

Book Reviews*

Entertainment Industry Economics: A Guide for Financial Analysis

By Harold L. Vogel, *Cambridge and New York, Cambridge University Press, fourth edition 1998, pp.490, \$39.95.*

Business economists working in the entertainment industry will recognize this new edition as an old friend. Since its first introduction in 1986, Vogel's *Entertainment Industry Economics* has been the first place professors sent students who wanted to begin serious study of the industry. While the book is serious in the sense of being a no-nonsense, fact-based treatment, complete with supply and demand curves and equations, it is far from humorless. Each chapter begins with a line like, "Break a leg" for the Performing Arts or "Happy trails to you ..." for Financial Accounting in Movies and Television. And then the line is connected to the subject in the introductory paragraph.

The book's subtitle is appropriate, because the focus of the book is the financial side of the industry. However, the book is much broader than accounting or financial analysis *per se*. In fact, these elements are mercifully minimized. The book is a collection of professionally researched industry studies, complete with bibliographic references and data. It covers the economic landscape of entertainment in its broadest sense, including cultural, social and political factors that influence the industry's economics. For example, in the first chapter when entertainment and recreation are differentiated, the value of time is discussed and contrasted with concepts spanning those of Aristotle and Veblin to modern economists such as Becker and DeSerpa. Financial aspects are explained as consequences of broad ranges of intervening variables and forces, from philosophical and social to political and historical. More than one-third of the book is devoted to citations, references, data and technical appendices.

The first chapters are about the cinema. A brief history of movies is recounted, beginning with Edison in the 1890s and the lower Broadway "Kinetoscope Parlor" to the century-later purchase by the Kirkorian group of MGM, MGM's buying the Orion library, and now the explosion of DVD titles. The inelastic market demand for tickets is discussed in the context of the seasonal fluctuations and changes in national income.

*These book reviews have been obtained and edited by Gerald L. Musgrave, Economics America, Inc., Ann Arbor, MI, who is Book Review Editor of this journal.

I was surprised to learn that the real price of tickets has fallen since the 1970s.

Film is like construction in the sense that capital is a critical factor of production. It is interesting that apparently a statistically significant inverse correlation exists, with at least a one-quarter lag, between interest rates and the number of production starts. Also, with at least a six-quarter lag, an inverse relation probably exists between production starts and borrowed reserves (credit availability). The lag structure is consistent with the long lead-time needed to assemble all of the components for motion-picture productions.

Many other aspects of the industry are discussed, including international aspects. Because 30 to 45 percent of the gross rentals earned by the major studios are from outside the United States and Canada, swings in foreign-currency exchange rates substantially affect domestic U.S. firm profitability. Many other economic and financial aspects that would interest potential investors are introduced, as well. In the analysis of the film industry's assets, there is an illuminating discussion of the real-estate holdings of the major studios.

The chapter on the financial foundations of making and marketing movies as well as the one on the financial accounting in movies and television motivates the book's subtitle. They were at just the right level for me. They gave me just enough information to understand the issues and to remind me why I became an economist and not an accountant. However, I recommend the chapters to other business economists. We operate in the business world, and we deal with numbers from financial accounting systems. Because of this, we need to understand the source and assumptions under which those numbers are constructed. Vogel makes a good argument that accounting problems in the industry are more often due to differing views, assumptions and interpretations than intended deceptions. Nevertheless, the book covers numerous arcane practices as well as a dozen simple tricks of the trade like pricing tickets below profit maximizing levels to maximize concession profit, called "downstream diversion." These conditions combine to reduce the transparency or reliability of financial information and reduce investment returns as well. The problem is only compounded because of the already risky nature of the business.

Other industries that are classified as media dependent include music, broadcasting, cable, publishing, and toys and games. Each chapter is a study of how markets and business works. They are fascinating and

written in a clear style that concentrates on economic issues. Each study is presented at a level above popular accounts and yet several levels below the abstraction or technical virtuosity of purely academic inquiry.

The wisdom displayed in the book comes from the selection of material and its concise explanation. No chapter is more exemplary of this than the one on gambling in the section of the book on live entertainment. This section also contains chapters on sports, the performing arts, plus amusement and theme parks. In terms of the general public, the fundamental economics of the gaming and wagering industries are probably the least understood of any industry. As in most entertainment, the one thing you are left with is the memory. However, in gambling the memory might be loosing, so the value must not be that memory. And because consumers spend more on gambling than any other form of entertainment, it certainly has value, and it is not a new value. Vogel traces the history of gambling from biblical times, through the postwar Nevada Bugsy Segel era, to modern issues such as the Indian Gaming Regulatory Act and bets placed via the Internet.

The industry's economics are mysterious to many, although casino and gaming equipment stocks are market favorites. In this chapter, the mathematics of gaming, along with references to *Journal of Political Economy* and *American Economic Review* articles, are melded with the socioeconomic differences between patrons at Caesars World vs. Circus Circus, together with glimpses into the ideas associated with the St. Petersburg Paradox, Friedman-Savage, Bernoulli, Asch, Malkiel and Quandt. This analysis is far from only theoretical interest because, as the author notes, economic analysis can be readily applied to everything from game playing to the determination of optimal credit policy and casino comps. These are practical questions being faced today. How much to "comp" Las Vegas gamblers, meaning to give complementary rooms and other services, was the subject of a recent *Wall Street Journal* story. It was in the special section covering a popular recurring event, the Kentucky Derby. Vogel's gaming chapter also contains sections on horse racing, sports book and lotteries, with appendices listing the legal status of dozens of activities from charitable bingo to telephone betting, plus a section covering international gaming exotica such as Pai Go, Fan Tan, Sic Bo, Trente-et-quarante and more. The chapter demystifies the industry not only for the business economist, but also for the general reader or potential investor.

So, why do people gamble? According to the author, it's entertainment. According to this reviewer, so is the book.

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Housing Partnerships: A New Approach to a Market at a Crossroads

By Andrew Caplin, Sewin Chan, Charles Freeman, and Joseph Tracy, Cambridge, MA, MIT Press, 1997, pp. 280, \$35.00.

Purchasing a home is for many Americans the essence of the American dream. Unfortunately, the dream remains an unattainable dream for many. The current housing finance system requires large down payments that take years for people of moderate means to accumulate. Others can't seem to save at all, because the goal seems unattainable. For these and other reasons, many are kept out of the market. That is on the demand side. On the supply side, some investors would like to invest in the housing market as equity participants. Now it is done via owning a home larger than would otherwise be demanded, or investing in home construction or supply firms. Otherwise they can only participate via the mortgage debt market or in rental property.

The authors of *Housing Partnerships* propose an intriguing solution. They create Partnership Markets that they believe would enable millions more Americans to become home owners and equity investors. They would split or decouple home occupancy from home ownership, i.e., one could own half of the home with a limited partner owning the other half. The institutionalization of limited partnerships between prospective owners and financial institutions would, the book argues, assist many in attaining their dreams of owning a home.

Here's how it would work. Aspiring owners would have the option to buy part of a house; the other portion would be financed by an institutional investor, who would provide capital for part of the down payment and a mortgage in exchange for a portion of the eventual sale price. In essence the limited partner would have an equity interest. Thus, just as a business can finance assets with a combination of debt and equity, the household could finance its largest asset with a combination of debt and equity. The authors also argue that the introduction of institutional investors as partners with the occupant would tend to increase the efficiency of the market.

The Managing Partner would occupy the home as usual, buyers could devote less time to saving for a down payment, greatly reduce their monthly expenses with smaller mortgages, and retain more of their income to spend, save, and invest. For the broader financial community, Partnership Markets would provide new opportunities for investment and diversification into the vast residential real estate market. The Limited Partners would supply equity capital to households in the same way as is currently done to business.

The proposal is based on the argument that, in the current housing finance market, home owners must

purchase the entire asset corresponding to the home in which they reside. The fundamental reason for developing the Partnership Market is that the asset defined by, say, the second half of the house, is worth less to the current home owner than it is to the financial community. They argue that, for the vast majority of home owners, much of their asset portfolio is tied up in their homes. What's more, housing is an extremely risky investment. Together, these two facts imply that a household that owns the whole housing asset should place less value on the ownership of the second half. After all, they argue, the second half of the home asset is perfectly correlated with the first half and is therefore the worst possible form of investment for asset diversification.

The book supplies a detailed structure of how the new arrangements would work and explains the economics behind the housing and mortgage markets as well as the financial risks. The authors also touch upon the innovation's wider impacts, including changes to the secondary mortgage market, the government's role and changes in housing policy, and the composition of assets held by institutions.

In *Housing Partnerships* the authors explain what typical home buyers face in the housing market and how Housing Partnerships might make the market work better for them. The book gives quantitative examples of the financial impact of the plan. In addition there is now a web site for the book, and it has a calculator where various alternatives can be entered. For example, a potential buyer who desires a \$125,000 house with a \$20,000 down payment is told that a traditional mortgage would be \$108,750 and would result in monthly payments of \$875. The Partnership mortgage would be \$47,500, with monthly payments of \$349. Or one can enter annual income, say, \$40,000 with the \$20,000 down payment. The calculator reports that the traditional maximum available mortgage would be \$111,000 and would require monthly payments of \$726. However, with the Housing Partnership a much larger home valued at \$173,900 with monthly payments of \$568 would be possible. The web site address is http://mitpress.mit.edu/ebooks/housing_partnership/calcpage.html for those who want to conduct their own experiments. The web site also has an interesting section covering frequently asked questions on just how the system would work in practice.

One element of moral hazard that might be reduced is the risk of default. For any given home value, the payment would be lower. However, some might simply trade up, as is presumed in the web site calculator, and not much risk reduction might result. On the other hand, home maintenance might increase moral hazard. Because only part of the asset would be owned by the Managing Partner, less maintenance and

repair would be expected if the occupant were to be responsible for all expenses. The home rental and auto leasing industries seem to be able to handle related issues. However, they are contentious. These points are mentioned in the book, but it would probably take a few business cycles to see how the market actually reached stability.

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U.S. Industry & Trade Outlook '98

DRI/McGraw-Hill, Standard & Poor's, U.S. Department of Commerce/International Trade Administration, pp. xxxix, 780, 1998, \$69.95.

It is always good to see an old friend, especially when the friend is dressed up in new clothes. This comment certainly applies to the revived and renewed *U.S. Industry & Trade Outlook*. This book is the successor to the *U.S. Industrial Outlook*, which was published by the International Trade Administration of the Department of Commerce until 1994, when budget constraints caused its demise. The new publication is the result of a public-private partnership between the Department of Commerce and the McGraw-Hill Companies. The contributing authors of the book are divided between the Commerce Department plus government agencies and the McGraw-Hill Company authors. As in the past, the Outlook is anchored by federal statistical data and industry outlooks with forecasts that are objective and bias free.

As Secretary of Commerce William Daley says in an introductory letter, "The *Outlook* is intended as a basic resource for information and also as a source of ideas for business development." The book starts with a set of economic assumptions for the United States for 1997-98, followed by a chapter on the outlook for the major areas of the world, with emphasis on those that are the top twenty markets for U.S. manufacturers. The following chapter highlights the major findings, including a table with forecasts of growth rates for 149 manufacturing industries and groups. The subsequent fifty chapters provide analyses and forecasts for major manufacturing and service industries, with both domestic and international perspectives.

The industry classifications continue to be based on the *Standard Industrial Classification Manual*. The new North American Industry Classification System (NAICS) presumably will be reflected in future issues. Most chapters begin with a new feature, a standard set of graphs that illustrate world market share for the industry, U.S. trade, export dependence and import penetration, and then output and output per worker. Chapters also discuss global industry trends and an

outlook through 1998. The tables in chapters that cover the SIC-coded manufacturing industries show historical data on the value of shipments, imports and exports for 1989, 1992 through 1995, estimates for 1996 and 1997 and forecasts for 1998. Historical data also are provided for capital investment, employment and earnings. Trade pattern tables show exports and imports for the six major areas of the world (NAFTA, Latin America, Western Europe, Japan/Chinese Economic Area, Other Asia, and the Rest of the World). Glossaries are added to each chapter that have substantial industry-specific terminology.

Each chapter has numerous tables that provide handy references. In addition to the text and tables, the

design of the book – its more than 650 charts, numerous tables and text – makes it attractive and readable. And, like its predecessor, each chapter concludes with references as well as the names and telephone numbers of the authors for those seeking more assistance. Based on past experience, these authors are very knowledgeable and have always been ready to help whenever asked.

As a ready reference and a useful source of information on a multitude of industries, the *Outlook* is unsurpassed. It provides a valuable resource for business economists in performing their daily tasks.

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