

# **BLOCKBUSTERS**

**HIT-MAKING, RISK-TAKING, AND THE BIG BUSINESS OF ENTERTAINMENT**

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sector's most successful impresarios are leading a revolution, transforming the business from one that is all about selling bottles—high-priced alcohol delivered to “table customers” seated at hot spots in the club—to one that is just as much about selling tickets to heavily marketed events featuring superstar DJs. But I'll also point to other examples, from Apple and its big bets in consumer electronics, to Victoria's Secret with its angelic-superstar-studded fashion shows, and to Burberry's success in taking the trench coat digital. As these will show, many of the lessons to be learned about blockbusters not only apply across the entertainment industry—they even extend to the business world at large.

## Chapter One

# BETTING ON BLOCKBUSTERS

In June 2012, less than two weeks after the news of his appointment as chairman of Walt Disney Pictures had Hollywood insiders buzzing, Alan Horn walked onto the Disney studio lot. The well-liked sixty-nine-year-old executive (“I try to be a nice person almost all the time, but next to Alan Horn I look like a complete jerk,” actor Steve Carell had joked during Horn's good-bye party at Warner Bros.) was excited about joining Disney, which he described as “one of the most iconic and beloved entertainment companies in the world.” But he also knew he had his work cut out for him, as Disney Pictures had posted disappointing box-office results in recent years. In his new role, Horn would oversee production, distribution, and marketing of live-action and animated films from Disney as well as its units Pixar Animation Studios and Marvel. Horn would have to decide whether the event-film strategy he had pioneered at Warner was the right approach for his new employer as well.

After working for producer Norman Lear early in his career and spending a decade at the helm of Castle Rock Entertainment (a production firm he had co-founded that was known for creating the hit television show *Seinfeld* and films such as *A Few Good Men*,

*The Shawshank Redemption*, and *When Harry Met Sally*), Horn had moved to Warner and fostered a different attitude toward risk. "Other studios made big movies, but no one was doing this on a consistent basis," he told me. "In fact, they were afraid of it. Because the price for movie tickets was fixed, taking on higher costs seemed a bigger risk."

Described as "a consensus builder," Horn went to great lengths to ensure that his Warner colleagues embraced the event-film strategy. His first event-film pick was *The Perfect Storm*, released in 2000. "George Clooney was not a big star at the time, and neither was Mark Wahlberg, but I really liked the story," Horn recalled. "We wanted to create the best visual experience for audiences, and we spent a lot to showcase those in our marketing campaign. I remember I saw an early cut of the trailer and asked, 'Where is the storm?' I wanted a shot of the boat in the storm, with the high seas. It took half a million dollars, but they made it happen in a week. We wanted everyone to know this was going to be big. So we had to have that shot."

Within a few years, the event-film strategy had taken hold, and Warner was releasing four or five such movies annually. Horn focused on what he called "four-quadrant movies": films appealing to young and old as well as male and female moviegoers. In 2008, the studio's picks included *The Dark Knight*, *Get Smart*, *Speed Racer*, and, before its release date was moved to 2009, *Harry Potter and the Half-Blood Prince*. In 2010, Horn's last full year in charge, *Inception*, *Clash of the Titans*, and *Harry Potter and the Deathly Hallows: Part 1* were among the event films. Each event movie received a higher-than-average production and marketing budget and generally had its release date planned years in advance. "The potential upside for our event films is so enormous that we believed it was worth the risk," declared Horn.

The results proved the wisdom of his strategy: under Horn's twelve-year leadership, Warner Bros. Pictures, the largest of the six major Hollywood studios, became the first studio in history to collect more than \$1 billion in theatrical revenues for ten years in a row. In 2010, the studio was the market leader in films with world-

wide box-office revenues of \$4.8 billion—its biggest haul ever. The eight Harry Potter films, the most successful motion picture franchise in history, collected \$7.7 billion at the worldwide box office. Warner Bros.' output during this period also included several other lucrative films, including *300*, *The Dark Knight*, *The Departed*, *Gran Torino*, *The Hangover* and its sequel, *I Am Legend*, *Million Dollar Baby*, *Ocean's 11*, *12*, and *13*, and *Sherlock Holmes*.

But Horn's strategy remained controversial precisely because it seemed so risky. "Making monster projects into profit centers is no slam-dunk," wrote one *Wall Street Journal* reporter, expressing a sentiment that was widely shared. "Someday soon, one of these big bets will crash so hard that a studio will be left with a staggering write-off." Disney's own *John Carter* was a recent case in point: it had cost an estimated \$250 million to produce and likely lost almost as much, easily making it 2012's biggest flop. Detractors of event-film strategies also loved to point to the western *Heaven's Gate*, otherwise known as "the film that sank a studio." Delayed for months and beset by cost overruns, the 1980 movie cost a then-unprecedented \$40 million, only to be roundly rejected by both the press and the public (one influential critic called it "an unqualified disaster"). United Artists sold only \$3 million's worth of tickets; as a direct result of the massive box-office flop, the studio collapsed and was sold off to MGM.

Horn acknowledged the downside of his approach. "The problem with event movies is that when we fail, it is a colossal failure." And for all of his successes, Horn also had his share of misses during his long tenure at Warner Bros. "In a good year, a major studio is happy to bat .500," he said. "The real goal is overall profitability." The countless variables involved in the moviemaking process plagued every live-action project he decided on. "When Jo Rowling was selling Harry Potter, she was turned down by a number of publishing companies. And they were reading it in the medium in which it would be released! Making a movie is—it's just ridiculous. We are reading a screenplay, and have to imagine what it will look like with a certain director, a certain cinematography, and a certain cast. You say, 'With Channing Tatum it will look this way,

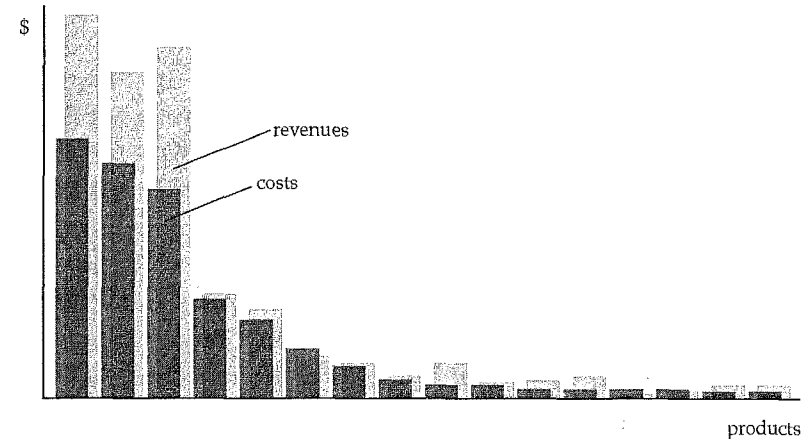
but if we go with Matt Damon it will look a different way.' It is such a gut-level decision that it is impossible to define criteria that can make a studio successful year in, year out."

Now, with his arrival at Disney, all eyes were on Horn to do just that: achieve success year in, year out. It didn't help that Disney's appetite for big risks was low after the *John Carter* debacle; making matters worse, Horn knew he would have to compete head-on with Warner and the very strategy he had invented. "Other Hollywood studios have embraced the event-film strategy, too," he said. "So the competition from other major studios for the best ideas, creative talent, and release dates has only increased in recent years. We will have to go up against other big movies in our release weekends." Could Horn bring the magic back to the Mouse House?

Is the event-film strategy—or, as I called it earlier, the "blockbuster strategy"—really the best approach to making and marketing entertainment? For major studios like Warner Bros. and for other large-scale content producers across the different sectors of the entertainment industry, the answer is an unequivocal "yes." In fact, the strategy that Warner Bros. followed is now a common approach among not just movie studios, but also publishers, television production companies, music labels, video game publishers, and producers in other sectors of the media and entertainment industry. But before we delve into the explanation for why such a seemingly risky approach makes sense even in today's competitive marketplace, let's take a closer look at the approach taken by Horn at Warner Bros. and understand the returns that are associated with it.

Rather than dividing its resources evenly across the products in its portfolio, a movie studio following a blockbuster strategy allocates a disproportionately large share of its production and marketing dollars to a small subset of products in the hope that they will bring in the lion's share of revenues and profits. This idea is illustrated in the chart that follows. Even amid considerable uncertainty, the studio bets heavily on the most likely hits. It makes

A Typical Pattern of Blockbuster Investments and Outcomes



"blockbuster bets": big-budget productions aimed at mass audiences. Given the nature of the movie-production process—where the trajectory from acquiring a script or the rights to a property to finally releasing a movie can easily take four years—the studio has to make its picks of the most likely winners at a very early stage. Given the fickle taste of consumers, and given the complexities of a production process that often involves hundreds of people, that's not a simple task. But, the studio's thinking goes, the rewards will be worth the risk.

As a way of examining Warner Bros.' strategy, let's take a look at the year 2010. The studio released twenty-two films that year, spending about \$1.5 billion in production costs and upward of \$700 million on advertising and other promotional efforts domestically. Warner spent a third of its 2010 production budget on its three biggest titles—\$250 million on *Harry Potter and the Deathly Hallows: Part 1*, \$175 million on *Inception*, and \$125 million on *Clash of the Titans*. Its fourth-biggest investment, the *Sex and the City* sequel, cost another \$100 million. Such big bets often feature not only A-list talent but also elaborate visual effects—spectacular sequences, sweeping shots, large-scale sets, multiple locations, and high-tech stunts, for instance—all of which drive up the picture's

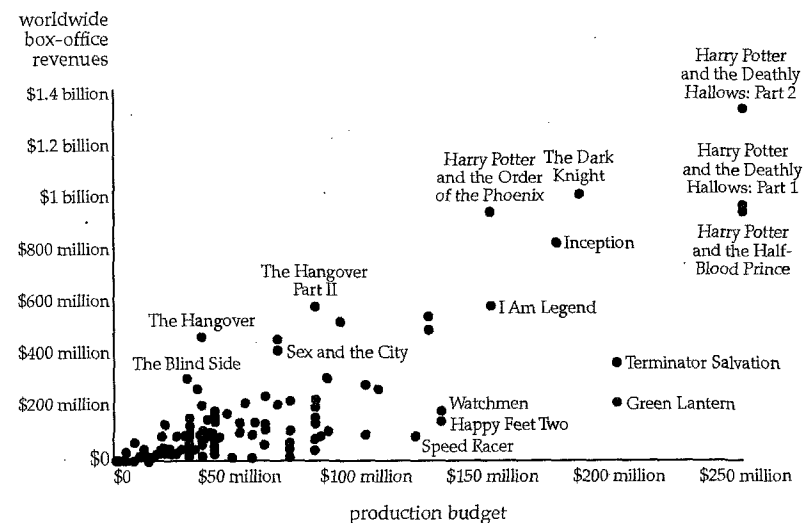
costs. If the movie is based on a successful property such as a book or a character (as the biggest bets, such as *Harry Potter*, often are), intellectual property rights can also be costly.

"We have made a conscious decision at Warner Bros. to make four to five movies each year that have a shot at reaching \$1 billion in revenues," one Warner executive said about the studio's strategy. "And if you commit a large share of your production resources to these few movies, it has implications for your other movies," Horn explained. "You might make a \$60 million movie instead of a \$90 million movie. It is a balancing act." A television executive I talked to made essentially the same point. "People are under the mistaken impression that studios and networks love all their children equally," he said. "But because there is only a finite amount of production and marketing money available, they have to prioritize."

At Warner Bros. under Alan Horn, the expectation was that those movies with the highest costs would also be the titles with the highest revenues—and the highest profits. In 2010, Warner's results lived up to that expectation. Although the top three biggest bets only accounted for a third of the total production budget, they were responsible for over 40 percent of the domestic and 50 percent of the worldwide box-office revenues generated that year. If we calculate the difference between production expenditures and box-office revenues, it becomes clear that over 60 percent of the year's total surplus came from the studio's top three investments, and nearly 70 percent from its top four movies. At the other extreme, the four least expensive movies released in 2010—*Flipped*, *Lottery Ticket*, *The Losers*, and *Splice*—accounted for just under 6 percent of total production spending but only 4 percent of domestic and 1 percent of foreign ticket sales, adding next to nothing to the surplus. Not all of this surplus is profit, of course—for instance, studios like Warner Bros. share close to half of their revenues with the theaters that screen their movies. But the pattern is clear: Warner's biggest investments in 2010 delivered the biggest returns.

So far, so good. But was 2010 just a lucky year, one that happened to be short of one or two big flops that could have seriously

Warner's Movie Bets from 2007 through 2011



The figure plots each of the 119 films that Warner released from 2007 through 2011 (according to research firm Rentrak) by its estimated production budget and worldwide theatrical revenues. For instance, the movie *The Hangover* cost an estimated \$35 million to produce and yielded close to \$470 million in ticket sales (of which \$190 million came in foreign markets).

altered the picture? Are studios like Warner Bros. taking too much risk with their blockbuster bets? The performance of Warner's movies over a longer time horizon certainly does not suggest that to be the case. In fact, the 2010 results reflect a more general phenomenon. Consider the chart above, which shows the returns on Warner's bets from 2007 through 2011, the last five full years of Horn's tenure. During this period, Horn was running his tent-pole strategy at full force, spending \$6.5 billion in production costs. But he was also facing strong competition from rival studios that were following his lead with big bets of their own.

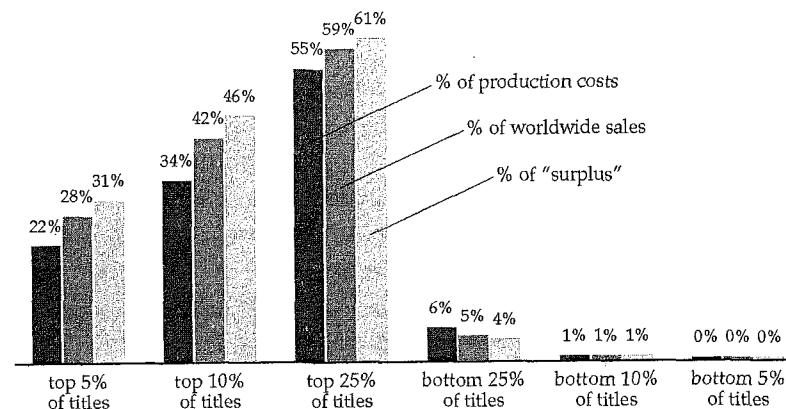
At first glance, the chart may look like a random scattering of data points. The messiness of the data reflects the unpredictability of the demand for theatrical films. Warner made substantial investments in a number of well-known franchises, including *Harry Potter* and the Batman film *The Dark Knight*. While several of those

were highly successful, other big bets stumbled at the box office—in particular, the \$120 million *Speed Racer* was an unmitigated disaster. (Inspired by a Japanese anime series, starring Emile Hirsch, and released in 2008, it sold well shy of \$100 million's worth of tickets across the globe.) As for the smaller investments, they seemed to present the same mix of hits, also-rans, and outright flops. *The Blind Side*, *The Hangover*, and *Gran Torino*, each costing less than \$40 million to produce, all made a killing at the box office, while the equally affordable *The Assassination of Jesse James*, *Whiteout*, and *Shorts* never connected with audiences.

But take a look at the next chart, which groups films more systematically by their production budgets. Across all films released over a five-year period, the top 5 percent of films accounted for one-fifth of the total production costs and more than one-quarter of worldwide grosses. The top 10 percent of films consumed roughly a third of the costs but generated more than two-fifths of all revenues—and accounted for nearly half of the difference between production costs and revenues. Warner's biggest investments thus generated disproportionately high returns. On the other end of the spectrum, although they sometimes posted big numbers, smaller investments had little effect on the grand scheme of things. Although the bottom 25 percent of films ranked by their budget (a group that consists of movies made for just below \$30 million) accounted for just 6 percent of costs, they generated only 5 percent of ticket sales. And the bottom 10 percent of movies had virtually no impact on sales.

The differences between films at both ends of Warner's portfolio may seem small in relative terms, but they are huge in absolute terms. And in the years of its biggest bets, Warner's total box-office revenues beat those of its main rivals, proving both that a blockbuster focus pays off and that individual blockbusters can significantly lift a content producer's performance. Some critics might say that Warner Bros. would have been far less successful in the mid- to late 2000s if it had not had the *Harry Potter* franchise or *The Dark Knight*. But that is exactly the point: one blockbuster bet can make a year. The best possible outcome of the blockbuster strategy

### How Warner's Big Bets Stack Up Against Its Small Bets



The figure shows how much the 119 movies, when grouped by their production costs, account for Warner's production costs, worldwide box-office sales, and the difference between both (defined as "surplus"). For instance, the top 5 percent most expensive titles account for 22 percent of the production costs, 28 percent of worldwide revenues, and therefore 31 percent of the surplus.

is having a film that lifts the entire bottom line. And the way to get there, my research shows, is by making sizable investments—not by spreading the available budget across a larger number of smaller films.

Horn's motivations for pursuing the event-film strategy are telling. "I was struck by research that shows that the average moviegoer in the US only sees five or six movies a year," he told me in 2012. "And it is even fewer in international territories. Last year, there were over 120 films released by the six major studios, and another 80 by the larger independents such as Summit and The Weinstein Company—that's hundreds of motion-picture viewing opportunities. There is a tough selection process going on," he said. "That is why having something compelling is so important—something of high production value, be it because of the story, or the stars involved, or the special visual effects." The goal, in other words, is to stand out from the competition—to win the battle for attention. That is what the blockbuster strategy is designed to do. "Even the most die-hard fans will not see more than a movie a

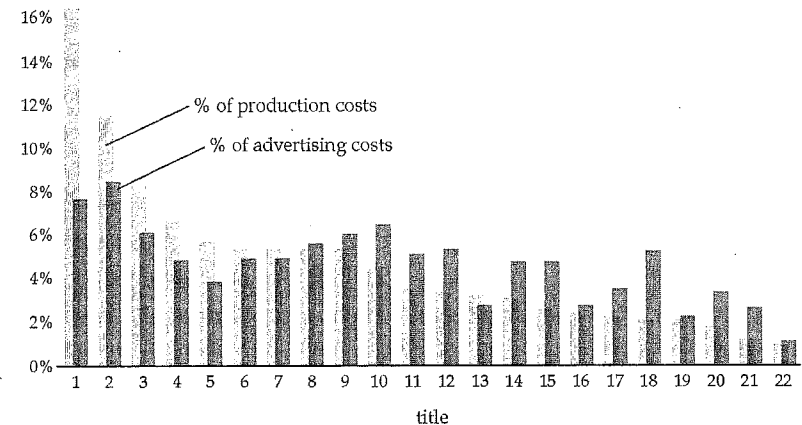
week," Horn declared. "You have to make sure it is your movie they see."

The success of the blockbuster strategy is even more apparent when marketing costs are included. Making bigger bets results in advertising efficiencies. "The advertising expenditures for a movie that costs \$150 million to make are not twice those for a \$75 million movie, even if you saturate the market," Horn told me. "You need a certain amount to make sure you can support the film nationally, just to tell audiences you are out there. That makes marketing the \$75 million movie expensive. But to give it the extra push you expect for an event movie is not going to cost that much more."

Although Hollywood studio executives are tight-lipped about their advertising spending, data that I obtained from an independent market research company—one that effectively counts the advertisements placed in various media (from television and newspapers to Internet and outdoors) and estimates its value—back up Horn's view. Indeed, when we look at Warner's 2010 movie slate, advertising the bigger productions was disproportionately cheap, as captured in the chart on the next page. The top three movies accounted for a third of the production budget, but those films required only 22 percent of the studio's \$700-million-plus advertising budget. Promoting *Inception* ate up the highest number of advertising dollars—just over \$60 million, or about a third of the movie's production costs. In contrast, Warner shelled out an extra 75 percent on top of its production budgets to advertise smaller productions like *The Town* and *Life as We Know It*, both made for less than \$50 million. Once again, bigger films emerge as relatively smart investments.

With the growing importance of global markets, the relevance of blockbuster bets will only increase. "International box office results are especially strong for event movies," Horn noted. "That's where the real growth is. By 2016, the international box office is projected to be \$27 billion, much larger than the domestic box office at a projected \$11 billion." Because international theatri-

### Production and Advertising Spending: Why Warner's Big Bets Pay Off More



The figure shows, for Warner's 2010 movie slate, how much each title received of Warner's total production and advertising budget. For instance, the second-most-expensive movie released in 2010, *Inception*, used 12 percent of the production budget but only 8 percent of the advertising budget. Ranked number 18 on the list with 2 percent of the production budget, the movie *Cop Out* received as much as 5 percent of the advertising budget.

cal markets are "under-screened"—meaning that when compared to the United States, other countries have relatively few theaters to serve moviegoers—international markets tend to be more selective. "They want four-quadrant movies, and they want stars or characters such as Harry Potter that they know," said Horn. "Those are the movies that travel well."

Movies make much of their revenues outside theaters—from such sources as DVD sales and rentals, streaming rentals, and television—which in theory is a way for smaller movies to make up for the lackluster returns. But in reality, the best predictor of a movie's revenues in subsequent distribution channels (or "windows") is its performance in the theatrical window. "All the ancillary markets are driven by theatrical," Horn said. "The revenues from DVD sales are almost directly proportional to box-office revenues. So those ancillary markets do not bail the smaller movies

out." In fact, when taking into account those other sources of revenues, the effect of bigger investments generating a better payoff is only magnified.

Properly executing a blockbuster strategy is more than just a matter of spending more money in order to generate higher revenues, of course—if the game were really that simple, anyone with deep pockets could be a successful studio head. Instead, it is about making the right bets. "There is no hope if you just make a bad movie," Horn declared. "You can try everything you want with your release strategy, but if the movie is not good enough, you are done. You have to have a good idea, and execute it well."

Luck helps as well. Warner Bros. had heaps of it with its biggest blockbuster, *Harry Potter*, as illustrated by the story of how Warner came to acquire the rights. "We had the rights to *Harry Potter* even before the book was a success in the UK," Horn told me. "A woman in the UK happened to buy the book in a store one day, as a gift for a family member. She liked it so much that she showed it to her boss, David Heyman, whom she worked for as an assistant, saying 'You have to read this—this is brilliant.' Now get this: David had a production deal with Warner Bros. And one of his childhood friends, Lionel Wigram, was an executive with us. So he pushed us to option it. But nobody knew what they had until the book exploded, and off we went." Warner's good fortune did not stop there, Horn recalled: "Before the book became known, my predecessor offered the *Harry Potter* property to [rival studio] DreamWorks in a partnership—and they passed. And then of course it became a hit, a little rocket ship that was taking off, and they called back and said, 'This was offered to us; we want to be partners with you.' But I said, 'No, you turned it down, and the offer is off the table.' I had it in writing. Now isn't that something?"

*Harry Potter* aside, have Horn and his team sometimes picked the wrong titles to focus their attention on? Yes. Each time one of Warner's big-budget event movies bombed, the studio incurred a substantial loss. "*Speed Racer* made a bigger dent in our bottom line

than any other movie in 2008," recalled Horn. "The Wachowski siblings wanted to make a family picture, with bright colors, giving it a cartoonish feel. It was very costly and, in the end, too big a leap. But to this day I don't fault them. It could have been the most innovative movie in history. You have to take risks." He added: "You've got to realize that someone walked into somebody's office at Pixar one day, saying they had an idea for an eighty-year-old man and a ten-year-old kid to take off in a house fueled by a balloon. You can see people go 'Wait a minute. . . .' But they made it anyway, and it was a tremendous success." (*Up* grossed well over \$700 million at the box office.)

And has Horn greenlighted breakout hits that no one at the studio saw coming? Absolutely. *The Hangover*, for instance, was produced for only \$35 million, but it pulled down \$470 million in ticket sales, shattering every record for R-rated comedies along the way. Not surprisingly, Warner turned the sequel into a tent-pole movie, with a production and marketing budget set accordingly—this time, the studio took no chances. The same is true for *Sex and the City* and its sequel: the first movie was a small bet that performed much better than expected, and the second got the full tent-pole treatment.

The blockbuster strategy is certainly not risk free, and there are limits as to how much studios can spend on any given film. But what is critical to understand is that a studio would be taking a greater risk if it put more emphasis on movies with lower production budgets—if, effectively, it made a larger number of smaller bets. It may sound counterintuitive, but for a studio like Warner Bros. those smaller bets could, in a typical year, actually lose the studio more money than they bring in. Even if some smaller investments do make money, a dollar spent on a big-budget film will average a much higher profit.

Another film studio, Paramount, learned these lessons the hard way—much as NBC did. In the late 1990s, Paramount chose to steer away from what its management saw as a dangerous reliance on big bets. It adopted a philosophy of sticking to mid-range budgets and lesser-known stars, and boasted that it would run its



movie production slate "like an actuary chart." But while the mantra on the studio lot was protecting the downside, the studio's cautious strategy ultimately had the opposite effect: by early 2004, Paramount had become known for mostly B-grade films featuring mediocre talent, and its profits had fallen by more than 30 percent. Realizing what was happening, Paramount's executives promptly reversed course, letting the creative community know that the studio was once again willing to pay top dollar for its movies, in part by giving Adam Sandler, Charlize Theron, and other top actors their highest salaries to date to star in upcoming movies. "We intend to relax risk aversion policies and to make more money available to finance more challenging productions," said Sumner Redstone, chairman of Paramount's parent company Viacom, at the time.

Only a mighty studio with significant scale and resources can aggressively pursue a blockbuster strategy—after all, it must be able to absorb an occasional loss the size of a *Speed Racer* or *The Adventures of Pluto Nash*. (The latter was one of the biggest box-office disasters of all time, costing a reported \$100 million to produce but generating only \$4 million in US theaters in 2002.) Like Warner Bros., Disney's film studio has the resources to invest in blockbusters. So don't expect the studio to dial back its bets on big movies under Horn's leadership.

Some of the reasons why the cost of making movies can run into the hundreds of millions of dollars are easy to understand, but other investments may be more difficult to comprehend. Film studios or television networks paying an actor or actress millions of dollars based on a hunch that audiences will want to see that person star in a movie or show, for instance, especially when there is no shortage of people waiting for their shot to make it in show business. Or producers investing heavily in an untested script just because the subject matter, be it superheroes or vampires, is "hot." Can't entertainment companies consistently avoid such enormous expenses? To find the answer, it's useful to consider why entertainment executives often get caught up in bidding wars. One of the most daring bids in the world of book publishing may be a good place to start.

His charming, unassuming personality easily made up for it, but Dewey Readmore Books, the star of Vicki Myron's *Dewey: The Small-Town Library Cat Who Touched the World*, was one fat cat. A million-dollar cat, in fact. In 2007, the Manhattan-based publishing house Grand Central Publishing shelled out \$1.25 million for the rights to the book about the fluffy orange creature, found abandoned as a kitten in the returned-book slot of the Iowa public library in which Myron worked.

Five days before the publisher made the winning bid, Karen Kosztołnyik, then a senior editor at Grand Central Publishing, received a forty-five-page book proposal from Myron's literary agent, Peter McGuigan. Impressed by what she read, Kosztołnyik quickly passed the document on to her boss, Jamie Raab, then senior vice president and publisher of Grand Central, who was hooked on *Dewey* just two pages into the proposal. The following day, they started the bidding process by offering an advance of \$300,000, already a significant amount for a book by a first-time author. Author advances in the tens of thousands of dollars were much more common. (Such advances are payments made against an author's royalty, which usually run between 10 percent and 15 percent of the retail price of a hardcover book.) A frantic bidding war ensued, during which McGuigan told Kosztołnyik that a second publisher was shadowing Grand Central's every move. But Raab urged Kosztołnyik to "do everything humanly possible to buy this book," and Grand Central eventually acquired the book in a preemptive strike, a day ahead of a scheduled auction that would have involved other publishers.

Raab and Kosztołnyik had high hopes for *Dewey*, billed as the feline answer to the best-selling *Marley & Me: Life and Love with the World's Worst Dog*, John Grogan's 2005 memoir of his misbehaving Labrador retriever. *Marley & Me* had garnered critical and commercial success, selling over three million copies to date. Dewey was no stranger to the spotlight. Over the course of his nineteen-year life, this unusually resilient cat—named in a contest after the

Dewey Decimal System used in most libraries to catalog books—became a mascot for the library and the town of Spencer, Iowa. As his popularity grew, he even started to attract the attention of tourists and filmmakers, appearing in two documentary films. Shortly after he died in November 2006—in Vicki Myron's arms—his obituary ran in more than 250 publications, including *USA Today* and the *Washington Post*.

However, this was an unprecedented level of pressure even for *Dewey*. When that exceedingly high bid was tendered, the reaction in many quarters was disbelief. William Morrow, a HarperCollins imprint, had paid a mere \$200,000 for the rights to *Marley & Me* back in 2004. Grand Central's gamble on *Dewey* immediately turned the book into one of the publisher's biggest bets for the year among its annual output of 275 to 300 books. "It's stunning, the advances being paid. If it might be the next *Da Vinci Code* or the next *Marley & Me*, the ante just increases," Robert Miller, the president of rival publisher Hyperion, said. The proposal did not scream instant success: typically, cat books are not big sellers. According to Kosztolnyik's records, Peter Gethers's *The Cat Who Went to Paris* and Stephen Baker's *How to Live with a Neurotic Cat*—next to *Marley & Me* the two most comparable titles—had sold only around 30,000 and 120,000 paperback units, respectively. And the book's main character had died—making him unavailable for, say, a publicity-grabbing appearance on Oprah Winfrey's couch.

"Magical things always happen around Dewey," Myron said about her furry friend after the bidding. But with more than a year until the book was published, it would be a while before Grand Central learned whether its seemingly outrageous bid for the manuscript had been the right move.

The double-or-nothing daring move to acquire *Dewey* was only one in a string of big bets made by Grand Central and a host of other leading publishing houses. Like major Hollywood studios, book publishers, too, have largely adopted a blockbuster strategy. In the year before the *Dewey* gamble, for instance, Grand Central spent close to 20 percent of its total adult hardcover acquisition

budget of \$40 million on its biggest title alone, and over half of this budget on the five most expensive titles on its list of roughly sixty adult hardcover front-list titles. (A publisher's front list is its catalog of new books; its back list contains books that have already appeared in an initial edition. On average, about 70 percent to 75 percent of a major publisher's sales comes from front-list titles.) Grand Central chose to compete this way in a sector where, like the film industry, the failure rate is high: only about one of every five new books recovers its costs in the marketplace, and retailers reportedly return roughly 30 percent of all publishers' physical book shipments. While exact rates differ across the various sectors and genres, it generally is the case that, for any given title, the most probable outcome is a financial loss.

Grand Central's aggressive pursuit of *Dewey* may prompt a prudent manager in any other industry to wonder what on earth the company was thinking. Faced with such low odds of success, why would Grand Central put itself in the position of having to outsell all cat books released in recent memory to earn back its seven-figure advance and make a decent profit? Rather than putting all their eggs in one basket, wouldn't the executives at Grand Central be smarter to place a larger number of smaller bets on a range of topics or, if the belief in pet books is so strong, commission a number of books on feline or other creatures? Publishers, like movie studios and other entertainment companies, sometimes seem like riverboat gamblers. What explains the prevalence of audacious bets such as the one Grand Central placed on *Dewey*?

The first thing to understand is that, given the variability in execution of books, movies, and television series, and given the constantly shifting tastes of consumers, it is extremely difficult to forecast demand for any individual new title. Speaking about the movie business, screenwriter William Goldman once said, "Nobody knows anything." Executives in the film industry often quote that famous line, and although it may be too strong a statement, Goldman's words accurately reflect the frustration of having to make a prediction based on just a proposal, a script, or even a pilot.

"It is guesswork," Jamie Raab told me. "To some extent, we are all just winging it. I have a good track record of picking winners, but it is far from perfect. No one in this industry has a perfect score. It really is a crapshoot, albeit an 'informed' crapshoot." The one useful indicator of potential—and this is a critical notion that drives much of how entertainment industries operate—is a new idea's resemblance along some dimension to an existing hit. But that is an indicator that, by its nature, is evident to any industry player, so there is heavy convergence of interest on certain properties. This, in turn, triggers competitive bidding situations for proposals and soaring fees for the creative people who can bring these properties to the page, the big or small screen, or indeed to any mass entertainment medium.

This was the kind of luck that *Dewey*, in characteristic fashion, stepped into. Soon after the book proposal started to make the rounds, many industry insiders compared *Dewey* to the runaway hit *Marley & Me*. The sixth-highest-selling book (fiction or nonfiction) of 2006, it spawned two related children's titles also written by Grogan about his rambunctious canine (an adaptation for ages eight to twelve, *Marley: A Dog Like No Other*, and the new adventure *Bad Dog, Marley!*), a number of other dog books, and even a Hollywood movie starring Jennifer Aniston and Owen Wilson. Publishers saw essential similarities in Dewey's story: it was a touching story about how an animal could bring out the humanity in people it encountered, featuring an animal that was much more than just an average pet. It would surely appeal to pet lovers, many felt.

While executives at Grand Central were careful about making comparisons between *Dewey* and *Marley*—the world is divided into cat and dog lovers, after all, and every title needs to be judged on its own merits—the similarities undeniably spurred publishers' enthusiasm for the *Dewey* rights. Fearful that the price would reach astronomical heights at auction, Grand Central snapped up the book a day before several other publishers would have had their shot at it. "You can't underestimate the market out there for people who love animals," remarked Kosztolnyik, who would oversee the editorial process. "*Marley & Me* has been a publishing phenom-

enon. I think there are equally as many cat lovers as there are dog lovers."

These same dynamics also explain why, when the popular television series *Sex and the City* ended in 2004, not one but two shows—*Lipstick Jungle* and *Cashmere Mafia*—sought to fill the gap by building a show around three successful professional women living in New York City. Likewise, the best-selling *Twilight* series sparked a renewed interest in vampires, and we have the smash hit *American Idol* to thank for the onslaught of talent shows—including NBC's *The Voice*—that fill our television screens.

During Alan Horn's tenure at Warner, many of the studio's event films were based on properties that had established their value in other domains. *Harry Potter*, for instance, was a megahit in book form, and *The Dark Knight* was based on the Batman comic-book series. Other event films leaned on formats that had worked in the past, be they sequels to original films that were a resounding success, such as *The Hangover* and *Sex and the City*, or ideas that featured stars, directors, or writers that have previously scored a hit. Even *Speed Racer* fit this pattern, remarked Horn: "The Wachowski siblings had done three *Matrix* movies which were phenomenally successful, and their next film, *V for Vendetta*, also made a fair amount of money. When they, with their track record, said they wanted to do *Speed Racer*, it was hard to say no."

When planning sequels to movie franchises or additional seasons of successful television series, studio executives will strive to leave a "winning formula" unchanged and thus avoid uncertainty about how, say, a switch of a lead actor or talent show judge will pay off. As a result, the costs of production often dramatically increase over time. *American Idol* is an example: in 2009 Simon Cowell was rumored to have pocketed well over \$100 million to extend his run as a judge on the show for one more year. (He later launched *X Factor*, a rival talent show, in the United States.)

With so much money invested in their most promising projects, entertainment executives will understandably do everything in their power to make these products a success in the marketplace. For both its fall/winter and spring/summer lists, Grand Central

turns a handful of its biggest bets into what Raab calls “focus books,” which receive a disproportionately high level of attention and promotional dollars. Of those, a small handful of titles per season are the all-important “make” books. “We pull out all the stops to make those books happen,” explained Raab. Focus books will get more attention from the marketing and sales team, more time during meetings (such as those with sales representatives), and a more prominent placement in the publisher’s catalog for retailers. At Warner Bros., event films not only receive a higher production and marketing budget; they are also often slotted into the most favorable opening weekends (such as around Memorial Day in the United States), and more efforts are dedicated to these films in dealings with exhibitors, retailers, and other partners. Similarly, television networks’ biggest bets are given the most valuable times in the television schedule and more airtime for promotions. The holy grail here is a spot during the Super Bowl, watched in recent years by a hundred million viewers—or, even better, airing an episode immediately after the game, as NBC chose to do in 2012 with a special episode of *The Voice*.

To pursue a more cautious strategy seems foolish. After all, if a product like *Dewey*, *The Dark Knight*, or *The Voice* fails to draw audiences, an entertainment company knows its profitability will be severely hurt. At the same time, the effect is to escalate the company’s commitment and increase the size of its bet. With such high stakes and money tied up in a few big projects in the pipeline, the need to score big with a next project becomes more pressing, and the process repeats itself. The result is what I call a “blockbuster trap”: a spiral of ever-increasing bets on the most promising concepts.

And so it happens that the expenditures required to procure winning properties can reach bet-the-farm proportions—this explains why NBC and Paramount were inclined to switch away from a blockbuster strategy for a time. When a first-time author can produce a bestseller like *The Art of Fielding* (a much-praised novel by Chad Harbach), when a show like *American Idol* can draw a huge audience after getting its start in an unfavorable summer slot amid decidedly modest expectations, and when a no-name

filmmaker with a minuscule budget can produce a major hit like *The Blair Witch Project* or *Paranormal Activity*, it might seem inadvisable to pay so much for material. The race for the next blockbuster can even stifle innovation: the same tendencies that lead to bidding wars for projects that resemble past winners work against other projects that look nothing like them but may have strong merits of their own. Many movie lovers lament the offerings available to them in theaters and speak disapprovingly of a market in which nine of the top ten selling movies in 2011 were sequels of major franchises, and the tenth, *Thor*, was based on a comic-book character.

Yet, as much as managers may crave to reduce the risks that go hand in hand with big bets, and as much as we might want to criticize entertainment executives for single-mindedly chasing after winning formulas, forgoing blockbuster bets altogether likely creates even more problems. What happens if a publisher like Grand Central decides to stop making large bids like the one it tendered for *Dewey*, or when a studio like Warner Bros. forgoes the kinds of investments associated with its event films? And what happens if a content producer of any kind walks away from the most sought-after, and therefore expensive, new properties?

First, when businesses opt out of the blockbuster race, they take themselves out of the market for the most promising new projects. Literary agents will stop sending their most sought-after book proposals and movie scripts to such a producer. “If you are constantly backing out of big-ticket auctions your list is going to hurt,” one publishing executive told me. “You are going to get a stigma that you don’t play for the big ones, and you are going to get shunned. Say historically you won’t bid more than \$2 million on a book, but an agent thinks they can get \$10 million on a project. Why would they bother letting you into the loop? They will no longer consider you for what they feel are their best projects.”

Editors at publishing houses work hard to cultivate working relationships with agents because they tend to be the sources for the lion’s share of proposals that eventually are turned into books. Even if a publisher could develop extraordinary competence in

finding gold in the “slush pile” of thousands of pieces of unsolicited material received each year from aspiring authors, the dividends would be limited. After one success, the talent the publisher has nurtured would discover the value of an agent, driving up the advance needed to sign the writer’s subsequent books. The same need to build relationships and be “in the market” for the best projects exists in the film business. “Sometimes this industry is like the mafia—it’s about showing respect,” said one Warner Bros. executive. Similarly, if a television network starts “managing for margins” rather than aiming for the widest possible audience, then agents, producers, and writers may quickly stop considering that network a good destination for their best projects.

In every entertainment business, a strong lineup of projects is often key to cultivating the next hit. Consider the world of television. Viewership is “sticky”: many viewers will not immediately switch channels after seeing their favorite program, meaning they may also end up watching the program in the next slot. In addition, networks primarily advertise new shows using promotions they run on their own channels, so that much of a new program’s viewership is a direct result of the popularity of the other programs on its channel. Even a casual examination of television schedules over the years reveals strong success-breeds-success trends. It is no coincidence that ABC launched *Grey’s Anatomy* and a number of other successes on a Sunday evening anchored by its breakout hit *Desperate Housewives*. Likewise, FOX used *American Idol* to boost *House*, *Lie to Me*, and most recently *Glee*. As a result, any smart producer sitting on what he or she believes is the next big idea in television will prefer to do business with the most popular network, as that increases the chances of market success. So the more content producers focus on saving costs rather than driving sales, the more they lose their bid to contend for the most promising new projects.

Second, if a publisher or studio would constantly shy away from blockbuster bets, the most talented editors, filmmakers, television producers, and other creative talent would leave to work for a company that would let them pursue the projects they thought

had the highest chances of success. This is not because of the much-discussed “big egos” of creative workers—a factor often named in the aftermath of bidding wars. It’s a simple result of the passion that many media and entertainment professionals bring to their work—and the fact that careers are built on blockbusters. Grand Central’s publisher and now president Jamie Raab, for example, is known for discovering the best-selling romance novelist Nicholas Sparks. As a result, Raab receives a steady stream of the best new love stories from literary agents.

When you work on a project-by-project basis, as most creative workers do, every project could be your last. Hits buy you extra time and new opportunities in your career. A few misses here and there can be overcome: A-list talent is rarely evaluated on a “hit rate” or “batting average”—the total number of hits, or just the most recent hit, generally matters more. George Clooney, for instance, became a leading man in the 1990s after his star turn on NBC’s popular series *ER*—at the time, everyone seemed to have forgotten that he had previously played parts in more than a dozen television shows that never went anywhere. But people and projects that have “failure” written all over them often receive the cold shoulder.

When, in the mid-2000s, a brave producer named Rob Ahrens wanted to resurrect the 1980 Olivia Newton-John roller-disco film *Xanadu*—widely seen as one of Hollywood’s biggest debacles ever—as a Broadway musical, he encountered strong resistance. Described by influential film critics as “the epic failure to end all epic failures,” “the most dreadful, tasteless movie of the decade,” and “truly stupendously bad” (one critic simply warned audiences to “Xana-don’t!”), *Xanadu* is credited with inspiring the Golden Raspberry Awards, affectionately known as the “Razzies” and now an annual celebration of Hollywood’s worst moviemaking. Not the most likely candidate for a musical adaptation, to say the least.

Although Broadway productions based on box-office hits are common—*Spamalot*, described by its makers as a musical “lovingly ripped off” from the successful motion picture *Monty Python and the Holy Grail*, is one example—shows based on Hollywood

flops are rare. Not surprisingly, Ahrens faced numerous obstacles during his five-year quest for support. "As soon as you say *Xanadu*," he remarked, "[people] either get it right away, or they look down on you and then they call the police." When Ahrens approached Douglas Carter Beane, his choice for playwright, Beane's first response—"No! Never!"—was not encouraging. "I passed several times, because it's a really bad movie," said Beane, who initially saw the opportunity as "theater suicide wrapped up in a nice box." He added: "My partner said, 'That sounds like a resume stopper.' Another friend of mine said, 'Do you want to keep working in this business we call show?'"

Third, by extension, not bidding for sought-after projects makes it harder to get best efforts from sales and marketing representatives and other employees. After winning the hotly contested rights to a book like *Dewey*, Grand Central executives can forcefully make the case that this book will beat its competitors. ("It's a sure bet to do as well as *Marley & Me*—why else would everyone be after it?") The same principle holds true in the film industry. As Horn put it, "It's really hard to convince marketing people to get behind a project when they have nothing to sell, whether it is a big star or a well-known literary property." Firing up those who will be involved in the development and marketing process is crucial, especially because most media titles have only a short window in which to make money and the lion's share of marketing activity takes place before their launch—when it is still largely unknown how audiences will respond.

Finding and fostering internal champions of projects is an integral part of executing a blockbuster strategy. Raab described their national sales meeting, held twice a year and attended by all salespeople, as a "pep rally." As she told me, "The idea is to have everyone walk out excited. Our job is to create the conditions to make a splash in the market—to get people to buy into our hopeful thinking." Similarly, at Grand Central's launch meetings, during which the company's projects are formally introduced to internal constituents from the editorial, sales, marketing, and other departments, as well as several senior executives of Grand Central's parent com-

pany Hachette, "a smart editor will make comparisons with other successful products [so] everyone understands this is going to be a big book," as the director of marketing put it.

Fourth, critically, if entertainment businesses forgo making big bets on likely blockbusters, they will find their channel power waning over time. Retailer support is decisive in most media markets. In the film industry, the number of screens a movie receives from exhibitors in its first few weeks remains the best predictor of its revenues. Exhibitors want to see evidence that a movie is worthy of their scarce resources; they like nothing better than to know that a studio is making a significant push for a film and planning an extensive marketing campaign. A blockbuster strategy helps them to use their resources effectively. "Exhibitors totally embrace the blockbuster philosophy," said Horn. "They don't bear any of the costs—whether the movie costs \$20 million or \$200 million makes no difference to them. But they do see the benefits of us spending more. What they want to do is sell popcorn. Blockbuster movies put a lot more people in seats, which means they sell more popcorn. That's the beauty of it for them."

In the book business, a large share of products is bought on impulse—surveys show that just under three-quarters of the people entering a bookstore buy a book they did not intend to buy—so securing significant display space with book retailers such as Barnes & Noble is particularly important. These "pile 'em high and watch 'em fly" tactics may seem old-fashioned, but they tend to be very effective at triggering sales. For television networks, getting buy-in from local television stations is crucial, and stations often strongly object to cost-cutting measures that may reduce the likely size of a popular show's audience. NBC experienced this firsthand in 2009 when the network announced that it would move Jay Leno's new show to the ten p.m. slot in place of more expensive dramatic content, which station managers believe is a better lead-in for local news programs.

The way in which retailers market entertainment products to consumers is driven by the same forces that made *Dewey* such a pricey creature. This is noticeable even in the smallest details. If you had



walked into a Borders bookstore around the time of the book's launch, you might have noticed the "Like This? Try These" signs with one arrow pointing to the bestseller *Marley & Me* and another arrow to several books that were similar to that book: *The Art of Racing in the Rain*, *A Three Dog Life*, and *Merle's Door*, all books about dogs. When *Dewey* hit the shelves, it, too, claimed a spot on that row—as much a "copycat" strategy as one will ever see. And so content producers, in turn, try to cater to the marketing strategies of retailers, sometimes going so far as to copy the look of products. For instance, publishers hoping to speak to the same audience that made Malcolm Gladwell's *The Tipping Point* a huge hit sometimes mimic that book's distinctive cover design. Gladwell himself has had no reason to change his winning formula: it's no coincidence that his more recent books, *Blink* and *Outliers*, look like they belong right next to *The Tipping Point* on the shelf. Many of the biggest blockbusters spawn knockoffs and imitators: in 2012 the erotic novel *Fifty Shades of Grey* prompted the release of such titles as *Fifty Shades of Pleasure* and *The Ninety Days of Genevieve*. (Literary agent Jonny Geller joked that his agency is now seeing so many unsolicited erotica manuscripts, they have renamed the "slush pile" the "blush pile.")

New channels through which consumers buy books work in similar ways: Amazon automatically lists comparable books under the "Customers Who Bought This Item Also Bought" section, which undoubtedly helps drive sales for those titles. By the same token, new films and television programs are often described as being "from the producers that brought you . . ." to highlight similarities with past winners, and promotions and trailers are placed around current hits that resemble them in some important way, be it the story line, central property, or star actor.

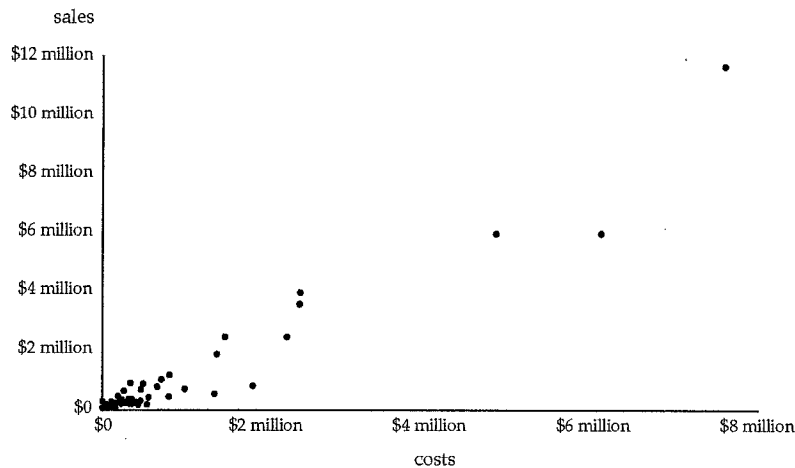
The blockbuster-focused marketing of many entertainment companies did not emerge in a vacuum—it mirrors the way consumers make choices among a wealth of competing entertainment offerings. Because people are inherently social, they generally find value in reading the same books and watching the same television shows and movies that others do. People have a taste for winners:

if, say, a book is popular and has been widely discussed in the media, consumers have more reason to read it than they would an otherwise identical book that has not received such attention. Compounding this tendency is the fact that media products are what economists call "experience goods," that is, audiences have trouble evaluating them before having consumed or experienced them. Unable to judge a book by its cover, readers look for cues as to its suitability for them. A prospective purchaser of Vicki Myron's book will thus find it very useful to hear that *Dewey* is "a *Marley & Me* for cat lovers." Just as publishers do, consumers value resemblances to past favorites.

No surprise, then, that the blockbuster strategy seemed to work wonders for Grand Central during the period *Dewey* was published, just as it did for Warner Bros. under Alan Horn. In 2006, the year before the company acquired the book, Grand Central's fall list consisted of sixty-one adult hardcover front-list titles. Just 20 percent of those titles accounted for roughly 80 percent of sales and an even larger share of profits. "The sins of the many are offset by the plentiful of the few," said one of the company's financial executives. As shown in the chart on the next page, the titles on its fall 2006 list with the highest acquisition costs were for the most part the titles that delivered the highest revenues—and the highest profits. Results are even more skewed than for Warner Bros.: the top 10 percent of Grand Central's titles account for 64 percent of its costs, 72 percent of its net sales, and a staggering 126 percent of its profits.

Remarkably, Grand Central made the lion's share of its profits on just one book—and that title was by far its most expensive. The most popular title that fall cost \$7.5 million to develop and market. The book generated net sales of just under \$12 million, and gross profits of nearly \$5 million—out of the nearly \$6 million in total gross profits across the entire list. Meanwhile, as the chart on the following page also shows, many of the publisher's small and medium-size bets lost money. For instance, the thirty titles that were cheapest to acquire actually lost an average of \$12,000 each. Even the rare winners among Grand Central's least expensive books

Grand Central Publishing's Bets in 2006

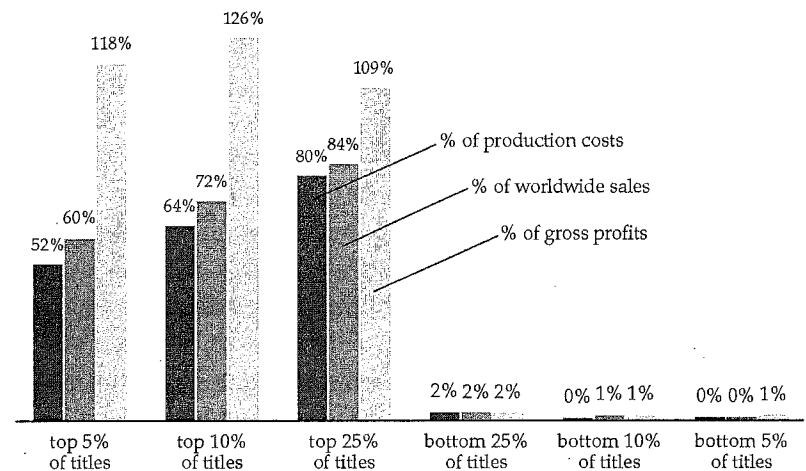


The above figure plots each of the sixty-one hardcover books on Grand Central Publishing's fall 2006 front list by its net sales and (development and marketing) costs. (The publisher asked for the titles not to be identified). The most expensive title on the list cost over \$7.5 million and generated \$11.6 million in net sales.

contributed very little to the company's profitability. And this particular list is no exception; it is illustrative of the publisher's results in other years as well.

As this example again makes clear, the idea of smaller bets being "safer" is a myth. Blockbuster strategies reliably beat the alternative of more risk-averse strategies: the highest-performing companies in the entertainment and media sector thrive by investing a relatively large proportion of their resources in just a few titles and then turning those choices into successes by giving them a higher level of development and marketing support. It may be partly a self-fulfilling prophecy, but it works. And because the marginal cost of reproducing and distributing entertainment products is relatively low—especially compared to their up-front production expenses—and because of the economies of scale involved in advertising campaigns, the advantage of a bestseller, a box-office champion, or a ratings monster is huge.

How Grand Central's Big Bets Stack Up Against Its Small Bets



The figure shows how much the fall 2006 hardcover titles, when grouped by their costs, contribute to the publisher's total costs, net sales, and gross profits. For instance, the top 5 percent, the most expensive titles, account for just over half of the development and marketing costs, 60 percent of net sales, and 118 percent of gross profits.

This does not mean media companies can spend without limits, of course—especially given the turbulent markets for their products. Book publishers are experiencing uncertain times with the rise of e-books, broadcast networks see their market shrinking relative to premium cable channels, and film studios can no longer count on DVD sales to be the dependable cash cow they once were. But yielding to an excess of caution and shying away from any attempt to create the next blockbuster with mass appeal may be the surest way for an entertainment company to lose further ground.

As for *Dewey*, how did our fat-cat friend fare? Published in September 2008, the book became one of those blockbuster bets that paid off—and then some. Released at a list price of \$19.99, Grand Central's big gamble performed beyond any of the executives' wildest dreams. It captured the number one spot on the *New York Times* hardcover bestseller list and sold 759,000 copies in just over three months, making it the sixth-highest-selling adult nonfiction title



that year. It sold another 130,000 hardcover copies in 2009, bringing the total close to 900,000 copies. Having tasted success with cat books, that same year another Hachette imprint published a children's book by Vicki Myron, Bret Witter, and illustrator Steve James. Called *Dewey: There's a Cat in the Library*, it sold 106,000 copies. The next year, Myron and Witter launched another follow-up, *Dewey's Nine Lives: The Legacy of the Small-Town Library Cat Who Inspired Millions*, which offered "nine funny, inspiring, and heart-warming stories about cats." At one point, there was even talk of a movie adaptation starring Meryl Streep as Dewey's caretaker.

Perhaps the key question is not why entertainment executives make blockbuster bets—the real puzzle, it seems, is why they continue to turn out products that are the result of much smaller bets. After all, the financial payoff from these modest investments looks decidedly shaky. If tent-pole films consistently generate the highest returns for Warner Bros., why does the studio also invest in the smaller films that make up the large majority of its annual output? And if Grand Central's expensive "focus" and "make" books consistently outperform the large majority of other titles on its list, why even bother with those smaller investments?

A close look at the way successful entertainment companies operate reveals that both kinds of investments play an important role in their portfolios. Bigger bets tend to generate the highest revenues and profits, bring excitement to the company, help build the brand, and foster future hits. But for a book publisher, a film or television studio, or another type of media producer to carry out a blockbuster strategy, smaller bets are needed, too—for a variety of reasons.

First, smaller investments can serve as test cases. Placing a reasonable number of less expensive bets can help a media producer discover the next big-hit franchise. In the film industry, sequels are seen as one of the safest blockbuster bets one can make, and smaller investments may help turn up another film that is ripe for a sequel, much like *The Hangover* and *Sex and the City*. This principle also applies to actors, directors, and other creative workers. Even if studio

executives are convinced that a little-known actor is the next Tom Cruise, asking him to star in a \$200 million film in his very first assignment seems ill advised. Instead, it is more sensible to commence a collaboration with a promising young actor by giving him a role in a smaller film, one that will allow the studio to learn whether he is truly capable of "carrying a film" and accomplishing all that comes with that responsibility, from performing at a high level on the set every day to fulfilling publicity obligations. Being able to test the appeal of new product formats, from vampire movies to talent shows, is another advantage. Some product types or genres may prove profitable as smaller-scope investments in their own right, as seems to be the case, for instance, with certain ultra-low-budget horror films.

Smaller bets can also help a media producer "fill the pipeline," thereby keeping companies that help sell the producer's output satisfied. For example, a book publisher that delivers a steady stream of new titles to the market will find it easier to build and maintain relationships with retailers. That, in turn, may put the publisher in a position to negotiate steeper discounts, favorable in-store placements, or other marketing advantages. In the film industry, Warner's commitment to producing two dozen movies each year—roughly one Warner Bros. film opens in theaters every other week—helps it to obtain better agreements with theater owners. "Our head of domestic distribution would go out and speak with exhibitors and say, 'I need your best theater on Wilshire Boulevard and I need it for four weeks,'" Horn told me. "The exhibitor might counter that Paramount wants it, too. But then we could say, 'We are Warner Bros., here is our lineup for the year, and this is what we need for this particular movie.' It will always be a back-and-forth in these negotiations, but having the largest number of films gave us weight in the marketplace, which got us better screens, for a longer time, and at a better revenue-sharing rate." Additionally, a larger number of products often leads to volume discounts in media buys: the more products they advertise, the more favorable the advertising rates studios and publishers can secure.

Pursuing a wide range of smaller projects allows studios,

publishers, and other entertainment businesses to form closer links with agents, who are involved in the lion's share of deals for new products and therefore critical gatekeepers in virtually any entertainment sector. Further, a broad portfolio of properties can attract needed financing. For a studio like Warner Bros., which under Horn's leadership relied on co-financing for nearly all of its projects but the surest bets like *Harry Potter*, a broad portfolio can be a useful way to attract outside investors willing to share risk. The studio takes a distribution fee off the top, and then splits revenues with those investors. "Some investors may push back on this model, but they usually don't have the power and the relationships to be an effective distributor, so we have the upper hand in these talks," said Horn. "Again, our scale worked in our favor."

That smaller bets may allow for more flexibility in dealing with these industry partners is an added advantage. For example, it is often easier to move release dates and shift advertising budgets for smaller-scale projects. Large media producers may buy advertising time on television months in advance; having smaller projects to move around can help optimize the use of those resources.

Going for smaller-scale products can enable entertainment companies to build and maintain a favorable critical reputation as well, which in turn can help them attract sought-after A-list talent and their projects. If, say, a film studio wants to cast a superstar actor in an event film, it can be beneficial to have the option of offering that actor the lead in a smaller "passion project," one with the potential to please critics and Academy Award voters. When Warner Bros. agreed to finance Clint Eastwood's *Million Dollar Baby* despite the poor performance of boxing movies in the past—and especially of boxing movies that revolved around female fighters—no one at the studio had any idea it would become a box-office hit. If anyone other than Clint Eastwood had brought the movie to the studio, it likely never would have seen the light of day (or, rather, the darkness of a theater). Fittingly, when Warner threw Horn a good-bye party, George Clooney publicly thanked him for "supporting the things we want to do that studios never want to do." Smart A-list actors remember these sorts of gestures and become allies.

Finally, developing and releasing a number of smaller projects helps producers spread the fixed costs of their production and distribution infrastructures. For the major film studios that have expansive lots and dozens of offices around the world as part of their distribution apparatus, being able to allocate the costs of those resources across a larger number of projects—even if the smaller-scale projects barely break even—can be a huge benefit. For one, it helps them fund their blockbuster bets. "Very few entities in this world can afford to spend \$200 million on a movie," noted Horn. "That is our competitive advantage."

Despite the advantages of having a broad and varied portfolio, major studios and other large-scale content producers would probably further tilt their investments toward the bigger projects if they could. But two key constraints make that difficult: raising the funds required to produce blockbusters is a constant challenge, and finding the ideas that lend themselves to bigger-scale production and marketing support is never easy. "We were keen to make more event films, and steadily increased the number over the years," Horn said about his time at Warner. "But there aren't many ideas with global appeal." What competing entertainment businesses do matters, too. As Horn pointed out: "There is a limit on good release dates in a given year."

And so, as a consequence of all these factors, many of today's largest entertainment businesses end up with product portfolios consisting of a few blockbuster investments that require most of their attention as well as a number of smaller bets. That's not to say that no other portfolio approach could possibly work. For example, animated movie house Pixar has an interesting approach: from the outset, it has focused on a very small number of films at any given time. Calling Pixar's strategy a "rifle-shot approach," Horn described its method this way: "They make one movie a year, and really handcraft each one. They are painstaking in their approach, highly self-critical, and work for years on one title before releasing it." That focus has paid off: Pixar has churned out one box-office smash hit after another, from *Toy Story* to *A Bug's Life*; *Monsters, Inc.*; *Finding Nemo*; *The Incredibles*; *Cars*; *Ratatouille*; *WALL-E*; *Up*; and

*Brave*. But Pixar is not a stand-alone studio: it operates as a unit at Disney and is now Horn's responsibility. Pixar thus can rely on the advantages that come with Disney's wider scale and power—a big plus, for instance, when it comes to distribution—while continuing to lavish attention on each of its films.

Another of Disney's units—Marvel Entertainment—is also a provider of a steady stream of huge hits. In fact, even more so than cats and dogs, comic-book heroes seem to be the favorite targets of Hollywood studios in search of the next blockbuster hit. The people behind the huge splash that the first *Spider-Man* movie made at the box office in 2002—and much of the superhero craze that followed in its footsteps—know a thing or two about creating and monetizing hits. The evolution of their business reveals just how dominant blockbusters have become and underscores many of the lessons learned about effective blockbuster portfolio strategies.

In August 2009, Disney announced a \$4 billion purchase of Marvel Entertainment, which owned and managed one of the oldest and most recognizable collections of characters in the entertainment industry. Its proprietary library of thousands of characters, collectively known as the Marvel Universe, includes superheroes such as Spider-Man, X-Men, The Hulk, Daredevil, The Punisher, The Fantastic Four, Captain America, and Thor, all of which were developed for an astonishingly rich trove of comic books dating back to the 1930s.

As Disney's purchase of the company came together, Isaac Perlmutter, Marvel's chief executive officer and at the time its biggest shareholder, and his now former colleagues Avi Arad (who served as chief creative officer) and Peter Cuneo (who preceded Perlmutter as chief executive officer) had every reason to reminisce about a rescue they had staged that none of Marvel's superheroes could have pulled off—that of the company itself. Perlmutter and Arad had made their fortunes as partners in a toy company. With business experience in sectors such as fiberglass, pharmaceuticals, power tools, and electric shavers, Cuneo was as unlikely

an entertainment mogul as one can find. But he was an expert at managing turnarounds, and that was his brief at Marvel when he joined the company in July 1999. He succeeded beyond all expectations: exactly a decade after Perlmutter and Arad acquired Marvel out of bankruptcy and hired Cuneo, and nine years after it posted a loss of over \$100 million and saw its stock price hover at around \$1, the Disney offer valued Marvel at around \$50 per share. It was a performance that made the feats of both Spider-Man, with his ability to scamper up the sides of tall buildings, and The Hulk, with his unparalleled power (and greenness), seem decidedly mundane.

During that ten-year period, the executives rebuilt Marvel's original comic-book publishing business into a profitable division, and revamped its toy and licensing operations. Marvel lent its characters to twenty movies, including Sony Pictures' *Spider-Man*, Universal's *The Hulk*, Twentieth Century Fox's *X-Men*, and Lionsgate's *The Punisher*. Many movies recouped their costs by the time they closed out their domestic runs and went on to post big numbers in markets across the globe. Fourteen movies made more than \$100 million in US theaters alone, six made more than \$200 million, and four made more than \$300 million. Remarkably, Marvel's sequels often outperformed its originals. As a result, worldwide grosses collected over a decade hovered close to the \$7 billion mark.

Marvel also made licensing deals for a wide range of other products, from video games to apparel and from party items to food. "We contribute our characters and our knowledge of the characters, we work hard to find the right partners, and we approve the products for quality, but we don't contribute any capital," one Marvel executive told me. "We just collect checks." Perlmutter added: "It's a gold mine. Cash just comes in every day."

Within a few years of Cuneo's arrival, early doubts about the company's business model started to disappear. So did fears that the company had milked the best gains from its most prominent characters and might not be capable of further developing lesser-known superheroes such as Ghost Rider, Iron Man, The Punisher, and The Fantastic Four to boost growth. "There is no end to our

success—we have a great library of characters,” Arad told me in 2004. “I do feel frustrated by all the revenue that we are just giving away,” he admitted, pointing to Marvel’s relatively modest share of the revenues for its motion pictures. For instance, despite *Spider-Man*’s impressive theatrical box-office gross of over \$820 million worldwide and sales of about 7 million \$20 DVDs on the day of its release in the United States, Marvel received only about \$25 million from Sony Pictures. “We have been focused on activities that require minimal capital investment on our part,” said Cuneo at the time. “There are bigger bets to be placed as we move more into the production and distribution of content—but there could be bigger rewards, too.”

In 2005, Marvel made its first strides toward that goal by landing \$525 million worth of financing courtesy of Merrill Lynch that allowed it to produce its own film slate, and by giving Paramount Pictures the right to distribute those movies. Under the terms of the partnership, Marvel could produce up to ten movies over an eight-year period, with budgets ranging from \$45 million to \$180 million per film. Marvel received a fee for producing each film and would be able to keep all merchandising revenues, while Paramount collected a distribution fee of 8 percent of the box-office revenues for each film. (The deal also applied to any sequels to these films.) “Marvel has become a marquee entertainment brand,” Paramount’s chairman and chief executive officer, Brad Grey, said when the agreement was made public. “It speaks to Marvel’s strength in the marketplace and the great popularity of its brand and characters that Marvel can obtain such innovative financing for its film slate. We are thrilled to partner with them in this new venture.”

Further evidence of Hollywood’s interest in Marvel’s hit characters and story lines arrived four years later when Disney purchased Marvel. Despite the high purchase price, the agreement required Disney to honor Marvel’s ongoing deals with other studios: Sony’s right to make movies based on Spider-Man—Marvel’s most sought-after character—lasts into perpetuity, and the deal with Paramount locked in several other characters. Yet Disney was

undeterred. As Bob Iger, Disney’s chief executive officer, put it: “This treasure trove of over 5,000 characters offers Disney the ability to do what we do best.”

Marvel’s reversal of fortunes over the course of a decade—one of the greatest turnaround stories in the entertainment industry and indeed the business world in general—is a direct result of major movie studios’ search for the next blockbuster. Basing a new event film on a Marvel character is now one of the surest bets a Hollywood executive can make. Ironically, the only major studio not mining Marvel’s riches is Warner Bros.; its parent company, Time Warner, owns rival comic-book publisher DC Comics, which is known for Batman, Superman, and a host of other characters. Together, Marvel and DC have the market for comic books cornered.

It is too easy to dismiss Marvel as a company that simply got lucky with its *Spider-Man* franchise and since then just banked on that initial success. But the truth is that every studio head knows that the first *Spider-Man*—the highest-grossing film of 2002, and at the time the tenth-highest-grossing movie ever worldwide—single-handedly turned Sony Pictures’ otherwise bleak year into a stellar one. In those early years, Marvel relied just as heavily on its biggest blockbuster. By my calculations, in fact, *Spider-Man* accounted for at least half of Marvel’s operating income—measured across toys, media licensing, and consumer-products licensing—in 2002 and 2004, and at least a third of the company’s operating income in 2003 (when no Spider-Man movie was released).

“It’s toys, apparel, school products, games, promotions, pajamas, skateboards, vitamins, lollipops—with Spider-Man, there’s virtually no limit,” one of Marvel’s consumer-products licensing experts told me. Cuneo agreed: “There is nothing close to Spider-Man. He is our number one character, with the widest demographic appeal of any fantasy property. His appeal starts with two-year-old children who wear Spider-Man pajamas and goes up to consumers in their sixties—they all enjoy Spider-Man. I wish all our characters were that broad.”

Early successes triggered a superhero craze. As other Marvel

movies such as *Daredevil*, *X2* (also known as *X-Men II*), and *The Hulk* performed well at the box office in the years following *Spider-Man*, and especially as the *X-Men* and *Blade* sequels outperformed their originals—a sign of a franchise having staying power or, as industry insiders say, “legs”—Hollywood executives began to compete ever more intensely for new Marvel characters that could be brought to the big screen. Marvel executives let the blockbuster trap work in their favor by pushing for better deal terms in negotiations with studios and other licensing partners. The original deals for *Blade* and *X-Men* stipulated that Marvel would receive a share of studio profits after all expenses had been incorporated. But studios had creative ways of calculating those profits that left only a negligible amount for Marvel—“Hollywood Economics,” as Cuneo put it. With a few early movie successes under its belt, however, Marvel was able to negotiate more favorable revenue participation deals that gave it a share, typically between 3 and 7 percent, of box-office grosses for its blockbuster movies. This was still only a fraction of what the partnering studios were able to keep, but a definite improvement.

Meanwhile, Marvel executives created a business model that was specifically designed to minimize product-development and advertising costs—the major financial burdens involved in marketing blockbusters. Minimize those costs for Marvel, that is, and shift expenses to the studios that were licensing Marvel’s characters. Here is how it worked. Marvel operated as a mini-conglomerate with divisions focused on comic books, toys, media licensing, and consumer-products licensing. The company developed its characters and story lines in its comic-book division, which effectively served as its research-and-development center, or as its incubator for ideas. And a highly efficient incubator at that, since comic-book publishing is relatively cheap and flexible: a typical print run costs the company only \$10,000 to \$20,000.

Marvel relied on partnering movie studios to advertise its brands. The company’s licensing contracts with studios stipulated that Marvel did not contribute to movie production and marketing expenses. “Usually we get anywhere between thirty million and

eighty million dollars in advertising devoted to our movies,” Arad told me in 2004. “As a result, the word spreads like wildfire—it leads to worldwide exposure for the Marvel brand and for the specific character.” Cuneo explained the resulting positive effect on its brands: “If you have seen our movies, you might get into our comic books, you might get into our video games, you might buy a T-shirt with a Marvel character, or you might buy some of the other consumer products.”

How did Marvel make money? Although the partnering studios would undoubtedly have preferred otherwise, Marvel retained full control over merchandising rights, which it used to drive sales in toys and consumer products, the company’s main sources of revenues. Consumer-products licensing in particular was—and is—a highly lucrative activity. Costs are incredibly low: at the time Disney made its move, Marvel’s consumer media group (which coordinates activities for all consumer products) consisted of just a few salespeople and assistants, supported by a dozen or so legal and product-approval specialists. Contracts specified a minimum guarantee, to be paid to the rights owner regardless of the sales of the licensee’s product, and additional royalties if sales exceeded the guarantee. Not surprisingly, the more the character was associated with blockbuster content, the higher both the minimum guarantee and the royalty rate that Marvel could negotiate. No wonder Perlmutter called it “a gold mine.”

Marvel’s approach to the management of its portfolio of brands was equally clever. Hollywood studio executives—and producers in many other sectors of entertainment—know that strong brands are not created overnight. For every *Finding Nemo*, which introduced a character that immediately resonated with audiences everywhere, there are hundreds of properties such as *Shark Tale* and *Delgo* that disappoint. Marvel’s good fortune was that it had an extensive library of tried and tested characters and story lines to exploit, and Perlmutter, Arad, and Cuneo recognized this value. “We don’t want to be a regular studio and come up with new ideas for movies,” said Arad at the time. “Then we’ll be like everybody else in this hit-and-miss business. That’s a shot in the dark—we

might as well play blackjack. Somehow the characters have permeated into our culture—that's our marketing advantage."

Blockbusters drove growth for other, lesser-known characters, building Marvel's portfolio over time. Helped by the fictitious Marvel Universe, which provided a common historical and contextual background for the company's characters, the executives emphasized the linkages that existed between its hit characters so as to grow smaller brands. (Elektra, for instance, made an appearance in the *Daredevil* movie and later starred in a movie of her own.) Cuneo explained the nature of the content library this way: "You've got to think of the forty-seven hundred characters not as individuals but as families. We have forty years of Spider-Man stories. There might be fifty bad guys associated with Spider-Man and fifty friends. So the Spider-Man family consists of one hundred, maybe two hundred, properties. The Hulk accounts for another hundred, while X-Men has about four hundred characters."

The essential natures of Marvel's franchise characters, built up over decades of appearances in comic books, are remarkably similar. As one Marvel executive put it: "They have some kind of vulnerability attached to them. Spider-Man is just a kid with glasses. Although they have superpowers, our characters are presented as normal people, with problems that anybody else would have." Because its brands are linked and in many respects similar, Marvel was in an ideal position to capitalize on Hollywood's search for the "next big thing" after the *Spider-Man* movie became a hit. Rather than fight against a blockbuster trap that was gaining momentum, the major studios helped to further strengthen Marvel's overall brand by pursuing the film rights to many of the company's other characters. Some marketing executives even asked for a Marvel-themed trailer to play just prior to their own films.

Realizing that bigger risks go along with bigger rewards, Marvel executives used their newfound powers to put together the groundbreaking deal with Paramount and Merrill Lynch—a move that fit Marvel's desire to capture more of the upside of its movies, but one that pitted the company directly against some of its other studio partners. By 2005, just a few short years after the first two

*Spider-Man* movies had together grossed more than \$1.5 billion in worldwide ticket sales, Marvel's characters had become so sought-after that it could negotiate innovative financing: the contracts with Merrill Lynch reportedly stated that an insurer would cover interest payments in case Marvel would not be able to—in return for the movie rights to the central character. Have characters serve as collateral? It is hard to think of a more fitting illustration of the power of the company's blockbuster brands.

Further proving the strength of Marvel's characters, the first films to come out of the company's deal with Paramount—*Iron Man*, *Iron Man 2*, *Thor*, and *Captain America*—performed well, together collecting over \$2 billion in global box-office revenues, over three times their estimated production costs. Coming at a time when Disney was struggling to generate hits of its own, Disney's bid for Marvel reflected the major studio's eagerness—or, given the billions of dollars involved in the transaction, some might say desperation—to call some of those blockbusters its own. In October 2010, less than a year after closing the purchase, Disney gained further control of the Marvel portfolio by buying Paramount out of its worldwide marketing and distribution rights for *The Avengers* and *Iron Man 3*, in return for at least \$115 million in distribution fees. Before long, no one at Disney had any regrets about the investments: in 2012, the first *Avengers* movie raked in a staggering \$1.5 billion in tickets; in 2013, *Iron Man 3* also crossed the \$1 billion mark. Whatever the further fortunes of Marvel's resilient superheroes, the evolution of the company and its new life as a subsidiary of Disney underlines Hollywood's reliance on the kind of colossal hits that only Marvel's superheroes and Hollywood's smartest executives can make happen.

## LAUNCHING AND MANAGING BLOCKBUSTERS

Standing backstage at a sold-out concert in Boston's TD Garden in March 2011 during Lady Gaga's smash-hit solo tour, the *Monster Ball*, her manager, Troy Carter, took a moment to take it all in. "When Interscope celebrated its twentieth anniversary last year, Gaga was featured as one of its top acts in the past two decades. . . . It is amazing how far we have come in such a short time," he told me. And he had a point: after emerging on the music scene in 2008—touring as a supporting act for New Kids On The Block, a former boy band beyond their glory years—Lady Gaga hit it big in the fall of 2009. Two short years later, she had become one of the biggest names in entertainment. Along the way, she collected multiple Grammy and MTV Video Music awards, garnering acclaim as both a singer and a songwriter. As Gaga's musical star rose, so did her status in the fashion world, helped by her memorable appearance in a "meat dress" at the 2010 VMAs and, a year later, her red carpet arrival in an egg-shaped vessel held up high by latex-clad dancers. By 2011, *Forbes* ranked her first on its Celebrity 100 list, ahead of Oprah Winfrey.

Working behind the scenes, the thirty-eight-year old Carter had also seen his fortunes dramatically improve. He had been intro-

duced to Gaga by top producer Vincent Herbert a few weeks after Herbert had signed her to his label Streamline Records, a subsidiary of major record company Universal Music Group (to which the flagship Interscope label also belonged). "I wanted someone who shared my vision for Lady Gaga, and Troy understands it. We have been close friends for fifteen years, and I knew he would appreciate this chance," recalled Herbert, who described Carter as "a little kid from Philly with a big heart and a dream to prove himself."

Although he looked much too young to have built a career in entertainment that spanned two decades, Carter had started out in the early 1990s carrying crates of records for Jeffrey Allen Townes and Will Smith, then better known as rap duo DJ Jazzy Jeff & The Fresh Prince. As the hub for all activities related to Lady Gaga ("I think of myself as the air traffic control center—just without the terminals," Carter said about his job as manager), he himself had become a force to be reckoned with in the world of entertainment. Now, after a series of investments and new ventures in Silicon Valley, he was also a rising star in the world of new technology. "The reality of being a talent manager is that I risk my job every week," Carter explained. "Lady Gaga trusts my decisions. We are about breaking boundaries, which means we do something different when we have a chance—we don't just do what worked last time, or what was successful for someone else. But if something doesn't work out, it is my responsibility."

Gaga's ascent to the top may have been swift, but her artistry had been a long time in the making. Born as Stefani Joanne Angelina Germanotta in New York City in 1986, Gaga began playing the piano at age four, composed her first piano ballad when she was thirteen, and played open mike nights at venues around New York one year later. As a student at Covenant of the Sacred Heart, an all-girls Catholic school in Manhattan, she excelled in lead roles in several of the school's musicals. In 2003, she was one of twenty students given early admission to New York University (NYU)'s prestigious Tisch School of the Arts, which allowed her to further develop her singing, playing, and songwriting. A year and a half



after arriving, she withdrew from NYU to focus on her music full-time—but not before striking a deal with her father to re-enroll if her music career fizzled: a smart safety net but, needless to say, one that ultimately proved unnecessary.

A day after hearing a recording of Gaga's, Herbert flew her out to Los Angeles. "I knew she was a star," Herbert said. "It was that simple." To Carter, the woman who would go on to sell tens of millions of copies of songs such as *Just Dance*, *Poker Face*, and *Bad Romance* on her first two albums, *The Fame* and *The Fame Monster*, had "being a performer running through her veins." Through a relentless touring schedule—for months on end, she put on seven to eight shows a week, sometimes performing three times per night, in different clubs around the United States and Canada—Gaga had built a fan base with a strong core. "This is not what pop artists usually do," Carter remarked, "but we wanted to build her fan base from the ground up. . . . Once the audience feels they own something, they are going to run with it, and do the work for you."

Gaga heavily relied on Facebook, Twitter, and YouTube to further spread word of mouth and strengthen her connection with her fans—or her "little monsters," as she liked to call them. She turned out to be extraordinarily skilled at doing so: by 2011, Gaga was the most popular living person on Facebook and the most followed person on Twitter. (In typical Gaga fashion, upon receiving the latter distinction, she posted a live video and tweeted, "May you always have soft cuticles while tweeting. May you never have carpal tunnel," to thank her fans for the honor.)

But when Gaga was ready to release her third album, *Born This Way*, Carter and his team decided to rely much less on a grassroots approach to propel sales. Rather, the idea was to support the launch with an intensive marketing effort—"much like opening this as a movie blockbuster in the summer months, like *Avatar*," explained Interscope's vice chairman, Steve Berman. Herbert added: "We can do that because of who she is—she is a part of culture now, and has an enormous platform." But the strategy would be a significant drain on resources, Carter acknowledged: "With an artist of Gaga's

caliber, reaching full potential means doing things on an enormous scale." He knew that the launch he had in mind would have to go beyond traditional music-distribution channels and would test the limits of what a record label, even one the size of Universal, could afford.

Now, as Carter made his way through TD Garden's hallways to the stadium floor—"the best place to experience the concert," as he put it—he wondered whether an expensive launch akin to that of a "tent-pole" movie was the right way to capitalize on Gaga's popularity. Or was a more moderate approach—much like the one that Carter had employed so successfully for her first albums—the best way to proceed?

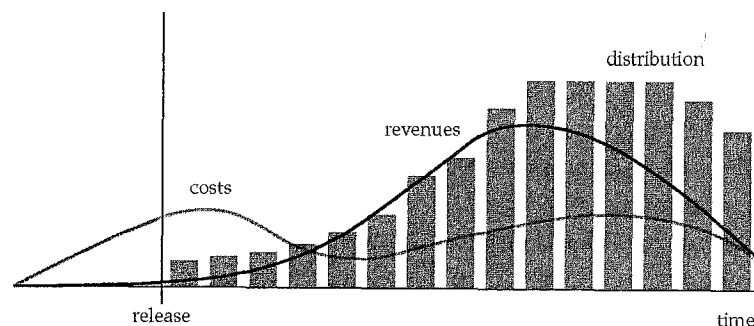
Not only do entertainment businesses make risky bets on the development of a select few products, they often further increase the stakes by investing a great deal of money in distributing and promoting those products as widely as possible, all with an eye toward opening as big as they can. And companies set those marketing budgets at high levels often well before they know how those products will be received in the marketplace. Why? Why would the team behind Lady Gaga want to move away from a word-of-mouth-driven launch that worked so well for them in the past? With Gaga's new album likely to sell like hot cakes, would record label executives not prefer to save on any unnecessary marketing expenditures?

It is hard to argue with anyone who has been as successful as Gaga—when I spoke with Berman, he noted that "she could be a chief marketing officer for a big corporation, because she understands the brand, and how important it is to stand by that brand." All evidence indeed points to team Gaga's approach to releasing *Born This Way* being the wisest course of action. To understand why, it is necessary to take a closer look at the pros and cons of the different ways in which entertainment products are launched—and how, more specifically, media producers decide to allocate their marketing dollars over time.

Most albums, movies, television shows, video games, and



A Limited Release Strategy



books—and, in fact, the majority of goods *not* produced by entertainment businesses—are launched using what marketers call a “limited” or “grassroots” release strategy, as illustrated in the chart above. The basic idea behind such an approach is to gradually discover what level of marketing spending is most appropriate. It is all about being as efficient as possible with the available resources.

How does this work? When products are introduced using a limited release strategy, initial distribution and advertising levels are relatively low. For instance, in the context of the film industry, this could mean that a film debuts on only a few screens in major cities, and is supported with print and online advertisements in those regions. The primary goal of these efforts is to attract not the largest, but rather the *right* audience to the product, in the hopes that those early customers will in turn spread positive word of mouth and help draw in new audiences. Only if the product takes off—or shows some signs of being on the verge of taking off—will the producer gradually increase the distribution coverage or intensity and support the product with more advertising to further enhance growth. Getting a positive response from the market is critical: if the product fails to impress, the producer will cease to invest, and copies will be pulled from shelves (or, in the case of a movie, from theaters). The principle is to spend sizable amounts of

money on the marketing of only those products that are worth it—those that truly have a chance of success in the marketplace.

Some of today’s biggest entertainment hits were launched using a limited release strategy. *My Big Fat Greek Wedding* is a classic example: a so-called sleeper movie that originally appeared on only a hundred screens in April 2002, it was initially promoted via a word-of-mouth campaign targeted at Greek communities in the United States. As the film caught on, the executives behind the film slowly expanded its distribution footprint and advertised the film to a wider audience. Not until August of that year was the film shown on a thousand screens—still a low number for a typical release in Hollywood, where films often play on three to four thousand screens at once—and made more than \$10 million a week. The film remained in theaters until April 2003, nearly a year after its opening week, and ultimately grossed \$240 million domestically. Not a bad haul, given its production costs of only \$5 million.

Lady Gaga’s first recordings were also released in this fashion. Her first single, *Just Dance*, a glam-influenced pop song co-written with R&B artist Akon and producer RedOne that also featured up-and-coming artist Colby O’Donis, was released in April 2008. Gaining traction proved difficult: “We could not get it played on pop radio,” Carter recalled. “Mainstream radio stations told us it was too much of a dance song for them.” Bobby Campbell, chief marketing officer at Carter’s management firm Atom Factory, chimed in: “Dance music simply was not on the air in Top 40 Radio. Radio stations were saying no to such music.” To overcome the problem, Carter followed a release plan that, inspired by successful rap artists’ launches, relied on an intense schedule of live performances targeted at communities that seemed especially receptive to her music.

“The gay community seemed to stick to her, and that resonated with her personally. So gay clubs were a natural fit to start the work. We gave them full access to her,” explained Campbell. “It was about finding different groups: the gay community, the dance community, the club-going community, the fashion community,

the art community, and developing those into a larger pool of Gaga fans. So when Interscope made some headway with radio later on, we had this really strong core of fans who had been following her for months, and who felt they were part of the reason why she was successful."

Most content producers opting for a limited release do so because they lack the funds necessary for a wider rollout. Getting broad distribution for a product tends to be costly, partly because of the additional demands that many retailers make. In the film industry, for example, cinema exhibitors often insist that a film producer or distributor spend a certain amount on marketing before they agree to show a film; these stipulations are frequently a part of the contract between both parties. In the book business, the initial launch of E. L. James's mega-seller *Fifty Shades of Grey*, which the British working mother of two wrote in her spare time, was remarkably modest: lacking the support of a publisher, James published the book's first volume as an e-book and print-on-demand paperback in May 2011. She chose to release the book with a small Australian company called Writers' Coffee Shop, and published two more novels by the same method over the next six months. Excitement about the books soon began to build on blogs and in social media, prompting an executive at major publisher Random House to sign James in early 2012 and give the trilogy a much stronger distribution and marketing push.

Having some control over which audiences become early adopters is another important advantage of a limited release. It is no coincidence that highbrow films are usually released in more upscale neighborhoods in New York City and Los Angeles before they are rolled out to other parts of the country. Producers and distributors know that audiences there are most receptive to those kinds of films, and count on the positive word of mouth from these audiences to then spill over to other markets and help propel sales to greater heights. Jimmy Iovine, Interscope's chairman, talks about capitalizing on "sparks": the idea is that if an entertainment product resonates with audiences in a given market, that market can, with the right kind of support, become a launching pad for a

wider rollout. In the case of Gaga's debut album, for instance, Iovine and his colleagues thought initial conditions were most promising in Canada and Australia, which is why they rolled out the album there first—not in the United States.

By their very nature, social networks and video-sharing sites are uniquely suited to enhance any early buzz around a product or artist; indeed, such sites now play a critical role in many grassroots releases. That certainly was the case for Gaga. "Where other people see digital distribution as a source of cannibalization, we see it as an opportunity," Carter said. "The Beatles, Michael Jackson, and Madonna didn't have Facebook or Twitter. We wanted to use those new tools." Gaga began using both sites in March 2008, right before *Just Dance* was released. Carter and his team arranged for fifty popular music bloggers to interview Gaga in the six months following the *Just Dance* launch; during that period, these interviews alone totaled over ten million impressions.

Using a more novel tactic, Gaga's team also initiated a series of two-minute videos, dubbed *Transmission: Gaga-Vision*, on Gaga's official YouTube channel. "There were fans that discovered her as early as April, and others that came on board months later," recalled Campbell. "Because she is such a visual artist, we felt we had to keep the visual fresh even if we did not release another single. So we put out a series of 'webisodes' that followed her around and gave a peek behind the scenes. It wasn't overly produced, and in fact mostly shot on a flip-cam—the idea was to create intimate moments that make you feel like you were there with her." Atom Factory's digital team worked to syndicate Gaga's content, from her tweets to her music videos, as widely as possible and made sure it got covered by other media.

As is the case with most limited releases, success came gradually. *Just Dance* broke into major charts for dance airplay and club play two months after its release; another two months passed before it entered the Billboard Hot 100, the main singles chart in North America. The song then spent the next five months working its way to the number one spot, which it reached in January 2009. *Just Dance*'s nine-month-long journey up the charts was the

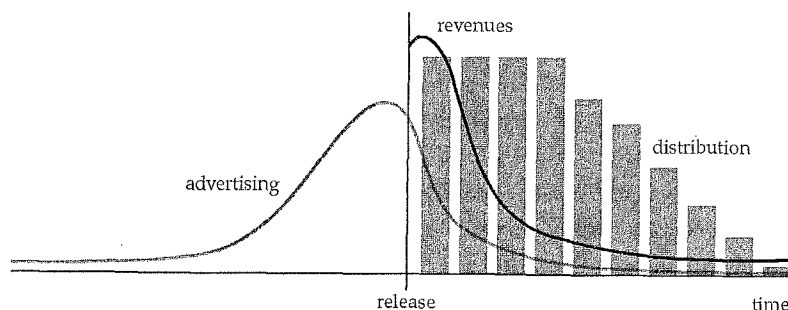
second-longest climb to the top spot in Billboard's history. By that time, *Poker Face*, a second single from the album that was marketed in much the same way, was moving up the charts right behind it.

Despite all the advantages that go along with a limited release strategy, however, most blockbuster bets in entertainment are released using what is known as a "wide" or "mainstream" release strategy. Wide releases, as suggested by the chart below, are not designed with efficiency in mind; instead, the goal is to "break through the clutter" and immediately capture the attention of as large an audience as possible.

For products launched in this manner, distribution levels start at a high level, while most promotional activities are concentrated at the time of release—or, to be more precise, in the short period leading up to the release. As a result, sales often peak immediately after launch and then taper off quickly. A successful opening is seen as critical: a failure to reach an acceptably high level of sales early on generally dooms a widely launched new movie, a new recording, or any other type of entertainment product.

Hollywood's event films are perhaps the best example of products launched this way. Major studios have the scale needed to make high up-front investments in advertising and marketing at a time when no sales are being generated. They start promoting a

A Wide Release Strategy



film months—and, if we include teaser trailers, sometimes years—in advance of its opening weekend. Spending ramps up dramatically in the six to eight weeks before release: a studio will spend as much as two-thirds of its marketing budget on television commercials in the final two weeks before a film's opening. And since some of Hollywood's biggest films open on four thousand screens or more across the nation, their first week of release is often also their biggest week in terms of revenues. In 2011, for example, the top hundred films, from *Harry Potter and the Deathly Hallows: Part 2* to *The Iron Lady*, collected 30 percent of their total of \$9 billion in domestic theatrical revenues in their first week alone.

As soon as Carter and his team had the opportunity, they opted for a wide release for Lady Gaga's music, too. Released in May 2011, *Born This Way* was shipped to an unprecedented twenty thousand locations across the United States—not just conventional music retailers but also coffee chains like Starbucks, electronics retailers such as RadioShack, and grocery stores and drugstores such as CVS and Walgreens. A long lead time made this possible: in 2010, knowing they would need months to pull off a launch of this scale, Carter and the Interscope executives convinced Gaga to push back the release date. "Normally there is a three- or four-month lead time, but we announced the album release seven months in advance," Berman said. "We wanted to put a stake in the ground." Gaga was initially less than thrilled about this plan, Carter recalled: "I still remember her crying her eyes out at the thought of having to wait this long."

Why put Gaga through this misery? Why do Carter and almost every other executive and manager in the entertainment industry, when given the chance, prefer to push for big openings by spending heavily on advertising and distribution, rather than increasing marketing expenditures more gradually? The reason is simple: all else being equal, the odds of achieving success in the marketplace are higher with a wide release strategy than with a limited release approach. That, in turn, follows from the very nature of entertainment products—and, in fact, from several of the same

songs never did terribly well (even when the rankings began inverted, the very best songs eventually made their way back to the top), any other scenario was possible.

The ultimate success of an entertainment product, Watts and his colleagues revealed, is extremely sensitive to the decisions of a few early-arriving individuals: if consumers making decisions about a product later in its life cycle can see whether that product is popular, they amplify the choices of those early consumers. The result is what Watts calls a "cumulative-advantage process," which helps explain the high unpredictability of the demand for popular-culture goods. Successful songs, movies, books, and artists are not necessarily "better," Watts argues; rather, what people like depends on what they think other people like, and what the market "wants" at any point in time depends on its own history.

Faced with this dynamic, executives will do everything they can to gain the upper hand in a battle with their rivals right from the time of launch—which means opting for a wide release strategy. Achieving scale from the moment of introduction is critical. In the case of *Born This Way*, for instance, it would be very risky to rely primarily on word of mouth: any loss of traction with initial audiences could seriously hinder the album's launch. Especially with a high-profile artist like Lady Gaga, attempting to raise a high level of awareness among the largest possible audience in advance of a new product's release is in fact the safest approach. "We chose a big launch because we could," is how Interscope's Berman put it. "Leave no stone unturned" was Carter's motto ahead of the *Born This Way* campaign: in other words, use every opportunity to make the launch as big as it could be. Similarly, no film-studio executive in his right mind will launch a \$200 million movie on a few screens in the hope that word of mouth carries the picture to a wider audience. Smart executives will do what is in their power to create buzz and open big, so as to avoid their products losing the battle for early adopters.

The preference for a so-called push strategy involving wide distribution and high advertising intensity has everything to do with a second characteristic of entertainment products: their expe-

riential nature. This is not to say that consumers will mindlessly choose whatever is put in front of them just because they cannot reliably assess product quality before the moment of consumption, but wide distribution and marketing can make a substantial difference. "In the business, we say 'you can buy an opening weekend,'" Horn said. "You can spend so much that audiences will show up. It will be disappointing for you and for them, but you can get them in those seats."

In the movie industry, study after study has shown that the best predictor of a movie's revenues is the number of screens on which it plays. Sophisticated statistical models (some of which I developed in my own research) that are designed to tease out the tangled effects of factors such as genre, star power, seasonality, competition, and advertising invariably demonstrate that, all else being equal, an increase in the level of distribution is the most effective way to increase sales. Higher advertising expenditures help, too: advertising not only directly increases sales by triggering audiences to buy tickets, it also indirectly drives sales by reassuring theater owners that dedicating screens to a movie will be worth their while. In the music industry, radio airplay—the main way through which new music is promoted—continues to be a critical predictor of recorded-music sales. And in book publishing, distributing a large number of physical books remains a classic tactic.

The fact that entertainment products are experience goods also explains the important role critics can play. Potential customers typically value the opinions of others who have already read, listened to, watched, or otherwise interacted with a product. Because judgments about the quality of these products are inevitably subjective, people tend to trust experts to tell them what to like. But the tastes of regular consumers matter as well, which is why Facebook, Twitter, and other online sharing tools, although mostly associated with grassroots releases, are just as relevant to wide releases. Because social networks make it possible to spread information and opinions about new products across the globe instantaneously, and because entertainment executives are often keen to benefit from that buzz, online sharing mechanisms can fuel ever bigger releases.

A third feature of entertainment goods is that in general they are relatively expensive to produce but cheap to reproduce. The first copy of an album (the “negative”) often costs hundreds of thousands, if not millions, of dollars to produce. But once a record label has the first copy in hand, the company has to spend only a fraction of that amount to create more copies and distribute them—each physical record sent to retailers costs a few dollars at most, and even less if the album is distributed online. Not only does this make blockbuster products disproportionately profitable (the more copies sold, the lower the production and distribution costs per copy sold), it also makes media producers eager to earn back their investments sooner rather than later. With so much money tied up in their projects, time is of the essence.

In some entertainment sectors, a wide release also makes it easier for media producers to plan multiple revenue windows, allowing companies to reap further rewards from hit products that carry low marginal costs. In the movie industry contracts between studios and theater owners are often specifically designed with wide releases in mind. Revenues can be shared on a sliding-scale basis, whereby studios receive a higher (and exhibitors a lower) percentage of revenues in the early weeks of a film’s release—giving studios yet another reason to aim for big openings. And such launches help protect executives from changes in audiences’ tastes in genres, stars, or other product features. The hunger for popular culture items can fade quickly—most are essentially “fads” or “fashions.” But some entertainment products are especially perishable or timely—think of a book about a politician running for election, or a new song by an artist who has just won a Grammy Award. For such products, if the necessary resources are available, experienced entertainment executives will favor a big launch over a limited campaign that plays out over many months.

All in all, just as blockbuster bets at first glance seem risky but upon closer examination may in fact be the safer choice, releasing those bets in a manner that emphasizes big openings may seem to only heighten the risk but is often the smartest approach. Such

launches are not for the faint of heart because they require huge up-front investments. With a wide release, entertainment executives are effectively doubling down on their investment. But they also increase the probability of achieving mainstream market success—which, of course, is critical to the profitability of blockbuster bets.

For Lady Gaga, the meticulous preparation for a massive launch paid off in spades. Carter and his team used the long buildup to the *Born This Way* launch to take advantage of a series of high-profile, attention-grabbing events to which the superstar had been invited in early 2011, including the Grammy Awards, a taping of *American Idol*, and the season finale of the television mainstay *Saturday Night Live*. And team Gaga worked closely with retailers, super fans, the media, and a variety of other partners in a concerted effort to help grow awareness for the album and make sure that it would be readily available for prospective customers.

Released on a wider scale than any other album in 2011, *Born This Way* sold 1.1 million units in its first week, making it just the seventeenth album to reach the one-million-copies-a-week benchmark since Nielsen SoundScan began tracking such data in 1991. Some say the sales total paints an unfair picture of the album’s “true” popularity, as online retailer Amazon sold an estimated 440,000 units for just 99 cents to promote its new cloud-based music service. But those critics overlook the fact that Amazon paid the same wholesale price that other retailers did and fully absorbed the resulting loss—as good an indication as any of Lady Gaga’s star power and the level of anticipation for the album. Within a year of its release, the album sold well over two million copies; during the same period, eighteen million copies of the album’s songs were sold. Whether Lady Gaga would have sold fewer copies had her team opted for a more gradual release is impossible to say, but her team did not want to risk finding out—and rightly so.

Most creative goods, of course, are released on a much smaller scale than Lady Gaga’s album, yet many of these products have made a significant difference in the world of popular culture. The

characteristics that drive major media producers' taste for blockbuster portfolio strategies.

First, because people like winners—because they prefer to consume entertainment products that are also chosen by others—a solid opening is often a huge factor in a rollout. For media products, initial success breeds further success, while a failure to achieve success early on frequently means having no chance to succeed at all. Alan Horn knows all too well how this dynamic works in the film industry. “We always found out how we did on opening weekend,” he explained. “For a film released on a Friday, I’d get a call that same night at eleven o’clock saying ‘Well, it is over.’ And I’d say, ‘When you say it is over . . .’ but before I could even finish they’d go, ‘No, no, it is over!’ For some of our event films, they’d tell me, ‘We are done. We have just lost \$100 million.’” When Disney’s \$250-million-budget *John Carter* generated a disappointing \$30 million in revenues in its first weekend, trade magazines called it a “fiasco”—a full two days into its run—and audiences fled. Within a week, Disney had issued a report stating it would take a \$200 million write-down.

In the film industry, with its tradition of publishing sales figures weekly, each weekend’s winner is ensured a great deal of free publicity. Opening-weekend revenues are a quality signal for subsequent moviegoers, and most customers (and indeed most reporters) pay little attention to the fine print, such as how many theaters were necessary to achieve the total grosses, or how much was spent on advertising. By contrast, the movies that, for whatever reason, fail to open well in their first week are immediately considered “losers.” They are quickly whisked away to smaller screens at the theaters or disappear from view altogether, only to make room for a new set of movies hoping to capture people’s attention from the very start.

But even in sectors where sales figures are harder to come by, we see similar patterns. In book publishing, if new titles fail to catch on, they are often pulled from the shelves in a matter of weeks. Extensive marketing campaigns and the star power of established authors can help place books in prime spots in book-

stores across the country, but they suffer the same fate if they do not open well. On Broadway, underperforming plays, no matter if they cost millions of dollars to produce, are regularly replaced after only a few weeks of disappointing ticket sales. Even Lady Gaga, for all her success, scrambled to release a third song in advance of her album *Born This Way* when the second, *Judas*, underperformed in the market.

Social influence is a powerful force in markets for popular culture. Because we are social beings, people tend to want to listen to the same music that others listen to, read the same books, and see the same movies. Simply put, we repeatedly show a preference for popular products. That tendency, economists have shown, can tip the scales in favor of those products that perform well at the outset—even if the difference between the top performers and the next level down is slight. If one product edges out a rival for the number one position in its first week, that success may become a topic of conversation at the water cooler and ultimately make a huge difference across a product’s entire run.

Even products that have no discernible quality differences can, as a result of these forces, experience very different outcomes in the marketplace—luck alone might lead to an early break. The sociologist Duncan Watts has proved this point convincingly. By conducting a set of experiments involving an artificial market for songs, he and his colleagues found that social influence played as large a role in determining the market share of successful songs as actual differences in quality. The experiment was designed to measure varying degrees of social influence: for instance, some respondents could see how many previous participants had downloaded a particular song while others could not, and some respondents saw a list ranked by song popularity while others saw a random listing. In one study, Watts and his colleagues presented respondents with false information—they showed a ranking that was completely inverted from what the download pattern of previous listeners actually looked like. What the study revealed was that while the “best” songs never did very badly and the “worst”

work of a small New York-based label is a case in point: Octone Records is among a select group of music companies that has perfected the art of creating hits with limited resources—and along the way demonstrated the value of a novel “hybrid” model that marries the strengths of both wide and limited releases.

**A**lthough he had the deep passion for music required for the job, James Diener never was your typical record-label executive. He mingled with top players in the private-equity sector, read *Harvard Business Review* articles just to keep up with the latest management thinking, and wasn't afraid to try a different model of creating hits in a collaboration with music-industry legend Clive Davis. Diener, who began his career at Columbia Records and rose to the position of vice president of A&R Marketing at the label, had started Octone in 2000 to put a new philosophy on how to launch music to the test. By 2007, after Octone had hit home runs with the first two bands signed—the pop-rock quintet Maroon 5 and the alternative rock band Flyleaf—music-business insiders were following the small label's every move. Initially rejected by the major labels, Maroon 5 had garnered both commercial and critical success, selling ten million copies worldwide of its 2002 debut album *Songs About Jane* and winning the prestigious Grammy Award for “Best New Artist.” Flyleaf's first album, meanwhile, had reached gold status with more than five hundred thousand albums sold, and was heading toward the million-units platinum mark.

With Diener in the role of chief executive officer and president, David Boxenbaum—fresh off a career as a strategy consultant at PricewaterhouseCoopers and sporting an Ivy League MBA—as general manager, and Ben Berkman as executive vice president and head of promotion, Octone was based on the belief that once a decision was made to sign an artist, it was the label's job to do everything possible to realize the artist's full potential. The team believed that most major labels were impatient, dropping acts too soon and failing to dedicate sufficient resources and efforts to

building their audience. “When I worked at Columbia we signed a lot of acts that didn't get a decent shot,” Diener told me. “I wanted to change that.”

Octone introduced an innovative model that borrowed the best practices from both independent and major labels. The idea was simple. Octone would focus its efforts on just a few artists each year. Initially, like most independent labels, the company would rely heavily on grassroots marketing campaigns to gradually build its artists' fan bases. But once artists succeeded to the point that they were on the verge of breaking through, the company's distribution and marketing efforts would enter a second, more aggressive phase. To make this phase possible, Octone structured a unique joint-venture model with Sony BMG Music Entertainment, a major label that at the time had revenues of \$1.75 billion and the second-highest share of the recorded-music industry (behind Universal Music Group). Diener had successfully pitched the idea of the partnership to Clive Davis and his colleagues at Sony BMG after the famed music executive, responsible for guiding the careers of superstar artists such as Whitney Houston and Bruce Springsteen, courted Diener to leave Columbia Records. Diener took on two roles: he became a full-time senior vice president of A&R and marketing at Sony BMG's J Records while also running Octone.

Under the terms of the partnership, Octone shouldered the initial costs of discovering and promoting its artists. Octone's acts remained exclusively on Octone's profit-and-loss statement until a so-called uplift into the joint venture took place. Artists could get uplifted in three ways, Diener explained. “First, if an artist reaches 75,000 records sold, Octone can elect to uplift the artist into the joint venture, and Sony BMG is required to accommodate this decision. Second, if an artist reaches 125,000 records sold, Sony BMG can compel us to uplift the artist. Third, both parties can mutually agree on a natural time in a project where it becomes appropriate to step in.”

Before an artist's uplift, Octone received all revenues and paid the artist's advances, all expenses related to recording the album, manufacturing costs necessary to physically produce the album,



tour support, promotion and publicity, and other fees. But after the uplift, Sony BMG was responsible for all new costs, be they distribution, promotion, or sales efforts. From this moment on, Sony BMG and Octone equally split the profits, while Sony BMG covered all losses. Post uplift, Octone continued to provide creative and marketing direction to Sony BMG's efforts, but its options for forcing Sony BMG to action were limited. "The risk in uplifting an album is that you lose total control," said Boxenbaum. "It can be a challenge to manage a relationship with a partner label."

Crucial to the launch of Octone were Laurence Fink, the chief executive officer of investment management firm BlackRock, and Howard Lipson, then senior partner at prominent private equity firm The Blackstone Group. Diener had met Lipson and Fink in 1999 and asked them to fund the proposed new record label. Successful Wall Street financiers and avid music fans, they solicited a group of private equity investors and raised a total of \$5 million in initial working capital. "We should have lost all of our money," recalled Fink. "The business conditions in the music industry are very difficult and there are sea changes going on that are seismic. However, Octone shows that you can beat the trends."

"Many independent labels did not have sufficient funds to execute their ideas or were going to run out of money before they could make it," added Lipson. "Therefore, they had to rely on an economic affiliation with a major label in which the major controls everything and the upside for the independent label is limited. Octone was well-capitalized, so we knew we had time to reach a certain level and fulfill our mandate. There was nothing we could do to guarantee success, but we set Octone up so that it could succeed."

For all its success in beating the steep odds of scoring a hit in the music industry—most record companies recovered their investments in only one out of every five or six new albums—Octone had not traveled a perfectly smooth road. Success had proven elusive for the third artist on its roster, Georgia-based singer-songwriter and guitarist Michael Tolcher. Although Octone spent over \$750,000 marketing Tolcher's first full album, *I Am*, it sold only one hundred

thousand copies, not enough to recover the costs incurred. Now, as they contemplated their next move, Diener and his colleagues faced three options. They could "grind it out," industry parlance for supporting the debut album over a prolonged period by leveraging the small beachhead of fans Tolcher had established on his last US tour in 2006; they could increase the stakes by backing a second album; or they could cut their losses and instead focus on other artists.

Is there a logic behind Octone's efforts to pursue a hybrid model that combines a grassroots with a more mainstream release strategy? Is such a model the answer to the entertainment industry's woes when it comes to consistently creating hits? Finding answers to these questions starts with the realization that, in most entertainment markets, a content producer's scale and its product-release strategy are closely linked. The larger a media company, the more it can afford to put significant marketing efforts behind a product in an attempt to create a hit. But scale also comes with disadvantages. And both those advantages and those disadvantages explain what Octone executives are attempting to do, and whether their model may be here to stay.

Smaller and larger content producers are different in their approaches. First, they vary in terms of the number of products they bring to the market. In the music business, major labels—the industry's biggest powerhouses, such as Sony BMG (now called Sony Music)—tend to have hundreds of artists on their roster, including multiple bestsellers. Alicia Keys, Beyoncé, John Mayer, Britney Spears, and Justin Timberlake were some of the artists on Sony BMG's roster at the time the executives at Octone were trying to determine their next step. Small "indie" labels, on the other hand, tend to have only a few artists. That, in turn, can mean that the success of one artist is essential to the small label's overall fortunes. For all its success, Octone heavily depended on its number one act, Maroon 5: the superstar band brought in more than \$10 million in annual profits in North America alone.

Second, while larger players will often prune products quickly



after a failed market launch (Sony, for instance, might terminate up to forty underperforming artists in a given year), smaller producers tend to support their products over a relatively long period of time. Larger labels typically do not invest a great deal of time in an album by a new, unproven artist; their strategy often comes down to giving an act one big push to see if the music catches on with fans. Because a major label has abundant resources and several blockbuster artists, it can afford to take a home-run swing and miss. Because of its high overhead costs, a major label also *needs* quick successes: it may not have the patience that is necessary to “break” an act through a series of small victories over a long time horizon. After all, the “next big act” in the label’s portfolio is always awaiting its turn.

By contrast, smaller labels like Octone are more committed to developing artists longer. “We tend to stick with our artists,” is how Diener described it. Octone both can *and* has to do so because of its smaller roster. It *can* afford to spend more time on its artists. According to Boxenbaum, the label’s lower costs—in 2007, it counted only ten employees—and its freedom from the pressure of quarterly earnings reports allow the Octone team to take its time to nurture each project. But it also *has* to make things happen with each of its artists for its model to work: it has limited content to fall back on if one of its new releases were to fail. “We put ourselves in a position of having no choice but to push harder to make our releases work,” noted Boxenbaum.

These differences affect how content producers typically release their products. The larger label’s wider portfolio and focus on short-term success are suited to a more mainstream release approach built on distribution and marketing strengths. Major labels often stage elaborate marketing campaigns before and around the launch of albums, usually involving a strong push for radio and video airplay and other forms of advertising and securing shelf space in large music and mass-market stores—much like the campaign for Gaga’s *Born This Way* album. Meanwhile, smaller labels rely heavily on grassroots marketing techniques, such as using

“street teams” of fans who have volunteered to promote the band (and are often recruited via the Internet and at concerts), social-networking techniques, distribution through small record stores (those that do “not just stock but actually *sell* records,” as Boxenbaum once put it), and extensive touring to refine an artist’s sound and gauge fan interest. These techniques go hand in hand with a gradual rollout of artists and their music, which fits Octone’s style of fostering deep connections with fans—much like Lady Gaga originally built a relationship with her fans.

Diener understands the advantages of scale as well as anyone: “Major labels are essentially in the volume business. They have the resources to push artists via mainstream outlets, and they have the ability to achieve economies of scale once sales momentum has been created. There is a reason that the majority of records sold today is distributed by major labels. Most independent labels are not well funded, and most owners or operators of those independent labels do not have the expertise of major labels.”

But he also knows that smaller labels can really nurture artists they feel hold artistic promise, even if it means forgoing early profits. “They excel in specialized artist development and marketing strategies, often employed over longer time horizons, that have launched many of today’s biggest selling artists,” remarked Diener, who pointed out that music that crosses established genres or otherwise does not fit the mainstream mold of the music industry usually comes from smaller labels. Smaller-scale producers may be better positioned to innovate—or, to put it in familiar terms, they may be less likely to fall into the blockbuster trap by spending big on acts that sound just like past winners. It’s telling that Adele, who sounds and looks very different from any other artist that dominated the charts before she did, was nurtured by an indie label, XL Recordings. Any music company hoping to copy her phenomenal success will find it has to pay top dollar for artists that could be “the next Adele.”

Clearly, then, a partnership between a larger and smaller content producer, when structured in the right way, can bring the best

of both worlds together: the smaller producers' ability to innovate, and the larger producers' power to market those products to a mass audience. For a smaller player like Octone, being able to tap into the distribution and marketing strength of a behemoth like Sony BMG brings substantial advantages. As Diener put it: "When artists are on the verge of breaking through, there is nothing like the marketing power of a major label to bring that final push." Boxenbaum agreed: "There are independent labels that have no relationship with major labels. They are just out there plodding along, they are surprised when an album starts to take off, and then they are stuck because they cannot take their campaign to the next level."

Octone's joint venture solves that problem. It helps the label to secure shelf space in retail chains such as Walmart and Target that rarely take risks on new artists, and to get the artists' songs played more on popular radio stations and video networks—the kinds of marketing actions that are commonplace for the major labels. Although borrowing Sony BMG's marketing power comes at a significant cost—half the profits—Octone is banking on sales to be elevated to such an extent that they will make up for the lost share of profits.

That is what seems to have happened with Maroon 5. Signed by Octone to a five-album deal in 2001, the category-blurring band entered the studio that same year. The resulting album, *Songs About Jane*, featured pop rhythms, classic soul melodies, searing guitars, a powerful rock undercurrent, and lead singer Adam Levine's expressive voice. The record was completed in February 2002 and released in the summer of that year. But generating radio airplay and sales proved far from easy. To remedy the situation, later in the summer of 2002, Octone organized a so-called branch tour that enabled invited radio station programmers and regional managers of record retailers to see the band perform, identified a number of retailers that received discounts and marketing support, and set up a tour schedule that ultimately lasted an almost unheard-of three years and involved opening shows for more established bands—it fought a "ground war," as one Octone execu-

tive put it. The strategy worked: in the spring of 2003, Maroon 5 fulfilled the uplift requirement.

Sony BMG then stepped in to fund all of the band's promotion, sales, and marketing activities and helped bring the band into more mainstream record stores, radio stations, and concert venues. From that moment forward, sales of the album took off. Helped by the marketing push, the record rapidly ascended the charts—domestically and internationally. At the height of its success, in December 2004, *Songs About Jane* sold well over 100,000 copies in a single week. It also yielded four hit singles, including *This Love* and *She Will Be Loved*, which together topped the charts for ten weeks in 2004. The album ultimately achieved quadruple platinum status in the United States, and reached gold or platinum status in over thirty-five countries.

The partnership wasn't just worthwhile to Octone; Sony BMG benefited, too. For them, the partnership reduced risk. "The dollars spent by Octone, prior to uplift, are the riskiest in the project," Diener said. "Those spent by Sony BMG at the moment of the uplift are some of the surest dollars spent in the music business." In the early stages of an act's career, it's difficult to know how the group's music will be received in the marketplace. By the time Sony BMG enters the picture, the band has already shown its ability to sell records. This is market feedback a label executive can rely on, thus making any further investments in the band safer than those in any untested new act. The lowered risk comes not just from the level of sales achieved; it is also the result of having a base of dedicated fans, name recognition, and greater sophistication about how to handle the media. "By the time of the uplift, Sony BMG can be confident that our artists have done two hundred photo shoots and two hundred interviews, and know how to tell their story to the press. They also have improved a great deal as performers and know how to connect with an audience either in a large concert hall or in a more intimate venue such as a club," Boxenbaum explained.

Are these gains worth the trouble for Sony BMG? Could a major label not establish one or more separate divisions that function

much like Octone does, each being responsible for a small roster of artists, so as to avoid having to share half of the upside of an uplifted artist? That surely is a possibility. But fully merging the cultures of a major label and a smaller one can prove challenging, and managing the costs of such "R&D divisions" can be tricky—Sony BMG would have to have a high rate of success in developing and nurturing artists in order for this strategy to be effective. A partnership like the one with Octone encourages Sony BMG to be more disciplined in making development and marketing investments: Octone's efforts allow Sony BMG to pick its battles.

The worth of Octone's model to major labels became apparent in early 2007, when Universal Music Group's Jimmy Iovine proposed to buy out Sony BMG's share in the joint venture and so bring Octone over to Universal. The offer established Octone's valuation at approximately \$70 million. Diener's team accepted the proposal and soon relaunched their label as A&M/Octone under the Universal banner.

Lacking the necessary resources to support a product on the verge of taking off is a key problem for many smaller content producers. But there's an issue they struggle with far more often that could ultimately prove more costly—that of not knowing when it is wise to stop investing in a product that is *not* quite catching on. Octone was experiencing that problem firsthand with its third act, Michael Tolcher.

An artist who hailed from Lovejoy, Georgia, Tolcher was in the midst of a string of cross-country gigs in clubs, bars, coffeehouses, and parties when Octone's executives discovered him in July 2002. They liked what they heard of a subsequent demo recording but still found him to be a little unpolished. "Some bands are very slick from the get-go and they have a lot of experience with production equipment and studio boards, but Michael was different," Boxenbaum recalled. "We didn't want to rush out a commercial recording before he was ready." Octone sought to strengthen Tolcher's fan base by arranging opening shows for such established artists as

Crosby, Stills and Nash, Sister Hazel, and Everclear, and by creating opportunities to play in small clubs and bars.

Tolcher's time on the road inspired many of the songs on his first full album, *I Am*, which was released in May 2004. By 2006, Tolcher was back on the road, touring extensively and accompanying Michelle Branch, Maroon 5, Gavin DeGraw, and numerous other acts. He also made television appearances on *Jimmy Kimmel*, *Last Call with Carson Daly*, and several network morning shows. Tolcher's single, *Mission Responsible*, received some airplay on the radio but the attention proved short-lived. By early 2007, *I Am* had sold a total of a little less than one hundred thousand copies, a lackluster performance given that he had been uplifted after the album achieved seventy-five thousand in cumulative sales. Worse, Octone's losses on the artist now totaled around \$800,000—and they were increasing every day.

Octone's predicament with Tolcher illustrates the difficulty in knowing when to stop investing in a product or artist launched using grassroots techniques. That's the critical issue with such limited releases: success could be just around the corner, in which case investing more seems the right thing to do, as it was with Maroon 5. But it is also possible that success may never come, in which case each additional dollar spent is a waste. Because the signals coming back from the market are noisy at best, it is virtually impossible to determine the right course of action. Boxenbaum, with all his experience in the music industry, realizes this all too well: "The great artists and the bad artists are easy—it is the good artists that can kill you. With the great artists you just keep putting fuel in their tank. With the bad artists, you realize your mistake quickly and cut your losses. It is the good artists that bankrupt you because they are good enough to make you think they are about to turn the corner and therefore keep you spending."

Octone—by then A&M/Octone—ultimately decided to give the artist one last push. The label released a new single, supported by heavy online and video promotions. However, the efforts did not generate the market response the executives hoped for, and in

2008 Tolcher was released from his contract. Knowing when to pull the plug on an investment, Diener and Boxenbaum have found out, can sometimes be the most critical decision of all. This is especially important in the entertainment business, where the odds of success for any given product are so low.

Fortunately, the label's blockbuster act Maroon 5 fared much better. Relying on Universal's distribution and marketing resources, A&M/Octone released the group's second album, *It Won't Be Soon Before Long*, in the spring of 2007. Featuring a duet with pop star Rihanna, the album debuted at number one on the Billboard album chart and went on to sell over four million units worldwide, earning the band two more Grammy Awards. The band's third album, *Hands All Over*, got off to a more modest start, but received a huge boost from the success of its fourth single, *Moves Like Jagger*, which became the ninth best-selling digital single of 2011 with worldwide sales of seven million copies. Lead singer Adam Levine's turn as a star judge on NBC's *The Voice* further propelled the band—and its appropriately named fourth album, *Overexposed*, released in 2012—into the mainstream market.

Meanwhile, Diener and his colleagues continued doing what they do best: helping a select roster of new artists find an audience. And thanks to their partnership with Universal, the A&M/Octone executives can be confident that they can ramp up quickly the moment they strike gold.

### Chapter Three

## INVESTING IN SUPERSTARS

In June 2009, Florentino Pérez, president of renowned Spanish soccer club Real Madrid, finally got his wish—and so did the object of his desire, the reigning world player of the year, Cristiano Ronaldo. Completing what Pérez described as a “dream move,” Real Madrid purchased the twenty-four-year-old Ronaldo for a record transfer fee of \$125 million, to be paid to his previous club, Manchester United, and the promise of a rumored annual salary of more than \$10 million. Earlier that month, the Madrid club had acquired Brazilian midfielder Kaká for a lower but still jaw-dropping amount—\$92 million—from AC Milan. But Ronaldo, who had racked up an impressive tally of well over one hundred goals in nearly three hundred games for Manchester United, had long been Pérez's top target.

The recruitment of Ronaldo was in many respects a return to what Pérez had termed his *Galácticos* strategy, a forceful effort to attract some of the world's biggest stars to his club. Galacticism reached its peak when twenty-eight-year-old David Beckham, one of the sport's towering names, was added to an already star-studded team that consisted of the Brazilians Roberto Carlos and Ronaldo Luís Nazário de Lima (commonly known simply as Ronaldo and