these films to selected theatres.

### Television Broadcasters

Like cinema, television is one of a most popular and important media for showing animation content – accounting for 28% of all industry revenues *(Source: ABN Amro)* – but, unless the programme has been commissioned by, or developed with the assistance of the broadcast or one of its partners, it is unlikely to receive airtime.

Ireland already benefits from the proactive participation of RTE, TV3 and TG4 in the development of new, indigenous content but it is clear that more schedule time needs to be found for animated film – short or feature – to stimulate a sustainable sector.

# 3.0 Key Market Dynamics cont.

### Video and DVD

The thriving home video market is worth approximately three times the theatrical market and, thanks mainly to DVD - the fastest-growing consumer electronics product of all time - it continues to enjoy vigorous growth. Most films that perform well theatrically go on to do well on video too as the audiences are complementary. By the same token, animations that have not enjoyed a successful cinema release are less likely to be particularly profitable in these ancillary markets.

There are increasing opportunities for independent film distribution on the DVD format as evidenced by the recent successes of the 'Cinema16' collections of shorts as well as Brown Bag Films' Give Up Your Aul Sins animation.

### Internet Distributors

The online possibilities for film are rapidly developing, increasing hand in hand with the take-up of broadband Internet connections worldwide. Companies such as Atom Films (now part of the Macromedia Shockwave group) act as multi-platform distributors often acquiring animation content for free online delivery prior to release to television, DVD or both.

These new web sites vary in the types of contracts they offer; some online exhibitors will screen an animation free of charge, others will charge a fee (perhaps to cover encoding, formats conversion etc.) or even pay a small royalty fee to show the film. As the web continues to be virtually the only advertising medium growing in value in recent times, it is common that the viewer will be shown a commercial advertisement prior to the selected film.

### Mobile Aggregators

As a consequence of the development of broadband, 3G mobile telephony, mobile television is believed to be a potential future distribution platform for film and programme content worldwide. Mobile digital television allows users to make use of broadcast, broadband, wireless and local area networks, which must find new 3G-ready content revenue streams with which to earn a return on their earlier investments, allowing relatively cost-effective rollout and widespread adoption. There is therefore a major market opportunity for a relatively new category of player, the wireless content publisher or 'aggregator', vendors who will identify, obtain, reformat (if needed), and stream content to wireless users working closely with specific operators.

Due to cost and capacity issues, mobile operators are offering games, streaming music and short video clips initially. Animation and synthesized music will play a big role at first, as they do not require as much data as digitised music and video. But content aggregators can shape the market by choosing, or contracting for, the right content for mobile users as the customer base, and their preferred technology, develops.

## 3.1.7 Customer Sales

The ultimate expression of sustainable economic viability for an animation project is, of course, whether or not the market's customers will pay to watch the film in sufficient quantities so as to repay the costs of production and provide an element of profitability with which to fund future creative activity. Without this activity, animation simply remains an art form to be created at the artists' own expense, perhaps supported by the public sector.

There are a number of mechanisms that can provide potential revenue streams as follows.

### Festival Winners

Winning an award at a film festival not only raises greater interest in the animation and its producers in the eyes of potential distribution and development partners but additionally can provide a source of income from cash prizes.

The actual value of the prizes is unlikely to result in real earning potential but can help to offset the costs of production for some low-budget animated shorts from independent producers.

# 3.0 Key Market Dynamics cont.

### Cinemas and Theatres

As above, it is unlikely that the cinema-going audience will have an opportunity to pay to see an animation unless it is already heavily backed and supported by the major international distributors.

The initial release to theatres does however tend to account for 26% of all total revenues for the film industry and enjoys an exclusive release window of between two weeks and four months depending on the audience's appetite for the title.

*(Source: ABN Amro)*

### Video and DVD

Typically, following any theatrical distribution, a film will be released on video or, increasingly, DVD. Initially, home video rental has a protected window of approximately six weeks, after which personal sales are allowed. The video and DVD markets account for an average of 46% of total revenue earned.

*(Source: ABN Amro)*

However, shelf space for products in the high street retailers is extremely limited and preference will always be given to known, successful titles and other releases from major international distributors making it difficult, again, for independent producers to participate in the market. Establishing an online store to promote and enable individual purchasing of an animated film, prior to digital or postal distribution, is the only viable alternative for most small companies.

### Television

Unless specifically commissioned by a television broadcaster, in which case the film's first and perhaps only release is via TV, a film will be made available for transmission after around six months of video exclusivity, accounting for the remaining 28% of all revenues.

*(Source: ABN Amro)*

The television market has its own hierarchy:

1. pay per view (two – six weeks)
2. premium channels (18 months)
3. network TV (12 – 18 months)
4. syndicated TV

### Internet and Mobile

Although it is clear that broadband Internet access and 3G mobile telephony will provide additional opportunities for the customer to enjoy and pay for film content, these media are not yet fully mature enough to be able to demonstrate a sustainable business model.

Currently short film and animation content is available for streamed or downloaded viewing via a number of sites including atomfilms.com and ifilm.com (as above) but in most cases these are made available to the user for free. The only current revenue stream would appear to be that of short advertisements that are displayed in advance of the actual film although, again, it is not yet clear whether this is providing sufficient profitability for the site operators.

The actual commercial value of an online short film is currently questionable but other web companies (e.g. moviemail.com) are appearing, offering exclusive net-based sales and marketing of low-budget, short and arthouse films on DVD.

The potential opportunities for telephone bill-based micro payments do indicate a possible mechanism for customer purchasing at least, and the current market for music and ringtone downloads does indicate that the market is willing to access preferred content in this way. The bandwidth available to the mobile industries and the handset display capabilities will however need to increase significantly before animation content can be distributed to these new audiences with the same degree of convenience and quality.

Online and mobile gaming in particular is likely to experience significant market growth, and the requirement for animation content as an integral part of the games production process should provide an enormous opportunity for producers.

# 4.0 Market Analysis

The animation industry is widely held to be one of the most exciting growth markets around the world. The cost of production methods and tools are decreasing annually due to technological innovation and market competition between manufacturers. Animation-based products can be easily and inexpensively transported and distributed to potential markets around the world.

However, the domestic and international markets for animation content are already experiencing extreme competition from oversupply. Domestically, saturated markets, higher quality thresholds and the entrance of new suppliers are reducing the opportunities for our indigenous producers. Traditional markets are fragmenting into smaller, lower value niches that must react to the needs of changing trends, fashions, methods of distribution and business models.

Internationally, competition from larger, more powerful companies overseas, benefiting from economies of scale as well as the new, emerging low-cost suppliers are reducing opportunities for new product development and work-for-hire contracts alike. Ireland's labour costs are now significantly higher than those of eastern Europe, Asia and the Pacific Rim countries and, in the absence of cheap labour, there do not seem to be many specific value benefits with which to win new production business. Without the economic growth from increased market share and profitability it will be increasingly difficult to retain our best talent when faced with competition from those overseas employers.

Animation companies in Ireland do, however, demonstrate excellent production skills. Education and training is of an excellent standard and access to production tools and facilities is readily available. The industry mostly consists of relatively small, compact, specialised businesses and individuals, reactive to changing market conditions and hungry for success. Ireland still enjoys relatively low human resources costs compared to some countries, such as the US.

However, our production companies are often too small, young, inexperienced and financially naïve, with insufficient financial resources to be able to compete internationally. The distribution, publishing and promotional infrastructures for indigenous animated film and games content are undeveloped and ineffective and there is insufficient development of original IP from within the industry with which to demonstrate any unique and attractive creativity.

Ireland benefits from being a naturally English-speaking nation, the first language of the international film and games industries. We enjoy a particularly good standard of living and work-life balance, coming top in the Economist Intelligence Unit 'International Quality of Life' index, 2005. We enjoy an attractive and supportive tax regime (Section 481) and have an historically successful place within the EU allowing access to a range of economic development initiatives There are excellent communications and transport infrastructures with the rest of the world and a clear national and cultural identity that could be exploited into the development of a strong brand image for the industry.

Ireland's location, on the edge of Europe, is often removed somewhat from the cultural activities of the continent and the rest of the world and there can be a difficulty developing and maintaining service-based relationships with international customers. There may be a culture of historic over-reliance on state sponsored financial aid and private and commercial mechanisms for financial investment in the industry are immature, largely misunderstood and inactive.

Animation companies in Ireland do not, in general, have adequate business management, finance or sales and marketing skills, neither is there currently sufficient training and accreditation in business skills specifically relevant to the industry. There does not seem to be sufficient awareness of the value of market intelligence-backed strategic planning.

Other industry sectors and businesses in Ireland though have been extremely successful in over-coming these barriers in the past, both domestically and internationally, and there are ready supplies of experience and knowledge in these other sectors. There is ample availability of market intelligence information with which to inform development strategies and excellent administrative and strategic assistance countrywide that can be made available to the animation industry.

# 5.0 Opportunities for Growth

## 5.1 Target Markets

Clearly one of the most obvious methods of increasing commercial opportunity is to identify the range of skills, services or products currently in demand and to become valuable to those markets. It is almost impossible to do this successfully however unless the animation industry becomes sufficiently aware of the issues affecting the market. This is essential in order to inform a successful strategic plan.

Both internationally and domestically, supply exceeds demand – even in this high-growth sector. Sustainable advantages will need to be identified and implemented to provide any chance of profitable competition. The animation industry in Ireland is simply too expensive to win traditional work-for-hire contracts and there is insufficient development of new IP-based projects with which to replace the existing service-based activity.

Animation is a labour intensive industry and good people are always in demand. Skills, training and experience are valuable assets and any opportunity to improve either should be firmly grasped. We know that our human resources are generally competitive in terms of production skills and that our educational systems are extremely good but we know also that there is a lack of the accompanying business management disciplines needed to win and manage the business for our production specialists.

An urgent requirement therefore will have to be the recruitment and training of specialist business management, project management and sales professionals to undertake the necessary marketing research activity and the resultant strategic planning needed to identify future market opportunities and shape the production activities accordingly.

Without wishing to pre-empt the required marketing research, we can say with certainty that new target markets are likely to be found by identifying the various factors that differentiate parts of the overall market, examining the individual needs within those customer segments, creating a product to satisfy those needs and communicating the availability of the solution to our new found customers. These demographic differentiators are going to include:

- geography
- culture
- language
- age group
- gender
- wealth
- access to technology
- required purpose (e.g. entertainment, industrial, medical, scientific)

Understanding these market segments and uncovering the needs within will provide strong route maps to profitable market opportunities. Consideration of different countries' cultural and language requirements, for instance, may provide interesting niche opportunities for internationalisation and translation of existing content. Examination of differing technology standards may provide opportunities for repackaging and deployment for different platforms.

But perhaps one of the most interesting differentiators for the industry in Ireland to consider will be that of the required purpose for the content. While most of our indigenous production activity is centred on art and entertainment-based content, research is almost certain to identify needs in other areas including the medical, scientific and industrial industries for instance.

The skills and processes involved in creating animation content for storytelling and gaming are essentially the same as those required to provide solutions to visualising medical or engineering issues. Recent examples of this 'outside the box' thinking have included forensic animation within the legal profession. Relatively unknown in Ireland, there are in fact many applications for 3D animation in the courtroom, including accident reconstruction, patent disputes, timeline analysis, data visualisation and failure analysis.

At a time when traditional content production and business-to-business opportunities may be on

# 5.0 Opportunities for Growth cont.

the decline – through tightening budgets and in-house supply – an ever-increasing climate of litigation worldwide may result in a rich new source of corporate work for individual animators and small companies alike.

IThis process of marketing research and needs analysis is required to identify the new targeted market opportunities that, if implemented, will provide a realistically achievable source of new business opportunity in the face of overwhelming competition for traditional sources of work.

## 5.2 New Product Development

It is entirely likely that the result of a formal marketing research project will be that the current activities of the majority of the animation industry in Ireland do not quite match the needs of the market. The industry may not be able to take advantage of the various opportunities available. We might learn that the quality is OK but that the price is too high or that the price is OK but the product isn't.

Similar to film, the market for games development is increasingly competitive and production costs for console games, including the animation content, are prohibitively high for independent developers. Mobile gaming, while not yet having a proven sustainable business model, should provide a new and growing market opportunity for animation producers.

It is more likely however that opportunities will arise from the development of new solutions to address new, or previously uncatered for, market needs and in this case the industry in Ireland will have to become more adept in a formal research and development (R&D) culture, ideally in partnership with our established academic and industrial institutions. This culture already exists and is demonstrably successful but little collaboration with the indigenous creative industries has occurred to date.

The R&D process provides clear project methodologies and there are some readily available sources of financial assistance. It is surely one of the most important methods by which the animation industry can begin to create new products and services that offer potential for sustainable advantage.

In existing markets however, the animation industry in Ireland will have to devote more energy and attention to the development of original IP. As discussed previously, IP is the only realistic long-term asset that is available to a content producer and is an area that has been traditionally overlooked.

Financing the development of new IP is, of course, currently difficult but not impossible. Support from a large, but currently dormant, investment and venture capital sector is readily available but will require an element of education from both sides as to each other's needs. Investors will need to feel secure in their participation and the involvement of formal R&D, marketing planning analysis, realistic business projections and proven business acumen are all essential to this. However, all of these seem to be, currently, complete strangers to the animation industry!

New technologies too will obviously provide opportunities for new products and solutions. Developments in distribution and playback mechanisms (broadband Internet, 3G mobile telephony, high definition broadcasting and next-generation DVD etc.) will all require new or repackaged content development. The downside is, of course, that everybody already knows this and any opportunities arising from initial reaction to new technologies are likely be vigorously fought over and probably only valuable in the short term.

What will be more sustainable however will be solutions that deal with new social trends that develop in the wake of mass uptake of new technologies and it is here that the more valuable opportunities will become apparent. Examples of this in the recent past include the now ubiquitous use of SMS text by mobile phone, devised in 1992 and now - with over 200 billion messages exchanged each month – accountable for between 60 and 80% of all data communications worldwide.

*(Source: The Netsize Guide 2005)*

# 5.0 Opportunities for Growth cont.

More recent technological developments include Internet-based commerce (e.g. eBay), digital personal video recorders (e.g. Sky+) mobile multimedia content delivery (e.g. 3G and, especially NTT DoCoMo in Japan) and the latest handheld gaming consoles, especially Sony's PSP. All of these are changing or set to change not only the way customers access content but, more crucially, how they arrange their lives as a consequence of the new ways in which they can access content.

Many of these consequences occur naturally and are fully explored by the technology developers themselves but provide genuine opportunities for business development nonetheless.

## 5.3 Value

The simple fact is that wage levels and associated labour costs in Ireland are now too high to allow the industry to successfully compete for work-for-hire business from international markets.

Costs in eastern Europe, Asia, and the Pacific Rim are much less expensive and, increasingly, the industry has witnessed mass off-shoring of the production processes of the US and Europe to these other markets. Even if, as over time, wage levels in these new producer countries start to creep upwards there seems to be no end of younger, hungrier economies prepared to grab a slice of the action by reducing costs still further.

This current globalisation of world commerce seems unlikely to be voluntarily halted by the largest international corporations. They will continue to try to minimise the costs of production for as long as there are low-cost labour markets to exploit, in order to maximise the profitability of their sales – for as long as their customers are able to keep buying the product.

As long as this model continues to dominate it will be impossible for Ireland to compete on a basis of price and the domestic industry should look therefore at other potential sources of competitive advantage. The most likely method will be to identify areas of added value that, in addition to the raw animated product, become an attractive ancillary product feature with which to develop a sustainable competitive advantage.

Once again the best possible and most obvious way to achieve this might be to simply ask the customers what they want most and simply try to supply the solution at a price that's remains acceptable yet sustainably profitable, in other words adding unique value propositions to the overall offering to provide customer satisfaction. It may be possible however to look at a number of our earlier industry strengths list and, by identifying those that are unique to Ireland, highlight some areas that are more likely to succeed. These might include:

- Past business success in Ireland – it may sound too obvious but surely animation can learn from other industry sectors (software development, pharmaceuticals etc.) Why they have been able to remain competitive in the face of low-cost competition? Those lessons should be readily transferable.
- The small, compact, specialised nature of our indigenous animation companies, capable of being more reactive to changing market conditions, might be able to target short-term solutions research and development work where normal economies of scale do not apply.

Ireland's standard of living and work-life balance, as stated in the Economist Intelligence Unit 'International Quality of Life' index, 2005, is an enormous opportunity for the creative industries and for the country as a whole. The index compares Ireland's status as the best country in the world to live and work with that of our most important potential customer markets; the US (thirteenth place), Japan (seventeenth) and the UK (twenty-ninth). The most influential companies and structures are already established and their market domination is assured but there is an undoubted opportunity to attract at least some of the operational bases to Ireland with the attraction of a quality of life that money simply can't buy elsewhere.

Another of the reasons that the industry in Ireland has not been more successful is that our companies have not yet been able to create, develop and foster strong long-term relationships with the most influential customers. When seeking a value-added basis for sustainable

# 5.0 Opportunities for Growth cont.

competition, increasingly companies are accepting that relationships, trust, co-operation and loyalty are far more attractive and mutually valuable than simple price-based transactions.

We have earlier established that historically the animation industry in Ireland has not had the same opportunity to develop these relationships and that our geographical position has perhaps not helped. There is however a natural and traditional warmth towards Ireland internationally and more effort should be made to understand the essential importance of sustainable customer relationships and to try to develop these accordingly.

## 5.4 Distribution and New Business Models

As with the other digital content sectors (games, film, music etc.) there is a distinct lack of a successful publishing and distribution infrastructure for the animation industry in Ireland. This is now so obvious and is so often discussed that it is tempting to believe that a solution may be just around the corner but, at present, it is hard to see where the initiative will come from.

The issue is that, without publishing, distribution, promotion and so on, the content produced by the animation industry cannot be offered to customers for possible purchase. Without any possibility of purchase there can be no hope of profitability and without profitability there can be no sustainability.

### 5.4.1 Television and Cinema

There are very few opportunities for the theatrical release of non-feature length animations although it is possible for a very few to be screened along with the main release. To succeed, there is likely to be a pre-existing relationship with the feature's producers or distributors and the animated short will have a clear thematic connection with the feature it is theatrically attached to. There are a number of distributors in the UK that specialise in short animated films (e.g. Short Film Bureau) and at least two active film distribution companies in Ireland (Monster Distributes and Sullivan Entertainment) but it is not clear what level of availability is open to new indigenous animators.

Broadcasters looking to acquire short films will generally source them from distributors or at festivals. It is possible also to approach broadcasters and distributors directly but it must be remembered that the number of films competing for airtime far outweighs the actual opportunities. Ireland already benefits from the proactive participation of RTE, TV3 and TG4 in the development of new, indigenous content but it is clear that more schedule time needs to be found for animated film – short or feature – to stimulate a sustainable sector.

### 5.4.2 Festivals and Competitions

One of the few opportunities for new and inexperienced film makers is the international film festival circuit, and one of the key elements of success is increased awareness of these international marketing opportunities. Strategically positioning a film in the global marketplace can help to secure commercial interest in the project, gain critical recognition and provide future project opportunities.

Festivals can attract many visitors including international distributors, festival programmers and the media and can easily create a buzz around standout films. It might be advantageous to target specific festivals, those that are more likely to cater for the animation genre (e.g. Annecy), or are more likely to support independent works.

The shelf life of an individual film can be as long as 24 months and, although some festivals require submissions to be premieres, it is possible to submit the film to multiple festivals to try to capitalise on the marketing opportunities of the circuit.

While there is not yet a large commercial market for the short animated film, the festival circuit provides opportunities to influence buyers of content for television, in-flight entertainment, DVD distributors etc.

# 5.0 Opportunities for Growth cont.

## 5.4.3 DVD Shorts

In a time when the costs associated with feature production are almost certainly prohibitive to new film makers, short animated and live action films can be produced at the director's own expense or with the assistance of the Film Board and NIFTC. The proactive marketing of the compilation DVD medium should provide a unique opportunity for these films to reach the mass consumer markets and create a vehicle for financial sustainability for the first time.

Among the most intriguing and critically acclaimed DVDs of the last couple of years have been the two Cinema 16 releases. Collections of short films by established and emerging directors, the DVDs provide an opportunity to explore these little-known films in one handy home-entertainment package. In many ways the marriage of short films and the DVD is obvious but these releases are among the first to prove that the combination can be genuinely commercially successful.

Key to the success of a direct-to-DVD market will be the participation of distribution companies with specialist experience of the retail markets and a number of these (e.g. Tartan Films, Vital Distribution) are beginning to emerge. As yet however there seems to be little Irish participation in the market, save for a few sporadic releases by individuals connected with the Irish Film Board.

One such release was the Oscar-nominated Give Up Your Aul Sins produced by Brown Bag Films in Dublin. Having already received critical acclaim at festivals and significant interest from the film-based Internet sites (discussed below) the response to the obvious market potential was to release the piece as part of a collection of short films on DVD. This venture has demonstrated the commercial viability of DVD as a distribution medium for independent projects adding genuine financial value to the undoubted quality of the work.

## 5.4.4 The Internet

In recent years the Internet has provided opportunities for short animated films to reach potentially huge audiences. There are now a number of well-established entertainment sites (e.g. atomfilms.com, ifilm.com) that stream or provide downloads of short films.

When Atom Films first started, only very little of the huge range of short films was being seen by a limited audience, either at festivals or on late night television. The films were being made only as a kind of expensive business card for up and coming directors hoping to get into the feature film market. Atom, however, recognised that these animated shorts were great entertainment in their own right and has sought to bring these films to a truly worldwide audience and create a sustainable mass market.

These new web sites vary in the types of contracts they offer; some online exhibitors will screen a film free of charge, others will charge a fee (perhaps to cover encoding, formats conversion etc.) or even pay a small royalty fee to show the film. As the web continues to be virtually the only advertising medium growing in value in recent times, it is common that the viewer will be shown a commercial advertisement prior to the selected film. Whether there is sufficient profitability as yet from Internet-only distribution remains to be seen, with the prevailing appetite for free content still very much in evidence.

## 5.5.5 Mobile Delivery and Micro Payments

One of the factors that might help to define the commercial future of online distribution may come, ironically, from the development of the mobile telephony markets and, in particular, how the link between delivery of content to the handset and payment via the telephone billing process matures.

Certainly, as the market for ringtones, music, video clips and games starts to take off, customers are becoming used to seeing relatively small payments for the content delivery appearing on their phone bills in addition to the normal line rental and call charges. These micro payments, while in themselves tiny compared to the costs of buying traditional media forms are more available to more of the international market. They provide an opportunity to derive profitability through sheer volume - the amounts charged appearing to be relatively insignificant to consumers' normal budgeting decisions.

# 5.0 Opportunities for Growth cont.

This process of telephone-based payment is proving to be so attractive to the markets that examples of ticket sales, grocery shopping and other functional applications are starting to appear in addition to the simple payment for delivery of media content. Although still very much in its infancy, the system is widely expected to become ubiquitous in the near future and will, no doubt, attract the interest of the established financial institutions as well as the traditional mobile network operators.

Mobile and Internet delivery of content does seem to provide an alternative, relatively low-cost, channel for distribution and financial reward for digital animation content in the future although, as always, the competition for the customers' attentions will develop and become more intense accordingly. Currently, the existing brand leaders (Nokia etc.) are able to largely dictate which products are best promoted, while companies such as Virgin and Sony, which have interests in both the telephony and content development industries, would seem to be ideally placed to exploit the opportunities.

Independent competition for the customer will prove to be as difficult and as expensive as ever and will rely, as it always has, on the integrated application of traditional advertising media (television, press etc.) to drive customers towards the otherwise easily and inexpensively distributable content. It's easy to build it but, if they don't know about it, they still won't come!

## 5.5.6 Animation Industry Cluster

In examining the current strengths, weaknesses, threats and opportunities facing the Irish animation industry – and accepting that the actual product quality is at least good enough for international success – many of the issues relate to the small-scale nature of the sector, its present lack of influential relationships with the major international markets and current financial powerlessness to bring about the desired changes. The obvious solution to this state of affairs might be to develop a greater sense of partnership within the industry and an appreciation that collaboration within an animation sector cluster could enable the attainment of the common goals.

Clusters can be defined as concentrations of competing, collaborating and interdependent companies and institutions which are connected by a system of market and non-market links. Clustering can bring a wide range of benefits to both business and the wider economy including the following:

- Companies can increase the expertise available to them if they locate amongst a cluster of other firms.
- They can also draw upon others with complementary skills to bid for large pieces of work which each of the individual firms would have been unable to complete.
- Advantage can be taken of economies of scale by further specialising production within each firm, by joint purchasing of common raw materials to attract bulk discounts or by joint marketing.
- Social and other informal links are important and can lead to the creation of new ideas and new businesses.
- Reputations spread quickly within the cluster, enabling finance providers to judge who the good entrepreneurs are and business people to find who provides good support services.
- The cluster enables an infrastructure of professional, legal, financial and other specialist services to develop.

*(Source: UK DTI)*

Current research suggests that clusters of firms and skilled workers may be one of the key drivers of economic growth in localities, cities and regions, increasing knowledge and spreading best practice, thus improving competitiveness and creating growth. Firms are finding that they can better utilise their knowledge capital, and increase the expertise available to them, if they locate amongst a cluster of other firms.

Firms in clusters can gain advantages from increased economies of scale – for example drawing upon companies with complementary skills to bid for large pieces of work which each of the individual firms would have been unable to complete. Collaboration also allows advantages by

# 5.0 Opportunities for Growth cont.

further specialising production within each firm, by cost reduction from more efficient resource development (e.g. skills training etc), and – especially important to the digital creative industries in Ireland – a more powerful and effective joint marketing process.

Clusters facilitate other forms of collaboration or networking between firms. In part, this is because co-location and repeated contact helps build up a relationship of trust. Many of these networking arrangements are ways of spreading best practice and the results of research and development. It is a key requirement for facilitating the growth of a cluster that firms are encouraged to take advantage of collaboration and to demonstrate that by working together their performance and financial sustainability will improve.

## 5.5 Opportunities at a Glance

### 5.5.1 Idea Generation

The development of new, unique, valuable intellectual property is critical to the future of the industry. A formal R&D process is essential to the development of new, market-ready ideas.

Recent changes to the broadcasting charter in the UK mean that independent production companies are now able to retain an increased proportion of rights and royalties in respect if their own IP, creating added value and profitability.

5.5.2 Project Development Skills

The development of scripts and visual treatments from initial IP is essential. Specific 'producer' skills are in short supply within both film and television markets.

### 5.5.3 Finance Management Skills

Film producers and television broadcasters are reporting a scarcity of industry-specific financial management and accounting personnel, particularly in respect of complex production arrangements.

### 5.5.4 Production Skills

Production opportunities exist within creative, technical and craft disciplines and the supporting business occupations.

The technology revolution is impacting on all areas of digital production and distribution and particular opportunities exist in:

- high definition filming and editing;
- CGI animation and special effects;
- interactive television (iTV) content development;
- content repackaging for interactive DVD (including HD); and
- content development and repackaging for mobile (3G+) distribution

Business skills in demand include:

- project management
- production management
- health and safety management
- sales and marketing

### 5.5.5 Distribution Technologies

New digital distribution technologies are creating demand for skilled engineering personnel in the following areas:

- satellite broadcasting
- digital terrestrial broadcasting
- IPTV
- 3G+ mobile telephony

### 5.5.6 Television Broadcast

Television, unlike film perhaps, is currently anticipating a period of future growth, largely due to the effects of the public service broadcast charter applicable to Northern Ireland and the rest of the UK.

It is anticipated that content production requirements in Northern Ireland, Scotland and Wales will need to increase by between 100 and

# 5.0 Opportunities for Growth cont.

200% to accommodate new regional targets and, although this may be somewhat offset by relocation of skilled personnel from London and the south east of England, there will undoubtedly be opportunities throughout Ireland.

### 5.5.7 Irish Language Content

There are increasing opportunities for the development of new Irish language content for both film and television distribution, evidenced by the specific development schemes operated by the NIFTC and IFB, the increasing popularity of TG4 and BBC NI's Irish Language Broadcast Fund.

### 5.5.8 New Markets

Developing markets based on opportunities from new technologies are appearing and maturing. As bandwidth and consumer uptake increases, the Internet and mobile telephony markets will become important customers for new content production although, as yet, there are few examples of successful business models.

Particular opportunities appear to be developing around the use of Macromedia's FlashLite product, a cut down version of the vector-based low bandwidth animation software that is beginning to be shipped on the latest generation mobile phones.

Currently, the most realistic distribution opportunity would appear to be the DVD sell-through market with growing evidence of consumer interest, critical acclaim and financial sustainability. The requirement for promotion and distribution however remain significant factors.

Additionally, there may be opportunities in relatively untested, non-entertainment markets, such as healthcare and the legal profession, where visualisation through animated content is useful in the absence of actual video footage being available or possible.

### 5.5.9 Production Finance

While there are still only limited commercial financing opportunities in Ireland there are significant funds available from both the NIFTC and IFB for projects matching the published criteria.

# 6.0 Conclusion

This report has discussed the issues currently affecting the animation content production industry in Ireland. It has examined the issues affecting the potential for long-term economic sustainability and offered suggestions for the development of sustainable advantage in an increasingly competitive global market.

Regardless of the artistic ambitions that may have led to individual market entry and the quality of the work currently available, the single greatest truth is that it is simply too expensive to create economically viable animation in Ireland for traditional markets in the face of unrelenting competition from low-cost, high quality labour markets overseas.

Traditional distribution outlets are fragmenting, consumer preferences for and willingness to pay for content are changing and Ireland does not have the capability to challenge head-on the domination of the corporate giants that essentially control the market opportunities.

Individually, companies do not have the financial resources to be able to seek out collaborative relationships with the main customer groups to develop preferred supplier status or long-term loyalty that might ignite confidence and provide stability.

And, although the most reliable way to break away from work-for-hire service provision towards actual long-term wealth creation – and despite a national history of unique creative flair – there is insufficient development and exploitation of original intellectual property. Even if there were a desire to attempt to produce original content however, the existing financial structures that might provide the necessary investment in new product development are not sufficiently developed or utilised by the industry.

Finally, our ability to compete for new business opportunities or market share is severely restricted by the lack of a specialised and focussed distribution, publishing and sales mechanism and a lack of suitably qualified personnel within the industry itself.

However, what we have also seen is that by engaging in a formal marketing research exercise we can identify genuine new market need; by mobilising the existing R&D culture we can begin to develop new products and services to provide solutions to the opportunities arising from new customers, technologies, social preferences etc.; and that in collaborating and operating more collectively, the animation industry in Ireland can combine to achieve the strength and scale to be an attractive long-term partner and supplier to the global media markets.

# 7.0 Appendix

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