

## Huace' s Current Dilemmas and Solutions

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**Abstract.** The study has intensively investigated the condition of the biggest Chinese film and television company Huace Film & TV under the current state of Chinese film and television industry. The aim of present study is to investigate the likely problems of Huace in recent years and the related solutions for these issues. Toward this aim, we have examined the role of the sub-company, diversified development and some television series and films produced by Huace. Taken together, the results of this study indicate the problems that potentially affect Huace, and we have suggested some useful and effective solution, such as enhancement of investment validation, cultivation of Huace's faculty and improvement of scripts.

**Keywords:** Huace; problems; solutions.

### 1. Introduction

Huace Film & TV was founded in October 2005 and is headquartered in Hangzhou, Zhejiang Province. It is a cultural and creative enterprise dedicated to the production and distribution of film and television products. On October 26, 2010, the company was listed on the GEM of Shenzhen Stock Exchange, becoming the first domestic listed company with TV series as its main business. Huace has nearly 20 holding subsidiaries such as Shanghai Croton Culture Media Co. and more than 20 equity subsidiaries, making it one of the largest and strongest private film and television enterprises in China. However, in 2019, the annual revenue of Huace Film was 2.631 billion yuan, a decrease of 54.62% year-on-year. The net profit loss attributable to the shareholders of the listed company was 1.467 billion yuan, with a cut in revenue and a huge loss in net profit. But in 2020, despite the impact of the COVID-19, Huace total operating income of 3.732 billion, compared with the same period the previous year, a significant increase of 41.88%. As the annual performance turned into a profit, Huace which coincides with the 10th anniversary of its launch finally looked forward to a rare high moment in recent years. However, such a trend did not last long. Huace released its 2022 semi-annual report which shows that in the first half of this year, its revenue was 1.188 billion, a decline of 39.50% year-on-year.

For the change in performance, Huace explained that the COVID-19 has affected the start-up, shooting, submission and forensics progress of some TV series projects of the company to varying degrees. Some projects that were expected to recognize revenue in the first half of the year were delayed to the second half of the year, resulting in a significant decrease in operating revenue for the reporting period compared to the same period last year. Thus cash flow from operating activities compared to the same period last year also declined significantly. However, in the case of 2020, the COVID-19 was not the only factor that affected its lower profit, at the same time, previous literature has provided little analysis of Huace's own strategic issues. Therefore, the research objective of our group will be Huace's own dilemma from several perspectives.

## **2. Introduction of Huace Film & TV and its current states**

### **2.1 Current states of Chinese film and television industry**

Production and distribution of movies and television have been severely constrained as a result of the pandemic. However, practitioners overcame the challenges in both areas and turned the crisis into opportunities. As a result of the demise of movie theaters, practitioners have used new revenue-generating models such as broadcasting online and cutting window period to increase revenue from various sources. Despite the fact that film and television production were impacted, the first half of 2022 saw a modest decline in quality in the film and television business, while high-class works frequently appeared. Like the movie “Lighting Up The Stars” smash \$1.7 billion box office, the television series “A Lifelong Journey” gain the score of 8.1 in DouBan app. Although the general state of the industry is still not as favorable as in previous years, a recovery is anticipated [1].

However, the glut of movies and TV dramas produced by the entertainment boom has steadily worn down the audience’s sense of aesthetics. In addition, Chinese TV dramas are strictly regulated and audited by the government, and it is forbidden for ghosts and gods, homosexuality, puppy love, and many other elements in TV dramas. There are severe limitations placed on creators, who are “dancing in chains”.

### **2.2 Introduction, Business Characteristics, and Historical Decisions of Huace**

Huace Film & TV was founded in 2005 and is now Chinese most productive and largest commercial film and television production firm. Huace's goal is to be both people-oriented and content-oriented. The company creates a large amount of high-quality material, with TV dramas accounting for approximately 60%, movies accounting for approximately 30%, and the other 10% involving variety, gaming, music, and many other industries. Huace’s TV dramas are the most popular with audiences, and many of them have earned good honors in domestic and international cinema and television contests. The company's TV programs have aired on international TV channels as well as different platforms such as Netflix, HBO Max, and Disney+. “Eternal Love” for example, has an 8.9 MDL rating, while the 2019 fantasy drama “The Blue Whisper” is even broadcast on African TV channels. Fans of Huace's TV dramas can be found practically anywhere in the world.

Huace Film & TV concentrates on the business of film and television dramas, as well as expanding new derivative businesses and extending the entire IP industrial chain. They also export cultural contents to global consumers and aggressively promote Chinese culture abroad. Huace was successfully floated on the stock market in 2010 and has utilized its enormous capital chain and influence to give numerous consumers with exceptional films and television dramas. The acquisition or merger of film and television-related enterprises is one of Huace's primary initiatives. For instance, in 2013, Huace acquired Croton Media for 1.65 billion yuan, which made the entire firm more international, permitted the consolidation of some proprietary technologies, enlarged the market and asset size of film and television plays [2].

### **2.3 The current state of Huace’s operations during the past several years**

Huace Film & TV lost a total of \$1,467,000,000 in 2019, excluding the effects of the epidemic crackdown and industry consolidation. The agreement dispute between Huace and its parent company, Croton Media, as well as Huace’s high investment and low income in the pan-entertainment industry, make it difficult to raise finance for working capital. The good news is that Huace made the necessary adjustments in a timely manner, as evidenced by the fact that its 2020 annual report reveals the total operating revenue is 3.73 billion yuan, there is a 41.88% increase over the same period in the previous year, and the net profit attributable to shareholders of listed companies is 399 million yuan, achieving a turnaround [3].

Although Huace Film & TV maintained a high revenue in the first half of 2022, the reputation of its film and television dramas and films declined in comparison to the previous time. The primary

reason is excessive modeling and mass production. Audience preferences have become increasingly unpredictable, and they are losing interest in Huace's formulaic television programs [4].

### 3. Huace's current predicaments

#### 3.1 Excessive dependence on Croton

As a film and television making company founded in 2005 in Zhejiang, Huace Film & TV is one of the most influential companies among media industry in China. To attract more audiences and develop overseas market and channel, Huace acquired Croton Media, another famous company focuses on film and television production founded in 2004 in Shanghai. The two companies signed a valuation adjustment mechanism agreement (VAM) in 2013, which agreed on the performance targets they wanted to achieve in four years and the compensation solutions on failures. During the four years from 2014 to 2017, Croton successfully achieved the valuation adjustment mechanism agreement. They created a lot of Chinese hit television shows and earned a large amount of money for both companies due to its excellent team on purchasing and producing good scripts for television shows [5]. In contrast, Huace didn't produce much popular television shows during these four years.

Although the merger of the two companies created a lot of values for both of them, the problems are becoming more and more obvious. Admittedly, the development of a company cannot only rely on one of its subsidiary company, however, the income created by Croton has already become an essential part of Huace's revenue. Before Huace acquired Croton, its television shows tended to be more period and wuxia style, and the appearance of Croton just perfectly made up its shortage of creating young idol television shows which are hugely popular in China. After the acquisition, almost 90 percent of Huace's hit TV dramas were created by Croton, such as "Love O2O", "Rush To The Dead Summer", which shows that Huace is becoming more and more dependent on Croton to produce hit TV dramas. In addition, Huace signed valuation adjustment mechanism agreement and labor agreement to maintain Croton's performance. Once the agreements expire, there are high risks that Huace will lose the executives of Croton since there are countless cases of leaving companies after the agreement end in the media industry. And if it happens, Huace is going to lose its ability of producing core contents and a lot of capable faculties [6]. And these future possibilities are all caused by Huace's dependence on Croton. Which results in troubles that Huace has right now that it doesn't have much hit TV dramas produced by itself and the lack of good scripts.

#### 3.2 lack of blockbuster dramas recent years

Unlike other film and TV companies that rely too much on one director or one star, Huace has always played a strategic model of "big IPs + flowing stars", and this has made Huace richly rewarded, with a number of breakout hits from 2015 to 2016, including "Eternal Love", which had a total viewership of 50 billion and became the first Chinese TV series to be included in the "World's Most Popular TV Series" list. It became the first Chinese TV series to be included in the list of the "world's most popular TV series". However, in 2017, "General and I", starring top actress Yang Ying, was cursed by viewers as "unscrupulous" and a "benchmark for bad dramas" because of its excessive gouging [7]. And in 2018, the mega-budget "The Rise of Phoenixes" hit a new low on Mango. Of the ten dramas to be broadcast in 2022, only one ("The Blue Whisper") was produced by Huace Film and Television, four of which were produced by Shanghai Tencent Penguin Film Culture Communication Co., Ltd, which was established in Beijing in 2015. It is clear that the ability of Huace Film and TV to create blockbusters is declining, and the strategy of "big IPs + flowing stars" is gradually failing.

Not only are the TV dramas created under the traditional model not yielding good returns, but the "big IPs + flowing stars" strategy itself is also facing greater operational difficulties. First of all, the meat and potatoes of IP has been divided up by the major film and television companies, and the price of the only remaining quality IP remains high. For example, the best-selling novels such as *Ghost Blows Out the Lamp* and *Notes from the Tomb Raider* have generated hundreds of millions of dollars in IP spin-offs [8]. This makes the risk of IP drama development much higher. In addition, the

conversion efficiency of Huace using flow stars in exchange for ratings is also much less than before. Since 2018, a series of celebrity scandals such as “yin and yang contracts” and “overpriced film fees” have reduced fans’ fervor for flow stars, and there are few dramas like “Jade Lovers” starring Zheng Shuang that have been taken off air due to celebrity scandals. This shows that the “big IP + celebrity” model is less cost effective and has a higher probability of putting the company at risk.

### **3.2 Financial risks due to diversified development**

This chapter will analyze the financial risks faced by Huace Film due to the unscientific nature of its diversified investments. Huace Film was listed on the GEM of the Shenzhen Stock Exchange on October 26, 2010 and was the first company in China to be listed with TV series as its main business. However, after the listing, Huace Film launched large-scale mergers and acquisitions. Instead of just being a TV drama producer, Huace Film is determined to become a comprehensive content company and to involve in the whole industry chain of film and television. Huace Film and TV's acquisitions include TV drama, movie and variety production companies, as well as downstream channel distribution, integrated marketing and talent agency companies. The advantage of doing so is that through building a diversified business portfolio, the overall business capability of Huace Film and TV can be enhanced. For example, the film industry is characterized by large investment scale, long production and return cycles, and unstable returns, but variety shows are "short and quick" and have a strong ability to attract money. Thus, the variety shows effectively making up for the shortcomings of the film business itself.

However, the involvement in a number of other businesses will put a certain amount of pressure on the company's finances. First of all, from the perspective of Huace's foreign investment efficiency, Huace bought 15% shares of NEW in South Korea for \$314 million in 2014, but lost \$115 million as of 2017. In 2014, Huace bought 20% shares of Beijing Herutang for \$104 million, and sold back the assets at a loss of \$50 million at the end of 2017 after a transfer in 2016 [9]. These figures show that the return on investment for Huace is not satisfactory, while Huace now wants to expand the new field of meta-universe. However, the current meta-universe framework and channels have not yet taken shape, and it is difficult to cut in with the content that Huace is known for. The key to entering this area is to create a channel entrance. The game, social scene is more realistic breakthrough, behind the massive investment and technical barriers, which is the blind spot of Huace. In fact, the chances of the game making a hit are not big, most of the game life cycle is 1-3 years, also requires a lot of investment. Therefore, for Huace, whose capital flow has always been tight, there is actually no need to invest in such areas that are not very relevant to the main business, but are prone to cause the deterioration of the results of diversification.

## **4. Methods to deal with problems**

### **4.1 Strengthening the cultivation of Huace's own faculties**

Cultivation of faculties is the one of the most important mission for the development of company. Huace can continue the “Huace Bei” training, inviting famous directors and producers to train and test the faculties and providing more opportunities for workers to promote and express their ideas. Also, Huace can hold more scenario competitions to attract more playwrights and writers to create various and better scripts. The establishment of Huace Film Academy (HFA) even provides Huace more chances to recruit talented people to make the films and television shows and help complete the talent supply chains of the company [10].

### **4.2 Focusing on contents and creating high-quality products**

With the rise of the new media industry, many short-form videos are not only creative, but also of the same quality and production level as TV dramas, and viewers of TV dramas and web dramas are being severely diverted, making competition between multiple content carriers increasingly fierce [11]. At the same time, as the entertainment industry is booming, the aesthetic level of viewers is

rising rapidly and their consumption of film and television is becoming more rational. It is no longer possible to rely solely on popular IPs and the fan economy to ensure high ratings, but only dramas with good plots, performances and graphics, and strong hard-working characters, can win both word-of-mouth and ratings. The first Chinese short drama to win the Silver Bird Award at the Seoul International Television Festival, "The Bad Kids" is an IP drama based on novel, but it is praised for its interlocking plot, superb performances and very cinematic filming techniques. If it wants to produce another hit series, Huace should change its mindset of relying on IPs and stars to gain attention, avoid the "fast-food" production model, strengthen its own content production capabilities and make real quality products.

#### 4.3 Expanding fundraising channels and strengthening project assessment

For Huace who wants to diversify its development, it needs to expand its fundraising channels. Therefore, Huace can take several measures: 1. Raise funds to invest in film and television production through private share issuance, which can obtain a larger amount of funds than bank loans. 2. Strengthen the management of current accounts, increasing the performance assessment of business departments and also improve its fund-raising ability [9]. 3. Legally issue corporate bonds to obtain funds with fewer restrictions. With this method, Huace can obtain more funds with less restrictive conditions. Therefore, Huace should try different low-risk financing methods so as to reduce the capital ratio.

Meanwhile, from the perspective of diversified investment, Huace firstly needs to strengthen the validation of investment projects. Before making investment decisions, it should consider the sustainable development of the enterprise and the maximization of benefits, also paying attention to the whole investment process. Huace should focus on the development of a few high-quality projects, or joint investment with other film and television companies to reduce the investment ratio to reduce risk.

### 5. Conclusion

In the context of the gradual recovery of China's film and television industry, Huace Film & TV has also emerged from the trough in 2019, but the hidden dangers such as declining reputation and financial risks behind the magnificent turnover should not be underestimated. According to the survey, Huace currently has three main problems: excessive dependence on Croton Media, lack of ability to create blockbusters in the present, financial risks due to diversified development. The management of Huace can alleviate the above difficulties by strengthening the cultivation of Huace's own faculties, focusing on content and creating high-quality products, expanding investment channels and strengthening project risk assessment. Other Chinese film and television companies can also refer to the leading enterprise Huace's problems to make their own strategic adjustments. At present, China's film and television industry is at a key point of recovery. Film and television companies are responsible for planning, production, distribution and other fields, which is of great importance to the development of the industry. Therefore, only if companies adjust their strategies and improve their management problems, can China's film and television industry obtain greater opportunities.

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