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Marvel Enterprises, Inc.

It was June 29, 2004, one day before the theatrical release of the highly anticipated sequel to the *Spider-Man* movie, which was based on Marvel Enterprises' most popular character. The movie seemed destined to follow in the footsteps of the original's record-breaking box-office run by offering its familiar mix of high-flying action and drama. However, Peter Cuneo, Marvel's vice chairman and former CEO, knew his management team had staged a rescue that *Spider-Man* (or any of the other superheroes to which Marvel owned the rights) could never have pulled off—that of the company itself. Only six years after the company emerged from bankruptcy, and only three years after it posted a loss of over $100 million and saw its stock hover at around $1, Marvel had amassed a market value of more than $2 billion, recorded over $300 million in sales and nearly $170 million in operating income in 2003, and seen its stock soar to over $20 (see **Exhibit 1**). "The culmination of our work came a few weeks ago, when *The Wall Street Journal* reported on the best-performing stocks," Cuneo said. "Guess who was number one on the New York Stock Exchange over the past three years?"

Not only had Marvel's original comic-book publishing business been turned into a profitable division, its toy and licensing operations had also generated impressive returns in recent years (see **Exhibit 2**). In the past three years alone, Marvel had lent its characters to eight movies, including Sony Pictures' *Spider-Man*, Universal's *The Hulk*, Twentieth Century Fox's *X-Men*, and Lions Gate's *The Punisher*. It had also made licensing deals for a wide range of other products, ranging from toys to video games, apparel, party items, and 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. We just collect checks," Allen Lipson, Marvel's president and CEO, said. "It's a gold mine. Cash just comes in every day," added Isaac Perlmutter, Marvel's other vice chairman and biggest shareholder.

Despite Marvel's remarkable rise, doubts about its business model and its growth potential continued to exist. That same day, *The Wall Street Journal* had reported on mounting concerns about the company's future in a lead article entitled "Marvel May Need Heroic Help."[1] The same paper that had compared Marvel's rise to "*Spider-Man* scampering up the sides of tall buildings"[2] had now expressed fears that the company had "milked the best gains from its most prominent characters" and had questioned Marvel's ability to "use lesser-known superheroes such as *Namor*, *Ghost Rider*, *Iron Man*, *Punisher* and *The Fantastic Four* and sequels to boost growth."

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[1] "Marvel May Need Heroic Help," *The Wall Street Journal*, June 29, 2004.

[2] "Shareholder Scoreboard: Leaders and Laggards in the Rankings," *The Wall Street Journal*, March 8, 2004.

Professor Anita Elberse prepared this case. Alexander Atzberger (MBA 2005) provided valuable assistance. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

"There is no end to our success—we have a great library of characters," responded Avi Arad, Marvel's chief creative officer and Marvel Studios' chairman and CEO. "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 DVDs (with an average retail price of $20) on the day of its release in the U.S., Marvel had received only about $25 million from Sony Pictures. According to *The Wall Street Journal* article, the sequel would have to be "one of the biggest hits on record" in order to contribute much more to Marvel's bottom line than the $10 million that Sony had paid in advance. "We have been focused on activities that require minimal capital investment on our part," said Cuneo. "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."

Cuneo knew that Marvel's management faced two sets of questions that were critical to its future. First, could Marvel sustain its success in the coming years, or had its winning streak been just a fluke? That is, was Marvel's success dependent on a limited set of "blockbuster" characters, most notably *Spider-Man*, and should Marvel continue to capitalize on those characters, or was it time to seek growth in a larger set of lesser-known characters? Second, in exploring growth opportunities, was it wise for Marvel to venture more outside the safety of its current business model and move into more capital-intensive activities? What marketing strategy would allow Marvel to sustain its success?

Company Background

The Marvel Universe

Marvel owned and managed one of the oldest and most recognizable collections of characters in the entertainment industry. Its proprietary library of over 4,700 characters included *Spider-Man*, *X-Men*, *The Hulk*, *Blade*, *Daredevil*, *Elektra*, *The Punisher*, *The Fantastic Four, Captain America, Namor, Thor,* and *Silver Surfer* (see **Exhibit 3** for some examples). Marvel's characters had been developed through a long history of comic books—the first Marvel comics appeared in 1939—which had contributed to each character's personality and context. The fictitious *Marvel Universe* provided a common historical and contextual background for the characters and story lines. Popular characters would often make "guest appearances" in comic books of lesser-known or newer characters. Morton Handel, Marvel's chairman, commented on the characters' appeal: "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."

Lipson clarified the nature of the content library: "You've got to think of the 4,700 characters not as individuals but as families. We have 40 years of *Spider-Man* stories. There might be 50 bad guys associated with *Spider-Man* and 50 friends. So the *Spider-Man* family consists of 100, maybe 200, properties. *The Hulk* accounts for another 100, while *X-Men* has about 400 characters." While many properties had been turned into household names, *Spider-Man* was widely perceived to be Marvel's most popular character. 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 60s—they all enjoy *Spider-Man*. I wish all our characters were that broad."

Early History: Marvel Comics

Marvel Comics had been founded in the 1930s. In the late 1930s and 1940s, its comics featured superheroes such as *The Human Torch*, *The Sub-Mariner*, and *Captain America*. The subsequent decade was characterized by a slump in sales, partly fueled by controversy about the potentially harmful effect of comics on children. Marvel's competitor DC Comics was the first to recover in the 1950s, with *The Flash* and *The Justice League of America* (which included *Superman*, *Batman,* and *Wonder Woman*) superhero series. In the early 1960s, following in the footsteps of DC Comics and led by editor/writer Stan Lee and artist Jack Kirby, Marvel revived its lineup of superheroes, created the *Marvel Universe*, and introduced continuity by moving away from single-issue story lines. Several popular characters arose in this period, including *The Fantastic Four* and *The Amazing Spider-Man*, and Marvel emerged as the second-largest comic-book publisher behind DC Comics. After Lee stepped down, Marvel continued to thrive for most of the 1970s and 1980s, although overall comic-book industry slumps generally also had their effect on Marvel.[3]

The Perelman Years: Marvel Entertainment Group

In 1989, investor Ronald Perelman bought Marvel and turned it into a publicly listed company, Marvel Entertainment Group. He eliminated unprofitable lines of business, streamlined operations, acquired other comic-book publishers, and diversified outside the core comic-book business. Initially, this led to a solid performance record. However, in the mid-1990s, the core business began to falter. For years, Marvel had capitalized on a speculative frenzy among collectors by significantly increasing the number of titles (which lowered the comics' overall quality) and by nearly doubling prices (to $3.00 per book). When the frenzy ended, collectors were left holding worthless paper, and many "regular" consumers had dropped out of the market, causing a plunge in Marvel's comic-book sales. Amid accusations that Perelman had mismanaged the company for his personal gain, Marvel was forced to file for bankruptcy in the late 1990s.[4] A fierce legal battle for the company ensued between various parties. Eventually, on October 1, 1998, a public toy company called Toy Biz, Inc. acquired Marvel Entertainment Group out of bankruptcy. The new entity was named Marvel Enterprises, Inc.

The Turnaround Years: Marvel Enterprises, Inc.

Marvel's new board, which included the former Toy Biz owners Perlmutter and Arad, named Cuneo CEO in July 1999 and hired several other new executives. The company's new start was a difficult one. After posting a $105 million loss for 2000, the stock traded at just over $1. However, after that year, performance substantially improved (see **Exhibits 1** and **2**).

Marvel's new strategy was first aimed at monetizing the content library via licensing characters for use with media products (such as motion pictures, television, publishing, and video games) as well as other consumer products (such as toys, apparel, collectibles, and food). Activities in these areas reinforced each other, according to Cuneo: "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."

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[3] See ComicsResearch.org (www.comicsresearch.org) and Les Daniels, *Marvel: Five Fabulous Decades of the World's Greatest Comics* (New York: Abrams, 1991).

[4] "Bankruptcy and Restructuring at Marvel Entertainment Group," HBS Case No. 298-059 (Boston: Harvard Business School Publishing, 1998).

Managing the library of characters to foster long-term value was the second key focus of Marvel's new management. Arad stated: "Almost everybody will have heard of *Captain America* or *The Fantastic Four*. They may not know anything specific about the characters or the stories, but we can change that. We can bring them to life, using motion pictures, television, animation, or toys." Cuneo added: "We're planning the career of each of our characters. *Spider-Man*'s career over the next five years is going to include two more movies, DVDs, toys, a video game, a promotion with Burger King, and so on." Bruno Maglione, president, International, went one step further: "We're sort of like a talent agency—but instead of Tom Cruise and Julia Roberts, we have *Spider-Man* and *Elektra.*"

Retaining some form of control over the creative process—to ensure the quality of the content that featured Marvel characters—was the third main strategic dimension. A high level of consistency in characters and stories was emphasized. Quality control was particularly relevant for the comic-book publishing division. Cuneo stated: "We knew we had to rejuvenate our publishing business, because that's where a lot of our credibility came from. Our comic book lines were embarrassing. Before the turnaround we had a 25% share of the North American market, and DC Comics had a 43% share. Today it's reversed." Marvel's management team had hired well-known artists and writers to lead its creative efforts in the publishing division, including popular writers from the film and television industry, and had started to sign exclusive contracts with key creative talent.

The strategy had been extremely successful by virtually any measure. In mid-June 2004, Marvel was able to redeem all of its remaining long-term debt and emerge as a debt-free company—a fitting end to the turnaround phase.

Marvel's Divisions

Marvel operated as what Kenneth West, executive vice president and chief financial officer, referred to as a "mini-conglomerate." Each of its divisions—comic-book publishing, toys, and licensing—were run as distinct businesses, but the *Marvel Universe* provided a common theme to all activities.

Comic-Book Publishing

Products The large majority of comic books revolved around the classic Marvel superheroes, such as *Spider-Man* and *The Fantastic Four*, while a small fraction of titles featured newly developed characters. Comic books came in two main formats: periodicals and graphic novels. Periodicals were comic books that looked like small magazines, contained roughly 30 pages (with advertisements) that were stapled together, appeared biweekly or monthly, and were typically priced around $3. Graphic novels ("trades") were mostly collections of periodicals that captured a "complete" story about a character's adventure, usually contained roughly 150 pages (without advertisements) bound as a book, and typically sold for anywhere from $10 to $25 (see **Exhibit 4**). Although the number of titles had decreased significantly compared with that in the mid-1990s, Marvel maintained an "aggressive publishing schedule," according to Gui Karyo, president of Publishing. About 60 periodicals appeared each month, and 100 to 300 graphic novels were published each year.

Increasingly, popular superheroes appeared in several series, each aimed at a specific audience. For example, *The Amazing Spider-Man* was a classic Marvel comic popular among core readers. Over 500 issues had appeared since the early 1960s. *Ultimate Spider-Man*, introduced in 2001, was a series in the *Ultimate* comics line that was developed with new comic readers in mind. "One of the problems with our standard comic books is that it's hard for new readers to get into them if they're coming into a story later—they don't have an opportunity to read the previous 30 years of comic books," Karyo explained. "What we did with the *Ultimate* series is move to complete adventures in four to six magazines, so a new reader can come into the series and get interested in the whole story." Bill Jemas, a former Marvel Publishing president and chief operating officer, added: "In the *Ultimate* series, we're retelling a lot of the classic stories in today's milieu, so young readers can relate. For example, in 1962 *Spider-Man* was bitten by a radioactive spider. In *Ultimate Spider-Man*, he was bitten by a genetically morphed spider—and he had a cell phone." The newest line, *Marvel Age*, introduced in 2004, was aimed at the market served by mass merchandisers. Each magazine dealt with a complete story, and artists adhered to specific style guides to ensure accessible content for readers of all ages.

Customers The primary target market for Marvel's comic books consisted of male teenagers and young adults from 13 to 23 years old, but established readership extended to adults in their mid-30s. "The large majority of our readers are in their early teens to late 20s," Karyo said. "They are predominantly male, and they also tend to be well educated." He estimated that there were about half a million people who read Marvel comics on a regular basis in the U.S. Readers roughly fell into two groups: those who bought comic books like any other magazines, and those who bought comic books as part of a collection.[5] "We're good at listening to comic-book fans, really understanding what they want, and getting that back to them in the comic books," Jemas said. Retailers played an important role in that process, he observed: "We realized that we will never understand the comic-book customer the way the guy who works in the comic-book shop does."

Distribution Marvel's comic books were distributed through three channels: (1) to comic-book specialty stores (the "direct market") on a nonreturnable basis; (2) to traditional retail outlets, including bookstores and newsstands (the "mass market"), on a returnable basis; and (3) on a subscription sales basis (also see **Exhibit 2**).

The lion's share of Publishing's net revenues was derived from sales to the direct market, which in the U.S. consisted of approximately 3,000 specialty comic-book stores.[6] They played a crucial role. "There are no other retailers in the world who are prepared to carry, or capable of carrying, as many products as we produce on a monthly basis as comic-book specialty stores. We print around 60 titles a month, DC Comics around 100, and there are a dozen other small publishers printing another 20 titles. All of these titles are best displayed with the cover clearly visible," Karyo said. "Can you imagine what it would mean for Wal-Mart, or even for a general bookstore, to display so many SKUs [stock-keeping units] that way?" General bookstores and mass merchants typically did not carry any periodicals and offered a limited selection of trade paperbacks.

However, the direct market had major disadvantages as well. Specialty bookstores generally did not occupy premier retail locations, were often not managed as professionally as general bookstores (such as Barnes and Noble and Borders) and mass-market retailers (such as Wal-Mart and Target), and had a very narrow customer base. "It is enormously limiting," Karyo said. "There has been little effort to build the market, and new readers have not been coming in." Marvel comic-book subscriptions were available for all periodicals, usually at 90% of the cover price.

Market performance Marvel circulation had grown to 3.6 million copies a month in 2003: approximately 1.6 million in the kids and teens market (17 years or younger) and 2 million in the young adult market (18 years or older). On average, classic monthly periodicals sold about 50,000 copies, and trades about 10,000 copies. Best-sellers included the classic *X-Men*, the newly launched

[5] Certain comic books were valuable commodities. For example, an early issue of *Amazing Spider-Man* in good condition could fetch between $60,000 and $70,000 (*Comics Price Guide*, June 2004).

[6] *Comics & Games Retailer Magazine*, June 2004.

Astonishing X-Men, and *Ultimate Spider-Man* (**Exhibit 5** presents key statistics for four popular titles for a six-month period in 2003). Highly collectible issues (such as the first issue in a series or by a particular artist or writer) sometimes generated sales of over 250,000 issues.

Sales often benefited greatly from exposure in other media, particularly movies. The publishing division adjusted supply accordingly. "Around the time of *The Hulk* movie, we were printing an enormous amount of *Hulk* product," Karyo indicated. "There is nothing that supports sales more than $20 million worth of advertising." He added: "The *Spider-Man* movie began a wave of interest in comics that actually grew the entire market. Before *Spider-Man*, the largest launch of a book with top-rated talent was around 100,000 units. Now a similar launch regularly breaks 200,000 units."

The publishing division strived to make a profit on each title in its portfolio. Describing his division's performance over 2003, Karyo said: "There were only three books that lost some money at the end of their stint. But more or less, everything we print is profitable." He added: "We generally don't publish anything that has less than a 30% margin." However, there was sufficient room for trial and error, according to Jemas: "We can try new characters at almost no risk. We can put it out, watch it for a couple of months, and if it doesn't seem to take off, cancel it. We might lose $10,000, but that's nothing compared to the revenues from the winners among our 60 titles each month."

The comic-book industry Total U.S. retail sales for comic-book periodicals and trades were about $300 million in 2003. The market had been relatively stable since 1997, when annual sales also totaled $300 million.[7] Periodicals typically accounted for the lion's share of sales—close to 90% in 2003. Marvel had a 40% dollar market share, compared with 35% for its nearest competitor, DC Comics, which was part of the Time Warner conglomerate. Also, because many editors, artists, and writers had worked for both Marvel and DC Comics over the course of their career, the comic-book publishing giants were engaged in a relatively friendly rivalry. Marvel competed with a wide range of other, smaller publishers that primarily produced creator-owned titles outside the superhero genre. Eight of the top 10 monthly comic books typically were Marvel publications.

Toys

Marvel's toy division designed, developed, marketed, and distributed a limited line of toys to markets across the world. In July 2001, Marvel had entered into a five-and-a-half-year exclusive licensing agreement with TBW, a Hong Kong-based independent company. Under this agreement, TBW licensed the right to manufacture and sell action figures that featured Marvel characters. In return, Marvel received a royalty fee of 15% of the wholesale value of toys sold. Also, because action figures generally accounted for 90% of Marvel's toy-licensing revenues, the deal had major implications for the way in which the toy division operated. Under a related agency arrangement, Marvel's toy division agreed to take care of product design, marketing, and sales for TBW with respect to Marvel-licensed toys. Marvel received a fee for those services that generally exceeded 20% of toy wholesale revenues. *Spider-Man* was the only character that was excluded from the deal with TBW—Marvel had a separate arrangement with Sony Pictures for that character.[8]

The nature of the agreement with TBW had important benefits for Marvel. "We are able to maintain control over the quality of the product, from design to final engineering and execution," explained Alan Fine, president and CEO of Marvel's toy division. "Of course we are also intimately knowledgeable about and aware of our characters—we know what they are all about, what their

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[7] *Comics & Games Retailer Magazine*, 2004.

[8] Marvel had also bought the rights to design, develop, market, and distribute toys based on the trilogy *The Lord of the Rings*.

powers are, and what the story of their life is." West pointed to another benefit: "Toy companies always are at risk that their toys don't sell. They risk their investment in inventory, the possibility that the items will be returned, and so on—risks are everywhere." He added: "We have toy designers, salespeople, and merchandising expertise. TBW is a manufacturing company. It is a perfect blend."

Because senior executives and salespeople in the toy division had been part of Toy Biz, Inc., the company that had acquired Marvel in 1998, Marvel had a great deal of experience with the toy business. In the early 2000s, Marvel's toy division was widely recognized as one of the world's foremost designers of action figures, action-figure accessories, play sets, and boys' role-playing toys for the mass market. The toy division maintained a product development and marketing staff of 12 to 14 people, sometimes obtained new product ideas from third-party inventors, and employed a large number of freelancers for the sculpting of figures and other toys.

Products Many of the toy division's designs (see **Exhibit 6**) had received praise from industry insiders and from consumers. The *Electronic Hulk Hands*, a pair of large green hands that produced a noise when they made contact, had been given the Toy Industry Association's "Boy Toy of the Year" award in 2003. It had sold over 4 million units at an average retail price of $18, becoming Marvel's most successful toy ever. It exemplified the creativity and simplicity for which the toy division was known, argued Jemas: "You're a little kid. You weigh 12 pounds. Everybody in the world is bigger than you. How do you play *Hulk*? It's the big hands. You put those big hands on and you feel the noise, the power. . . . Once I put on a pair of the hands I knew we had a hit." Fine added: "Our *Spider-Man Web Blaster* this year is going to be the biggest toy we've ever had. It's just a glove with a can of Silly String—you can shoot Silly String directly from your hand. No fancy technology, but a huge amount of play value, a chance for a child to become *Spider-Man*—all for a $15 retail price."

The assortment of toys for movies was generally very broad. For a *Spider-Man* movie, for instance, Marvel designed at least five sets of *Spider-Man* action figures, each with an accessory, and each with a number of supporting characters, as well as a number of other toys. Prices for end-consumers ranged from $7 for an average action figure to $15–$20 for role-play toys. A special line of toys for the collector market, *Marvel Select*, was sold for a minimum retail price of $20. Retailers generally received a margin of 35% to 50%.

Toy design and marketing activities were largely dictated by upcoming movie releases, Fine indicated: "Avi Arad gets a script into my hands as early as possible, and we have lots of dialogue on it. When we develop a line for a movie, we're using lots of the material from the script. We try to represent that in the direction and the tone of our toys." He added: "We know that toys usually represent the first exposure of a child to a character. It determines whether it's going to be thumbs up or thumbs down. If it's thumbs up, then the likelihood of that child buying a T-shirt, a lunchbox, a backpack, and a pair of sneakers based upon that character is much higher."

Customers Marvel toys were "primarily aimed at boys from four to 12 years old," according to Fine. "The sweet spot is a boy who is six to seven, maybe five to eight years old." "There's also a collector segment," he continued, "which consists of the adults who have grown up with action figures, who now buy the figures, store them, and watch them grow in value over the years." The collector market accounted for about 20% of total sales, according to toy division executives.

Distribution With the exception of *Marvel Select* figures (which were exclusively sold through specialty stores and comic-book stores), outlets for toys included specialty toy retailers, mass merchandisers, mail-order companies, and variety stores. Marvel also sold toys to independent distributors who in turn shipped the products to retail outlets. The toy division's five largest customers were Wal-Mart, Toys 'R' Us, Target, Kay-Bee Toy Stores, and Kmart. Together, these customers accounted for 66% of Marvel's total toy sales in 2003. Direct sales efforts to retailers typically started 12 months prior to the period in which Marvel sought to sell toys, to ensure that retailers provided a guaranteed minimum order and sufficient shelf space for the toys. Because the time from concept to production of a new toy could range from six to 12 months, that meant sales efforts usually started well before the product development process.

Market performance In 2001, the line of toys based upon the first *Spider-Man* movie had accounted for more than 10% of Marvel's net revenue. In 2002, the year in which the first movie was released, the share was just over 35%. In 2003, without the support of a major movie, Marvel had sold more than 1.5 million units of the *Spider-Man Dual Action Web-Blaster*.[9] For 2004, the year of the movie sequel's release, Marvel expected *Spider-Man* toy sales of around $165 million.

The toy industry The toy business as a whole generated over $20 billion in sales in 2003. The action figures and accessories category accounted for $1.2 billion in revenues.[10] By industry standards, the last few years had been lackluster. Intense rivalry existed among the big retailers. For example, specialist retailers FAO Schwarz and Kay-Bee Toy Stores had both filed for bankruptcy in recent years. The high level of consolidation had made retailers very powerful vis-à-vis toy manufacturers vying for shelf space. Also, because toys were characterized by short life cycles, competition for shelf space was intense. Marvel's main competitors included Bandai (with its *Teen Titans* line), Hasbro (with its *Star Wars* and *G.I. Joe* lines), and Mattel (best known for its *Barbie* line).

Licensing

The licensing division licensed Marvel's characters to a variety of media, including feature films, television programs, video games, animation, and destination-based entertainment (such as theme parks). Marvel also received fees from the sale of licenses for use in a wide variety of consumer products. "We're helping our licensees sell their products under a Marvel brand," Handel said. Two teams handled activities with U.S. licensees. Marvel Studios, based in Los Angeles, primarily dealt with motion pictures and had 11 full-time employees. Marvel's Consumer Media Group, based in New York, coordinated activities for all consumer products and consisted of three salespeople and three assistants, supported by 15 legal and product-approval specialists. Marvel had recently opened offices in Tokyo and London to increase its licensing activities in international markets.

Motion pictures Marvel had licensed several of its most popular characters with studios for use in motion pictures. The company pursued a diversified base of studio partners, both to ensure their commitment to each project and to mitigate risks. **Exhibit 7a** provides details on the eight movies released since 1998. *Spider-Man* was the most successful in terms of box-office performance—it was the highest-grossing film of 2002, the sixth-highest-grossing movie ever in the U.S., and the 10th-highest-grossing movie ever worldwide. However, with the exception of *The Punisher*, all movies had captured the highest box-office grosses in their respective opening weekends, and four movies had held on to that position for two weeks. All sequels had outperformed the originals. **Exhibit 7b** lists Marvel's movie schedule through 2006. *Spider-Man III* was targeted for release in 2007. Not all of Marvel's more popular characters had been licensed for use in motion pictures as of June 2004; unencumbered properties included *Captain America*, *Thor*, and *The Avengers*.

All motion picture projects found their origins in the existing library and story lines of Marvel characters. Marvel Studios' executives were closely involved in the film development process and

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[9] In 2003, the *Lord of the Rings* toy line contributed more than 10% to net revenue.

[10] Source: Toy Industry Association, 2002 State of the Industry, www.toy-tia.org.

played a key role in relaying information on characters and story lines to studio partners. "We don't want to be a regular studio and come up with new ideas for movies. 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," said Arad, Marvel Studios' chairman and CEO. "We have to do things here that are in line with other aspects of our business." David Maisel, Marvel Studios' president and COO, added: "Even though the comic-book area is small, I bet you that if you asked people about *Captain America* or *The Fantastic Four*, awareness is very high. Somehow the characters have permeated into our culture—that's our marketing advantage." He continued: "The movies have showed that the characters resonated strongly with a dramatically bigger group of people than were exposed to it through comic books."

Specific details of licensing agreements varied across movie projects. Early deals, made in the Perelman years, had been extremely unfavorable to Marvel. Since then, two main forms of revenue-sharing agreements had been in use (see **Figure A** for a simplified overview).

Figure A Common Revenue-Sharing Agreements

Agreement:	**Revenue Participation**	**Profit Participation**
Marvel's share:	3%–7% of the movie studio's *theatrical gross revenues* + 1%–2% of the movie studio's *home video gross revenues* + 3%–7% of the movie studio's *other gross revenues*	50% of the movie studio's *operating profit* across windows

Definitions:	Studio's *theatrical gross revenues*:	Theatrical box-office revenues minus the share (typically 50%) for cinema operators
	Studio's *home video gross revenues*:	Home video revenues minus the share (typically 40%) for channel partners
	Studio's *other gross revenues*:	Revenues in other release windows (e.g., television) minus the share for channel partners
	Studio's *operating profits*:	Total gross revenues minus production costs, costs of prints, advertising expenditures, and distribution fees

Source: Marvel Enterprises, casewriter estimates.

Under all deals, the film studio retained the right to determine the release timing and strategy. Marvel retained control over merchandising rights and never contributed to movie production and marketing expenses. Those expenses were often relatively high. For the nearly 200 movies that had been distributed by major studios, U.S. theatrical box-office revenues averaged just under $42 million in 2003.[11] The U.S. theatrical market typically accounted for 20% of total motion picture revenues, the foreign theatrical market for another 20%, worldwide home video for 40%, and additional windows (such as television) for the remaining 20%.[12] Production costs averaged $64 million, and print and

[11] U.S. Entertainment Industry: 2003 MPA Statistics, Motion Picture Association of America. "Major studios" refers to Buena Vista, Sony, MGM, Paramount, Twentieth Century Fox, Universal, and Warner Brothers.

[12] "Industry Surveys: Movies & Home Entertainment," Standard & Poor's, February 12, 2004.

advertising expenditures $40 million in 2003.[13] "Usually we get anywhere between $30 and $80 million in advertising devoted to our movies," Arad said. "As a result, the word spreads like wildfire—it leads to worldwide exposure for the Marvel brand and for the specific character."

In addition to the eight films based on Marvel characters, nine other comic-book adaptations had been released since 1998. Together, those movies had grossed $1.7 billion in the U.S. alone, of which Marvel's movies had brought in $1.2 billion. Non-Marvel movies mostly were adaptations of creator-owned comics and covered more than just the superhero genre. Although Warner Brothers had a rich history of movies based on DC Comics' heroes (particularly *Superman* and *Batman*), Marvel's main competitor had played no role at the box office in recent years. Its pipeline was full, however, with *Catwoman* scheduled for release later in 2004, *Batman Begins* and *Constantine* due in 2005, and a new *Superman* movie rumored to be under development. A wide range of other movies competed in a similar space. Pixar's animated movie *The Incredibles*, a film about a family of superheroes due out in the fall of 2004, was one particularly noteworthy example.

Other media Marvel licensed its characters for use with other media as well. For example, in the summer of 2003, a half-hour animated show featuring *Spider-Man*, produced by Sony Pictures, had appeared on MTV in the U.S. In May 2004, Marvel entered into an agreement with Lions Gate Entertainment to develop, produce, and distribute original animated DVD features based on certain characters within the *Marvel Universe*. Specifically, Marvel and Lions Gate would commence production on eight original animated projects, the first of which was due for release in late 2005.

Several licensees, including Activision, Encore, Universal Games, THQ, and Electronic Arts (EA), produced video games based on Marvel characters. Activision's *Spider-Man* game had sold more than 6 million copies since its debut in May 2002, making it one of the most successful video games ever. Under an agreement with the leading video game publisher, EA would develop fighting video games that mixed existing Marvel superheroes against a new set of EA's characters. In addition, Marvel had agreed to various licensing deals with theme parks, shopping malls, and special events. For example, Marvel characters appeared in the Islands of Adventure theme park at Universal Orlando in Orlando, Florida, at Universal Studios Hollywood, and at the Universal Studios theme park in Osaka, Japan.

Other consumer products Marvel also received fees from the sale of licenses for use in a wide variety of consumer products, including toys, apparel, accessories, footwear, collectibles, and food products. At the end of 2003, it had over 450 active license contracts in domestic and international markets for such products. The company further sold licenses for short-term promotional use, such as sweepstakes and contests.[14]

"Our strength is the *Marvel Universe*," Timothy Rothwell, president of the Consumer Media Group, remarked. "It's very unique, and it allows us to continuously offer freshness—different characters all the time." However, not all characters were equally suitable for this form of licensing. "Take a character like *The Punisher*," Maglione said. "This was a low-budget movie. We've had a movie and a video game, we will make money on the DVD, and we could easily do a series of adult novelizations, for example. But it's not toys, apparel, school products, games, promotions, pajamas, skateboards, vitamins, lollypops—it's not all those other things." "With *Spider-Man*," he continued, "there's virtually no limit."

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[13] U.S. Entertainment Industry: 2003 MPA Statistics, MPAA.

[14] For example, in March 2003, it had made an agreement with Pepsi-Cola International under which Pepsi introduced hundreds of thousands of Marvel-themed soft-drink packages throughout Europe, Asia, and other territories.

Marvel's goal was to secure the "best-in-class" licensing partners in all major categories. Licensees entered into a legal contract with Marvel that gave them the right to use certain Marvel characters within a product category. Most contracts involved one or more characters that had appeared, or were scheduled to appear, in movies. Licensees had to adhere to strictly defined style guides in their branding efforts and had to submit samples of the final product for Marvel's approval. The contract specified a minimum guarantee, which was to be paid to Marvel regardless of the sales of the licensee's product. The level of the guarantee typically depended on the popularity of the character. If sales exceeded the minimum guarantee, licensees were required to pay additional royalties, so-called overages. Royalty rates typically ranged from 8% to 15%, but could be as high as 30%, of wholesale prices, depending on the category, the character, and other details of the licensing agreement.

Marvel had signed up 128 new licensees with an average guarantee of $348,000 in 2003—a 148% increase compared with 2000. The increase was predominantly the result of the popularity of *The Hulk* and *Spider-Man* classic toy lines. The large majority of licensing arrangements had resulted in the payment of royalties, and the average royalty revenues per contract had increased from $78,000 in 2000 to $318,000 in 2003. Toys, apparel for boys, and video games generated about 50% of all of Marvel's licensing revenues.

The licensing industry Licensing represented a significant market opportunity. Manufacturers paid $5.8 billion in licensing royalties in the United States in 2003, which projected out to over $110 billion in retail sales of licensed products. The largest sector was entertainment and characters, with $2.5 billion in royalty revenues, which corresponded to nearly $50 billion in retail value. This sector was also the most concentrated of all major licensing sectors, with a few large players representing the consumer products divisions of major entertainment studios, the main sources of licensing activity in this sector.[15] Marvel competed with a range of entities that owned intellectual property rights in characters, including DC Comics and The Walt Disney Company.

Positioning Marvel for the Future

By June 2004, Marvel executives were convinced that the company was on the verge of a period of enduring growth. However, they realized that two marketing challenges were critical to Marvel's future success.

First, Marvel managers had to decide how to use its library of characters. Two opposing strategic directions could be distinguished.

- Marvel could continue to capitalize on the strength of a limited set of prominent characters, most notably *Spider-Man*. "There is no reason to believe *Spider-Man* is ever going to end," noted Maisel in support of this option. "There will always be an appetite for our primary characters." However, Marvel would have to address concerns expressed by channel partners and the investment community. How long could the company create value with its main characters? Consumer tastes for media properties were notoriously fickle. How real was the risk of Marvel's business turning sour as a result of consumers losing interest in a character like *Spider-Man*?

- Marvel could decide to shift focus to a larger set of lesser-known characters that might have the potential of becoming blockbuster characters but were largely unknown to the wider

[15] Source: Licensing Industry Survey 2003, The International Licensing Industry Merchandisers' Association. This survey was conducted by professors Ravi Dhar (Yale School of Management) and Bharat N. Anand (Harvard Business School).

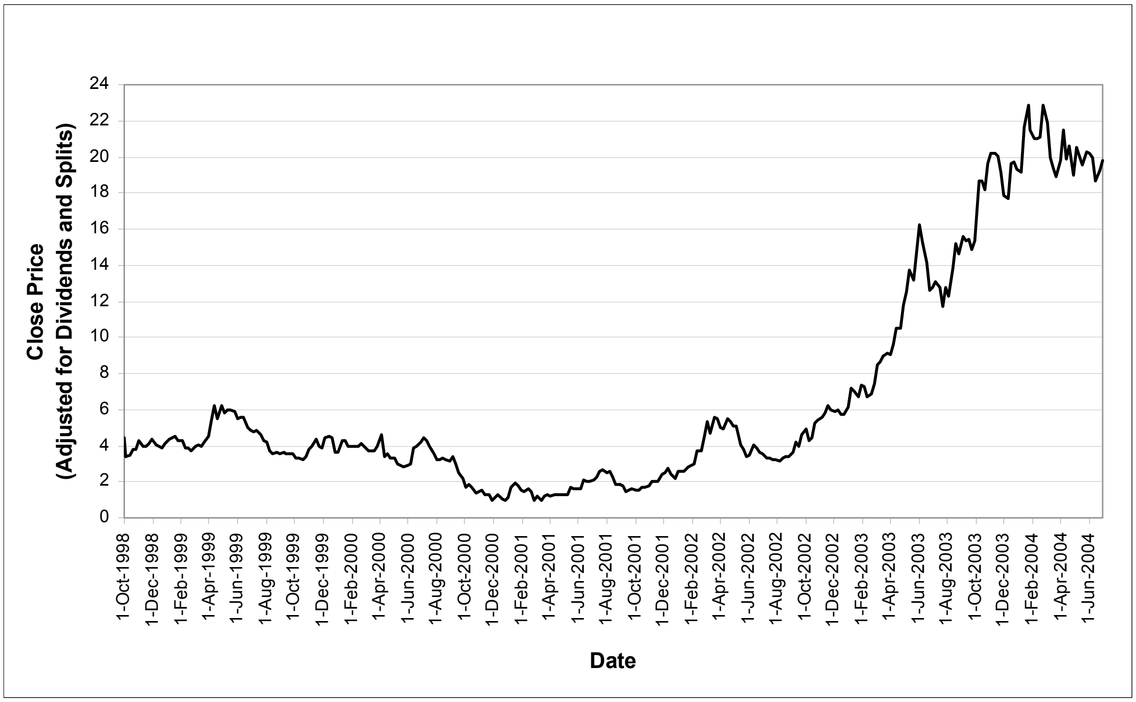
public. "This is about converting *Spider-Man* fans into Marvel fans," said Cuneo. "We could launch several new character franchises. For example, next summer, the big-event film is *The Fantastic Four*. It's going to be a family-oriented, action-adventure movie, with four heroes. We can use that movie as the entry point for a *Fantastic Four* business." Would Marvel be better off dedicating its resources to growing businesses for its lesser-known characters? If so, how?

Second, Marvel executives would have to decide whether it was wise to venture beyond the current business model and take on more capital-intensive—but also potentially more profitable—activities in the value chain for entertainment products. "We create content in only two areas—comic books and toys," Cuneo said. "In other areas, we assist, but we don't create content ourselves. For example, we play a very important role in the movie-scriptwriting stage by providing information on our characters, and writers can't do without us, but we don't make our own movies."

Marvel's success had brought the discussion about a possible role in content production and distribution to the forefront. "We never had the cash to consider these issues," Cuneo pointed out, "but now we do." "There are a number of ways for us to bring our properties to the market—film, television, home video, the Internet, video games," said Maisel. "The questions are which properties to use, in what order, and what the best way to do that is on a spectrum from having a licensee assume primary responsibility at one end to taking complete control ourselves on the other end." Given the potential costs and revenues involved, the preferred strategy in the area of motion pictures was a particularly heavily debated issue. Were the rewards worth the risks?

"It only looks like magic from the outside," Cuneo concluded. "It is an awful lot of hard work and nail biting on the inside." He knew Marvel's executive team faced critical strategic questions, but he was convinced of the company's potential for growth. "We can take Marvel to a whole other level," he said. "If we are successful, people will one day talk about Marvel the way they talk about a conglomerate like Disney."

Exhibit 1 Stock Price for Marvel Enterprises (October 1, 1998–June 29, 2004)



Source: New York Stock Exchange.

Exhibit 2 Selected Financial Information for Marvel Enterprises ($000)[a]

Category		**2000**	**2001**	**2002**	**2003**	**2004, Q1**
Publishing	Net Sales	46,300	49,500	64,500	73,300	19,600
	• *Direct Market*	--	--	*48,900*	*52,000*	*13,200*
	• *Mass Market*[b]	--	--	*8,700*	*9,100*	*2,500*
	• *Subscriptions*	--	--	*1,500*	*2,000*	*400*
	• *Advertising*	--	--	*4,200*	*6,400*	*2,700*
	• *Other*[c]	--	--	*1,100*	*3,800*	*800*
	Gross Profit	22,400	25,600	33,100	39,000	10,600
	Operating Income	--	14,500	19,600	25,400	7,300
Toys	Net Sales	166,800	91,700	155,000	85,200	52,600
	Gross Profit	61,700	26,900	48,800	40,000	21,000
	Operating Income[d]	--	-5,800	8,900	21,700	15,600
Licensing[e]	Net Sales	18,500	40,000	79,600	189,200	50,100
	• *Apparel & Accessories*	--	*7,700*	*11,300*	*39,200*	*19,700*
	• *Entertainment*[f]	--	*14,800*	*39,500*	*50,600*	*5,400*
	• *Toy Royalties & Fees*	--	*6,400*	*24,500*	*79,700*	*9,600*
	• *Other*	--	*11,200*	*4,200*	*19,700*	*15,400*
	Gross Profit	18,200	40,000	75,100	189,200	50,100
	Operating Income	--	5,200	69,400	139,400	38,500
SG&A	Total	-107,500	-62,000	-85,800	-108,900	-32,100
	• *Publishing*	--	--	*-14,700*	*-13,600*	*-3,300*
	• *Toys*	--	--	*-34,300*	*-14,800*	*-5,000*
	• *Licensing*	--	--	*-19,500*	*-61,100*	*-19,700*
	• *Corporate*	--	*-12,500*	*-17,300*	*-19,400*	*-4,100*
Total	**Net Sales**	**231,700**	**181,200**	**299,000**	**347,600**	**122,300**
	Operating Income[g]	**-59,000**	**1,300**	**80,500**	**167,200**	**57,300**
	Net Income	**-89,900**	**5,300**	**22,600**	**151,600**	**31,300**

Source: Marvel Enterprises.

[a] Totals may not add due to rounding.

[b] Includes newsstands.

[c] Includes custom publishing, international, and other.

[d] In 2002, the toy division recorded write-offs of about $10 million related to the *Lord of the Rings* toy line.

[e] Toy royalties and service fees included in the "licensing" category relate to the licensing and agency agreement with TBW (see page 6), while figures for the "toys" category capture only the *Spider-Man* and *Lord of the Rings* product lines.

[f] Includes studios, themed attractions, and electronic games.

[g] In 2001, amortization charges of $24 million depressed earnings. In 2002 and 2003, Marvel received $13.8 million and $10.8 million in income from its *Spider-Man*-related partnership with Sony.

Exhibit 3 Marvel Characters: Some Examples

Spider-Man
Granted incredible arachnid-like powers by a spider bite.

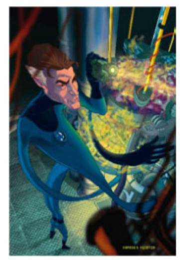
Mary Jane
Spider-Man's love interest.

Green Goblin
Spider-Man's greatest enemy.

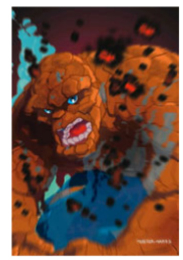
Doctor Octopus
Another Spider-Man enemy.

Human Torch
A member of The Fantastic Four.

Invisible Woman
A member of The Fantastic Four.



Mr. Fantastic
Leader of The Fantastic Four.

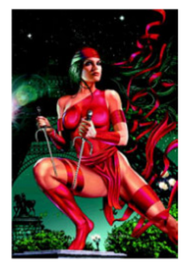


Thing
A member of The Fantastic Four.

Captain America
The American Super-Soldier.

Daredevil
Blind, but his other senses have superhuman sharpness.

Doctor Strange
Master of the Mystic Arts and Earth's Sorcerer Supreme.

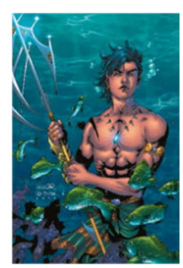


Elektra
Femme fatale, driven by tragedy, honed by training, kills for hire.

Ghost Rider
A skeletal fire demon, avenges just souls touched by evil.

Incredible Hulk
Turns into the personification of his repressed rage and fury.

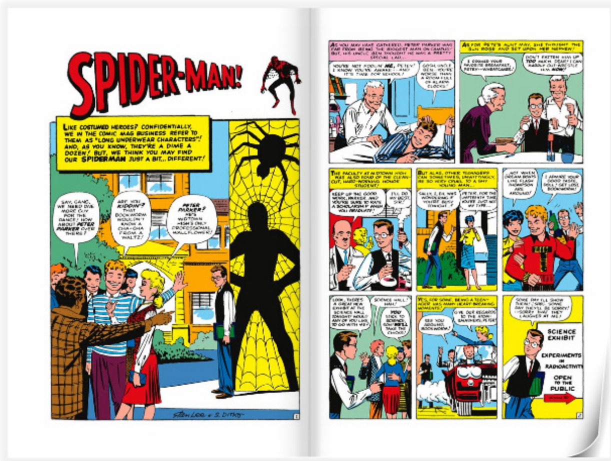
Iron Man
Invincible due to his high-tech life-sustaining shell.



Namor the Sub-Mariner
The monarch of the mighty, sunken empire Atlantis.

Source: Marvel Enterprises.

Exhibit 4 Comic Books: Some Impressions



Amazing Fantasy, #15 (1962)

Ultimate Spider-Man, #2 (2001)

Marvel Age Spider-Man, #1 (2004)

Periodicals

Inside a Comic-Book Store

Graphic Novels

Source: Marvel Enterprises.

Exhibit 5 Marvel's Publishing Division: Statistics for Four Titles

	Jul '03	Aug '03	Sep '03	Oct '03	Nov '03	Dec '03
Amazing Spider-Man						
Number of publications	2	2	1	1	1	1
Retail price per copy	$2.25	$2.25	$2.25	$3.50	$2.25	$2.25
Number of copies	315,500	333,500	165,000	225,200	165,400	158,304
Total revenue	$710,000	$750,300	$371,200	$788,300	$372,100	$356,200
Marvel's revenue	$247,400	$252,300	$125,000	$291,200	$127,500	$122,100
Total cost of goods sold	$98,400	$96,400	$53,000	$90,800	$52,500	$51,600
Gross profit	$149,000	$155,900	$71,000	$200,400	$75,000	$70,500
Ultimate Spider-Man						
Number of publications	1	2	1	2	1	2
Retail price per copy	$2.99	$2.99	$2.99	$2.99	$2.99	$2.99
Number of copies	121,400	248,500	125,100	240,800	118,100	249,400
Total revenue	$273,000	$559,200	$374,200	$541,800	$265,700	$658,000
Marvel's revenue	$119,200	$244,900	$163,900	$237,100	$116,200	$288,300
Total cost of goods sold	$44,400	$89,900	$57,000	$88,400	$44,200	$124,000
Gross profit	$74,800	$155,000	$106,900	$148,700	$72,000	$164,300
Punisher						
Number of publications	1	1	2	2	2	1
Retail price per copy	$2.99	$2.99	$2.99	$2.99	$2.99	$2.99
Number of copies	50,300	49,900	99,100	106,500	102,000	47,600
Total revenue	$150,500	$149,300	$296,200	$318,400	$304,800	$142,400
Marvel's revenue	$66,600	$66,100	$130,700	$123,600	$118,100	$64,000
Total cost of goods sold	$40,600	$40,700	$81,100	$86,200	$85,200	$41,900
Gross profit	$26,000	$25,400	$49,600	$37,400	$32,900	$22,100
The Fantastic Four						
Number of publications	3	2	1	1	2	1
Retail price per copy	$3.30	$2.25	$2.25	$2.25	$2.25	$2.25
Number of copies	169,400	137,900	68,473	67,400	131,100	64,300
Total revenue	$559,400	$310,200	$154,100	$151,600	$295,000	$144,600
Marvel's revenue	$246,900	$135,600	$67,300	$66,100	$128,600	$63,000
Total cost of goods sold	$72,700	$52,300	$26,300	$26,100	$51,500	$25,500
Gross profit	$174,200	$83,300	$41,000	$40,000	$77,100	$37,500

Source: Marvel Enterprises.

Exhibit 6 Toys Based on Marvel Characters: Some Examples

The Hulk
(Electronic Hulk Hands)

Spider-Man
(Triple Action Web Blaster)

Spider-Man
(Action Figures)

Wolverine
(Oversized, Twist ‘m, Classic, Legends Series, Collector’s Edition)

Source: Marvel Enterprises.

Exhibit 7a Marvel Movies to Date

Title	Description (Main Actors)	Studio	Production Cost	Rating[a]	Profit-Sharing Arrangement[b]	U.S. Release Date	Total Box Office U.S.	Total Box Office World
Blade	The tortured warrior Blade (Wesley Snipes) may be humanity's last hope for survival against an army of immortal vampires.	New Line	$45M	R	HE	August 21, 1998	$70M	$113M
X-Men	The X-Men (Hugh Jackman, Halle Berry, and others), a group of superhuman mutants, attempt to stop Magneto (Ian McKellen), an angry mutant who has vowed to eradicate human existence.	20th Century Fox	$75M	PG-13	HE	July 14, 2000	$157M	$296M
Blade II	The sequel to Blade.	New Line	$55M	R	HE	March 22, 2002	$82M	$150M
Spider-Man	High-school student Peter Parker (Tobey Maguire) is bitten by a genetically altered spider and wakes up with acute vision and incredible strength. Peter Parker has become Spider-Man.	Sony	$139M	PG-13	RP	May 3, 2002	$404M	$822M
Daredevil	Although attorney Matt Murdock (Ben Affleck) is blind, his other four senses function with superhuman sharpness. At night Murdock is Daredevil, a relentless avenger of justice.	20th Century Fox	$75M	PG-13	RP	February 14, 2003	$103M	$179M
X-Men II	The sequel to X-Men.	20th Century Fox	$110M	PG-13	PP (but only 5% share for Marvel)	May 2, 2003	$215M	$406M
The Hulk	After a freak lab accident unleashes a genetically enhanced, impossibly strong creature, The Hulk (Eric Bana), a terrified world must marshal its forces to stop a being with incredible abilities.	Universal	$120M	PG-13	RP (but $5M cap)	June 20, 2003	$132M	$242M
The Punisher	The Punisher (Thomas Jane) has no superpowers to battle the evil he sees, only years of combat experience and his iron determination to avenge those wronged by society's villains.	Lions Gate	$33M	R	PP	April 16, 2004	$34M	TBD

Source: Marvel Enterprises.

[a] "G" denotes General Audiences, "PG" Parental Guidance Suggested, "PG13" Parents Strongly Cautioned, and "R" Restricted. Source: MPAA (www.mpaa.org).

[b] "RP" denotes Revenue Participation, "PP" Profit Participation, and "HE" Hollywood Economics. The latter was a term Marvel used to describe deals in which Marvel receives a share of studio profits after all expenses; the manner in which studios calculated such profits typically resulted in a negligible amount that could be shared.

Exhibit 7b Marvel Movies: Pipeline for 2004–2006

Title	Description	Studio	Targeted U.S. Release Date	Status
Spider-Man II	The sequel to Spider-Man.	Sony	June 30, 2004	Completed
Blade III	Third installment of Blade.	New Line	August 12, 2004	Completed
Elektra	Elektra (Jennifer Garner), the girlfriend of blind lawyer Matt Murdock, is a mistress of the skills of the ancient ninja of Japan. She must stand up to her ninja peers.	20th Century Fox	February 18, 2005	Filming
Fantastic Four	A freak encounter with cosmic rays forever changes the lives of a family of adventurers rocketed into space, granting each unique powers.	20th Century Fox	July 2, 2005	Contract, Script, Cast
Iron Man	Gravely injured by an act of industrial sabotage, billionaire genius Tony Stark saved his life by designing a life-sustaining high-tech shell.	New Line	Q4, 2005	Contract, Script
The Punisher II	Sequel to The Punisher.	Lions Gate	Q4, 2005	Contract
Ghost Rider	Bad-boy biker Johnny Blaze (Nicolas Cage) finds himself transformed into a skeletal fire demon thundering through the night on a mystical motorcycle of hellfire. As Ghost Rider, he avenges just souls tarnished by the touch of evil.	Sony	Q4, 2005	Script, Director
Luke Cage	Wrongly convicted of a crime that he didn't commit, Luke Cage is submitted to a strange experiment to win his freedom from prison. Years later, he continues to fight the good fight . . . for the right price.	Sony	Q1, 2006	Script
Black Widow	Formerly an agent of the Soviet Union, Black Widow now uses her amazing fighting skills and acrobatic abilities for good.	Lions Gate	Q1, 2006	Contract
Deathlok	A suburban husband and father who is infected with a techno-organic virus must find a cure before it takes over his mind and turns him into a killing machine.	Paramount	Q2, 2006	Contract, Script
X-Men III	Third installment of X-Men.	20th Century Fox	May 3, 2006	Contract
The Hulk II	The sequel to The Hulk.	Universal	Q3, 2006	Contract
Namor	Namor, monarch of the sunken empire Atlantis, rises from the depths of the sea to defend all humanity.	Universal	Q4, 2006	Contract, Script

Source: Marvel Enterprises.