

What opportunities
made cinemexs
success possible
finance essay



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Several factors made it possible for Cinemex to emerge as a highly successful exhibition movie theatre chain. First, the Mexican exhibition market was highly regulated for decades and these regulations established a fixed, low ticket price. This provided a disincentive for exhibition owners to invest in their properties since they were unable to raise ticket prices to compensate for their investments. The end-result was a growing collection of “old and dilapidated” theatres. When the regulations were lifted, Cinemex co-founders Matt Heyman, Adolfo Fastlich, and Miguel Angel Davila believed that an opportunity to provide a high-end movie watching experience by constructing state-of-the-art theatres existed. The team “followed a strategy of differentiation through branding.” Cinemex improved moviegoers’ experiences by installing larger screens, providing better sound, employing courteous staff, and making other improvements over what was considered the typical Mexican exhibition. Based on the information available, this quality advantage seemed to last at least until Cinemex was acquired by Canadian buyout firm Onex.

Next, Cinemex capitalized on the declining value of the peso in late 1994 and early 1995. This decline allowed Cinemex to purchase land at a cheaper price. Furthermore, it fortuitously (for Cinemex) discouraged potential competitors in the high-end field, such as AMC and Lowes, from entering the Mexican market. The value of the Mexican Peso continued to substantially decline. This made it continuously cheaper for Cinemex to use US Dollars to purchase new land to build Mexican movie theatres. Further, the improving Mexican economy, population growth in Mexico City, and continued emergence of middle class in Mexico all provided opportunities for Cinemex.

Graph the time series of attendance and prices for each Wednesday in 2001. What factors account for the week-on-week differences in attendance for Cinemex and the city as a whole? What is the interpretation in terms of a demand curve?

Several factors account for the week by week differences in attendance for Cinemex and Mexico City theatres. Factors such as the ticket price, time of the year, popularity of current films, local weather conditions, and timing of holidays all made attendance highly variable from week to week. In terms of the demand curve, it may move “ out” or “ in” depending on the combination of the above variables.

In Spring 2001, Cinemex’s main competitor introduced 2-for-1 pricing. Describe, in conceptual terms (and using a demand diagram), the effect this had on Cinemex’s demand curve. In the same diagram show the effect of Cinemex’s price response.

Conceptually, when Cinemex’s competition introduced 2-for-1 pricing, the demand curve for Cinemex moved “ in” (or “ left”). At a given ticket price, a certain percentage of moviegoers who would typically choose to see a film at Cinemex would instead choose to forego the additional quality of Cinemex’s theatres and take advantage of Cinemex’s competitors’ lower prices.

In the chart below, D0 (blue line) is the demand at a given price for Wednesday showings at Cinemex before the 2-for-1 pricing was introduced by competitors. D1 (red line) represents the reduced demand for Cinemex after 2-for-1 pricing was introduced by competitors. Finally, the bullet point

outlined in yellow on line D1 reflects Cinemex's new Wednesday 2-for-1 price.

0: Equilibrium before price changes

2: Cinemex lowers price on Wednesdays

1: Cinemex demand moves left after

competitors introduce 2-for-1 pricing

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Please note, D1 is shown to the left of D0 since we are speaking in conceptual terms. In actuality, other factors beneficially impacting Cinemex may place the true location of D1 to the right of D0. Further, the price change took place over a year after the initial placement of D0. Therefore, there is some time for beneficial factors to have a sum impact that is relatively more positive than the negative impact Cinemex competitor's price drop would have. We explore these possibilities in later answers.

How would you construct a counter-factual scenario for what would have happened had this 2-for-1 pricing by competitors not occurred? [Suggestion: one useful place to start might be to compare 2001 to 2000. Explain your answer in terms of the diagram you drew in the previous question.]

The 2-for-1 pricing by Cinemex competitors did not occur until after week 13 in 2001. Therefore, by comparing the weeks 2 through 13 in 2000 and 2001, we can estimate the increase in attendance from comparable periods in the remaining weeks. This “growth factor,” or ratio, can then be applied to the 2000 attendance figures in order to estimate what the attendance in 2001 would have been if Cinemex’s competitors had not put forth the 2-for-1 deal. Applying the growth factor eliminates the effects of Cinemex’s competitors’ 2-for-1 deal and creates counterfactual data that takes into account other socioeconomic factors driving increased attendance over time. These socioeconomic factors include low unemployment, low inflation, population and GDP growth, and the continued emergence of the middle class. Essentially, this methodology allows our team to reconstruct the original demand curve (D0) and account for growth in the overall market.

Construct this counterfactual for attendance. Discuss how you isolate the effect of the competitor's price change from the effect of all the other things pushing demand around (the stuff you discussed in part (b)). Be clear about the extent to which you are able to do this (remember no analysis of real data is ever perfect in this regard, but it is important to be able to spot the limitations of whatever methodology you do employ).

The table below illustrates attendance at Cinemex on Wednesdays. Weeks 2 through 13 can be analyzed between 2000 and 2001 to determine a “growth factor” for Cinemex. This “growth factor” is determined by taking the ratio between the average attendance numbers of 2000 and 2001 for Block 1. In this case, the “growth factor” is equal to 1.09 (it is the same between 2001 and 2002). The predicted Cinemex attendance for 2001 (depicted in the table below) is determined by multiplying the 2000 attendance numbers, for Blocks 2 through 5, by 1.09. The result of this calculation gives the attendance numbers that Cinemex would have seen had its competitors not established the 2-for-1 deal.

Wednesday Attendance Figures – Cinemex

2000

2001 (without 2-for-1)

2001 (with 2-for-1)

Block

Weeks

Actual (Avg)

Predicted (Avg)

Actual (Avg)

1

2 to 13

51602

56445

56445

2

14 to 22

60762

66231

57305

3

23 to 27

66626

72622

67124

4

28 to 34

97717

106511

105479

5

35 to 48

46195

50353

*60642

NOTE: The year was broken down into 5 blocks in order to better analyze the effect of seasonal demand. Week 1 and weeks 49 to 52 were omitted due to the volatility of the holiday season's attendance. Also, predicted and actual

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numbers match for Block 1 due to this period being utilized for determination of the “ growth factor.” *- Indicates that both Cinemex and its competitors are using 2-for-1 pricing.

Using this counterfactual, quantify the impact of competitor’s 2-for-1 pricing in Cinemex’s Wednesday attendance?

Our team analyzed the difference in predicted and actual weekly attendance on Wednesday’s at Cinemex during the time period when Cinemex’s competitors utilized the 2-for-1 deal and Cinemex maintained its pricing (Blocks 2, 3 and 4). The data indicates that the competitor’s 2-for-1 deal adversely impacted Cinemex’s actual attendance. We observe attendance figures that are lower than the predicted attendance figures. The below table quantifies the average weekly impact of the competitors 2-for-1 deal. To arrive at the estimated dollar impact, we multiplied the difference between predicted and actual attendance by the average ticket prices during each Block. For example, the average ticket price during Weeks 14 to 22 was \$20.98. Therefore, \$20.98 times 8962 equals \$187,288.41.

Weekly Impact on Cinemex's Wednesday Attendance

2001

2001

2001

Block

Weeks

Predicted minus Actual (Avg/week)

%

Dollar Value of lost Attendance (Avg/week)

1

2 to 13

0

0.00%

\$ 0.00

2

14 to 22

8926

-13.48%

\$ 187,288.41

3

23 to 27

5498

-7.57%

\$ 114,216.15

4

28 to 34

1032

-0.97%

\$ 21,552.93

Please note, Block 5 was not included in this impact analysis because it encompasses the time period during which Cinemex matched its competitors' 2-for-1 deal.

Cinemex was most adversely impacted during Weeks 14 to 22 and Weeks 23 to 27. Fortunately for Cinemex, the 2-for-1 deal offered by competitors had only a minimal impact on the summer months. This is likely due to the superior quality of socioeconomic conditions and movies offered during this time (i. e, " summer blockbusters"). It appears that individuals are willing to pay a higher price to watch superior movies in a superior environment.

Overall, Cinemex's actual attendance during Weeks 14 to 34 was 1, 589, 718. Our team predicted that had the competitors not implemented a 2-for-1 pricing strategy, Cinemex would have had attendance numbers of 1, 704, 766. This represents an impact of 6. 7%, or 115, 048, on attendance over the 21 week period in which Cinemex did not offer a 2-for-1 deal and its competitors did.

Taking the average ticket prices during Blocks 2, 3, and 4 (\$20. 98, \$20. 77, and \$20. 88 respectively) and multiplying it both actual and predicted revenues allows us to evaluate the dollar impact. Total actual revenue was \$33, 213, 977 and predicted revenue was \$35, 621, 524, a difference of \$2, 407, 547 or 6. 76%.

Building on the strategy you developed, quantify the impact of Cinemex's own 2-for-1 deal on its Wednesday attendance? Discuss your methodology in terms of a demand diagram framework.

Cinemex matched its competitors' 2-for-1 deal in Block 5. Based on the data, it appears that this time period has reduced demand compared to the summer months. Demand appears to be similar to Block 2 (Weeks 14 to 22). Therefore, had Cinemex not matched the 2-for-1 deal and maintained their prices, we assume that their attendance numbers for Block 5 would have dropped by the same percentage as Block 2, or 13. 48%.

Wednesday Attendance Figures – Cinemex

2001

No 2-for-1 Deals

Both Use 2-for-1

Only Competitors Use 2-for-1

Block

Weeks

Predicted (Avg)

Actual (Avg)

Predicted (Avg)

5

35 to 48

50353

60642

43565

As illustrated in the table above, Cinemex's actual average weekly attendance during this period was 60, 642. Cinemex's predicted average weekly attendance for Block 5, assuming no 2-for-1 deals, is estimated by using the aforementioned 1. 09 growth factor. This provides an estimate of an average weekly attendance of 50, 353. If Cinemex had not engaged in the 2-for-1 deal, and its competitors did engage in the 2-for-1 deal, then we predicted the average weekly attendance for Cinemex would decline the <https://assignbuster.com/what-opportunities-made-cinemexs-success-possible-finance-essay/>

same as it did in Block 2, by 13.48% of the 'No 2-for-1 Deals' figure, or a total weekly average of 43,565. This decrease is identical, in terms of percentage (13.48%), as the predicted impact of competitor pricing on Block 2. Blocks 2 and 5 represent the worst case scenario for Cinemex in terms of attendance totals and represent the point of highest demand elasticity.

Overall, Cinemex's actual attendance during Weeks 35 to 48 was 848,988. Our team predicted that if Cinemex chose to not use the 2-for-1 promotion, attendance would have been 690,910. This is a difference of 239,078.

The actual average ticket price for Block 5 was \$15.20. Our team assumed that the average ticket price would have remained roughly the same in Block 5 as it had been in Blocks 2, 3, and 4 had Cinemex not chosen to do the 2-for-1 promotion. The average ticket price for Block 5, therefore, would have been the same as the average ticket price for Blocks 2, 3 and 4, or \$20.88. This results in actual ticket revenue of \$12,908,555 versus predicted revenue of \$12,734,921. The 2-for-1 promotion improved ticket revenue by \$173,634. h) Extending the analysis from the previous question, provide an estimate of Cinemex's

demand elasticity (with respect to its own price) for Wednesdays.

Extending the analysis from Part G, two points on the D1 demand curve have been established and the elasticity (within the 2-for-1 market) can now be estimated for Wednesdays. At the \$15.20 ticket price, elasticity is -0.75. This represents a relatively inelastic demand and Cinemex should increase price.

Demand Elasticity Estimate – Cinemex

Block 5 Attendance

Block 5 Attendance

Cinemex Not Using 2-for-1

Cinemex using 2-for-1

Attendance

43565

60642

Price

\$20.88

\$15.20

Elasticity

-0.75

The equation for the 2001 Cinemex Demand Curve is: , or, in other words, .

Knowing that ; we can determine elasticity at any point of the curve.

Taking the derivative of the Demand curve gives us: ; and so the elasticity equation becomes: ; for any point along the demand curve.

Bottom line: Was Heyman right to match the 2-for-1 pricing? Discuss

Our team believes that Cinemex should not introduce yearly 2-for-1 pricing.

As illustrated in the chart below, our team developed a scoring system to determine which pricing strategy would be most effective.

Cinemex Employs 2-for-1 Deal

2-for-1 customer

Regular customer

20. 43%

79. 57%

Revenue

Ticket Price

\$15. 20

\$15. 20

Concession Per Person

\$10. 00

\$13. 96

Other Revenue Per Person

\$0. 20

\$0. 24

Total Revenue

\$25. 40

\$29. 40

Expenses

Concession Expense Per Person

\$2. 70

\$3. 77

Payroll Per Person

\$3. 82

\$3. 82

Supplies Per Person

\$3. 18

\$3. 18

Occupancy Expense Per Person

\$6. 10

\$6. 10

Total Expenses**\$15. 80****\$16. 87****Total Income Per Person****\$9. 60****\$12. 53****Weighted Average****\$11. 93**

x20. 43% Attendance Growth

Final Score**\$14. 37**

The following assumptions were made:

We took year 2000 actual attendance for Block 5, multiplied by the expected growth rate of 1. 09, and arrived at 50, 353. From here, we saw the actual attendance in 2001, when Cinemex did match prices, to be 60, 642. This is an increase of 20. 43%. Therefore, on average, we expect a 20. 43% increase in attendance as a result of the 2-for-1 promotion. This increase in customers would be made up of a stingier group of individuals. These individuals, instead of paying \$13. 96 on average for concessions, would pay \$10. 00. Also, the “ other revenue” would drop by roughly the same proportion to \$0. 20. We found the average income per moviegoer and arrived at the weighted average of \$11. 93. Then, seeing as attendance increased by 20. 43%, we arrived at a “ final score” for this solution of 14.

37. Finally, we assumed screen advertising would stay the same since Cinemex is now playing to more full theatres rather than half-empty theatres. Argument can also be made that scale could reduce per-ticket costs, but we did not believe the attendance boost was substantial enough for that.

In contrast, had Cinemex not implemented 2-for-1 pricing, the final score would be higher, 18. 51.

Cinemex Does Not Employ 2-for-1 Deal

Regular customer

Income

Ticket Price

\$21. 18

Concession Per Person

\$13. 96

Other Revenue Per Person

\$0. 24

Total Revenue

\$35. 38

Expenses

Concession Expense Per Person

\$3. 77

Payroll Per Person

\$3. 82

Supplies Per Person

\$3. 18

Occupancy Expense Per Person

\$6. 10

Total Expenses

\$16. 87

Total Income Per Person / Final Score

\$18. 51

The final score here is 18. 51, higher than 14. 37. This is because Cinemex can't discriminate against the type of customer. By reducing the ticket price for all customers, it negatively impacts its box office revenues. 80% of the customers would have attended had prices not been reduced. Furthermore, our assumption that the growth will be fueled by stingier customers reduces concession stands sales. These factors combine to make it a money-losing proposal to offer 2-for-1 deals. If Cinemex could somehow strategically target certain Wednesdays or certain customers, the 2-for-1 proposal may be more viable.

Overall, as it stands now, Cinemex should not offer a 2-for-1 deal for all Wednesdays.