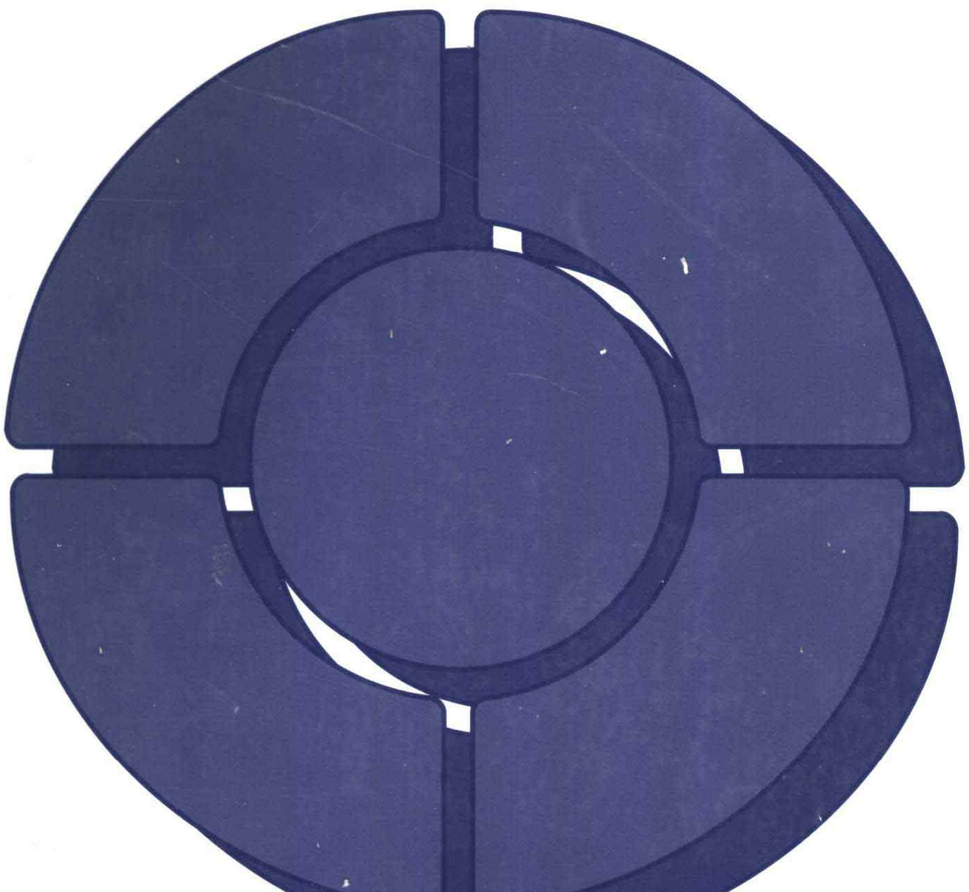
Applications in Basic Marketing

Clippings from the Popular Business Press

McCarthy/Perreault



1993-1994 Edition

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IRWIN

Homewood, IL 60430
Boston, MA 02116

Printed in the United States of America

ISBN 0-256-13942-3

4 5 6 7 8 9 0 WCB 0 9 8 7 6 5 4

Preface

This is the fourth annual edition of *Applications in Basic Marketing*. We developed this set of marketing "clippings" from popular business publications to accompany our texts—*Basic Marketing* and *Essentials of Marketing*. All of these clippings report interesting case studies and current issues that relate to topics covered in our texts and in the first marketing course. We will continue to publish a new edition of this book *every year*. That means that we can include the most current and interesting clippings. Each new copy of our texts will come shrink-wrapped with a free copy of the newest (annual) edition of this book. However, it can also be ordered from the publisher separately for use in other courses or with other texts.

Our objective is for this book to provide a flexible and helpful set of teaching and learning materials. We have included clippings (articles) on a wide variety of topics. The clippings deal with consumer products and industrial products, goods and services, new developments in marketing as well as traditional issues, and large well-known companies as well as new, small ones. They cover important issues related to marketing strategy planning for both domestic and global markets. The readings can be used for independent study, as a basis for class assignments, or as a focus of in-class discussions. Some instructors might want to assign all of the clippings, but we have provided an ample selection so that it is easy to focus on a subset which are especially relevant to specific learning/teaching objectives. A separate set of teaching notes discusses points related to each article. We have put special emphasis on selecting short, highly readable articles—ones which can be read and understood in 10 or 15 minutes—so that they can be used in combination with other reading and assignments for the course. For example, they might be used in combination with assignments from *Basic Marketing,* exercises from the *Learning Aid to Accompany Basic Marketing*, the *Computer-Aided Problems,* or *The Marketing Game!* micro-computer strategy simulation.

All of the articles are reproduced here in basically the same style and format as they originally appeared. This gives the reader a better sense of the popular business publications from which they are drawn, and stimulates an interest in ongoing learning beyond the time frame for a specific course.

We have added this new component to our complete set of **P**rofessional **L**earning **U**nits **S**ystems (our **P.L.U.S.**) to provide even more alternatives for effective teaching and learning in the first marketing course. It has been an interesting job to research and select the readings for this new book, and we hope that readers find it of true value in developing a better understanding of the opportunities and challenges of marketing in our contemporary society.

E. Jerome McCarthy and William D. Perreault, Jr.

Acknowledgments

We would like to thank all of the publications that have granted us permission to reprint the articles in this book. Similarly, we value and appreciate the work and skill of the many writers who prepared the original materials.

Linda G. Davis played an important role in this project. She helped us research thousands of different publications to sort down to the final set, and she also contributed many fine ideas on how best to organize the selections that appear here.

The ideas for this book evolve from and build on previous editions of *Readings and Cases in Basic Marketing*. John F. Grashof and Andrew A. Brogowicz were coauthors of that book. We gratefully recognize the expertise and creativity that they shared over the years on that project. Their fine ideas carry forward here and have had a profound effect on our thinking in selecting articles that will meet the needs of marketing instructors and students alike.

We would also like to thank the many marketing professors and students whose inputs have helped shape the concept of this book. Their ideas—shared in personal conversations, in focus group interviews, and in responses to marketing research surveys—helped us to clearly define the needs that this book should meet.

Finally, we would like to thank the people at Richard D. Irwin, Inc., our publisher, who have helped turn this idea into a reality. We are grateful for their commitment to making these materials widely available.

E.J.M. and W.D.P.

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French Food Concern Has to Teach Region the ABCs of Capitalism

By E.S. BROWNING
Staff Reporter of THE WALL STREET JOURNAL

PRAGUE – Hoping to take Eastern Europe's market by storm, French food company **BSN** SA is spending hundreds of millions of francs to build and buy production plants from Warsaw to Budapest.

That's the easy part. The hard part is managing them.

Here in the former Czechoslovakia, for example, BSN and its partner **Nestle SA** now control 60% of the cookie and chocolate market. They won their dominant position in February by buying control of the state's main cookie and chocolate company.

But when they took control, they discovered that the company's handful of salesmen were accustomed to making just one sale a month – to the state wholesaler. Now that the market is free, competitors like **Mars Inc.** are moving in, and the salesmen must quickly learn to service dozens of orders a week from 250 new wholesalers.

BSN, which makes Dannon yogurt, is also fighting to dominate Eastern Europe's yogurt market, producing locally and delivering with a fleet of refrigerated trucks. But some stores, the company has discovered, have the bad habit of leaving yogurt boxes on radiators. Others turn off refrigerator cabinets at night, saving electricity but letting products spoil.

"The biggest problem is simply that the Czechs don't yet understand what a market economy is," laments Max Berger, a Dutch cookie expert sent in by BSN to run the big cookie and chocolate company, Cokoladovny AS.

Third World Methods

No one ever said bringing capitalism to Eastern Europe would be easy. BSN, in fact, has found itself using methods it originally developed for Third World countries. The company doesn't even try to teach management techniques at first. Instead, it just tries to teach employees what a market is – what it means, for example, to have customers who actually can refuse to buy your products because someone else's are better.

Faced with this sometimes Kafkaesque task, some European companies like **Cadbury Schweppes** PLC have decided against producing in Eastern Europe for now. Most big food companies, however, are taking the plunge.

"When people tell me about the dangers of Eastern Europe, I am reminded of Spain," says Antoine Riboud, BSN's ebullient 74-year-old chairman. "After Franco's death, everyone told me to go slow there and prepare for political and economic crisis. Today, Spain's economy is one of Europe's most dynamic, and I am delighted to be there. I expect the same success in Eastern Europe."

BSN is gambling more on Eastern Europe than most. Bigger companies such as Nestle and **Unilever** NV have developed a strong presence in the U.S.; with one or two exceptions (such as its Evian water and Dannon yogurt), BSN hasn't. Now it's largely bypassing the slow-growing U.S. market in favor of Eastern Europe and Asia.

Eastern Europeans are hungry for high-quality, Western-style food. BSN says that its Czech and Hungarian operations are already profitable, barely a year after taking control. Although people's purchasing power has fallen and some heavier industries are suffering, food sales are growing.

The division of Czechoslovakia into two nations complicates things. But BSN says production won't be severely affected because its main factories are all on the Czech side.

To build sales, however, companies like BSN must make hard-currency investments. Those outweigh profits, which come in soft currencies. And teaching locals to meet Western production standards is no piece of cake.

At one of the Prague cookie factories acquired by BSN and Nestle, for example, bored-looking women in stained white coats still feed dough into baking machines by hand – scooping it out of vats with their fingers. At a meeting with securities analysts last year, BSN Vice Chairman Georges Lecallier compared the nation's factories with those that existed in France at the end of World War II.

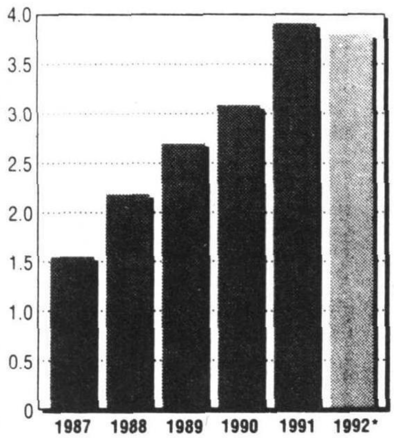
Offended by a reporter's question about the machines' ages (which turn out to be two decades and more), the Czech plant manager points to her pride and joy, a sparkling new machine to wash the plastic tubs that transport dough and freshly baked cookies. It seems an odd machine to buy so soon after a takeover, but the decision is easily explained.

"In the past, they didn't wash those

BSN by the Numbers

The Profit Picture

Annual net profit in billions of francs



*Company estimate

The Fundamentals

	1991	1990
SALES (billion francs)	66.07*	52.90
NET PROFIT (billion francs)	3.91	3.09
EARNINGS PER SHARE	59.00	53.40

*$12 billion

MAJOR PRODUCT LINES:

Dannon yogurt, Evian water, Kronenbourg beer, cookies & crackers, noodles and sauces

MAJOR COMPETITORS:

Nestle,* Unilever, Kraft General Foods (a unit of Philip Morris)

*In the Czech Republic, BSN and Nestle are partners, having jointly acquired the country's biggest cookie and chocolate company.

(cont.)

tubs for years," says Mr. Berger, the Dutch cookie expert. "You'd find them encrusted with fat and old cookies."

The aging factory's floors have been patched so often, and are so cracked, that they are almost impossible to keep clean, Mr. Berger adds. Another big problem is keeping machinery repaired. Accustomed to delays and parts shortages, repairmen don't believe in speed; getting something fixed can take weeks.

Then there is the challenge of training and retraining managers, and for that BSN and Nestle are trying an experiment. At a vacation center near the Moldau River, 45 minutes outside Prague, they are asking senior managers to spend four days playing a board game. It looks a bit like Monopoly, run by a small computer.

The managers form teams with limited money for plants, market studies, wages and the like. They win by selling things customers want and are penalized if they over-invest or undercut wages (which can cause strikes).

At the end of one such seminar, Mr. Lecallier meets with newly trained managers. The executive, a man so fascinated by marketing that he spends most Saturday mornings visiting supermarkets and watching people shop, keeps his advice simple. Keep products fresh and tasty, he says. Use convenient packaging. Innovate. As he finishes, a hand goes up.

"You have said we should try to understand the needs and desires of consumers," says a Czech manager. Mr. Lecallier nods and smiles. "My question is, how do we determine what those are?"

The room is silent, and Mr. Lecallier stares for a moment in disbelief. Then he starts again, speaking in even simpler terms about monitoring sales, conducting studies and doing all the other things the managers are supposed to have spent the previous four days learning.

Lack of Understanding, Initiative

Some local managers find basic market concepts almost impossible to comprehend. Others are reluctant to exercise individual initiative. Initially, BSN sent in more expatriate managers than planned.

And there's another two-pronged threat that companies like BSN don't like to discuss: politics and corruption. Some senior managers at any former state company are sure to be old Communists who oppose Western practices. Others are caught in a system of bribes and kickbacks. The same goes for labor leaders. Finding and eliminating corruption is a big problem for any Western company in Eastern Europe.

"In Eastern Europe, we are hiring young people straight out of university," says a manager at another big Western food and beverage concern. "We figure that it is better to have someone weak on experience than someone who has been polluted ethically."

Korean Black Market Stymies U.S. Firms

By DAMON DARLIN
Staff Reporter of THE WALL STREET JOURNAL

SEOUL, South Korea — A thriving black market here is complicating efforts of U.S. companies to sell their products in Asia's second largest consumer market.

Since the end of the Korean War, Korean entrepreneurs have sold imported, mainly U.S., goods taken from U.S. military bases in South Korea. Even now, the black market is the main way that Korean consumers get foreign consumer products. And it got a boost in May, when the U.S. lifted some restrictions aimed at curbing the flow of goods from military bases.

The black market does build name recognition and consumer demand for a host of products with little effort from their manufacturers. When companies selling such brands as Spam canned luncheon meat, Taster's Choice instant coffee and Johnson & Johnson baby oil set up direct sales, they won significant market shares quickly because their products had been in vogue for years. "There is a status to having an American brand," says Lawrence P. Lauck, deputy commissary officer at the Army base in Seoul, the main source of black-market goods.

Same Product, Different Prices

Comparison of cost of selected items in South Korea, in U.S. dollars

	U.S. MILITARY BASE PRICE	KOREAN SUPERMARKET PRICE	KOREAN BLACK MARKET PRICE
Skippy Peanut Butter	$ 2.88	$ 6.90	$ 5.52
Johnson & Johnson Baby Oil	2.44*	6.76**	4.83*
Coca-Cola (6-pack)	1.14	2.48	3.28
Spam	1.81	3.15	2.76
V-8 juice (6-pack)	1.49	4.14	2.76
Oxtails (1 lb.)	1.74	6.59	5.65
Aqua-Net hair spray	1.40	3.45	2.76
Chivas Regal	21.00	99.00	40.00

*14 oz. **11.25 oz.

Underselling Themselves

But the black market can hurt companies that are trying to set up long-term legitimate distribution. Many concerns, especially when they are starting out and their retail networks are small and weak, find themselves being undersold by their own products flowing from U.S. bases.

The sales prices at military commissaries average 25% less than those at American supermarkets. But legitimate distributors pay South Korea's duties, usually around 15%, as well as taxes and high freight charges, so the black marketer has a decided price advantage — even after the black-market wholesaler doubles the commissary price. Legitimate Aqua Net hair spray, for example, is $3.45 at a Korean supermarket, 20% more than on the black market.

Says a **Procter & Gamble** Co. official who finds his Pampers, imported from Japan, up against black-market Pampers off the base, "Generally, it is more of a hindrance than a help."

"Maybe it's good initially," adds Marjorie Taylor, director of international services for **St. Ives Laboratories**, Los Angeles. "But it can really kill growth." She says Korea has always been "a kooky country" for St. Ives. The company sells about $1.7 million a year of fruity facial scrub — or about 10% of its total overseas sales — to its exclusive Korean distributor, but it estimates that 50% more slips onto the black market. The scrub is so popular that the U.S. military commissaries can't keep the shelves stocked and must keep the stuff locked in a warehouse to prevent theft. (Aqua Net is also kept locked up.)

Manufacturers of Scotch whisky complain that the black market prevents their expansion. The Scotch Whisky Association in Korea estimates that two-thirds of all scotch purchases in Korea, or about 90,000 cases a year, are made on the black market. It complains that diversion of almost $45 million retards investment in advertising because manufacturers get back only a third of the potential revenue while putting up 100% of the costs of building a brand image.

"It would be crazy to invest," says Alan Robson, marketing manager of United Distillers, a unit of **Guinness** PLC that makes Johnny Walker, Dimple, White Horse and Dewar's scotches. "It is impossible to get a right start in this market as long as the black market exists."

British Ambassador to Korea David Wright recently suggested that the black market could become a trade issue between Korea and Britain. "What we need is fair treatment and fair treatment would be coming if the black market could be choked off," said the ambassador.

Alternate Distribution

In fact, the term black market is something of a misnomer for the small but well-stocked shops that can be found in every urban South Korean neighborhood. The Korean *tokebi shijang*, or goblin market, is really an alternate distribution system. Military stores on Korea's U.S. bases sell about $380 million in goods a year to the 70,000 troops, civilian employees and their families authorized to use the stores. At least 20% — and probably as much as 33% — of the goods end up in the Korean black market, the U.S. Army says. That is equivalent to the sales volume of one of Korea's largest supermarket chains.

Although the goblin markets are illegal, they operate openly in all neighborhoods, including the affluent ones where the country's prosecutors and customs officials live. The operators openly acknowledge that the goods come from the base, and some will even take special orders. Many leave the base price tags on to show the authenticity of their goods. A price tag on a $6.20 can of black-market Hershey's cocoa, for example, says it sold on the base for $2.20.

Some shipments are hijacked between the docks, where they arrive duty free, and the stores, but investigators say that most of the products are bought on military bases by Koreans — either wives of soldiers or store employees — who then resell them off the base to a wholesaler.

For a foreign company that is firmly entrenched in Korea, the black market isn't such a big problem. **Johnson & Johnson** says that its volume is now big enough so that its Korean-made baby-care products can undercut its U.S.-made products on the black market. **Nestle**, the Swiss food giant, undersells the black market Taster's Choice instant coffee by 16% and Coffee-

(cont.)

mate coffee whitener by about 28%. And **Mars** Co., which sells its Snickers bars for only 300 won, or 41 cents, across Korea, says some black-market shops have actually switched from a military-base supply to legitimate channels.

For image products like Coca-Cola, well-to-do Koreans will pay the black-market price even when it's higher. The reason: The black-market product has no Korean on the label and some people like to show off the American version to guests.

Foreign marketers argue that one of the biggest problems with the black market is that it satisfies the demand for imports, retarding liberalization of South Korean trade restrictions. The American Chamber of Commerce in South Korea describes the market as "a pressure valve that moderates internal political pressure for broader market opening."

It's no accident that the items doing the briskest business on the black market are those that are either banned from South Korea or carry high tariffs and taxes, like beef, bananas, cheese, rice and electronics. A fifth of Chivas Regal, which goes for $40 on the black market, costs $99 in a store. And the black market in cigarettes ended after the government allowed U.S. tobacco in.

The U.S. government has an obligation, under a treaty with the Koreans concerning U.S. troops, to prevent the flow of duty-free items from the commissaries. But stopping black marketing was becoming a Sisyphean task. The U.S. military spent almost $13 million a year on personnel, computers and other equipment trying to track what 70,000 people were buying and then trying to limit purchases.

It court-martialed soldiers who were violating the rules, sending some to prison, but it found that the Korean government did little to stop the black market. "If they think it is important enough to put duties on and to ask the U.S. to enforce it, they ought to think it is important enough to participate in a partnership to enforce it," says Air Force Col. Bennie J. Wilson III, the assistant chief of staff for the U.S. forces in Korea.

With "ration control" failing, Congress complained and the Pentagon cut the enforcement budget to $3 million. In May, without enough enforcement funds, the U.S. military lifted most ration controls.

Tape Transfer

Disney Leads Shift From Rentals to Sales In Videocassettes

Marketing Movies Like Soap, It Finds a Way to Escape Cycle of Hits and Flops

Baby Sitter With a Pedigree

By RICHARD TURNER
Staff Reporter of THE WALL STREET JOURNAL

The hottest "toy" this Christmas isn't a doll or an action figure or a squirt gun shaped like an Uzi. It's a movie.

When "Beauty and the Beast" went on sale Oct. 30, Walt Disney Co.'s home video division manufactured and shipped an unheard-of 17 million videocassettes to stores. In the first week, before the advertising campaign had even begun, astonished retailers watched as customers carted away a million a day. Total projected sales by year's end: a record 20 million units.

Notably, most "Beauty" sales weren't at the local mom-and-pop video hut but at mass-merchandising behemoths such as Target, Wal-Mart and Toys "R" Us, where people go to buy plastic dish racks and Barbies. No other studio has pushed this idea as far as Disney, selling videotapes year-round with an aggressiveness that has turned what's called "sell-through," as opposed to rental, into a major video market.

The glamorous part of the movie business still is film production, in which moguls make movies and put them on the big screen. But Disney's Buena Vista Home Video division is, in effect, Hollywood's largest and most profitable studio. It succeeds by having a different mind-set. Says an admiring rival, "They're thinking like a soap company."

Video Savants

And Disney home video is awash in profits. In 1992 the division will have revenue of $1.1 billion. The arithmetic is simple but remarkable: The "Beauty and the Beast" videocassette carries a suggested retail price of $24.99 and wholesales for about $13.50. With 20 million units, the revenue to the company will be $270 million. Each videocassette costs about $2 to manufacture and perhaps $2 to market. So Disney's profit is $200 million in the U.S. alone. No theatrical release has ever been so profitable.

Of course, the rental business is highly profitable, too, and each studio must make the calculation of when sell-through is worth the gamble for a particular video-tape. A rental tape is sold to retailers for about $65; retailers keep all the rental revenue. A hit rental movie will sell more than 300,000 units, for $20 million in revenue, which equals about 1.5 million sell-through titles. And by shipping relatively few cassettes and selling only to merchants, a studio avoids some manufacturing and marketing costs.

If a sell-through is a hit, though, it will sell many more than 1.5 million copies, a windfall that no rental can match.

Though having hits like "Beauty and the Beast" and the current "Aladdin" is essential, Disney's home video arm has gone beyond dumb luck: It has proved it can sell practically anything. By focusing year-round on selling through mass merchants, its executives have managed to smooth out the usual cycles of hits and flops in the entertainment business.

Mermaid vs. Rubbermaid

Says Bill Mechanic, president of Disney home video and architect of the strategy: "We're competing with Rubbermaid." Not many Disney executives are anxious to acknowledge the comparison. Top officials fear that warm and fuzzy consumer feelings about Disney evaporate when too much of its inner business workings is revealed.

Still, Disney's all-out attitude toward home video comes from the top. Says Chairman Michael Eisner: "An asset is only an asset if you use it. The value of our library is its ability to generate cash flow."

It's gotten to the point, says toy analyst Sean McGowan, that when a movie opens, his colleagues at the New York investment firm of Gerard, Klauer, Mattison & Co. joke that "it's just a commercial for the video, like a trailer." Disney executives didn't sweat much when last summer's theatrical re-release of "Pinocchio" took in a disappointing $18.7 million. The real point of the exercise comes in March, when the video ships out for the first time since 1985.

Pricing Pinocchio

How important is home video to Disney? The company had operating profit of $508.2 million for the year ended Sept. 30. Home video, including rentals, represented "at least three quarters of it," according to S.G. Warburg analyst Lisbeth Barron, even if substantial production costs of the original movies are allocated to cassettes. Disney doesn't break out the figure and won't comment on the estimate.

Disney didn't invent sell-through, and it entered the market reluctantly. The first time it released "Pinocchio," seven years ago, the company's new management team was cautious about over-exploiting the vaunted "family jewels," which paid like annuities when shown at theaters every few years. So they priced "Pinocchio" at a rental rate, $79.95. Sales were slow, and Disney got stuck with inventory.

Within months, Disney slashed the price to $29.95 and sold nearly 500,000 units directly to consumers. That was considered brisk for its day, since fewer than half of homes had VCRs; now nearly 80% do.

Under the guidance of Mr. Mechanic, 42, formerly a pay-television executive at Paramount Communications Inc., Disney home video got more aggressive, releasing "Sleeping Beauty" in 1986 at the same low price, but with a multimillion-dollar marketing campaign. It sold more than a million copies.

Disney kept releasing classics like "Cinderella" and "Lady and the Tramp" in holiday gift-giving seasons, but Mr. Mechanic had another goal – to sell videos every day of the year. He pursued this with evangelical fervor. One day his staff showed up for a meeting dressed in customized T-shirts with a ferocious, gun-toting Mickey Mouse threatening, "Buy or Die."

Disney's timing has been nearly flawless. Baby boomers were becoming parents, and had fond memories of the animated classics. Among the cheaply made videos aimed at kids, the Disney brand was like a Good Housekeeping seal of approval. And a new market was evolving, a coincidence of demographics and video technology: Kids would watch these things 10, 20, and 30 times, making it worthwhile to buy them. Disney was a baby sitter with good references.

"There's an ethos," says John Thrasher, purchasing vice president for Tower Records. "Disney is selling more than just a tape; they're selling a lifestyle."

Disney has come up with a never-ending series of elaborate cross-promotions that have had businesses such as McDonald's, Burger King or Nabisco provide millions of dollars in free advertising for the videos. It has also created a kind of auction-fever mentality by putting films on "moratorium," or taking them off sale after a certain period. The strategy reached its apotheosis when Disney, after years of saying it would never release "Fantasia" on video, brought it out for 50 days, then retired it "forever."

Actually, despite a drug-hazed revival in the 1960s, "Fantasia" has never been a popular movie. Kids don't like it much, and it has done poorly at the box office. But it sold a record 14.5 million copies last year.

Rebates Galore

Marketing mimics the packaged-goods business: Disney promotes "new, improved" restored versions of older films. Rebate deals are commonplace; consumers can send in proof of purchase on another product and get perhaps a $5 rebate, enabling stores to advertise in large numbers the "final low price to consumers." Yet the actual rate at which customers bother to go through the laborious rebate process is said to be somewhere in the low single digits.

Disney achieved year-round sales by packaging less-heralded animated films and pouring in marketing dollars. Video had long been perceived as a "hit-driven" business, but Disney changed the mold, and last year its sales of non-current movies increased 75%.

"It keeps the pipeline full," says George Krieger, president of CBS/Fox Video. "A parent will buy the lead title, and then pick up the little 'Chip 'n Dale' that's sitting next to it." Time Warner Inc.'s video division, by contrast, with formidable assets and global reach, hasn't packaged its own massive cartoon library as aggressively.

Disney's promotional support is huge. The marketing budget for its 30 releases since last April is a combined $65 million.

Disney's clout has become so great it was able to get the video rights to the Muppet series even though the Muppets' owners were at loggerheads with Disney's corporate management. It picked up other titles with a confidence its rivals didn't always share: the old Ed Sullivan shows, Alvin and the Chipmunks, and the Rocky and Bullwinkle animated series.

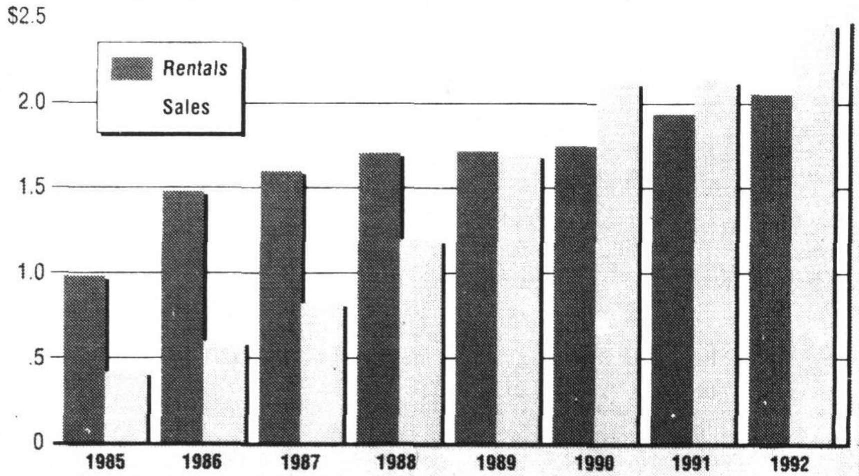
Walt-Mart

Today, nearly three-quarters of Disney's video revenue comes from sell-through, a far higher percentage than that of any other studio. "Anyone who says it's just the luck of the catalog is incorrect," says Bob Pollack, merchandise manager for movies, music and books at Target, a unit of Dayton-Hudson Corp. "The primary reason Disney is so successful is that *the whole company straight from the top* is focused strictly on sell-through. Others have it as an afterthought."

Disney's competitors are pursuing its lead. Time Warner's video unit had sell-through hits with Warner's "Batman" movies. Sony Corp. did well with "Hook." Matsushita Electric Industrial's MCA even was emboldened to release "Beethoven" in sell-through this year – the first studio to take the risk on a live-action movie that grossed less than $100 million at the box

The Changing Video Market

Studios' revenue from sales to rental outlets vs. revenue from videos sold to the public, in billions of dollars



Source: Paul Kagan Associates, Carmel, Calif.

office (it paid off). But Disney's head start in sell-through has made it No. 1 in market share for the last five years: In 1992, Disney had 21% of wholesale industry revenue, compared with second-place Warner's 12%, according to the trade publication Billboard.

Disney's Mr. Mechanic took a big risk two years ago with an "R"-rated movie about a prostitute. When Disney decided to put "Pretty Woman" on sale, it broke a lot of the rules. But with its research, Disney knew it had access to the target audience: a 39-year-old housewife with children, shopping at Kmart. Priced extra-low at $19.99, "Pretty Woman" sold 10 million units. "We didn't want to just be in a kid's corner," Mr. Mechanic says.

Disney has had disappointments. "Honey, I Shrunk the Kids" was a box-office phenomenon that wasn't repeated when it went into sell-through, apparently sunk by too much competition. Its sequel will go out quietly on rental, as did the earlier "Dick Tracy" when the movie didn't live up to its hype at the box office. And there have been embarrassments, such as when the box for "The Little Mermaid" cassette rendered a castle tower in an anatomically unmistakable way that somehow slipped by Disney watchdogs.

The Lesson of Bambi

Disney home video's biggest mistake led to a major business change. The catalyst was "Bambi." Videotape manufacturing is still a cumbersome process, not much more sophisticated than pushing the "record" button on thousands of video-cassette machines and waiting for them to finish. So delivery schedules can be inflexible.

Disney initially shipped about six million units of "Bambi" in 1989. During the first week, they sold far above projections. Video distribution companies–middlemen who ship copies to the stores – called frantically for re-orders. So Disney rushed orders for four million more tapes. But in the three weeks they took to make, demand cooled and Disney was stuck with warehouses full of "Bambi."

"It was an important lesson," says one video executive: Distributors didn't necessarily know the marketplace. Very quietly, so as not to upset the industry, Disney began eliminating the middleman, dealing directly with some mass merchants.

The company also realized that it needed solid sales information. So at a big cassette-manufacturing plant in Livonia, Mich., run by Technicolor, a unit of U.K.-based Carlton Communications PLC, Disney developed an expensive and highly sophisticated computer system to gather data from stores around the country and to regulate inventory control, fulfillment and "space management." The system facilitates just-in-time delivery: At the punch of a button, Disney can tell if someone at a certain store in Florida has bought a copy of "Beauty and the Beast."

Reluctant of Blockbuster

Disney assures itself good shelf space at huge retailers with a more liberal return policy than most competitors, so retailers have an incentive to order more. And the mass merchants who had been leery of video find that it's now one of the fastest-

(cont.)

growing segments in the discount retailing business. When Target first carried the old version of "Pinocchio," Mr. Mechanic recalls, it was in a bin in the back. Now Target and others are teaching Disney about merchandising with "endcaps" and "presentation dynamics."

There has been one major laggard in the sell-through business. For years, Blockbuster Entertainment Corp., the 2,000-store video specialty chain that has come to dominate the business, gave sell-through short shrift. The chain was more focused on building new stores than clearing space to sell, rather than rent, tapes. While it looked the other way, mass merchants' share of sell-through swelled to nearly 50%, with supermarkets, mail order, video rental stores and other outlets splitting the rest.

Last year Blockbuster changed. A former Toys "R" Us executive joined as president, and most stores began carrying about 700 different sell-through titles (out of about 8,000 total titles). "Our involvement grew with consumer demand," says Carol Feinberg, general merchandise manager for the chain. Blockbuster now has a "power aisle" running down the middle of stores stacked with sell-through titles, and Disney gets dedicated space in many stores.

Mom-and-pop stores, already threatened by the dominance of Blockbuster and other large chains, are ambivalent about sell-through. The $14 wholesale price beats the usual $65 they pay for rental titles, so by renting movies intended for sale they can load up on more titles. But they don't feel they have the shelf space for much selling.

After years of double-digit growth, the video rental market has matured. But Mr. Mechanic believes there's still lots of room for sell-through growth, since there are about 30 million households with children, and so far only 60% of the VCR-owning population buys tapes.

But if anything shows the industry's growth, it's the fact that total consumer spending for videos was about $11.2 billion last year. This year, it's likely to surpass another, far older consumer category: the toy business.