

Japan Animation Industry Trends

Japanese Economy Division

Summary

Japanese animation is in the spotlight not only in Japan, but overseas as well. Amid an expanding domestic market for films, television and videos, Japanese animation film producers have also been turning their eyes toward overseas markets. At the same time, new developments have been seen in terms of diversified funding methods for film production. Against this background, the Japanese animation industry is working hard to deal with shortages in certain human-resource skills, reductions in domestic film-production sites and the challenge of expanding operations overseas.

1. Market Overview

Japanese Animation Market in 2004

The talk of the Japan animation market in 2004 was Studio Ghibli's smash hit, *Howl's Moving Castle*, the studio's first new release in three years, which opened in November. Director Hayao Miyazaki's work exceeded 10 million viewers in just 44 days, faster than any movie in Japan. Its popularity continued thereafter, with viewers rising to 14.23 million as of March 8, 2005, breaking the mark set by Miyazaki's *Princess Mononoke* and placing it number two in Japanese film history. The question now is how close it will get to Japan's all-time record of 23.5 million set by *Spirited Away*. *Howl's Moving Castle* has also been shown in South Korea and other countries, including 60 cities across the U.S. beginning in June 2005.

Market Environment

Japanese animation ("anime") has been acclaimed worldwide for its original, Japan-based culture and content, to the extent that it is called "Japanimation." Director Mamoru Oshii's animated film *Innocence* was nominated for an award at the 57th Cannes film festival in 2004. *Innocence* is the sequel to *Ghost in the Shell* (1995), which reached number one on Billboard's video chart in the United States. Miyazaki's *Spirited Away* won the feature length animation Oscar at the 75th Academy Awards in 2003, reprising its capture of the Golden Bear at the 2002 Berlin Film Festival and proving once again Japan produces world-class animation.

Many American and Asian animators reportedly want to work on Japanese anime productions, indicating that Japanese animation is viewed by professionals as leading its field. *Spirited Away's* commercial success, however, demonstrated Japanese anime's merits and international competitiveness among the global general public as well. The world clearly views Japanese anime as having potential for big business.

Nonetheless, the industry has not yet shifted its posture sufficiently to respond to overseas acclaim. Moving forward, the Japanese anime industry not only must expand overseas, it also must develop the necessary production/distribution systems and personnel to capitalize on the global business opportunities for anime and other content. Production systems have in fact been set up, but the industry still has many glaring weaknesses in domestic/overseas distribution and rights, such as licensing and international business expertise in general. In the field of personnel development, animators do not have a suitably high social standing, so the exodus of such personnel to other industries and countries has become a large problem.

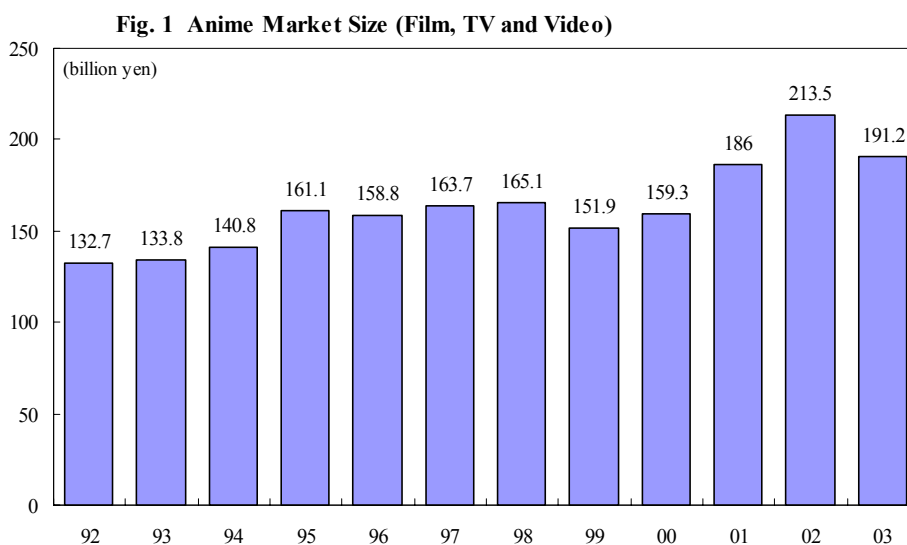
2. Shifting Market Size

Japan's domestic anime market can be broadly divided into three categories:

- 1) Feature-length films
- 2) TV shows
- 3) Video and DVD versions of the above two, and original productions

According to the Media Development Research Institute, Japan's anime market sales fell 10.4% to 191.2 billion yen in 2003, including box office revenues for anime films, TV animation production fees and profits from sales and rental of video and DVD titles. This was the first decline in two years (Fig. 1). The substantial gains realized in 2001 and 2002 were largely due to *Spirited Away's* success at the box office (30.4 billion yen) in 2001 and then in DVD form in 2002. The lack of this sort of hit led to market contraction in 2003, but sales are estimated to have grown in 2004 due to the success of *Howl's Moving Castle*.

The market for anime content, including character licensing/merchandising, selling rights to use character images on other products and the sale of character toys, is estimated to be worth about two trillion yen.



Source: Dentsu Communication Institute Inc.

3. Industry Structure

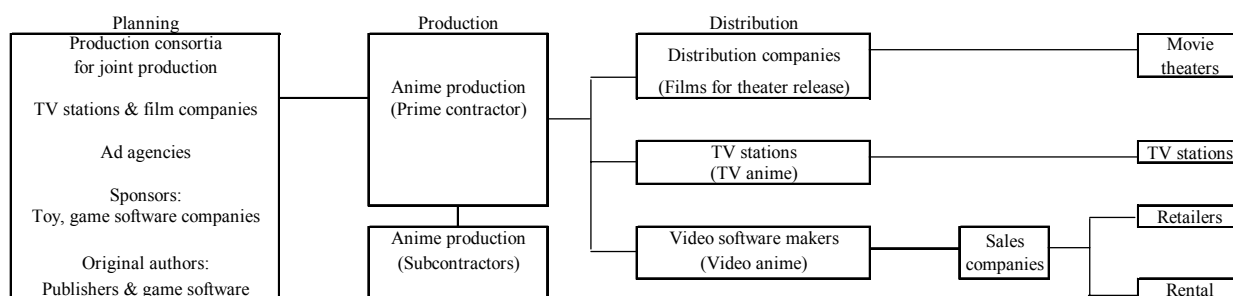
Figure 2 provides a simple description of the anime industry's structure. The diagram below is an actual example of television animation in general. Of course, circumstances can vary for each TV program or film, especially in the planning stage.

Television stations, ad agencies, toy companies and anime production houses form production consortiums to undertake joint planning. Toy companies join at this point because they are indispensable to the secondary use of characters in the case of TV anime. Actual production is undertaken by a prime contractor supported by numerous subcontractors in every phase of production.

Statistics regarding anime specialists, entrepreneurs involved with anime, and employers are unclear, but there are said to be around 430 anime production houses in Japan. Of these, 264, or 61.4%, are concentrated in Tokyo's 23 central wards, with Nerima and Suginami accounting for particularly high percentages. Enterprises that primarily produce feature anime for theater release are the exception, as most anime production companies produce for TV.

Financing for the anime industry is diversifying. Content such as anime was previously considered unable to offer any guarantees, so backup financing was difficult to obtain. In 2004, however, Japan's first anime fund was founded by Gonzo, Japan Digital Contents, Rakuten Securities, and JET Securities, and in 2005 Japan Digital Contents and the Organization for Small & Medium Enterprises and Regional Innovation, an independent government agency, pooled 500 million yen each to start an investment financing fund for content production. Also, the banking industry has altered its comparatively conservative stance and Mizuho Bank is now aggressively extending financing to content creators.

Fig. 2 Anime Industry Structure



Additionally, the production consortium system of funding procurement has also gained favor. This is because each of the main players cooperates financially to split the risk. This has already worked well in cases such as *Spirited Away* and *Innocence*. Diversification of capital procurement is thus playing a key role in anime's growing success.

Human Resource Limitations and Reliance on Outsourcing

While Japanese anime has been in the spotlight overseas, the industry is struggling to overcome problems with production cost cutbacks, a lack of animators and a dependence on production outsourcing.

a. Production cost cutbacks

A 30-minute TV animation production generally costs nearly 10 million yen, although there are cases in which production companies have received only around five million yen. Most TV animations run a loss that the production companies attempt to overcome through secondary uses of content, such as sales of videos, DVDs and character products.

As such, low wages in the anime industry have led to a steady exodus to the game industry and elsewhere. Employees in many smaller enterprises are not paid monthly salaries or do not have guaranteed stable incomes. Particularly in the case of production companies that subcontract work from TV stations, unstable work volume and funding are leading to lower production quality and a drain of superior personnel.

b. Moves to outsource production and train personnel

Production has increasingly been outsourced in recent years. This includes sending original prints and other digital data to production companies in China, South Korea and elsewhere, which return content all the way up to the stage of coloring. Toei Animation retains around 130 people at its studio in the Philippines. Ghibli subcontracted part of the work on *Spirited Away* to Korean companies, reflecting the fact that titles produced solely in Japan are becoming rarer.

While planning, directing and other processes requiring advanced expertise have remained in Japan, animating, coloring and other simple operations are being shifted to other countries. Processes in which young staff acquire basic animation skills are declining in Japan, which has set off alarms regarding the domestic industry's own production capabilities.

Moreover, South Korea, which previously served as a subcontractor for Japan, has been laying plans for a national policy to promote its domestic anime industry as a result of rapidly accumulating expertise in recent years. Almost all animation on South Korean television used to be from Japan, but now about 30% to 40% is produced locally. It is feared that the hollowing out of Japanese production sites and the concomitant increase in the competitiveness of other countries and regions is undermining the foundations of Japan's anime industry.

Moves are being made to establish forums for animators who possess high levels of expertise and to train people in needed skills. At Production IG, which worked on *Innocence*, competitiveness is maintained by supervising the entire production process in-house to ensure the output of high-quality titles. Under this system, many animators are reportedly earning annual

incomes of 10 million yen. Japan's first anime vocational graduate school is scheduled to open in April 2006, serving as a location for training personnel in the advanced skills required by today's animation industry. This is a venture directed by Wao Corporation, which set up the first vocational school to train animators in 1997.

Studio Ghibli: Model of Success for Feature Anime

Studio Ghibli's titles serve as models for the production of feature anime. Studio Ghibli has an established method for creating major pictures with the backing of TV stations, publishing houses, ad agencies and others under the production consortium formula, which is credited with stabilizing capital procurement while generating high-quality works.

For Studio Ghibli's representative work, *Spirited Away*, the production consortium formed with Tokuma Shoten Publishing, Nippon Television Network, Dentsu (Japan's largest ad agency), Tohokushinsha Film and others came up with approximately 2.5 billion yen for production costs. The companies participating in the consortium split the costs and divided the profits in proportion to their respective investments. Because three-tiered income from the box office, video/DVD and TV was anticipated, it was not surprising that firms of this type took part in the consortium and that their participation strengthened the marketing of the film. *Spirited Away*'s production cost was an extraordinary amount, given that a Japanese film that grosses one billion yen at the box office is considered a major hit.

Ghibli's success has spurred companies such as Toei Animation to renew their interest in feature-length anime movies. Other companies are also considering producing higher-quality films for theaters, even if the costs are higher, and releasing these and other anime overseas.

4. Product Trends

Feature-length anime box office revenues in 2003 came to 33.7 billion yen, the second consecutive annual decline (Fig. 3), according to estimates by the Dentsu Communications Institute. But Spirited Away helped the market grow in both 2001 through 2002, and the trend has been generally upwards since the mid-90s. Further, the record 165 first-run films that debuted in 2003 (Fig. 4) was a big jump from the previous year. The number of first-run imported anime movies increased, but did not result in higher box office revenues because there were fewer big hits than in the year earlier.

Anime movies produced by film production/distribution companies and video sales companies in 2001 totaled 346, an eightfold increase from 1998 according to the Ministry of Economy, Trade and Industry's (METI's) survey of selected service industries (Fig. 5).

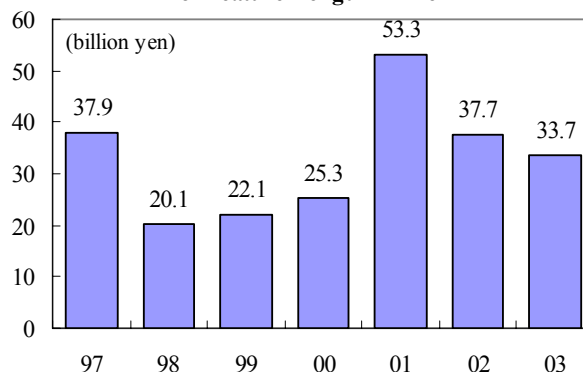
A separate survey of selected service industries (Fig. 6) found that 20.36 million theatergoers saw anime at theaters in 2004, which was 18.7% of the total theater attendance that year. Theater attendance has been growing since 2002 due to the increased number of screens at new cinema complexes. Although anime attendance declined in 2003 due to a lack of outstanding hits, it rebounded in 2004 on the strength of Howl's Moving Castle.

Television Anime

The amount of animation broadcast on TV in Japan has been growing in recent years. According to a company called Video Research, TV anime programs broadcast in 2003 totaled 2,850, up by 102 for the year, which was the second consecutive annual rise. Most of the programming was domestic.

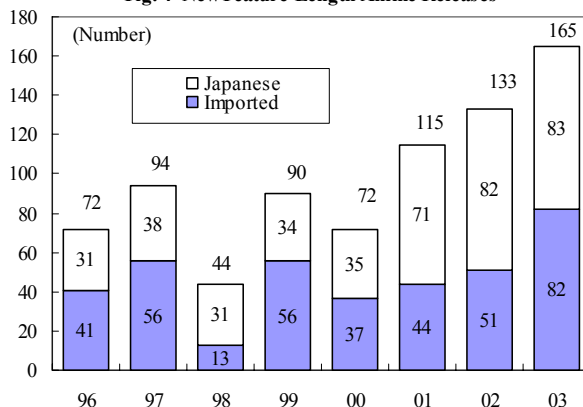
Sixty percent of TV anime is broadcast after six p.m., mostly targeting preschoolers and other children during prime time. But programs for adults shown after 11 p.m. have also contributed to the high ratio of post-six p.m. broadcasts. In addition, 30% of the anime is shown in the morning and 10% between noon and six p.m.

Fig. 3 Estimated Box Office Revenues for Feature-Length Anime



Source: Dentsu Communication Institute Inc.

Fig. 4 New Feature-Length Anime Releases



Source: Dentsu Communication Institute Inc.

Fig. 5 Number of Films Produced and Videos Sold Annually

		2001	Ratio	Change from 1998 survey
Film production	Number of films produced annually	4,904	100.0%	11.4%
	For theater release	571	11.6%	35.6%
	Feature films	225	4.6%	-40.9%
	Animation	346	7.1%	765.0%
	Educational films	265	5.4%	-29.5%
	Documentaries	2,726	55.6%	154.3%
	Other	1,342	27.4%	-47.0%
Video sales	Number of videos sold annually	64,408,548	100.0%	15.1%
	For theater release	35,054,436	54.4%	41.0%
	Japanese	14,317,939	22.2%	100.2%
	Feature films	3,935,652	6.1%	17.4%
	Animation	10,382,287	16.1%	173.3%
	Imported	20,736,497	32.2%	17.1%
	Feature films	15,987,108	24.8%	78.9%
	Animation	4,749,389	7.4%	-45.8%
	TV programs	8,295,120	12.9%	8.4%
Original videos	21,058,992	32.7%	-10.1%	

Source: Ministry of Economy, Trade and Industry

Video and DVD Anime

Sales of anime videos fell 5.5% to 92.59 billion yen in 2004, according to a survey of Japan Video Software Association member companies (Fig. 8). This consisted of 80% Japanese anime and 20% imported animation. Imports for general audiences increased rapidly in 2004, probably due to the Disney hit *Finding Nemo*.

The Nomura Research Institute estimated that, based on the number of DVDs sold, the anime market was worth 20 billion yen in 2004. Anime fans, who spend substantial portions of their disposable incomes on anime, accounted for about 13% of the total.

Secondary Uses: The Character Business

Character merchandising is a growing category. Licensors, such as production companies and investors, obtain fees from licensees who use characters to create products. Licensees in fields including finance, toys, automobiles, airlines, food and others employ anime character dolls/figurines and the characters themselves as corporate or product mascots. Anime's value has thus appreciated as a promotional tool. This is why toy and game manufacturers are increasingly working with advertising agencies to plan anime production.

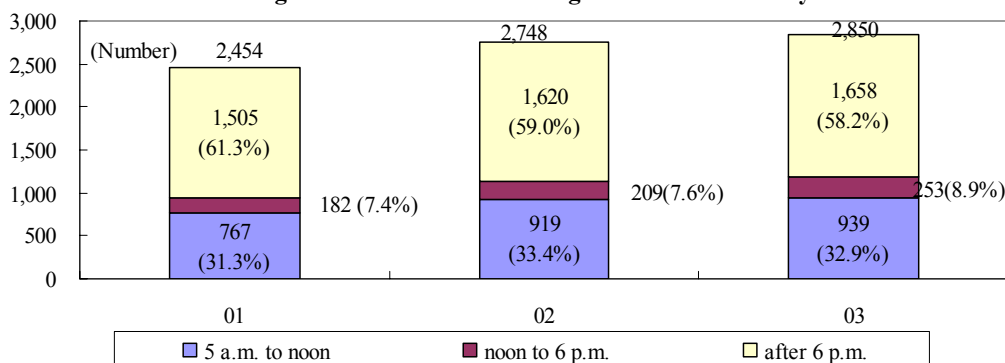
Fig. 6 Theater Attendance

(Viewers)

	2000	2001	2002	2003	2004
Total attendance	45,870,073	48,764,386	90,321,473	90,947,473	109,813,470
Japanese	8,962,164	7,832,728	13,458,378	22,033,875	28,787,320
Imported	29,066,717	28,529,076	60,472,744	57,380,488	60,366,971
Animation	7,841,192	12,402,582	16,390,351	11,533,110	20,659,179
Number of screens	584	577	1,087	1,089	1,376
Times shown	1,066,459	991,649	2,017,865	2,018,911	2,512,897

Source: Ministry of Economy, Trade and Industry

Fig. 7 Number of Anime Programs Aired Annually



Source: Video Research

Fig. 8 Anime Video Software Profits in 2004

(million yen)

Genre	Total earnings	Ratio	YoY	Tapes	DVDs
Japanese (general audiences)	58,785	63.5	88.7	5,999	52,786
Imported (general audiences)	17,211	18.6	186.3	2,073	15,138
Japanese (for children)	13,401	14.5	83.3	5,372	8,029
Imported (for children)	3,193	3.4	82.6	334	2,859
Total	92,590	100	94.5	13,778	78,812

Source: Japan Video Software Association

5. Import and Export Trends: Overseas Releases

Japan Has Top Share of Global Market

Japanese anime broke into the world market beginning in the 1980s, after which it steadily established a leading position. TV cartoons such as *Astro Boy*, broadcast in the U.S. from 1963, and *A Dog of Flanders* broadcast in Europe have long been accepted by viewers outside Japan without any conscious recognition that these works were made in Japan. *Doraemon* has been a popular anime in Asia and *Sailor Moon*, *Dragonball* and other TV anime features that were popular in Japan have also gained popularity in Europe. In the U.S., *Akira* and *Gundam* and Studio Ghibli titles have enjoyed success. *Ghost in the Shell* made news in 1998 when it topped Billboard's video sales chart in the U.S.A.

International sales data is not exact, but around 60% of the anime shown worldwide is made in Japan, according to a METI report issued in January 2004. Twenty Japanese anime programs were being broadcast on American TV as of March 2003.

While Japan supplies anime to markets around the world, its animation imports are primarily American or European titles.

Production Reflects Overseas Market Considerations

Shogakkan's *Pokemon*, the animated version of Nintendo's portable game software, was the first huge success by a Japanese anime overseas. Released in 45 countries and regions around the world, as of the third installment of the series it had generated overseas box office revenues of 38 billion yen, or double that in Japan. Gross global earnings, including related products, are estimated at three trillion yen. *Pokemon* was noted for the enormity of its character-related business, bolstering the impression that anime was an extremely important element in generating appeal for characters.

The general rule in the past was that TV anime or movies that enjoyed a certain degree of popularity in Japan would be offered overseas, but titles produced recently have increasingly borne overseas markets in mind from the outset. In addition, most export titles through the 1990s were TV programs, but *Spirited Away*'s success has prompted attempts to develop artistically appealing feature-length works for overseas release. TV stations are also actively trying to move overseas; NHK announced in April 2004 that it would produce *Phoenix*, an original work of Osamu Tezuka, and sell it overseas.

Interest in Japanese Anime Increases

The Disney Group has set up an entertainment content purchasing division within its Japanese organization, which until then had focused on distributing Disney animation in Japan. It is now buying Japanese anime with games and other products for distribution in 54 countries. Joint film and anime productions in Japan are also being considered. There are now examples of overseas TV stations and distribution companies investing in anime produced in Japan and becoming involved from the planning stage, joint productions with overseas production companies being broadcast in both countries, and overseas production houses investing in anime production companies in Japan.

There has also been increasing praise for Japanese anime in Hollywood. American film production companies have bought the remake rights for Japanese anime such as *Akira*, *Dragonball*, and *Lupin III*. The Wachowski brothers, who turned *The Matrix* into a hit, approached several Japanese directors about producing an animated version of their film. And, of course, *Spirited Away* won the Academy Award for feature-length animation in 2003. Given these developments, the global market for the Japanese anime market is expected to expand further.

Content Business Issues

As noted, the extreme shortage of personnel well-versed in international legal affairs related to intellectual property rights has resulted in low profitability for Japanese anime overseas. When video software is sold in the U.S., for example, the distributor generally provides a minimum guarantee and also makes payments if sales exceeded the minimum. Japanese anime rights owners need people who can negotiate with U.S. counterparts on equal terms, and also audit sales performance, to ensure equitable, profitable arrangements in overseas markets

Bandai Visual's lost royalties in overseas markets are estimated at tens of millions of yen annually. Aiming to expand its overseas sales from 700 million to two billion yen in a three-year plan implemented from February 2004, the company began stressing thorough oversight of overseas copyrights. Japanese with experience in European markets are being hired to supervise marketing and product designing for Europe. The company is making sure these people keep a close watch on sales performance in Europe and audit sales agents' data to identify when titles exceed their minimum guarantees.

Japanese production houses that have been able to bargain over joint productions on equal terms with American counterparts have been the exception up to now. While they have been relatively successful with their subcontracting arrangements, it would help if they possessed stronger planning and negotiating abilities. Production IG, whose productions *Ghost in the Shell* and other titles have won overseas fans, has a U.S. subsidiary that retains lawyers and accountants familiar with local business practices and legal affairs when the Japanese headquarters negotiates sales and joint production contracts with American distributors.

On the other hand, equitable copyright income has been difficult to obtain in Southeast Asian countries and other regions where video piracy is rampant. As in other content businesses, pirating has become a large issue in overseas product releases.

6. Industry Topics

Yu-Gi-Oh! Scores Big in U.S.

The feature-length film of *Yu-Gi-Oh! Duel Monsters*, a popular Japanese TV anime, opened in Europe and the U.S. in September 2004. It was shown in 2,400 theaters in the U.S. and achieved box office revenues of around 2 billion yen, second only to *Pokemon*. Besides being a popular TV program, *Yu-Gi-Oh!* was also featured in Shueisha's weekly magazine, *Shonen Jump*, and was a popular Konami card game. Once it began airing on TV in the U.S. in 2001, toymaker Mattel began selling dolls. The popularity of the TV cartoons and character products helped pave the way for the film's success.

TV Tokyo's *Naruto* to be Released Overseas

TV Tokyo, seeing the successes achieved overseas with *Pokemon* and *Yu-Gi-Oh!*, has decided to export its popular television anime feature *Naruto*. Broadcasts on American cartoon channels will begin in September 2005. Licensing negotiations are also under way in Europe and the anime is already scheduled to air in the U.K. and Italy, although the timing has yet to be decided.

Howl's Moving Castle a Hit in Japan and Elsewhere

Studio Ghibli's first new film in three years, *Howl's Moving Castle*, has been a hit in Japan and other countries. *Howl's Moving Castle* was released in November 2004 and reached 10 million viewers in just 44 days, a record for a Japanese film. It also will likely break *Spirited Away's* box office record of 30.4 billion yen. Interest overseas is strong because *Spirited Away* won an Academy Award. Released in South Korea in December 2004, it is scheduled to open in 50 countries in 2005.

Director Hayao Miyazaki to Receive Golden Lion for Lifetime Achievement at Venice Film Festival

It has been announced that Hayao Miyazaki, director of *Spirited Away* and *Howl's Moving Castle*, will be awarded a Golden Lion for lifetime achievement at the 62nd Venice Film Festival that begins in August 2005. This award, bestowed on directors who have given the world many excellent films, has been awarded to masters such as Steven Spielberg and Stanley Kubrick. Miyazaki is both the first Japanese and the first director of animated features to receive the prize. *Howl's Moving Castle* was shown in competition at the 61st festival in 2004 and the producer, Studio Ghibli, received the Osella prize for best technical contribution.

Animated Features Perform Well in Worldwide Markets

Director Mamoru Oshii's *Innocence*, the sequel to *Ghost in the Shell* (produced in 1995 and topped Billboard's video sales chart in the U.S. in 1998) was released in Europe and the U.S. in

2004. Yu-Gi-Oh!, an anime feature based on a TV program, was released the same year. Considering that overseas distribution had not even been decided when Pokemon was released in 1998, after which it earned 17 billion yen in the U.S. and in Canada, the times have certainly changed since then.

TV Anime Distributed Overseas

Toei Animation established a U.S. subsidiary in March 2004. Gashbell began airing in Hong Kong and Taiwan the same year, with American broadcasts starting in March 2005. One Piece began showing in the U.S. in September 2004. Planning and production now reflect anticipated overseas distribution and related tailoring to the tastes of foreign viewers.

Sony Pictures Entertainment has produced Astro Boy for TV. Now showing on Fuji Television affiliates in Japan, it aired in Asia in the fall of 2003 and in the U.S. from the beginning of 2004. Scenes with specific types of violence, religion or other themes that could have become impediments to broadcasting overseas were deleted in advance.

GDH joined to form GO-N Productions, a French animation joint-venture company, in the summer of 2004. The plans is to combine strengths on joint production projects and actively seek to enter the respective partners' markets.

Nippon Animation's Hunter X Hunter is already airing in three Asian countries and broadcast rights have been granted to TV stations and program distribution companies in France, Italy, Mexico, Spain and elsewhere. A further goal is to broadcast the program in Germany, Portugal and the U.S., and joint efforts regarding video sales and rentals, as well as granting character merchandising rights.

Distribution via Internet is Brisk

Major anime production house Toei Animation has begun using the Internet to distribute anime titles from its archives. Hokuto no Ken and other programs shown in the past can also be viewed. Sets of four or five episodes cost 420 yen and all episodes of a given title can be viewed for 2,100 to 5,250 yen. This has indeed attracted attention as a secondary use for content. Hal Film Maker is exploring the Chinese animation market and has already set up a joint venture with a company in Dalian for anime production, programming and character merchandising.

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