

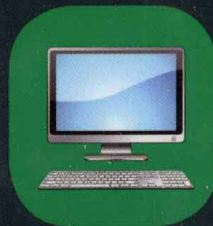
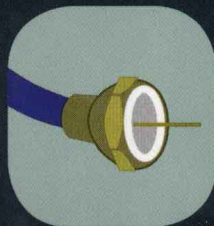
Eighth Edition

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# Entertainment Industry Economics

## A GUIDE FOR FINANCIAL ANALYSIS

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Harold L. Vogel

CAMBRIDGE UNIVERSITY PRESS

Cambridge, New York, Melbourne, Madrid, Cape Town, Singapore,  
São Paulo, Delhi, Dubai, Tokyo, Mexico City

Cambridge University Press

32 Avenue of the Americas, New York, NY 10013-2473, USA

[www.cambridge.org](http://www.cambridge.org)

Information on this title: [www.cambridge.org/9781107003095](http://www.cambridge.org/9781107003095)

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First edition 1986

Second edition 1990

Third edition 1994

Fourth edition 1998

Fifth edition 2001

Sixth edition 2004

Seventh edition 2007

Eighth edition 2011

Printed in the United States of America

*A catalog record for this publication is available from the British Library.*

*Library of Congress Cataloging in Publication data*

Vogel, Harold L., 1946–

Entertainment industry economics: a guide for financial analysis /

Harold L. Vogel. – 8th ed.

p. cm.

Includes bibliographical references and index.

ISBN 978-1-107-00309-5

1. Performing arts – Finance. I. Title.

PN1590.F55V6 2011

338.4'7791–dc22 2010040291

ISBN 978-1-107-00309-5 Hardback

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# Preface

**en·ter·tain·ment** – the act of diverting, amusing, or causing someone’s time to pass agreeably; something that diverts, amuses, or occupies the attention agreeably.

**in·dus·try** – a department or branch of a craft, art, business, or manufacture: a division of productive or profit-making labor; especially one that employs a large personnel and capital; a group of productive or profit-making enterprises or organizations that have a similar technological structure of production and that produce or supply technically substitutable goods, services, or sources of income.

**ec·o·nom·ics** – a social science that studies the production, distribution, and consumption of commodities; considerations of cost and return.

*Webster’s Third New Unabridged International Dictionary*, G. & C. Merriam Company, Springfield, Massachusetts, 1967.

Each year Americans cumulatively spend at least 140 billion hours and more than \$280 billion on legal forms of entertainment. And globally, total annual spending is approaching one trillion dollars. So we might begin by asking: What is entertainment, why is there so much interest in it, and what do its many forms have in common?

At the most fundamental level, anything that stimulates, encourages, or otherwise generates a condition of pleasurable diversion could be called entertainment. The French word *divertissement* perhaps best captures this essence.

But entertainment can be much more than mere diversion. It is something that is universally interesting and appealing because, when it does what it is intended to do, it moves you emotionally. As the Latin root verb *tenere* suggests, it grabs you: It touches your soul.

Although life is full of constraints and disciplines, responsibilities and chores, and a host of things disagreeable, entertainment, in contrast, encompasses activities that people enjoy and look forward to doing, hearing, or seeing. This is the basis of the demand for – or the consumption of – entertainment products and services; this is the primary attribute shared by the many distinct topics – from cinema to sports, from theme parks to theater – that are discussed in the pages that follow.

Entertainment – the cause – is thus obversely defined through its effect: a satisfied and happy psychological state. Yet, somehow, it matters not whether the effect is achieved through active or passive means. Playing the piano can be just as pleasurable as playing the stereo.

Entertainment indeed means so many different things to so many people that a manageable analysis requires sharper boundaries to be drawn. Such boundaries are here established by classifying entertainment activities into industry segments, that is, enterprises or organizations of significant size that have similar technological structures of production and that produce or supply goods, services, or sources of income that are substitutable.

Classification along those lines facilitates contiguous discussion of entertainment *software*, as we might more generically label films, recordings, and video games, and of *hardware* – the physical appurtenances and equipment on which or in which the software's instruction sets are executed. Such classification also allows us to trace more easily the effects of technological developments in this field.

So accustomed are we now to continuous improvements in the performance of entertainment hardware and software that we have trouble remembering that, early in the twentieth century, moving pictures and music recordings were novelties, radio was regarded as a modern-day miracle, and television was a laboratory curiosity. Simple transistors and lasers had yet to be invented, and electronic computers and earth-orbiting communications satellites were still in the realm of science fiction.

These fruits of applied technology have nevertheless spawned new art forms and vistas of human expression and have brought to millions of people around the world, virtually at the flick of a switch, a much more varied and higher-quality mix of entertainment than had ever before been imagined feasible.

Little or none of this, however, has happened because of *ars gratia artis* (art for art's sake) – in itself a noble but ineffectual stimulus for technological development. Rather, it is *economic forces* – profit motives, if you will – that are always behind the scenes, regulating the flows and rates of implementation. Those are the forces that shape the relative popularity and growth patterns of competing, usually interdependent, entertainment activities and products. And those are the forces that ultimately make available to the masses what was previously affordable only by upper income classes.

It is therefore surprising to find that most serious examinations of the economics of entertainment are desultory and scattered among various

pamphlets, trade publications and journals, stockbrokers' reports, and incidental chapters in books on other topics. The widely available popular magazines and newspapers, biographies, histories, and technical manuals do not generally provide in-depth treatments of the subject.

This book, then, is a direct outgrowth of my search for a single comprehensive source. It attempts to present information in a style accessible and interesting to general readers. And, as such, it should prove to be a handy reference for executives, financial analysts and investors, agents and legal advisors, accountants, economists, and journalists. To that end, some supplementary data appear in Appendix C.

Yet *Entertainment Industry Economics* will most likely be used as a text for graduate or advanced undergraduate students in applied media economics and management/administration courses in film, music, communications, publishing, sports, performing arts, and hotel-casino operations. Instructors should find it easy to design one-semester courses focused on one or two areas. A minimum grasp of what entertainment and media economics is all about would require that most students read at least the first halves of Chapters 1 and 2 and, at the end of the course, the first section of Chapter 15. But many different modules can readily be assembled and tailored. Among the most popular would be concentration on film, television, and music (Chapters 2 through 8), gaming and sports (Chapters 7, 8, 11, and 12), arts and popular culture (Chapters 6, 7, 9, 10, and 13), or entertainment merchandising and marketing (Chapters 2, 7, 9, 10, and 14).

The topics covered in the book have been chosen on the basis of industry size measured in terms of consumer spending and employment, length of time in existence as a distinct subset, and availability of reliable data. In a larger sense, however, topics have been selected with the aim of providing no more and no less than would be required by a "compleat" entertainment and media industry investor. The perspectives are thus inevitably those of an investment analyst, portfolio manager, and economist. Although this decision-oriented background leads naturally to an approach that is more practical and factual than highly theoretical, it nevertheless assumes some familiarity, supported by the appended glossary, with the language of economics and finance.

This eighth edition has been further revised and broadened and differs from its predecessors by inclusion of a new section relating to the legal aspects and limitations and long tail effects common to all such "experience" industries, reference to the emerging field of the psychology of entertainment, partial restructuring of and additions to the music chapter, enhancement of the section on advertising, and broadening of coverage in the gaming and wagering chapter.

I am especially grateful to Elizabeth Maguire, former editor at Cambridge University Press, for her early interest and confidence in this project. Thanks are also owed to Cambridge's Rhona Johnson and production editor Michael Gnat, who worked on the first edition, to Matthew N. Hendryx, who worked on the second, and to Scott Parris for the third through eighth.

I am further indebted to those writers who earlier cut a path through the statistical forests and made the task of exposition easier than it would have otherwise been. Particularly noteworthy are the books of John Owen on demand for leisure; Paul Baumgarten and Donald Farber on the contractual aspects of filmmaking (first edition; and second with Mark Fleischer); David Leedy on movie industry accounting; David Baskerville, Sidney Shemel/M. William Krasilovsky, and Donald Passman on the music business; John Scarne and Bill Friedman on the gaming field; Gerald W. Scully and Andrew Zimbalist on sports; and William Baumol and William Bowen on the performing arts. Extensive film industry commentaries and data collections by A. D. Murphy of *Variety* (and later, *The Hollywood Reporter* and the University of Southern California) were important additional sources.

My thanks also extend to the following present and former senior industry executives who generously took time from their busy schedules to review and to advise on sections of the first edition draft. They and their company affiliations, at that time, were Michael L. Bagnall (The Walt Disney Company), Jeffrey Barbakow (Merrill Lynch), J. Garrett Blowers (CBS Inc.), Erroll M. Cook (Arthur Young & Co.), Michael E. Garstin (Orion Pictures Corp.), Kenneth F. Gorman (Viacom), Harold M. Haas (MCA Inc.), Howard J. Klein (Caesars New Jersey), Donald B. Romans (Bally Mfg.), and James R. Wolford (The Walt Disney Company). Greatly appreciated, too, was the comprehensive critique provided by my sister, Gloria. Acknowledgments for data in the second edition are also owed to Arnold W. Messer (Columbia Pictures Entertainment) and Angela B. Gerken (Viacom).

Although every possible precaution against error has been taken, for any mistakes that may inadvertently remain the responsibility is mine alone.

I've been most gratified by the success of the previous editions and, as before, my hopes and expectations are that this work will provide valuable insights and a thoroughly enjoyable adventure.

Now . . . on with the show.

Harold L. Vogel  
New York City  
November 2010

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# Part I

## Introduction



# 1

## Economic perspectives

*To everything there is a season, and a time to every purpose under the heaven. – Ecclesiastes*

Extending this famous verse, we can also say that there is a time for work and a time for play. There is a time for leisure.

An important distinction, however, needs to be made between the precise concept of a time for leisure and the semantically different and much fuzzier notion of *leisure time*, our initial topic. In the course of exploring this subject, the fundamental economic forces that affect spending on all forms of entertainment will be revealed, and our understanding of what motivates expenditures for such goods and services will be enhanced. Moreover, the perspectives provided by this approach will enable us to see how entertainment is defined and how it fits into the larger economic picture.

### 1.1 Time concepts

#### Leisure and work

Philosophers and sociologists have long wrestled with the problem of defining *leisure* – the English word derived from the Latin *licere*, which means “to be permitted” or “to be free.” In fact, as Kraus (1978, p. 38) and Neulinger



(1981, pp. 17–33) have noted, leisure has usually been described in terms of its sociological and psychological (state-of-mind) characteristics.<sup>1</sup> And closely tied in to this is the more recent notion that “play” is a fundamental aspect of life.<sup>2</sup>

The classical attitude was epitomized in the work of Aristotle, for whom the term *leisure* implied both availability of time and absence of the necessity of being occupied (De Grazia 1962, p. 19). According to Aristotle, that very absence is what leads to a life of contemplation and true happiness – yet only for an elite few, who do not have to provide for their own daily needs. Veblen (1899) similarly saw leisure as a symbol of social class. To him, however, it was associated not with a life of contemplation, but with the “idle rich,” who identified themselves through its possession and its use.

Leisure has more recently been conceptualized either as a form of activity engaged in by people in their free time or, preferably, as time free from any sense of obligation or compulsion.<sup>3</sup> As such, the term *leisure* is now broadly used to characterize time not spent at work (where there is an obligation to perform). Naturally, in so defining leisure by what it is not, metaphysical issues remain largely unresolved. There is, for instance, a question of how to categorize work-related time such as that consumed in preparation for, and in transit to and from, the workplace. And sometimes the distinctions between one person’s vocation and another’s avocation are difficult to draw: People have been known to “work” pretty hard at their hobbies.

Although such problems of definition appear quite often, they fortunately do not affect analysis of the underlying structures and issues.

## Recreation and entertainment

In stark contrast to the impressions of Aristotle or Veblen, today we rarely, if ever, think of leisure as contemplation or as something to be enjoyed only by the privileged. Instead, “free” time is used for doing things and going places, and the emphasis on activity corresponds more closely to the notion of recreation – refreshment of strength or spirit after toil – than to the views of the classicists.

The availability of time is, of course, a precondition for recreation, which can be taken literally as meaning *re*-creation of body and soul. But because such active re-creation can be achieved in many different ways – by playing tennis, or by going fishing, for example – it encompasses aspects of both physical and mental well-being. As such, recreation may or may not contain significant elements of amusement and diversion or occupy the attention agreeably. For instance, amateurs training to run a marathon might arguably be involved in a form of recreation. But if so, the entertainment aspect would be rather minimal.

As noted in the Preface, however, entertainment is defined as that which produces a pleasurable and satisfying experience. The concept of entertainment is thus subordinate to that of recreation: It is more specifically defined through its direct and primarily psychological and emotional effects.