Should Disneyland expand?

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California Expansion Analysis

The following paper analyzes whether or not Disney should expand upon the facilities that it currently operates in Anaheim, California. The viability of expansion hinges on Disney's ability to draw additional tourists to this region, attract current visitors to the region to Disney facilities, and/or convert current day or overnight travelers into resort tourists. The analysis relies on the experience of Disney World Resorts in the Orlando, Florida area.

Today, the main difference between Disneyland in California and Disney World in Orlando is that Disney World is a resort that holds many guests for their entire vacation while Disneyland is a one-day stop for most guests. Higher revenues are possible from a resort where complementary services such as stores, restaurants, and hotels contribute to Disney's bottom line. To transform Disneyland into such a resort, more attractions are necessary. Last year, Disneyland added a second theme park, Disney California Adventure, and built Downtown Disney, a collection of stores and restaurants. This is the first step in creating a true resort experience, but two theme parks do not create a lure as strong as the four Disney theme parks in Orlando. Poor early attendance at California Adventure is likely the product of Disney being stuck in the middle, between a destination resort and a more regional park. Visitors are primarily day or short weekend visitors to Disneyland and are not compelled to spend an extra night just to visit California Adventure, particularly when they may be staying off property in Los Angeles. At minimum, a third theme park is necessary to keep more guests on Disney property for the majority of their vacation.

Introduction and Summary of Findings

There are numerous ways to define the industry in which Disney's Parks & Resorts division competes. To maintain focus, we chose the fairly narrow definition of Theme Parks. Within this market, differentiation among competitors is primarily along three dimensions: Age of target customer and Length of stay (as shown in Exhibit 1) and Theme. The proposal to expand the offerings in California can be partially represented visually by moving Disneyland on the lower Hotelling line to a point equivalent with Disney World in Orlando.

We believe that thoughtful expansion in California is a prudent move for Disney at this time. The structure of the industry supports sustained profitability and additional investment. Disney's current presence in Anaheim, with its proximity to the Los Angeles tourist market, makes this a logical location for expansion. However, Disney must recognize and develop around the differences between the Orlando and Los Angeles markets. A myriad of non-theme park attractions shifts the focus from theme park competition to cooperation with providers of substitute entertainment products. The lesser role of theme parks in the California area increases competition for the smaller market size and makes preemption of another firm’s development a key to success. Differentiating an expanded resort from the existing Orlando resorts might be the most difficult strategy to carry out. One option is to target families with slightly older children, making the parks more complementary. Families can visit Disney World first, then Disneyland when their children get a little older. Another differentiation option is to offer more of a thrill-based park that is tailored more closely to the current demographic of Los Angeles tourists.

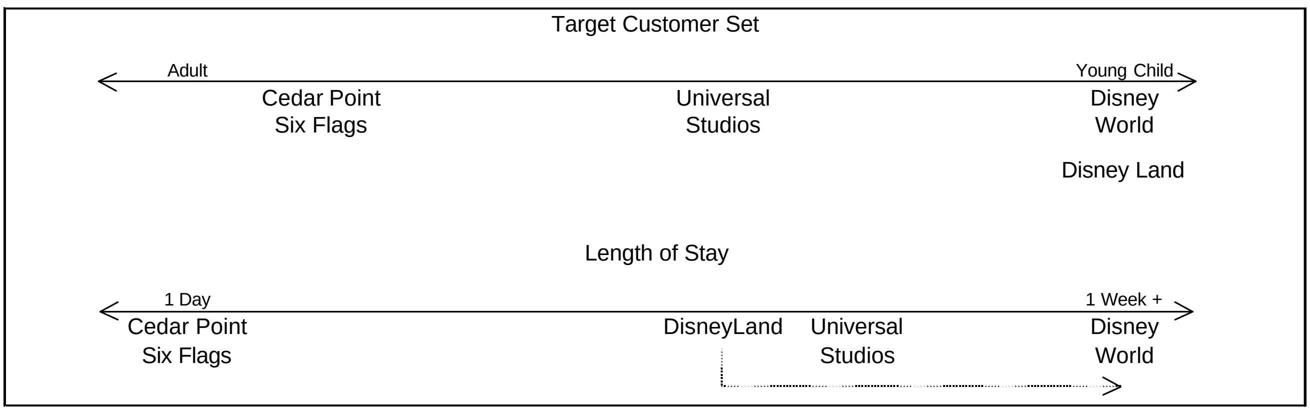

Exhibit 1: Hotelling Lines

Industry Analysis

Disney’s primary competitor in the theme park industry is Universal Studios, and only a small number of relatively large-scale park operators exist including Anheuser Busch, Premier Parks, and Cedar Fair. Rivalry among these competitors is not particularly intense. Despite high fixed costs and marginal costs that are essentially zero, theme park operations provide steady profits at a high margin, as shown in Exhibit 2. Competition is dampened across many of the firms first by geographic diversity. Regional parks rarely compete directly with each other, with the possible exception of the enthusiast customer, in which case they compete on feature attractions - building the highest, fastest, tallest roller coaster. Several parks operating in close proximity tend to form a destination resort as they have in Orlando. These resorts are further defined by a myriad of complementary offerings - including lodging, shopping, restaurants and golf. Operation of multiple parks and the relative lack of substitute attractions encourage competitors to offer these complements themselves. Competition and stronger rivalry are encouraged for customers visiting that market, but there is also greater basis for cooperation in promotion of the market as a whole. In this way, competitors are also complements. In such cases, rivalry is held in check primarily through differentiation by theme, which helps to segment target customers by age. Complementary offerings can create a lock-in effect for the destination resort customer, further reducing the rivalry once a visitor has gotten to the area. By fulfilling all of a traveler's needs, competitors more completely divide the market amongst themselves. For the segment of the market that does not want to have their vacation dominated by just one set of attractions, there is a reasonable basis for the firms to cooperate with joint promotions (or at least jointly-timed promotions). However, competition for the complementary spend from this group of the market is also likely to be the most intense.

(millions)	2001 Performance			2000 Performance		
	Revenues	Operating Profits	Margin	Revenues	Operating Profits	Margin
Disney Parks & Resorts	$ 7,004	$ 1,586	22.6%	$ 6,809	$ 1,615	23.7%
Six Flags, Inc.	1,046	150	14.3%	1,007	177	17.5%
Anheuser Busch Entertainment Corporation	848	147	17.4%	838	115	13.7%
Cedar Fair, L.P.	477	99	20.7%	473	116	24.4%
Universal Studios	INFORMATION NOT AVAILABLE					

Source: Company Annual Reports

Exhibit 2: Theme Park Operating Performance

As mentioned above, complements play a vital role in the industry. Self-provision of direct complements like hotels and multiple parks allow firms to offer complete packages. This, in turn, allows firms to more closely control the entire experience, giving them more power in the relationship with the customer. Competing parks and other tourist offerings act as complements as well, drawing additional traffic and potentially broadening a location's appeal. A second level of complements includes the television, film and/or ancillary products that help develop and establish theme. In-house production of such complements exploits economies of scope in promotions and reinforces the branding of the product to the customer. In fact, these are necessary complements as theme parks inherently require a theme. Firms create demand by popularizing characters that the target audience can relate to, creating the park as an extension of the experience begun on film. Other complements, like transportation and reservations services or family situation are less important, but will help to increase or decrease the size of the total available market.

There are high barriers to entry in the industry. Additional entry is likely to be in the form of expansion, and new entry is unlikely. Theme-generating complements act as one form of entry barrier, limiting potential outside entrants to entertainment driven companies with marketable characters or cash-rich firms willing to buy the rights to a theme. The concentration in theme park ownership seems to indicate that management and operational expertise may form an additional barrier, further limiting possible entrants. Immovable assets with few alternative uses make exit costs extremely high, which also dissuades entry. High up-front costs (pushed even higher by the provision of complementary offerings) and the importance of reputation act to reinforce the strength of other barriers. The industry's position in the mature stage of the product life cycle further suggests that entry is unlikely by outside firms. Consolidation of park management and turnover in ownership is currently quite prevalent. Examples include the ownership changes of Six Flags and the purchase of Sea World attractions by Anheuser-Busch.

The attractiveness of the industry and of destination resorts has played out in Universal's competitive response to past Disney expansion. Universal responded to Disney World by building a resort of its own in Orlando that consists of two theme parks and many hotels and restaurants. Internationally, Universal responded to Disney's licensing in Tokyo and Paris by building theme parks in Japan and Spain. The Southern California market is also a battleground for these two competitors. Universal Studios Hollywood has added many restaurants and shops to capture a larger share of tourist dollars. It is likely that Universal Studios would want to match Disney's expansion by building a second theme park of its own, further replicating the competitive environment in Orlando and attracting the resort tourists that Disney wants to create and claim.

In sum, the theme park industry presents good prospects for sustained profitability. Consequently, expansion by Disney is a solid decision. Clear lines of differentiation allow for sustained profitability, and high barriers promise to protect the industry from new entrants. Substitutes, including ski and beach resorts, family visits and outdoor recreational activities are imperfect substitutes, and can actually act as complements by allowing for a more diverse family vacation. Neither suppliers nor buyers wield any power against theme park operators. Furthermore, the highly important role of synergies between the theme and the park position

Disney particularly well, even relative to current competitors. Finally, expansion decisions can rationally proceed soon, since the option value of waiting is minimal given the low likelihood of new significant information on decision variables. The theme park industry analysis is summarized in Exhibit 3.

Product:	Theme Park entertainment
Competitors:	Universal Studios, Six Flags, Cedar Fair, Anheuser-Busch
Rivalry:	Weak
Barriers to Entry:	High
Substitutes:	Numerous, but imperfect
Complements:	Numerous, highly important
Buyer Power:	None
Supplier Power:	None
Conclusion:	High likelihood for sustained profits, Disney well positioned

Exhibit 3: Theme Park Industry Analysis

Market Analysis

A quick look at attendance figures in Exhibit 4 emphasizes the complementarity between parks. Six of the top 10 parks are owned and operated by Disney. Seven are in Orlando, with the remaining three in Southern California. In the Orlando market, Disney's peripheral attractions are able to capture each customer, on average, 1.7 times per visit to the Magic Kingdom. This data suggests that Disney is currently foregoing as many as 15.9 million potential visitors annually by having a contracted offering in the Southern California market[1]. Furthermore, although precise data is not publicly available, a significant number of these visitors stay on Disney property for a majority of their visit, pumping up the spending per visitor once lodging and meals are factored in.

Currently, the demographics of visitors to Orlando and Los Angeles[2] have some important differences. These differences are not unexpected given the importance of theme parks in

[1] 12.3 million visitors to Disneyland times 1.7 peripheral visits less the 5.0 million visits achieved by California Adventure in 2001

[2] Los Angeles used as a proxy for the Anaheim, Southern California market. Significant differences would affect the conclusions of our analysis.

Orlando[3] tourism and the greater degree of business conducted in Los Angeles. Los Angeles tends to attract younger visitors in smaller groups whose stays are nearly 1/3 shorter than those in Orlando. However, per person spending in the two cities is remarkably similar, making Disney's objective capturing a greater share of current spending as opposed to increasing the overall spend of visitors. This demographic information reveals an important strategy for the long-term effectiveness of expanding the Disneyland resort. Make a positive impression on younger adult visitors (who may not yet have established families) and business travelers who first encounter the region on a non-leisure trip to attract people back to Disneyland when their situations more closely align with Disney's target.

Park, Location	Owner	Attendance
Magic Kingdom, Orlando	**Disney**	**14,700,000**
Disneyland, Anaheim	**Disney**	**12,300,000**
Epcot Center, Orlando	**Disney**	**9,000,000**
Disney-MGM Studios, Orlando	**Disney**	**8,300,000**
Animal Kingdom, Orlando	**Disney**	**7,700,000**
Universal Studios, Orlando	Universal Studios	7,200,000
Islands of Adventure, Orlando	Universal Studios	5,500,000
Seaworld, Orlando	Anheuser-Busch	5,100,000
California Adventure, Anaheim	**Disney**	**5,000,000**
Universal Studios, Hollywood	Universal Studios	4,700,000

Source: Amusement Business

Exhibit 4: Top 10 Most Visited U.S. Parks in 2001

Geographically, Orlando has the potential advantage of proximity. This allows for quick, easy travel between attractions for customers and relatively cheap provision of the transportation as an added complement for Disney. However, this proximity also applies to competing parks, increasing the likelihood of at least some non-Disney spending during a vacation. Southern California is geographically more diverse, which bestows the advantage of more plentiful non-theme park attractions. Southern California also has a climate advantage, with more temperate weather, particularly in the summer months, and significantly less rainfall.

Despite the broad-based appeal of Disney in Florida, a majority of domestic visitors still come from the Eastern and Southern United States. Similarly, Disney in California attracts primarily

[3] Theme Parks a "primary reason" for visiting Orlando for 64% of domestic visitors and 89% of international visitors, versus only 18% and 49% for Los Angeles. Source: Orlando/Orange County Convention & Visitors Bureau Inc.; Los Angeles Convention & Visitors Bureau.

Western US residents, while both attract a significant number of international visitors[4]. This suggests that threat of cannibalization of Disney's current Florida customers is not as great as it might otherwise be. Overall, the Southern California market represents significant untapped potential, and therefore is an attractive target for expansion. Geographic and business differences must be considered, however, in determining the appropriate strategy for growth.

Strategy Considerations

Disney must first keep sight of its goal of maximizing overall attendance across all of its parks. Despite drawing many regional visitors, Disney must still be mindful of the potential to cannibalize customers from its other resort locations. They must carefully construct a web of interrelated, self-reinforcing strategies that both creates a differentiated product from its own and competitor's offerings and takes advantage of the differences between the two markets. Principally, because of the reduced emphasis on the theme park experience in the Southern California market and the proliferation of substitute activities like beaches and general interest sightseeing, Disney should not plan to dominate the traveler's vacation like they do in the Orlando market. Surely, Disney could lead the creation of an environment similar to that in Florida, but success would either be elusive (given the differences in tourist demographic) or at the expense of its Orlando operations (if successful in attracting the same target). This broad conclusion leads to a number of specific strategies.

First, Disney should de-emphasize the theme park while keeping it near the center of the vacation. While Disneyland visitors will still spend multiple days in the theme parks, they are also more likely to engage in other activities. One element of achieving this strategy is to establish or expand cooperative relationships with current non-theme park attractions. These might include Hollywood tours or tour guides, sporting events[5], national parks, beaches, etc. Cooperation might encompass integrated vacation packages offered through travel agencies, price promotions, joint advertising campaigns or information packets for customers detailing the surrounding area. Additionally, Disney should locate a portion of its lodging options further away from its own parks in Anaheim and closer to the other attractions in Los Angeles and Hollywood. This would show a commitment to supporting these outside attractions as well as

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[4] Tourist demographic information gathered from Los Angeles Convention and Visitors Bureau and the Orlando/Orange County Convention & Visitor's Bureau Inc.

[5] Here, Disney can cross-promote with it's Major League Baseball and National Hockey League holdings

making Disney property more attractive to the customer who wants both experiences. The distance between Disney and other points of interest also suggests that provision of transportation is a key issue. Providing a limited set of bus services between its properties and a few key area attractions can further signal Disney's commitment to the surrounding area. Either establishing or partnering for on-site rental car service would allow families the opportunity to see other area attractions or take a day trip to San Diego. These transportation options add convenience for the traveler and effectively expand what Disney has to offer, increasing their role in the vacation.

Next, Disney should attempt to expand their target customer set in California to include older children and younger adults, taking advantage of the current tourist demographic. This is consistent with its need to differentiate an expanded Disneyland from Disney World. The danger in this strategy is in sending mixed signals about what families can expect and causing brand confusion by creating an experience that is too "un-Disney." A slightly older age target is also likely to be more immune to exploiting synergies with movie and television characters. And as indicated by Exhibit 1, expansion in California will form a competitor for Disney's existing Orlando resort. The potential benefit, however, is great as well. Success would mean creating complementarities between resorts. A Disneyland vacation would become a perfect follow-up to a Disney World vacation, extending the experience and drawing customers who might otherwise have quit after one Disney trip. One option for Disney to expand in this way is to build a thrill-based park as a part of Disneyland as opposed to the strictly family offerings it has currently.

Disney should also consider lowering the price points for portions of their expanded resort, particularly lodging. This will support the strategy of attracting a broader audience to Disney property, making their offering attractive relative to other local options. Revenues forgone here can be recovered on food or transportation services. One mechanism for this should be discounted one-day admissions or bundled hotel stays in conjunction with local businesses. Out-of-town employees or clients will be encouraged to sample Disney's offering and may be attracted back with their families.

Lower prices will also support the final element of strategy, which is to dissuade entry by other parks (or encourage exit where they already exist), particularly Universal. Accommodation and greater cooperation with competitors makes sense in Orlando where theme parks make up nearly the entire offering. But in California, the focus of cooperation shifts to substitutes as mentioned above and rivalry with competitors should be strong. The fewer dollars spent on the theme park experience indicates that the market only supports one firm, making it more important for Disney to capture a greater share in this winner-take-all market. One option for achieving this result is to ensure a complete offering of park experiences. So, where Universal or another competitor might fill a niche, Disney should preempt by identifying and filling that niche first. This might be in the form of a series of “mini-parks” that fill the product space. For example, having a thrill-ride park, a water park and an educational park that are all reasonably priced and potentially bundled, might dissuade expansion by other parks. Another option for Disney is to partner with the existing Universal Hollywood park, which has fairly low attendance draw. By helping their competitor to maintain a small share, Disney can make the market less attractive to entry while keeping its nearest competitor in check. While this is not Universal’s favored outcome, it may be more desirable than direct competition on terms that Disney has established.

By expanding via this set of self-reinforcing strategies, we believe Disney will be able to enhance profitability in the California market.