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Disney in Asia, Again?

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DISNEY IN ASIA, AGAIN?



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INTRODUCTION

“We could be getting close to the time for a major Disney attraction in the world’s most populous nation.”¹

“I am completely confident that Chinese people love Mickey no less than they love a Big Mac.”²

Early in 1999, Michael Eisner, CEO of The Walt Disney Company, voiced his opinions concerning potential markets for his firm’s entertainment products and services. A major thrust for the new millenium would be development in Asia.

The firm had now achieved a certain level of experience with owning and/or managing assets and operations outside the United States. They had two competing models that would be utilized to analyze and ascertain the financial and operating structure of their next foray into the global business arena.

Their first experience was Tokyo Disneyland. Modeled after Disneyland in California and located six miles from downtown Tokyo, the park opened in 1983 and was literally a cultural and financial success from its start. However, not all of the potential financial benefits had accrued to Disney shareholders, since the facility was entirely owned by The Oriental Land Company. Disney had generated a large and growing stream of fee income, but had not participated as an owner. The architect of Disney’s strategy was Ron Miller, CEO, son-in-law of Walt Disney, and leader of a very conservative management team.

By the time a development decision for Western Europe rolled around in 1987, Michael Eisner was Disney’s CEO. The new management team was convinced of the benefits of ownership. In negotiating with the governments’ of Spain and France, Disney sought to maximize their ownership interest in any theme park operation. This was accomplished with their 49 percent ownership of Euro Disney, which opened east of Paris in 1992.

Attendance and operating income in France were less than anticipated and a major restructuring of the Euro Disney operating company was effected in 1994. Cultural challenges, as well as a European recession in the early 1990s, resulted in less than expected success of the park and its related hotels and facilities. Renamed Disneyland Paris early in 1994, and with enhanced performance, the Disney European experience

finally began to pay off for this facility, which, by the late 1990s, was the largest theme park in Western Europe!

With these two, quite different, experiences in operating a large theme park and resort facility outside of the continental United States, the Eisner management team was ready to move into China. Two locations were “in the running” early in 1999, representing quite different operating and financial strategies and structures. Either Hong Kong or Shanghai would likely be the site of the next Disney theme park. This was the challenge faced by the Disney management team, with a target decision date of June 1999.

THE WALT DISNEY COMPANY

The Walt Disney Company, together with its subsidiaries, was a diversified international entertainment organization with operations in three major business segments. From humble beginnings at The Disney Brothers Studio, founded in 1923 by Walter E. and Roy O. Disney, the firm had developed into a global powerhouse in the leisure services industry.³

Multimedia Production

The company produced and acquired line-action and animated motion pictures for distribution to the theatrical, home video, and television markets. The firm also created original television programming for the network and first-run syndication markets. Disney distributed its filmed products through its own distribution and marketing companies in the United States and most foreign markets.

The company licensed the name “Walt Disney,” as well as the company’s characters, visual and literary properties, songs, and music to various consumer manufacturers, retailers, show promoters, and publishers throughout the world. The firm also engaged in direct retail distribution principally through the Disney Stores, and published books and magazines for the general public in the United States and European markets. In addition, Disney produced audio and computer software products for the entertainment market, as well as film, video, and computer software products for the educational marketplace.

Buena Vista Internet Group (BVIIG) coordinated the company’s Internet initiatives. BVIIG developed, published, and distributed content for narrow-band online services, interactive television platforms, interactive web sites, including Disney.com, Disney’s Daily Blast, ESPN.com, ABC News.com, and the Disney Store Online. The Disney Store Online offered Disney-themed merchandise to customers over the Internet.

Television Broadcasting

The company operated the ABC Television Network, which had affiliates providing coverage to U.S. television households. Disney also owned television and radio stations, most of which were affiliated with either the ABC Television Network or the ABC Radio Network. The company's cable and international broadcasting operations were principally involved in the production and distribution of cable television programming, the licensing of programming to domestic and international markets and investing in foreign television broadcasting, production, and distribution entities. Primarily domestic cable programming services were operated through subsidiary companies and joint ventures. These companies included ESPN, the A & E Television Network, Lifetime Entertainment Services, and E! Entertainment Television. The company also provided programming and operated cable and satellite television programming services for the Disney Channel and Disney Channel International.

Theme Parks and Resorts

This division of the company operated the Walt Disney World Resort ® in Florida, and Disneyland Park ®, the Disneyland Hotel, and the Disneyland Pacific Hotel in California. The Walt Disney World Resort included the Magic Kingdom, Epcot, Disney-MGM Studios, and Disney's Animal Kingdom; thirteen resort hotels; and a complex of villas and suites; a retail, dining, and entertainment complex; a sports complex; conference centers; campgrounds; golf courses; water parks; and other recreational facilities. In addition, the Theme Parks and Resorts division operated Disney Cruise Line from Port Canaveral, Florida. The company's first ship, Disney Magic, commenced operations in July of 1998 and a sister ship, Disney Wonder, was launched in 1999.

Disney Regional Entertainment designed, developed, and operated a variety of new entertainment concepts based on Disney brands and creative properties, operated under the names Club Disney, ESPNZone, and Disney Quest.

The company earned royalties on revenues generated by the Tokyo Disneyland ® theme park near Tokyo, Japan; a facility owned and operated by an unrelated Japanese corporation, Oriental Land Development. The company also had a 39 percent ownership stake in Euro Disney S.C.A., a publicly-held French entity that operated Disneyland Paris.

The company's Walt Disney Imagineering unit designed and developed new theme park concepts and attractions, as well as resort properties. Disney also managed and marketed vacation ownership interests in the Disney Vacation Club. Included in the Theme Parks and Resorts division were the company's National Hockey League franchise, The Mighty Ducks of Anaheim, as well as an ownership interest in the Anaheim Angels, a Major League Baseball team.

The Walt Disney Company had a long history of successfully managing theme parks. Not only do they operate as stand-alone investment projects; they may also be thought of as valuable marketing venues for other aspects of Disney's business. For example, from two years before Disney in Anaheim, California, opened to five years after, sales of company merchandise in the United States increased 100 percent. In the case of Tokyo Disneyland, a comparable time period produced a 200 percent increase in merchandise sales. After Disneyland Paris opened, merchandise sales in Europe over a comparable period grew by 1000 percent. China and other Pacific Rim nations had a sales potential that was just as inviting.

DISNEY AND CHINA IN THE 1990s

Relations between the Disney Company and the government of China had not been particularly tranquil in recent years. In late 1996, China's leaders vehemently objected to Disney's plans to distribute the movie 'Kundun,' Martin Scorsese's film that told the story of Tibet's exiled spiritual leader, the Dalai Lama, and China's brutal occupation of that nation. Following the film's release in 1997, China's leaders made threatening statements concerning Disney's future in their markets.

Disney held firm on its position on the movie. "Disney's potential business in China is infinite. But Disney has to decide whether it wants to facilitate business or stand for free speech."⁴

Another Disney film, the animated movie 'Mulan,' about a legendary Chinese woman-warrior, proved to be a box-office disappointment in China. It was claimed that the film's Chinese characters looked too Western. In addition, pirated video versions of the film were available in China before the film arrived in theaters.⁵

Not all of Disney's relationships with China were negative however. The liberalization of China's markets had generated benefits for the firm. 'The Lion King' had brought in almost \$4 million in 1996 and the soundtrack had sold 1.4 million copies.

POTENTIAL OF THE ASIAN MARKET

Building and investing in a multi-billion dollar theme park would represent another major, long-term commitment for The Walt Disney Company. Therefore, much research and planning were involved in this decision. In addition to the attractiveness of each of the remaining cities, Shanghai and Hong Kong, the market characteristics of the demand for theme park experiences by the Chinese people would have to be carefully evaluated.

Although the success of the Tokyo Disney theme park would strengthen the case for another facility in Asia, other data and experience brought up additional questions. Between 1993 and 1998, more than 2000 theme parks had been opened in China, developed and financed by both domestic and foreign investors. Disney management was convinced that a huge, child-loving populace would support a lively theme park business. Instead, many projects were swamped by excessive competition, poor market projections, high costs, and relentless interference from local officials.

Several hundred parks had already been closed, due to poor quality of service and less than exciting entertainment experiences. Instead of increasing, consumer enthusiasm for theme parks had dwindled.⁶ These parks had also been unsuccessful at attracting a significant number of customers from other Asian nations.

Other factors affecting the viability of an Asian theme park in China had to be evaluated. The Chinese economy was one of the fastest growing during the 1990s and was expected to experience significant growth well into the new millenium. At least one-third of the nation's 1.2 billion people resided in the rapidly developing coastal region, the industrial heartland of the nation. The largest and most developed population centers were located in this area, where an awakening and growing middle class lived and worked. Their leisure time had increased significantly and was expected to continue to outperform the rest of the nation. With their income levels approaching \$1,000 per month, China's middle class families were a prime target audience for Disney theme park experiences.

The Chinese had a cultural disposition toward pampering children, which had been accentuated by the nation's one-child per couple policy. Although many theme parks in China had not been successful, it was still generally believed that an exciting experience of high quality would attract visitors to a park. A mundane experience would be unlikely to spark interest in a second visit. Based on the repeat visitors at every other Disney theme park, management was quite confident that they would be successful in attracting Chinese visitors not only the first time, but also the second, third, and fourth times.

INTERNATIONAL THEME PARKS AND RESORTS THE DISNEY EXPERIENCE

Foreign visitors had always been an important component of Disney's U.S. theme parks in Anaheim, California, and Orlando, Florida. In 1979, the firm's management decided to take their park experience to the international community, an unprecedented move in its history.

Tokyo Disneyland

This park, located on landfill in Tokyo Bay, was only 6 miles from downtown Tokyo. In keeping with the traditional conservative philosophy of the Disney

management team in the 1970s, the park was designed as a close replica of the original Disneyland. A proven theme park prototype was, in effect, transplanted across the Pacific Ocean to a site where 30 million people lived within 30 miles of the new facility.

Disney's management controlled most aspects of the design and operating characteristics of the park. The successful themes of Adventureland, Tomorrowland, Frontierland, etc. were faithfully reproduced. Even the famous Disney standards of no alcoholic beverages served within the park and no food from outside vendors allowed in, were translated to the new facility. Cleanliness, neatness, and precision operations were also incorporated into the workings of the new park. The Disney application of total quality management had to be upheld, regardless of the location of the facility.

In keeping with their conservative philosophy, the Disney management team, led by Ron Miller, wanted to reduce the financial risks inherent in international investments. Therefore, they gave up any ownership in the park and, for a mere \$2.5 million procured a 45-year contract that gave the company the rights to collect 10 percent of admission revenues, 5 percent of food and merchandise sales, and 10 percent of corporate sponsored agreements. Disney retained responsibility for artistic design and development of the facility.



Tokyo Disneyland opened its doors to the public on April 13, 1983, and was instantly successful, from both a cultural and financial perspective. In its first full year of operations, it attracted approximately 9.9 million visitors, almost equal to attendance at Anaheim Disneyland, that same year. Over the next decade and a half, attendance grew steadily to more than 15 million by 1998, making this park the largest in the world.

Revenues from royalties and licensing fees were rapidly approaching an annual level of \$100 million.

A number of factors contributed to the success of Tokyo Disneyland. The Japanese government was supportive of efforts to develop and promote the park. The Japanese people enthusiastically embraced the concepts, ideas, characters, and themes of the park. Tokyo Disneyland “appealed to the deep-seated Japanese passions of cleanliness, order, outstanding service, and technological wizardry.”⁷

Other forces also supported the attractiveness of the park to the Japanese people. Its opening coincided with a strong economy in Japan. Personal incomes were expanding, discretionary spending was increasing, and there was a developing focus on relaxation and entertainment by a rapidly growing segment of the Japanese population.

All of these factors had contributed to the initial and continuing success of this park. By the mid-1990s both the owner of the facility, Oriental Land Company, Ltd. and the Disney organization had commenced plans for a second park at that site, Tokyo DisneySea. Once again, Oriental Land would make the initial investment, estimated in excess of \$2.5 billion, while Disney would contribute creative content and management expertise, in return for an agreed-upon fee structure.

Euro Disney (now Disneyland Paris)

When Disney management evaluated their experience in Japan they vowed to learn from it and take maximum advantage of perceived opportunities in Europe. They desired a relatively large area of land, to facilitate future parks as well as hotel and real estate development. And, with high expectations for immediate success in attracting visitors, they would build a park of similar size and capacity to Tokyo Disneyland. Finally, they would take as large an equity ownership position as was permitted under European Union guidelines (49 percent).

In order to support their visitor level forecasts in a multicultural setting, they chose to localize some of the purely “American” aspects of their U.S. parks. They would incorporate the history and European roots of some of the most well-known Disney characters. Pinocchio was an Italian boy, Peter Pan and Wendy were of British origin, and Cinderella was a French girl. Disney re-emphasized these traditions in their marketing programs and theme park attractions.

The final location decision for a single European theme park complex was Marne-la-Vallee, a 4800 acre site 35 kilometers east of Paris. This region, including Paris and its suburbs, boasted three airports, six railway stations, a highly developed road network, and a link to Paris in the form of a high speed TGV train station to be constructed at the site.⁸

The development of the site would be in stages, with Phase I including a Magic Kingdom theme park and 5,000 hotel rooms. Other retail and entertainment attractions (golf courses, convention center, water park, etc.) would be built over the next few years, to convince visitors to extend their time at the facilities. Approximately 5 years after opening, Phase II would commence with the construction of a Disney Studios theme park.

From a financial perspective, Disney management negotiated potentially lucrative contracts with the French government and Euro Disney, S.C.A. the owner and operator of the facilities. Disney invested approximately \$450 million in the venture, primarily in the form of creative content, design expertise, and managerial talent. In return, they received a 49 percent ownership of the operating company, which became a public company through a highly successful IPO in November 1989. In addition, Disney received fees based on attendance and revenues from food and merchandise sales. They would also be entitled to a “base management fee” amounting to 3 percent of gross revenues for the first five years of operations, rising to 6 percent within five years. Further, they would receive an “incentive management fee” amounting to 30 percent of pre-tax cash flow in the first year of operations, rising to 50 percent of pre-tax cash flow from year five onward. If projected visitor attendance of 11 million were realized, with expenditures in the park at modest levels, the rates of return on Disney’s “investment” could have reached 70 percent or more in the first five years of operations.

In retrospect, the best forecasts were not achieved, even if given more time to reach expected goals. During the five-year construction program for Phase I, expenditures rose from \$2.4 billion to \$4.4 billion, due to a variety of factors, from unexpected quality enhancements to the inherent inefficiencies of having 38 general contracts working simultaneously.

The financial structure of the Euro Disney operating company was highly leveraged, with \$4 of debt for every dollar of equity. With high fixed operating expenses, coupled with high fixed financial charges, the breakeven level for operating profitably was more than the firm could handle or achieve.



The gates swung open to the park in the Spring of 1992, to great fanfare and heavy promotion. However it was not long before management realized that major problems faced this operation. Attendance was approximately 2 million per year below the most probable projected levels. Recession in Western Europe and cultural clashes between the French people and the park's managers contributed to these shortfalls. Expenditures for food and merchandise inside the park were also lower than expected, as were occupancy levels at the on-site hotels (within a year one of the hotels was actually closed).

The financial implications of these activities were unsettling for all stakeholders. The common stock price of Euro Disney shares plunged more than 70 percent in less than three years, management turnover at the operating company rose, a major financial restructuring of the company took place, and The Walt Disney Company agreed to give up its fee income for more than five years. Attendance levels did not reach year one expectations until year seven of actual operations. The harsh realities of the French theme park experience were vivid reminders of the risks inherent in a large, complicated, multiyear investment project. Expansion into Asia, again, would also bring with it global risks as well as uncertain opportunities.

RECENT DEVELOPMENTS

In the closing months of 1998, Mr. Eisner announced a restructuring of the theme park and resort operations. Consolidation of operating control was placed in the hands of a 20-year veteran manager of the division, Judson Green. For the first time all aspects of Disney's recreation and travel business would be under one manager, reporting directly to Mr. Eisner.

The new division was renamed Walt Disney Attractions and would include existing theme parks and resorts, Walt Disney Imagineering (which designed the parks and rides), and Disney Regional Entertainment, a new unit that had been developing Disney Quest arcades and ESPN restaurants in various markets.

Mr. Green's first major task was to plot the firm's next phase of theme park expansion. Its focus was to enhance operations in foreign markets. "There are major parts of the world we are barely penetrating," he noted.⁹

Mr. Eisner instructed executives in all of Disney's major business units to begin planning to boost their overseas operations. Not only would they expand outside the U.S. but plans were also being formulated to attract more foreign visitors to the domestic parks. For example, the current level of 20 percent foreign visitors to Walt Disney World was projected to grow to 50 percent in ten years. This restructuring laid the ground work for an aggressive attempt by Disney to expand its presence in foreign markets, especially China.

In order to formalize the analysis and evaluation of constructing and operating a theme park operation in China, Mr. Green assembled two teams, similar to the process utilized for the European location decision in the late 1980s. Although the Asian market could eventually support two or more theme park operations on a long-term basis, the decision to be made in 1999 was to identify and support only one new investment site. If both locations resulted in positive net present values, only one would be chosen now while the other could be built at a later date.

In recent years, operating results of the Disney Company had been less than stellar. Even with a strong economy in the U.S. and Europe, problems at the broadcasting unit and lackluster results from studio operations created challenges for Mr. Eisner. In addition, in 1998 and early 1999, there was the acceptance of two cruise ships for Caribbean operations that required outlays of approximately \$350 million each.

In the theme park division, "California Disney" in Anaheim was scheduled to open early in 2001, at a cost in excess of \$1 billion. In Orlando, the fourth theme park within the Walt Disney World complex, Animal Kingdom, was completed in 1998 at a cost of \$800 million. These major projects had absorbed not only large amounts of capital, but also managerial time and creative capital at the Imagineering division.

At Tokyo Disneyland, a second theme park, "DisneySea" was also under construction. Although there was no financial investment by Disney, the firm was still heavily involved in creative content, design, development, and, ultimately, managerial

expertise. Even for a world-class leisure and entertainment business such as Disney, there was just so much that could be accomplished within a given period of time. Asia would now become the focus of this division, as the board carefully reviewed and evaluated the demands of each project with the resources available at the company.

Criteria for an Asian Site

In deciding on a site for a China theme park, a number of factors had to be identified, considered, and evaluated. Mr. Green, in consultation with Mr. Eisner and the Disney Board of Directors, was looking for an “international character” for this park. A diversified visitor base would reduce the risks of problems in one country having an adverse effect on international visitor flow.

Infrastructure in the area of the park and the region supporting it were also important. Visitors should be able to reach the park easily, by a variety of forms of transportation -- airports, railroads, roadways, tunnels, bridges, bus lines, etc. should be well established or enhanced while the park was being constructed. A prime area would be easily accessible and would also support a park most efficiently.

The park and the region should contribute to visitors extending their time spent at the Disney facility. Management knew that convincing visitors to stay at the site, in a Disney hotel, was likely to generate greater cash flows from the park and its ancillary facilities. A stock of hotel rooms to support park visitors was also important. Rooms at a variety of price points, from economy to luxury should be available when the park opened.

Successful theme parks in the area of the Disney facility may be viewed positively or negatively. They represent competition but, at the same time, may convince more people to visit the area to experience both facilities. This has occurred at the U.S. theme parks in Anaheim and Orlando, as well as the more recent experience in Paris.

Gross and disposable income levels of the area’s citizens as well as of foreign visitors would ill affect the success of the park. International visitors are more likely to be able to afford to travel and pay for attendance and in-park purchases. This is especially true of the U.S. parks. In contrast, in Tokyo, approximately 95 percent of visitors are Japanese, yet the park is tremendously successful.

Land area and its configuration contribute to the potential success of a theme park. Relatively flat areas are preferred, with extra land for expansion a definite asset. While land was plentiful in France, it did not contribute as much as originally anticipated

to the success of the park. In contrast, Tokyo transformed a block of barren coastal landfill into an important economic engine for the greater Tokyo area. Hong Kong officials hoped for the same results in their potential agreement with Disney.

In all Disney international operations, support from the local government is critical to the Disney Company. Making land available in a preferred location and investing in the park, in the form of equity and/or debt guarantees is very important. Mutual respect for what each side brings to the table will significantly impact the operation of a theme park facility for at least the next fifty years.

Once again Disney's position is to make a minimal equity investment in any operating entity and generate most of its returns through royalty, licensing, and fee income streams. International risks would be reduced to fluctuations converting local currency cash flows into U.S. dollars.

Finally, while each city might try to convince Disney to sign an exclusivity contract with respect to future development in China, the company definitely will not sign such a document. They want the option to grow their theme park business in other cities in China and all over Asia, based on future economic and financial circumstances.

The Shanghai Plan

Shanghai, known in the past as the "Paris of the Orient," had emerged in recent years as the largest and most affluent city in China. It was China's most "Western" city and in the 1990s had emerged as a growing industrial and commercial metropolitan area.

Formal and informal discussions concerning a theme park facility in Shanghai had been taking place since the early 1990s. The mayor of Shanghai, Mr. Xu Kuangdi, had been pushing Disney to locate in this city and, if necessary, to build a smaller park in Hong Kong. Mayor Kuangdi also had powerful allies in Beijing, where the final decision would ultimately be made. From Disney's perspective the focus would be on the right mix of financing, available land, and governmental approval. "There's no question that if they build a theme park, people will come," said Christopher Dixon, New York-based entertainment analyst for Paine Webber. "The trick is to make money, too."¹⁰

Shanghai had already earmarked a site for a Disney theme park. The Pudong New Area, a 200-square-mile region across the Huangpu River from downtown Shanghai was being developed as part of a plan initiated in the early 1990s. Several zones had been established to support development of finance and trade, export processing, free trade, and high technology.

Infrastructure investments on a massive scale were also being made. New highways, railway facilities, and a second international airport were being built. A Disney theme park would “fit right in.”

The Disney site would be across the Huangpu River from the Bund, Shanghai’s world famous waterfront promenade. It is a mile long, with parks and some of the city’s major historic buildings.

The city was growing in population and financial stature, to serve an increasingly affluent mainland market. A number of other growing population centers (Changzhou, Suzhou, Wuxi, Wujiang, etc.) were within a few hours drive or train ride from the Disney site. Major rail lines served the city from the North, West, and South. The Shanghai metropolitan area, as well as the bordering provinces of Jiangsu, Zhejiang, and Anhui had a total population in excess of 130 million with average per capita income slightly exceeding \$2100 per year.¹¹

The projected cost of the proposed facility in Shanghai was approximately \$1 billion. Disney’s preferred course of action was to obtain a licensing deal, similar to that of Tokyo Disneyland. Technology, creative content, and managerial expertise would be exchanged for annual royalties and fees derived from admissions to the park, purchases of food and Disney products in the park, and revenues from new hotel facilities near the park.

This facility would be designed to operate profitably with a projected 9 million visitors in year one, rising at a rate of 3 percent per year for the next 10 years. A Magic Kingdom park would be constructed in Phase I, with the potential of an EPCOT type theme park added after at least five years of operations.

For the city of Shanghai, attracting a Disney theme park would be a vote of confidence from a high-profile foreign investor. It could serve as a signal that this city, the pride of the country’s Communist Party-led government, had attained international status.¹²

From Disney’s perspective it was important to attain “first mover” advantage in exploiting the Chinese marketplace. Other global theme park operators were watching Disney’s international movements and following them around the world, and it would be important that they continue to ‘follow’ rather than to take the ‘lead.’ In particular, Disney recognized that they must keep abreast of the operations of Seagram’s Universal Studios theme park operations.

Universal had followed Disney to Orlando, they had followed them to Europe, and they were obviously evaluating Asian opportunities quite carefully. If Disney did not stake out a clear presence in Shanghai, it could result in their trailing Universal’s lead into China. Disney theme parks have never had to follow any firm into a potentially lucrative market. They have been number one from their genesis in Anaheim, Orlando,

Tokyo, and Paris. They felt that they must be number one in China. Hong Kong could wait!

The Hong Kong Plan

It had been less than two years since the Disney Company considered Hong Kong as a possible theme park location. Informal negotiations with government representatives commenced in October of 1998. Yet, the process of evaluating a site had progressed rapidly. A number of unique characteristics of the former British Crown Colony had contributed to Hong Kong now being considered as a prime target for Disney development and investment.

In the 1940s and 1950s, this area was primarily a trading port. Development continued, and by the 1980s, it was a low-cost manufacturing powerhouse. In the 1990s, as costs increased and manufacturing moved to lower cost Asian areas, Hong Kong became a regional financial center. As each of these periods developed and then declined, transformations took place to revitalize the area. The results were new, higher levels of growth and development for the region and its population.

In the late 1990s, some analysts were projecting another decline, due to the high costs of operating in the region. It was anticipated that cheaper destinations such as Shanghai and Singapore would attract business away from Hong Kong.

For a while these predictions seemed to be coming true, especially when Hong Kong stumbled into a deep recession in the aftermath of the Asian financial crisis of 1997-1998. Real estate and equity values declined sharply, firms went bankrupt and unemployment levels reached 20 year highs.

Yet, Hong Kong seemed destined to transform itself once again. Government officials and private business owners and managers staked out yet another new role for the region: an information technology center serving greater China. The Special Administrative Region (SAR), established when control of Hong Kong had reverted to China rule from Great Britain in July 1997, had been quite successful in attracting a growing number of new investments in software, e-commerce, and dot com companies.

Known as the “City of Life,” Hong Kong had always had an international character, with a high percentage of tourists and visitors in relation to its indigenous population. The infrastructure needed to support a Disney theme park was already in place, with a new world-class airport, as well as commitments for enhanced railroad and ferry service between Lantau Island and the mainland. The availability of hotel rooms and restaurants could easily support the expected international visitors. While relatively expensive, they had a strong Chinese flavor and would complement the All-American theme of a Magic Kingdom where Mickey reigned supreme.

A Disney theme park in Hong Kong would be expected to draw visitors from China and South East Asia. The area had had some experience with theme and amusement parks. In Hong Kong, Ocean Park had become a popular amusement park, while in Shenzhen, across the border in China; there were several attractions for children. The most well known and successful facility was Splendid China, which featured replicas of the Great Wall, the Forbidden City, and other famous country-wide tourist sites. A more recent park, Window of the World, featured miniaturized tourist sites like Moscow’s St. Basil’s Cathedral.

Hong Kong is located at the mouth of the Pearl River Delta of south-eastern China’s Guangdong Province. This region had, over the last two decades, achieved the fastest economic growth of any in China. Seventy million people now lived in the province, with an average per capita income approaching \$2000 per year. The capital, Guangzhou (formally Canton), with almost 7 million people, was 60 miles up river. In contrast, the annual per capita income levels in Hong Kong were approximately \$22,000.

Hong Kong had always been a center for business travelers and “we’ve always had lots of exciting things to do for adult visitors,” said Mike Rowse, Commissioner for Tourism. “Our shopping, dining, and hotel facilities are world renowned. But one thing missing has been an attraction that would make families sitting down together to plan their holidays think of Hong Kong as a good destination. A Disney theme park would fill that gap in our tourist product.”¹³

After analyzing the experiences of Disney’s other international theme park performances, the following plan had been established for a Hong Kong theme park. A world class facility would be constructed on Lantau Island, at Penny’s Bay, a location between the new international airport and downtown, a distance of only six miles. The facility would be designed to accommodate approximately 5 million visitors per year. More than 3 million of them would be expected to come from the mainland as well as Taiwan, Southeast Asia, and Australia.

Growth would be expected as the park matured and positive leisure time experiences were shared by visitors. Between 17 and 20 major attractions, all proven at other Disney theme parks, would be developed, with additions as visitor levels increased. Within 5-10 years an estimated 10 million visitors per year would be coming to the park, and a second park would then be built on adjacent land.

The site also had room for Disney-theme hotels. They envisioned two or three hotels with 1400 rooms, adding another 700 rooms over the next 5 to 10 years. As part of this resort complex, retail, dining, and entertainment facilities would also be built.

This approach to development would reduce the risks to The Walt Disney Company, yet allow for a large and growing return on their investment. Incremental enhancements to facilities would be added as the visitor market developed, resulting in a balanced approach between investment and visitor demands.

DECISION TIME

Mr. Eisner and his management team were well prepared for the evaluation of the two sites in China. Experienced financial executives at The Walt Disney Company were quite comfortable working with cost of capital estimation, forecasting of entertainment expenditure demand, and various methods of project evaluation.

Within the Disney corporate organization, division hurdle rates were used regularly to evaluate investment projects within each of the firm's operating units. Each of the teams representing the alternative sites, Shanghai and Hong Kong, were instructed to incorporate country and/or political risk factors and adjustments, either to their revenue streams or cost of capital estimates. The Disney Board of Directors would decide on the location of the new theme park site after evaluating each team's proposal. Mr. Eisner would then pronounce it to the world. Let the presentations begin!



ENDNOTES

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