Joseph L. Rotman School of Management
University of Toronto

MGT 2019: Entertainment Industry Strategy
Prof. Olav Sorenson

RSM 157: Wednesdays, 6:30 p.m. to 8:30 p.m.

Course overview

In this course, we will examine some economic features common to most entertainment industries, how those features pose unusual challenges for managers, and some approaches for overcoming those challenges. These features include:

- Large fixed costs for the first copy of new products and brands, but small variable costs for each additional copy;
- Intrinsic uncertainty in the probable success of products prior to their introduction into the market; and
- An unusual relationship between product age and value: on the one hand, products initially lose their value rapidly; on the other hand, the goods produced retain some residual value for an effectively infinite period, raising interesting questions about the value of 'libraries' versus new products.

I have three main goals for the course. First, I wish to give you a nuanced view of the structure of several entertainment industries (film, television, team sports, music and video games), and to help you understand how those structures affect firms operating within and interacting with these industries. Second, from these specifics, I intend to extract a set of general strategies that firms in almost any industry can use to cope with the challenges posed by operating in high risk, high fixed cost environments. Finally, via the assignments and in class analysis, I hope to improve your skills for using data to inform decisions.

I have designed the course to interlace two elements. First, through lectures and readings, I will detail the workings of several industries in this sector: Who are the major players? Who captures the profits? Who bears the risk? How have the interactions between these players evolved over time? Second, through a series of lectures and case discussions, we will analyze how firms within these industries create and capture value, and manage the risks associated with those activities: How do these strategies work? Do they have their own associated risks? Who wins and who loses from their implementation?

Assessment

I will evaluate your performance in the course on four components: two assignments, class discussion, a midterm project and a final paper. I will weight them as follows in determining the final grade.

Component	Weight
Assignments (2)	20% (10% each)
Class participation	20%
Midterm project	30%
Final paper	30%

Assignments: In sessions two, three and four, at least one of the cases has an assignment option. You must do two of these, but you can select which two of the four you prefer. All of these exercises involve some quantitative analysis using a spreadsheet. Beyond the quantitative modeling, you should not need to write more than one or two pages to answer the questions. Please e-mail your assignment (write-up + spreadsheet) to me the day *before* the class in which we will discuss the case to which it pertains. I may ask you to describe your approach in class, so please come prepared to explain your analysis to others.

Participation: Through effective class discussion, we will all learn more about the industry and its operations. You add value when you (i) listen to others, (ii) *constructively* critique others' arguments, (iii) ask questions or pose arguments that improve our understanding of the materials, (iv) describe and connect related personal experience to the discussion, and (v) integrate material from other courses into the discussion.

Midterm project: In teams of four students, you should select an industry sector (if you want to learn more about a sector not covered in depth in the class, this project could serve as a good means of doing so) and compare the strategies, economic performance, and underlying assets of two firms in that sector. Teams may wish to break into two sub-teams of two and dissect each firm, then bring the results together to compare, defend, and contrast their results. I expect you to use publicly available data unless for some reason you already have access to other information on the firm. You should select your teams and companies by the third class session. In session 8, each team will have roughly 15 minutes to present their results. An annotated version of the slide deck can serve as the written report for the midterm project.

Final paper: For the final paper, you should pick a publicly traded entertainment company and write a 10- to 12-page analyst's report (not including exhibits). The report should address the competitive landscape in the industry, the firm's current strategy and its future prospects. Your report should also estimate a value for the company and recommend whether investors should consider purchasing the stock at its current price. You should submit this report by the time of the final class meeting.

Instructor

You can reach me either by e-mail (`olav.sorenson@rotman.utoronto.ca`) or telephone (416-946-5511). For those interested in a quick response, I would recommend the former over the latter.

If you wish to talk with me for whatever reason, I hold office hours every Tuesday afternoon (1:30 p.m. to 5:30 p.m.). If you do not wish to wait, please sign up for an available time slot by noon on Tuesday. I have a sign up sheet posted on the board next to my office.

Schedule

1. Course introduction & Introduction to the film industry.
   - Reading: Chapter 3, Vogel
2. Valuing uncertain projects.
   - Reading: DeVany, Arthur, & W. David Walls (2002), "Does Hollywood make too many R-rated movies? Risk, stochastic dominance, and the illusion of expectation." *Journal of Business*, 75: 425-451
   - Case: *Investing in Motion Pictures*

     Study question:

     (a) In which option would you invest? Why?
   - Case: *Arrundel Partners: The Sequel Project*

     Assignment option: Estimate the per-firm value of a portfolio of sequel rights such as Arrundel proposes to buy (you may find it helpful to consult the Appendix to understand better the data in Exhibits 6-9). What problems might Arrundel encounter in writing an enforceable contract?

     Study questions:

     (a) Why do the partners want to buy the rights in advance rather than negotiating on a film-by-film basis?

     (b) What other information would help you refine your analysis?

3. Profiting from individual projects.

   - Reading: Chapter 4, Vogel
   - Reading: Desai, Mihir A., Gabriel J. Loeb & Mark F. Veblen (2002), "The strategy and sources of motion picture finance." HBS Teaching Note 9-203-007
   - Case: *Tax-Motivated Film Financing at Rexford Studios*

     Assignment option: Estimate the value of the deal to each party. Who benefits the most from the deal? Should either party try to renegotiate?

     Study questions:

     (a) How does the proposed financing structure create value?
     (b) What risks does each party face?
   - Case: *Introducing The Matrix: Reloaded*

     Assignment option: Approximately how much does the sequel need to earn at the box office for Warner Brothers to break even (hint: model other sources of revenue as multiples of the box office)?

     Study question:

     (a) How much money did Warner Brothers earn on *The Matrix*?

4. Profiting from portfolios.

   - Reading: Brynjolfsson, Erik, Yu Hu & Michael D. Smith (2006, Summer), "From niches to riches: Anatomy of the long tail." *MIT Sloan Management Review*: 67-71
   - Case: *Netflix vs. Blockbuster* (to be distributed)

     Assignment option: At what price can Netflix break even? Should Blockbuster match Netflix's pricing?

     Study questions:

     (a) What value does Netflix offer to its customers?
     (b) Is Netflix a threat to Blockbuster?
     (c) How should Netflix respond to Blockbuster?

5. Introduction to the television industry.

   - Reading: Chapters 6 & 7, Vogel

6. Profiting from vertical scope.
   - Case: *Fox Entertainment Group (A): Vertical Integration in the Television Industry*

     Study questions:

     (a) How did Fox manage to enter the broadcast television industry successfully?
     (b) Does vertical integration help or hinder Fox?
     (c) How does vertical integration change the incentives for producers and distributors?

7. Profiting from horizontal scope.
   - Case: *Viacom, Inc. – Carpe Diem*

     Study questions:

     (a) What factors account for Viacom's domestic success?
     (b) What should Biondi do about the proposed Kirsch deal?
     (c) How should Viacom manage issues such as the one it faces in the case?

8. Midterm project presentations.

9. Introduction to team sports.
   - Reading: Chapter 12, Vogel

10. Leagues and other forms of collusion.
    - Case: *Broadening the Field: The NFL and Arena Football*

      Study questions:

      (a) Should the NFL exercise its option to acquire Arena Football?
      (b) Who stands to benefit most from the acquisition?
      (c) What risks does the NFL face in such an action?

11. Standards battles.
    - Reading: Shapiro, Carl & Hal R. Varian (1999), "Waging a standards war." Pp. 261-296 in *Information Rules*, Boston: Harvard Business School Press
    - Case: *Playstation 3 and the Next Generation of Video Games* (to be distributed)

12. Technology and the future of distribution.

   - Case: *Peer-to-Peer File Sharing and the Market for Digital Information Goods*

     Study questions:

     (a) Why have P2P networks been so successful?
     (b) How many filesharing networks will survive in the long term?
     (c) Why has iTunes been so successful?
     (d) Who will win the competitive battle over the long run?

13. Final paper presentations.

Materials

Harold L. Vogel (2004) *Entertainment Industry Economics: A Guide for Financial Analysis (6th Edition).* New York: Cambridge University Press

Course reader contents:

1. DeVany, Arthur, & W. David Walls (2002), "Does Hollywood make too many R-rated movies? Risk, stochastic dominance, and the illusion of expectation." *Journal of Business*, 75: 425-451

2. *Investing in Motion Pictures*, UCLA Case POL 2003-4

3. *Arrundel Partners: The Sequel Project*, HBS Case 9-292-140

4. Desai, Mihir A., Gabriel J. Loeb & Mark F. Veblen (2002) "The strategy and sources of motion picture finance," HBS Teaching Note 9-203-007

5. *Tax-Motivated Film Financing at Rexford Studios*, HBS Case 9-203-005

6. *Introducing The Matrix: Reloaded*, UCLA Case POL 2003-5

7. Brynjolfsson, Erik, Yu Hu & Michael D. Smith (2006, Summer), "From niches to riches: Anatomy of the long tail." *MIT Sloan Management Review*: 67-71 (SMR215)

8. *Fox Entertainment Group (A): Vertical Integration in the Television Industry*, UCLA Case POL 2003-7

9. *Viacom, Inc. – Carpe Diem*, HBS Case 5-398-174

10. *Broadening the Field: The NFL and Arena Football*, UCLA Case POL 2003-6

11. Shapiro, Carl & Hal R. Varian (1999), "Waging a standards war." Pp. 261-296 in *Information Rules*, Boston: Harvard Business School Press

12. *Peer-to-Peer File Sharing and the Market for Digital Information Goods*, HBS Case 9-706-479