case fifteen

Euro Disney: From Dream to Nightmare

TEACHING NOTE

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■ SYNOPSIS ■

The case examines Walt Disney Company's creation of its European theme park, Euro Disneyland (later renamed Disneyland, Paris) over the period 1984 to 1994.

The period covers two main management decision points. First, Walt Disney Company's decision to create Euro Disney. This involves addressing the questions:

- Should Disney build a theme park in Europe?
- What should be the mode of entry (e.g., licensing or ownership)?
- How should Disney adapt its theme park to the European social and cultural context?

Second, in the light of the problems that have beset the park during its first two-and-a-half years of operation, what should CEO Bourguignon do now?

The account of Disney's decision to create a European theme park draws heavily on Euro Disney's prospectus that preceded the IPO of 1989. The case outlines the history of Disney's theme park operations, including its first overseas foray with Tokyo Disneyland. It goes on to describe the structure and organization of the Euro Disney project, including the complex relationships between the French company that owns and operates the park, Euro Disneyland SCA, and its minority parent, the Walt Disney Company. The case outlines the business case for Euro Disney, including summaries of the market analysis and the financial forecasts undertaken by Disney. The case allows students to assess the arguments for Disney's establishment of a European theme park and to explore the rationale for the multiple relationships between Disney and the park (which includes minority equity ownership, a licensing contract, and a management contract).

The second part of the case describes the difficult startup experiences of Euro Disney and closes with the situation facing the new CEO of Euro Disneyland SCA, Philippe Bourguignon. This part of the case allows students to examine the reasons for Euro Disney failing to achieve its performance targets, to consider some of the problems facing a huge and highly complex leisure project in an overseas country, and to consider recommendations for both Euro Disneyland SCA and the Walt Disney Company.

■ TEACHING OBJECTIVES ■

The case is designed to accompany Chapter 14 of *Contemporary Strategy Analysis.* It deals with three key issues concerning international strategy:

- evaluating an overseas expansion decision;
- the design of a foreign market entry strategy;
- the management of overseas subsidiaries, with special reference to the issues of globalization versus national differentiation (particularly with regard to adaptation to the national culture of the host country).

■ POSITION IN THE COURSE ■

I use the case in the part of the strategic management class that deals with international strategies.

■ ASSIGNMENT QUESTIONS ■

1. Evaluate Disney's decision to build a theme park in Europe.
2. Explain why Disney chose to enter Europe through a combination of equity ownership, a licensing contract, and a management contract, as compared with its US theme parks (100% ownership) or with Tokyo Disneyland (pure licensing).
3. In what ways did Disney adapt to a French and European context? How effective was this adaptation? Should Disney have adapted more or less?
4. Advise (a) Philippe Bourguignon on what further actions he should take to improve the financial viability of Euro Disney and realize its potential for shareholder return, and (b) Michael Eisner on how Disney's interests in Euro Disney can best be protected and furthered.

■ READING ■

R. M. Grant, *Contemporary Strategy Analysis* (6th edn), Blackwell Publishers, 2008, Chapter 14.

■ CASE DISCUSSION AND ANALYSIS ■

Should Disney Establish a European Theme Park?

I adopt a hierarchical approach to this issue: I begin with the overall attractiveness of the theme park industry, look at the theme park business in Europe, consider Disney's competitive advantage in operating a European theme park, then look at more specific aspects for the Paris project. Hence:

1. *Attractiveness of the theme park industry.* The case has little information on the theme park industry as a whole. Nevertheless, I find it useful to get students thinking about the nature of this business and the structural features likely to drive it to profitability. From a Porter five-forces viewpoint, key features are likely to be:
   - Few players in most markets.
   - Highly differentiated offerings.
   - Large scale, capital intensive, and most costs fixed: hence, profitability is highly dependent on capacity utilization – operate close to full capacity and they can be very profitable; during seasonal or cyclical slumps, huge losses are possible.
   - Many substitutes – most other family leisure pursuits are potential competitors.
   - Entry barriers are very high.

2. *Attractiveness of the theme park industry in Europe.* The main differences between Europe and the US concern the underdevelopment of the European market. There are very few theme parks in Europe – but is this positive (latent demand, little competition) or is it a warning (Europeans don't want or need US-style theme parks because their leisure preferences and vacation preferences are different (more diverse and more conservative))? It is also evident that substitute competition is likely to be greater in Europe: Europeans don't need a "magic kingdom" with a Cinderella's castle; they've got real kingdoms with real castles.

3. *Disney's ability to establish a competitive advantage in the European theme park industry.* Whether or not the European theme park business is a potentially attractive sector, it seems likely that Disney has the potential to earn a return that is considerably better than the industry average because of the vast arsenal of resources and capabilities that it can deploy. These include:
   - financial resources;
   - Disney's massive reputation and consumer recognition;
   - Disney's characters;
   - the technology and designs that Disney has developed and applied to its existing theme parks;
   - Disney's capabilities in designing and operating attractions;
   - Disney's capabilities in managing government relations;
   - the advantages derived from four major theme parks in terms of scale economies, learning economies, and opportunities for best practice transfer.

4. *The prospects for a Disney theme park based near Paris*. As the case explains, Disney considered a number of possible locations of a European theme park, in the end it came down to a choice between Paris and Barcelona. Did Disney back the right horse? The advantages of Paris were:
   - it is accessible to very large population within easy traveling distance;
   - Paris is a major tourist destination;
   - the local population center was capable of supporting workforce requirements;
   - generous government support – large area of land made available at a modest cost, provision of first-class transportation linkages, and good tax breaks.

   However, there is one major disadvantage – the weather (especially the long winter). The other issue I raise with the students is whether Euro Disney is a risky project. The entertainment industry tends not to be as cyclical as other industries (semiconductors, steel, etc.). However, the operating risk is high because of the very high level of fixed cost. Thus, small variations in revenue streams produce large swings in profit. In terms of market risk, the key problem is that this is an all-or-nothing project; unlike most consumer goods, it is impossible to test-market a theme park. There are many other risks too – the project's high profile means that it might be a target for terrorists, labor union protests, or political protests. There are various construction and operating risks – how easy will it be for Disney to transfer its capabilities from the US to Europe?

Can Disney Rely on the Financial Projections?

While our analysis has been based on qualitative considerations, A. D. Little produced detailed forecasts of Euro Disney's revenue and cost streams. (These are summarized in Appendix A in the case.) The financial projections have been prepared using much thought and background research and embody seemingly conservative assumptions. However, for a project of this size and risk the question has to be: "What can go wrong?" The key area of difficulty for the Euro Disney project is likely to be the widespread assumption that the experience from Disney's other theme parks can provide a reliable guide to the likely outcomes of the Paris park. In particular:

- Attendance figures based on Florida and Tokyo may be unreliable indicators of the appeal of a Disney theme park in Europe.
- Admission charges will be higher than other Disney theme parks – how do we know whether the market will bear these charges?
- The growth figures for per capita expenditure and admissions may be over-optimistic.
- The per capita expenditure figures assume that each guest will spend as much on food and souvenirs as on admission – possibly over-optimistic.
- Construction costs may overrun.
- Difficulties in transferring Disney's operating capabilities and human resource practices to Europe may result in operating expenses being higher than anticipated.
- Disney may decide to delay or cancel the second theme park scheduled to open in 1996.

However, there is one area of financial return where the projections have paid little attention – the increased value of land. The case concentrates on the theme park, but the park occupies a small part of Euro Disneyland's 1,700 hectares (approximately 4,300 acres). At a price of FFr11.1 per square meter (approximately $8,360 per acre), Euro Disney may represent one of the greatest real-estate deals of the past quarter-century.

The Choice of Entry Strategy

To explore the complex relationship between Disney and Euro Disney, I begin with Tokyo Disneyland. Disney has 100% ownership and management of its US parks, but Disney owns none of Tokyo Disneyland – this is a pure licensing deal where Disney receives a 10% royalty. I ask why Disney chose to enter Japan with such an arm's-length arrangement.

The obvious answer is *risk.* For its first overseas park and the first in a cool climate, Disney allowed its Japanese partner to shoulder all the financial risk. But is Disney really losing out? A 10% risk-free royalty (which is mainly profit) is not a bad return. So there is also the issue of whether Disney would make more profit from owning Tokyo Disneyland as opposed to simply licensing its trademarks, characters, and technology.

When it comes to Disney's European entry, why did it adopt a different approach from either Florida or Tokyo? The first issue is to clarify what the key elements of the entry strategy are. Disney has three main relationships with Euro Disney:

- ownership – 29% equity participation;

- licensing contract – a royalty of 10% on admissions and 5% of other revenues;
- management contract – a fee of between 3% and 6% of revenues, plus an incentive fee.

Let us look at the alternatives:

	Full ownership and control	Licensing	Minority ownership licensing management contract
Return and risk	Maximum return; maximum risk	Limited return; almost no risk	Guaranteed return plus upside potential from real estate appreciation
Control	Complete	Very little	Very high
Ability to deploy full range of Disney's resources and capabilities	Yes	No	Yes
Ability to access host country resources and capabilities	Limited	Substantial	Substantial

The complexities of Disney's relationships with Euro Disney may be explained by Disney's desire to optimize its package of risk, return, management control, and access to critical host country resources. For example:

- By combining a substantial equity stake with licensing and management contracts, Disney is limiting its risk while maximizing its return opportunities: it is taking its return both "off the top" (royalties and management fees are paid out of revenue) and "off the bottom" (it receives dividends on its equity stake). Hence, Disney can make money out of Euro Disney, even if the latter is unprofitable. Also, with its equity stake, Disney shares in the upside potential from land appreciation. Indeed, Disney has struck a good deal with its equity stake; it is acquiring its shares at a much lower cost than any other investor.
- Disney is operating the park and hence it retains management control. Why was this seen as important in Paris but not in Tokyo? Maybe Disney has more faith in the ability of a Japanese company to operate a Disney theme park than a European company.
- Because Euro Disneyland SCA is a French company and not a Disney subsidiary, this has probably facilitated Disney's access to the critical resources that it needs for the park: a big chunk of land, transportation, other forms of infrastructure, and government subsidies, tax breaks, and guarantees.

Adapting to the Local Culture

I ask the students how Disney has adapted its theme park offering to the local culture and whether this adaptation is adequate or excessive, and whether it's effective or misjudged.

The cultural issues are certainly interesting, but difficult to systematize and generalize – however, they do give rise to some pretty lively class discussion!

In terms of the main dimensions of cultural adaptation, two areas are particularly important: adapting the product and adapting the management of the park.

Product adaptation raises the issues of which aspects of a complex service offering does a company need to adjust to local conditions. For Disney the issue is especially difficult: the Disney entertainment concept is strongly rooted in American popular culture. The risk is that in adapting the product, the product's appeal is destroyed. Moreover, the more the product is adapted, the less easy it is to exploit economies of scale, economies of learning, and opportunities for best-practice transfer across multiple locations. To the extent that Disney is a US company whose films have achieved global appeal and that the whole concept of a theme park is US based, there would be significant risks in changing any major aspects of the theme park offering. In particular, it is probably best to keep the rides and attractions exactly the same as in the other Disney parks. The key questions relate to the ancillary services: the cuisine, the hotels, customer interactions, crowd management techniques, and so on. But even here, the desirability of adaptation is hard to judge. Euro Disney's costs escalated greatly through Disney's attempts to raise standards of restaurant and hotel facilities significantly above that of its US parks – however, there is a chance that, once inside Euro Disney, European visitors will behave just like Americans and favor fast food over sit-down lunch.

The second area of cultural adaptation relates to management methods, especially human resource management. Again, this presents Euro Disney with a difficult dilemma. French employer–employee relations, employee expectations, work norms, and employment legislation are very different from those in the US. Clearly, Disney must accept the French employment law, but how far should it adapt its rigorous set of employment policies and employee expectations? The danger is that such adaptation may result in the quality of customers' experiences being eroded.

Finally, what culture is Disney adapting to? The whole concept has been of a European park. But what is Europe and what is a European culture? The history of European marketing is littered with the failures of multinationals who thought that Europe was a single market. Indeed, the term "Euro" has attracted pejorative associations – when applied to music, cuisine, or politics it is linked with lack of distinctiveness, dumbing down, low-brow, and lacking in inventiveness and flair. It is interesting to note that the name of the park was changed to Disneyland Paris.

Assessing the Situation in November 1994

Having discussed the decision to build Euro Disneyland, I then turn to the situation in 1994. To develop some strategy options for Disney and Euro Disney, it's useful first to consider what has gone wrong at Euro Disney.

Comparing the financial projections with actual results for 1993 and 1994 shows that the key problems appear to be on the side of both revenues and costs. On the revenue side, Euro Disney has not reached its target number of visitors, and revenues for 1994 are about half what were forecast in the model. Costs ran ahead of estimates – construction costs exceeded estimates, as did labor costs and interest costs.

How far are financial problems a result of general economic circumstances? Euro Disney's timing was unfortunate. The park opened after the Persian Gulf War, with interest rates high and Europe mired in recession. With demand weak, Euro Disney spent heavily on continued advertising and promotion (including discounted admission prices). Inflation also fell – the financial model had assumed inflation at 5% per annum.

Certainly there were operational and design difficulties that plagued the park for its first two years of operation. The change of name from Euro Disneyland to Disneyland Paris was viewed as one way of distancing the park from the difficulties of its first two years, as well as of associating Disneyland more closely to the specifics of Paris than to the vagueness of Europe.

What also became clear was that Disney probably had too good a deal out of Euro Disney. With the levels of remuneration built into Disney's royalties and management fees, it was difficult to see how Euro Disney would ever reach profitability. Essentially, Disney was raking off any potential profit before shareholders got a look in. Disney's temporary waiving of its royalties was an essential requirement for moving Euro Disney towards financial viability.

Ultimately, however, certain basic issues concerning the original decisions over Euro Disneyland reassert themselves. The existence of a market for a Disney theme park in Europe was proven beyond doubt – although how much European families valued a visit to Euro Disney was still in question. The key issue concerns location. Euro Disney's revenue problems arise primarily because of the concentration of customers in the few months of summer. Disney's willingness to open a park in northern Europe was heavily influenced by its Tokyo experience. However, Europeans were never likely to be as enthusiastic over Disney as the Japanese. Also, there is the real estate theme. The theme park may continue to be a marginally profitable venture so long as demand is seasonally concentrated and Disney rakes off most potential profit. But over the long term there is the development potential of the Euro Disney site for residential and commercial use.

Recommendations for Euro Disney and Disney

For Philippe Bourguignon, there are a few big strategic issues – should Euro Disneyland sell off Euro Disney, should it move ahead with the promised second phase of its development (the Disney/MM studio tour), should Disney consider summer-only opening? Apart from these, there are a bunch of mainly operational issues concerning the continued fine-tuning of Euro Disney in order to improve revenues and reduce costs.

In terms of closure, even winter-only closure, the events to date have largely answered these. Disney appears to have passed its biggest crisis. The banks have agreed to financial restructuring; new equity has been injected. There seems to be little advantage in selling off the park or breaking up the company (would anyone be likely to add more value than Disney?). Similarly, it seems as though summer-only opening will make the financial picture worse rather than better.

The biggest major issue concerns the second theme park. Disney is committed to this in its agreement with the French government, but no doubt this could be renegotiated at some cost to Disney and Euro Disney. The second theme park needs to be considered both on its stand-alone merits and from complementarities with the existing Magic Kingdom park. Two theme parks will allow some economies of scope in administration, maintenance, and marketing. They will also increase the popularity of Euro Disney as a destination resort, possibly increasing the average length of time that visitors stay.

On the operational front, Bourguignon needs to boost attendance, in particular to improve the park's utilization over the winter. On the cost side, continued efficiencies need to be obtained, but are these possible if Euro Disney is to maintain the standards expected of a Disney park? Disney's issues are closely aligned with those of Euro Disney. The differences are, first, Disney can make money out of Euro Disney even when Euro Disney is operating a loss and, second, Disney needs to consider its broader interests. On this second point, Disney has considerable credibility tied up in Euro Disney. Disney has implied that it would allow the park to fail, but this seems to be a tactical move aimed at getting concessions from creditors. Disney's commitment to the survival of Euro Disney is indicated by its foregoing of its royalties. At the same time, Disney has reduced its exposure to Euro Disney through cutting its shareholding. It seems that Disney will simply have to play a long-term game here – forgo profits in the medium term and rely on the long-term development potential of the project.