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CORPORATE CASH

Coleco hits with home video games

In a high-powered television advertisement, Coleco Industries Inc. spells out the name of its hot-selling ColecoVision video game machine in TV monitors stacked to look 30 ft. high. It is the new look for a company that spent most of its 50 years as a low-profile purveyor of backyard swimming pools and toys.

Coming virtually out of nowhere, Coleco has captured 10% of the market for home video cartridges and something less than that for home consoles in the $2 billion-plus home video game business. In the process, its sales soared to more than $500 million last year from $178 million in 1981 as earnings made an even more impressive gain, rising at least five times 1981's $7.7 million. The company's video game business accounted for 75% of last year's sales, compared with only 20% for electronics products in 1981. Most of 1982's action was in the second half, when Coleco shipped 550,000 ColecoVision game machines—which sell for $169 to $189—booking orders for nearly that many more, and some 8 million cartridges for its machine and for those made by Atari Inc. and Mattel Electronics.

By yearend, Coleco had $69 million in long-term debt, no short-term debt, and $50 million in cash. Coleco President Arnold C. Greenberg expects to start 1983 with first-quarter sales of at least $160 million, churn out two million [illegible] players this year, and launch European sales through a marketing deal with [illegible] Inc. "This is an extraordinary growth opportunity," says Greenberg. "We are looking at the infancy of the industry."

Tougher going. But competition is growing fast, too. "They will have strong sales in the first half of 1983. After that it's hard to tell," says Harold Vogel, a Coleco analyst at Merrill Lynch, Pierce, Fenner & Smith Inc. He is recommending purchase of Coleco stock at up to $40 a share; it now sells for about $38.

This is because other sophisticated consoles—including color home computers from such suppliers as Texas Instruments Inc. and Commodore International Ltd.—are joining Atari and Mattel on the market at prices below $200. And with 10 million or more game machines in homes, Atari already has an advan-

Commentary

By Gene Koretz

The case for taxing health care premiums

At first glance, the Administration's consideration of a plan to tax employer-sponsored health insurance premiums appears to be a callous grab for revenues—morally offensive because it hits all Americans facing escalating medical costs. But the real motive behind the proposal, which is being pushed hard by health economists, is not simply to raise revenues. In fact, it would produce only $1 billion or $2 billion in its first year, and plans are afoot to apply half of this to purchase health insurance for the unemployed. The true motive is to promote competitive reform of the health care system by making both employers and employees more conscious of the costs of health insurance and medical care.

The case for taxing a portion of health care premiums rests firmly on the law of supply and demand. When companies offer free or low-cost comprehensive health insurance, consumers are encouraged to seek more health care than they might need. The increased demand drives up the price of medical care.

The traditional function of insurance is to protect people against the risk of large and unexpected expenses. But health insurance has often gone much further, covering such minor expenses as eyeglasses and routine dental care. And until recently, many employers tended to reduce or eliminate deductibles and coinsurance (the share paid by their employees).

Such expansion of coverage has occurred because it is a good deal for both employers and employees. Employers do not have to pay payroll taxes on their contributions, and thus can provide a generous fringe benefit at lower costs. And employees get a bargain: A government study indicates that workers save about 40¢ on the dollar by receiving health insurance as a fringe benefit rather than getting the equivalent money as taxable income.

Because insurance frees both consumers and providers from concern over costs, economists argue that its excessive growth has encouraged overuse of the medical system—and thus a continuous rise in prices. It has also fostered expensive, elaborate treatment patterns when more efficient and economical therapies are available. Further, the insurance tax subsidy, which could hit $27 billion this year, helps mainly middle- and upper-income workers. One study indicates that only 6% of the benefits go to the poorest 29% of the population.

Rival plans. Limiting the tax-free nature of employer-sponsored health insurance, it is argued, would make companies and their employees more cost-conscious in buying medical insurance and using medical services. In response, insurance companies and providers would begin to compete on a price basis. One result might be more insurance plans requiring deductibles and coinsurance but providing full coverage of catastrophic costs. Another is likely to be more widespread development of rival health care plans in which separate groups of hospitals and doctors band together and compete for insurance contracts by offering either discounted fees or prepaid care to subscribers (BW—Feb. 8, 1982).

The irony of the present situation is that consumers have the most to gain from capping the tax-free status of employer-sponsored health insurance. The present open-ended tax subsidy gives the medical profession a blank check to boost prices and increase services. And that, in turn, simply spurs demand for even more insurance—pushing health costs ever higher into the stratosphere.

A roomy cap. Although details are still being worked out, the plan would not tax all or even most insurance premiums. It would simply place a cap on the amount of employer-paid health insurance that can be provided as a tax-free fringe benefit to employees. And the cap would be high enough—perhaps $2,400 for a family premium and $975 for an individual—to continue providing most insurance to workers tax-free. Employees and labor unions, of course, could still opt for extra coverage, but they would have to bear the added cost out of aftertax income.

One way or another, something has to be done. Health costs have been growing so fast that the rate of increase will have to be curbed. Expenditures hit $287 billion, or almost 10% of the gross national product, in 1981, compared with only $27 billion, or 5.3% of GNP, in 1960. Economists believe that excessive expansion of tax-free health insurance is a major cause of the medical cost spiral.

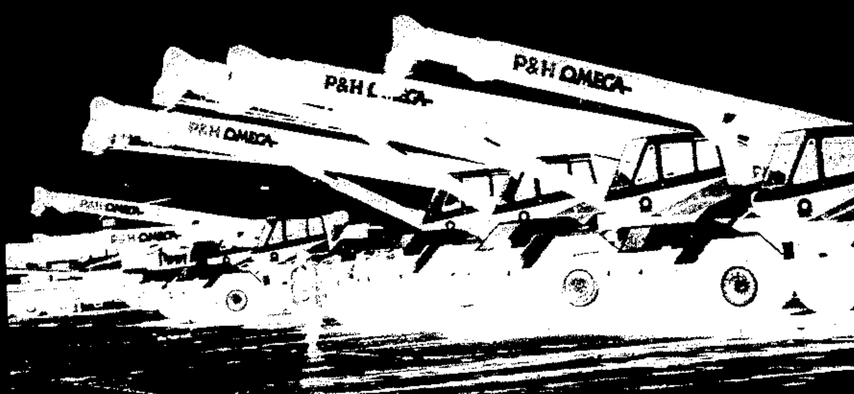
tage in attracting software suppliers. Also, one of Coleco's newest products—a module that allows a user to play Atari cartridges on ColecoVision—is the subject of an Atari patent-infringement suit. Greenberg claims Coleco will lose "nothing" if it loses the suit, mostly because more sophisticated game players will replace the Atari unit by next year.

James H. Levy, president of cartridge maker Activision Inc., says Coleco can credit its strong showing to its game machine. "Buyers are buying [ColecoVision] for its more advanced graphics," he says, adding that his company may make game cartridges for ColecoVision. It already turns out cartridges for Atari and Mattel and will make game cartridges for Atari's home computers.

'Sinfully profitable.' Coleco knows it cannot afford to wait for other suppliers, and is turning its cash pool to use. Greenberg depends heavily on consultants to convert licensed arcade-game or cartoon properties into home-game cartridges, and he is not squeamish about licensing costs. "We will pay whatever we have to pay," he says. "Outrageous costs notwithstanding, software is outrageously—if not sinfully—profitable." Profits, he says, can run to 50% of a cartridge's price, with the rest going for manufacturing, advertising, royalty, and other costs. Tarzan, Rocky, and the Smurfs people his games, which will include up to 40 new titles for ColecoVision, 7 for Atari, and 7 for Mattel this year.

Coleco also has a line of game accessories including a pistol-grip controller with a sensory feature: When Rocky throws the punch, you feel it in the handle. In June it will unveil an under-$200 computer module for ColecoVision. And Greenberg plans to pour about $25 million into research and development this year, boosting staff to 250 from 100.

The moves will take Coleco even closer to what Greenberg calls the "computerized entertainment industry." Estimates show up to 15 million U.S. homes had a video game machine or home computer—which still are used mainly for games—by Christmas, 1982. That leaves 65 million U.S. homes without them, as well as a large trade-up market. Says Greenberg: "Saturation is not an issue to be dealt with seriously. People always buy a better mousetrap." ■



New cranes: With sales down 31%, President Goessel is drastically slashing inventories.

A whirlwind cleanup at Harnischfeger

Senior executives of Harnischfeger Corp., a troubled manufacturer of heavy equipment, gathered recently at the Milwaukee home of the company's new president, William W. Goessel. Suddenly a courier, sent by an anonymous group of shareholders, arrived carrying a bouquet of balloons and a message: "Take heart, these balloons testify that once-flat objects can rise to new heights."

While it is too early to tell whether the message is prophetic or just so much hot air, Goessel is moving quickly to overhaul a company that is losing money and has defaulted on some of its debt. In its latest fiscal year, Harnischfeger posted a loss of $76.5 million as sales fell 31% to $447.5 million. Goessel, 55—hired away from Beloit Corp. five months ago by Chairman Henry Harnischfeger, 59—is the first president from outside the Harnischfeger family.

'A simple restructuring.' The equipment maker violated loan covenants on net worth and working capital last summer, and Goessel is negotiating with its 14 lenders to restructure its $152 million debt. Having increased its cash balance to more than $32 million over the past year, the company claims it is in no danger of bankruptcy. "This is a rather simple restructuring," says one lender. The company hopes to have new loan agreements in two to three months.

To shore up the balance sheet, Goessel has accelerated personnel cutbacks, slashing employment by an additional 25%. He took a $23.7 million write-off to close the company's big Escanaba (Mich.) crane plant. And he is drastically shaving inventories and toughening up receivables collections and credit policies. "Many of these things should have been done last January or February," Goessel says.

The new president also needs to remake a corporate culture that has tended to be paternalistic and lacks central direction. Despite its products' good reputation in construction, mining, and materials handling, the company has been plagued by power struggles between divisions, leading to poorly timed product expansion and erratic marketing. Even Goessel admits that some former Harnischfeger executives supported only "parochial interests," with the loudest voices gaining priority in corporate funding. For example, he explains, "an inordinate amount of money" was spent on the construction division in relation to its growth potential.

A buyout? The management problems were not alleviated by a 1981 McKinsey & Co. study. As one executive points out, "The study had us restructuring our management in line with a company that would be doing $1 billion in sales in a couple of years." However, Harnischfeger's decision to reexamine itself was not without value: Henry Harnischfeger determined that bringing in an outsider as president was "one of the most important jobs I've ever had." Just 18 months later, Goessel is revamping the company again and putting a strong emphasis on corporate planning.

Goessel and Henry Harnischfeger expect the materials-handling division to replace construction equipment as the company's largest business by 1985-86. Although that sector is mired in a severe slump, the company made two acquisitions in the area last year, and Henry Harnischfeger claims it has the technology to gain ground on industry leader Eaton Corp. Both executives also hope to increase the company's presence in foreign markets through licensing, production, and financing arrangements with Japan's Kobe Steel Ltd., which owns a 10% interest in Harnischfeger.

Still, recovery depends on an upturn in markets, which is at least a year away. Meanwhile, the company may be dressing itself up for a buyout. It rebuffed a 1979 bid by Paccar Inc. at $20 a share, and in that same year the Federal Trade Commission blocked a $27.50-a-share offer from West Germany's Mannesmann. Harnischfeger says he has talked recently with other possible suitors. "When you are selling at about $7 a share," he says, "people are interested." ■