

INFORMATION ASYMMETRY IN THE SPHERE OF THEATRE

Andrea Sovova

Abstract

In the present-day culture when anything can be delivered to any place, the theatre (performing arts) remains one of the culture goods which cannot do so. There are few exceptions, however, such as busking (street performance) or video sharing sites. Thus, theatre (together with museums and galleries) has a special position in creative industries and the navigation of customers (i.e. theatre-goers) becomes a key issue. As in any other market, customer's behaviour is dependent on availability of information about the quality of the offered goods. If the seller of a good knows more about the quality of a product (theatre performance) than both the customer and the deal are affected. Is there any possibility to face the information inequality in the theatre sphere? Based on the work of Alexander Dolgin and his notion of adverse selection in culture industries, this contribution deals with information asymmetry in the sphere of theatre. In the paper, so-far solutions of information asymmetry examples (such as moral hazard and adverse selection) are analyzed and alternative solutions are suggested.

Key words: adverse selection, moral hazard, theatre

JEL Code: D82, Z11, Z19

Introduction

There are many opportunities for the occurrence of information asymmetry in the sphere of Theatre. When we ask ourselves why, we can find out that the complexity of information distributed by a seller of a good to a consumer is insufficient. Thus, problems of adverse selection and moral hazard are generated. The consumer (theatre-goer) has no possibility to find out whether the product (performance) is good quality. To decide, the consumer may be advised by a third party, i.e. professional critics or theatre-goers references. The demand for the product is affected by a season, influenced by a consumer's capacity to afford the product (culture itself is considered a non-essential good), by the genre of the play and other factors.

On the other hand, the party of a seller has no information whether the performance will be successful. There is a risk that the attendance will be low. Theatres have little chance to predict this but they help themselves by a signalling behavior or they can manage the risk by insurance. As a consequence, information asymmetry may be affected by the nature of the organization, i.e. whether it is a private sector theatre or a state-subsidised theatre.

1 Information asymmetry, its causes and manifestations

Asymmetry of information is one of the causes of imbalance in the market. It refers to a situation where one side of the market relationship has fuller information than the other party. Asymmetric information has two forms:

1.1 Adverse Selection

Adverse selection (Dolgin, 2009) is a manifestation of asymmetric information, when "less desirable" actors participating in market transactions more than "more desirable" actors of the market (i.e., goods of higher quality are replaced by goods of low quality).

As an example (Tumay, 2009), at the insurance market where the insured person has more information about the possible risk than the insurance provider, and is capable of determining the rate of premiums (before the conclusion of the contract), the insurance company is unable to adequately assess the risk of damage. From the point of view of the insurance companies, adverse selection can be described as crowding out quality clients (i.e. less risky) by high-risk clients. Another example (Hořejší, Soukupová, Macáková, & Soukup, 2010) is the sale of used cars: Deploying higher prices on lower quality cars and price reductions for quality cars by a dealer leads to a lack of information about the product on the side of a consumer.

In case of adverse selection, information asymmetry can be reduced by taking into account the quality of activities related to the product i.e., regulation of conditions of sale of goods, provision of guarantees by the manufacturer, brand name, branded chains of restaurants that provide the same quality in all premises (under license) and formal professional qualifications.

As regards the abovementioned example, information asymmetry solution for the insurance industry can be found in differentiation of insurance contracts. When calculating insurance premiums, the insurance company should take into account the level of risk of clients and offering them a contract with a tiered rate of premiums. This may lead to a fair classification of clients according to the risk.

Alternatively, adverse selection may be reduced by a signaling behavior (Lofgren, Persson & Weinbull, 2002) when better informed party of the market is developing an initiative to ensure that less informed (i.e., weaker) side of the market has gained sufficient information on the quality of the product (i.e., the risk of failure of the product moves from buyer to seller). Less informed side of the market may then decide according to the level of assurance by the signal and better informed party decides whether to sell the goods for a bid price.

An example of this solution may be the warranty for a particular product (provision of a guarantee is a little costly for those offering high quality goods/services). Another example of signalling behaviour (Hořejší, Soukupová, Macáková, & Soukup, 2010) is the situation on the labour market when a potential employer is looking for a new employee who will be productive. How to find him/her? The solution to this situation is the analysis of signalling behaviour, e.g., university students are sending a clear signal to potential employers, that their productivity is high (based on the assumption that more productive people easily reach higher levels of education).

1.2 Moral Hazard

Moral hazard is a manifestation of asymmetric information when activities of the better informed subject may reduce benefits for the less informed (Hořejší, Soukupová, Macáková, & Soukup, 2010). Also, one of the characteristics of moral hazard is that these activities cannot be verified.

If we once again mention the situation from the insurance market, moral hazard is the ability of the insured to increase its expected damages by changing his/her behavior, after the insurance contract entered into force (i.e. the change of behaviour of the insured people increases the risk and the likelihood of claims).

Another example is a situation where there is a relationship between two economic operators: a tenant and an agent (Principal-Agent). Agent shall exercise the tasks/services for the lessee and all the consequences of the activities are shared by both of them (their benefits are linked). Agent and tenant are both motivated by their individual interests which may not match each other.

The main solution to information asymmetry in case of the moral hazard (in case of Principal-Agent situation) is using motivational incentives (ownership interest, remuneration system, control of activities of the lessee, etc.).

2 Information asymmetry and the sphere of Theatre and its solutions

Daniel Urrutiaguer (in Towse, 2011) emphasises that there are two strongest influences on demand in the theatre sphere: attendance per performance in the previous year and the size of the venue. It can be added, too, that it is necessary to be an insider since the critics in the culture sections of the press alert you to major events only after the event (Dolgin, 2009). The right choice is than up to the public, i.e. whether people follow the recommendations and reviews (or annual reports of a particular theatre).

Theatre in the Czech Republic are to some extent still dependent on grants, i. e., on a public financial support (they also often subsidize their income from secondary activities such as leases of theatre premises, revenue from admission, operation of theatre café etc.). On the other hand, a purely private bodies are dependent on the revenue from admission and sometimes on the complementary activities (fundraising, leases of theatre premises, sale of souvenirs etc.).

2.1 Adverse selection

The theatre business is affected by many factors, for example (from the theatre-goer's point of view) it is a seasonal nature of the production, location of theatre (dependence on a good transport availability), the audience's willingness itself to go to the theater, competition of other leisure time activities, price of tickets, etc.

Hidden information which are the basis for occurrence of asymmetric information concern above all professional quality of a particular theatre performance.

Theatre as a business entity knows about the performances more than potential audience (party of the seller is better informed than the buyer). For the purpose of efficiently invested money, the theatre-goers tend to know more about the quality of a performance before they buy tickets. Currently, the only way to find out the „truth“ about the quality of a certain performance is to be recommended by a professional critics or by word of mouth.

Also, the assessment of the quality can be controversial. In the case of used cars (Hořejší, Soukupová, Macáková, & Soukup, 2010) it can be often determined which car is better (i.e., which one is in better technical condition, which one has less mileage, etc.).

The perception of quality in the theatrical sphere, from the point of view of a theatre-goer, is influenced by many of factors, such as technical, aesthetic, cultural and social factors of the product (performance).

The perception of the consumers (spectators) may also be both in a positive and negative sense influenced by professional critics, whose interests may not be identical with the interests of the audience (for example, the theatre-goer wants performance to be fun, critics are trying to find an artistic overlap in performance etc.). Consumer's choice (less informed party) is based on insufficient information, only very experienced theatre-goer can handpick. Other consumers must rely on information supplied by the party of the seller (theatre), from professional critics criticism or from those who have already visited performances.

Thus, theatre goers often decide on the basis of often conflicting or contradictory information (Dolgin, 2009). There is also the factor of uncertainty and risk: go to the same (i.e. already attended performance) with the same cast is a certainty. But the desire to see a different cast or a new play can prevail over the risk of bad choices and the result can be that the spectator will not like the performance. It is not only due to the fact that he/she does not recognize that it is a lower quality performance. Other spectators may like it, but the impression may be affected by a sense which is on the subjectively the itself. an unpleasant experience at work, a difficult path to the theater, inability to concentrate etc.

As mentioned before, in the decision-making process shall a third party: professional critics in the media and spectators, who have already seen the performance (effect of recommendations, word-of-mouth). The third party provides to the public the supporting documents about the quality of performance, performances of individual actors, directorial concept, consequence of a play and other points of interest.

These (often contradictory) information have a significant influence on the decision-making of the potential audience. To solve the problem of adverse selection theatres often use signaling behavior: make public theatre awards that artists received for their performances, interviews with the artists, publish recordings of rehearsals, reviews etc. Signals are meant to be a guarantee of quality: the more awards or positive (or even sometimes negative) reviews the play has, the higher is the probability that it is a high-quality performance.

On the other hand, for the purpose of efficiently incurred costs, theatre managers also tend to receive the information about the quality of a performances (no matter the "stone" theatres or theatre groups without a permanent scene). A major argument against the methods of measuring performance, however, is the fact that the quality of the performance cannot be so far efficiently measured. There are two ways to find out whether the performance is good quality:the

number of sold tickets and their belief in professionalism of artists creating the performance (proved by certificates, diplomas, professional experience, references etc.).

Decision making process of theatre managers is based on the often conflicting objectives (art vs. profit), estimation on the basis of experience and thus they cannot avoid subjective perceptions of a risk and sometimes even there have also a risk aversion. Key factors influencing financial results of the theatre are production and price risks, relating to the volatility of individual performances and prices of inputs (i.e., the cost of the particular play).

In the Czech Republic there is not available a system of insurance against the failure of theatre performances. In United Kingdom or in the U. S. there is a possibility of insurance that reduces this risk (it is classified as a so-called „cover of extraordinary expenses incurred“) by covering any loss, if the performance is canceled for the lack of interest.

This system would be suitable for private theatre productions in the Czech Republic, in particular for those theatres subsidizing performances on their own, not from public subsidies. The insurance contract, however, would have to be differentiated (i.e., with a tiered rate premiums) in order to take into account the level of risk of individual performances (or individual theaters). Each theater would then be fairly classified according to risk.

2.2 Moral hazard

Moral hazard as mentioned in the first chapter is a situation when the informed body while maximizing its benefits reduces the benefit of the misinformed participants in the transaction. For example, theatres receiving money are not too much depending on reviews or attendance, because they have money to keep the business going (Dolgin, 2009).

Decisions of theatres as economic entities are always taking place under uncertainty. Income is influenced by the season, the weather, repertoire, quality of artists, locality of the theatre, the financial situation of potential audience, the competition across the market, i.e. not just other theatres, but any other leisure activities etc.

As regards the relationship Principal-Agent in theatre realm, theatre manager (producer) is the lessee (the Principal) and theatre director is the Agent. Agent performs work for the Principal, which affects benefits of the theatre as an economic entity. Benefit of both (agent and tenant) is, therefore, mutually linked. Agent (director) may tend to act only in his own interest (e.g. not taking into account the objectives and mission of the theatre). There are three ways how to motivate the agent to act in the interest of the tenant.

1. Co-partnership between the agent and the tenant

There exists co-partnership of profit in private productions (a percentage of the profit, which is governed by a special treaty). However, the entire risk lies on the producer (i.e. the owner of the theatre). Activities in private productions are often subsidized by the theater management, i.e., the profit is used for remuneration of employees and also serves to ensure operation of the theatre itself. To mitigate the risk of moral hazard, the solution might be the system of allocation of funds which would take into account the quality of performance, attendance, profitability and other factors (in particular, the performance of employees¹).

2. Observation of activities of the Agent

Observation of activities of the Agent means that the producer or his/her representative participates in the process of selection of actors, monitor rehearsals etc.

The play which has already had a premiere is controlled by a so-called overhead surveillance. Assistant Director ensures that the play is played in accordance with the concept of a Director. This measure reduces the risk of lowering the quality of performance.

Another example of observation is typical for musical theatre productions who buy the license for a certain period of time. The production company agrees that the representative of the licensee keeps track of rehearsals and may also decide on the cast, music, directing, etc.). The purpose of this measure is to reduce the risk of decreasing quality of the brand (the license).

3. System of remuneration

Private production usually have a minimum of permanent employees who receive a fixed salary. If we regard the actor as an Agent the policy in Czech conditions is as follows: actor without an employment contract is rehearsing for free². Remuneration comes with premiere and reruns (where the unpaid fees from rehearsals are counted), There is an assumption that if the agent (in this case, the actor) has not assured salary, he/she is motivated to give the best performance, in order to increase the probability of success and the higher income of a production he/she is playing in.

In theaters where the actor receives fixed salary, he/she must play roles that he is given, if he/she is given more demanding role, he may get a surcharge to a fixed salary. In the public-subsidized theaters (grant system) there is a fixed budget, for example. the actor has a steady

¹ For this solution it would be necessary to set up a reliable performance assessment criteria which would mean additional costs for theatres.

² Theatre director is given a fee for directing once and for all fee.

salary in accordance with tiered tables (again, for a more demanding role he/she may get an extra surcharge). The risk of failure may be often ignored by receiving agents (directors, actors) due to the assurance of salary.

Conclusion

Reduction of the effect of asymmetric information is possible in several ways:

The problem of adverse selection is often solved by signaling behavior: the number of theatre awards or positive reviews, this all can navigate the customer to a high-quality performance.

The risk of financial failure of the theatrical production (related to the problem of adverse selection) is possible to cut through insurance premiums. This is in Czech condition prevented by the unavailability of such credit insurance in the Czech environment, and this insurance would also be conditioned by the differentiation of insurance contracts (by determining the riskiness of individual entities in order to ensure the production risks).

The downside of this solution (insurance application) into the theatre sphere is that thorough analysis would be needed at the local level, which would increase the cost of the proposal for each insurance policy. This method would be likely possible only in the case of private bodies, in case of publicly-funded bodies the insurance would likely be ineffective (because the production costs are already covered by the public, no matter the success or failure of the play). Another factor that prevents this method of reduction of adverse selection is the possibility that insurance costs could be less favourable than the ability to benefit from the existence of adverse selection.

Moral hazard is reduced in the current practice by observing activities (of already made theatre plays in particular). It would be possible to reduce the moral hazard even more through the system of monitoring (assessment) of not only outputs, but also inputs. This solution is, however, expensive and dependent on a reliable method of performance assessment.

Remuneration (as another way of reducing moral hazard) which would reflect the efforts of an agent, is not easy to implement, because a perfect observation of activities of the agent is not possible. Private productions (without a permanent ensemble) solve this problem by means of that the actors are unpaid during rehearsals and rehearsal fees are paid when the play is made.

References

- Cellini, R., & Cuccia, T. (2011). Information externality in the arts and the public intervention: A note. *European Journal of Scientific Research* , 51(1), 40-43.
- Chvalina, J., & Novak, M. (2009, September). *Hyperstructures of preference relations* . In Hoskova, S. (Eds.), *AHA 2008: 10TH INTERNATIONAL CONGRESS-ALGEBRAIC HYPERSTRUCTURES AND APPLICATIONS, PROCEEDINGS* (pp. 131-140). Brno, Czech Republic.
- Dolgin, A. (2010). *Manifesto of the new economy: The second invisible hand of the market*. (p. 256). Moscow, Russian Federation: Springer Verlag GmbH Berlin Heidelberg.
- Dolgin, A. (2009). *The economics of symbolic exchange*. Springer-Verlag Berlin Heidelberg.
- Han, K. (2011, April). *Research on externality of professional sports market* . In Zhou M. (Ed.), *2011 SECOND INTERNATIONAL CONFERENCE ON EDUCATION AND SPORTS EDUCATION (ESE 2011)* (pp. 441-444). Guangzhou, Peoples Republic China.
- Hořejší, B., Soukupová, J., Macáková, L., & Soukup, J. (2010). *Mikroekonomie*. (5th ed.). Prague, Czech Republic: Management Press.
- Kapoor, S., & Magesan, A. (2012, August). In Angelo Melino (Chair). *Paging inspector Sands: The costs of informing the public about impending events*. RCEF 2012: cities, open economies, and public policy, Toronto, Canada. Retrieved from <<https://www.economics.utoronto.ca/conferences/index.php/rcef/2012/paper/viewFile/362/109>>.
- Last, A.-K., & Wetzel, H. (2009). The efficiency of German public theaters: A stochastic frontier analysis approach. *University of Lüneburg Working Paper Series in Economics*, 134.
- Lofgren, K. - G., Persson, T., & Weinbull , J. W. (2002). Markets with asymmetric information: The contributions of George Akerlof, Michael Spence and Joseph Stiglitz. *Scandinavian Journal of Economics*, 104(2), 195-211.
- Pashigian, B. P., & Self, J. K. (2007). Teaching microeconomics in wonderland . *JOURNAL OF ECONOMIC EDUCATION* , 38(1), 44-57 . doi: 10.3200/JECE.38.1.44-57.
- Thaler, R. H. (2008). Mental accounting and consumer choice. *MARKETING SCIENCE* , 27(1), 15-25.
- Towse, R. (2011). *A handbook of cultural economics*. (2nd ed., p. 456). Cheltenham, UK: Edward Elgar Publishing.
- Tumay, M. (2009). Asymmetric information and adverse selection in insurance markets: The problem of moral hazard. *Yönetim ve Ekonomi*, 16(1), 107-114.

Whitnack, C., Heller, A., & Bagajewicz, M. J. (2008, June). *A microeconomics-based approach to product design under uncertainty* . In Braunschweig, B; Joulia, X (Eds.), *18TH EUROPEAN SYMPOSIUM ON COMPUTER AIDED PROCESS ENGINEERING Book Series: Computer-Aided Chemical Engineering* (pp. 181-186). Lyon, France.

Yang, W., & Fan, H. (2009, October). *Organizational interface management of construction projects under asymmetric information* . In Li, QM; Yang, J; Yam, MCH; et al. (Eds.), *CRIOCM2009: INTERNATIONAL SYMPOSIUM ON ADVANCEMENT OF CONSTRUCTION MANAGEMENT AND REAL ESTATE* (pp. 2006-2009). Nanjing, PEOPLES R CHINA.

Contact

Andrea Sovova

Department of HR Management

Faculty of Business Administration

University of Economics, Prague

nám. W. Churchilla 4, Prague, Czech Republic

xsova01@vse.cz