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FORTUNE

MOUSE HUNT

Marc Gunther. **Fortune**. New York: Jan 12, 2004. Vol. 149, Iss. 1; pg. 106

Author(s): Marc Gunther

Article types: General Information

Publication title: Fortune. New York: Jan 12, 2004. Vol. 149, Iss. 1; pg. 106

Source Type: Periodical

ISSN/ISBN: 00158259

ProQuest document ID: 522288391

Text Word Count 2655

Article URL: http://gateway.proquest.com/openurl?ctx_ver=z39.88-2003&res_id=xri:pqd&rft_val_fmt=ori:fmt:kev:mtx:journal&genre=article&rft_id=xri:pqd:did=000000522288391&svc_dat=xri:pqil:fmt=txt&req_dat=xri:pqil:pq_clntid=9269

Full Text (2655 words)

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[Headnote]

For Roy Disney, the company founded by his Uncle Walt is much more than a business. MARC GUNTHER sat down with him to learn what made him so mad at CEO Michael Eisner, and why he's leading a MOUSE HUNT

A week or so before Thanksgiving, a film editor at the Walt Disney Co. asked Roy Disney, the company's longtime animation chief, if he planned to attend a screening of ideas for new animated films.

Disney was puzzled. He hadn't been invited. He called the president of animation, David Stainton, and said he'd like to come. No problem, he was told.

Then came an e-mail from Michael Eisner, Disney's chairman and CEO. Please don't go to the screening, it said. The movie ideas are not ready for review.

Roy Disney telephoned Eisner to protest. Eisner stood his ground. he told Disney, who had become a vocal and persistent critic, that he had no business at the screening.

"I really think I ought to be there," Disney said.

"Well," Eisner replied, "I guess I can't put a guard by the door."

"I'll take that for a yes," Disney said.

When he arrived at the screening, Disney was flabbergasted. He had expected a small group. Instead, close to 100 people filled the room. Had it come to this, he thought? He had worked at Disney for 50 years. He was a member of the board. he believed that Disney should be run as a family company, a place where people treated one another with kindness and respect. Michael Eisner, he thought, simply did not understand.

TO COMPREHEND THE STRUGGLE THAT has erupted over the future of the Walt Disney Co., it helps to understand Roy Disney, the 73-year-old nephew of company founder Walt Disney and the son of Walt's older brother and partner, Roy O. Disney. As the last link between the founding family and a \$27-billion-a-year global entertainment giant, Roy Disney has become the point man for an unorthodox campaign to oust Eisner as CEO. His hope is that the company's prolonged financial slump has generated enough discontent among investors that they will clamor for change. For eight years Disney's earnings have been flat, and its stock performance has been disappointing. Its board of directors, too, has been dominated by Eisner. So Roy Disney and his business partner, Stanley Gold-also a Disney director-quit the board to launch a grassroots uprising that will try to use the Internet to rally small shareholders. Borrowing from Democrat Howard Dean's script, they created a website called Save Disney (www.savedisney.com). "[Dean] has been able to organize a group that felt disenfranchised," Gold says. "We're going to do the same thing."

But this battle for control of an American icon is not just about shareholder value or corporate governance. Nor is it about the animosity between Roy Disney and Michael Eisner, though there's plenty of that. It is, at heart, about a family and its legacy. Corny as it sounds, Roy Disney wants to take the company back from Michael Eisner because, he says, it has lost its soul.

"The Disney company is unique," Roy Disney tells FORTUNE, in the first in-depth interview he has given since launching his crusade. We're in a conference room at Shamrock Holdings, the family's investment company in Burbank, Calif. It's not far from the Disney lot, where, for the first time in 80 years, no Disney family member goes to work. Even after shaving his moustache, Roy Disney resembles his famous uncle. The oval face, sloping nose, and folksy manner take me back to Sunday nights in the late 1950s on ABC. "Disney," he says, as if reading my mind, "has an awfully long and deep and nostalgic relationship with the public, literally worldwide. I've felt it all my life. At age 4, I was watching bits and pieces of Snow White when it was in production. I grew up not only around the films but also around the people, which is even more important. It's not something you can just walk away from. It is somehow in my soul."

Little in Roy Disney's past has prepared him for the role he has now chosen to play. Business never interested him much. Nor has he sought the spotlight. So shy was he as a young man that he proposed to his wife, Patty, by writing her a fivepage letter. He struggled to summon the courage to ask his Uncle Walt for permission to produce his first film. The Otter in the Family, it was called.

Gentle and self-effacing, Roy Disney devoted the first 20 years of his career at Disney to making nature films. Later he became a champion of animation, laboring for nearly a decade on Fantasia 2000, a succession of clever little cartoons set to classical music that won critical acclaim but fared poorly at the box office. Always, he did what he could to protect the Disney name and reputation. When Kellogg obtained a license to make a breakfast cereal called Mickey Magix, Roy asked that Mickey Mouse not be shown facing outward on the box because, he said, he didn't want the mouse to be seen as a cereal salesman. Disney and Kellogg obliged.

As the company thrived, Roy Disney built his very own Magic Kingdom. He owns a castle in County Cork, Ireland, to which he retreats with his wife, four children, and 16 grandchildren. A world-class sailor, he just acquired an 86-foot sloop that he will race this spring in the Caribbean. He travels in his own Boeing jet. "I'm very lucky," he says. "I could have all the nice times I want."

Plainly he doesn't need this fight; nor did he seek it out. But when he was asked to leave Disney's board because of his age, he refused to go quietly. He summoned his four children to a family meeting. They sat together in a circle, clasped hands, and agreed he should take on Eisner. "His identity is more wrapped up in this company than you can imagine," says his daughter Abby, a New York philanthropist. "He's prepared to be called names. But this is so important to him."

With that, Roy Disney went on the attack. In a letter released when he quit the board, he said that the Disney company is now widely seen as "rapacious, soulless, and always looking for the quick buck." Since the death of Eisner's partner, Frank Wells, in 1994, "the company has lost its focus, its creative energy, and its heritage," he wrote. The following day Gold quit too and charged that the board has been "an enabler to entrenched management." Eisner has not responded publicly, and he declined to be interviewed for this story.

Dethroning the CEO will not be easy. The company is showing signs of a turnaround: Disney's stock price grew by more than 35% in 2003, and executives say that earnings per share will increase by more than 30% in the current fiscal year. As dissident directors, Roy Disney and Stanley Gold were unable to convince their fellow board

members that Eisner was to blame for the company's troubles. It will be even harder to make their case as outsiders. "Strategically, I think what they did was pretty stupid," says a Disney insider who is no fan of Eisner's.

But it would be a mistake to count out Roy Disney and Gold. They've been down this road before. As president of Shamrock, which manages money for the Disney family and others, Gold has been an activist investor-he hates being called a raider-for many years. In 1984, when the Disney company was led by inept managers and besieged by takeover threats, Gold and Roy Disney joined forces with the Bass brothers to seize control. They brought in Eisner and Wells, who led a spectacular turnaround-a revived animation unit, new theme parks and hotels, cool Mickey Mouse gear, Disney stores in every mall, and more. Everyone did well, especially Eisner, who cashed in \$850 million of options over about 15-years.

The thrill ride came to a screeching halt in the mid-1990s. Why it happened is a matter of debate. The dissidents say that Wells's death in a helicopter crash and the acquisition of ABC overwhelmed Eisner, who tried to do too much himself. A succession of misjudgments ensued-hiring Michael Ovitz, fighting the departed Jeffrey Katzenberg in court, wasting money on the Internet, overpaying for Fox's Family Channel, mismanaging ABC, and so forth. "Michael was once a very good creative executive, but he ran out of gas," asserts Gold. Eisner's supporters concede mistakes, but they attribute the company's problems to competition in feature animation, a recession, and aftershocks of 9/11, which clobbered the theme parks. They say that the money invested in the parks and cable channels will pay off, and they tout such growth stories as ESPN and the Disney Channel.

Still, the numbers are what they are. In fiscal 1994, Disney produced operating income of \$3.1 billion. Since then the company has generated close to \$25 billion in cash that it has reinvested in operations. In fiscal 2003, after all that investment, Disney produced operating income of just \$3.2 billion. This is from a company that once delivered earnings growth of 15% a year. "Someone has to have the courage to say that the emperor has no clothes," declares Gold. "The board won't do it." Savvy investors Warren Buffett and Capital Research's Gordon Crawford sold their Disney shares years ago.

Roy Disney owns 17.3 million shares, according to public filings, worth about \$400 million at the end of 2003. Other Disney family members own nearly as much. That's more than enough to care about performance but less than 2% of the shares outstanding. Formed in 1978, Shamrock has diversified into radio stations, real estate, technology, and companies in Israel, but Disney stock remains the family's largest asset.

Even a substantial rise in the stock price won't mollify Roy Disney. He'll declare victory only if Eisner is deposed, he says. That's because he believes Disney's sluggish financials reflect something more troubling-a company that has lost its creative edge and no longer takes care of its employees, customers, or partners.

"Morale is awful everywhere," he says. "Nobody is empowered to do anything on their own. Everything goes up to Michael if it costs more than a dime." The theme parks, he gripes, aren't well maintained, and three newer parks-Disney's California Adventure, Disney Studios in Paris, and a Disneyland under construction in Hong Kong-have been built on the cheap. "They spent a half or a third of what they should on California Adventure and charged full price, same as Disneyland," he says. "Probably, for \$10 people would have come out saying, This is the best damn park yet.' Instead, the perception was, 'They're screwing me again.' " The feeling in the parks is that "everything has kind of shriveled," Roy Disney says. He feels an emotional tie to the parks because he married Patty the year Disneyland opened-their kids practically grew up there-and his father got Walt Disney World built in Orlando after Walt's death in 1966.

While the Disney company might want to spend more on its theme parks and charge people less to get in, that approach wouldn't do much for the bottom line. The trouble is, Roy Disney doesn't seem to think about Disney as a business that, like any other, has to balance the needs of employees, customers, and owners. The company chose to conserve capital while building the newer parks, which are being expanded as they bring in revenue. You can argue with that strategy, which hasn't worked well at California Adventure. But overspending poses its own risk. Money-losing Euro Disney had to delay its interest payments to banks and suspend its licensing payments to the Disney company because of a crushing debt load.

But Roy Disney makes no apology for his belief that Disney is unlike any other business, more akin to a national treasure than to a Hollywood studio. When I suggest to him that Eisner and his people do their best to keep the Disney brand fresh without damaging its time-honored appeal, he grimaces. "If you'll forgive me, I can't use that word-brand," he says. "I find the word repugnant. It means all the things that we're not. We're Snow White and Mickey Mouse and Donald Duck and Goofy and all those guys and gals. We're in people's hearts, people's souls.

Calling it a brand demeans it."

Roy Disney is also bothered by the company culture. He hates it when executives talk about "killer deals." Deals shouldn't be about killing your partners, he says; they should allow everyone to feel good. Eisner, he says, always seems to be fighting with someone—Steve Jobs or Harvey Weinstein or cable operators who don't want to pay rising fees for ESPN. The Disney CEO also has a tendency to badmouth his own people after they leave the company.

In the long run you can't be successful if you don't treat people well, Stanley Gold says. "With Michael, you are either with him or you are the enemy. The enemy needs to be scorched, and there are fewer and fewer people with him. In the end this is not just a personal trait of Michael's. This begins to decay the company."

Whether Stanley Gold and Roy Disney can make that case to the company's shareholders is an open question. While they aren't saying much about their strategy, they plan to seek meetings with Disney's institutional shareholders and communicate with smaller ones via the Internet. (The top 35 owners hold about 40% of Disney's stock.) They won't run their own slate of directors this year, but they may ask shareholders to withhold votes for Eisner or for directors who they say are under the CEO's thumb. Gold muses out loud about organizing a public gathering of dissident shareholders in March, on the eve of Disney's annual meeting, which will be held in Philadelphia. Then, the next day, they could confront Eisner and the board.

Neither the dissidents nor the company will talk about who might succeed Eisner, who is 61, if he opts to step down when his contract expires in 2006 or if the board decides to replace him. Roy Disney and Gold say there are plenty of candidates, and the board should do a search. "Michael has perpetuated the myth that he is irreplaceable," Roy Disney says. "That is absurd." Speculation about candidates focuses on eBay CEO Meg Whitman and Steve Burke, president of Comcast Cable, both of whom are former Disney executives, as well as Peter Chermi of News Corp. and Yahoo CEO Terry Semel. A company turnaround could boost the prospects of Bob Iger, Eisner's well-liked No. 2.

Roy Disney says he isn't pushing any candidate. "My loyalty is to the company, and to the people we serve, and to our cast members, who I consider friends," he says. "It goes way beyond the economics."

Maybe so, but economics will likely decide the battle for Walt Disney Co. If Eisner can deliver his oft-promised turnaround, he'll win shareholder support. If not, the clamor from Roy Disney and Gold, as well as a strengthened board, will hold him accountable. In other words, Disney will operate more like an ordinary company, as it should. This probably won't please Roy Disney, who sees the company as a public trust, or Eisner, who has run it as a fiefdom, but it should deliver long-awaited relief to Disney's shareholders. And they're the ones who own the place.

[Sidebar]

HUNTING PARTNER Stanley Gold, Roy Disney's ally, turned sour on Eisner.
"Somebody has to have the courage to say the emperor has no clothes. The board won't."

[Sidebar]

EISNER RESTORED the company's luster once. Can he do it again?

[Sidebar]

ROY'S MAGIC KINGDOM includes a castle in Ireland and a serious racing yacht.
"Michael has perpetuated the myth that he is irreplaceable. That is absurd."

[Author Affiliation]

FEEDBACK mgunther@fortunemail.com

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