A BLUE OCEAN STRATEGY ANALYSIS OF IMAXs' MOVE TO GO HOLLYWOOD

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ABSTRACT

The IMAX Corporation is a large format film production and Distribution Company who found their niche market in the early 2000s challenged not from competitors, but from other sources of entertainment ranging from home theater, sporting events, computers and other entertainment options. Changing dynamics, demographics and technologies led to a deterioration of profitability and share price for IMAX. The resulting financial problems caused IMAX to consider dramatic changes to their core values, strategy and operations. Faced with a challenging and uncertain future, IMAX decided to go Hollywood and embarked in expansion from their niche market in predominantly educational movies and documentaries shown in museums and zoos to new partnerships with theater chains and the conversion of full-length Hollywood blockbuster movies, animations and 3-D format in the IMAX format.

The present paper will examine the given situation IMAX was facing at the time and analyze whether these changes constituted a new Blue Ocean for IMAX utilizing the Blue Ocean Strategy analytic framework.

Keywords: *IMAX, Blue Ocean Strategy, Strategic Management*

1.0 INTRODUCTION

Organizations have long sought to create shareholder wealth as a cornerstone of strategic development and execution. Some companies have been able to achieve this through the introduction of new products, expansion on existing product lines or geographical distribution through globalization or diversification strategies, and through acquisition of new businesses and products to achieve new revenue generation growth, while others have focused on cost cutting and improved productivity and efficiencies to reduce costs as a way to enhance overall profitability. At some point however, revenue growth from existing products and markets becomes stagnant and mature due to changes in market dynamics, consumer behavior shifts, competition or new product introductions an enhancements; while improving financial performance through efficiencies from productivity initiatives slows and becomes more difficult to continually translate into increased profitability. It is at this point, that traditional strategy development must be augmented and firms must look to new alternatives ways of thinking to grow the organization and create new revenue streams, products or market development initiatives.

IMAX was no different. An innovator, IMAX developed the technology to transfer the traditional 35 mm. film regular movie going experience into "the IMAX experience" by showing larger than life cinema productions on substantially larger screens (up to 8 stories). IMAXs vision of a niche market was targeted at the educational and documentary film market using their customized unique film and projection equipment in exclusive venues, principally within museums and zoos, which were attended largely by visitors and schools looking to educate and learn. The term that has been used to describe this is "Edutainment", described by the American Heritage Dictionary as "The act of learning through a medium that both educates and entertains" (American Heritage Dictionary). Although the experience was unique and distinctive, IMAX found themselves in financial difficulties by the early to mid 2000's.

The present paper seeks to ask the question of whether the strategic move from "Edutainment" to Hollywood was a case of Who Moved My Cheese, where the market demand shifted or the creation of a new Blue Ocean, as proposed through the analytic framework of Blue Ocean Strategy, as created by Chan & Mauborgne (2005). To do this, we must understand the situation IMAX found themselves in which led to the decision to go Hollywood and the impact of that decision

1.1 IMAX

In 1967, IMAX was launched in Montreal, Canada to correspond with the opening of EXPO '67 as an experimental multi-screen film. The first IMAX film was shown three years later at EXPO '70 in Japan. In

1994, IMAX went public and started to consider moving into Hollywood films, however, it was not able to capitalize on the venture as the critical mass in distribution was not sufficient to excite Hollywood as there wasn't sufficient venues to show IMAX format movies. The first venture was to take advantage of this technology was Apollo 13; however, to accommodate this transition meant that there was a significant delay between the initial release of the movie and the IMAX release. (IMAX, 2013)

IMAX, then turned to a new invention creating Digital Re-Mastering or DMR to take existing Hollywood movies and re-mastering them into the IMAX format and expanded this to the IMAX MPX system in 2003. This reduced the timeframe of production to allow IMAX to come out with movies almost simultaneously to the Hollywood release and significantly reduced production conversion costs (IMAX, 2013). The conversion of Hollywood blockbuster movies such as the *Matrix Re-loaded*, the *Harry Potter* series and *Polar Express* led other motion picture studios to increase faith in the production and economic viability of IMAX format films.

In the 1990's, IMAX continued to expand beyond their institutional settings by forming alliances with theaters such as AMC, Cinemark and Regal, selling IMAX hardware into these theater chains; however with the rapid expansion of theaters, oversaturation led to many theater owners filing for bankruptcy and IMAX suffered problems of receivable collections, leading to their own financial difficulties. Their stock price plummeted from a high of $32.69 per share in 1999 to only $0.58 by 2001 (Institutional Investor, 2002).

In 2004, IMAX stock, which had climbed back to nearly $5, fell again to $4.04, when it was revealed that 11 officers and directors of the company had purchased $1 million in IMAX stock, subsequently driving the price as high as $5.18 prior to the release of *Harry Potter, Catwoman* and *Polar Express*, (Blackwell, 2004). This caused concern for investors stung by accounting scandals of the early 2000s including Enron and WorldCom, which ultimately led to the establishment of the Sarbanes-Oxley (SOX) act to re-stimulate confidence in the financial markets.

IMAX had developed a three-pronged strategy for growth. They were in the hardware business of selling IMAX systems into movie theaters, requiring theater owners to cover the estimated $1.4 million cost to retrofit and install the IMAX projectors. Later on, IMAX made arrangements for the theater chain to cover the cost of retrofitting the theater ($150-175,000), while IMAX installed the equipment ($500, 000) and agreed on a revenue sharing arrangement. In December 2007, IMAX made an agreement to install 100 theaters with AMC providing "territorial exclusivity" and another deal with Regal (US News, 2008).

The second business was in movie production business and the third was in movie distribution. A series of patents protected the production business from competitors, and provided a stimulus to help with movie distribution. Many of the large production and distribution companies were becoming vertically integrated which otherwise could have threatened IMAX, without the patents. Partnering with Hollywood movies made sense from the standpoint that the large studios (Disney, PIXAR, MGM, Lions Gate) paid for the Actors and Marketing and distribution costs, while IMAX provided an extra weapon to roll out blockbuster movies at a relatively small cost. The larger threat to IMAX at this point was to be a takeover target by one of the larger studios.

Questions however began to arise about the move to Hollywood. Should IMAX gamble on a move which was fundamentally different from their core image of providing educational entertainment in a scholarly environment, or put another way, would the move to Hollywood, alienate them from the institutional market that had been the core of their existence and erode their image? Should they stay as a small niche market player? Would their financial problems allow them to maintain a "Stay the Course" strategy.

The struggle IMAX found themselves in came from a combination of sources; principally, the oversaturation of the movie theater industry in the early 1990's through rapid growth and expansion, causing many theaters and chains to go bankrupt and creating receivable issues for IMAX, and the increased diversity of alternative options for movie goers from Home Theaters, DVD and eventually Blu-Ray and 3-D video options to the many other forms of entertainment including Sporting Events, Live Theater, Dinners and other means of entertainment for adults and families.

In the early 2000s, IMAX faced stagnation in revenues due to changes in consumer behavior, reflected in the dramatic fall in stock price, which would lead to a need for management to make changes to increase shareholder value. Revenues for IMAX dropped partially in response to changes in consumer behavior in youth markets and attendance at “educational venues” such as zoos and museums, largely based on the growth of the tech market with continuing advancements in computer technology. Youth markets were more interested in playing video game systems such as Sony Playstation, Nintendo Wii and Microsoft Xbox. Other forms of entertainment such as the Apple IPOD, advancements in personal computing, the internet, Blu-ray, large screen TVs and the introduction of home entertainment systems created increased competition for IMAX.

The advances in technology allowed filmmakers to provide audiences with more realistic special effects and with Hollywood studios competing for consumer dollars led to more “over the top” movie experiences (special effects) and consumers demanding more movies meant the product lifecycle of movies required faster turnaround time, Hollywood movies had a limited amount of time to recoup their production, distribution and marketing costs, with new summer release movies coming out every week. This, however, was in stark contrast to IMAX movies which, once released in their theaters could show for years at a time (The Living Seas released in 1995 is still showing at theaters today), providing IMAX with a much longer-lifecycle to recoup costs compared to Hollywood movies.

Other advances in technology, most notably the internet and mass production of computers, introduction of laptops, brought the prices of home computers down and allowed consumers to change their behaviors as visits to museums and other forms of educational entertainment diminished as consumers became more concerned with being “online” and getting their educational experience by visiting the Louvre in Paris or the Great Wall of China through the comfort of their homes via the internet. Student groups were a primary source of customer base for IMAX in their educational environments of museums and zoos, but cutbacks in education budgets and the ability to access “edutainment” online, allowed teachers to show the equivalent movies in the classroom and avoid the expense of going to the museums and zoos.

1.2 WHO MOVED MY CHEESE

In 1998, S. Johnson wrote a short parable called “Who Moved My Cheese” about two mice and two little people. Each day they go to a location to eat cheese. One day the cheese is gone. The mice saw the cheese dwindling and moved on to find new cheese, while the little people continued to return to the same location asking “Who moved my Cheese?”. Eventually one of the little people goes out into the maze to look for new cheese, while the other refuses to move, (Johnson, S., 1998).

The parable leads to an analogy about the implications of market stagnation (through declining revenues, flat share price or shrinking markets) and a company’s response to the situation. The changes observed in consumer behavior could be analogous to IMAX’s cheese being moved. Consumer demand for instant gratification, bigger and better special effects, advances in technology and the expansion of the internet, as well as new formats for home entertainment threatened the very existence of the IMAX experience, and their profitability. This created a change in market dynamics and a move away from educational entertainment such as museums and zoos, as well as other forms of entertainment as will be argued by Blue Ocean Strategy below.

The management at IMAX had to respond to these changes, they could either try to focus or continue to carve out their niche in the edutainment area, risking becoming obsolete, or they could attempt a bold change in the very format of their strategy, risking their identity and using their technology to move into new unchartered territory to expand their operations and create shareholder value.

2.0 BLUE OCEAN STRATEGY

Blue Ocean Strategy was developed by Chan and Mauborgne of INSEAD University in France. The authors developed their strategic hypothesis theory of “Blue Oceans” by analyzing a number of successful products and service launches over the past 100 years and extracted commonalities in the method in which these products and services came into being. From this analysis, they induced a methodology that firms could use to create their own “Blue Oceans” from “untapped market space” and achieve new revenue streams from previously untapped markets. We will apply this methodology to the strategic move IMAX executives took in going Hollywood.

IMAX’s introduction of the new “large screen” movie experience in 1970 in Japan did, at the time, create a new blue ocean. It was a revolutionary process printing on films 10 times larger than regular 35mm files, which allowed movies to be displayed on a large screen (up to eight stories), while maintaining high resolution. The success of IMAX edutainment films were a draw to the museums and zoos where they were situated and created a viable niche market for IMAX. Subsequently, IMAXs’ moved into partnering with Hollywood and theater chains using the same large screen format IMAX was known for. IMAX films were differentiated from the traditional theater experience and were perceived to be justified in asking for an additional $3-5 by moviegoers to appreciate the “IMAX experience”, in a similar way to Starbucks charging additional cost to appreciate the “Starbucks experience”.

The move to Hollywood was considered risky as only 1 of 10 movies recouped their cost of production and IMAX was already facing financial difficulties due to their receivable problems in the early 2000’s. Further, the subsequent agreements (discussed above) made with theater chains called for IMAX to put up the $500,000 installation cost of equipment from the previous arrangements of the theaters putting up all up-front costs.

In 1991, J.B. Barney, created a framework known as the VRIO Model. It was a model developed to determine if a company had a product or service that could be considered to lead to a Sustainable Competitive Advantage. If a company had a sustainable competitive advantage, they would be able to continue to create abnormal returns (those greater than competitors) based on the four criteria of the model VRIO (Valuable, Rare, Imitable and Organizational). To determine if IMAX could have simply maintained their existing model and not change their strategy, we will analyze the IMAX experience using the framework developed by Barney, 1991.

1. Valuable: Yes, the technology and systems capabilities are the basis of the firm’s entertainment experience for its customers, resulting in a $3-5 premium cost to consumers.
2. Rare: Yes, each capability requires high expertise and the skill sets and tacit knowledge are even more rare capabilities.
3. Costly to Imitate: Yes, the individual capabilities require industry specialists, practical/deployment (“Learning curve”) experience as well as system knowledge. DMR took 4-5 years to develop, and subsequently the MPX system. IMAX has patents to protect its Intellectual Property (IP) which further impedes imitators. IMAX has also locked in most of the major theaters into contracts to re-fit theaters to accommodate the IMAX format (Switching cost would be high).
4. Exploited by Organization? Yes, the company is actively and effectively exploiting its technology through market expansion.

Thus we can say that IMAX does have a product which could lead to a sustainable competitive advantage using the VRIO framework. If the market does not change, then IMAX could look forward to years of uninterrupted sustained competitive advantage, however, the market dynamics did change and thus IMAX did respond by adding the new revenue stream of Hollywood movies to their existing markets. The question we will now ask is,”Does the change represent a new Blue Ocean?”

Using the Blue Ocean Strategy Analytic Framework, we will analyze the move to Hollywood through analyzing the six paths framework, establishment an ERRC grid and strategic curve analysis.

In analyzing the six paths framework, IMAX must compare themselves to other alternative industries such as dinner/theater/sporting events or a night out. IMAX is well positioned relative to many other forms of entertainment at a cost of $10-12 versus other competitors at $50-$120 for other forms of entertainment (live theater, sports events and dinner), but is more expensive than traditional movies.

The chain of buyers (influencers) looks at demographics. The typical IMAX (institutional museum or zoo) goer is 19-65 years old, university educated and high household income, with a large portion of receipts from school groups (IMAX). This is in contrast to typical movie (theater) audiences which tend to be younger aged (12-24 year old) representing 38% of movie admissions and also more frequent moviegoers (41%), with 25-39 year old representing another 29% of admissions, while 75% of movie goers make $35,000 or more, (MPAA, 2007).

In looking at the functional versus emotional path, IMAX's edutainment focuses primarily on functional, providing information, while the typical Hollywood movie focused on emotional aspects of fantasy and fictional storytelling. The IMAX Hollywood switched its focus to the emotional aspect only promoting big budget blockbuster movies which are visually stunning, action packed fantasy, which elicits an emotional response in moviegoers.

The second analysis is the Elimination, Reduction, Raise and Create (ERRC) grid:

Eliminate	**Raise** - Size of screen - Technology - Sound - Price vs. Traditional Movies - Visual Experience - Sharpness of image
Reduce - Number of movie offerings (vs. traditional production firms)	**Create** - Wow factor - 3D large format

Although nothing was eliminated, IMAX did reduce the number of film offerings in the IMAX format versus traditional production companies like SONY, Disney, PIXAR, MGM, not transforming all movies into the IMAX format. IMAX raised the visual component through the size of screen versus traditional theaters, introducing new technology (shooting style) and Digital Re-mastering (DMR), sound, Pricing of movies, visual experience and sharpness of image and Created a new WOW factor to the large blockbuster films (Harry Potter, StarWars, Spiderman, Shrek, AVATAR, Pirates of the Caribbean: At World's End and James Bond franchise), as well as large scale 3-D format movies.

In looking at the strategy curve, we can further see the differential which led to the decision to go with Hollywood movies.

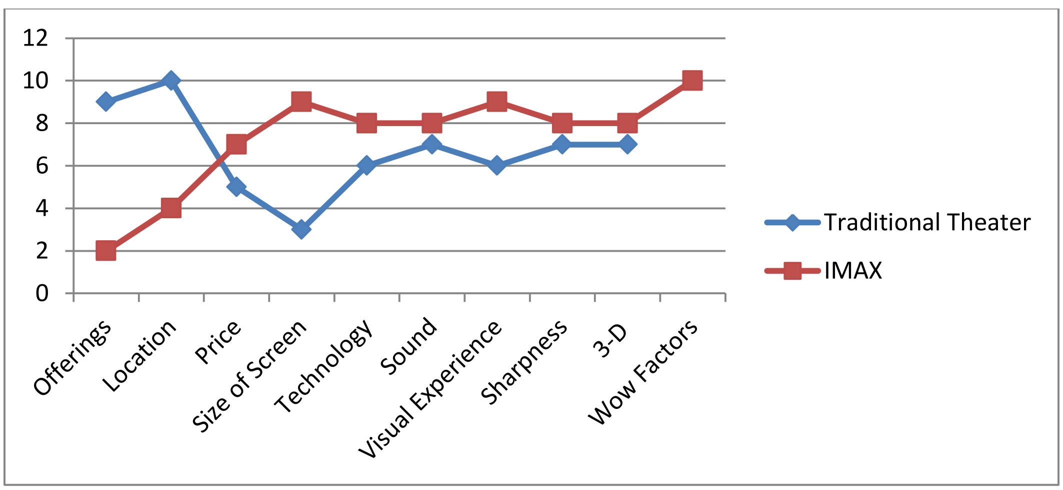


Figure 1: Strategy Canvas of IMAX versus Traditional Theater

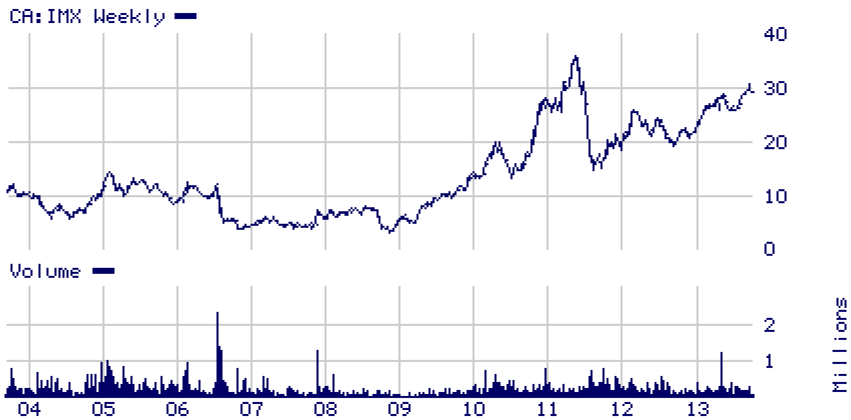
When considering the Buyer Utility Map we identify various utilities that would be relevant to the movie going experience for buyers and look for pain points to alleviate and also capture and enhance utilities of the movie going experience. The new format to view movies provided an enhanced utility for movie goers, with superior graphics using the Digital Re-Mastering technique and state of the art sound providing a different and enriched experience for customers. By partnering with theater chains across North America and around the World, IMAX has been able to expand the place utility by allowing movie goers more locations to experience the IMAX format.

To determine if a Blue Ocean was created, Chan and Maubourgne use a test of the Blue Ocean Index checking for: Utility, Price, Cost and Adoption. In analyzing the move to Hollywood, we see that there is, from the value curve in the Strategy Canvas an enhanced utility for which movie goers were willing to pay a higher price (considered a negative – but was able to meet the needs of the masses) as the cost was lower than other forms of entertainment. The cost structure for production/conversion to the IMAX format was low and through economies of scale and learning curves would continue to be reduced and did meet the adoption hurdles of clients (both theater chain owners and movie goers) by absorbing the primary cost of installation and providing an enhanced movie experience for which movie goers were willing to pay a higher cost.

Using Blue Ocean Concepts we would say that this strategic move would be considered a blue ocean strategy with a unique value curve which differs significantly from traditional theater curves.

3.0 UPDATE ON IMAX

In retrospect, we can see that the move to Hollywood has been successful. IMAX was able to return to profitability with their share price rising from $0.58 in 2001 to its current valuation at $31.05 on September 30, 2013. Revenues have also grown to $284 million USD today.



IMAX weekly stock quote 10 years (IMAX, 2013)

Blue Ocean Strategy theory suggests that once a blue ocean is created, competitors will be drawn into the market and it will form a red ocean. IMAX has been able to maintain their unique competitive advantage as a result of patents, contracts with major theater chains (preventing imitation) and the continued allure of the IMAX experience for moviegoers by choosing the right type of movies to convert to the IMAX format. Currently IMAX now has 738 theaters in 58 countries (IMAX 2013).

4.0 CONCLUSIONS

IMAX, in going through the value curve definitively did create a blue ocean on paper, but the question still remains as to what caused this need. Was the market that they were in contributing to the need to seek out a new blue ocean? In the early years following the company going public, the stock price of IMAX was depressed (over 90% off their peak), consumer trends were shifting and there was a threat that the company could be in dire financial trouble.

The company could have maintained in the edutainment market as a niche player, while the market slowly dwindled (a case of who moved my cheese), however the management made a conscientious strategic move to look for new cheese (Hollywood). The early agreements were favorable to IMAX, with the theaters covering the upfront installation cost of transitioning to the IMAX experience but this became a catch 22 with the cost preventing widespread adoption, while Hollywood not wanting to pay the cost of conversion to IMAX due to low distribution potential.

IMAX, converted to a new technology DMR, which reduced the cost and structured new agreements, splitting the cost of retrofitting and installation and also splitting the higher revenues from the IMAX experience, while focusing on a niche portion of Hollywood movies which are visually stunning and action packed which intensifies the IMAX experience to movie goers.

In conclusion, IMAX did create a new blue ocean, going after a market that they had no revenues in and their gamble, eventually paid off with a much more financially stable organization than prior to the Hollywood move.

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