Cinemex

In April 2001, Matt Heyman, co-founder of Cinemex, the largest chain of movie theaters in Mexico City, looked out the window of his office and pondered the future of his company. In just seven years, Heyman and his partners had nurtured Cinemex from a student idea into the largest theater chain in Mexico City, but they faced new challenges every day. Many of these challenges came from competitors. For years competitors ran old, poorly-maintained theaters, but in recent months they had begun to imitate Cinemex's top-of-the-line exhibition venues. Their latest tactic: offering two tickets for the price of one on Wednesdays. Heyman wondered whether Cinemex should offer a similar deal, or instead rely on the Cinemex brand and hold the line on price.

Movie exhibition

Movie theaters — known as exhibitors in the film business — are the last link in the chain of events for a theatrical release:

Story Rights Acquisition → Pre-production → Principal Photography →
Post-production → Exhibition

Exhibitors worldwide compete through their locations, their choice of films, and the quality of experience they give their customers. Heyman calls it a straight EBITDA business. Revenue consists primarily of ticket sales (box office) and concessions (food and drink sales). Expenses include film rental (the cost of renting the movie from the distributor, generally a percentage of ticket sales), the cost of facilities, payroll, and the cost of goods sold at concessions.

History of Cinemex

Cinemex started with a student business plan. Heyman and two of his business school classmates, Adolfo Fastlich and Miguel Angel Davila, speculated that Mexico was ready for world-class movie theaters. Decades of regulation, including fixed (low) ticket prices, had produced an installed base of old and dilapidated theaters. When the regulations were lifted, Heyman and his colleagues decided that Mexico City offered an attractive market for a high-end chain of theaters. Rejecting job offers from Blockbuster, Goldman Sachs, McKinsey, Pepsico, and others, they took their plan on the road in search of investors.

In 1994, they secured $21.5m in equity financing from JPMorgan Partners and a partnership of the Bluhm family of Chicago. The deal is generally acknowledged to be the

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This case was written for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The text was prepared by Kenneth Goldman under the supervision of the Stern economics department, with thanks to Matthew Heyman for data and advice. © 2005 NYU Stern School of Business.

largest venture capital start-up in Mexican history. In December the economy collapsed, with real output falling by 15% and the value of the peso falling in half between early December 1994 and mid-1995. Although this made Mexico a less-attractive market in the short run, it also made land cheaper and scared off potential competitors (AMC and Lowes) who had seen the same opportunity. Cinemex opened its first complex, Cinemex Altavista, in August 1995.

From the start, Cinemex followed a strategy of differentiation through branding. Since all theaters have access to the same films, and in some cases the same or similar locations, Heyman felt that the greatest leverage was in the quality of the theater itself. The low quality of existing theaters presented an opportunity to develop a brand associated with quality, including bigger and better screens, complete carpeting in all rooms, well-illuminated interiors, emergency lights on the floors, modern light cards for promotional placards, and attractive marquees. These amenities, considered standard for decades in most American theaters, were seen as almost revolutionary when first introduced into Mexico. The candy shops were the same in all the complexes, with large displays and well-maintained cash registers that allowed for quick service. Management trained its employees to be courteous and helpful. It was also the first movie chain in the world to introduce its own system for customers to purchase and reserve tickets by telephone and the Internet, and was the only chain in the world with 100% digital sound.

This commitment to quality was rewarded by the market. By 2000, Cinemex had captured 52% of Mexico City's movie market and 23% of Mexico's national market. The National Organization of Theater Owners named Cinemex "International Exhibitor of the Year" in 2001. By mid 2002, the company had 349 screens in 31 locations and had generated a reported compound annual rate of return well in excess of 20% for its initial investors.

2-for-1 Wednesdays

In the spring of 2001, Cinemex's competitors began offering a special deal: any customer who purchased a ticket to see a film on a Wednesday (traditionally a slow day at the box office) would receive a second ticket at no additional charge. This ploy cut into Cinemex's attendance figures (see attached file cinemex.xls). On five of the first six Wednesdays after the deal's introduction, Cinemex's attendance was less than in the same week during the previous year.

Heyman faced a difficult decision. Should he offer his own two-for-one deal on Wednesdays? This might raise attendance, but since many tickets would be given away for free, it might also reduce ticket revenues. Or should he do nothing, hoping that the appeal of Cinemex's customer service package would eventually bring customers back?

Heyman's first step was to review his attendance data. What made this difficult was that week-to-week attendance was highly variable, depending on (among other things) the time of year, the popularity of current films, local weather conditions, and the timing of holidays. The question was how to disentangle the impact of these factors from those of price. After waiting a few months, Heyman decided to match his competitor's offer beginning Wednesday, August 29, 2001.

Postscript

In July 2002, Heyman announced the sale of Cinemex to Canadian buyout firm Onex and Los Angeles-based Oaktree Capital Management. He planned to focus on Digital Projection Partners, a startup he formed in 2001 that was in discussions with MPAA companies (movie studios) regarding the funding and implementation of the studios' digital projection initiative.

Questions for Analysis

(a) What opportunities made Cinemex's success possible? Did these opportunities last?

(b) Graph the time series of Cinemex's attendance and prices for each Wednesday in 2001. What factors account for the week-on-week differences in attendance for Cinemax and the city as a whole? What is the interpretation in terms of a demand curves?

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

(d) How would you construct a counterfactual 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.)

(e) 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 employ).

(f) Using this counterfactual, quantify the impact of competitor's 2-for-1 pricing on Cinemex's Wednesday attendance? (That is, provide a number: e.g. the 2-for-1 pricing lead to attendance increasing, for a representative week, by 7,654,321 people or 53%).

(g) Building on the strategy you developed above, 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.

(h) Extending the analysis from the previous question, provide an estimate of Cinemex's demand elasticity (with respect to its own price) for Wednesdays.

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

Notes

Notes on the data file cinemex.xls: Ticket prices are net of film rental. Week 12 in 2001 and Week 18 in 2002 were holidays and were not eligible for the 2-for-1 deal. Week 14 in 2001 marks the start of the competitor's 2-for-1 deal. Week 35 in 2001 marks the start of Cinemex's 2-for-1 deal.

In preparing your answer, provide clear, concise and precise answers. Use diagrams, tables and figures to show how you approach the data. Make sure these tables are no more complex than necessary. Simple and elegant is always better than complex and involved. There is no set length for an answer, but it is certainly possible to provide a clear and complete answer in less than 10 pages (including pictures). That said, if you need to use more to be clear then use it.