Will The Roxy Theater Maximize Profits by Eliminating Its Student Discount?

B. Peter Pashigian
University of Chicago

For once, things were looking up for The Roxy Theater. The Roxy movie theater is located in a small city within walking distance of the university. The Roxy’s management has just learned from the rumor mill that the university movie series, run by the students and heavily subsidized by the university, would be eliminated in 1998. Without the student movie series to compete against, the management is looking forward to an increased student demand for movies shown at The Roxy but is concerned that its seating capacity will fall short of the number of tickets that are demanded.

THE DEMAND FOR FILMS SHOWN AT THE ROXY

There are two sources of demand for films shown at The Roxy. The mainstay demand comes from the general public. They make up the bulk of the total demand for films shown at The Roxy. University students are the remaining component of total demand. There is reason to believe that the shapes of the demand curves of the two groups differ. The Roxy management believes that the general public market is less sensitive to price changes than is the student market. While the management has not conducted detailed statistical studies to verify this, it does act on this premise. The Roxy movie theater has offered students at the nearby university discounts of 20% for many years. Currently, tickets at The Roxy are $6.00 for the general public and $4.80 for students with ID cards. These prices have not changed over the last five years and The Roxy has never faced a serious problem of counterfeiting of student ID cards.
COMPETITION AND SUBSTITUTES

The only competition faced by The Roxy, other than the student movie series, is from the Fine Arts, a movie house 40 miles away. The Roxy’s management does not consider the offerings of this theater to be a close substitute since this distant competitor frequently shows foreign films and is known as an “artsy” movie house. However, The Roxy faces competition from the growing use of VCRs. More and more members of the movie-going public have VCRs, and Blockbuster has an outlet in town. Over time, The Roxy has tried to stay ahead of Blockbuster by showing more first-run films.

RECENT TICKET SALES HISTORY

Over the last 15 years, the theater has had periods where ticket sales have increased and other very brief intervals where they have declined. However, the recent five-year decline in ticket sales has management very concerned. Table 1 shows The Roxy’s ticket sales by type of customer over the last five years.

The Roxy’s management believes the decline in the number of tickets sold to the general public is due to the growing use of VCRs. Ticket sales to the general public have declined by 16.7% over the last five years or by an average of 3.3% per year. Ticket sales to students over the same period have declined by 63.6%. Most of this decline occurred in 1996 when the university introduced its “free” (heavily subsidized) student-sponsored movie series at the university.

THE STUDENT FILM SERIES: RECENT DEVELOPMENTS

Because the university has been losing money during the last two years, it is reviewing all of its activities with an eye to cutting costs and raising revenues. In a period of red ink, the university is no longer willing to subsidize the movie series and wants the series to stand on its own feet by charging much higher prices. It has adopted the philosophy that “every ship should have its own bottom.” In terms of student activities, this means that these ventures should at least break even.

The student sponsors of the movie series support the small fee that is being charged and are opposed to charging more for the films. They claim the tuition that they pay covers the subsidy for student activities. A complicating factor is that the union for all university workers is threatening to strike. Tickets to the series have been sold and collected by student volunteers on the night of the performance. The union has always objected to this arrangement and is demanding that its members be used to sell and collect tickets at the performances. The university strongly disagrees with this position. Since the student organizers of the movie series are unwilling to cross picket lines if there is a strike, it appears that the university will disband the movie series.

MANAGING EXCESS DEMAND

As it begins planning for 1998, The Roxy’s management must decide whether to maintain its current pricing policy or to change it. Before it can decide what prices to charge, it must develop an estimate of student demand in 1998. Assuming the movie series will be eliminated, management forecasts student demand for tickets in 1998 by extrapolating from ticket sales during 1993–95, a baseline period when the student
movie series did not exist. Without a student film series to compete against, the management team anticipates that student demand for films shown at The Roxy will shift outward, and the number of student tickets sold at the discounted student price of $4.80 will rise from 12 per showing in 1997 to 33 tickets in 1998, the average number of seats sold per showing during the 1993–95 seasons. Management estimates a total demand for tickets of 113 tickets per showing, 80 by the general public and 33 by university students.

In retrospect, it appears that management erred by reducing seating capacity to 95 seats in 1996. However, at that time, it was believed that the university was committed to subsidizing the student film series for the foreseeable future. Consequently, it seemed quite reasonable to expect that student demand would be reduced and to accept a profitable offer to downsize the size of the theater.

**WHAT PRICING POLICY TO ADOPT?**

Given its current seating capacity of 95 seats, which cannot be increased in the short run, the management team anticipates that The Roxy will be turning away customers on a regular basis if it stands pat on pricing. If management does not raise the student price, some form of rationing will inevitably limit total demand. Presumably, the rationing will be done by non-price means. It will probably mean that only those students or members of the general public who show up early to buy tickets for each performance will get to see the movie. Having to come early to the theater to improve the chances of seeing the movie is a form of a price increase to a movie fan. Those movie fans that have a high cost of time and are likely to come at the last moment will be out of luck. This is bound to create some ill-will, especially by the faithful customers who have regularly attended showings at The Roxy in the past.

Perhaps Disneyworld can rationalize charging low prices and having 90-minute waits for the Matterhorn ride, but The Roxy’s management team does not see how the interests of its shareholders are advanced by setting low prices and creating queues. Several members of the management team want to eliminate excess demand by eliminating the student discount. After all, they note that it is the increase in student demand that is causing the excess demand problem. Since The Roxy’s management expects the total demand for tickets will exceed its seating capacity if it maintains its current pricing, they say it no longer makes sense to offer students a discounted price. One member of the team put it succinctly, “Why give a student discount when you can still sell out at the higher $6.00 price?” They believe The Roxy’s long standing student discount policy was rational because The Roxy had to fill a theater that had excess seating capacity in previous years. But, through a series of fortuitous circumstances, this is no longer true now nor is it likely to be in the near future. Consequently, they propose to raise the student price immediately to $6.00 and expect this pricing strategy will reduce, if not eliminate, the excess demand. By dropping the student discount, they expect to eliminate the anticipated excess demand and maximize The Roxy’s profits.
Table 1 Seating Capacity and Ticket Sales at The Roxy Theater from 1993 to 1997

<table>
<thead>
<tr>
<th>Year</th>
<th>Seating Capacity</th>
<th>Average # of Tickets Sold per Showing</th>
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<tr>
<td></td>
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<td>General Public</td>
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<td>1997</td>
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STUDY QUESTIONS

1. Do you agree with management's forecast that student demand will average 33 seats per showing and total demand will average 113 seats per showing in 1998? Explain why or why not.

2. Assuming that students have a lower cost of time than members of the general public and therefore will come earlier to the theater to purchase tickets, present an estimate of the increased profits The Roxy will earn if it raises the student ticket price to $6.00?

3. Do you agree or disagree with the decision to raise the student price to $6.00? Will the price increase maximize The Roxy's profits? Be prepared to defend or criticize the management's decision at the next class.

4. Comment on the statement, "Why give a student discount when you can sell out at a higher student price?"