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Packaging Deals in the Entertainment Industry: A Bargaining Approach

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Abstract: Creation of a television or movie project requires the bundling of inputs—writers, actors, directors—into a coherent package that can be produced and distributed. Traditionally this bundling was done by studios, which then negotiated compensation deals with input suppliers via their agents. In recent decades, however, large talent agencies have increasingly engaged in the practice of "packaging," which involves creating vehicles for their clients and selling the completed projects to studios. The union for screenwriters has recently challenged this practice as constituting an unfair business practice, arguing that it creates a conflict of interest on the part of agencies. This paper evaluates this argument using tools and insights from the literature on transaction-specific investments and the holdup problem.

Key words: Entertainment industry, packaging deals, transaction-specific investment, holdup problem
JEL codes: L14, L23, L82

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A Bargaining Approach

1 Introduction

The production of a television show or feature film requires the assembly of numerous creative inputs into a coherent package. This process has traditionally been performed by production studios, which then negotiate compensation deals with the individual input suppliers through their agents. The agents are paid in turn by a commission equal to a percentage of the client's gross salary, usually set at ten percent. A relatively recent trend in the industry, however, involves the development of "packaging deals," whereby "an agency creates the framework for a new television series or movie by bundling various clients—writers, directors, actors and others—and sells it to a studio that then funds the production and distributes it" (Watson and Flint, 2019, p. B3). In return, the agency receives a "packaging fee" as compensation for its role in putting the project together. Packaging has been around since at least the 1970's, but it has lately become the industry norm. Indeed, it is estimated that in the 2016-2017 television season, nearly 90% of scripted television series were created in this way (Watson and Flint, 2019).

Input suppliers (especially screenwriters) have expressed concerns about this practice for at least two reasons. The first is a claim that by pre-packaging the inputs from among its existing pool of clients, an agency excludes from consideration clients of other agencies. The second is that agents owe a fiduciary duty to their clients, but in undertaking the packaging function, the agency effectively becomes a partner with the production company, thereby creating a conflict of interest (Watson and Flint, 2019). On the basis of these allegations, the Writers Guild of America (WGA), the union representing screenwriters, filed suit in 2019 against the four largest

talent agencies (Robb, 2019). The agencies countered that packaging deals actually benefit their clients by increasing job opportunities. This is true because "packages are presented to studios as fully developed ideas, increasing the chances they will be made" (Watson and Flint, 2019, p. B3).

This paper seeks to evaluate the merits of these arguments by developing a simple economic model of the creation of a television or movie project, beginning with the bundling of the necessary creative inputs, and culminating with the bargaining process by which the returns from a successful project are divided among the various participants. The analysis specifically compares two organizational structures within which this process has historically unfolded. Under the *traditional structure*, the studio makes the initial investment, and then solicits the necessary inputs (actors, writers, etc.), who then negotiate with the studio, via their agents, for compensation. Under the *packaging structure*, by contrast, an agency takes the lead in bundling the inputs, and then bargains with the studio over the sale of the completed package. In comparing these two structures, we are interested in both the efficiency of the production decision—specifically, what projects are undertaken—and the division of the resulting surplus, as both issues bear on the ongoing dispute between writers and agencies.

The results of the analysis provide some support for both sides of the argument. In particular, it will show that traditional agency may be better at aligning the interests of agents and their clients, whereas packaging deals will generally result in more projects going forward and hence more employment opportunities for input suppliers. Thus, the overall impact of packaging deals on client income is ambiguous. In terms of efficiency, however, packaging deals appear to be the superior organizational structure.

From an economic perspective, the analysis here is related to the large literature on transaction-specific investments and the holdup problem.[1] The prototypical holdup problem arises when two parties, a buyer and a seller, contemplate entering into a transaction that requires one (or both) of them to make a non-salvageable investment prior to contracting that will enhance the value of the exchange. However, because subsequent bargaining over the price of the exchange cannot generally be made contingent on those investments, the parties will underinvest for fear of not being able to capture the full returns. Various solutions to this inefficiency have been studied in the literature, including long-term contracts and vertical integration. The analysis in this paper studies how the two organizational structures just described address this problem in the entertainment industry.

The remainder of the paper is organized as follows. Section 2 lays out the basic model and derives some preliminary conclusions in a simplified setting where the interests of agents and their clients are assumed to be fully aligned. Section 3 then extends the model to incorporate possible conflicts of interest between the two parties. Finally, Section 4 summarizes the conclusions.

2 Set-up of the Model and Preliminary Results

Consider a prospective television or movie project that is expected to generate gross revenue of R, but which first requires the creative "assembly" of various inputs, including actors, writers, directors, etc., in a way that produces a coherent and viable package. One might think of this initial investment as defining the "concept" or the "treatment" of the contemplated project. We assume that this initial investment is specific to the project at hand and so is not recoverable

[1] The classic citations are Goldberg (1976, 1985), Williamson (1975, 1985), Klein Crawford, and Alchian (1978), and Hart and Moore (1988). Also see Bolton and Dewatripont (2005, pp. 560-578) and Miceli and Segerson (2012).

if the project fails to go forward. The total cost of the project to the investor equals the cost of this up-front investment plus the negotiated compensation of the inputs.

As noted, the key differences between the two organizational structures that we will compare is the identity of the initial investor. Under what we are calling the traditional structure, it is the studio (the buyer of the project), whereas under the packaging deal, it is the agency representing the input suppliers (the seller of the project). Another key difference is that under the traditional structure, input suppliers negotiate individually (via their agents) with the purchasing studio, whereas under the packaging deal the assembling agency negotiates one-on-one with the studio for sale of the package as a whole. In the latter case, the compensation of individual inputs is determined according to some prior arrangement between the agency and suppliers, the cost of which is reflected in the package that is presented to the studio. In comparing these different arrangements, we will be interested in two issues: first, how the surplus from those projects that go forward is divided among the various parties; and second, the selection of which projects will actually go forward. The former consideration is purely distributional, while the latter is allocative.

We will assume throughout our analysis that representation of input suppliers by talent agents is inherent to this market. This is justified by the assumption that most suppliers are not well-versed in the business aspects of the production process and so need representation. This situation, however, creates the possibility of a conflict of interests between agents and their clients. Indeed, as we previously noted, this is one area of contention on the part of the WGA in its legal challenge of packaging deals. Initially, however, we will ignore this issue in order to focus attention on how bargaining and the holdup problem affect the choice between the two structures. Later, we will ask how the possibility of conflicts of interest affect our conclusions.

2.1 The Traditional Structure

Under the traditional structure, the studio acts first and makes a non-salvageable investment at a cost x, which determines the gross value of the prospective project, R. It then negotiates pairwise with the various suppliers of the necessary inputs (via their agents)[2] over the amount of their compensation. The outcome of the negotiation determines the division of the surplus from the project. Let w_i be the payment to input i, and let the opportunity cost of each input be c, which represents their next best option. Thus, the net return for input supplier i is $w_i - c$.[3] Some of this must be shared with i's agent, but in the current scenario the exact split won't matter because we are assuming that in bargaining with the studio, the agent's interest is perfectly aligned with that of his or her client.

For simplicity, we consider only two inputs. Thus, the profit for the studio is given by

$$\pi = R - w_1 - w_2 - x \tag{1}$$

Aggregating the returns of the three parties (the studio and the two input suppliers plus their agents) yields the joint return, $R - 2c - x$. It is therefore efficient for the studio to make the initial investment if

$$R - 2c > x \tag{2}$$

Note that a necessary condition for this to hold is that $R-2c>0$, which we will call the variable surplus. The actual choice of the studio is determined by (1) and so will depend on the w_i's.

We examine the decisions of the parties in reverse sequence of time. Thus, following the studio's initial investment of x, if it is determined that $R-2c>0$, the studio and the input suppliers

[2]It doesn't matter under this scenario whether the inputs are represented by the same or different agents.
[3] We assume equal opportunity costs for simplicity. This will, of course, which result in equal returns to each input in equilibrium.

will bargain pairwise over the division of this surplus. (The cost x does not affect this bargaining because it is sunk.) Assuming ordinary Nash bargaining, we obtain w_1 as the solution to

$$\max_{w_1} (R - w_1 - w_2)(w_1 - c) \tag{3}$$

taking w_2 as given. This yields

$$w_1 = \frac{R + c - w_2}{2} \tag{4}$$

Solving this equation simultaneously with the corresponding equation for w_2, we obtain the common wage

$$w^T = \frac{R + c}{3} \tag{5}$$

The net return for each input is therefore

$$w^T - c = \frac{R - 2c}{3} \tag{6}$$

while their joint return is twice this amount:

$$\frac{2(R - 2c)}{3} \tag{7}$$

Finally, substituting (5) into (1) gives the studio's profit:

$$\pi = \frac{R-2c}{3} - x \tag{8}$$

Using (8), we can move back to the studio's decision to spent x. Since it can anticipate how the subsequent bargaining will unfold, it will invest x if and only if (8) is positive, or if and only if

$$R - 2c > 3x \tag{9}$$

Comparing this to (2) shows that the studio will underinvest relative to the social optimum, meaning that some efficient projects are forgone. This inefficiency is a consequence of the

holdup problem, which arises here because the studio does not expect to capture the full return from its initial investment as a consequence of subsequent bargaining with the input suppliers.

The inefficiency is illustrated in Figure 1, where the downward-sloping curve reflects all possible projects, arranged in decreasing order of their gross value, R. The horizontal line at $2c+x$ is the social cost of a project, reflecting the true opportunity cost of the various inputs, while the line at $2c+3x$ is the actual cost to the studio according to (9). The number of projects undertaken, n_T, is therefore less than the efficient number, n^*.

[Figure 1 here]

2.2 The Packaging Deal

Now consider how the situation would unfold under a packaging deal. The key difference, recall, is that a single agency representing both (all) of the inputs takes on the role of making the initial investment of x, and then bargains with the studio for sale of the packaged product for a single fee, denoted F. As above, we will assume that the incentives of the agency, once it has spent x, are perfectly aligned with those of the input suppliers in bargaining with the studio.

Consider first the bargaining between the agency and the studio. With x sunk, a successful bargain yields a return of $R-F$ for the studio and $F-2c$ for the agency-cum-input suppliers. Thus, under ordinary Nash bargaining, we have

$$\max_F \ (R-F)(F-2c) \tag{10}$$

which yields the solution

$$F = \frac{R}{2} + c \tag{11}$$

The resulting return for the studio is

$$\frac{R-2c}{2} \tag{12}$$

while the joint return for the agency and its clients, net of the initial investment, is

$$\frac{R-2c}{2} - x \tag{13}$$

Moving back to the investment stage, we find that the agency will invest x if and only if (13) is positive, or if and only if

$$R - 2c > 2x \tag{14}$$

Comparing this to (2) shows that the agency also underinvests relative to the social optimum, but by less than the studio did under the traditional structure. This is shown in Figure 1 by the fact that $n^* > n_P > n_T$. It follows that the holdup problem is less severe here. This is true because the agency expects to capture a greater share of the variable surplus from bargaining (one half), as compared to what the studio expected to capture under the traditional structure (one third). This difference arises from the consolidation of the inputs by the agency prior to bargaining with the studio under the current structure.

2.3 Comparing the Two Arrangements

We now compare the outcomes under the two structures. We first consider the impact on the return to input suppliers (combined with that of their agents), holding the number of projects fixed. The relevant comparison is between (7) and (13). It immediately follows that input suppliers as a group are better off under the traditional structure as compared to the packaging deal. This is true for two reasons. First, as we have already noted, because suppliers bargain individually with the studio under the traditional structure, they are collectively able to capture two-thirds of the variable surplus, leaving only one-third for the studio. Under the packaging deal, by contrast, the agency brings the already-completed package to the studio, and so it is only able to obtain one-half of the surplus on behalf of the inputs, while the studio keeps half. Thus,

the packaging deal, by consolidating the inputs prior to bargaining, entails a bargaining *dis*advantage for the input suppliers as a group vis-à-vis the studio.

This disadvantage is reinforced by the fact that, under the packaging deal, the agency-cum-input suppliers must bear the up-front assembly cost, x, whereas that cost is borne by the studio under the traditional arrangement. In combination, these results provide support for the claim of input suppliers that packaging deals place them at a disadvantage compared to the traditional structure.

The preceding conclusions, however, were based on a constant number of projects, but we have seen that the number of successful projects will generally differ under the two structures. Specifically, more projects will be completed under the packaging deal because the holdup problem facing the agency is less severe than that facing the studio under the traditional arrangement. This was true precisely because the studio captured less of the surplus from bargaining individually with input suppliers under the traditional structure, whereas the agency was able to capture a larger share (one-half) under the packaging deal. Thus, although clients earn less per project under the latter arrangement, it will result in more projects being initiated. The impact on their overall income is therefore ambiguous. Note that this trade-off exactly mirrors the two sides of the debate between writers and agencies regarding the impact of packaging deals.

3 Accounting for Conflicts Between Agents and Their Clients

The preceding analysis may not have done full justice to WGA's argument against packaging deals, however, because it assumed away possible conflicts of interest between input

suppliers and their agents. This section addresses that shortcoming by explicitly accounting for the differing interests of the two parties.

3.1 Traditional Structure

Consider first the traditional structure, under which input suppliers are each represented by agents according to a pre-arranged contract. We will specifically assume that agents are compensated by a commission that is computed as a fixed percentage of their clients' net return from any successful projects. In particular, let the return for client i's agent be equal to $\theta(w_i - c)$, with the client retaining $(1-\theta)(w_i - c)$, where θ is the commission rate which in the entertainment industry is typically set at ten percent.

In the bargaining between agents and the studio over their clients' fees, depicted above by the problem in (3), $\theta(w_i - c)$ will therefore replace $w_i - c$. The result, however, turns out to be exactly the same, resulting in gross compensation for clients as shown in (5). Thus, when agents are compensated by a percentage commission, they act as if they were maximizing the client's gross income. Note that this conclusion supports the contention of the WGA that traditional agency aligns the interests of agents and clients.

After compensating their agents, the net return to clients (as a group) is equal to

$$(1-\theta)\frac{2(R-2c)}{3} \tag{15}$$

while agents collectively receive

$$\theta\frac{2(R-2c)}{3} \tag{16}$$

Expressions (15) and (16) therefore necessarily sum to (7), while the return to the studio remains equal to (8). Thus, its decision about what projects to pursue is unaffected by the relationship between clients and their agents, and continues to be determined by (9).

3.2 Packaging Deal

Now consider the packaging deal. A complicating factor here is that we need to consider the timing of the agency's expenditure of x. Specifically, does it occur before the agency negotiates contracts with input suppliers over the latter's compensation, or does it occur after this negotiation? This amounts to asking whether the input suppliers are recruited and signed on for specific projects that the agency has already initiated, or whether the agency brings clients under contract before initiating any projects for them. Note that this timing issue didn't arise in the previous version of the model because agents and clients were assumed to act in a unified manner.

Consider first the case where the agency spends x before recruiting the inputs. Thus, x is sunk when the agency negotiates with prospective clients. The specific sequence of decisions is as follows: (1) the agency spends x to initiate a project and assemble the necessary inputs; (2) the agency and those input suppliers then enter into contracts that determine the latter's compensation; and (3) the agency and the studio negotiate over the payment for the packaged deal.

As usual, we proceed in reverse sequence of time. Thus, in the final stage the agency and the studio negotiate over the fee for the entire package, F, taking the input costs, w_1 and w_2, and the investment, x, as given. Thus, F solves

$$\max_F \ (R - F)(F - w_1 - w_2) \tag{17}$$

This yields

$$F = \frac{R + w_1 + w_2}{2} \tag{18}$$

Using (18), we obtain the following expression for the agency's return:

$$F - w_1 - w_2 = \frac{R - w_1 - w_2}{2} \tag{19}$$

Now consider negotiation between the agency and the input suppliers to determine the w_i's. Assuming pairwise Nash bargaining, we find w_1 as the solution to

$$\max_{w_1} \left(\frac{R - w_1 - w_2}{2} \right) (w_1 - c) \tag{20}$$

taking w_2 as given. Note that x does not enter this problem because it is sunk. A corresponding problem determines w_2 as a function of w_1. Solving the resulting first-order conditions simultaneously yields the common wage

$$w = \frac{R + c}{3} \tag{21}$$

Using (19) and (21) we can compute the returns to the various parties. First, the studio receives a return of

$$R - F = \frac{R - 2c}{6} \tag{22}$$

Next, the input suppliers as a group receive

$$2(w - c) = \frac{2(R - 2c)}{3} \tag{23}$$

And finally, the agency receives

$$F - 2w - x = \frac{R - 2c}{6} - x \tag{24}$$

Summing these gives the overall net return of $R - 2c - x$.

Moving back to the initial stage, we determine that the agency will invest x if and only if (24) is positive, or if and only if

$$R - 2c > 6x \tag{25}$$

The agency therefore invests in fewer projects here as compared to the above packaging scenario, and also less than under the traditional structure. The reason is that the holdup problem that arose in the previous version as a result of bargaining between the agency and the studio is amplified here by bargaining between the agency and clients. This is true because both negotiations take place *after x* has been spent. Thus, the inefficiency in the agency's decision to invest x is compounded.

Consider next the scenario under which the agency negotiates with input suppliers *before* spending x. As noted, this reflects a situation where the agency initiates projects after it has already signed a pool of clients to contracts. The specific sequence of events in this case is: (1) the agency and clients negotiate the w_i's; (2) the agency spends x to initiate a project; and (3) the agency negotiates with a studio for sale of the bundled project.

The determination of F in the final stage occurs exactly as before, and so again yields the expression in (18). Moving back to stage two, we determine that the agency will spend x if and only if

$$F - w_1 - w_2 - x > 0 \tag{26}$$

taking w_1 and w_2 as given. After substituting from (18), this becomes

$$\frac{R - w_1 - w_2}{2} - x > 0 \tag{27}$$

We will return to this condition after deriving the w_i's.

In stage one, the agency and prospective clients bargain over compensation for any future projects. Importantly, this happens *before x* has been spent. Assuming pairwise bargaining, we therefore obtain w_1 as the solution to

$$\max_{w_1} \left(\frac{R - w_1 - w_2}{2} - x \right) (w_1 - c) \tag{28}$$

taking w_2 as given. Note that here, in contrast to (20), the agency's return is net of the initial investment cost because that investment will only be made if a bargain is reached. In other words, x is a variable cost at this stage, unlike in the prior scenario where it was sunk at the point that the agency and clients bargained. Solving (28) along with the corresponding problem for w_2 gives the common payment to each input supplier:

$$w = \frac{R + c - 2x}{3} \tag{29}$$

Which is clearly less than the amount in (21). Finally, substituting this into (27) gives the condition for the agency to invest x:

$$R - 2c > 2x \tag{30}$$

which is identical to the corresponding condition from the model without conflicts between agents and clients (see (14)). This is true because the agency doesn't spend x until it has already negotiated compensation deals with its clients, and so the latter cannot hold up the agency as they did in the scenario where the agent spent x first.

The resulting returns for the studio, the input suppliers (jointly), and the agency, respectively, are as follows:

$$\frac{R - 2c + 4x}{6} \tag{31}$$

$$\frac{2(R - 2c - 2x)}{3} \tag{32}$$

$$\frac{R - 2c - 2x}{6} \tag{33}$$

Compared to (22)-(24), it is clear that the studio and the agency are better off here, but clients are worse off. This is true because the agency is able to shift some of the cost of x onto clients. The studio also gains because there is a larger surplus for it to split with the agency owing to the

smaller input costs. On the other hand, the agency invests in more projects, which increases the overall gains available for all parties to share.

3.3 Comparison

The second packaging-deal scenario seems to be the more relevant one given the current state of the industry, where four large agencies dominate the market (Watson and Flint, 2019). Thus, these agencies already have under contract a sufficient number and diversity of clients to produce a wide variety of projects entirely in-house. This obviously puts clients of smaller agencies at a disadvantage, which, recall, is one of the points of contention of the critics of packaging. This concern therefore seems to be justified, though the current model cannot assess its significance.

Leaving that issue aside, we first note that clients are better off on a per-project basis under the packaging deal if (32) exceeds (15), or if

$$R - 2c > \frac{2x}{\theta} \tag{34}$$

Given θ<1, this may or may not hold, though it becomes more likely as θ increases (i.e., as agent's capture a larger share under traditional agency). Recall that in the model from Section 2 where the interests of agents and clients were perfectly aligned, the traditional structure was clearly better for clients.[4] The fact that agents siphon off a fraction of this return is what creates the ambiguity here.

As for the investment choice, the comparison is between (9) under the traditional structure and (30) under the packaging deal. As already noted, the latter results in more projects being produced, which supports the argument made by the agencies. It follows that, from the narrow perspective of input suppliers, the overall comparison between the two structures is

[4] In that scenario, we implicitly assumed that θ=0, so (34) could never hold.

ambiguous. However, from the larger perspective of efficiency, the packaging deal in which the agency spends x after negotiating contracts with its clients is clearly superior because it results in a less severe holdup problem as compared to traditional agency. What the current model cannot assess is whether large agencies are able to exploit market power over would-be clients in the form of monopsony.

4 Conclusion

The paper has applied traditional concepts from the industrial organization literature to an on-going dispute between Hollywood screenwriters and their agents over allegedly unfair business practices on the latter's part. The specific point of contention is the so-called "packaging deal," under which agencies bring pre-packaged concepts for television shows or movies to studios, which then purchase and distribute them. The claim of the writers is that such deals create an unholy alliance between agencies and studios, thereby potentially interfering with the fiduciary duty that agencies owe to their clients. Agencies counter that the packaging deals increase the employment opportunities of their clients by expanding the number of projects that ultimately go forward.

The analysis in this paper showed that, as in most such disputes, there are legitimate arguments on both sides. While traditional agency may be better at aligning the interests of agents and their clients with respect to bargaining with studios, packaging deals are better at overcoming holdup problems in the development of profitable projects, thereby resulting in more employment opportunities for clients. As a consequence, the overall impact of packaging deals on client income is ambiguous. In terms of overall efficiency, however, packaging deals appear to be the superior structure.

Data Availability Statement: Data sharing is not applicable to this article as no new data were created or analyzed in this study.

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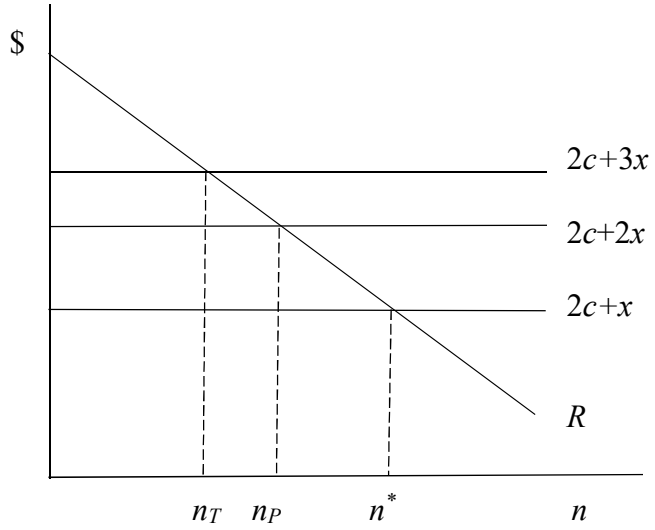

Figure 1. Inefficiency from the holdup problem under the two organizational structures.