Arvato Mobile: Leading and Shaping the Mobile Content Industry

By

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**Background**

Historically, innovation on the mobile platform has focused around the development of infrastructure and devices. Thus telecommunications operators have invested significant resources into wireless technologies, primarily by building out the telecommunications infrastructure to accommodate the growing demand for wireless services, developing hardware such as cellular telephones and wireless hubs, or acting as service providers.¹ In their rush to create innovative products and services, mobile operators paid almost no attention to content development prompting some industry analysts to contend that the wireless arena was just a ‘watered down web’ with little content that users wanted to access or pay for.²³

While much of the industry was still driven by mobile telecommunications operators in 2003, innovation in the mobile technology industry was entering a new phase in which the emphasis had shifted somewhat toward content innovation, that is, the innovation that takes place on top of the software or hardware platforms and devices. BeMobile (as it was then called) a mobile service provider based in Hamburg, Germany, was capitalizing on this new wave of innovation.⁴ From its origins as Handy.de, an entrepreneurial startup which sold cell phones, service plans and some entertainment content through its website, the Company had evolved into one of the leading mobile service providers in Europe. The sale of handsets, service plans and personalized content on its website as well as through print and television channels gave the Company a solid presence in the business-to-consumer mobile market. However, BeMobile’s fastest growing and most important business focused on enabling “… network operators, media companies and Internet-portals to offer their customers first-rate mobile content and innovative applications.”⁵ In effect, BeMobile’s new business model was to be a packager and integrator of content for the mobile operators who could outsource the complex management of content licenses, intellectual property rights as well as content design for a technology platform that was continually evolving, lacked standards and had a confusing array of devices.

Though BeMobile succeeded in establishing itself in the lucrative business-to-business mobile entertainment/service provisioning arena and was profitable, the Company still faced significant challenges. For one thing, the mobile platform and especially the mobile content industry were still being defined as various constituencies vied for the revenue streams. Mobile operators for example, who overwhelmingly controlled the customer base, were trying to retain their domination by controlling the pricing structure of premium content and had developed revenue sharing models with content providers that for the most part favored the operators.⁶ The music labels, who were struggling to survive as their industry was being transformed by digitalization, saw the mobile content arena as a place where they could use their considerable assets to generate revenues for their ailing industry.⁷ In addition, there were
small companies that produced ring tones and service companies who were trying to emulate BeMobile’s model and capture parts of the marketplace. BeMobile was an early entrant in the mobile content provisioning arena, but had to contend with an increasingly crowded marketplace.

Another important challenge for the young Company’s management was to ensure that there was sufficient organizational growth to meet the increasing demands of the marketplace. In 2003, BeMobile had only fifty people in its Hamburg, Germany location and had three concurrent business models. Along with its business-to-consumer transactions and its leadership as a mobile content aggregator and service provider, BeMobile was also developing value-added services such as Premium SMS and providing mobile solutions for companies who wanted to integrate the mobile platform into their existing information technology infrastructure. Moreover, though the Company was based in Germany, there were plans to expand its services on a global scale. There was definitely a need to scale up the Company in order to be able to address each of these markets. Yet at the same time, those in senior management positions placed great emphasis on maintaining a relatively small organization and focusing the Company’s efforts on providing the quality products and services which had distinguished BeMobile from its inception.

While BeMobile recalibrated its own internal strategies, it also was positioning itself within the organizational context of Bertelsmann, its parent company, which had acquired it in 2002. Bertelsmann’s vast array of businesses includes among others RTL, Europe’s leading television production company, BMG, one of the five major music labels and Random House, the largest English language book publisher in the world (Exhibit 1). Bertelsmann is a highly decentralized organization and encourages its business units to develop their own directions as well as manage their own balance sheets. As a small entrepreneurial venture in this corporate environment, BeMobile’s management had to learn how to work with the other business units to create cross media synergies and balance those efforts with keeping its own distinctive culture intact. Moreover, while Bertelsmann has a tradition of embracing innovative ideas, its recent forays into the digital marketplace such as its investment in Napster, the online music swapping business, had not been very successful and as a result, the conglomerate had begun to scale back its efforts in the online environment and place more emphasis on its core operations. Though the management of Handy.de welcomed the acquisition by Bertelsmann, how this overall corporate retrenchment would affect new media businesses such as BeMobile remained to be seen. BeMobile had established a strong foothold in the emerging mobile content arena. Yet, there were many outstanding issues that needed to be addressed as the Company developed within a volatile, changing marketplace.
Handy.de as an Innovator in the Mobile Content Arena

In 1999, Thorsten Rehling and Dirk Friese were MBA students at the University of California’s Berkeley campus. Their assignment for a class on entrepreneurship was to write a business plan for a startup. They had both heard about the emergence of the mobile platform from their Scandinavian and Japanese classmates and were intrigued. In addition, Thorsten Rehling owned the URL www.handy.de, which designated a website for handys (the German name for cell phones) in a German domain. The two students decided to set up a website which would sell wireless devices, service plans and handset accessories. During their summer break, while Rehling commuted to work at EBay and Friese to Sun Microsystems, Friese wrote the code for the Handy.de website on his laptop. Handy.de was initially housed in Berkeley’s off-campus business incubator. After Handy.de received some initial startup capital from Dr. Neuhaus Techno Nord, a venture capital company based in Hamburg, the site quickly took off as the fastest growing Internet website in Germany with more than 2500 users registering daily.

As they developed their company, Rehling, Friese and Martin Ostermayer, another young entrepreneur who had joined them at Handy.de, discovered that along with cell phones and service plans, their customers were beginning to buy the entertainment and personalized content on the site which consisted mainly of ring tones, screen savers and wallpapers for handsets. There obviously was a market for personalized mobile content especially among the 18-30 year olds. For this audience, cell phones were not just a utility; this age group viewed handsets as an extension of their personal identities and life styles and had already shown their willingness to pay for monophonic ring tones. In Japan alone, ring tone sales doubled in 2002 over the previous year with an average of 110 million ring tones being downloaded each month.

Nevertheless, there was an enormous amount of skepticism on the part of the investment community as to whether there really was a market for ring tones and other mobile content. In general, creating viable business models for the mobile platform had proven to be a difficult task especially in the United States where the expectation of obtaining free content on the Internet had been carried over into the mobile environment. Thorsten Rehling, who was the CEO of Handy.de at the time and later became a Managing Director at BeMobile, described the initial obstacles they encountered:

There was a high barrier to technological innovation because half of the VCs laughed at us and said first of all, people are not going to buy and pay for this type of content because everything is free on the Internet and it won’t happen in the mobile space. Secondly, they said, we don’t believe in this business. Who’s going to pay one or two Euros for a ring tone and make it a mass market? And that has been our main challenge. We believed in the business and we said let us build a market, a market where we don’t have any research data and where we don’t have any benchmarks.
Despite the misgivings of the venture capitalists, Handy.de began creating personalized mobile content in-house and by October 2002, the Company had more than 3.5 million registered users. When asked why the website was so successful, Thorsten Rehling replied:

Having a young management team, listening to the users’ comments, having an image of being playful but at the same time very reliable, being first with new services so our users can be the trendsetters in their peer group. All these aspects in combination with the company logo design has made Handy.de the leading mobile entertainment brand in Germany.

Though they continued to nurture the Handy.de website and provide services and content to their growing user base, the managers of the Company saw an opportunity for Handy.de to become an important player in the emerging content management market and provide their expertise to mobile operators. For Rehling and his co-entrepreneurs, their entry into the business-to-business market seemed like a natural evolution. They had already gained several years of experience dealing with their customers on their website and now could apply what they had learned to this new business model. Thorsten Rehling, explained the value proposition:

One of the main value propositions is content management for the operators because it is very complex to adapt the content to various handsets. You have the legacy devices and the latest devices coming to the market and the content needs to be adjusted to every single device. We also produce the content in-house because music companies don’t produce ring tones and we do the rights clearing which in Europe and in the US is a very complex business as well….So there is a new value chain of rights management, a new value chain of producing content and a new value chain of managing a service for the mobile Internet business…Our mission is to help our customers make more revenue and generate more business.

Handy.de’s dual business model strategy appeared to be working and the content providers as well as the investment community were beginning to take notice. Following the initial investment by Techno Nord, Gunnar and Jahr, a division of Bertelsmann, took a 10 percent stake in the fledgling company. Later in 2001, G&J took a majority stake in the Company. With Bertelsmann’s acquisition of Handy.de, the Company was set to enter a new phase in its development.

**Handy.de Becomes BeMobile**

Under Thomas Middlehoff, who became CEO of Bertelsmann in 1998, the media conglomerate embarked on a strategy which focused on electronic media businesses ranging from Internet services such as AOL to a digital-based television joint venture in Germany. Middlehoff, who initially persuaded the Bertelsmann leadership to buy 5% of America Online in 1995, was convinced that the online environment...
offered new opportunities to the German conglomerate and would draw new customers to Bertelsmann’s core businesses. To prove his point, he invested $300 million in Barnes and Noble Inc. which was earmarked for the bookseller’s website, BarnesandNoble.com.\textsuperscript{17} He also reconfigured Bertelsmann’s music business to include not only BMG, its original music business, but also online music offerings such as CDNow, a leader in online music provision; MyPlay an online storage service; and Napster, an online music file sharing service. In mid-2001, the BeMusic division, which was the umbrella organization for all of the Company’s online music efforts had 23 million subscribers and $1 billion in music sales,\textsuperscript{18} and was successfully competing with other companies in the music entertainment field such as Vivendi, MTVi Group, and AOL Music.\textsuperscript{19} Overall, Middlehoff’s investments in the online arena put Bertelsmann in a leading position on the Internet right behind AOL and well ahead of other media conglomerates such as Disney, Vivendi, and Viacom (Exhibit 2).

A key aspect of Middlehoff’s strategy was to encourage collaboration among the business units in the Company. Middlehoff’s views about cross-media synergies were antithetical to the long standing tradition of allowing business units to operate independently and manage their own P&Ls.\textsuperscript{20} Yet he did succeed in promoting cooperative ventures within the Company. For example on the anniversary of Elvis Presley’s death, BMG sold millions of copies of its “Elvis 30 #1 Hits Album”, Arvato produced the CDs, Random House published books on Elvis; and Gruner and Jahr produced as special ‘bookazine’ in the United States. In addition, the Book Clubs marketed specials on books about Elvis. (Exhibit 3) The net result of this collaboration was approximately €100 million.\textsuperscript{21} During this time, Middlehoff had also begun to invest in mobile content and had funded TJNet, a business unit within Bertelsmann which focused on providing music for mobile phones. To add to this initial business venture, Middlehoff had acquired Handy.de and together with TJNet, the conglomerate established a mobile business unit called BeMobile\textsuperscript{22} and placed it within its Arvato Division (Exhibit 4), which provides information technology, storage and print services to a worldwide market as well as services internally to the Bertelsmann organization.\textsuperscript{23} Organizationally, BeMobile became part of Arvato Systems which had been an in-house IT service provider for the conglomerate but had recently begun to focus on an external customer base with such subsidiaries as Empolis, a provider of knowledge management to content-intensive companies.\textsuperscript{24}

Middlehoff’s vision seemed to make sense in the late 1990s when there was a general belief that investing in the online environment was the key to a successful media company. However, it became clear that developing new media businesses presented major challenges for old-line media companies such as Bertelsmann. In 2001, many of Bertelsmann’s online ventures began to lose money and in July 2002, Bertelsmann’s Board fired Middlehoff and replaced him with Gunter Thielen, who was charged with reviewing the strategy of the Company. Thielen proclaimed a return to the entrepreneurial culture
which had been a salient characteristic of the Company.\textsuperscript{25} The Company also began to sell off its Internet-based businesses and retrenched with an emphasis on its core operations.\textsuperscript{26} As a result of these efforts, Bertelsmann’s flagging financial state began to show signs of recovery.(Exhibit 5)

During the Middlehoff regime and then under Gunter Thielen, BeMobile had adjusted to the strategy which emphasized both synergy across the business units as well as a decentralized environment which placed most of the burden for success on the business units and their management. The management of BeMobile viewed this hybrid strategy as one of the great advantages of being part of the media conglomerate because BeMobile could leverage the strengths of the parent Company while also having the freedom to experiment and chart its own direction. Rehling explained:

This is one of the few examples where the company has been successfully integrated into the large organization. You don’t find that often. It has been renamed as BeMobile. It also took on new business segments such as services for TV and print… We talk to each other a lot. There is a mentality that everyone is responsible for their own P&L but there is also a mentality in Bertelsmann that if you can do business with each other, then you do it quickly and there is some intermeshing of services. For example, if BMG needs a service in the marketplace, they will come to us but we must make sure that we offer the same quality and the same price. That’s why there are market conditions within the Company. Otherwise, there will be cross subsidization of one area by another. It is very important that we talk to them because RTL is a very large TV station group, Random House is the largest English publisher in the world and BMG is a fantastic music company.

As a business unit within Bertelsmann, BeMobile was able to expand its role as an aggregator and packager of content because along with external sources of content which included brand name content from large media companies such as Disney and the content produced by BeMobile’s designers, it now had access to the content developed in-house by the various business units of the media conglomerate. An additional resource was an external cadre of 50 expert designers from whom BeMobile bought content. BeMobile’s ability to provide multiple content offerings was important given the state of the mobile content arena. Hoping to retain their customers and seeing possible revenue opportunities, the operators had begun to sell content on their websites and had set up mobile portals to attract new users. For example, in October 2002, Vodafone, a leading mobile carrier in Europe launched Vodafone Live!, a portal for accessing mobile content which was aimed primarily at young adults.\textsuperscript{27} Other carriers such as Orange and O2 were following suit with their own mobile content portals.\textsuperscript{28} As they entered the mobile content arena, these mobile operators/service providers soon realized that they needed to access the capabilities of content powerhouses order to satisfy the needs of their user populations. In Japan for example, NTT DoCoMo partnered with Disney to provide Disney-branded content to its teen population,
29 and Vodafone made agreements with 250 content partners, including Sony Pictures Mobile, a division of Sony Pictures Digital Networks and Reuters.30

While launching mobile content portals gained them customers, the operators still had to deal with the complexities of content licenses and adopting the content to the various types of handsets and other mobile devices. This was in stark contrast to the early days of the World Wide Web when content-intensive companies addressed the challenges presented by the online environment of the World Wide Web by simply ‘shoveling’ their existing content onto websites, thereby avoiding the task of redesigning the content for the digital world.31 Editing of content was done to enhance the content offering or to hypertext capabilities to the initial text but the vast majority of the content stayed intact.

However, in the mobile environment, ‘shoveling’ content onto wireless devices which had different sized screens, color and graphics capabilities was not an option since mobile content had to be edited for both the physical constraints of the small screen and the lack of bandwidth which could place limitations on an optimal user experience. Even songs, which were initially ported intact into digital format and downloaded by large number of users, needed to be reformatted for wireless devices. Moreover, distributing single pieces of content such as ring tones and sports scores over the mobile network presented intellectual property rights issues because of the possibility of the content being cannibalized as it was ported to small screens and different formats. As Thorsten Rehling observed, “Most of the content [for cell phones] does not exist today. The Disney brand name exists so Mickey Mouse can be easily transported or Britney Spears can be transported as a brand name. But what cannot be transported is traditional content. Nobody will read a full book on a small screen on a mobile phone…You need to have content that fits on a screen. It’s very challenging to design content that people like and buy.”

BeMobile was able to leverage its expertise and provide the mobile operators with a way to manage both the content and the technology platform thereby freeing the operators to concentrate on taking care of their existing customers and exploring new markets. Rehling explained the process:

Vodafone does a deal with a traditional brand and then they ask us to take care of everything with the partner they did the licensing agreement with. So we produce the content, adjust it to the handset and together with the content application, bring the content live to the mobile phones.

An operator like Vodafone would benefit from this arrangement in various ways. If the operator did not use the services of Handy.de, it would have to deal with numerous handset manufacturers in order to ensure that the content would be suitably adapted for use on the vast array of handsets in the marketplace. Royalty management was also a complicated issue. Rights holders of ring tones for example include artists who have produced the original tune, music publishers, music labels, and rights agencies. In
Germany alone, there are up to twenty different rights holders for a particular ring tone and all of these stakeholders have to be dealt with appropriately (Exhibit 6).

Perhaps most importantly, the operators were able to benefit from BeMobile’s ability to gauge the pulse of the users who purchased the mobile content primarily through the Company’s immediate contact with the customers who accessed the Handy.de website. Rehling described how they tapped into the user community:

We have direct contact with the users via our own website and every week we receive feedback through email in which the users tell us what they like and what they don’t like and ask about how to find particular products. We take the feedback and prioritize the issues so we know what the top three demands are that week and the top three things that don’t work and we implement changes immediately to address these demands.

In addition, BeMobile continually consulted with the people who worked in the Company who were not in the target user group but were close in age to that group and understood what the members of that target group wanted. The Company also held focus groups which had provided some insights into market trends and employs scouts who kept the Company informed about new developments in the market. All of these strategies helped to ensure that the operators will provide high quality content which users would find attractive and want to buy. Rehling said the operators as well as BeMobile had much to gain from this arrangement from a financial point of view:

Having great content can make a 500 percent difference in the amount of revenue operators generate. Boring content that is difficult to access and not attractive to end users will not sell. Instead of doing everything on your own, it is better to give some percentage of the revenues to a service provider who helps you to make twice as much money. This is better for you the operator, better for us [BeMobile] and better for the company which licenses the content.

In the past, one of the main obstacles to successfully marketing the content was that when the applications were out in the market, the handsets were often not ready for the applications or the network infrastructure was not sufficiently strong. One result of the Company’s interaction with both the users and the operators was that there was better coordination between the handset manufacturer, the network operator and BeMobile as the content producer:

We are now in close contact with the handset manufacturers, via the network operators and we know what is coming in three four months. By the time, the product is out there in the marketplace, the service is there which gives the end consumer a fantastic experience and they run out and tell everyone what is cool and that stimulates the market.
Organizational Challenges for BeMobile

As BeMobile continued to evolve, its management faced several organizational challenges. When BeMobile first became part of Bertelsmann, the senior management of the conglomerate assessed the ability of the three founders to manage the business unit and were satisfied that they were capable of continuing to build the business. Rehling and Friese, the two founders who remained at the Company, understood that integrating the Company into Bertelsmann entailed operating the organization in a bi-modal mindset:

They [Bertelsmann] don’t leave us completely alone because we need to bring our numbers and report to them. But they have delegated the responsibility to us and this means that we have more responsibility as individual business units. For us as entrepreneurs, it is a different way to work. We stayed here. We liked it a lot and we have a lot of freedom to continue with the original idea that we had four years ago and to make it even more successful.

BeMobile’s senior management also recognized that one key to their success was the team that they established early on in the development of the Company. Rehling described how they built the organization’s leadership:

All the group leaders have at least three to four years experience in the field. They are excellent. Because when we built the company, we said that we need to have good second level management from the very beginning. They could build their own teams and have the same kind of freedom and responsibility that we have.

Rehling and Friese relied on these managers to build their organizational units which consist of a content group, an information technology group, a marketing group, a sales organization and an E-commerce group.

In addition to building and sustaining a strong second-tier managerial team, there was the continuing challenge of finding the right people for the organization. Since the mobile content industry was very new, it was hard to find people who had the multiple skills needed to work in a mobile entertainment company:

It’s comparable to the Internet in 1995 where people came from other businesses. It is not that easy to find people. The people we hire come from the telecommunications business or the media content business so that they bring expertise from either one of the industries and the second one they get as a result of training which takes place in-house.
Along with having the necessary skill sets, BeMobile’s senior management made sure that the people whom they hired fit into the organization’s cultural milieu. For Rehling and others in the organization, it was not just about experience and skill but also about having the right spirit and enthusiasm:

…the whole team is very passionate and they help us to build what we started four years ago even more successful. They [team members] could have taken other jobs with operators. But they enjoy the spirit of the company.

Another challenge facing BeMobile was that it was part of a global industry. Though the Company was based in Hamburg and served the German market, BeMobile had to assess its opportunities within the global marketplace. Indeed, many of its customers operated in several countries and the mobile content business by its very nature was a worldwide phenomenon. Rehling explained that the plan for internationalization called for basing the major business of the Company in Hamburg, i.e., the development of digital content and the service provisioning business, but that in addition, there would be an expert group in each country which would provide account management as well as keep abreast of new developments in the marketplace within that particular country. These experts would essentially perform a scouting function in which they would interact with the operators as well as the actual users of the content in order to get continual feedback from the field. Rehling believed that operators more and more wanted a globally oriented organization to service them. BeMobile already had had some success in implementing its global strategy; T-Mobile signed a deal which gave BeMobile the ability to provide mobile content provisioning to their entire company which spans multiple countries and continents.

While BeMobile focused most of its resources on its business as an aggregator/packager of mobile content, it also was continuing to develop one of its original businesses, that of selling handsets through their Internet site and had expanded this to include a thriving E-commerce business which reached potential customers through print mail and television advertisements. In addition, BeMobile was building a new mobile service business focused on Premium SMS for television:

In this service, you can call certain numbers that are on the TV screen or send SMS to these numbers. For example, you can vote for a candidate, send SMS to a particular phone number which appears on the television screen. And when you send SMS, it will appear on your phone bill and we get a share of it. The network operator is offering us these numbers. We can be licensed by them and then they give us the kickback. For them it is successful because they have the revenue streams. They offer the billing and the number. For the TV stations and print magazines, it will be successful if SMS is better than the dial-in number and for us it is successful because it is a new service that we offer.
Despite its multiple business strategies, BeMobile’s senior management worried about growing too big, too fast:

We have been very careful and organic in our growth. We haven’t hired 20 people overnight who don’t fit into the organization because we believe from the all the processes we have established that the quality matters to our customers and if we go out and acquire too many customers and hire too many people overnight that don’t fit into the organization, it will come back to haunt us.

There were many uncertainties in the marketplace but Thorsten Rehling and the rest of the senior management at BeMobile were confident that the future was filled with opportunity:

There is a strong force behind growth in three areas: Ecommerce where there is huge growth potential in the direct mailing and TV businesses. It’s a slow growing business. The second one is the service area with TV and print. It’s a large growing market and we believe that SMS will mostly replace fixed line. And the third one and the fastest growing business is the service provider/producer/rights manager for mobile entertainment content as an aggregator/packager. The business is growing so fast and every mobile phone that is sold today is a new business and a new customer for us. Right now, we have 10 percent of the market. It will grow to 100 percent once all the older phones are replaced. There will be one phone for work and one for private life. We will add new products for existing customers, and on top of that we will acquire new customers and help them to be more successful in other countries.

**Facing the Future: BeMobile is Renamed Arvato Mobile**

On February 1, 2004, BeMobile once again was renamed, this time as Arvato Mobile. The Company had established itself within the Bertelsmann’s Arvato Division and was well on its way to becoming a leader in the mobile content provisioning arena. Yet, many challenges remained.

The mobile content industry was still in a state of constant upheaval. For one thing, there were new content providers such as Bango, which provided a service that enabled users to send a message to a global phone number which then connected them to various mobile content sites, and Carphone Warehouse, a mobile content download shop which enabled consumers to browse and preview games and ring tones. A new generation of mobile devices called Portable Media Centers (PMCs) which enabled users not only to listen to music but view video content taken from their PCs, was forecast to hit the marketplace in the near future, and there had been some interest in providing music videos and even live TV over cell phones. Meanwhile, the worldwide market for ring tones was projected to generate about $2 billion in revenue in 2004 with some in the industry projecting that the revenue from ring tones would double by 2008. The music business, which was under continual attack by digital music services, was still hoping to reap the potential benefits of the ring tone phenomenon by using polyphonic ring tones.
as a way of marketing CDs. (See Appendix I for a discussion of the music industry and the mobile platform).

The mobile operators continued to provide content for their burgeoning user bases but there was no standard for monetizing this content. Operators such as NTT DoCoMo, Verizon, and Vodafone used subscription models for disposable content, that is, content such as SMS messaging and one-off downloads. For premium content, which included stock quotes, sports scores, ring tones, and video clips, there was a pay-per-product model. The operators’ revenue sharing models with content providers varied widely according to global region and individual partners.

In 2004, Arvato Mobile’s parent company Bertelsmann was just beginning to recover from its fiscal problems (Exhibit 7). Gunter Thielen, who had overseen a round of cost cutting, now was encouraging his managers to be creative and develop new business models. But along with his call for tapping into new markets, he was also setting strict margin targets for all of his managers.

As Arvato Mobile entered the next stage of its growth, the challenges of a volatile marketplace as well as the continual recalibration going on in its parent company were certain to occupy its senior management (Exhibit 8). The questions remained: What strategic direction would Arvato Mobile take in the coming months and years? How would its management guide their entrepreneurial venture in a changing business environment?
Appendix 1

A Brief Note on the Music Industry and the Mobile Technology Platform

For the past several years, the music industry, which has been controlled by five record labels, has undergone a major transformation due to the introduction of digitalization. This new innovation provided users with the ability to transform previously analog-based recordings into readily available digital files. As a result, online music services such as Kazaa and Napster were created by computer savvy users to facilitate the sharing of these files. For the music labels, these online services ate into their already shaky revenue streams from the sales of CDs. Moreover, the music labels viewed these services as illegal in large part because they violated the intellectual property rights of music pieces that were held by these companies. The subsequent turmoil resulted in several lawsuits against users as well as the shutdown of Napster and other ‘illegal’ online music services. With revenues declining, consolidation was inevitable and in November 2003, the first of these mergers was announced as Sony and Bertelsmann made it known that they were combining their music businesses.

Recently, there have been several developments which have changed the music industry landscape and may signify a resurgence in the fortunes of this ailing industry. One of them is the development of legal online music services such as Apple’s iTunes. Instead of bypassing the record labels, Apple made agreements with them to sell their songs on the Apple website for the company’s computers and portable devices. Other software and hardware companies such as Dell and Microsoft followed Apple’s lead and set up their own music services.

The other major development is the growth of the mobile technology platform. As mobile phones have proliferated, young people especially are beginning to buy entertainment content with which to personalize their phones. Ring tones, which were once thought of as a novelty, have become an important part of this trend toward personalization and sales of monophonic ring tones have soared. Mobile operators have also developed devices and music downloading services. From the vantage point of the music labels, the emergence of mobile entertainment as a legitimate business has been a welcome development. With polyphonic ring tones set to reach the marketplace, these digital music files are now looked upon not only as a direct source of revenue but also as a means of marketing albums. Music label executives hope that consumers will see a ring tone as a reincarnated version of a single and that this musical snippet will entice them to buy an entire album. Indeed, in 2003, ring tone sales surpassed sales of singles in the UK as well as in the United States.

As mobile entertainment content becomes more pervasive in the marketplace, there are important opportunities for the music industry as well as other content-intensive industries whose content can be successfully ported to mobile devices. Music labels have already begun to sell the rights to musicians’
recordings to the operators and other companies which produce content for mobile phones. Yet, the mobile technology platform remains complex. Though polyphonic ring tones and even music videos may be something that consumers will want to buy, handsets may not be ready for this new kind of content and mobile operators still control the pricing structures for premium content. Moreover, as more music becomes digitized and easily accessible, it will be harder for the music labels to control the intellectual property rights associated with these pieces of music. In addition to the technology issues and the challenges of intellectual property rights, new companies and services are emerging which threaten to bypass music labels and operators altogether. An example of this is Xingtone, a Los Angeles based company which provides users with a software kit that enables them to turn digital music files they have acquired legitimately or illegitimately into ring tones. Nevertheless, the mobile technology platform represents a new way for the music industry to reinvent itself and recapture a marketplace over which it once held sway.
Exhibit 1
Bertelsmann Organizational Structure

Organisation of Bertelsmann

Bertelsmann AG

Chief Executive Officer
G. Thielen

Chief Financial Officer
S. Luther

Focus on
• improvement of operational profitability
• strengthening entrepreneurship and leadership
• small to mid size acquisitions
Exhibit 2
Media Conglomerates and the Internet - 2001

Bertelsmann is in a leading position on the internet behind AOL Time Warner

Unique Visitors in millions (June 2001)

- AOL Time Warner**: 54m
- Bertelsmann*: 41m
- Disney: 22m
- Vivendi: 22m
- Viacom: 16m
- News Corp.: 6m
- Amazon: 26m

* no. minority interests
** AOL Time Warner Network without proprietary services
Source: Media Metrix
Exhibit 3

Group Synergies at Bertelsmann

Exploiting the synergies of Bertelsmann . . .

- Content creation
- Aggregation/production
- Distribution

Key Results

- Great success in the UK, USA and Germany - pan-European introduction in progress
- Peak viewership of up to 15 million (FRG)
- Superstar CD "Unitac" introduced on 10th February reached #1 in the first week
- "ELVIS 30 #1 Hits" became No. 1 in 17 countries worldwide in its first week, including the USA and UK
- Special "backazine" published by G+J USA
- "Elvis Treasures" published by Random House

... to drive earnings growth
### Exhibit 4

**Arvato Division**

**Arvato** is the world’s leading media services provider

<table>
<thead>
<tr>
<th>RTL</th>
<th>Revenues¹: €3,586 mm</th>
</tr>
</thead>
<tbody>
<tr>
<td>G+J</td>
<td>% Group revenue: 17.4%</td>
</tr>
<tr>
<td>Random House</td>
<td></td>
</tr>
<tr>
<td>BMG</td>
<td></td>
</tr>
<tr>
<td>Springer</td>
<td></td>
</tr>
<tr>
<td>Arvato</td>
<td></td>
</tr>
<tr>
<td>Direct Group</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EBITA: €223 mm</td>
</tr>
<tr>
<td></td>
<td>EBITA margin: 0.3%</td>
</tr>
</tbody>
</table>

**Selected services of Arvato:**

- **Customer relationship management**
  - Call centre
  - Loyalty systems
  - #1 Europe

- **Data management**
  - Direct marketing
  - European leader

- **Financial Services**
  - Online payments
  - European leader

- **Distribution**
  - Distribution
  - #1 Germany
  - Media fulfillment
  - European leader

- Internationally networked media services provider
  - Services: Leading positions in Europe
  - Printing: #1 in Europe
  - Storage Media: top 3 world-wide
  - Systems
  - Knowledge management
  - Operating in 23 countries worldwide
  - 80% of revenues derived from third parties
  - Consolidation phase to optimise the ROI in Printing business
  - Taking advantage of outsourcing trend in Services business; growing business internationally and through extension of value chain

¹ Including contribution from the storage media division

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Note: Financials for the twelve month period to June 2001 based on HGB reporting standards

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# Exhibit 5

Bertelsmann Consolidated Financials

## Bertelsmann consolidated figures

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting format</td>
<td>IAS</td>
<td>IAS</td>
<td>HGB</td>
<td>HGB</td>
<td>HGB</td>
</tr>
<tr>
<td>Revenues</td>
<td>18,312</td>
<td>18,979</td>
<td>20,036</td>
<td>16,524</td>
<td>13,289</td>
</tr>
<tr>
<td>Operating EBITDA&lt;sup&gt;1&lt;/sup&gt;</td>
<td>936</td>
<td>573</td>
<td>1,092</td>
<td>1,195</td>
<td>899</td>
</tr>
<tr>
<td>Net Income</td>
<td>968</td>
<td>1,378</td>
<td>970</td>
<td>672</td>
<td>465</td>
</tr>
<tr>
<td>Cash Flow&lt;sup&gt;2&lt;/sup&gt;</td>
<td>1,115</td>
<td>294</td>
<td>663</td>
<td>1,317</td>
<td>924</td>
</tr>
<tr>
<td>Investments</td>
<td>5,263</td>
<td>2,539</td>
<td>3,258</td>
<td>2,049</td>
<td>2,398</td>
</tr>
<tr>
<td>Total Assets</td>
<td>22,168</td>
<td>23,734</td>
<td>17,551</td>
<td>14,692</td>
<td>10,070</td>
</tr>
<tr>
<td>Total Equity&lt;sup&gt;3&lt;/sup&gt;</td>
<td>7,744</td>
<td>8,384</td>
<td>4,501</td>
<td>3,638</td>
<td>2,734</td>
</tr>
<tr>
<td>Net Financial Debt&lt;sup&gt;4&lt;/sup&gt;</td>
<td>2,741</td>
<td>859</td>
<td>1,188</td>
<td>2,146</td>
<td>1,692</td>
</tr>
<tr>
<td>EBITDA&lt;sup&gt;1&lt;/sup&gt;</td>
<td>1,666</td>
<td>1,500&lt;sup&gt;5&lt;/sup&gt;</td>
<td>1,969</td>
<td>1,805</td>
<td>1,187</td>
</tr>
</tbody>
</table>

<sup>1</sup> EBIT and EBITDA include corporate, exclude capital gains and special items (also interest losses until 2001)

<sup>2</sup> Cash flow = net income + capital gains + depreciation and amortization of non-current assets + increase in long-term provisions and profit participation certificates + other cash & non-cash items

<sup>3</sup> Equity includes shareholders’ equity, minority interests and (under HGB only) profit participation certificates

<sup>4</sup> Gross financial debt. Cash equivalents; in 2000/01 marketable securities of EUR 603 mm were included in cash equivalents; includes finance leases under IAS

<sup>5</sup> estimated
Exhibit 6
Overview of Relevant Rights

- **Right of Name (Namensrecht)**
- **Mechanical Rights (mechanische Rechte)**
- **Making available to the public (Verbreitung und Vervielfältigungsrecht)**
- **Cover Right (Bearbeitungsrecht)**
- **Copyright (Ureberrechte)**
- **Copyright (Ureberrechte)**
- **Personality Copyright (Urheberpersonlichkeitsrecht)**
Exhibit 7
Bertelsmann Revenues by Division – March 2004

Revenues –
Nearly stable development on adjusted basis

Growth
adjusted*  +0.6%  +1.3%  -4.5%  +0.7%  +0.7%  -6.9%

EUR in bn
2003  4.36  4.45  2.00  1.78  2.80  2.48  3.67  3.64  2.71  2.29
2002

RTL Group  Random House  G+J  BMG  Arvato  Direct Group

* exchange rate and portfolio changes
Exhibit 8
Biographies of the Arvato Management Team

Bernard Ribbrock
Chief Executive Officer (CEO)

Bernhard Ribbrock has been working for Bertelsmann since 1979 with a few brief gaps in between. After completing his computer science studies at the University of Paderborn, he joined Bertelsmann in April 1979 and started off in the area of EDP for the German book club where he was promoted to management level in 1984. 1987/88 saw Bernhard Ribbrock take over management of the key Communication Networks department in the area of Central Information Processing at Bertelsmann acting as deputy manager of the area from 1995 to 1996. In October 1996, he set up mediaWays as a joint-venture between Bertelsmann and Devis Systemhaus.

Within a mere six years, he had developed the company to become a leading and profitable supplier of Internet technology. When mediaWays was sold to the Spanish telecommunications company Telefónica, he continued to work as CEO for the network operator until early 2002. He returned to Bertelsmann in May 2002 and took over management of the newly established Mobile unit in the area of Bertelsmann Capital. In addition to his position as CEO of Bertelsmann’s mobile unit he took over the position as CEO of Empolis GmbH on October 18, 2002.

Dirk Friese
Co-Founder and Managing Director

Together with Martin Ostermayer and Thorsten Rehling, Dirk Freise founded Handy.de in May 1999 while completing his MBA at the Walter A. Haas School of Business at UC Berkeley. At Bemobile he focuses his activities on IT and new product development. Prior to Handy.de Dirk Freise had 4 years of market research experience at Synovate, a leading independent market research agency where he led international market research studies.

Dr. Christoph Hartlieb
Managing Director and Chief Financial Officer (CFO)

Christoph Hartlieb graduated and gained a doctorate at the University of Göttingen. He started his career at Porsche AG where his activities included controlling and consulting. In 1998 he moved to Gruner & Jahr and helped to launch the newspaper Financial Times Deutschland. After a short intermezzo at Mannesmann, he managed G+J Multimedia Ventures GmbH. This investment arm of Gruner and Jahr
acquired a stake in Handy.de. Christoph Hartlieb has been a managing director of Handy.de since 2001 and is responsible for Finance, E-Commerce and Customer Support.

Thorsten Rehling
Co-Founder and Managing Director

Together with Martin Ostermayer and Dirk Freise, Thorsten Rehling founded Handy.de in May 1999 while completing his MBA at the Walter A. Haas School of Business at UC Berkeley. At Arvato Mobile he focuses on Sales, Marketing and Content. Prior to Handy.de Thorsten Rehling worked as a consultant for A.T. Kearney Germany and as an international marketing manager at Ebay USA

Paolo Roatta
Chief Executive Officer and Managing Director, TJ Net

Before founding TJ net in 1999, Paolo Roatta was General Manager at music company BMG Ricordi. He was the head of the Strategic Marketing and Catalog division in charge of the largest music catalog in the country. Mr. Roatta spent the first of his four years at BMG by working directly for the BMG International President in New York contributing to the development of the group strategy. Prior to BMG, Mr. Roatta worked for three years in the Finance Department of the European HQ of Procter & Gamble in Brussels. He also worked for Bain & Co. in Milan and for Morgan Stanley in London in the Investment Banking group. Mr. Roatta graduated from the Sapienza University of Rome with a degree in Business Economics, and obtained an MBA from Harvard Business School. He is fluent in English and French.
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