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Hard and Soft Mega-Media Conglomeration: Has Sony's Strategy Created Synergies?

by Yasuhiro INOUE*

Introduction

Sony Corporation acquired CBS Records and Columbia Pictures in 1988 and 1989, respectively. The total of seven billion-dollar acquisitions made possible the vertical integration of hardware (Sony) and software media companies (CBS Records and Columbia Pictures). Now, Sony (media and entertainment divisions only) is one of the largest media group in the world. It is apparent that Sony aimed at creating synergies out of the integration (Neubauser & Cowley, 1992; Jeffrey, 1993). A few years after the acquisition, however, critics said that the combination of hardware and software did not churn out any magical "synergy" at all (for example, see Sims, 1993; Williams, 1993; *The Economist*, 1994 & 1997b). However, it may have been too early at the early stage to judge whether or not Sony's conglomeration was a successful case that created "synergy." In addition, new information technology such as WWW (World Wide Web) was still in its infancy in the early 1990s, but it drastically changed the media business environment in the late 1990s. For example, Internet business and media content business have been merged into a single entity such as AOL Time Warner. It is thus necessary to investigate synergy effects in the new media environment.

More than a decade after the big deals, it may be the right time to assess the synergies from the hard-soft combination, if any. The purpose of this study is to examine the effects of Sony's acquisitions of these two entertainment companies on its economic performance by focusing on the U.S. market. The effects of mergers and acquisitions (M&A) in terms of synergies is controversial. Adams and Brock (1989) criticize mega-mergers and acquisitions in general and say that M&A is "[a] profitable game, perhaps, for the players, but hardly an adventure in creative capitalism" (p. x). On the other hand, proponents for M&A

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assert that acquisitions in general have been demonstrated to create economic value by reducing costs of the combined entity and utilization of resources (for example, Jensen & Ruback, 1983; Chatterjee, 1986).

In order to observe synergies that could be attributed to the acquisitions, the changes of Sony's performances in various markets are compared before and after the acquisitions. Sony's vertical integration is unique because few media conglomerates have been integrated like Sony's hardware and software segments. Most media conglomerations are horizontal integration or simple conglomerations by mergers and acquisitions. Thus, the examination of this unique vertical integration will provide not only the answer about synergies but also more insight into M&A research.

Literature Review

Synergy

Synergy in business is defined as "the ability of two or more units or companies to generate greater value working together than they could working apart" (Goold & Campbell, 1998: 133). Put in other words, the value of the whole is greater than the sum of the values of the parts. It is said that various aims for merging or acquiring are profit maximization, risk avoidance, enrichment of senior management, or simply the desire to form huge corporations (Ducoffe & Smith, 1994: 16). The management of large companies pursues synergy out of M&A by setting up cross-business teams to plan coordinate product development (Goold and Campbell, 1998). The communications industry is not an exception. Synergy is often cited as one of the major reasons behind the recent wave of communication industry conglomerate mergers (Litman & Sochay, 1994).

According to Goold and Campbell (1998), synergies by M&A take one of the following forms: shared know-how, coordinated strategies, shared tangible resources, vertical integration, pooled negotiating power, and combined business creation. Eisman (1992) explains the mechanism of synergy creation; "Vertically integrated marketing, or synergy, occurs when companies under the same corporate umbrella promote their products or services simultaneously. One benefit of practicing synergy is that companies can reap cost savings from sharing promotional costs among divisions" (p. 61). Bielinski listed sources of synergy that might be created by mergers and acquisitions: (1) New markets for acquirer's product, (2) New markets for target's products, (3) Stronger combined product line, (4) Manufacturing efficiencies, (5) Buy raw materials in larger volume-better price, (6) Eliminate/integrate duplicate general and administrative functions and departments, (7) Eliminate duplication where suppliers are few and common to acquirer and target, (8) Eliminate duplication where customers are relatively few and in similar geographic territories, (9) Tax benefits, (10) Avoid additional capital expenditures through use of acquired warehouse or manufacturing capacity, (11) Lower cost of money, (12) Sale of unneeded assets, and (13) Risk and cost reduction through vertical or horizontal integration.

Pro-M&A

Supporters for M&A argue that increasing size resulting from mergers and acquisitions allows companies to accomplish economies of scale by sharing systems and eliminating duplicate management and infrastructure. And most importantly, integration of various companies can create and maximize synergy. In addition, mergers and acquisitions of foreign companies make it possible for multinationals to enter into international markets. For Sony, acquiring U.S. companies can give the company advantages in doing business in the U.S. market, which is the world's largest consumer market.

William F. Baxter, President Reagan's first chief of the Justice Department's Antitrust Division stated that, "Merger activity in general is a very important feature of our capital markets by which assets are continuously moved into the hands of managers who can employ them efficiently" (cited in Adams & Brock, 1989: xii). Jensen and Ruback (1983) reviewed literature on corporate takeover and found evidence that M&A generate positive gains, that target firm shareholders benefits, and that bidding firm shareholders do not lose. Chatterjee (1986) collected data for 157 mergers from the Federal Trade Commission's Statistical Report on Mergers and Acquisitions and then compared the performance of the merged companies with that of rival firms. He found in general that M&A created economic value.

For example, Warner Bros took comic book characters such as Batman and Wonder Woman from its DC Comics division and turned them into feature films, TV series, and paperback books. Paramount turned the Star Trek television series into a successful feature film and book franchise (Hammer, 1989). These examples point out that at least some of the global media conglomerates of today were able to develop synergies by utilizing conglomeration by M&A.

Con-M&A

Contrary to these findings and statements, Goold and Campbell (1998) found that synergy initiated by M&A often falls short of what was initially expected by the management. They stated that, "Some never get beyond a few perfunctory meetings. Others generate a quick burst of activity and then slowly peter out. Others become permanent corporate fixtures without ever fulfilling their original goals. If the only drawbacks to such efforts were frustration and embarrassment, they might be viewed benignly as 'learning experiences'" (p. 132).

The M&A aiming at synergies sometimes backfire and end up with destruction of value rather than creation of value because M&A could erode customer relationships, damage brands, or undermine employee morale (Goold & Campbell, 1998). Bielinski (1992) states, "synergy is a euphemism for, 'The CEO got carried away and paid too much." (p. 9).

The evidence generated from Ravenscraft and Scherer's analyses of nearly 6,000 corporate mergers (1987) strongly suggests that mergers and acquisitions undermine efficiency in production, prevent technological advance, and ruin international competitiveness. Ducoffe and Smith (1994) examined the effects of mergers and acquisitions on the advertising industry. Findings generally suggested that M&A seldom gave advantages over control agencies. Rather, while bigger corporations were found to be more productive, "the data indicate that the post-merger performance of agencies was worse than firms of similar size" (p. 25). M&A in the advertising industry have not created synergies.

Cultural Chemistry

One of the difficulties of management for acquired companies results from cultural and psychological mismatches between acquirers and acquired (Callahan, 1986; Bryan and Buck, 1989). "When a basic chemistry between the people of the merger partners does not exist, the postacquisition stage, no matter how quickly and expeditiously it is executed after the closing, may be too late to correct the flaws imbedded by managerial disharmony" (Callahan, 1986: 47). A cultural chemistry clash leads to catastrophe for a small company; even for a big company it is painful problem (Callahan, 1986; Bryan and Buck, 1989). It is said that a big company is less susceptible to the cultural clashes, although a wrong chemistry can be the biggest impediment to an expected and possible synergies. Sony operates worldwide; however, it is still a Japanese company. Acquisitions of CBS Record and Columbia Picture could have these chemistry problems.

Sony Corporation

Sony was found in 1946 as Tokyo Tsushin Kogyo (Tokyo Communications Industry) by two legendary tycoons, Ibuka and Morita. Since then, Sony has been driven by innovation and product development. As early as 1955, Sony produced "TR-55", Japan's first transistor radio. Sony then produced the world's first transistor television in 1960. Sony's Walkman came onto the market in 1979. In the same year, Sony and Philips invented the Compact Disc (CD) and started to sell it in 1982. Walkman and CD along with Sony's Video Walkman (1988) are listed as "Major technological inventions" of the year by *The Cambridge Factfinder*.

After the CBS Records (1988) and Columbia Pictures (1989) acquisitions, the Japanese electronics giant then entered into the video game industry in 1994, which had been virtually dominated by another Japanese company, Nintendo. Sony's video game system, Play Station, has been outperforming Nintendo's since its introduction to the world market. Sony Computer Entertainment (SCE), which developed the video game, accounts for one third of total profits of Sony Corp in the late 1990s (Sony company report).

Prior to the Play Station, Sony exclusively introduced the MD (mini disc) that is a smaller version of CD. And most recently, Sony and other electronic giants started selling DVD (digital video disc) in 1997 in the United States (1996 in Japan). DVD, which has the potential to outstrip VHS, is a next generation medium. DVD is the same size as a CD; however, it can hold a 2-hour long movie with high resolution. In the near future, Sony and Phillips will exclusively start selling super audio CD, which outperform the present CD in quality.

Sony obtained multi-level "windows" through which the company can distribute a single product (movie) and spread the "first copy" cost of the product. In the media industries such as print, television and especially motion film, creating the "first copy" costs a tremendous amount of money. The "windows" range from movie theaters to home videos. Sony has widened the range to Play Station and DVD. Specifically, a movie is shown first in the theaters, then home video and/or DVD, then to pay-per-view, television, and lastly possibly in Play Station game software. The greater the potential reach of the movie, the lower will be the average cost per viewer (Thomas & Litman, 1991). Therefore, Sony can spread high first copy producing cost across as many households as possible to accomplish economies of scale.

Sony can use the huge library of Columbia's motion pictures to promote its products into the market. It is apparent that Sony had sought software to bundle with its 8mm video[1] when the company acquired Columbia. For example, a movie can be promoted and advertised while hardware is simultaneously promoted. Furthermore, Sony can save huge amounts of money for the use of movie copyright when the company advertises its hardware by using footage from its motion pictures. This process can be referred to as "multidimensional scale economies" (Thomas & Litman, 1991). Long-run average cost curves decline relative to the number of viewers and relative to the number of movies brokered. This is one of Sony's advantages over "unintegrated" media companies. Sony's Play Station outsells its Nintendo counterpart because of its more sophisticated visual and sound effects that could be applied to Columbia's visual and CBS's audio technologies. The popularity may also be enhanced by using Columbia's movie characters that can appear in Play Station game software to appeal consumers.

Movie theme songs are also good examples of simultaneous promotion/ advertisement. Sony can take advantage of linking music songs with motion pictures. As is the case of DVD and motion picture, a movie can be promoted/advertised while its theme song can be exposed to viewers/listeners. Sony's advantage can be summarized as mutual-reliance and reciprocity. This means that the hardware division can receive expertise from in-house suppliers. In turn, software divisions, such as Columbia's visual and CBS Record's sound, can receive hardware technologies necessary to produce quality and efficiency. Ultimately, the structure as a whole can receive cost-efficient and intangible benefits.

Sony as a group, one of the largest electronic companies, has deep pockets to absorb unexpected losses that are inherent to the entertainment industry. An important Japanese business principle is "ultra-long-termism," which allows a new venture to continue regardless of relatively short term loss. Thus, the company can sustain the operations of its entertainment divisions.

Research Topics

The burning question is whether the marriage of Sony's hardware technologies and Columbia/CBS's software expertise has created synergies. To answer the question, this study first examines before and after acquisition performance of the company as a whole, and then the performance of specific segments. Research topics to be analyzed are as follows:

1. Sales and profits of Sony Corporation as a whole, before and after the acquisitions.
2. Sales and market shares of particular products such as motion picture, VCR, DVD, CD, and video game before and after the acquisitions.
3. Whether or not the acquisitions contributed to the development of Sony's video game Play Station in terms of technology transfer, and vice versa.
4. Cross megahits, if any (music vs. motion picture and motion picture vs. video game)

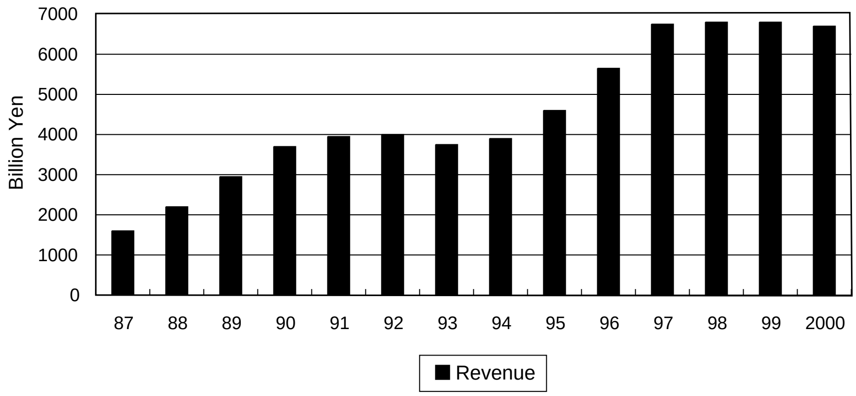
Results: After Acquisitions

Overall Sales and Profits

About 70 percent of Sony's total revenues came from foreign sales in the late 1990s and 2000. Sales in the U.S. accounted for about 30 percent of Sony's total revenues in the same period. This means that its revenues are subject to foreign currency rates, especially the exchange rate for the U.S. dollar and Japanese yen. Thus, the figures of sales and profits do not necessarily reflect the company's performance precisely. One should be very careful in analyzing and interpreting the data. For simplicity, it is assumed that the figures of revenues and profit/loss in Japanese yen reflect the company's performance.

Chart 1 shows the company's consolidated sales. The sales have increased after the CBS acquisition in 1988 except for 1993 and 1994. When Sony acquired CBS in 1988, the company's overall revenue was 2,201 billion-yen. In 1999, the revenue peaked at 6,804 billion yen, which was more than three times that of 10 years ago. Chart 1 demonstrates that the growth rates of late 1980s and mid 1990s are greater than those of early 1990s and late 1990s. This can be partly ascribed to the fact that the Japanese yen rose and the U.S. dollar fell during the lower growth rate period. It is not surprising that the consolidated sales revenue increased in 1988 and 1989 because the revenue of these two years included the revenue from CBS Record and Columbia Picture. The slow growth rate in the early 1990s might be interpreted as indicating that the acquisitions needed a "take off" period to create synergies.

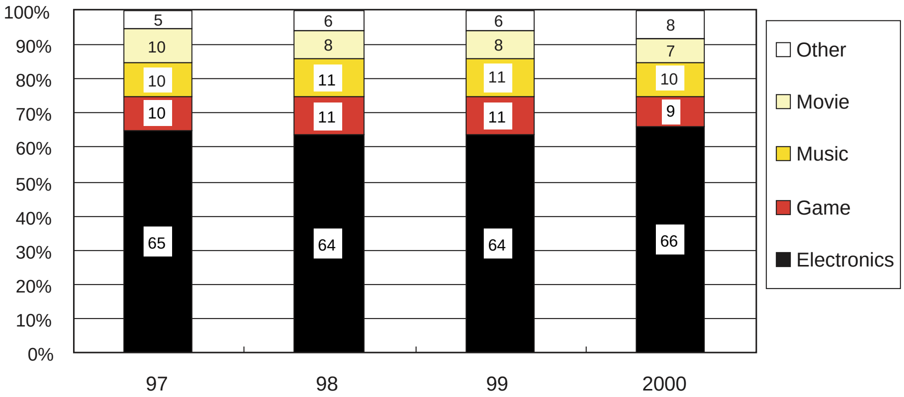
Chart 1: Consolidated Sales



Source: *Sony Company Report*

Each entertainment division makes up about 10 percent of the total revenues (Chart 2). In terms of revenue, Sony is a growth company before 1997. It seems that the growth is attributed to the acquisition and subsequent synergies. However, it is too early to conclude that the overall growth is due to synergies at this point.

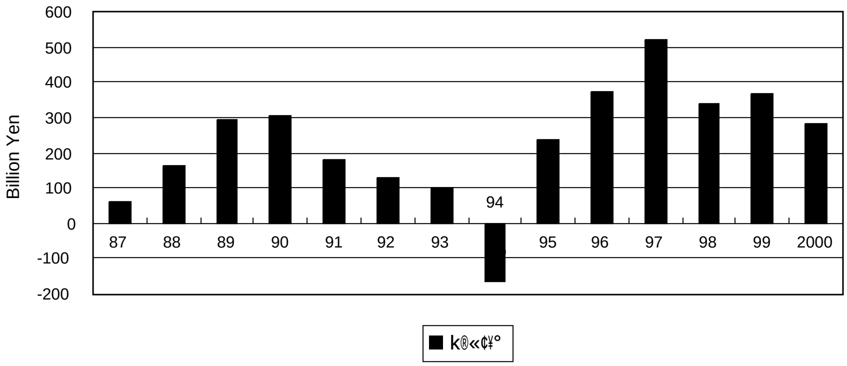
Chart 2: Consolidated Revenue by Segments



Source: *Sony Company Report*

Chart 3 shows that the company's consolidated profits. The profits soared from 1995 to 1997. The profits since then decreased partly due to the drastic shift to higher Japanese yen against the U.S. dollar. However, the company is overall doing very good. Sony lost the total of 170 billion yen in 1994. According to Sony's company report, this is due to the movie division's repayment for the goodwill and payment for an out-of-court settlement. The division lost the total of 273 billion yen, which exceeded the company's profits in the year.

Chart 3: Consolidated Profit

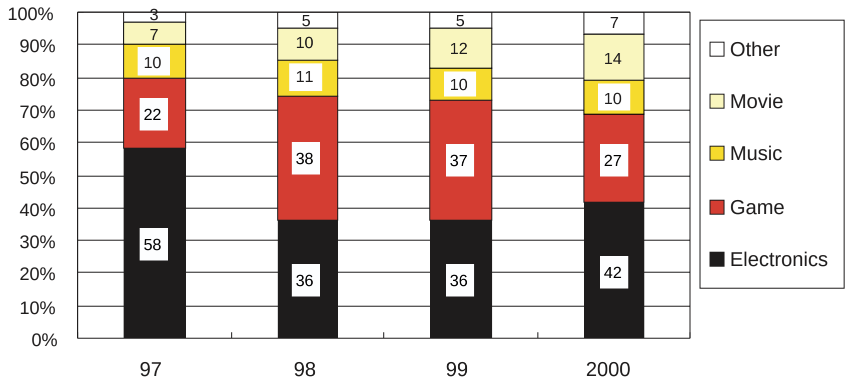


Source: *Sony Company Report*

Motion Picture and Video

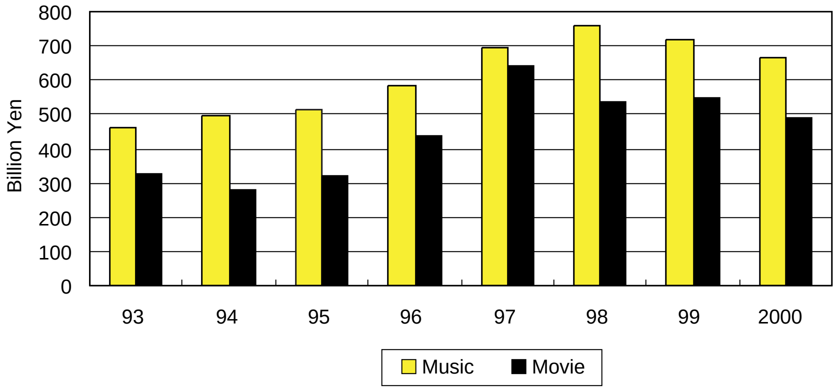
Sony's revenues come from five major segments; electronic, video game, music, motion picture, and insurance. The soaring sales and profits do not necessarily mean that entertainment segments such as movie and music are also performing very well. Therefore, one needs to look at the performance of Sony's entertainment segments specifically. Chart 4 shows Sony's profits by segments from 1997 to 2000. Sony paid more money to acquire Columbia than CBS Records, however, the sales of music division have consistently outperformed the movie division during the period. Chart 5 shows the revenues of the two divisions. Whereas the revenue of the music division has been relatively stable, that of the movie division has fluctuated. Chart 4 also shows that the video game division's huge contribution to the company's profits. In terms of revenue, the game division accounted for about 10 percent, which was about the same percentage as the movie and music divisions. The game division is literally a newcomer in the business, which began its business in 1994. However, the game division made up 22 percent of the total profits in 1997. In the following year, the game became the most profitable segment and accounted for 38 percent of the total profits.

Chart 4: Profits by Segments



Source: *Sony Company Report*

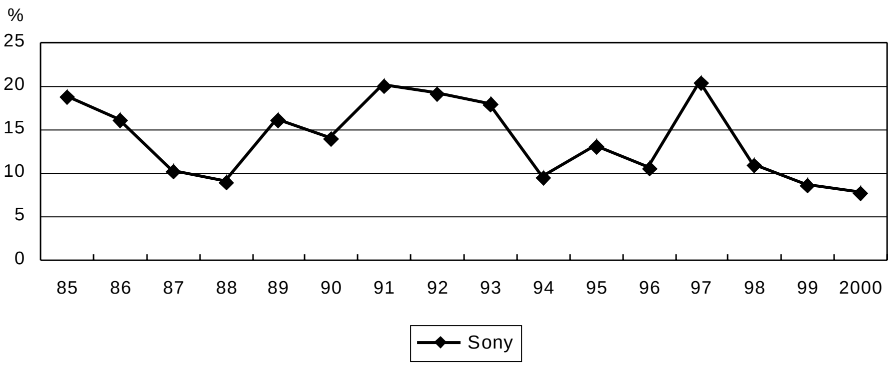
Chart 5: Sales of Music and Movie



Source: *Sony Company Report*

Chart 6 shows Sony Pictures Entertainment (Columbia and TriStar) box office market shares in the U.S. from 1985 to 2000. After Sony acquired Columbia in 1989, the movie division increased its market share for a few years except for 1990. The division recorded a 20 percent market share in 1991, which was the highest in the U.S. movie industry. However, Sony's market share decreased after that year. In 1994, the movie division accounted for only 9.5 percent market share. Although the market share of the division rebounded in 1997 (the highest market share among majors, 20 percent), its share relapsed into 11 percent market share in the following year and went down to 7.7 percent in 2000, which was the lowest after Sony's acquisition of Columbia.

Chart 6: Sony's Box Office Market Share (US)

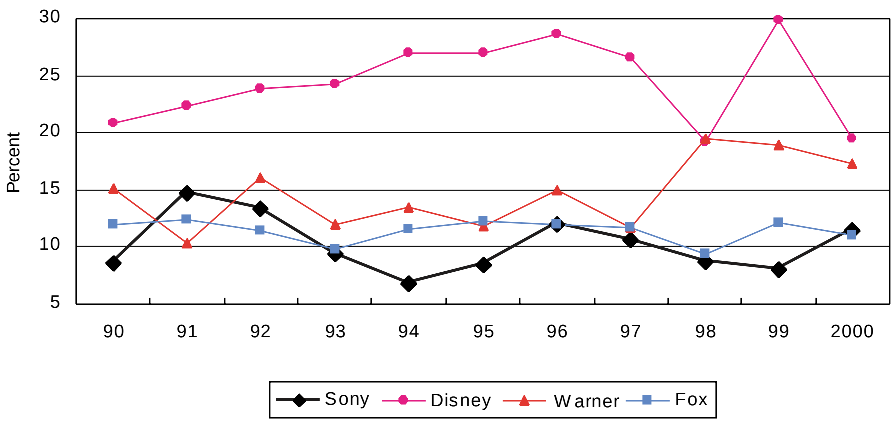


Source: *Variety and Hollywood Reporter*

Of course, the volatility of the market share is applied not only to Sony but also to other motion picture majors. The volatility may be one of the industry's attributes. All six majors—Sony, Disney, Warner, Paramount, Universal, and Fox—have quite similar patterns; ups and downs of market share over time. However, if Sony's vertical integration had created the promised synergies at all, Sony's movie division should have managed to stabilize or increase the market share. Sony's market share is still subject to the volatility of the rest of the industry. So far, one may be able to conclude that Sony's acquisition of Columbia and TriStar did not create synergies at least for the movie division.

This "tentative" conclusion seems to be supported by other data. Chart 7 shows the market shares of home video. Sony is the only company among six majors that produces video hardware. Thus, the company should be able to take advantage of the vertical integration of video software and hardware. However, Sony's home video software market share in the U.S. is quite volatile, like the box office market share. Although the volatility is a part of the movie industry, Sony's performance in the home video market is not as good as those of other majors. For example, Disney has topped the market share constantly. Other majors' market shares are consistently higher than that of Sony. The market shares of VCR hardware makers in the U.S. also support that Sony's vertical integration has not created satisfactory synergies. In 1996, Sony's market share was seven percent. RCA (Thomson) was ranked first (21 percent) followed by NAP (11 percent). Matsushita (Panasonic) was ranked third (9 percent). Sony held the distant fourth place. Considering that Sony was initially producing only Beta format VCR, which was driven out by VHS, its relatively low market share in VHS player can be explained.

Chart 7: Home Video Market Share (US)



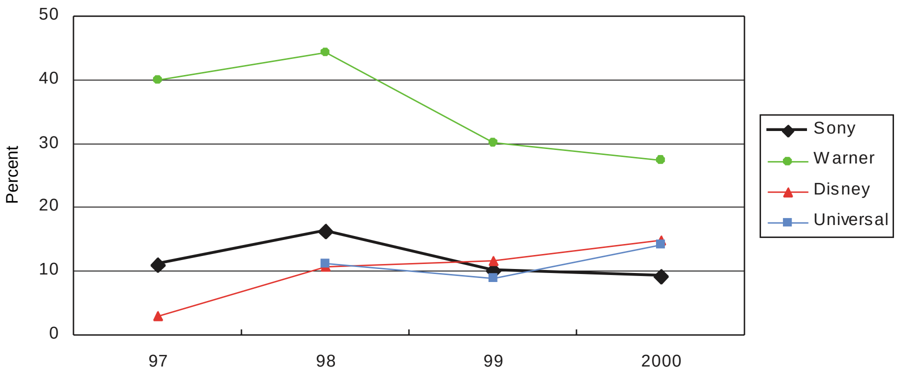
Source: *Billboard and Video Week*

DVD Sale

DVD was developed mostly by Japanese electronic companies with Sony being one of the developer companies. The developers were requested by Hollywood motion picture majors to make DVD so it would be able to hold more than a two-hour long motion picture with quality comparable to much larger LD (laser disk). DVD was developed for the next generation motion picture medium from the start. Since Sony is the only electronic giant that can produce DVD player and Hollywood motion pictures, the company should be able to take advantage of DVD for the sales of both software and hardware.

Sony has not been performing well in terms of DVD software sales, however (Chart 8). The market leader is Time Warner, not Sony. In 1997, the year of DVD introduction into the U.S. market, Time Warner's market share was four times as much as Sony's. Though it seems that the gap is narrowing, Time Warner's dominance has continued. In addition, Disney is moving ahead of Sony into the second place in 1999. In the following year, Sony dropped into the fourth place.

Chart 8: DVD Market Share (US)



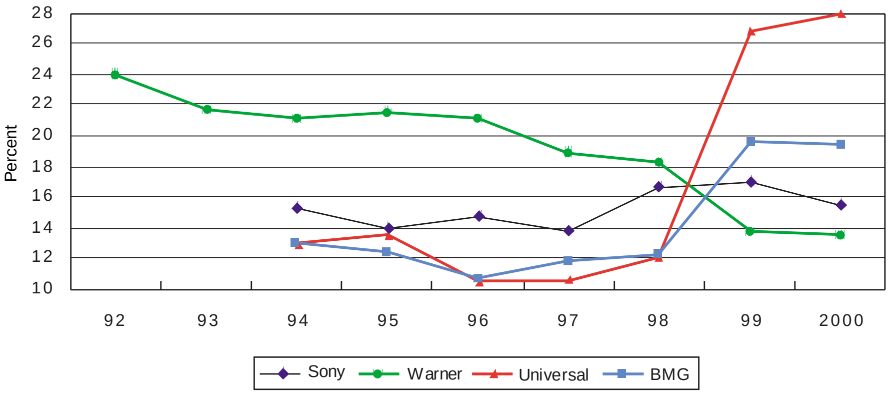
Source: *Video Business, Video Scan, and Video Week*

One of the reasons that has not boosted DVD sale is the fact that *Titanic* was not available for DVD. The biggest box office hit was produced by 20th Century Fox and Paramount. If the movie had been produced by Sony, *Titanic* would have been available to promote DVD players, especially the Sony-made player. Sony, however, was able to take advantage of *Titanic* hit; the label of the CD Soundtrack is Sony. The soundtrack sold about 10 million copies. This big sale made it possible for Sony to become the number one leader in the U.S. current album market (mentioned later).

Music

Unlike the relatively poor performance of movie and DVD sales, Sony's music division (Sony Music Entertainment) seems to have been performing well. Chart 9 shows the market share of album sales in the U.S. Whereas Time Warner's dominance has been receding, the market share of Sony is quite stable. According to SoundScan, a research company, Sony was ranked first in the "current" album sale in 1998 (17.5 percent), followed by Time Warner (17.3 percent). As mentioned previously, the revenue of the music division is greater than that of the movie division, even though CBS was much cheaper to acquire than Columbia.

Chart 9: U.S. Music Album Market Share



Source: *SoundScan*

Looking at music hardware, Sony dominates the U.S. market. In 1996, Sony made up 27 percent of the market share for CD player (ranked first followed by Pioneer's 13 percent). Considering growing market share in music and dominant share holding in hardware by Sony's music and electronic divisions, it seems that Sony has been successful in creating synergies out of vertical integration of music related areas. Sony is one of the two developers (the other is Philips) of CD. Thus, Sony's market dominance in CD players may be neither surprising nor ascribable to synergies from the vertical integration.

Video Game

Sony's game division has been growing and contributing to the company's overall high profitability since it introduced Play Station in Japan in 1994 and in the U.S. market in 1995. As mentioned before, the game division became the most profitable division and made up 38 percent of the company's total profits in 1998. Play Station now literally dominates the world video game market. As of December 1998, the accumulated shipment of the game hardware reached to 50 million in the world. In the U.S. market, more than 19 million Play Station machines were sold by the end of 1998. Play Station accounted for 66 percent of the U.S. market share in 1998, followed by the former market dictator Nintendo (30 percent). It can be assumed that Play Station was developed with the visual expertise from Columbia and audio expertise from CBS. This is not true at all, however. According to a development engineer of Sony, Play Station was developed by a game division totally independent from Columbia and CBS's expertise. Research question 3 is whether or not the acquisitions contributed to the development of Sony's video game Play Station in terms of technology transfer, and vice versa. The answer is apparently "No."

The basic technology (three dimensional computer graphic system) for the video game was invented long before the acquisition of Columbia and CBS (Asakura, 1998). The driving force in the development of the game was not from the acquisition of the motion picture and music companies. Play Station was invented and developed in Japan. If the developer had ever needed knowledge from Columbia and CBS, language barriers would have prevented collaborative works. The explosive hit is attributed to the good relationship between game software companies and Sony, not the relationship between Columbia/ CBS and Sony (Asakura, 1998).

Columbia's movie characters could have been used in Play Station game software. However, video games based on motion pictures are generally doomed to be terrible (*The Economist*, 1997a). There seems an exception, of course. Star Wars is thought of as a promising film that can be used in a video game, although it is a Fox movie. It was reported that Sony tried to obtain the right to use Star Wars characters, however, Nintendo outbid Sony to get the right. Whereas Columbia's expertise in visual effects has not been used in Play Station, according to a Play Station engineer, the game's technology can be sooner or later used in special effects on film makings. Synergies could be created when Play Station technologies are applied to Columbia's film makings. Pokemon, which was originally created for Nintendo video game software, was eventually turned into a very popular television cartoon show and movie. Thus, characters in Play Station software could become popular icons in the future. However, no synergies or cross megahits have been born so far in the relationships between the motion picture and video game divisions.

Conclusion

The present case study examined whether or not Sony's vertical integration of hardware and software created synergies. The answer is mixed, though, mostly no. For Sony Corporation as a whole, the business results have been very good. However, the findings suggest that the excellent business performance cannot be attributed to synergies out of the vertical integration except for the music division. It is definitely true that Sony's overall performance depends on the newly born game division. Play Station was successful in dominating the world market in just a few years. The driving force of the video game, however, was not created out of the integration of the entertainment industry.

The U.S. box office market shares of Sony Pictures Entertainment have been quite unstable even 10 years after the conglomeration that could provide capital. In addition, the vertical integration of film making and hardware has not contributed to the sales of VCR and its software, home video. This poor performance can be ascribed to the fact that Sony had not produced the VHS format until recently. Nonetheless, Sony has been under-performing in the sale of DVD hardware and software. Considering that Sony is the only company that produces DVD hardware and software, the vertical integration is "hardly an adventure in creative capitalism" (Adams & Brock, 1989). On the other hand, the business showing of Sony's music division (Sony Music Entertainment) has been relatively good. It may be too early to state, but it seems that the vertical integration of music related industries has created some synergies.

I would like to present an alternative explanation for the poor performance of the vertical integration. Since Sony is a Japanese company, the acquisitions of American companies (Columbia and CBS) may block the interchange between hardware and software divisions. They literally speak different languages. Gelsi (1997) points out the communication problem and states:

> Although Sony is a top global brand and an expert at communicating with consumers, its own divisions have been known to have a rough time communicating with one another. The company's recorded music, movies, consumer electronics and computer divisions have done little in the way of cross-promotion beyond a series of tie-in projects for new product intros and seasonal initiatives. In the process, Sony has lost out on marketing opportunities and brand synergies that a more integrated approach would create (p. 20).

If the acquisitions of the American entertainment companies had been made by other American companies, the results would have been different. The language barrier may suppress collaborations and exchanges that could become bedrock to create synergies. Negroponte (1996) states that the acquisitions did not work due to not only the divisions between Japan and America but also between Sony's engineering culture and Columbia/CBS's art culture. These barriers, however, may lower or even disappear in the future (Negroponte, 1996).

Lastly, Sony has been aggressively entering the Internet business that requires high-quality content. Sony does have qualified content such as motions picture and music. This is not to say that the conglomeration of an Internet company and media content company shows great promise, as AOL Time Warner has been struggling to create synergies. However, Sony's conglomeration of soft, hard and Internet media business is a unique case so that it still may be too early to judge the effects of the conglomeration. Thus, one needs to examine the Sony's vertical integration again in the future.

NOTE

1. When Sony acquired Columbia, the company intended to promote 8mm video format to take "revenge" on the VHS camp by driving out VHS format. But Sony realized it was nonsense and decided to promote 8mm exclusively for camcorder.

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