DreamWorks Animation Downsizes

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On January 22, DreamWorks Animation (DWA) announced that it would close its PDI/DreamWorks studio in Redwood City, California, effective immediately. DWA will eliminate approximately 500 jobs, or about 20 percent of its workforce, including animators, storyboard artists, and support staff. These layoffs are the largest in the studio's history, surpassing the firing of 350 employees in 2013. In total, DWA has shed nearly a third of its workforce in less than two years—a startling indication of the studio’s ongoing financial struggles and its inability to reshape creative operations at a time of industry-wide economic uncertainty.

It wasn’t long ago that DreamWorks Animation was thriving. In 2011 it was featured among Forbes’s Best Small Companies and Fast Company’s Most Innovative Companies. DWA’s popular *Shrek* and *Madagascar* franchises helped to sustain it as one of the few animation studios to remain in Southern California in an era of rampant outsourcing. Furthermore, a multiyear deal with Netflix for over 300 hours of original programming enabled the television division to actively recruit showrunners and artistic talent from other studios. DWA acquired YouTube's teen network AwesomenessTV in 2013, launched a publishing division last year, and ramped up its release schedule to three feature films per year. As recently as May 2014, financial analysts predicted the studio's slate of film sequels would generate enough revenue to sustain the company until its television division and its joint venture in China, Oriental DreamWorks, picked up steam.

Yet perhaps the studio was growing too big too fast in an increasingly tenuous economic environment, especially for the film business. In 2014, summer box office revenue hit a fifteen-year low, and ticket sales have continued to decline year after year. Whereas the deep corporate reserves of major conglomerates like Disney or Universal help to absorb financial losses at the box office, a single flop proves devastating for a small studio's bottom line. DWA faces an even higher risk because its business model is based almost exclusively on its feature film releases—box office returns account for nearly 75 percent of the studio's total revenue.

Thus, when a major release in each of the past three years – *Rise of the Guardians* (2012), *Turbo* (2013), and *Mr. Peabody & Sherman* (2014) – failed to catch fire with audiences, it eviscerated the company's financial sustainability. DWA found itself with negative free cash flow and therefore unable to pay dividends, make acquisitions, develop new projects, or reduce its debt. Attempts at leveraging the studio's features into ancillary markets likewise failed because the films never attracted theatrical audiences in the first place.

Along with the staff cuts, the studio will reduce its output to two films per year and will cut its average cost per film from $145 million to $120 million, but even the lower figure is more than 50% higher than the budgets for some of its competitors' biggest hits. Those studios curb costs by relocating their animation houses elsewhere in order to take advantage of state or international subsidies. Such is the case with Fox's Blue Sky Studios in Connecticut and Sony Pictures Animation in Vancouver, Canada. Others simply outsource their animation to international houses, like Warner Bros. did with Australia-based Animal Logic for *The Lego Movie*. These tax credits and subsidies remain a contentious solution to the problems of runaway production and job relocation.Yet, even the recently approved California film subsidy bill AB 1839 would not have helped an animation studio like DreamWorks since the subsidy only applies to films whose principal live action photography is done in California.

Given these circumstances, CEO Jeffrey Katzenberg has attempted to sell the studio to a corporate partner with deep pockets, first to Japanese new media giant SoftBank and then to toymaker Hasbro. Both overtures were unsuccessful.

Commentators at the time suggested the studio was an unappealing prospect given its over-reliance on feature films, its underdeveloped ancillary revenue streams, and its recent string of box office failures. Despite its vibrant studio culture in Redwood City, DWA has been unable to persevere in the face of headwinds that have dramatically transformed the animation industry since the 1990s.