

# Towards an Entertaining Business Model: a Teaching Case

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**Abstract-** For managers in established firms the Internet is a tough nut to crack. It is simple to set up a web presence, but difficult to create web-based business models. The brave new world of electronic commerce offers opportunities for businesses to enter new markets, create new products and deliver them in innovative ways. However, these opportunities can be threats. A key threat to any business, almost regardless of their place in the value chain, is disintermediation. Suppliers, who may be current collaborators, find that they can now reach customers directly. While those supplying physical goods face the risk of being 'disintermediated', the situation is worse for businesses that deliver digital or at least digitisable products. This case analyses the response of one firm, Egmont, to such threats and their quest for a new model upon which to base their business.

## I. PART A: INTRODUCTION

Egmont has a vision of providing consumers with quality entertainment. For example, Egmont publishes 70% of the world's Disney stories, and it currently sells or rents about half of all videos and 60% of all film tickets in Copenhagen. In 1998, Egmont and Disney celebrated 50 years of co-operation, which started with the publication of a monthly Donald Duck comic in Sweden. Today, Disney-Egmont co-operation encompasses the publication of magazines and books in 28 countries. Egmont's CEO, Jan Froeshaug, sees the Group's unique competency as 'making great products'. Egmont 'makes great products' primarily on the basis of rights, characters and scripts licensed from content producers. Their key skill is in transformation where content is created and leveraged internationally, but localised for different markets. Egmont is grappling with rapid changes in technology, markets and competitors. It has activities in all the stages of the value chain. However, as it is mainly an intermediary transforming entertainment products, Egmont is squeezed from both ends of its value chain - by originators and by retailers and customers.

The entertainment sector faces rapid changes in both delivery formats and business models. Games, music and film are increasingly downloaded directly from networks, so a strong position in the Internet channel will be essential to retain distribution rights. The ability of interactive media to

track user behaviour and predict demand will enable the sector to source better. Yet, Ole Timm, Senior VP and managing director of Egmont Entertainment (ENS) and chairman of Egmont Online (EON) is reluctant to expand rapidly investments in the Internet and commit EON fully to e-commerce in entertainment products because of the risk of channel conflicts and low current market volumes.

### A. Firm Background

Egmont, based in Denmark, is Scandinavia's largest entertainment media group with activities in 29 countries. The breadth, scale and international nature of Egmont's business make it potentially a dominant player in interactive media. Egmont's vision is to be a world-class media house providing consumers with quality entertainment 'while they read, watch, listen and play.' According to Egmont's CEO Jan Froeshaug the 'raison d'etre' of the Group is its unique competencies in making entertainment products, focusing on children in Europe and the whole family in Scandinavia.

### B. Financial Situation

In 1998, Egmont's profit before tax and extraordinary items was \$46m (see Figure 1). Group revenues increased by approximately 6% to \$1.1bn in 1998 (see Figure 2). In 1998, sales outside Denmark were 85% of the total. Sales via electronic media is expected to increase in line with industry trends from 40% in 1998 to about 50% after 2000.

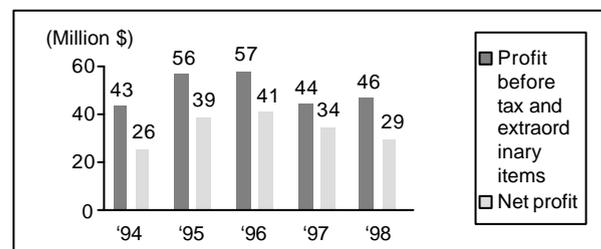


Fig. 1. Profit Before Tax and Extraordinary Items, 1994-1998 (Source: Egmont)

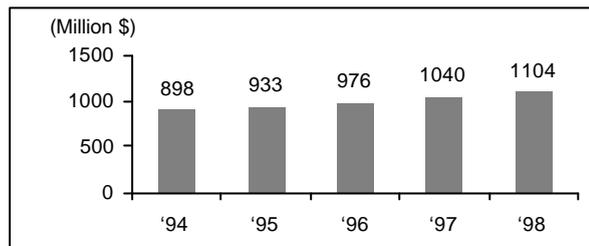


Fig. 2. Group Revenue, 1994-8 (Source: Egmont)

### C. Organizational Structure

It all began with Egmont H. Petersen, who, at the age of 17, set up a printing shop in his mother's kitchen in Copenhagen in 1878. After his death in 1920, the company became the Egmont Foundation, a charity generating funds through commercial activities. All commercial activities are conducted through the Egmont Group, supervised by the Foundation's Board of Trustees and are managed by a Group Management Board. Today, the Egmont Group comprises 107 active companies. With a total of 4,047 employees, the Egmont Group is structured in five main pillars, each representing a business sector (see Figures 3, 4 and 5).

*Egmont Magazines* controls 1/3 of the weekly magazine market in Scandinavia including 30 weekly and special interest magazines with more than 5m weekly readers in Scandinavia. Revenues were \$240m in 1998. In principle, each magazine may transfer reader loyalty into interactive media, thus extending and adding value to the print products.

*Egmont Juvenile* is Europe's largest publisher of comics based on rights to exploit characters from Disney (now in 28 countries), King Features, Marvel, Mattel, Turner, Warner and others. Egmont Juvenile develops 18,000 pages of new stories annually published in 30 countries with 1998 revenues of \$290m. The stories are published in comics, albums and pocket books, or adapted and published on audio cassettes and CDs. The publications are based on long-term licensing agreements. This high volume, multi-lingual content production ability could provide the basis for an international children's on-line service. Egmont Juvenile has not been content to stay within the confines of Europe and is expanding in the Far East. The entry of Egmont Juvenile to the Japanese market was not easy. The Japanese comics market is the largest in the world and based on an Asian narration form called 'manga', in which visual expression is more important than text. Consumers knew of Donald Duck and Mickey Mouse from other products, but they did not know them from comics. Earlier attempts by other publishers to launch comics in a European style were unsuccessful. With support from both Japanese and European cartoonists, Egmont spent more than two years recreating the 'Ducksberg universe in manga style'. The new, highly visual comics were launched after thorough market testing, and should lead to opportunities in other markets – initially in Asia.

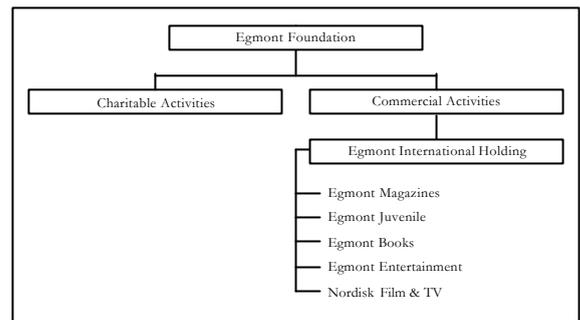


Fig. 3. Organizational Structure (Source: Egmont)

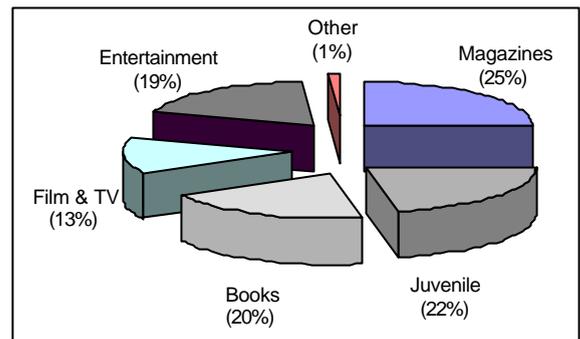


Fig. 4. Employees 1998 (Source: Egmont)

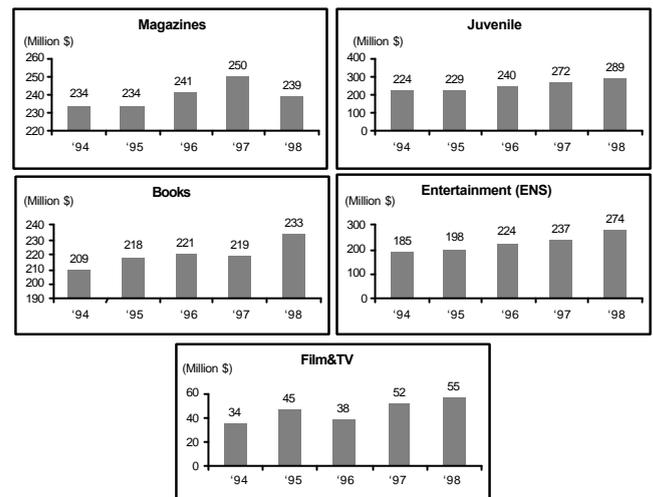


Fig. 5. Annual Revenue per Business Sector (Source: Egmont)

*Egmont Books* operates in 25 countries with 1998 revenues of \$233m. It is Europe's largest publisher of children's books capturing more than 10% of the highly fragmented European children's book market. Also, it is the second largest publisher of adult books in Scandinavia. Egmont Books includes 20 publishing houses and 58 book clubs. Distribution has grown from 5m to 60m books annually in five years. About 3,500 new titles are added every year and distributed through book stores, kiosks, supermarkets, department stores, catalogues and the Internet, as well as through extensive book clubs. For Egmont, it is important to

constantly strengthen its position in book publishing in order to remain an attractive partner for authors, licensors, and the retail trade. Both acquisitions and organic growth have characterised this development. In 1998, Egmont launched a children's Lego book club in the Danish and German-speaking markets as a first step of strategic co-operation with Lego, a co-operation that is foreseen not to remain limited to the operation of a single book club. Further, through active support of Internet sales, both directly and indirectly, the market for print publications could be increased opening up new delivery formats such as digital books.

*Nordisk Film & TV (NF&TV)* is one of Scandinavia's largest suppliers of original film and TV titles and production services. Egmont Imagination is responsible for developing new children's characters and managing their introduction through the production of animated TV series for the global market. They co-own TV2 Norway and TV stations in Sweden and Finland. NF&TV is active in the production of interactive content for the Internet and real-time 3D game platforms. These activities are not consolidated in the 1998 revenues shown in Figure 5. 1998 revenues from content creation were \$55m. Enormous demand is anticipated as Internet bandwidth expands and processor speeds increase to provide a more TV-like interactive experience.

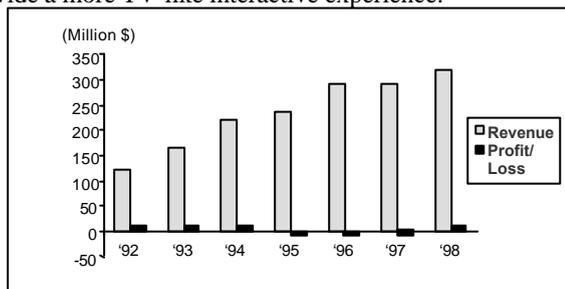


Fig. 6. ENS Revenues and Profit (Source: Egmont)

*Egmont Entertainment (ENS)* is the leading distributor of film, video and electronic games in Scandinavia. Being essentially a distribution business, it does not directly add value through content creation, but only via marketing and distribution of products. Both films and electronic games are marketed through the traditional video trade, in kiosks, supermarkets and department stores, as well as increasingly in electronics shops. ENS operates its own distribution company based on many years of co-operation with leading film and electronic game producers such as Columbia Tristar, 20th Century Fox, Disney Interactive, and Sony. The sector also includes Denmark's largest chain of cinema theatres with about 10,000 seats. 1998 revenues were \$273m, making the first profit for three years (see Figure 6). For the first time electronic games topped the list of revenues earners.

Overall, the Egmont Group has subsidiaries aiming to provide world-class entertainment in very different environments and media. Egmont believes that this is best done close to the customer. However, Egmont strives to

connect their people across media and national borders to enhance communication and competitiveness. In 1998, Egmont implemented an intranet, 'InSight', that facilitates dialogue and information among Egmont's employees around the clock. InSight contains several thousand pages of information helpful to Egmont's daily work. Some of the many networks, such as the Disney books and magazines, have functioned for many years, while the Barbie network is recent. Egmont's staff develops new ideas and improves shared content in books and magazines across national borders – Barbie is now published by Egmont in 27 countries. According to Egmont, 'networking has made personal training and business development synonymous' (Egmont Annual Report 1998).

## II. MARKET DEVELOPMENTS

Entertainment products face the most rapid changes in both delivery formats and business models due to interactive media. Entertainment distribution is a 'fast moving' and 'hit-driven' business where PC games, movies and videos quickly become obsolete. It requires strong management in product sourcing, logistics, and marketing. As games, music and film are increasingly – though still at a rather low percentage – downloaded directly from networks, a strong position in the Internet channel may become essential to retain entertainment profits.

The entertainment market is seeing an increasing shift from print to electronic. Yet, the print market is still growing and will remain important for the foreseeable future (Figure 7). Jupiter Communications forecasts rapid growth in on-line purchasing from all sectors with music and entertainment expected to be among the leaders (Figure 8). While television watching is expected to increase, the biggest changes in spending leisure hours are predicted to be in web surfing and video games (Figure 9). On-line content is forecasted to grow and magazines are predicted to outstrip book growth as a percentage of the total market. However, on-line content is expected to grow much beyond 1% market share by 2002 (Figure 10). According to Jan Froshaug the data for 2002 represents the current habits of the 30% most web-active consumers. Egmont's research outlines that, after a period of rapid growth, user on-line time will drop among heavy web-users, as is already the case in Norway. Further, their investigations show that in the US few users visit more than ten web-sites routinely.

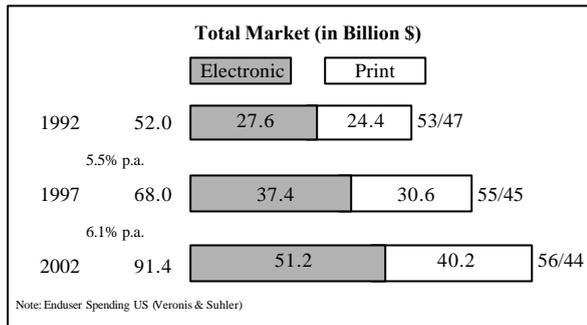


Fig. 7. The Entertainment Market (Source: Egmont after Veronis & Suhler)

Product	1997 Sales in Million \$	2002 Sales in Million \$	Change (in %)	Industry Share in 2002 (in %)
Travel	911.3	12,802.1	1,305	8.4
PC Hardware	985.5	6,434.4	533	13.3
Books	151.9	3,661.0	2,311	11.3
Groceries	63.3	3,529.2	5,479	0.7
Clothes and Accessories	103.1	2,844.5	2,658	1.6
Software	84.5	2,379.1	2,714	35.3
Music	36.6	1,590.6	4,248	9.2
Entertainment Tickets	51.8	1,809.9	3,397	7.0

Fig. 8. Online Purchases (Jupiter Communications)

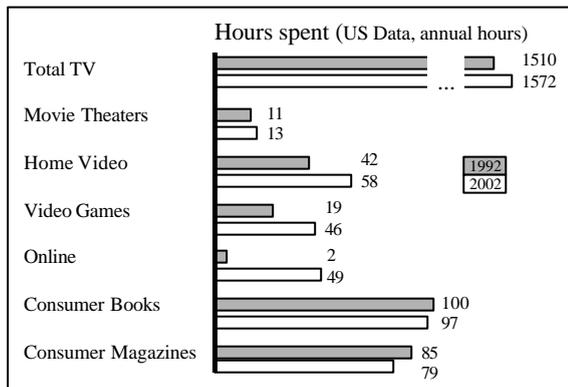


Fig. 9. Battle for the Consumer's Time (Source: Egmont after Veronis & Suhler)

Category	Growth 1997-2002 % p.a.	Size of Market 2002 (in %)
Filmed Entertainment	6.3	90
Interactive Entertainment	5.1	9
Online Content	22.4*	1
Consumer Books	5.2	42
Consumer Magazines	6.2	58

\*excl. Advertising Revenue (Growth Rate incl. Adv. Revenue: 44.4%)

Fig. 10. US Entertainment Market US (Egmont and own analysis)

### III. ENTERTAINMENT VALUE CHAIN IMPLICATIONS

There are essentially four elements in the *entertainment business value chain* (Figure 11). The chain starts with *originators* that own the rights and the ideas. This value chain position is very lucrative; successful ideas often result

in large revenues and substantial profits but costs and risks can be high too. Originators sell licences to transformers. *Transformers* make the rights and ideas into goods for sale. The third value chain element are *producers*. Typically, this is a less profitable niche. At the end of the value chain come *distribution and logistics*, which may be offered by physical retailers, mail order companies, or via electronic platforms such as TV or online channels. Physical or electronic platforms almost 'own' the customer, but only *after* the customer has chosen a retail outlet or TV station. There is strong concentration in this fixed-cost driven, highly profitable sector (e.g. yahoo, TV stations, large department stores). Traditional retailers (especially membership-based mail order companies and others who use special customer cards) accumulate customer data, register purchase patterns, and now use the Internet as a tool. They foster distribution, aiming for a margin in the last stage of the value chain. For instance, Boxman, a successful Swedish CD retailer on the Web, does not own the rights to any of the music it sells.

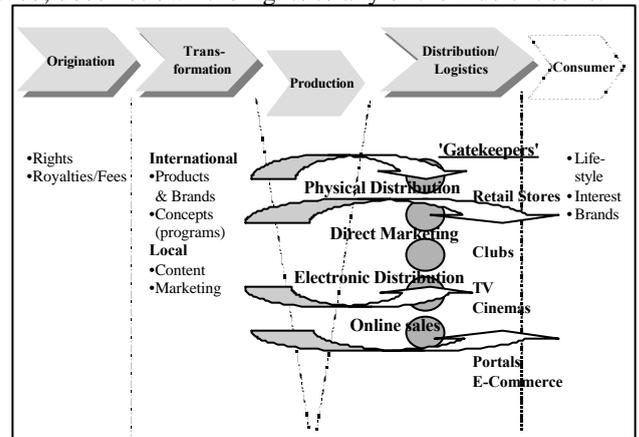


Fig. 11. The Entertainment Industry Value Chain

- Question 1. How do you expect the market for Egmont's products to change as use of the Internet expands? How will the skills Egmont requires be affected?
- Question 2. Where are Egmont's activities in the industry value chain? Assess the nature and extent of competition and competitors at each stage of the value chain. How is it likely to change? Who is likely to gain, who to lose?
- Question 3. Entertainment firms depend on securing the rights to content. What will determine who secures such rights in the Internet world?
- Question 4. What competitive strategy would you advise Egmont to follow?

### IV. PART B: EGMONT ONLINE (ONL)

In 1996 Egmont established *FunOnline*, a children's Internet community in Germany. It was an initiative that proved to be ahead of its time, costing Egmont \$15m. Parents

were uncomfortable with the new medium, its influence and significance, fewer people had PCs at home, and the technology was not as user-friendly as it is now. FunOnline was subsequently redefined and today is one of the most visited sites in Germany; it is growing rapidly. In December 1998, there were 300,000 page visits, while by August '99, page visits amounted to 2.4m. Many of the lessons learned from the FunOnline venture formed the basis of Egmont's subsequent investments in interactive media, especially Egmont Online.

Egmont Online (ONL) was established to be the Group's strategic investment in new technologies. It supplies entertainment, news, information and advertising space to its net communities. ONL started in late 1996 supplying Internet consulting services to Egmont companies. In June 1997, ONL shifted from consulting to developing and managing an 'interactive media platform' for the Egmont Group through which 'Egmont-to-consumer services and products' could be distributed. The platform was launched in December 1997 under the name EON (Egmont Entertainment Network, www.eon.dk).

In 1998, *100% Live* was introduced to the market, a net TV developed and operated in close co-operation with Nordisk Film & TV. Arguably the first Internet talkshow, *100% Live* allows viewers to direct their questions to the studio host and guests via computer. Pictures and sound are sent over the Internet directly to home PCs.

In February 1998, Telia, the largest Scandinavian telco, invested \$2.5m for 33% of ONL. In 1998, ONL had revenues of approximately \$1.4m and a net investment of about \$2.6m. By February 1999, net investment was \$6m.

ONL's primary distribution channel is the Web. Its two primary media activities are *EON* and *Netpool*. ONL's platform *EON* is, primarily, a collection of on-line communities. By 1998, it had 325,000 monthly entries, 1.8m monthly advertising exposures, and 53,000 registered members. Figures 12, 13, and 14 illustrate EON growth. More recently in 1999Q3 page views have soared from 0.25m to 1.2m. EON's design and architecture are aimed at handling business-to-consumer e-commerce for entertainment products and services (magazines, books, CDs, tickets, videos etc.) as soon as on-line markets and payment technologies have matured. Although currently only operating in Denmark, EON has been developed as an international platform with the potential to support Egmont businesses around the globe. Currently EON is the only 'platform' of its kind in Denmark and should be able to attract more channels. The biggest task will be to demonstrate to content owners that participation in EON is worth giving up some control for.

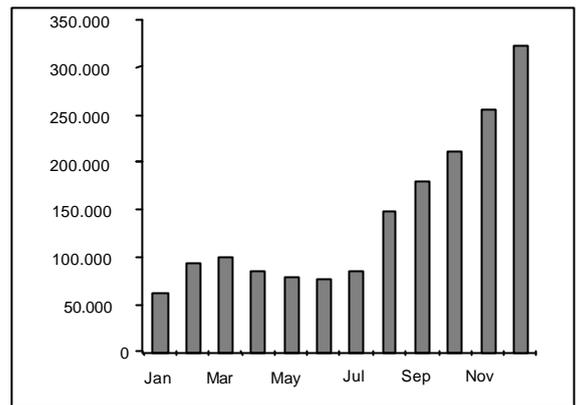


Fig. 12. EON Sessions 1998 (Source: Egmont)

In April 1999, EON received an award for being the best Internet service in Denmark. H. Hojberg, head of the jury, commented, 'EON has constantly developed its services in time with the new opportunities the Internet provides. There's no doubt that they will play a prominent role in the future when competing for customers' interests.'

*Netpool* is a centralised advertising management and sales organisation acting as a middleman between advertisers and Web site owners. In 1998, ONL established Netpool Denmark and acquired a stake in Netpool International. ONL is one of Netpool's largest clients.

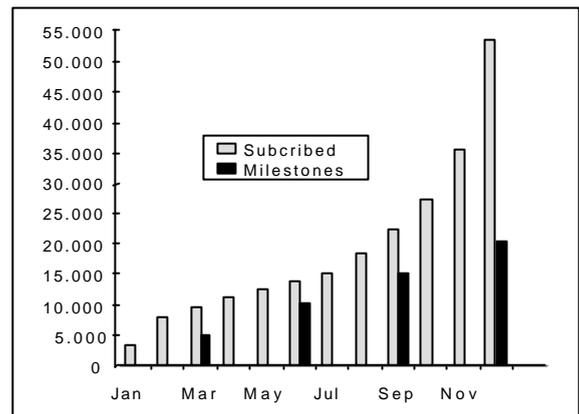


Fig. 13: EON Members 1998 (Source: Egmont)

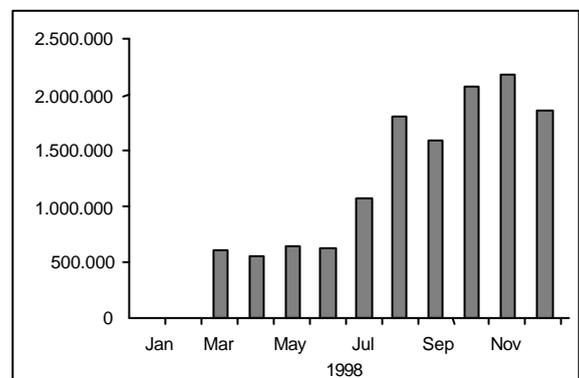


Fig. 14. EON Ad Exposures 1998 (Source: Egmont)

#### IV. ONL'S COMPETITIVE POSITION

There is fierce competition for the rights to the most attractive assets on the Internet. Most assets go to highest bidder, hence a strong competitive position requires financial strength and potential to get a return on the investment. In spite of overlaps, two aspects of competition are investigated: (i) 'investment' and (ii) 'market share'.

##### A. Investment

Like their US counterparts, Scandinavian media companies are investing heavily in the Internet. Through its investments in Scandinavia-Online, Schibsted had a three-year head start over Egmont, but their attempt to develop a pan-Scandinavian service has not been successful so far. Scandinavia-Online is a general Internet business, and it is currently losing about \$15m per annum. In 1998, Schibsted invested an estimated \$8.5m in the Danish market; more than three times ONL's spend. Another competitor, Kinnevik, operating in Denmark as Tele2 and Get2Net, has acquired distribution rights for Disney's Daily Blast for an estimated \$1.8m, twice the price Egmont felt it justified. Egmont assessed that there is insufficient return solely in distribution and did not attempt to acquire the rights. Tele2 is on track to become the highest-profile Danish children's on-line media. Additional threats may stem from Bonniers and TV2, international competitors with Wall Street funds, as well as from aggressive Scandinavian start-ups such as the independent 'Jubii'.

International competitors funded by huge domestic markets keep raising consumer expectations. Firms must cooperate to be profitable in interactive media. As with manufacturers that leverage R&D investments over broad product lines, keeping up with the changing Internet requires sharing investment across many interactive media products. This is particularly important in small language markets such as those in which ONL and many Egmont companies operate.

##### B. Market Share

Web sites struggle for market share. The Danish market has about 50 firms competing for the attention of 300,000 active (1-3 times per month) local Internet users and an on-line advertising market of about \$10m. On average, there are 6,000 users and \$0.2m of revenue per year per site - insufficient to justify the investment required to run a high quality independent site.

Market share estimates are unreliable, but ONL's EON service is consistently highly rated for quantity. Positive press and strong partnerships have given ONL a reputation for quality, fairness and foresight. These will be essential for maintaining trust and translating EON membership into a market for other Egmont products.

By concentrating all responsibilities for banner sales in Netpool, ONL has kick-started the Danish banner market, and captured significant market share for ONL early on. By joining a pan-Scandinavian alliance, it simultaneously reduced the costs and risks.

##### C. A Promising Start

ONL has had successes, but for Egmont this is only one step towards a new business model. A major issue for Egmont is how this step leads to the next. Egmont recognises that there are a number of potential next steps and that well-considered steps may be better than premature leaps. While development of ONL and its subsidiary activities has enhanced brands and built valuable knowledge of consumers and their habits, Egmont could go further into e-commerce.

*Question 5. How can Egmont best structure ONL to reap group-wide synergies?*

*Question 6. ONL's business model covers three main areas: (1) profiting from content and distribution, (2) harvesting membership and customer profiles, and (3) selling Internet access. Comment on how you would develop each of these.*

*Question 7. ONL is a step towards a new business model for Egmont. It raises a number of management problems concerning inter alia, channel conflicts and internal structure and co-ordination. How might Egmont deal with these?*

#### V. PART C: NEXT STEPS

##### A. Towards E-commerce

Egmont aims to operate EON as a strategically important infrastructure for direct and on-line sales in order to foster e-commerce in each of its five business sectors 'whenever the market will suggest and demand it' (Jan Froeshaug). Egmont's CEO believes the e-commerce market is not large enough, yet. Hence, Egmont's strategy is to *start by bringing their clubs on-line*. Profits from this are booked to the clubs, not to ONL.

The clubs have about 250,000 members in Denmark (in total they have over 1 million members in book clubs and more than 1.5 million in all clubs). They offer focussed product lines (unlike general book retailers), but stock thousands of copies of best-selling titles. Typically, clubs sell about 60,000-70,000 copies of each best-seller, an average 'non-club' title sells about 1,000-5,000 in Denmark. Currently, about 30% of book club customers use the Web. Egmont management supports all Egmont clubs being available on the Web through ONL or directly through the club's web address. In this model, ONL lets (potential) customers learn about Egmont products, buy tickets to movies, order books etc., and

to chat about all the available products. Besides 'racking', the clubs heavily contributed to Egmont's year-long experience with direct sales and the according logistic challenges. For instance, in 1998, around 60% of Egmont Entertainment (ENS)'s sales were indirect (via video stores, other retailers, and mass distribution) and 40% direct (through clubs and racking companies). Direct selling experience is one of Egmont's strongest assets, direct sales require skills in physical distribution that Egmont already has in place.

In Denmark, Egmont controls the largest book and video clubs. Hence, it has access to consumers, both targeted consumer groups through clubs and more general consumers, Egmont and Bonnier vie for the prime club spot in Scandinavia.

In Sweden and Denmark, Egmont has distribution and logistics centres where orders are handled and shipped to retail and consumers. In Koege, not far from Copenhagen, Egmont has the most modern itemised delivery system in Scandinavia with completely automated processes. The system has recently been identified as an example of good practice by Disney.

Clubs sell direct; however, they are mainly mail order, despite more transaction phases being offered and/or executed via the Internet. Egmont's CEO, Jan Froeshaug, comments, 'just using the Internet for the "club business" is not sufficient to term it "e-commerce". "True" e-commerce requires on-line sales – direct or indirect'.

Aside from successfully setting up the interactive media platform EON, e-commerce presents other challenges to Egmont.

- Internet projects are *capital intensive* compared to Egmont's usual investments and riskier. As a foundation, Egmont has little experience of financing 'risky' investments on the stock market. Risk sharing with a partner implies some loss of control over the project.
- Egmont is a decentralised, profit-centre-based organisation that may find difficulty in realising group synergies and jointly leveraging assets. "There is no uniform recipe for growth. This also applies to Egmont where companies devise widely different growth strategies" (Egmont, Annual Report 1998, p.18).
- Building direct sales channels implies the risk of *channel conflicts*. Egmont's current Internet strategy involves building a direct sales channel. The Entertainment and Books sectors are dominant distributors and they fear that selling directly on-line will violate retail relations. On the other hand, Egmont already operates various direct sales businesses in Entertainment and Books in the form of clubs, mail order and racking. Competitors with similar vision and ambitions are already taking market share and building relationships with

'Egmont customers'. Egmont must be prepared to face retaliation from retailers (and competitors) via exclusion from certain retail chains, price competition and favouring of competitors. The reactions may be alleviated by carefully managing e-commerce initiatives so retailers see it as a necessity for Egmont. Consolidation in retailing and on-line services implies fewer, stronger retailers that might out-bargain Egmont against producers and/or make themselves unavoidable for Egmont.

## VI. CONCLUSIONS

Due to the rapid development, staggering impact and hype of the Internet, few firms yet have a clear picture of, and strategy for, a digital future and its business potential. The debate over 'early mover' versus 'wait and see' is unresolved. It remains to be seen how quickly consumers will shift to Internet buying and if advertisers will move media budgets on-line. Decision aids such as business experience, track records or benchmarks are unavailable. Technology is making current business models obsolete, allowing new (and unforeseen) competitors to steal competitive edges. Yet technology can only go so far. Trust and relationships may be the key to the next wave as the technology become ubiquitous. Consumers can be empowered by the web, but loyalty and habit in buying patterns gives existing vendors an advantage. It has never hurt any business to know its customers and Egmont, demonstrates that this is more important than ever. Customers can only drive technologies and businesses that are there and willing to be driven. If customers are 'doing the driving' then flexibility in strategy, operations, processes, systems and technology come to the fore.

Egmont's industry is changing rapidly, with electronic media growing quickly and printed media stagnating. Egmont can grow in printed media from increasing market share through innovation, geographic expansion and acquisitions, but the real growth prospects are in electronic media. The Group will continue to invest in new concepts, products and markets but the investment demands of this are high.

Egmont's CEO considers few players, especially in the entertainment sector, have found a successful and stable business model. Egmont has made a deliberate choice not to be first mover. Jan Froeshaug considers that there is the potential to lose a lot of business for a small Internet market. Hence, Egmont's strategy is to be ready and to be flexible so that if, and when, the market turns into something big, Egmont can be a rapid entrant.

This case demonstrates how rapid changes in industry sectors and threats such as disintermediation can be countered by forward-thinking, innovative strategies and a technological solution in on-line, entertainment sales.

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## Note

Some exhibits have been omitted from the teaching case in order to suit the ECIS page constraint. A 12-page Teaching Note including additional 7 exhibits / slides is available to instructors upon request.