

Case 9-4: Cost Volume Profit (CVP) Analysis and Strategy: The ALLTEL Pavilion

The ALLTEL Pavilion in Raleigh, North Carolina is an outdoor amphitheater that provides live concerts to the public from April through October each year. The seven-month season usually hosts an average of 40 concerts with 12 year-round staff planning and managing each season. SFX Entertainment Inc. operates the pavilion. SFX is the largest diversified promoter, producer, and venue operator for live entertainment events in the United States. Upon completion of pending acquisitions, it will have 71 venues either directly owned or operated under lease or exclusive booking arrangements in 29 of the top 50 U.S. markets, including 14 amphitheaters in nine of top 10 markets.

HISTORY/DEVELOPMENT

The ALLTEL pavilion was built in 1991 by the City of Raleigh and Pace Entertainment Company of Houston, Texas. The management of the pavilion was contracted to Pace Entertainment and Cellar Door Inc. of Raleigh, NC. Hardee's Food Systems, Inc. of Rocky Mount, NC, the original sponsor of the amphitheater, paid an annual fee to carry their name and logo on all signs and ads regarding the amphitheater. On February 3, 1999 the title sponsor for the amphitheater became ALLTEL Corp.

The demand for the outdoor facility came about because the rapidly growing city of Raleigh lacked a major entertainment complex. So, in the mid to late 80s and early 90s Pace Entertainment and the City of Raleigh came to an agreement to build the facility. The City of Raleigh would own the land while Pace Entertainment would assume sole operations of the facility and Cellar Door would do the booking for all the concerts.

In 1998, SFX Entertainment Inc. acquired Pace Entertainment Inc. The amphitheater facility and its employees became part of SFX Entertainment Inc. Also, in 1999 SFX Entertainment Inc. acquired Cellar Door Inc. and merged with Clear Channel Communications Inc., the largest owner of radio stations in the country. This move brought together both worlds of the entertainment business. While the company has diverse holdings, the philosophy of SFX is "*One Company, One Mission.*" Many companies that are now owned by SFX were at one time hard-nosed bitter rivals in the concert promoting business. These companies now maintain good working relationships within SFX.

PERSONNEL

When the marketing department plans a promotion for an up-coming event, it coordinates with sales to see if there is a conflict in sponsorship. Marketing also coordinates with operations to effectively manage the activities in preparation for and on show days. Finally, the budgets of each department (sales, marketing, and operations) are reviewed by the accounting department and head of finance for the overall financial management of the project.

BRINGING CONCERTS TO REALITY

A concert becomes reality in many steps. First, a group or performer with an interest in performing at ALLTEL will discuss with Cellar Door, Inc. the possibility of performing at the pavilion, and look at the open dates. When agreement is reached, Cellar Door and the booking agent for the performer sign a contract. A time is specified for gate openings and once the gate is opened the show is underway. The job of the staff during a concert is to make sure every patron of the ALLTEL Pavilion has a pleasant experience and that the mission of the company is clearly seen by everyone that "*a concert...it's better live.*" After a show, Clean Sweep Inc. of Raleigh handles the cleanup.

KEY BUSINESS ISSUES

Marketing has an important role in the success of ALLTEL Pavilion, but marketing expenditures are carefully watched. For every show, the marketing budget is limited to \$20,000. For many shows it is difficult to stay within the budget, since the Pavilion serves a 5-market region consisting of Raleigh-Durham, Fayetteville, Wilmington, Greensboro, and the Carolina Coast. Most of the marketing budget is spent on advertising with radio, TV, and print media in the designated regions. Prior to developing advertising plans, the marketing staff analyzes ticket sales geographically over the five-market region. It is important to know the demographics of the five regions and compare them with the profile for each performer. The more ALLTEL Pavilion can know about the fans, the more they know about where to spend the \$20,000.

While the different advertising media were viewed initially as cost-based strategic business units, SFX now considers them to be profit-based SBUs and develops measures of performance and profitability for each advertising media, by region. This type of analysis is important to the ALLTEL Pavilion because increased ticket sales, through effective advertising, not only affects ticket revenues but also revenue from parking, merchandise, and concessions. It is also important because of the increased cost of advertising. The advertising rates in the Raleigh-Durham region are comparable to the rates in Washington, D.C. The rates are up two hundred percent over the last five years while the budgets per show are only up fifteen percent over this time.

Other areas where costs have increased dramatically include the cost of the performing artist. The average cost for an artist is approximately \$160,000. Some of the artists are paid on a fixed-fee basis, and others are paid on a per capita basis. Generally, the most popular artists seek a per-capita contract because they are confident of a high level of attendance. In contrast, the artist paid on fixed base is guaranteed the same fee whether 100 or 20,000 people attend (the capacity of the Pavilion is approximately 20,000 attendance). The fixed-fee shows often have a projected attendance under 10,000. These artists do not have the “draw” of the other artists. In these types of shows, the role of marketing is especially important, as the Pavilion must work hard to attract attendance for the artist. As noted above, lower ticket sales also mean less money spent on parking, concessions, and merchandise, so effective marketing is critical. One method the Pavilion uses in addition to advertising is to distribute “comp” tickets (comp tickets are free tickets distributed throughout the community) to build interest in the Pavilion that will later be realized in paying customers, and because the comp customers will spend on parking, concessions, and merchandise.

This cost of the performing artists grows annually, so that it is very important for the ALLTEL Pavilion to reduce non-artist costs. There are a number of operating costs at ALLTEL Pavilion, including expenses for parking, security, concessions, and merchandise. Also, there are a number of other methods used to make the concerts more profitable. For example, the parking service passes out flyers for upcoming events. Also, the pavilion trades “comp” tickets for online spots in the radio industry and gives local businesses tickets in exchange for advertising on their premises.

FUNDING AND FLASH REPORT

The sources of funding for the Pavilion are ticket revenues, concession (food) revenues, merchandising revenues, parking revenues, sponsorship revenues, and other. Exhibit A is a mock flash report for an example show, the KFBS Allstars. A flash report is a projection of what a concert will cost and what revenues will be received. The guaranteed talent cost (\$160,635) is the amount the KFBS Allstars are guaranteed for the show. Attendance is the number of projected **paying** ticket holders, while the “drop count” is total attendance, both for paid tickets and comp tickets. The drop count is usually projected to be about 125% of paying attendance. The Flash Report then projects total revenues including parking, food, and merchandise based on per capita (drop count) rates. Also, other revenues include per capita facility charges and service charges paid by the performer. The parking, food concession, and merchandise operations are outsourced to other service providers, so the direct costs for parking, merchandise and concessions are determined based on contracts with the service providers which include both a percentage (10%) of applicable (parking, merchandise or concession) revenues and a fixed fee. Operating expenses include an allocation of the total of fixed production and operations costs for the season, the advertising expenses for the KFBS Allstars event, and other variable expenses. These are then

added to the direct costs for concessions, merchandise, parking, and insurance to determine total operating expenses.

REQUIRED:

- 1) How would you describe the competitive strategy of the ALLTEL Pavilion? What do you think it should be?
- 2) For the show illustrated in Exhibit A, the KFBS Allstars, how many tickets must ALLTEL Pavilion sell to break even?
- 3) For which type of performer (fixed fee or per capita) is breakeven analysis particularly important, and why?
Which type of performer is preferred by the Pavilion, and why?
- 4) Explain how sensitivity analysis could be used to better understand the uncertainty surrounding the KFBS Allstars event.

Exhibit A – Flash Report for The KFBS Allstars

ARTIST NAME	The KFBS Allstars
ACTIVITY/EVENT NUMBER	10310001
EVENT MONTH	7
EVENT DATE	7/31/07
<u>Projected Sales (Number of Seats)</u>	
A Seats	2,778
B Seats	2,845
C Seats	1,747
D Seats	<u>881</u>
TOTAL Number of Seats	<u>8,251</u>
<u>Projected Ticket Price (net of 3% tax)</u>	
A Seats	\$36.29
B Seats	\$22.22
C Seats	\$11.31
D Seats	<u>\$ 4.92</u>
PROJECTED NET AFTER TAX ADMISSIONS	<u>\$182,479</u>
AVG TIX PRICE NET OF TAX PER PAYING PATRON	<u>\$22.12</u>
TALENT %	88.03%
GUARANTEE/TALENT COSTS	\$160,635
NUMBER OF PERFORMANCES	1
DROP COUNT (includes comp tickets)	10,349
Other Ticket-Related Revenue	
FACILITY CHARGE	\$24,010
Per-capita	\$2.91
S/C REBATES	\$16,172
Per-capita	<u>\$1.96</u>
REVENUE FROM TICKETING	<u>\$222,673</u>
Per-capita	\$26.99
ANCILLARY REVENUES	
PARKING	\$19,767
Per-capita	\$1.91
FOOD CONCESSION	\$79,273
Per-capita	\$7.66
MERCHANDISE	\$36,428
Per-capita	\$3.52
RENTALS	<u>\$0.00</u>
REVENUE FROM ANCILLARIES	<u>\$135,468</u>
Per-capita	\$13.09
TOTAL REVENUE	<u>\$358,141</u>
Per-capita	\$34.61
<u>Other Direct Costs</u>	
PARKING CONTRACT	\$4,448
CONCESSION CONTRACT	\$43,356
MERCHANDISE CONTRACT	<u>\$17,826</u>
TOTAL DIRECT COSTS	<u>\$226,265</u>
Per-capita	\$21.86
PERCENT OF SALES	63.2%

Flash Report (continued)

TOTAL REVENUE (from above)	\$358,141
TOTAL DIRECT COSTS (from above)	<u>\$226,265</u>
GROSS PROFIT	<u>\$131,876</u>

OPERATING EXPENSES:

TOTAL PRODUCTION EXPENSE	\$15,506
TOTAL OPERATIONS EXPENSE	\$14,991
TOTAL OTHER VAR. EXPENSE	\$14,323
TOTAL ADVERTISING EXPENSE	<u>\$20,030</u>

TOTAL OPERATING EXP	<u>\$64,850</u>
Per-capita	\$6.27
PERCENT OF SALES	18.1%
	<u>\$67,026</u>

OPERATING INCOME	\$6.48
Per-capita	18.7%
PERCENT OF SALES	

DETAIL: OTHER CONCERT VARIABLE EXPENSE (per person in attendance):

Insurance Expense per person	\$0.17
COGS – Concession per person	\$0.35
COGS – Merchandise Inventory per person	\$1.12
COGS – Parking per person	\$0.08
Other Variable Concert Expense per person	<u>\$0.02</u>
TOTAL OTHER VARIABLE EXPENSE	\$14,323