

Closure of the market analysis on the film distribution industry

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Executive summary

The Hungarian Competition Authority (Gazdasági Versenyhivatal – GVH) initiated a market analysis to examine the operation of the markets of film distribution and exhibition on 31 July 2014. In the course of the market analysis, the GVH examined the vertically integrated markets of film production and distribution; the structure and the characteristics of the operation of the film exhibition market, in particular, the system of distribution agreements between film distributors and cinema operators and the practice of applying Virtual Print Fees (VPF).

The launch of the market analysis was timely because the markets of film distribution and exhibition have significantly changed in the last 5 years. The merger in 2011 between Cinema City International N.V. (CCI) and Palace Cinemas significantly changed the film exhibition market; as a consequence, CCI became the only undertaking in Hungary operating huge, multiplex cinemas. The authorisation of the GVH was not needed for the merger as it did not meet the notification threshold. As expected, the market analysis revealed a concentrated structure on the film exhibition market: Cinema City has a market share that is significantly over 50%, and according to some opinions, over 80%. Apart from the so-called ‘art’ theatres, cinemas that are part of the Cinema City network rarely have competitors. This is due to the fact that in the early period of digitalisation, several cinemas went out of business because they could not finance their operation costs and the costs of transition to digital equipment. However, in the late period of digitalisation, this trend reversed and digitalisation in art theatres and the opening of regional one-hall cinemas were supported by state aid.

From the middle 2000s, significant technical changes took place in relation to film distribution, resulting in films being distributed in reusable digital form. While the Hungarian film distribution market is competitive, the distributors (InterCom, Fórum Hungary, UIP Duna) which have contracts with one of the leading American film studios cover a significant part of the market. InterCom’s position is specifically strong according to the number of broadcasted films, however – partly due to its vertical integration – UIP Duna, which has great traditions similar to InterCom, and Fórum Hungary are significant market players.

In the international practice, VPF was introduced in order to share the cinema operators’ costs of transition to digital technology between film studios, distributors and cinema operators. The film distributor (or the film studio directly) pays this fee to cinema operators who apply digital technology. The introduction of VPF played an

indispensable role in the transition. As a result of digitalisation, the investment and operation costs of cinema operators have increased, while film distributors have saved money. In this situation, it may seem reasonable to reset the rate of sharing costs and income between the participants of the vertical relationship, as film distributors and film studios take part in the digitalisation by incorporating VPF into the production costs.

Apart from Cinema City, there was no other market participant that could either conclude an agreement with a leading American film studio or finance the transition to digital broadcasting with the help of the integrator system appearing in the European market. Having small market shares, most of these cinema operators could not convince film distributors to provide financial support. As a consequence, the competitive disadvantage of small theatres has further increased in comparison to the market situation of Cinema City because in their case the film distributors save the amount of VPF. It should be highlighted that the behaviour of the film distributors does not create competition concerns in the absence of signs indicative of a restriction of competition.

The agreements made between Cinema City and the major US film studios may have an indirect effect on the competition between film distributors, as the top US film studios reimburse the VPF costs of their exclusive Hungarian distributors. As a result of this the VPF charges do not show up as actual costs. This must be compared to the situation of independent film distributors, which must bear these extra costs themselves.

The shift to digital projection – at different rates depending on the costs incurred – is in the interest of all film distributors. Consequently, it is not unreasonable for cinema operators to expect film distributors – up to the recovery of the switching costs – to contribute to the costs of the digital switchover by paying VPF fees.

The financing system of the transition can be considered a proportionate system if it ensures the recovery of the arising – primarily investment-type – costs, without exceeding either the required time or the amount of the costs. The information obtained during the market analysis is not sufficient to assess whether the current funding system is proportionate.

The manner in which broadcast settings are scheduled can indirectly contribute to increasing the importance of the leading US film studios on the market. The result of which primarily threatens the cultural diversity of the film supply. However, based on the information currently available, this is not considered to be a competition problem. With the aim to counterbalance the high audience rates achieved by American films, a possible solution could take the form of a bigger subsidy from the Hungarian National Film Fund for the film distribution market.

Based on the above-mentioned, the GVH established that the conduct of Cinema City may have an indirect effect on the participants of the film distribution market and may cause market failure; however, it also established that the problems arising from this failure would not be able to be remedied in full or in part by competition supervision proceedings. Consequently, the GVH had to find an alternative solution to this competition problem.

The GVH suggests that the VPF fees charged by the cinema operators should aim to recover the investment costs. On the other hand, the GVH recommends that the National Assembly increases the competences of the motion picture authority and strengthens its supervisory functions.

Lastly, the GVH suggests that merger control should also be a possibility in those cases in which the undertakings do not meet the notification threshold under the current rules, but which involve a merger that may nevertheless significantly affect the structure of the market.

The full report on the market analysis and further information are available on the [website of the GVH](#).