Third Space & the Entertainment Business

A Case Study of Disney-Pixar

By Jonathan Taplin & Ernest Wilson

USC Annenberg School for Communication and Journalism

2016

Over the course of two years of research, a team at the USC Annenberg School of Communication and Journalism has developed an approach to understanding a set of skills that we feel are critical for managers in the 21st Century.

Intellectual Curiosity: a deep hunger to learn and grow and a willingness to experiment in order to learn. Where is it most lacking? Among senior executives, according to our research.

360-Degree Thinking: the ability to think holistically, recognize patterns, and make imaginative leaps based on those patterns. More than 90% of our respondents see it as a critical skill for senior executives and most lacking among recent graduates and entry-level employees.

Cultural Competence: the capacity to think and act across the boundaries of functions, organizational cultures and global cultures. Senior executives see it as most critical for middle managers and most lacking among them.

Empathy: a deep emotional intelligence, closely connected to cultural competence, that enables those who possess it to see the world through others' eyes, and understand their unique perspectives. It is most lacking, said our respondents, among middle managers and senior executives.

Adaptability: mental agility, comfort with ambiguity, and the capacity to change old behaviors in light of new evidence. Senior executives indicated that adaptability was most lacking among middle managers and most likely to be found among recent graduates.

Third Space and Creativity

Given that the media and entertainment business is in the midst of an extraordinary era of disruption we believe that these skills will be crucial for both management and line production personnel to master. Clearly the industry is being challenged in the areas of diversity, but in a deeper sense the notions of empathy, intellectual curiosity and adaptability are so critical to the creative process that the industry needs to understand the third space, regardless of the current focus on cultural competence. The psychologist who has specialized in the study of creativity, Mihaly Csíkszentmihályi, noted the presence of "flow" in highly creative artists and sports stars. Flow, also known as the zone, is the mental state of operation in which a person performing an activity is fully immersed in a feeling of energized focus, full involvement, and enjoyment in the process of the activity. Csíkszentmihályi hypothesized that people with several very specific personality traits may be better able to achieve flow more often than the average person. These personality traits include curiosity, persistence, empathy, and a high rate of performing activities for intrinsic reasons only. People with most of these personality traits are said to have an *autotelic personality*. We feel this tracks closely to the Third Space skills we are seeking to teach.

The Disney-Pixar Case Study

Given our belief that Third Space skills map to creative industries, a good case study of how firms have used Third Space skills to manage these skills is the Walt Disney acquisition of Pixar in 2006 for $7.3 billion. The relationship between Disney and Pixar, which started under the auspices of CEO Michael Eisner, as a distribution deal with the release of Toy Story in 1994 is a classic culture clash which took almost 12 years to resolve. The story of how Disney's next CEO, Bob Iger brought the Third Space skills of Empathy, Intellectual Curiosity and Cultural Competence to heal a rift that had grown between Disney and Pixar is a classic case study, best told using excerpts from Walter Isaacson's biography of Steve Jobs as well as material from Disney Case Studies from the Harvard Business Review and from Professor Timothy Wise at Southern Arkansas University.

The Disney-Pixar case study is important because it simultaneously reveals the consequences for strategy when powerful leaders possess different mixes of the five talents; and it reveals how organizational repertoires and cultures also play a role in strategy design. This case is also fascinating because it pitted two powerful men holding two very different visions of the future of one of the most important companies in the creative economy, involving thousands of people and billions of dollars. If ever there was a wrangling to reveal how Third Space attributes can affect outcomes, it is this one.

Eisner's Management Style

The story starts during the period when Michael Eisner was CEO of Disney. Eisner had made the distribution deal with Steve Jobs and Toy Story had been a big hit. The Pixar team and Jobs guarded their independence and since they financed their own films they never show anything but the finished film to Disney. Eisner hated their independence and was the kind of micro-manager who wanted to be involved in every stage of the filmmaking process. As the Harvard Case Study, "Walt Disney Company: The Entertainment King" points out, Eisner liked to manage through conflict, the opposite of Third Space Style management.

> Disney had a strategic planning unit that was a financial check on Disney's various divisions. The system encouraged conflict by pitting division managers against the strategic planning department. "You always have to fight your colleagues to show your worth," said one Disney executive. Eisner's "feeling is that if you put a lot of smart people in a room and let them duke it out…the best ideas will pop out," said another Disney executive.

But this process eventually wore creative people out. Between 1994 and January 2000, 75 high-level executives left the company. Ray Hansen, one of those who left told the HBR, “It’s not as fun a place as it used to be. The creative side doesn’t rule anymore.”

Eisner’s relations to the artist’s at Pixar in Northern California began to sour in this atmosphere. When they showed Eisner their second film, he wrote a memo to his staff, "Yesterday we saw for the second time the new Pixar movie, *Finding Nemo*, that comes out next May. This will be a reality check for those guys. It's okay, but nowhere near as good as their previous films. Of course they think that it's great."

Because Eisner was in an on going battle to control Pixar, he leaked the memo to the Los Angeles Times. This escalated the battle with Jobs telling reporters that all of the films that Walt Disney Animation Studios had produced over the past 5 years had been " ... embarrassing duds." The fight continued even after the success of *Finding Nemo*. Eisner countered by claiming that Disney didn't really need Pixar anymore, since the Disney already legally had the right to make sequels to Toy Story and all of the other films that this Emeryville, CA-based animation studio had produced. For the artists at Pixar, John Lasseter and Ed Catmull, the notion that the Disney Animation Team would “take away their children”, was the final straw. They asked Jobs to begin talking to other studios about distribution.

Robert Iger’s Challenge

As Iger explained in an exclusive interview with Isaacson for his book:

> Michael didn't understand that Disney's problems with animation were as acute as they were. That manifested itself in the way he dealt with Pixar. He never felt that he needed Pixar as much as he really did.

Iger, the Disney COO, who evidenced early on a non-linear 360 degree perspective, became acutely aware of just how much Disney truly needed Pixar. When Iger joined Eisner at the September 2005 grand opening of Hong Kong Disneyland, he watched the usual Disney parade down Main Street. Iger realized that the only characters in the parade that had been created in the past decade were Pixar's. "A light bulb went off," he recalled. "I'm standing next to Michael, but I kept it completely to myself, because it was such an indictment of his stewardship of animation during that period. After ten years of The Lion King, Beauty and the Beast, and Aladdin, there were then ten years of nothing." Soon after, Eisner was deposed from the CEO spot and Iger went to work repairing the Disney-Pixar relationship. Iger understood that a loss of the Pixar distribution would be devastating for both Disney's bottom line and its 60 year domination of the animation business. As Timothy Wise's case study, "Creativity and Culture at Pixar and Disney: A Comparison" noted, "Forty-five percent of the operating income for Disney's film operations came from the sale of Pixar movies and Disney's own marketing research showed that mothers trusted the Pixar name more than Disney." As Isaacson explains, Iger was methodical in his approach.

> Iger went back to Burbank and had some financial analysis done. He discovered that (The Walt Disney Company) had actually lost money on animation in the past decade. At his first meeting as the new CEO, he presented the analysis to (Disney's board of directors), whose members expressed some anger that they had never been told this.
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> "As animation goes, so goes our company," he told the board. "A hit animated film is a big wave, and the ripples go down to every part of our business -- from characters in a parade, to music, to parks, to video games, TV, Internet, consumer products. If I don't have wave makers, the company is not going to succeed."
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> (Iger) presented (Disney's board) with some choices. They could stick with the current animation management, which he didn't think would work. They could get rid of management and find someone else, but he said he didn't know who that would be. Or they could buy Pixar. "The problem is, I don't know if it's for sale, and if it is, it's going to be a huge amount of money," he said. The board authorized him to explore a deal.

Empathy for the Artists

It was at this point that Iger reached out to Jobs. And according to Isaacson, Steve was charmed by how forthright Bob during that initial discussion. Here is how Iger displayed both Empathy and Cultural Competence.

> “That's why I just loved Bob Iger," recalled Jobs. "He just blurted (that Disney badly needed Pixar) out. Now that's the dumbest thing you can do as you enter a negotiation, at least according to the traditional rule book. He just put his cards on the table and said, 'We're screwed.' I immediately liked the guy, because that's how I work too. Let's just immediately put all the cards on the table and see where they fall."

And given that Iger was so obviously respectful of Pixar's past efforts and genuinely seemed to want to do right by both companies, Jobs agreed to speak to John Lasseter and Ed Catmull on Disney's behalf.

> ... so (Steve) asked (John & Ed) to come over to his house. He got right to the point. "We need to get to know Bob Iger," he told them. "We may want to throw in with him and help him remake Disney. He's a great guy ... It's night and day different from Eisner's Disney. He's straightforward, he listens and there's no drama with him."
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> And once Steve had plowed the road for Bob ...
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> ... (Iger) flew from Los Angeles to Lasseter's house for dinner, and stayed up well past midnight talking. He took Catmull out to dinner, and he visited Pixar Studios, alone, with no entourage and without Jobs. "I went out and met all the directors one on one, and each of them pitched their movie," he said. Lasseter was proud of how much his team impressed Iger, which of course made him warm up to Iger.

Having won the artists over, Jobs proposed that Disney buy Pixar for $7.4 billion in stock. Disney's board of directors was going to need a little persuading, which is why Iger arranged for Jobs to bring Lasseter and Catmull to Century City, Los Angeles on a Sunday morning so they could then meet in secret with members of the board and explain how they planned on reviving Walt Disney Animation Studios.

Eisner Fights Back

Unfortunately, Michael Eisner -- as the largest individual shareholder The Walt Disney Company had at that time (Eisner owned 1.7% of the company's stock versus Roy E. Disney's 1%) heard about the meeting and decided to try to block it. According to Isaacson

> ... Before the Disney Board got a chance to approve the merger, however, Michael Eisner arose from the departed to try and derail it. He called Iger and said it was far too expensive. "You can fix animation yourself," Eisner told him. "How?" said Iger. "I know you can," said Eisner. Iger got a bit annoyed. "Michael, how come you say I can fix it, when you couldn't fix it yourself?" he asked.
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> Eisner said he wanted to come to a (Walt Disney Company) board (of directors) meeting, even though he was no longer a member or an officer, and speak against the acquisition. Iger resisted, but Eisner called Warren Buffett, a big shareholder and George Mitchell, who was the lead director. The former senator convinced Iger to let Eisner have his say. "I told the board that they didn't need to buy Pixar because they already owned 85% of the movies Pixar has already made," Eisner recounted. He was referring to the fact that for the movies already made, Disney was getting that percentage of the gross, plus it had the rights to make all the sequels and exploit the characters. "I made a presentation that said, here's the 15% of Pixar that Disney does not already own. So that's what you're getting. The rest is a bet on future Pixar films." Eisner admitted that Pixar had been enjoying a good run, but he said could not continue. "I showed the history of producers and directors who had X number of hits in a row and then failed. It

> happened to Spielberg, Walt Disney, all of them." To make the deal worth it, he calculated, each new Pixar movie would have to gross $1.3 billion. "It drove Steve crazy that I knew that," Eisner later said.

After he left the room, Iger refuted Eisner's argument point by point. He noted that the existing Disney Animation group had neither adaptability nor intellectual curiosity. They had adapted to the new tools of computer animation that Pixar had invented and perfected. And more importantly, they were looking outside their own storied history to find new subjects for films. They were intellectually curious like the Pixar artist/scientists. When Iger was finished, the board approved the acquisition. The rest is history.

Conclusion

We believe there is both empirical and anecdotal evidence that managers of creative enterprises need to hone new skills that are not necessarily taught in either business schools nor engineering schools. We are aware that the creative industries are going through a once in a generation transition in which technology is becoming increasingly central to the distribution of media content. Therefor there is a tendency to try to hire engineering talent and integrate them into the creative enterprises that produce movies, music, TV, games and journalism. In addition, as the size of the firms that produce and distribute media continues to grow both organically and through acquisition, the need for managers with classic business management training is acute. But as the Disney-Pixar case points out, the combination of engineering and business training are not enough to manage creative workers for whom the notions of empathy, adaptability, cultural competence and intellectual curiosity are critical.

Lessons Learned

- Be ruthlessly intellectually curious. If something is mission critical for your business don't take other people's description of how it works (i.e. animation) Probe behind the obvious questions, lift up the hood. At a USC event in Shanghai Robert Iger said that Intellectual Curiosity was the single most important thing he looks for in his employees.

- Recognize that your ‘company’ really consists of distinctive tribes each with its own separate culture, language, leadership styles and the like. Especially at the boundary between management and the creative team. The same is likely to be true for your closest customers and suppliers

- Don’t be prepared to adapt as situations demand it, but be eager to adapt before the situation demands.

- Having one, two or three of the Third Space attributes is good, but the real art and talent is the knack and sophistication of how to bring these different talents into play at the right time, in the right order, so each enhances the other. There was a time when Eisner could have been more adaptable and intellectually curious. There were moments when Iger could have been too adaptable toward his boss, Eisner. Yet like a great musician, he found the right rhythms and notes of empathy when he chose to deal directly, face to face, with Steve Jobs.