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The video game business— it's easy to lose



The quarters flow in: a "twinkle box" arcade in Rockville, Md.

"ONLY \$729" gives you control over "3 VIDEO GAMES" ... Earn a "safe, high cash income with a minimum of time & money" ... "unheard-of returns" ... "PRIME LOCATIONS" ... "complete guidance."

Those are excerpts from ads trumpeting a way that housewives, retirees, executives—just about anybody—can cash in on the video game craze, or try to. It sounds like an easy road to riches: Buy or lease a few coin-operated video game machines like Pac-Man or Donkey Kong; arrange to set them up in bars, motels,

convenience stores, arcades and such; then come around every few days and collect bags of quarters, which you split with the proprietor.

It's no secret that a lot of quarters are clinking into these "twinkle boxes"—\$5 billion in 1981 by some accounts. "Their high profit potential has made these electronic games an attractive investment," asserts a guide to getting in on the action.

But missing from this beguiling picture is the fact that an array of booby traps awaits unwary investors.

► Advertising in the *Wall Street Jour-*

And there's certainly more to it than just collecting all those quarters people are feeding the machines.

nal and hundreds of other newspapers, Jerlor Marketing, Inc., of Cincinnati promised maintenance, high-quality equipment and profitable locations in theaters, skating rinks, shopping centers and airports.

William Waters, 61, a San Antonio retiree, paid \$18,000 to Jerlor for six machines featuring a game called Circle of Fun. He got neither the machines nor his money back.

"Only a few buyers ever received a machine at all," and they had to install them themselves in poor locations, says Kenneth H. Fletcher, chief inspector for the U.S. Postal Service. The two Jerlor promoters were caught, convicted of mail fraud and sentenced to four years' imprisonment. Their victims lost more than \$230,000.

► The principals of Marketing Associates, Inc., a now-defunct Denver operation, vanished just as the Federal Trade Commission moved in with an injunction. Many of the company's known customers (about 50) received nothing for their money; some got machines but no help in locating them, as had been promised. The average loss was \$10,000. The head of the company, William E. Beilman, had previously served two jail terms in Colorado for theft.

► David and Sue Reed of Arlington, Va., lost over \$18,000 on five pinball machines. One was damaged when they unpacked it; the others broke down soon afterward.

The seller was Fascination International, Inc., of Schaumburg, Ill. That company has been accused by California authorities of failing to register its offerings and lying to customers.

Photographed by Mahmood El Qanish at Putt Putt Golf and Games

The suit is one of several brought by the California attorney general's office against promoters who ballyhoo video games as high-profit investments or business opportunities for people seeking ways to make money. Injunctions barring future infractions have been issued against Leisure Time Electronics, Inc., of Indianapolis; Potomac Mortgage Co. of Dallas; and the American Game Exchange, Inc., of San Diego. Leisure Time was assessed \$5,000; Potomac was assessed \$5,000 and ordered to offer refunds to 23 purchasers in California; American Game was assessed \$40,000 and ordered to offer 29 refunds.

Other perils

Fraud and shoddy merchandise aren't the only perils of video game ventures. Even with quality equipment, which is widely available from established distributors of vending machines and coin-operated amusement devices, the risks are formidable.

"The name of the game is location, and the good ones have been taken in most places," says John M. Tifford, an FTC attorney in charge of franchise and business opportunity regulation. What few investors realize, apparently, is that the business of placing and servicing video games, juke boxes and other amusement devices is dominated at the local level by long-established commercial enterprises, called operators. There are more than 6,000 of them from coast to coast, in communities large and small. The typical operator staked out a territory years ago, knows the good locations and constantly prospects for new ones.

"Anybody in a built-up area could pretty much assume that if there isn't a video game in a place he would think of putting one, it is because businessmen who know their stuff have decided it's not financially worthwhile," says Tifford.

A retired Air Force man who lives in Oxon Hill, Md., found that to be all too true for areas he scouted. After buying two machines for \$2,700 each, he spent four months looking for places to put them. "Every Saturday I'd hit the pavement, go door to door for hours," he told *Changing Times*. "Absolutely no takers."

The places he propositioned either wanted no machines on the premises or had exclusive contracts with operators. "I'd hear it all the time," he says. "We have a contract." Finally he found an arcade owner willing to take his games. He has been grossing about \$80 a week from each machine.

"Make sure everybody knows this is no get-rich scheme," urges Maj. John Hitt, an engineering instructor at Fort Belvoir, near Washington, D.C. In November 1981, he bought three machines for \$9,800 plus taxes and shipping costs. He has been grossing an average of \$45 per machine each week and calculates that at that rate the investment will be paid off in 18 months. But, he says, "there's a lot of work involved, too. You have to empty the machines, you have to change them, you have to service them. If you don't have a good location, you have to move them."

Short life spans

Without a popular game, even the best location may be unprofitable. More than 100 video games are currently on the U.S. market, and new ones emerge regularly. Only about ten or 15 are really hot at any one time.

In Mount Prospect, Ill., near Chicago, there's a market test center—a large arcade—where manufacturers can place their wares to measure popularity. During a recent seven-day period, collections from 47 machines there ranged from \$496 down to \$27.

"Most games retain their popularity for no more than nine to 12 months," says FTC lawyer Tifford. "After that they lose their appeal." And life spans are getting shorter, both for video games and pinball machines, adds Leo Droste, executive vice-president of the Chicago-based Amusement and Music Operators Association.

Machines are available that can be modified and fitted with some new games as they come along. It's done by changing cassettes or circuit boards. But these constitute only a small segment of the industry. One distributor suggests being wary of interchangeable machines, explaining that they're not "first-line stuff."

Another cause for caution is the possibility of restrictions and steep

taxes on video games. An estimated 80% of all arcade customers are teenagers, and parents and school officials worry about the potential harm the games may have. Kids have been known to squander lunch money and study time in what may prove to be an addictive habit. Electronic warfare is a common format of video games, and psychologists voice concern about that.

Ordinances disallowing any new permits for video games have been adopted in Coral Gables, Fla., and Orange County, Cal. The number of games in a single location is limited to three in Irvington, N.Y., and Los Angeles has put a freeze on new arcade licenses. Other jurisdictions have slapped on stiff taxes.

There is also the question of how long the public's fascination with video games will last. A fad that sweeps the country like a prairie fire can sputter and die just as quickly.

The big manufacturers know this and are trying to keep interest alive by coming out with new machines. Atari, the largest producer, plans sophisticated models that use advanced computer technology.

"You'll see three-dimensional holographic games," predicts Leo C. Loevner, who runs two arcades in the Washington, D.C., area. "Imaginations are going crazy. You'll be able to have gunfights with Gary Cooper."

Selling the machines

Atari and the Bally Manufacturing Co. produce about 80% of the equipment. They and other major manufacturers sell to regional or local distributors (the major manufacturers say they sell only to distributors). There are dozens of small manufacturers, some of which make only one or two games.

Investment promoters sprang up with the first signs of a boom. They buy equipment from some manufacturers and distributors, mark up the price and resell to individuals. A few promoters send sales crews from city to city. They set up an equipment display room in a hotel or some other public facility, stage an own-your-own business show, take orders and move on. Other outfits operate locally. Besides selling machines, they claim to

offer insurance, maintenance contracts, counseling and help in finding locations, often for fees of about \$150 each. If a location is unproductive, the company typically claims it will move the machine for free—except possibly for transportation costs—at least once.

The sales pitch is usually the same: Fabulous profits can be made from a small investment in money, time and effort. In California, Leisure Time Electronics told investors they could "reasonably expect" to net \$38,000 a year from three pinball machines and three video games. "In fact," said the attorney general's complaint, "these amounts of income are not a reasonable expectation for most purchasers." Potomac Mortgage went even further, declaring that with an initial outlay of \$6,500 a buyer of ten machines could be raking in \$300,000 a year within 18 months.

All too often, equipment sold by investment promoters is overpriced, substandard or obsolescent. Worse,

imitations of copyrighted popular games have been sold. It's extremely easy to make them, and a buyer who is caught with one could lose everything, says arcade owner Loevner. Bally has brought "a whole flock of suits" against alleged perpetrators, according to a company spokesperson.

A *Changing Times* reporter dropped in on several promoters and inquired about getting into the business. On his first call the reporter was told by the company's marketing director: "Basically, we take the risk factor out for the investor." By using tax write-offs and putting tax savings into a tax-deferred annuity plan, an investor could recapture his entire outlay in three years, the director said, displaying a sheaf of papers with charts and figures.

"I'd like to show that to my accountant," the reporter said. The reply was, "Oh, no—we can't let that out."

True, there are tax advantages—

investment tax credits, depreciation, business-expense deductions—but experts disagree on whether some write-offs will be allowed. Confided the president of a distributing company: "I got five different answers from five CPAs" on the depreciation rules. (The Internal Revenue Service says video game machines can be written off over a five-year period, not three years, as some investors have been told.)

In another office a vice-president confessed that although some of her 50 clients were doing "very, very well," others were having problems. One problem: a machine that grossed only \$10 a week. "So we'll move it," she said. What if it keeps on striking out? "Then maybe [the owner] ought to think about selling it."

Loevner notes that "machines depreciate fast—one that cost \$2,300 four years ago is now worth \$400."

People with big bucks can buy or set up a games arcade themselves or buy a piece of one through an investment partnership. Arcade franchises are available in some areas. But many of the same risks exist here also, including possible market saturation and competition from big-money corporations. Bally, for instance, operates more than 375 twin-kle-box establishments of its own around the country.

Should you invest?

What it all adds up to is a business that is more precarious than most, at least for amateurs. If you're thinking about taking a plunge, the best advice may be not to risk money you can't afford to lose. You might ask yourself why so many people want to sell these things to you if they're really so lucrative. And you might want to consider a statement by Droste of the Amusement and Music Operators Association. That group recently surveyed its members on profitability. Figures submitted by those who responded indicated that the average return on invested capital was 7.5%.

It's possible that the operators are being overly modest. After all, why should they say anything that might encourage competition? In any event you can get a lot more than 7.5% these days from Treasury bills and money-market funds—with almost no risk at all. □

Laws you should know about

The federal government and about 18 states regulate sales of business opportunities, including video game propositions, in an effort to protect the public against chicanery.

Since 1979 the Federal Trade Commission has required sellers of franchises and business opportunities to give prospective buyers a disclosure statement at least ten business days before any money changes hands or legal commitments are made. The document must include the seller's history and financial status (balance sheet, income statement and cash-flow statement); the cost of starting and running the business; the names of others who have bought the offering; and other information. If the seller makes any past or potential earnings claims, they must be extensively documented.

Some enterprises, including gasoline stations and auto dealerships, are exempt, but a reputable company will provide such information anyway. If you don't get it, don't invest.

"A few days spent checking out a business could prevent the loss of lifetime savings," notes the FTC.

The state laws vary to some extent but have the same purpose. In Maryland, for example, sellers must register with the securities commission and make similar disclosures to buyers. Violators can be shut down immediately. Victims of fraud or deception can sue.

The attorney general's office or a consumer protection agency can tell you about the laws in your state. Free franchise information and more details about FTC regulations are available from the FTC. Write to the Public Reference Branch, Federal Trade Commission, Rm. 130, Sixth St. and Pennsylvania Ave., N.W., Washington, D.C. 20580.

Another note of caution: Be on your guard when talking with references or people listed as satisfied customers. One prospective buyer of video games discovered later that a woman she had interviewed was the wife of a salesman for the company.