1 | What Is Special About the Economics of Entertainment Industries?

Each industry possesses certain characteristics which, while not necessarily unique, contribute to the distinctive nature of its business. What is special about the entertainment industries? Do the basic principles of economics apply to movies, popular music, professional sports? In some sense, the fields of economics and entertainment could not be further apart: the latter is about cheering up people, whereas the former is oft described as the dismal science. But as I will argue next, while it would be foolish to ignore the idiosyncratic features of the entertainment industries, it would be equally wrong to ignore the economics they contain.[1]

Managing creative talent

Most entertainment offerings result from the confluence of various creative talents: from the scriptwriter to the movie director to the actor; from the songwriter to the composer to the singer; and so forth. It is no exaggeration to say that frequently artists have a high opinion on themselves and are easily irritable. Managing such source of creative value is no small task.

The concept of prima donna originates in opera, and opera is one of the best examples of the difficulties of dealing with difficult people whose contribution is essential for the running of an operation. Those who can manage such a daunting task are nothing less than management hall of famers. Take Joseph Volpe, general manager of the New York Metropolitan opera from 1990 to 2006. Some criticize him for the "dictatorial" way in which he handled artists: "Superstar singers are pampered and granted wide-ranging artistic control, but anyone who doesn't guarantee a sold-out house is treated with a shocking disdain."[2] Be that as it may, most agree that, under Volpe's tenure, the Met solidified its position as one of the leading opera companies worldwide. He was a model of efficiency.

Take another example from the music world. Producer George Martin is frequently referred to as "the fifth Beatle," and not without reason: Martin crafted song structures, wrote beginnings and endings, harmonies and solos (*All You Need Is Ears* is the title of his autobiography). But equally important, he knew how to deal with each band member according to his unique personality. He would sit at the piano to work with McCartney; do his best to accommodate Lennon's vague requests ("I want you to score this for me"); attempted to encourage Harrison's songwriting (thought admittedly too late); and generally tried to encourage the always underrated and somewhat under-appreciated Starr. "I taught them a few tricks and they were very quick to learn — like hothouse plants, they just sprung up."[3]

One could go on and on giving examples of why people are important and special — and difficult to deal with. One of my favorite stories is that of *The Third Man* (1849), the classic *film noir* set in post-war Vienna. The fact the movie was finished at all is a miracle of sorts, considering all the conflicts that arose among the various parties involved: screenplay writer Graham Greene and producer David Selznick clashed over the choice of an ending; director Carol Reed had difficulty in getting lead actor Orson Welles to set a time for shooting in Vienna; and then, when Welles finally arrived, the actor refused to continue filming the scenes set in Vienna's sewers, an important part of the thriller. Carol Reed, besides being a first-class director, should also be credited for his patience and tact in dealing with such a group of strong egos. He was also humble enough to welcome Welles' multiple suggestions and ad-libs, including the now famous "cuckoo clock" speech. Finally, Reed also showed his ability to spot talent when he heard zither player Anton Karas at a Vienna party and eventually lead him to work on the movie's soundtrack, including the unforgettable "The Third Man Theme."

To sum up: It is a common mistake — and a frequent one among economists — to take labor as just any other generic production input. In the case of creative industries, it is a particularly big mistake.

Buyers, sellers and engagement

In a certain sense, a star is a seller who supplies a service (entertainment) to fans. But the relation between stars and fans goes well beyond that of buyer and seller. Suppose that ACME Widgets — a company you know nothing about — decides that, henceforth, each customer will pay whatever he or she feels like. It's a fair bet that the widget supplier will quickly file for bankruptcy.

But witness the recent experiment by British rock band Radiohead: their seventh studio album, *In Rainbows*, was released online on October 10, 2007. The price?—Whatever each downloading fan decides is fair. While exact figures are not available, some analysts estimate that 1.2 million copies were sold, well above the 200–500k range of previous releases. *CNN Money* found Radiohead's move worthy of their "101 Dumbest Moments in Business" list, but the math suggests that the band may have come out well ahead.

The comparison between widgets and songs is not entirely fair: the marginal cost of a music download is zero, whereas that of a widget is not. A better comparison might be between Radiohead and a software developer (since the marginal cost of a software download, like music, is zero). Would downloaders be willing to pay for free software if they were offered the same deal as Radiohead? Probably not.

Dumbest Moment in Business? —Not likely.

In Chapter 6 I examine additional examples of the general principle that the relation between star and fan is more complex than the relation between buyer and seller. While the examples are all from the music industry, the idea extends to other entertainment industries, including movies and professional sports.

It's not the money, it's the principle

David Puttnam will not win any popularity contest in Hollywood, but he is unquestionably one of the industry's most influential figures. In his *Undeclared War*,[4] Puttnam sets out his thesis that movies and TV shape attitudes and values, create conventions of style and behavior. For this reason, he argues, creative artists share a heavy moral responsibility to inspire and affirm, not just to entertain.[5] For example, Puttnam recently said that "films featuring violence and aggression devoid of human consequences lead to the growth of bullying in the playground, with children imitating what they saw on the big and small screens."[6] More generally, he blames the entertainment industry for creating a world of "moral ambiguity:"

> In the 1960s we decided moral ambiguity was a more interesting subject. The trouble with moral ambiguity is you are creating doubt in the minds of young people and it is probably more than a lot of them can cope with at such an early age.[7]

In other words, the movie and TV businesses are not just like any other business. "Films must transcend profit and loss." They should make a profit "but profit isn't enough. We do have other responsibilities."[8] Nor is Puttnam just talking the talk, as shown by an impressive list of financial and artistic hits such as *Chariots of Fire*, *The Mission* and *The Killing Fields*.

The idea that the bottom line is not the bottom line extends beyond beyond movies and television. In professional sports, a related issue is that of team loyalty. When F.C. Barcelona star Luís Figo left for archrival Real Madrid — thus becoming the first "Galatico" — he immediately became persona non grata at Nou Camp — or worst than that, some would argue. The argument that the deal made of lot of business sense seemed irrelevant — at least to his former Catalan fans.

The conflict between financial and other objectives may also imply a conflict between the management and the creative agents of a business. Consider for example the problem of

In one of the most controversial sports transfers ever, Portuguese soccer legend Luís Figo left FC Barcelona for Real Madrid Madrid in the summer of 2000 for what was then a world record transfer fee. "For me [joining] Madrid was a new stage. I joined them to earn more in every way — prestige, titles and money — and I got them." Barcelona fans, however, were furious and let him know it: on Figo's first re-appearance in Barcelona, the crowd's jeers and missiles led the referee to suspended the match for 13 minutes, fearing for the players' safety.

monetizing newspaper content. In 2011, *The New York Times* re-introduced a "paywall" on access to its content. This is probably the best business solution for a newspaper struggling with declining readership of its paper edition; but is it the best outcome for content creators, such as the newspaper's columnists? Thomas Friedman, for example, has an interest in the *Times*' financial success, just as every employee is concerned with his or her employer's economic viability. But Friedman is equally or more interested in attracting a wide audience, and raising a paywall may considerably limit readership.

Technology and content

History has shown that the relation between technology and content is not always what it seems at first. In 1982, as the consumer video-cassette recorder (VCR) became increasingly popular, Jack Valenti, then president of the Motion Picture Association of America, declared that "the VCR is to the American film producer and the American public as the Boston strangler is to the woman home alone."[9] But by 2004, 72% of the U.S. movie industry revenues came from rentals or sales of videotapes and digital video discs.[10]

Since the days of the video-cassette recorder, various entertainment-relevant technological developments have taken place, including in particular the Internet. Together with the trend towards greater globalization, these have changed (and continue changing) the business models of the music industry, the movie industry, professional sports, and so forth. Have the new combinations of technology and content increased or decreased value? How do the various players stand to gain or lose from technology evolution: hardware vs software, talent providers vs promoters, small stars vs superstars? These are some of the important open questions in many entertainment industries (and media industries, one might add).

For example, in Chapter 7 I consider the impact of digital technologies and the Internet on the evolution of the music industry. Some argue that the 2000s were the industry's lost decade: CD sales, for example, dropped by more than 50% from 2000 to 2010. But if we consider all of the music related revenues — including digital downloads, concerts, merchandizing and in particular music related hardware — then we observe a healthy growth rate throughout the entire decade. We thus have a case of value shift more than one of value destruction.

Competitors and complementors

Co-opetition, the business best-seller by economists A. Brandenburger and B. Nalebuff, popularized the concepts of competitors and complementors.[11] All too frequently, the authors argue, we think of business strategy as an attempt to capture the greatest slice of the pie. But more often than not what matters is how different players within the same industry come together to *increase* the size of the pie. When that happens, they act as complementors — even if, strictly speaking, they are market competitors.

The phenomenon of complementors is not unique to entertainment industries (a classical example is that of Microsoft and Intel). However, most entertainment industries feature one or more instances of complementarities of the sort described in *Co-opetition*. For example, revenue sharing contracts in the home video industry, which became popular in the late 1990s, were responsible for significant increases in industry value. Here we have a situation where studios and video-rental stores came together not so much to negotiate the split of existing revenues but rather to find new ways to organize distribution that would be mutually beneficial.

The movie industry is rich in examples of of complementors. Consider for example the *Lion King* franchise. In addition to the movie, there is the Broadway play, the theme park attractions, the book, and a whole series of merchandizing products. To the extent that these are owned by different players, then we have a situation of complementors. When a promotional effort by the Broadway play leads to increased ticket sales,

Professional sports leagues are another important instance of complementors. There is a clear and obvious way in which the different teams in a given league are competitors: when F C Barcelona and Manchester United meet on the field, they play a zero-sum game ("my gain is your loss"). But there are many business and sports issues on which the two teams' interests are aligned: for example, the design and governance of the Champion's league or a possible European super-league.

What is *not* special about the entertainment industry?

Having argued that the entertainment industries are in some respect unique and special (and closely related to each other), I should now add that there are also many ways in which the entertainment industries are very similar to other industries. For example, the distribution of movie revenues has been shown to be quite skewed, with quite a few blockbusters that fall outside Normal distribution patterns. Box-office "fat tail" revenue distributions turn out to be very similar to those of pharmaceutical drugs. In fact, there is a certain similarity between a medical drug's creative process and that of a motion picture, both in terms of the talent it entails and the outcome uncertainty it leads to.

A second example is given by music and beer (two industries that are closely related in the eyes of the consumer). Some say that the music industry is evolving in the direction of a greater number of very small artists ("the long tail") and a small number of increasingly big artists ("superstars"). If we look at the evolution of the beer industry, we observe (in the U.S., perhaps also in other countries) an increase in size of the top players but also the emergence of a large number of very small producers — just as in the music industry. Can the parallel be extended?

A third example is given by pricing. In 2003, the New York Mets, a Major League

Baseball (MLB) team, introduced variable pricing. Until then, all tickets for a certain stadium seat were priced the same regardless of the game being played. Beginning with the 2003 season, "better" games were classified as "gold" and priced accordingly, followed by "silver," "bronze" and "value" games. Beginning with the 2009 season, the San Francisco Giants, another MLB team, introduced dynamic pricing, whereby a given game's ticket prices are adjusted in "real time" according to the starting pitcher, the opponent's current standing, etc.

Anyone flying on a commercial airline should be familiar with these pricing strategies, both in terms of quality tiers and in terms of dynamic adjustment. Can sports teams learn from airline pricing? The same might be said of rock concert organizers. And are movie theaters leaving money on the table by setting uniform prices (that is, prices that do not vary as a function of each movie's popularity)?

In summary, the study of entertainment industries is greatly enriched by the knowledge of industries such as air travel or pharmaceuticals. Conversely, the knowledge gained by studying the business of entertainment may help understand the workings of other industries as well. There is an element of generality in economics that transcends the particular industries it is applied to.

Endnotes

1. Not surprisingly, other scholars have different views as to what is distinctive about the entertainment industry. See the introductory chapter in Richard Caves, *Creative Industries*, Harvard: Harvard University Press, 2000. See also William Grampp, *Pricing the Priceless: Art, Artists, and Economics*, New York: Basic Books, 1989.
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3. Alan Light, "The Real Fifth Beatle," music.msn.com, visited April 2009.
4. David Puttnam, *The Undeclared War: The Struggle for Control of the World's Film Industry*, London: Harper Collins, 1997.
5. John Baxter and Michael Perkins, "Hollywood or Bust," *The Autstralian*, July 9, 1997.
6. Sarah Womack, "Puttnam blames violent films for increase in playground bullying," *The Daily Telegraph*, April 20, 2005.
7. Ben Russell, "Hollywood Distorts History, Says Puttnam," *The Independent*, June 1, 2000
8. Aljean Harmetz, "David Puttnam, A Force in International Films," *The New York Times*, May 3, 1983.
9. U.S. House, April 12, 1982. Cited by Oberholzer-Gee and Strumpf.
10. Digital Entertainment Group 2005; MPAA 2005.
11. A. Brandenburger and B. Nalebuff, *Co-opetition*, New York: Currency Doubleday, 1996.