Activists come for Disney…

In January 2023, Nelson Peltz goes public with his demand for a seat on Disney's board and a push for costs controls (especially at Disney+)

February 2020
Iger steps down and the board names Bob Chapek as successor

October 2020
Chapek announces major restructuring, with Disney Plus taking center stage.

2020-22
Disney Plus is a hit, in terms of subscribers, but with huge content costs.

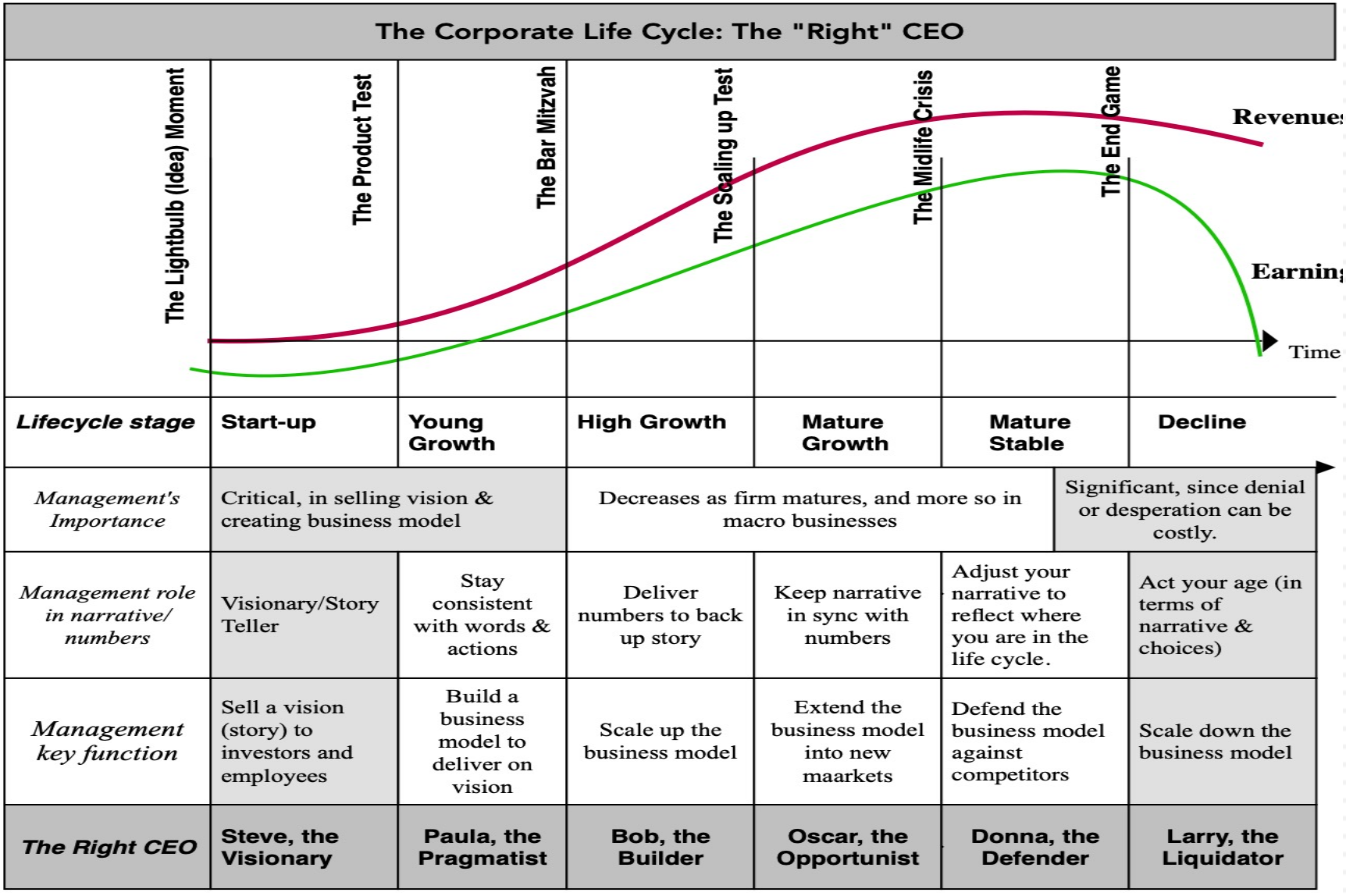
September 2022
Dan Loeb targets Disney, [ushing for spin off of ESPN & reining in of content costs.

November 2022
Disney reports annual numbers for 2022, missing on revenue and earnings.

Time: January 2020 - January 2023

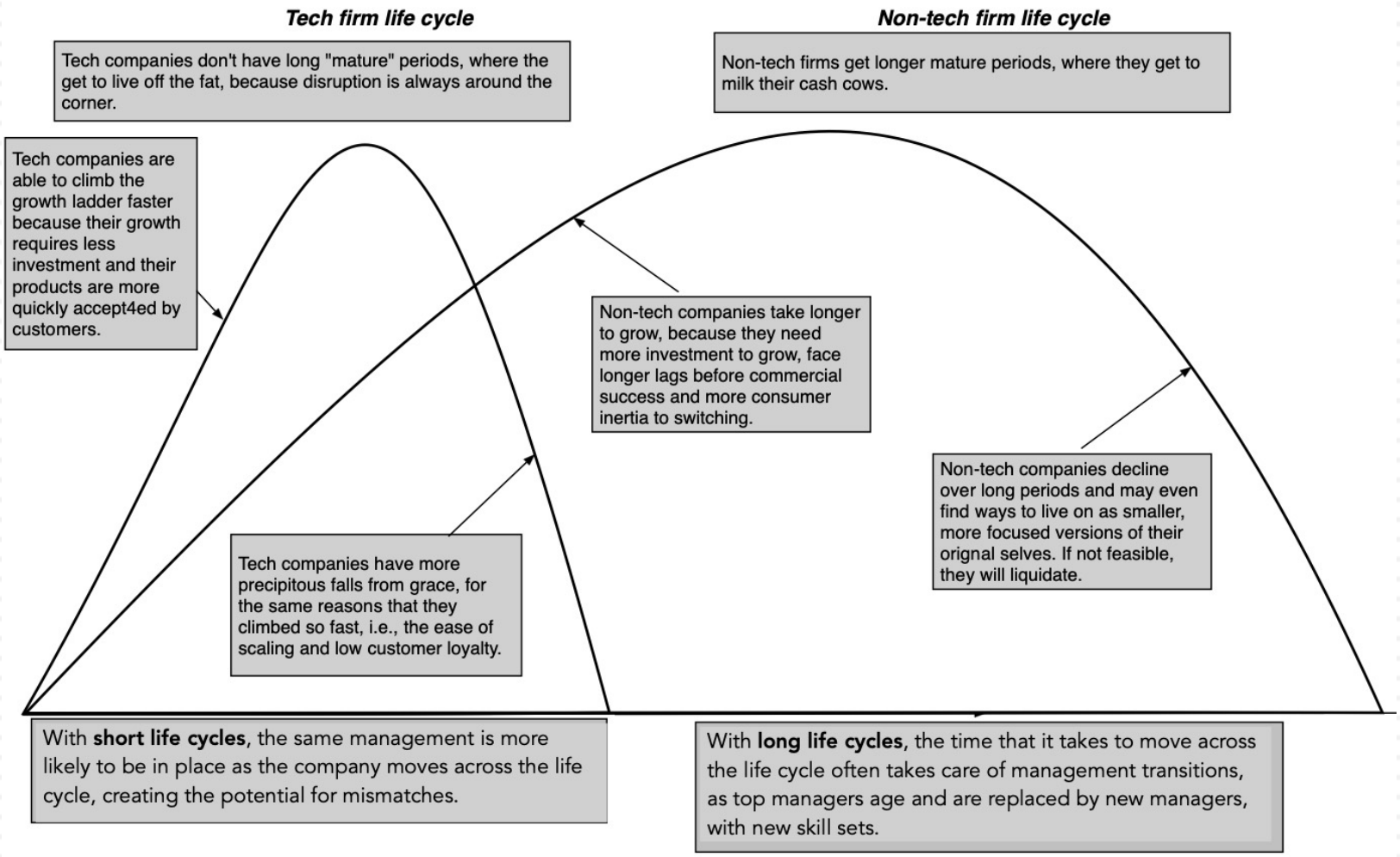
In **November 2022**, Bob Iger returned to the firm as CEO, replacing Bob Chapek as CEO and firing Kareem Daniel from his position at the top of the media & distribution business.

A Life Cycle View of CEOs

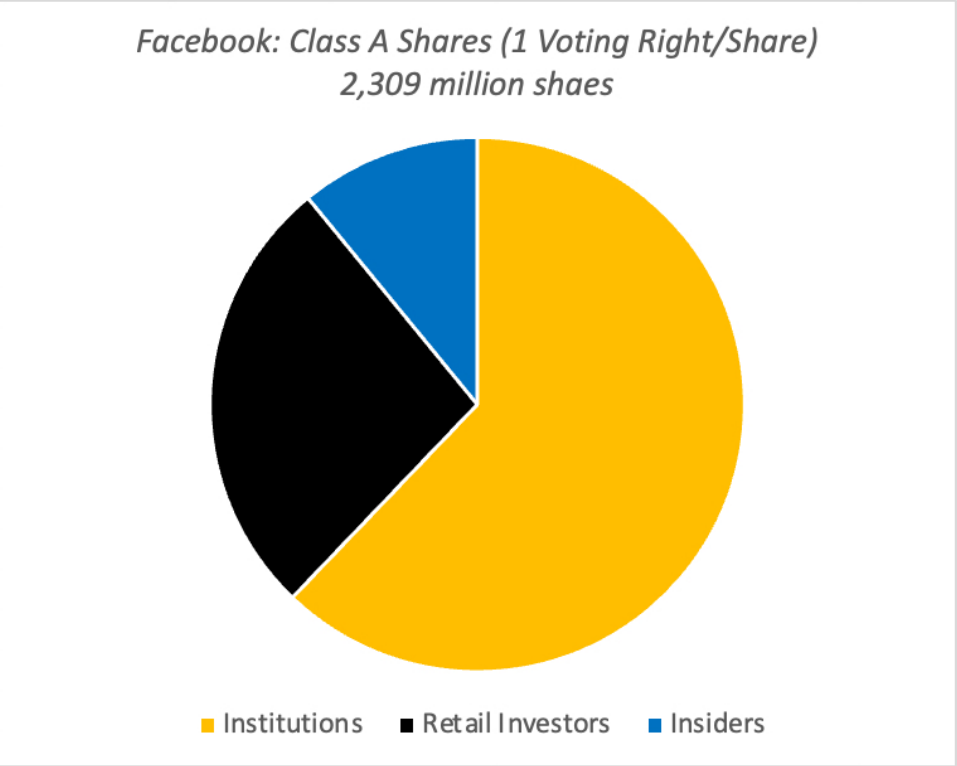


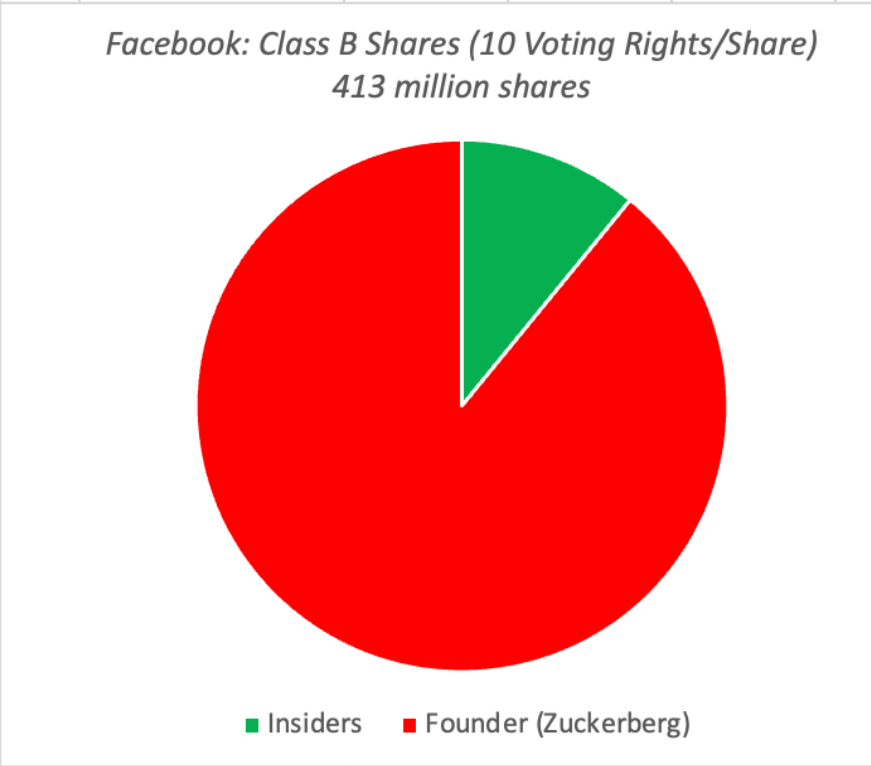
The Corporate Life Cycle: The "Right" CEO						
	The Lightbulb (Idea) Moment / The Product Test / The Bar Mitzvah / The Scaling up Test / The Midlife Crisis / The End Game					Revenues / Earnings / Time
Lifecycle stage	**Start-up**	**Young Growth**	**High Growth**	**Mature Growth**	**Mature Stable**	**Decline**
Management's Importance	Critical, in selling vision & creating business model		Decreases as firm matures, and more so in macro businesses			Significant, since denial or desperation can be costly.
Management role in narrative/ numbers	Visionary/Story Teller	Stay consistent with words & actions	Deliver numbers to back up story	Keep narrative in sync with numbers	Adjust your narrative to reflect where you are in the life cycle.	Act your age (in terms of narrative & choices)
Management key function	Sell a vision (story) to investors and employees	Build a business model to deliver on vision	Scale up the business model	Extend the business model into new maarkets	Defend the business model against competitors	Scale down the business model
The Right CEO	**Steve, the Visionary**	**Paula, the Pragmatist**	**Bob, the Builder**	**Oscar, the Opportunist**	**Donna, the Defender**	**Larry, the Liquidator**

The Compressed Tech Life Cycle



Corporate Governance at Tech firms: The Facebook example





	% of shares	% of voting rights
Institutions	52.72%	22.29%
Retail Investors	22.83%	9.65%
Insiders (no Zuckerberg)	10.93%	10.92%
Zuckerberg	13.52%	57.14%

2. The Bondholders' Defense Against Stockholder Excesses

- More restrictive covenants on investment, financing and dividend policy have been incorporated into both private lending agreements and into bond issues, to prevent future "Nabiscos".
- New types of bonds have been created to explicitly protect bondholders against sudden increases in leverage or other actions that increase lender risk substantially. Two examples of such bonds
  - Puttable Bonds, where the bondholder can put the bond back to the firm and get face value, if the firm takes actions that hurt bondholders
  - Ratings Sensitive Notes, where the interest rate on the notes adjusts to that appropriate for the rating of the firm
- More hybrid bonds (with an equity component, usually in the form of a conversion option or warrant) have been used. This allows bondholders to become equity investors, if they feel it is in their best interests to do so.

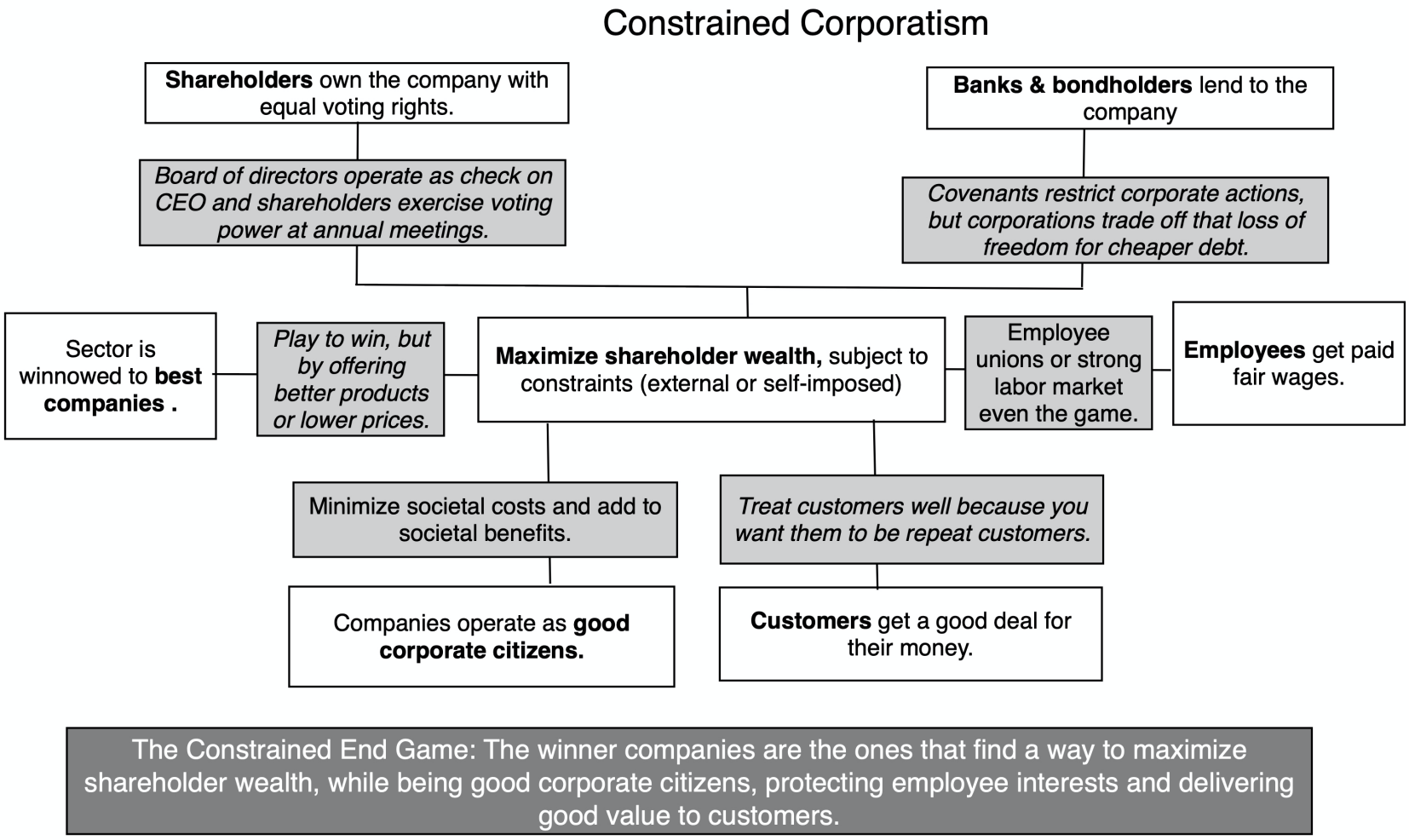
3. The Financial Market Response

- Companies can mislead investors for long periods, leading stock prices away from value and skewing capital allocation across firms. (Firms that mislead have access to more capital than they should…)
  - Analysts, for the most part, seem to be ineffective at uncovering these "problems", sometimes because of tunnel vision and sometimes because of biases.
  - As investor access to information improves, it is becoming much more difficult for firms to control when and how information gets out to markets.
  - If there are ways of trading on over valuation, the payoff to uncovering negative information about companies rises, and there will be an incentive on the part of investors to uncover the truth.
- No matter what, the truth eventually does come out, and when it does:
  - The punishment is not only quick, but it is savage. Stock prices drop, as markets reset.
  - The management of the company loses credibility making it difficult for the company to find its way back to health.

4. The Societal Response

- If firms consistently flout societal norms and create large social costs, the governmental response (especially in a democracy) is for laws and regulations to be passed against such behavior.
- Even if governments and regulators do not act, a company that deliberately flouts societal norms and acquires a reputation as a bad company can pay a price:
  - For firms catering to a more socially conscious clientele, the failure to meet societal norms (even if it is legal) can lead to loss of customers and revenues.
  - These firms may have trouble holding on to employees
  - Investors may choose not to invest in stocks of firms that they view as socially irresponsible and lenders may be reluctant to lend money to the firm.
  - If this seems like a back-handed argument for ESG, it is, but it is a very restrictive one where the advice to companies it to not be bad (rather than to be good).

Constrained Corporatism



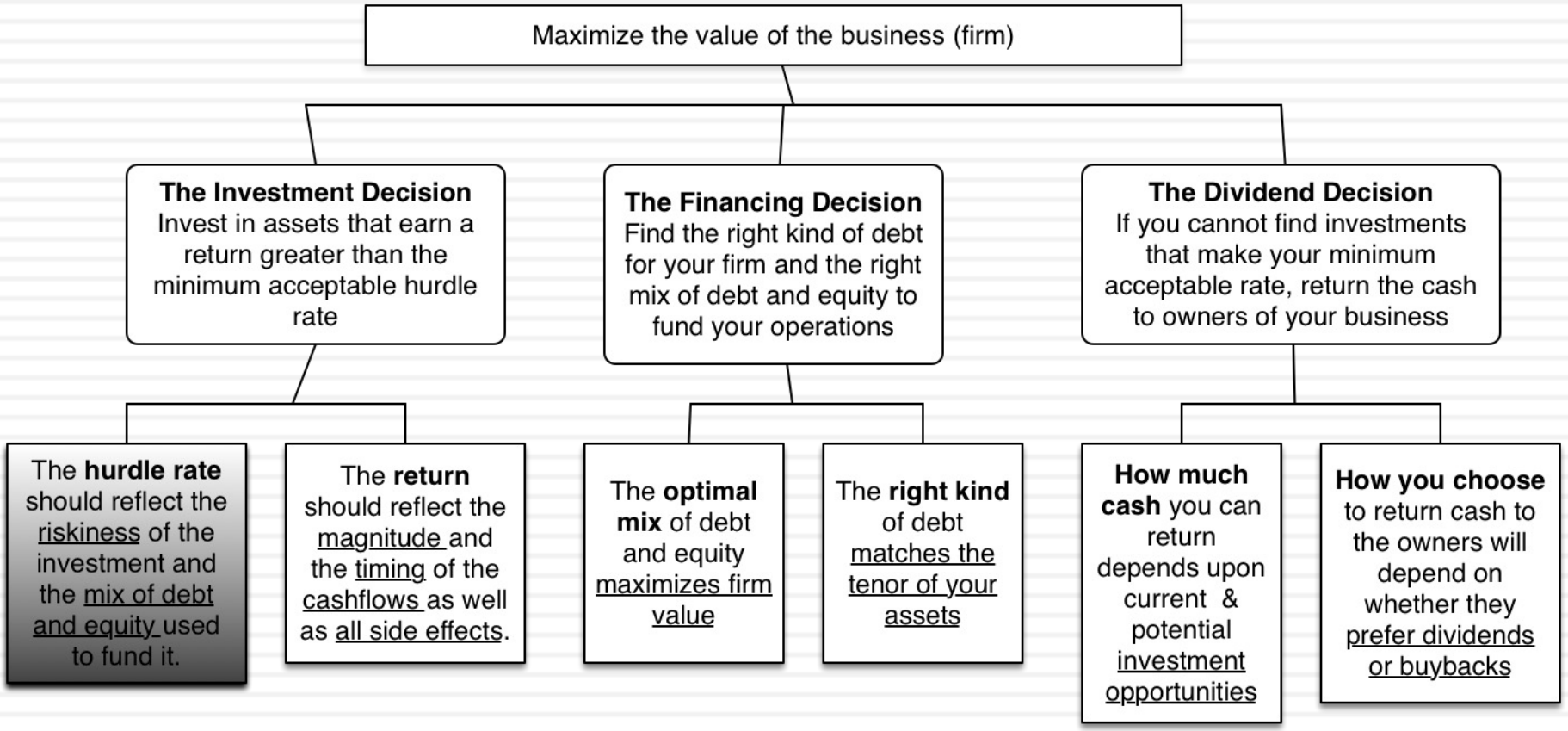
The Modified Objective Function

- For publicly traded firms in reasonably efficient markets, where bondholders (lenders) are protected:
  - Maximize Stock Price: This will also maximize firm value
- For publicly traded firms in inefficient markets, where bondholders are protected:
  - Maximize stockholder wealth: This will also maximize firm value, but might not maximize the stock price
- For publicly traded firms in inefficient markets, where bondholders are not fully protected
  - Maximize firm value, though stockholder wealth and stock prices may not be maximized at the same point.
- For private firms, maximize stockholder wealth (if lenders are protected) or firm value (if they are not)

THE INVESTMENT PRINCIPLE: RISK AND RETURN MODELS

"You cannot swing upon a rope that is attached only to your own belt."

First Principles



The notion of a benchmark

- Since financial resources are finite, there is a hurdle that projects have to cross before being deemed acceptable. This hurdle should be higher for riskier projects than for safer projects.
- A simple representation of the hurdle rate is as follows:

  Hurdle rate = Riskless Rate + Risk Premium
- The two basic questions that every risk and return model in finance tries to answer are:
  - How do you measure risk?
  - How do you translate this risk measure into a risk premium?

What is Risk?

- Risk, in traditional terms, is viewed as a ‘negative’. Webster’s dictionary, for instance, defines risk as “exposing to danger or hazard”. The Chinese symbols for risk or crisis, reproduced below, give a much better description of risk

危機

  - The first symbol is the symbol for “danger”.
  - The second is the symbol for “opportunity”, making risk a mix of danger and opportunity. You cannot have one, without the other.
- Risk is therefore neither good nor bad. It is just a fact of life. The question that businesses have to address is therefore not how to avoid risk but how best to incorporate it into their decision making.

A good risk and return model should…

1. It should come up with a measure of risk that applies to all assets and not be asset-specific.
2. It should clearly delineate what types of risk are rewarded and what are not, and provide a rationale for the delineation.
3. It should come up with standardized risk measures, i.e., an investor presented with a risk measure for an individual asset should be able to draw conclusions about whether the asset is above-average or below-average risk.
4. It should translate the measure of risk into a rate of return that the investor should demand as compensation for bearing the risk.
5. It should work well not only at explaining past returns, but also in predicting future expected returns.

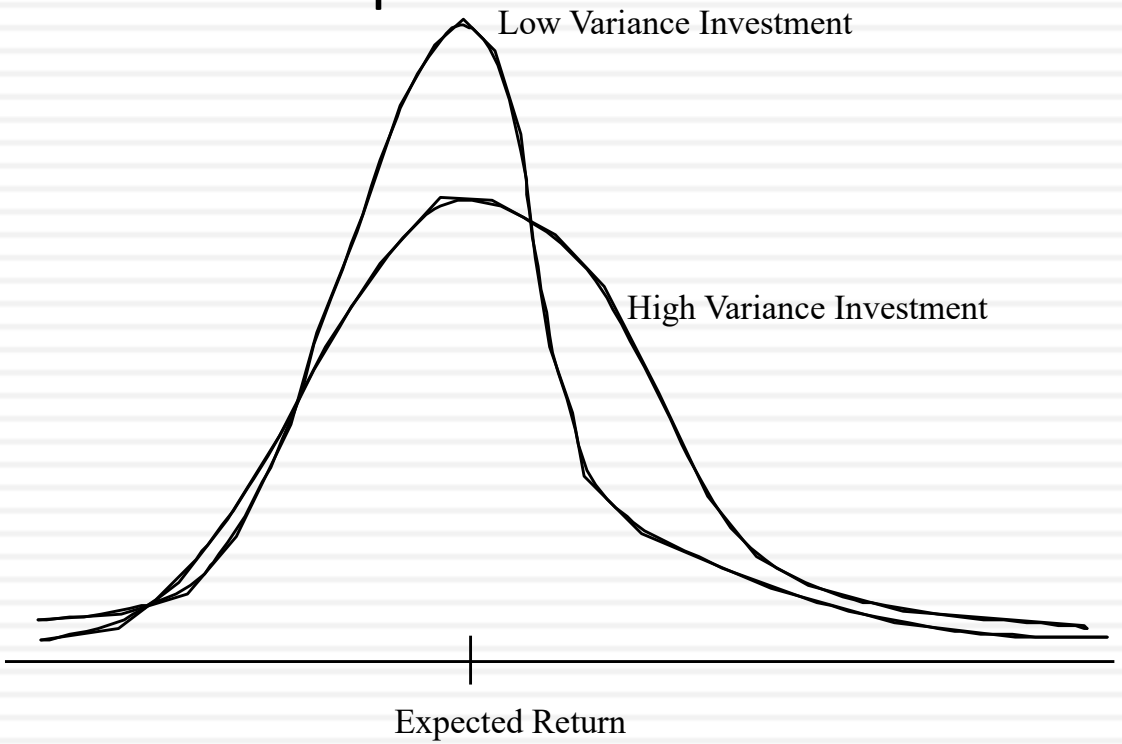
The Capital Asset Pricing Model

1. Uses variance of actual returns around an expected return as a measure of risk.
2. Specifies that a portion of variance can be diversified away, and that is only the non-diversifiable portion that is rewarded.
3. Measures the non-diversifiable risk with beta, which is standardized around one.
4. Translates beta into expected return -

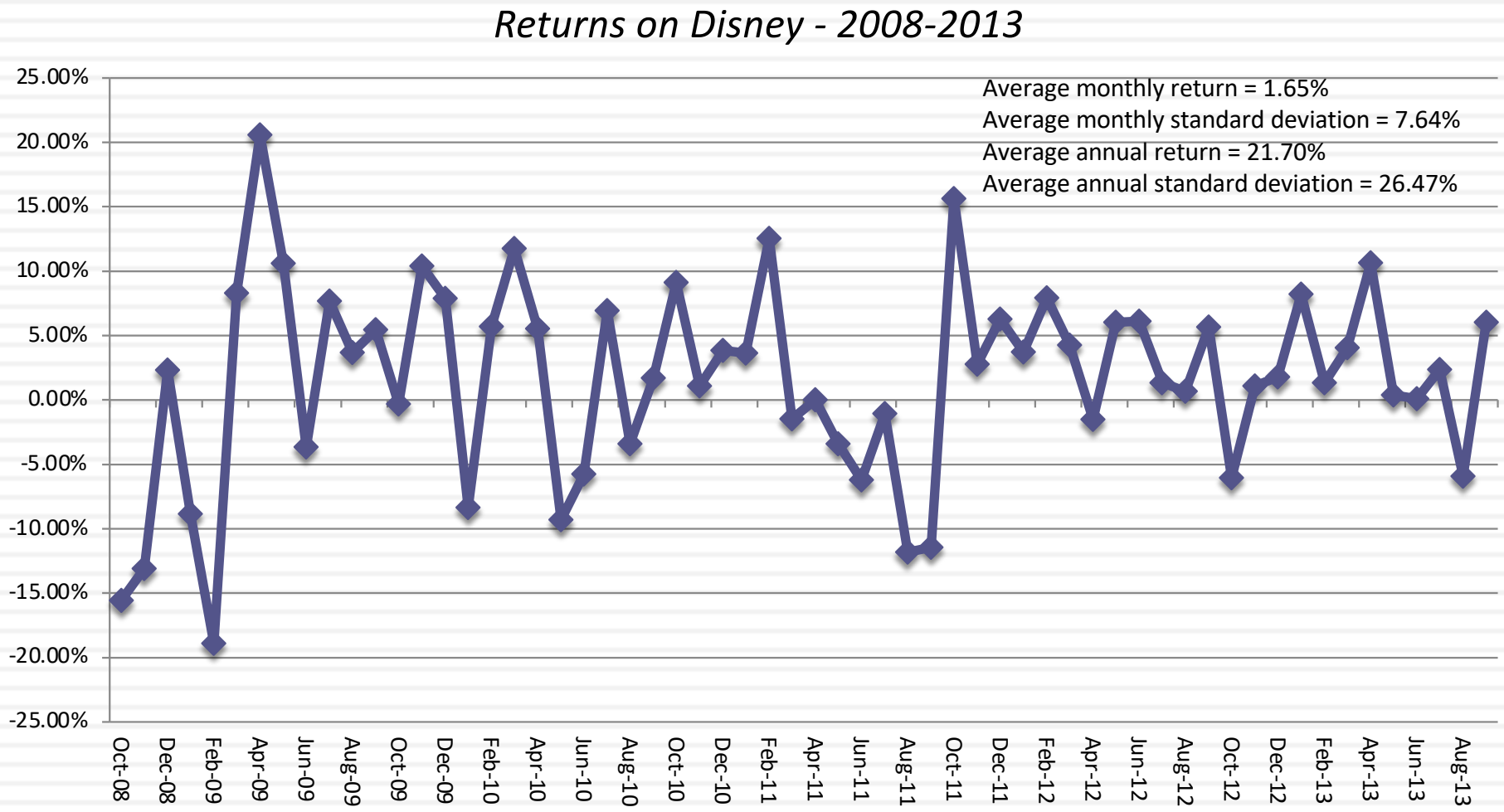
   Expected Return = Riskfree rate + Beta * Risk Premium
5. Works as well as the next best alternative in most cases.

1. The Mean-Variance Framework

- The variance on any investment measures the disparity between actual and expected returns.



How risky is Disney? A look at the past…

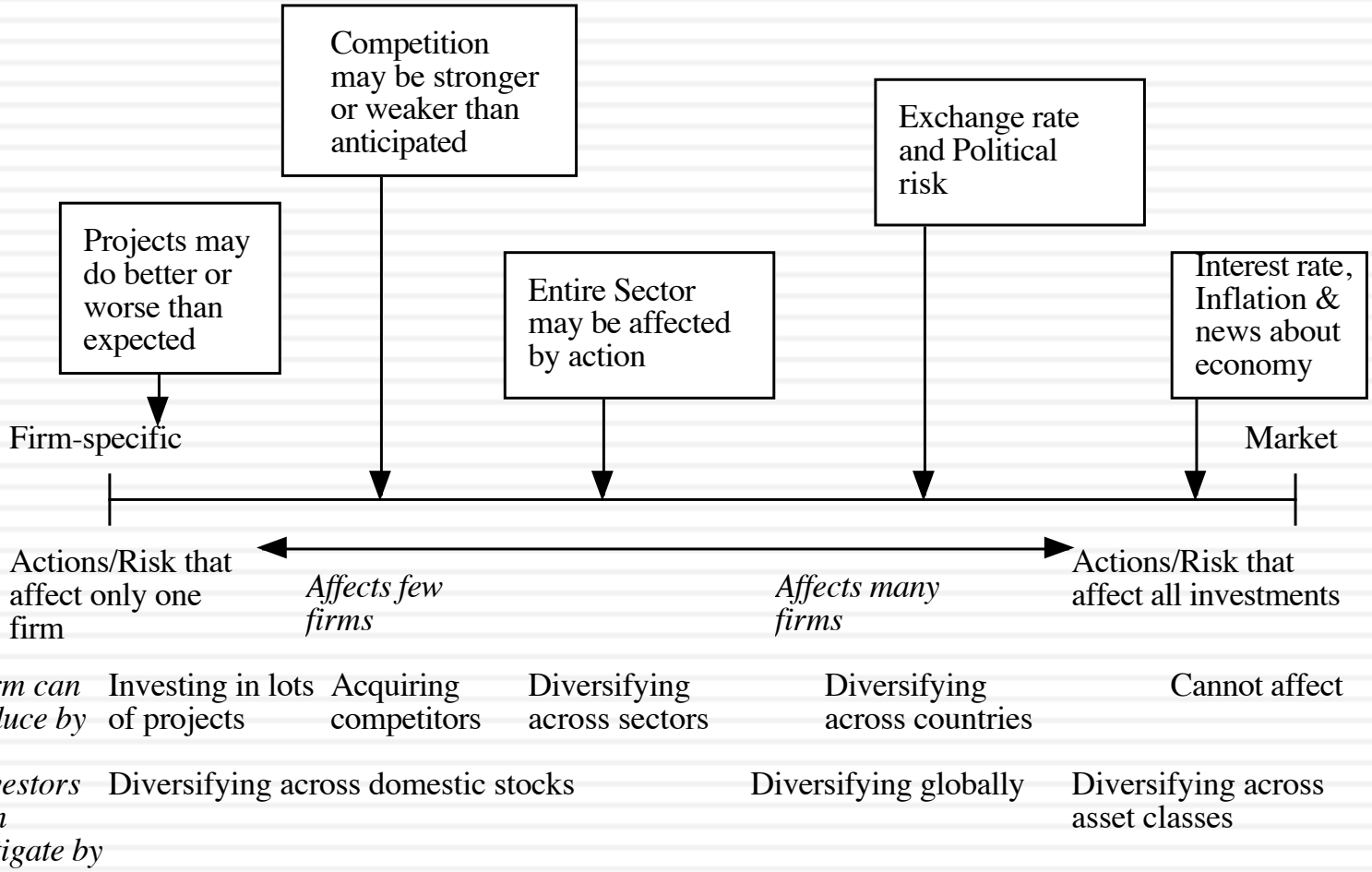


Do you live in a mean-variance world?

- Assume that you had to pick between two investments. They have the same expected return of 15% and the same standard deviation of 25%; however, investment A offers a very small possibility that you could quadruple your money, while investment B's highest possible payoff is a 60% return. Would you
  a. be indifferent between the two investments, since they have the same expected return and standard deviation?
  b. prefer investment A, because of the possibility of a high payoff?
  b. prefer investment B, because it is safer?
- Would your answer change if you were not told that there is a small possibility that you could lose 100% of your money on investment A but that your worst-case scenario with investment B is -50%?

2. The Importance of Diversification: Risk Types

Figure 3.5: A Break Down of Risk



Why diversification reduces/eliminates firm specific risk

- Firm-specific risk can be reduced, if not eliminated, by increasing the number of investments in your portfolio (i.e., by being diversified). Market-wide risk cannot. This can be justified on either economic or statistical grounds.
- On economic grounds, diversifying and holding a larger portfolio eliminates firm-specific risk for two reasons-
  a. Each investment is a much smaller percentage of the portfolio, muting the effect (positive or negative) on the overall portfolio.
  b. Firm-specific actions can be either positive or negative. In a large portfolio, it is argued, these effects will average out to zero. (For every firm, where something bad happens, there will be some other firm, where something good happens.)

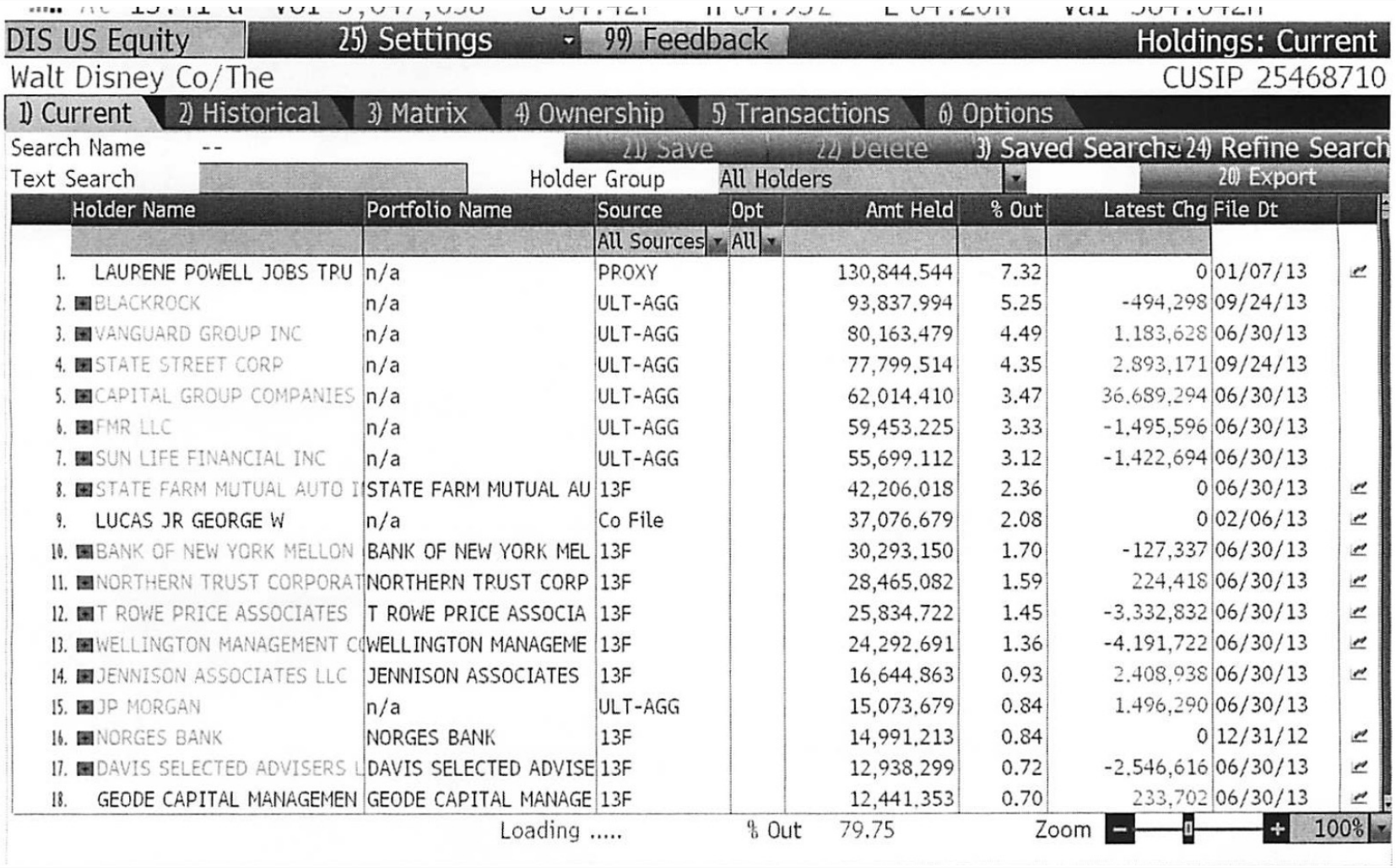
The Role of the Marginal Investor

- The marginal investor in a firm is the investor who is most likely to be the buyer or seller on the next trade and to influence the stock price.
  - Generally speaking, the marginal investor in a stock has to own a lot of stock and also trade that stock on a regular basis.
  - Since trading is required, the largest investor may not be the marginal investor, especially if he or she is a founder/manager of the firm (Larry Ellison at Oracle, Mark Zuckerberg at Facebook…)
- **In risk and return models in finance, we start with the marginal investor is well diversified**.

Identifying the Marginal Investor in your firm…

Percent of Stock held by Institutions	*Percent of Stock held by Insiders*	*Marginal Investor*
High	Low	Institutional Investor
High	High	Institutional Investor, with insider influence
Low	High (held by founder/manager of firm)	Tough to tell; Could be insiders but only if they trade. If not, it could be individual investors.
Low	High (held by wealthy individual investor)	Wealthy individual investor, fairly diversified
Low	Low	Small individual investor with restricted diversification

Gauging the marginal investor: Disney in 2013



DIS US Equity | 25) Settings | 99) Feedback | Holdings: Current

Walt Disney Co/The — CUSIP 25468710

1) Current | 2) Historical | 3) Matrix | 4) Ownership | 5) Transactions | 6) Options

Search Name -- | 21) Save | 22) Delete | 23) Saved Searches | 24) Refine Search

Text Search | Holder Group: All Holders | 20) Export

	Holder Name	Portfolio Name	Source	Opt	Amt Held	% Out	Latest Chg	File Dt
			All Sources	All				
1.	LAUPENE POWELL JOBS TRU	n/a	PROXY		130,844,544	7.32	0	01/07/13
2.	BLACKROCK	n/a	ULT-AGG		93,837,994	5.25	-494,298	09/24/13
3.	VANGUARD GROUP INC	n/a	ULT-AGG		80,163,479	4.49	1,183,628	06/30/13
4.	STATE STREET CORP	n/a	ULT-AGG		77,799,514	4.35	2,893,171	09/24/13
5.	CAPITAL GROUP COMPANIES	n/a	ULT-AGG		62,014,410	3.47	36,689,294	06/30/13
6.	FMR LLC	n/a	ULT-AGG		59,453,225	3.33	-1,495,596	06/30/13
7.	SUN LIFE FINANCIAL INC	n/a	ULT-AGG		55,699,112	3.12	-1,422,694	06/30/13
8.	STATE FARM MUTUAL AUTO I	STATE FARM MUTUAL AU	13F		42,206,018	2.36	0	06/30/13
9.	LUCAS JR GEORGE W	n/a	Co File		37,076,679	2.08	0	02/06/13
10.	BANK OF NEW YORK MELLON	BANK OF NEW YORK MEL	13F		30,293,150	1.70	-127,337	06/30/13
11.	NORTHERN TRUST CORPORAT	NORTHERN TRUST CORP	13F		28,465,082	1.59	224,418	06/30/13
12.	T ROWE PRICE ASSOCIATES	T ROWE PRICE ASSOCIA	13F		25,834,722	1.45	-3,332,832	06/30/13
13.	WELLINGTON MANAGEMENT C	WELLINGTON MANAGEME	13F		24,292,691	1.36	-4,191,722	06/30/13
14.	JENNISON ASSOCIATES LLC	JENNISON ASSOCIATES	13F		16,644,863	0.93	2,408,938	06/30/13
15.	JP MORGAN	n/a	ULT-AGG		15,073,679	0.84	1,496,290	06/30/13
16.	NORGES BANK	NORGES BANK	13F		14,991,213	0.84	0	12/31/12
17.	DAVIS SELECTED ADVISERS L	DAVIS SELECTED ADVISE	13F		12,938,299	0.72	-2,546,616	06/30/13
18.	GEODE CAPITAL MANAGEMEN	GEODE CAPITAL MANAGE	13F		12,441,353	0.70	233,702	06/30/13

Loading ..... | % Out 79.75 | Zoom 100%

Extending the assessment of the investor base

- In all five of the publicly traded companies that we are looking at, institutions are big holders of the company's stock.

	Disney	*Deutsche Bank*	*Vale (preferred)*	*Tata Motors*	*Baidu (Class A)*
Institutions	70.2%	40.9%	71.2%	44%	70%
Individuals	21.3%	58.9%	27.8%	25%	20%
Insiders	7.5%	0.2%	1.0%	31%*	10%

Company	*Largest holder*	*Number of institutional investors in top ten holdings*
Disney	Laurene Jobs (7.3%)	8
Deutsche Bank	Blackrock (4.69%)	10
Vale Preferred	Aberdeen (7.40%)	8
Tata Motors	Tata Sons (26.07%)	7
Baidu (Class A)	Capital Group (12.46%)	10

3. The Limiting Case: The Market Portfolio

- The big assumptions & the follow up: Assuming diversification costs nothing (in terms of transactions costs), and that all assets can be traded, the limit of diversification is to hold a portfolio of every single asset in the economy (in proportion to market value). This portfolio is called the market portfolio.
- The consequence: Individual investors will adjust for risk, by adjusting their allocations to this market portfolio and a riskless asset (such as a T-Bill):

Preferred risk level	*Allocation decision*
No risk	100% in T-Bills
Some risk	50% in T-Bills; 50% in Market Portfolio;
A little more risk	25% in T-Bills; 75% in Market Portfolio
Even more risk	100% in Market Portfolio
A risk hog..	Borrow money; Invest in market portfolio