Disney and pixar: partnership agreement

Introduction

In January 2006, the US based media and entertainment company Walt Disney announced that it would acquire its animation partner Pixar for US$ 7. 4 billion in stock. The deal was expected to be finalized by mid-2006. Disney had already been in partnership for producing and distributing animation films with Pixar since 1991. However, in January 2004, owing to differences with Disney's then CEO Michael Eisner, Pixar had announced that it would partner with another distribution company in 2006. But Robert Iger, who took over from Eisner on September 30, 2005, revived talks with Pixar and finally succeeded in acquiring it.

Our project will examine the partnership agreement between Disney and Pixar and the incidents that led to the break-up of ties. We will discuss how the new CEO Robert Iger, who succeeded Michael Eisner, went on to re-establish ties with Pixar and Steve Jobs, who held 50. 6% equity stake in Pixar. The questions we seek to answer through this case are:

1. Is there a synergy between Disney and Pixar?

2. Did Disney pay too much to acquire Pixar?

3. Is the Pixar acquisition in the best interest of Disney's shareholders?

4. Will the difference in corporate culture allow Disney and Pixar to work effectively together?

5. Will this acquisition be successful?

History

The Disney Story

Walt Disney Animation Studios is the subsidiary of The Walt Disney Company. It was founded in 1934 when Walt Disney initiated the production of Snow White and the Seven Dwarfs, which was Walt Disney's first feature length animation film. The move however started in 1937, when selected animators from the ' shorts' division were moved into the features division.

Snow White was an unprecedented success when it was released in February 1938. It moved critics and audiences alike and is considered one of the true animation classics of all times. After, the viability of feature length animation was firmly established with the success of Snow White, WDAS would go on to make a series of critically acclaimed and successful animated features like Dumbo, Cinderella. They would also expand into new segments like live action features, television and theme parks.

Since its founder's death in 1966, The Walt Disney Company had narrowly survived takeover attempts by corporate raiders. Its shareholders Sid Bass and Roy E. Disney brought on Michael Eisner and former Warner Brothers chief Frank Wells to replace Ron W. Miller in 1984 and turn the company around.

During the second half of the 1980s and early 1990s, Disney revitalized. Beginning with The Little Mermaid (1989), its flagship animation studio enjoyed a series of commercial and critical successes that helped reinvigorate the American animation industry. Disney also broadened its adult offerings in film when then Disney Studio Chairman Jeffrey Katzenberg acquired Miramax Films in 1993. Disney acquired many other media sources, including ABC and ESPN.

However, by this time, the competitive scenario changed again. Many new studios had risen up and were producing high quality animated features. Also there was significant tiredness and indifference from the audience who had had enough of Disney's storytelling and animation styles. The rise of new studios also increased demand for artists and stencillers, driving salaries up, causing the budgets of hand drawn animation features to inflate. The rise of Computer Generated Imagery (CGI) was also eating into Disney's market share.

Starting from 2000 onwards, massive layoffs had reduced staff to 600. Also the Studio decided to focus on CGI animation for future releases instead of the traditional animation methods to compete with Pixar, Dreamworks and Blue Sky Studios. This led to the shutdown of the Paris Studio in 2003 and the conversion of the Orlando Studio into a theme park attraction in 2004.

Michael Eisner Story

In 1976, the Chairman of Paramount Pictures, recruited Michael Eisner from ABC and made him president and CEO of the movie studio. During his tenure at Paramount, the studio turned out such hit films as Saturday Night Fever, Grease, the Star Trek film franchise, and Beverly Hills Cop, and hit TV shows such as Happy Days, Laverne & Shirley, Cheers and Family Ties.

Diller, the Chairman of Paramount, left in 1984, and Eisner expected to assume Diller's position as studio chief. But he was passed over. Eisner then lobbied for the position of CEO of The Walt Disney Company.

Michael Eisner took over as CEO of the Walt Disney Company in 1984 and turned it into a media giant whose interests included movies, sports franchises, theme parks and television networks.

During the early part of the 1990s, Eisner and his partners set out to plan " The Disney Decade" which was to feature new parks around the world, existing park expansions, new films, and new media investments. While some of the proposals did follow through, most did not. These included the Euro Disney Resort (now Disneyland Paris), Disney-MGM Studios (now Disney's Hollywood Studios), Disney's California Adventure Park, Disney-MGM Studios Paris (eventually opened in 2002 as Walt Disney Studios Park), and various film projects

Frank Wells, COO of Walt Disney. died in a helicopter crash in 1994. When Jeffery Katzenberg was passed over for Wells post, he resigned and formed Dreamworks SKG with partners Steven Spielberg and David Geffen. Dreamworks would go on to become one of the biggest and most successful movie studios of all time and a big competitor to Disney's animation features. Instead, Eisner appointed Michael Ovitz, one of the founders of the Creative Artists Agency, to be President, with minimal involvement from Disney's board of directors, which included many influential and respected members. Ovitz lasted only 14 months and left Disney in December 1996 via a " no fault termination" with a severance package of $38 million in cash and 3 million stock options worth roughly $100 million at the time of Ovitz's departure. The Ovitz episode left a bad taste in the mouth and people were very disappointed with Eisner's high handedness and autocratic style of working.

By 2003, Disney's fortunes had flagged and Roy E. Disney, the son of Disney co-founder Roy O. Disney and nephew of Walt Disney, resigned from his positions as Disney vice chairman and chairman of Walt Disney Feature Animation, accusing Eisner of micromanagement, flops with the ABC television network, timidity in the theme park business, turning the Walt Disney Company into a " rapacious, soul-less" company, and refusing to establish a clear succession plan, as well as a string of box-office movie flops starting in the year 2000.

On March 3, 2004, at Disney's annual shareholders' meeting, a surprising and unprecedented 43% of Disney's shareholders, predominantly rallied by former board members Roy Disney and Stanley Gold, withheld their proxies to re-elect Eisner to the board. This effectively ended Eisner's stint at Disney.

On March 13, 2005, Eisner announced that he would step down as CEO one year before his contract expired. Eisner's replacement was his longtime assistant, Robert Iger.

The Pixar Story

Pixar started in 1979 as the Graphics Group, a part of the Computer Division of Lucasfilm. It is based in Emeryville, California. It was launched with the hiring of Dr. Ed Catmull from the New York Institute of Technology (NYIT), where he was in charge of the Computer Graphics Lab (CGL).. The team at Pixar under Dr. Catmull worked on creating Motion Doctor, which allowed traditional cel animators to use computer animation with minimal training.

Initially, Pixar started off as a computer hardware company whose core product was the Pixar Image Computer, a system primarily sold to government agencies and the medical community. One of Pixar Image Computers biggest customers was Disney Studios. However, The Image Computer never sold well. In a bid to drive sales of the system, Pixar employee John Lasseter—who had long been creating short demonstration animations, such as Luxo Jr., to show off the device's capabilities—premiered his creations at SIGGRAPH, the computer graphics industry's largest convention, to great fanfare. This would begin Pixar's journey into the world of animated feature films.

Poor sales of Pixar's computers threatened to bankrupt the company, And Lasseter's animation department began producing computer-animated commercials for outside companies to bring in much needed revenue. Early successes included campaigns for Tropicana, Listerine, and LifeSavers.

The team began working on film sequences produced by their parent, Lucasfilm or worked collectively with Industrial Light and Magic, ILM is another Lucasfilm company, on special effects. In 1986, Steve Jobs purchased Pixar from Lucas Films shortly after he left Apple Computer. Jobs paid $10 million as capital into the company. The newly independent company had 45 employees and was headed by Dr. Edwin Catmull, President, and Dr. Alvy Ray Smith, Executive Vice President and Director. Jobs served as Chairman and Chief Executive Officer of Pixar.

Pixar has made 10 feature films beginning with Toy Story in 1995 and each one has achieved critical and commercial success. Pixar followed Toy Story with A Bug's Life in 1998, Toy Story 2 in 1999, Monsters, Inc. in 2001, Finding Nemo in 2003 (which is, to date, the most commercially successful Pixar film, grossing over $800 million worldwide), The Incredibles in 2004, Cars in 2006, Ratatouille in 2007, WALL-E in 2008, and Up in 2009 (the first Pixar film presented in Disney Digital 3-D).

John Lasseter Story

Lasseter was born in Hollywood, California. When he was in college., he heard of a new program at California Institute of the Arts and decided to leave his current college to follow his dream of becoming an animator.. Lasseter was taught by three members of Disney's Nine Old Men – Eric Larson, Frank Thomas and Ollie Johnston.

On graduation in 1978 , Lasseter joined The Walt Disney Company, as a Jungle Cruise skipper at Disneyland in Anaheim. He later obtained a job as an animator at Walt Disney Feature Animation, Since the release of 101 Dalmatians in 1961, Lasseter felt WDFA had hit its creative peak and there was no innovation coming through in either the animation or the storytelling. In 1980 or 1981 he came across some video tapes from one of the then new computer-graphics conferences, and he experienced as a revelation. He saw the huge potential of this new technology in revitalizing the creative juices at WDFA. Lasseter realized that computers could be used to make movies with three dimensional backgrounds where traditionally animated characters could interact to add a new, visually stunning depth that had not been conceived before.

During this time, Lasseter tried to sell his ideas to Disney's top bosses and he got the approval to do a short test film on the famous story Where the Wild things are. However, he unknowingly stepped on some of their direct superiors' toes by circumventing them in their enthusiasm to get the project into motion. One of them, the animation administrator Ed Hansen disliked it so much that when Lasseter and Wilhite tried to sell the idea to him and Ron Miller, which they at that time were already aware of, they turned it down. A few minutes after the meeting, Lasseter was summoned by Hansen to his office, where John was told that his employment in the Walt Disney Studios had been terminated.

While putting together a crew for the planned feature for Disney, he had made some contacts in the computer industry, among them Alvy Ray Smith and Ed Catmull at Lucasfilm Computer Graphics Group. After being fired, Lasseter visited a computer graphics conference at the Queen Mary in Long Beach, where he met and talked to Catmull again. Before the day was over, Lasseter had made a deal to work as an " interface designer" with Catmull and his colleagues on a project that resulted in their first computer animated short: The Adventures of André and Wally B.

Lasseter oversaw all of Pixar's films and associated projects as executive producer. He also personally directed Toy Story, A Bug's Life, Toy Story 2, and Cars.

Lasseter has won two Academy Awards, for Animated Short Film (Tin Toy), as well as a Special Achievement Award (Toy Story). He was also nominated on four other occasions – in the category of Animated Feature, for both Cars (2006) and Monsters, Inc. (2001), in the Original Screenplay category for Toy Story (1995) and in the Animated Short category for Luxo, Jr. (1986), while the short Knick Knack (1989) was selected by Director Terry Gilliam as one of the ten best animated films of all time.

Corporate Culture at Pixar

At most studios, a specialized development department generated new movie ideas. Pixar assembles cross-company teams for this purpose. Teams comprise directors, writers, artists and storyboard people who originate and refine ideas until they have the potential to become great films. Pixar believes in finding people who will work effectively together and ensures a healthy social dynamics in the team and this, they believe helps the team solve problems.

Another important tenet in Pixar is the creation of a peer culture, where employees encourage people throughout the company to help each other produce their best work. At Pixar, daily animation work is shown in an incomplete state to the whole crew. This process helps people get over any embarrassment about sharing unfinished work, so they become even more creative. It enables creative leads to communicate important points to the entire crew at once. And sometimes a innovative piece of animation sparks others to raise their game.

At Pixar, the belief is that, the most efficient way to resolve the numerous problems that arise in any complex project is to trust people to address difficulties directly, without having to get permission. So, everyone is given permission to communicate to anyone. Within Pixar, members of any department can approach anyone in another department to solve problems without having to go through proper channels. Managers understand they don’t always have to be the first to know about something going on in their realm, and that it’s okay to walk into a meeting and be surprised.

Special attention is given to craft a learning environment, this reinforces the mindset that everyone is learning and that its fun to learn together. “ Pixar University” trains people in multiple skills as they advance in their careers. It also offers optional courses (screenplay writing, drawing, sculpting) so people from different disciplines can interact and appreciate what each other does.

While many people dislike Post-Mortems of projects as they would rather discuss what went right than what went wrong and after investing extensive time on a project, they’d like to move on. So post-mortems at Pixar are structured to stimulate discussion. Pixar asks post mortem participants to list the top five things they’d do again and the top five things they would’nt do. The positive-negative balance makes it a safer environment to explore every aspect of the project. Participants also bring in lots of performance data – including metrics such as how often something had to be reworked. Data further stimulates discussions and challenges assumptions based on subjective impressions.

Corporate Culture at Disney

Under autocratic former CEO Michael Eisner, control rather than collaboration was the norm and unit heads became afraid or unable to make decisions. With Disney vying for a share of digital market, the timing of the upheaval could hardly have been worse.

Fortunately, new chief executive Bob Iger is a completely different animal to Eisner and immediately set out to restore harmony. Achieving this involved transforming the culture rules almost beyond recognition. Unlike his predecessor, Iger:

* Rules by consensus

* Shows faith in his subordinates

* And is willing to keep a low profile and let others take the plaudits.

No longer shackled by central control, key players in the organization now enjoy greater freedom to call the shots. And while Eisner overtly pooh-poohed any ideas he did not like, Iger values and encourages the contributions of others. Consequently, during weekly meetings the dialogue no longer flows just one way.

The CEO visits rank and file to show them that their efforts are appreciated and has made his office a more welcoming place. This might seems as trivial gestures to some but the effect on morale can be priceless.

But perhaps Iger's most significant attribute is the trust he places in his people to get the job done. In contrast, Eisner cramped the style of others by insisting on being involved in anything and everything. In time, Disney gained a reputation of being slow to react. But Iger tells his people to go for it and will only get involved when it is absolutely necessary.

Iger's back seat style of leadership has allowed scriptwriters more freedom and the studio chief greater decision making power.

Disney and Pixar: The Partnership

During the 90s there was an explosive growth in the use of CGI in animation and live action feature films. Soon CGI animation came to dominate special effects in both kinds of features. The barrier between animation and special effects were shattered and the enhancement of Hollywood films using CGI became second nature and often went unnoticed.

In 1991, due to losses suffered from their computer hardware business, there was serious financial strife at Pixar. This resulted in substantial layoffs in their computer department. Pixar made a $26 million deal with Disney to produce three computer-animated feature films, the first of which was Toy Story. Despite this, the company was losing money and Steve Jobs was thinking about divesting his shares in Pixar. Only after confirming that Disney would distribute Toy Story for the 1995 holiday season did he decide to give it another chance. The film went on to gross more than $350 million worldwide.

Disagreements started to crop up between Disney and Pixar from their next project together, Toy Story 2. Originally intended as a straight-to-video release (and thus not part of Pixar's three-picture deal), the film was eventually upgraded to a theatrical release during production. Disney refused to consider this feature film as part of the three picture deal as demanded by Pixar. Pixar's first five feature films have collectively grossed more than $2. 5 billion, equivalent to the highest per-film average gross in the industry. Though profitable for both, Pixar later complained that the arrangement was not equitable. While Pixar was created and produced, and Disney only handled marketing and distribution, Profits and production costs were being split 50-50, and not only that, Disney exclusively owned all story and sequel rights and also collected a distribution fee. The lack of story and sequel rights was perhaps the most onerous aspect to Pixar and set the stage for a contentious relationship.

The two companies attempted to reach a new agreement in early 2004. The new deal would be only for distribution, as Pixar intended to control production and own the resulting film properties themselves. The company also wanted to finance their films on their own and collect 100 percent of the profits, paying Disney only the 10 to 15 percent distribution fee. More importantly, as part of any distribution agreement with Disney, Pixar demanded control over films already in production under their old agreement, including The Incredibles and Cars. Disney considered these conditions unacceptable, but Pixar would not concede.

Disagreements between Steve Jobs and then Disney Chairman and CEO Michael Eisner made the negotiations more difficult than they otherwise might have been. They broke down completely in mid-2004, with Jobs declaring that Pixar was actively seeking partners other than Disney. Pixar did not enter negotiations with other distributors. After a lengthy hiatus, negotiations between the two companies resumed following the departure of Eisner from Disney in September 2005. In preparation for potential fallout between Pixar and Disney, Jobs announced in late 2004 that Pixar would no longer release movies at the Disney-dictated November time frame, but during the more lucrative early summer months. This would also allow Pixar to release DVDs for their major releases during the Christmas shopping season. An added benefit of delaying Cars was to extend the time frame remaining on the Pixar-Disney contract to see how things would play out between the two companies.

Acquisition by Disney

Disney announced on January 24, 2006 that it had agreed to buy Pixar for approximately $7. 4 billion in an all-stock deal. Following Pixar shareholder approval, the acquisition was completed May 5, 2006. The transaction catapulted Steve Jobs, who was the majority shareholder of Pixar with 50. 1%, to Disney’s largest individual shareholder with 7% and a new seat on its board of directors. Jobs’ new Disney holdings exceed holdings belonging to ex-CEO Michael Eisner, the previous top shareholder, who still held 1. 7%; and Disney Director Emeritus Roy E. Disney, who held almost 1% of the corporation’s shares.

As part of the deal, Pixar co-founder John Lasseter, by then Executive Vice President, became Chief Creative Officer (reporting to President and CEO Robert Iger and consulting with Disney Director Roy Disney) of both Pixar and the Walt Disney Animation Studios, as well as the Principal Creative Adviser at Walt Disney Imagineering, which designs and builds the company’s theme parks. Catmull retained his position as President of Pixar, while also becoming President of Walt Disney Animation Studios, reporting to Bob Iger and Dick Cook, chairman of Walt Disney Studio Entertainment. Steve Jobs’ position as Pixar’s Chairman and Chief Executive Officer was also removed, and instead he took a place on the Disney board of directors.

Lasseter and Catmull’s oversight of both the Disney and Pixar studios did not mean that the two studios were merging, however. In fact, additional conditions were laid out as part of the deal to ensure that Pixar remained a separate entity, a concern that analysts had had about the Disney deal. Some of those conditions were that Pixar HR policies would remain intact, including the lack of employment contracts. Also, the Pixar name was guaranteed to continue, and the studio would remain in its current Emeryville, California location with the “ Pixar” sign. Finally, branding of films made post-merger would be “ Disney•Pixar” (beginning with Cars).

EXHIBITS

Name of Feature Film

Studio

Total Gross

1

The Lion King(1994)

Disney

$783, 841, 776

2

Finding Nemo(2004)

Disney/Pixar

$864, 625, 978

3

Shrek(2001)

Dreamworks

$484, 409, 218

4

Monsters Inc(2001)

Disney/Pixar

$525, 366, 597

5

Toy Story 2(1999)

Disney/Pixar

$485, 752, 179

6

Aladdin(1992)

Disney

$504, 050, 219

7

Snow White(1937)

Disney

$184, 925, 486

8

Ice Age(2002)

20th Century Fox

$383, 257, 136

9

Incredibles(2004)

Pixar

$631, 442, 092

10

The Little Mermaid(1989)

Disney

$183, 355, 863

Exhibit 1 : Top Grossing Animated Feature Films

DIS 1-yr chart

Exhibit 2 Disney Stock Price from Aug 06 to Jun 07

We start off our analysis using Porters Five Forces of Competition to understand Disney's situation in the industry and the rationale behind its actions.

* Threat of New Entrants

* Bargaining Power of Suppliers

* Bargaining Power of Buyers

* Threat of Substitutes

* Rivalry among competing firms

Threat of new entrants: CGI animation movie industry is a robust industry which is urdergoing a period of phenomenal growth. This is an attractive segment for movie studios to venture into as revenues from live action movies are falling while their budget rises ever higher. CGI animation movies are an interesting option for many movie studio to increase their toplines without hurting their bottomlines. In this regard, we have seen many established movie studios partner with independent animation studios from within and outside the United States in creating CGI animation movies. While, these movies have not been able to garner the critical or commercial acclaim of that of Pixar, the quality and quantity of such ' outsourced' CGI animation movies are increasing YoY and represent a significant threat to the market pull of existing players in the segment. So we would rate the threat of new entrants as high.

Bargaining Power of Suppliers: Resources needed for making CGI animation are the technology behind the animation, the story and the animators. Pixar has been a pioneer in creating the technology for animation and with its acquisition, Disney has backward integrated with its supplier, hence reducing the uncertainty in its environment. Both Disney and Pixar have a large team of dedicated scriptwriters and animators, all of whom work under short or long term employment contracts, the loss of a few of the talent will not reduce the quality of the output of either Studios. However, scriptwriters in US are unionized and have in the past gone on strike against major studios to renegotiate revenue sharing agreements from movie revenue. The strike cost studios hundreds of millions of dollars in lost opportunities, movie shooting delays and cost overruns. So the employees cannot be taken for granted and Disney will have to strike a fine balancing act to please both it employees and shareholders if it wants to get the best work of the employees. We would rate the bargaining power of suppliers as medium.

Bargaining Power of Buyers: While in the past, almost the entire revenue receipts from movies came from the theatergoing public within the US, due to the effects of globalization and technology diffusion, the receipts can now be classified on basis of geography and the mode of delivery of content.

Worldwide movie market outside United States have become big movie spinners for Hollywood movies, sometimes receipts from offshore markets exceed that of the US market. The important markets outside of US for Hollywood movies are:

* Japan

* United Kingdom

* China

* Europe

Studios sells distribution rights of their movie to other studios, who are often better placed to reach out to these markets. Since Disney and Pixar have a large brand following and pull, they are better placed that most other studios to negotiate for more favourable distribution contracts. Since all movies made by Pixar till now have been movie spinners for everyone associated with it, Disney has considerable clout in negotiating for contracts.

The mode of delivery of movie content can be classified into:

* Theatrical Release

* DVD Release

* Internet Release

* Satellite TV Release

Other than a theatrical release, the release of DVDs and the Satellite TV rights of the movie are a significant revenue stream. The reasons stated earlier regarding Disney and Pixar's unique brand placement help them negotiate the best contracts in both types of releases. Internet release is a new phenomenon and is not a significant enough part of the revenue to affect the dynamics.

Overall, we would rate the bargaining power of buyers to be low.

Threat of Substitute Products: A big threat facing movie studios in general is movie piracy. Piracy is causing a meltdown in both movie and the music industry causing many studios to fail and others to change their business model. Piracy initially started off with CDs and DVDs, but with the advent and diffusion of broadband internet, online piracy is on the rise. Piracy since the 80s has been the biggest threat to the survival of movie studios as they lose billions of dollars worth of revenue receipts because of it.

Since CGI movies appeal to all demographics, live action as well as traditional animated movies can be thought of as substitute products. However, historical data suggests that there is considerable cross selling between these genres and it is unlikely that somebody’s interest in a different genre is going to prevent him from watching CGI movies.

Overall, We would rate the threat of substitute products as medium.

Intensity of Competition among existing players: The existing players in the segment are very aggressive and spend a lot on advertising and media to promote their movies. Further consolidation within the industry looks unlikely in the short term future as most studios in the segment have backers with deep pockets.

Looking into the future as the frequency of CGI movie releases by major studios increases, the intensity of competition and one upmanship between studios will rise inflating budgets and reducing margins.

So, we would rate the intensity of competition between existing players as high.

We will summarize the competitive scenario in this grid.

Threat of New Entrants

High

Bargaining Power of Suppliers

Medium

Bargaining Power of Buyers

Low

Threat of Substitutes

Medium

Rivalry among competing firms

High

As you can see, Disney is functioning within a dynamic environment with a fairly high degree of uncertainty.

We have tried to analyze the reasons behind Disney's acquisition by breaking down the reasons of why companies go for M&A. Given below is a pictorial representation of the same,

Reason 1: To Increase Market Power

When a firm's size, resources and capabilities increase, it increases its ability to compete. With the acquisition of Pixar, Disney gains access to Pixar's pool of talented artists and creative and technical teams. These artists and content developers are big assets in this industry as good talent is hard to find and harder to replace. With the increase in resources, Disney – Pixar combine can create more movies per year potentially resulting in a significant value addition to Disney.

Reason 2: Horizontal Acquisition

Companies go in for acquisitions of firms competing in the same marketspace for obtaining:

* Cost Based Synergies

* Revenue Based Synergies

This is an obvious case of the latter. Pixar’s last six movies have reportedly earned more than $ 2. 5/3. 2 billion in total whereas Disney’s last movie Chicken Little was only a moderate success. Disney plans to exploit Pixar’s creative and technical teams in combination with its well established and huge distribution system to increase its revenue. Disney in recent years have been unable to connect with its audience and hence create movies that ha