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transparency

Transparency and its asymmetric secrets

"The theoretical propositions are clear. Whenever market information is imperfect (which means always), then the State can, in theory, intervene to bolster market efficiency – even though the State is also subject to the negative effects of imperfect information."

JOSEPH. E. STIGLITZ,
NOBEL PRIZE–WINNING ECONOMIST, *GLOBALIZATION AND ITS DISCONTENTS*, 2002.

The awarding of the 2001 Nobel Prize for economics to three American researchers, George A. Akerlof, A. Michael Spence and Joseph E. Stiglitz, brought economic theory and more specifically, the theory of asymmetric information, back into prominence. Work on asymmetric information originated with the pioneering work of Kenneth J. Arrow, who won the Nobel Prize for Economics back in 1972, for his contributions to the theory of General Equilibrium. In his acceptance speech when he was awarded the prize, Stiglitz gave a very clear explanation of how the theory of asymmetric information was a paradigm shift away from neo-classical economics, demonstrating the theoretical consequences of the knowledge (which has been shown empirically) that one of the conditions laid down by Adam Smith for optimisation of perfectly competitive markets, that of all the agents in the market possessing perfect information, is never fulfilled. Akerlof's initial work illustrated this by taking the example of the market for 'lemons', or used cars. Spence, on the other hand, looked at the effects of asymmetric information on the labour market, while Stiglitz examined the implications of the theory for economic policies.

One of the central conclusions of Stiglitz's research is that the existence of asymmetric information often causes sub-optimal allocation of resources, thereby preventing the market working perfectly and even leading to its destruction. In cases of market failure, Stiglitz firmly defends the role of government in the correction of market distortions caused by asymmetries of information, by acting to influence the economic behaviour of consumers and companies and thus maximising welfare.

As far as I know, the theory of asymmetric information has never been applied to the analysis of audiovisual markets or of the micro-market of information on the audiovisual sector itself. Although this would need to be shown in more detail than I can outline here, I think it is quite likely that this theory, especially as used by Stiglitz in describing State policies, could provide the basis for justifying the need for a public policy regarding information on the audiovisual markets, channelled through a body such as the European Audiovisual Observatory.

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The film market has, ever since its inception, demonstrated all the characteristics of an oligopoly. Film has all the features of the information good as described by Arrow, especially the fact that constant yields are impossible, as nothing is gained by replicating this information good. However, an information good can be used both by the person producing that information good and by the person that benefits from it being replicated. Control over producing value generated by this replication comes both from control of the distribution networks and the efficiency of the laws governing intellectual property rights allowing the owners to reap benefits, large or small, from the information good they created. This need to control the distribution channels in order to maintain a firm hold on the value generated has led the film industry, particularly in the United States, to develop through a pattern of vertical integration that only legislation has been able to hold back.

The fact that a film is an information good had led to remarkable examples of asymmetric information. It is not so much the structure of the market itself but rather the intrinsic nature of the film as an economic good that creates this situation: the consumer does not possess complete information about the good before consuming it, even if certain factors, such as the identity of the director and the actors involved, provide some prior knowledge. The most blatant example of asymmetric information is of course in the information that the consumer does receive. To compensate for the lack of prior information, distributors invest widely varying amounts in promotion in order to single out their films. The imbalance in the "signals" (to use the term coined by Spence) coming from the different distributors to convince consumers to go and see their films is such that it is hard to maintain that most people make their choices with full knowledge of the facts.

The fact that the consumer does not have all the information he needs to decide between all the options set before him is certainly not the main informational weakness of the system. Some of the defenders of the oligopoly in the culture industry claim that the domination of distribution channels by the majors is offset by the fact that the creative teams represent public demand within the production system, and that they anticipate the public's tastes by synthesising the information that they are given by the market, which therefore makes them the legitimate middle-men between the public and the investors. Jack Valenti, the flamboyant spokeman for the principal distributors, puts it bluntly in his famous quote "we just have to give to the people what the people want". This claim to represent the public within the film production system could, in the ethical terms of the Frankfurt School's Critical Theory, be denounced as alienated representation or as a form of ideological domination. As seen through the theory of asymmetric information, it could be described as an informational illusion, since it is patently obvious today that, even in Hollywood, no one knows exactly what the public is going to like. The widespread use of misleading indicators such as box-office takings (rather than the number of tickets sold) or audience-measurement data, the fundamental currency for the exchange of information between broadcasters and advertisers rather than the in-depth study of audience ethnography, has led the industry to forget that decisions governing cultural consumption are also micro-economic choices made by the consumers and that statistical indicators hide the individual dynamics of these decisions.

This imbalance in information is not just to be seen in the U.S. market but has spread across the world and is especially evident in Europe, the result of the globalization of the film industry since the end of the First World War. The most obvious sign that this informational imbalance is kept up by the dominant players is the MPAA's persistent refusal to publish the aggregate rentals of its members per territory and per type of rights. One of the most important statistics for understanding how the world market is evolving is therefore available only within the very closed club of the Hollywood managers.

I do not, however, intend with this example to imply that the Hollywood oligopoly is the only reason for the imbalances in information in the audiovisual sector. Recent examples have shown that European enterprises, sometimes including public service companies, are also fully capable of withholding information so as to boost their market position or quite simply to play down poor financial performance or disguise monopolistic profits.

The lack of transparency in the market does not come solely from the players' reticence to disclose information considered as strategically useful. It can also stem from the actual make-up of the market, the heterogeneity of the national audiovisual systems, and traditional practices such as in the publication of corporate financial statements. In Europe, probably even more than in the United States, whole segments of the audiovisual market remain opaque, despite the efforts made by Governments and a very large number of professional organizations. There are still a huge number of pitfalls for even the most experienced expert in trying to put a figure on intermediate markets, such as the production and distribution of televisual works and the duplication of disks and video cassettes, or even on end markets such as cable distribution or pay-TV.

Both Europe and the United States have recently seen a number of spectacular bankruptcies and corporate failures that have shown up weaknesses in corporate financial auditing and the lack of transparency in corporate accounting. The legal need for greater transparency applies especially to listed companies. In June 2002, the Council of Ministers of the European Union adopted a Regulation that obliges companies, including banks and insurance companies, to draw up their consolidated financial statements in accordance with international accounting standards (IAS) from 2005 onwards. In the words of the European Commission “this Regulation will help break down the barriers to cross-border trading in securities by ensuring a higher degree of reliability, transparency and comparability in corporate financial statements over the whole of the European Union. This will make the market more efficient and reduce the cost of raising finance, while in the long run benefiting corporate competitiveness and growth.” On 4 November 2002, the European Commission presented the report of the High Level Group of Company Law Experts on the Europe-wide implementation of a modern regulatory framework for corporate law, including corporate governance. The report sets out the arguments for bolstering requirements for greater transparency and the publication of more detailed reports for listed companies, as well as improved public access to corporate information, in particular through company web sites.

Measures instigated by the European Union can only have a limited effect on transparency in the audiovisual sector, especially if they are restricted to listed companies. Compared to the United States and Canada, there are relatively few "open companies" in Europe, in particular in the context of an audiovisual industry composed chiefly of small and medium-sized companies. Legal requirements (and compliance with these requirements) relating to the publication of limited liability companies' financial statements vary considerably across Europe. Our experience indicates that in France over 90% of sociétés à responsabilité limitée (limited liability companies) in the audiovisual sector comply with transparency obligations, while their financial statements can easily be accessed through various on-line data bases. In Germany, however, over 90% of the audiovisual sector GmbH fail to make their accounts public. In the United Kingdom, one often finds audiovisual production companies that publish their balance-sheets, but not their profit and loss accounts. The implementation of the provisions relating to the transparency of financial statements as laid down under Section 10 of the 4th directive on on the annual accounts of certain types of companies (78/660/CEE) should be examined in detail.

There is also a problem of a more technical nature involving the different accounting practices for the valuation of production. A recent British report revealed the diverse methods used by production and broadcasting companies for valuing production, most of which was generally recorded under inventories. In France, production assets are split between

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intangible capital (fixed capital) and inventories (current assets). In Germany and Luxembourg, broadcasters record their programme assets in a halfway category between assets and circulating assets. The study requested by our Advisory Committee and carried out by IDATE for the Observatory to look into ways of defining an indicator for measuring broadcasters' investments into production was obliged to admit defeat, due largely to the heterogeneity in accounting practices.
Despite the imperfections in the financial information available on audiovisual companies, the European Audiovisual Observatory has, over the last two years, been able to make considerable headway using the AMADEUS database, which holds the financial statements of some 6 million European companies, including around 30,000 from the audiovisual sector. The Observatory's use of this tool, which was originally designed for banks and investment companies, caused a certain degree of surprise and occasional expressions of scepticism or concern on the part of certain professionals. Initial results, that highlighted the financial fragility of both broadcasting and production companies, indicate that the European audiovisual sector, over and above its traditional, long-known handicaps, has now moved into a period of turmoil, that could turn into a serious, long-term crisis.

I am sure that, beyond the analyses carried out since we started trying to make it easier to understand European audiovisual markets, we should continue to delve into the financial situation of the sector, in order to help prepare public policies. In some European countries, audiovisual policies have, often successfully, been made up not just of supplying public-sector funding for subsidies, but of regulating the sector to channel funds from the stronger branches towards the weaker ones. These re-allocations (either regulated or by common agreement between market actors) can only be rationally and, hopefully, efficiently implemented if they are based on accurate, up-to-date information as to the financial situation of the various branches within the sector. Statistical work comes into its own when used to reinforce government intervention following market failures.

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When the European Audiovisual Observatory was founded in 1992, it was clear that it would have to help increase the efficiency of a European audiovisual market that found itself torn between its traditions, its regulations, and its specific national, community or regional features. Apart from this point agreed by all, there were two opposite conceptions of how the Observatory should operate.

In the first model, which I would classify as micro-economic intervention, the Observatory was supposed to be above all an information centre that could be accessed by all sector professionals. For a fee, the Observatory would be able to provide prompt information in answer to queries from sector professionals, or failing this, to indicate where such information could be found. The fees would be used to allow the Observatory to rapidly gain financial independence.

The second model, which owed more to macro-

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economic intervention, saw the Observatory working not so much for the sector professionals as a whole, taken individually, as for the various organizations that make up the sector, such as political decision-makers, national administrations, professional bodies, consultants and journalists. The model had the Observatory adopting an approach based on offering useful syntheses on markets and regulatory developments, rather than replying to individual requests.

It would be easy to show that this polarization tied in with different perceptions of the extent of asymmetric information in the sector, perceptions linked to the advantages to be drawn from the existence of these informational imbalances between the different actors in the market. It would also be easy to show how, during its early years, the co-existence of the two models was both the strength and weakness of the fledgling Observatory. Now, with the Observatory celebrating its tenth year of existence, I think that the choice of the second model was the right one to make.

It is nevertheless important for the Observatory to avoid working exclusively for what Arrow called the "informational elite". "Information can be offered collectively," he wrote "but to be used it needs to be absorbed individually". The setting-up of databases such as LUMIERE or KORDA should not be used simply for producing new statistical syntheses: these databases should also be seen as services that sector professional can access individually for information purposes. Even if we are happy with their initial success, it is still too early to find out if, once certain asymmetries in the circulation of information have been cleared up, they will offer significant improvement in a market which, quite often, does not like to be a market…

But that is another story.

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