



Unique and beautiful

Willingness to pay is a fluid concept

From Dr Andreas Hinterhuber.

Sir, Ira Sohn (Letters, January 3) suggests that asset values are determined by cash flows. He dismisses the intuition of his students “that rents associated with the Empire State Building are high because the value of the building is high” as incorrect. A qualifier is, I fear, due.

For commodities, asset values, in fact, tend to reflect cash flows, if markets function properly. Prof Sohn’s point here is well taken: the price of a cow is equal to the discounted sum of expected milk flows plus any residual value. But prices of differentiated products or services reflect the subjective willingness to pay of market participants: any marketing professional worth his or her salt knows that willingness to pay is a fluid concept, subject to creative manipulation (Apple seems to have digested this notion superbly well). Rents in the Empire State Building are high precisely because the building has a high value, which reflects its uniqueness and beauty.

Let us be clear: subjective perceptions determine asset values for differentiated products. That nearly all products can be differentiated is then the subject of another lesson.

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Who knew a cow was a valuable educational tool?

From Prof Ira Sohn.

Sir, I was not too surprised to learn that the rates of return on owning cows in India were negative as reported in a study cited by Sir Samuel Brittan (“Cattle look good on gift cards, but look like poor investments”, December 27), as I was reminded of an amusing story about a gift horse that was presented by an Arab notable to Dr Chaim Weizmann, the first president of Israel. The president instructed his staff to thank the sheikh for the gift, but in the end the horse had to go; as he explained, “a gift that eats is not a gift”.

On the subject of determining asset values, I always ask my students if the price of the Empire State Building is high because the rents are high, or vice versa, the rents associated with the Empire State Building are high because the value of the building is high? Invariably, most initially choose the latter. For reasons that are inexplicable to me, when I ask them the same question but substitute “cows” for “the Empire State Building” and “milk, manure, and calves” for “rents”, their responses immediately reverse: asset values are



Weizmann: horse was not a gift

determined by cash flows, not the other way around. I never knew cows could be such a valuable educational tool, especially with students who most likely have never seen a live cow!

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