# Sony and Loews

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In April 1998, officials at Sony were ecstatic. The Department of Justice (DOJ) had agreed to allow their theater division to acquire a substantial interest in Cineplex Odeon. Under the terms of the agreement, the new Loews Cineplex Entertainment would have to sell 25 theaters in Manhattan and Chicago, but would retain a dominant presence in both major markets. Joel Klein, the DOJ's antitrust chief, described the settlement as "a big win for movie-going consumers."

Sony also thought it was a big win. The company would own just under 50% of Loews, giving it access to over 2600 screens in North America. The purchase was the latest step in adding exhibition capability to its strong position in movie production. Howard Stringer, president of Sony Corporation of America, noted that Sony Pictures Entertainment would be not only the top movie production company, but would be positioned to become "the global leader in theatrical exhibition" (Sony press release). Theaters were not Sony's primary business, but they appeared to fit well into its overall corporate strategy of combining hardware (consumer electronics) and software (music and movies).

Three years later, Loews was bankrupt. Was this simply bad luck, or was Sony's downstream integration into exhibition a bad idea from the start?

**Early History of US Film Exhibition**

In 1904, Marcus Loew introduced the "nickelodeon" cinema to the United States, laying the foundation for the Loews Theatre chain. (See Exhibit 1.) As he expanded, Loew sought to provide content for his movie houses and purchased a silent movie studio called Metro Company. In 1924, he joined forces with Louis B. Mayer and Samuel Goldwin to form the Metro-Goldwyn-Mayer studio. MGM grew into one of so-called Big Five movie studios, the others being Paramount, RKO, Twentieth Century Fox, and Warner Brothers.

The Big Five dominated the growing film industry for decades and produced such classic films as "Metropolis," "Gone with the Wind," and "Casablanca." One key to their success was the studio system, under which studios controlled a film's production, distribution, and exhibition. Actors, directors, and writers all worked for the studios, typically under seven-year contracts, which included studio options to renew or terminate. The studios realized that control over distribution and exhibition guaranteed an outlet for their product. While studios didn't own all the theaters, they owned a substantial percentage of the larger and better-located ones. Paramount, home to such stars as Bob Hope and Bing Crosby, was typical. It owned more than 1000 theaters during the 1930s and 1940s, investing in palatial exhibition halls in major cities to showcase its products.

The studios loved this system, but the DOJ was concerned that complete vertical integration was anti-competitive. One concern was that control over exhibitors might act as an entry barrier to small film producers, who might be locked out of studio-owned theaters. Another was that independent theaters might not have access to the same films, at the same terms, as studio-owned theaters, potentially putting them at a competitive disadvantage that could force them from the business and ultimately reduce competition among theaters.

The DOJ won a landmark Supreme Court decision against seven major motion picture companies in 1948. The court decided in the "Paramount case" that the studios conspired to fix minimum theater admission prices; fix patterns of runs at theaters; and restrain trade by licensing motion pictures in blocks (take all our films or get none). While allowing the possibility that studios and theaters could in principle be under the same ownership, the court found that the defendants had unreasonably restrained trade. "It is clear," wrote Justice William O. Douglas for the 7-1 majority, "so far as the five major studios are concerned, that the aim of the conspiracy was exclusionary; i.e., that it was designed to strengthen their hold on the exhibition field" (US v Paramount, 1948).

The Court suggested that the district court revisit a previous determination that the studios divest themselves of theaters. The DOJ signed consent decrees with RKO in November 1948, Paramount in early 1949, and the others by the end of 1949 in which the studios agreed to divest themselves completely of their theater chains and eliminate the practice of block booking.

**Post-Paramount Reintegration**

The consent decrees that followed the Paramount decision were rigorously enforced for several decades. In the 1980s, however, the DOJ began to approach vertical and unrelated horizontal mergers with less antagonism. The DOJ continued to uphold the consent decrees that followed the Paramount decision, but signaled it was willing to consider exemptions to the prohibition of studio ownership of theaters.

With the door open, Columbia Pictures bought a 58% stake in New York-based Walter Reade theaters in 1985. Meanwhile, Loews Theatres became the Loews Corporation, a diversified holding company with interests in cigarettes, hotels, and transportation. In 1985, Loews left theater exhibition altogether, selling its 350-screen circuit to a privately held company. The chain was subsequently purchased by Tri-Star Pictures and then merged into the entertainment division of Coca-Cola, which had purchased Columbia Pictures. Other film producers followed the same path. In 1986, Universal's parent MCA invested $75m in Cineplex Odeon, then the second-largest theater chain in North America, and Paramount bought 119 theaters. By the end of the decade, the largest theater chains were United Artists (65%-owned by TCI), Cineplex Odeon Corp (50%-

owned by MCA), AMC, General Cinema, Loews (a subsidiary of Columbia, which was 49%-owned by Coca-Cola), and Carmike (*Wall Street Journal*, February 9, 1989). There was far less integration than in the 1930s, but integration was no longer a legal impossibility.

In 1989, Coca-Cola sold Columbia Pictures to Sony in 1989 for $3.4b.

**Sony**

Sony is one of the world's leading consumer electronics manufacturers. To complement its strength in "hardware," the company moved aggressively into "software" in the late 1980s, buying CBS records in January 1988 before purchasing Columbia Pictures from Coca-Cola. While Sony was attracted primarily to Columbia's television properties and film library, the Loews theater chain also filled a niche. As the Associated Press put it: "Sony will own or produce the movie, the movie theater, the snack bar, the soundtrack album, the television series adaptation and the VCR and stereo system on which the videocassette and album can be played."

Prior to its purchase of Cineplex Odeon, Sony had 1,038 screens in 139 locations. Theaters were primarily under the Sony and Loews brand names, though a partnership with basketball star "Magic" Johnson led to the first Magic Johnson Theatres complexes in Los Angeles. Sony focused its efforts on making each location as unique and profitable as possible. A good example was the Sony Theatres Lincoln Square complex at Broadway and 68th Street in Manhattan, a 12-screen state-of-the-art complex with an IMAX theater with 3D video and advanced sound.

Loews was part of an increasingly successful pictures division, generating between 7 and 10 percent of the company's revenue in the mid-1990s with feature films and syndicated television shows ("Wheel of Fortune," "Jeopardy"). "Men in Black" and "Air Force One" helped make 1997 (fiscal 1998) the most successful ever in the industry, with Sony Pictures Entertainment grossing $1.3b in the US and $2.3b worldwide.

Despite its interest in the movie business, Sony remained first and foremost an electronics company, with roughly 65 percent of its $55 billion in fiscal 1998 revenues tied to the sales of items such as home-use digital camcorders, VAIO notebook computers, cellular phones, and assorted electronic components (Exhibit 2). Games, particularly the PlayStation console, were a growing part of Sony's repertoire, generating 10 percent of revenue and 22 percent of operating income in fiscal 1998 – an increase from nothing at all in 1994. By early 1998, 30 million consoles were in play around the world.

Some observers wondered, however, whether integration of production and exhibition was a good strategy in the film business. One theater owner remarked: "If I were working for Loews, I'd be concerned that Sony might force me to take films that no one else wanted. And if I worked for a competitor, I'd worry that getting films from Sony would strengthen my competitor. I don't see an up side in either case." Others were more optimistic. One noted that integration gave producers greater control over the timing and location of a film's release, factors sometimes critical to success. Another suggested that vertical integration helped to resolve the "public goods" aspect of advertising, which generated benefits to both producers and exhibitors.

**Exhibition in the 1990s**

The trend toward reintegration of film production and exhibition was accompanied by a substantial increase in exhibition capacity, with the number of screens increasing by more than a third between 1988 and 1997 (Exhibit 3) while tickets sales were relatively flat (Exhibit 4). In 1998, investment firms Hick Muse and KKR combined to purchase the Regal and Act III cinema chains. Issuing $400m in debt in May 1998, Regal embarked on an aggressive expansion, opening more than 100 new theaters with almost 2000 new screens. With more screens available, exhibitors found that competition for films increased the amount they paid to distributors, and competition for customers forced them to invest heavily in new luxury megaplexes, with stadium seating and high-quality sound. National Amusements President Shari Redstone commented: "The financial players came in, and they wanted to grow for the sake of growth. They didn't have a strategic plan. They didn't have a focus on the financial viability of each project." Others suggested that the newcomers didn't understand local markets well enough to select the best locations and most appropriate films. (See *Wall Street Journal*, September 27, 2000.)

The result was a blood bath. Loews, Regal, Edwards, and United Artists all filed for bankruptcy protection in 2001 or early 2002. In March 2002, Loews emerged from bankruptcy under new ownership led by Canadian buyout firm Onex Corp and Oaktree Capital of Los Angeles. Sony had officially left the exhibition business.

**Questions for Analysis**

(a) What advantages of vertical integration do you see for film producers in the 1930s? Disadvantages?
(b) What advantages of vertical integration do you see for Sony in the 1990s? Disadvantages?
(c) What drove Loews Cineplex into bankruptcy?
(d) Bottom line: Was Sony's decision to buy a controlling interest in Loews a good one?
(e) How does Sony's experience with theaters compare to other examples that cross your mind of "downstream integration"?

**Additional Information Sources**

- National Association of Theatre Owners: http://natoonline.org/
- Sony: http://www.sony.com
- US v Paramount: http://www.cobbles.com/simpp_archive/1film_antitrust.htm
- Richard Caves, *Creative Industries*, Harvard University Press, 2000. Nice overview of the economic structure of entertainment industries and the arts.

**Notes**

*Brad Skillman prepared this case under the supervision of Mariagiovanna Baccara, David Backus, and Luís Cabral for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The author thanks Matt Heyman and Mark Wanamaker for useful comments and advice.*

**Exhibit 1**
**Loews Theatres Timeline**

- 1904: Loews Theatres founded by Marcus Loew.

- 1924: Loew joins forces with Louis B. Mayer and Samuel Goldwyn to form the Metro-Goldwyn-Mayer studio, which Marcus Loew heads.

- 1948: Supreme Court orders a district court to reconsider the possibility of forcing studios to divest themselves of their theaters.

- 1949: Paramount signs a consent decree that leads to the separation of its studios and theaters. Other studios follow, with Loews and MGM finally separating 10 years later.

- 1979: Cineplex Odeon founded.

- June 1982: Coca-Cola Co. purchases Columbia Pictures Entertainment Inc. for about $682 million in cash and stock.

- 1985: Loews Corp sells its 350-screen circuit to private company.

- 1987: Loews Theatres purchased by Tri-Star Pictures. Net assets and operations consisting of the Enterprise Business Sector of the Coca-Cola Co. exchanged for shares of Tri-Star; name changed to Columbia Pictures Entertainment Inc. Coca-Cola subsequently owned 80 percent of common stock.

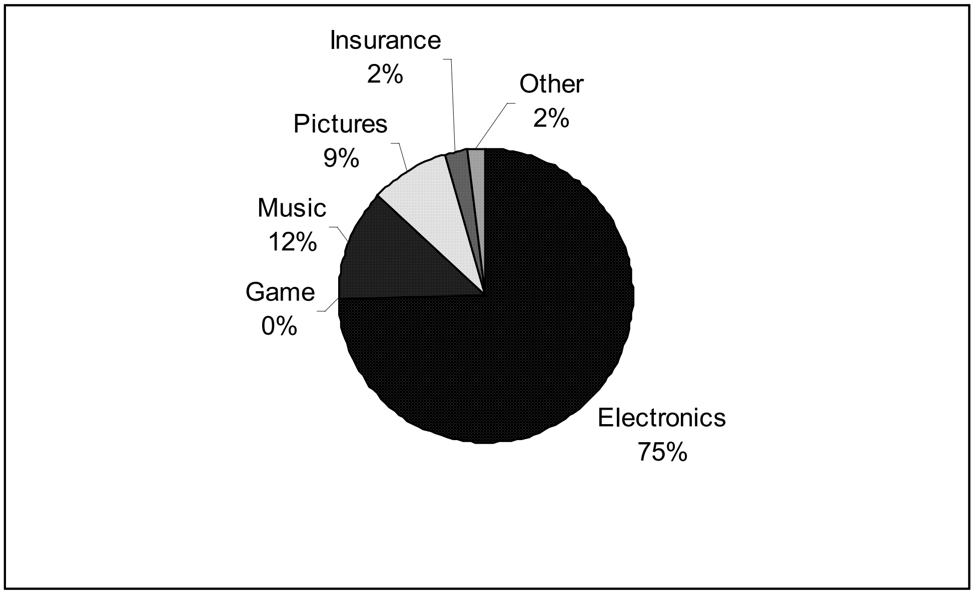
- 1989: Sony acquires Columbia Pictures from Coca-Cola for $3.4 billion.

- 1998: Loews Theatres and Cineplex Odeon merge, creating Loews Cineplex Entertainment. Equity shares following a July 1998 equity offering were Sony (39%), Universal (27%), Claridge (7%), and public (28%).

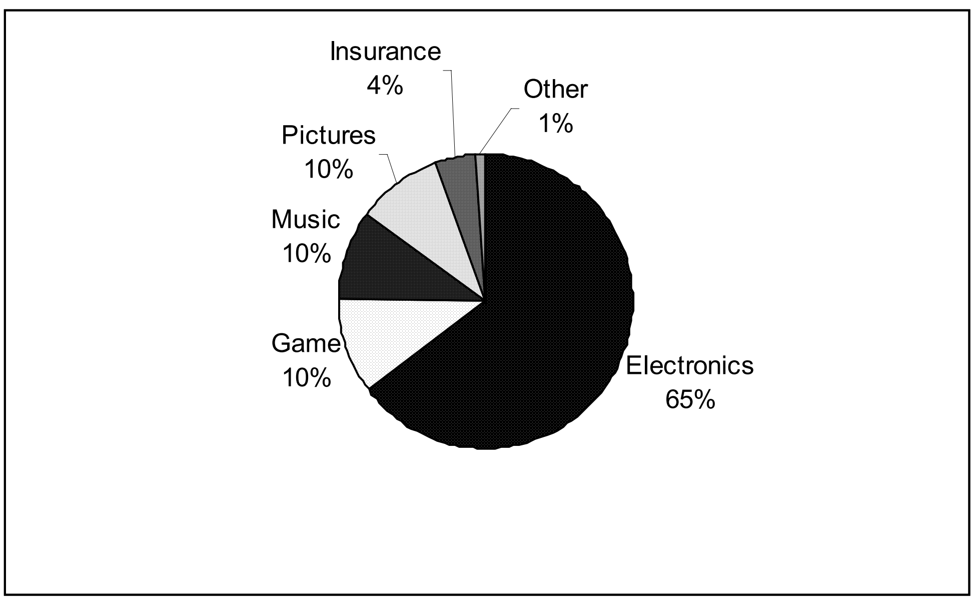
Sources: Coca-Cola and Loews Cineplex web sites.

**Exhibit 2**
**Sony Sales by Segment, 1994 and 1998**

Composition of Sales by Segment, 1994




Composition of Sales by Segment, 1998




Source: Sony annual reports.

**Exhibit 3**
**US Movie Theater Screens**

| Year | Indoor Screens | Outdoor Screens | Total Screens |
|---|---|---|---|
| 1948 | 17811 | 820 | 18631 |
| 1954 | 14716 | 3775 | 18491 |
| 1958 | 12291 | 4063 | 16354 |
| 1963 | 9150 | 3502 | 12652 |
| 1964 | 9200 | 3540 | 12740 |
| 1965 | 9240 | 3585 | 12825 |
| 1966 | 9290 | 3640 | 12930 |
| 1967 | 9330 | 3670 | 13000 |
| 1968 | 9500 | 3690 | 13190 |
| 1969 | 9750 | 3730 | 13480 |
| 1970 | 10000 | 3750 | 13750 |
| 1971 | 10300 | 3770 | 14070 |
| 1972 | 10580 | 3790 | 14370 |
| 1973 | 10850 | 3800 | 14650 |
| 1974 | 11612 | 3772 | 15384 |
| 1975 | 12168 | 3801 | 15969 |
| 1976 | 12562 | 3414 | 15976 |
| 1977 | 12990 | 3564 | 16554 |
| 1978 | 13129 | 3626 | 16755 |
| 1979 | 13439 | 3656 | 17095 |
| 1980 | 14171 | 3504 | 17675 |
| 1981 | 14790 | 3354 | 18144 |
| 1982 | 15117 | 3178 | 18295 |
| 1983 | 16032 | 2852 | 18884 |
| 1984 | 16749 | 2840 | 19589 |
| 1985 | 18327 | 2770 | 21097 |
| 1986 | 19554 | 2811 | 22365 |
| 1987 | 20595 | 2084 | 22679 |
| 1988 | 21632 | 1497 | 23129 |
| 1989 | 21907 | 1014 | 22921 |
| 1990 | 22904 | 910 | 23814 |
| 1991 | 23740 | 899 | 24639 |
| 1992 | 24344 | 870 | 25214 |
| 1993 | 24789 | 837 | 25626 |
| 1994 | 25830 | 859 | 26689 |
| 1995 | 26995 | 848 | 27843 |
| 1996 | 28905 | 826 | 29731 |
| 1997 | 31050 | 815 | 31865 |

Source: US Census Bureau, National Association of Theater Owners.

**Exhibit 4**
**Ticket Sales of US Motion Picture Exhibitor**

| Year | Admissions | Percent Change | Average Price |
|---|---|---|---|
| 1980 | 1021.5 | -8.9% | $2.69 |
| 1981 | 1067.0 | 4.5% | $2.78 |
| 1982 | 1175.4 | 10.2% | $2.94 |
| 1983 | 1196.9 | 1.8% | $3.15 |
| 1984 | 1199.1 | 0.2% | $3.36 |
| 1985 | 1056.0 | -11.9% | $3.55 |
| 1986 | 1017.2 | -3.7% | $3.71 |
| 1987 | 1088.5 | 7.0% | $3.91 |
| 1988 | 1084.8 | -0.3% | $4.11 |
| 1989 | 1262.8 | 16.4% | $3.99 |
| 1990 | 1188.6 | -5.9% | $4.22 |
| 1991 | 1140.6 | -4.0% | $4.21 |
| 1992 | 1173.2 | 2.9% | $4.15 |
| 1993 | 1244.0 | 6.0% | $4.14 |
| 1994 | 1291.7 | 3.8% | $4.18 |
| 1995 | 1262.6 | -2.3% | $4.35 |
| 1996 | 1338.6 | 6.0% | $4.42 |
| 1997 | 1387.7 | 3.7% | $4.59 |

Source: Motion Picture Association of America.