

The Pixar Business Story

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Pixar's business success is a good lesson, but not for the reason you might expect. It's a story with a happy ending but it's a cautionary tale; this is everything that has to go right.

At TheWaitersPad.com we look at podcasts, videos, and books to learn lessons. That's what we'll do here, Pixar's history and lessons in under an hour.

First a warning. There are no heroes in this book, only people. Some will appear wiser than others, but everyone was locally logical. The 'dumbasses' had succeeded while the times had changed. The 'visionaries' rode the winds of luck and skill.

We'll draw mostly from Ed Catmull's Creativity Inc. and Lawrence Levy's To Pixar and Beyond. Catmull co-founded Pixar and still works there. Levy IPO'd Pixar and has moved on to new projects. Between these two - and a scattering of other sources - we'll see how to navigate the business pinhole Pixar burst through.

The history book on the shelf, Is always repeating itself. — ABBA's Waterloo, 1974

In 1974 Catmull graduated with a computer science Ph.D. and "a nice list of innovations under my belt." He worked in New York and got his first taste managing a group that wasn't grad students. "Once Alex (Schure) brought me in (to the New York Institute of Technology), he left it to me to assemble a team. I had to give that to him: He had total confidence in the people he hired." This early example of a decentralized command would go on to be something Catmull made central to Pixar. He wrote about

New York, “giving a ton of freedom to highly self-motivated people enabled us to make some significant technological leaps in a short time.” David Ogilvy advised the same thing, suggesting people hire “gentlemen with brains.

In 1977 *Star Wars* premiered and by 1979 Catmull worked for George Lucas in Marin County California. It was one hour north of Silicon Valley by car, and one hour north of Hollywood by plane. Lucas moved there because “he thought there was something a bit unseemly and inbred about it (Hollywood).” There, Catmull was able to continue his work. “The resulting environment felt as protected as an academic institution.”

Having space to focus helped Ken Burns too, who told entrepreneur.com, “I don’t live in Los Angeles or New York City. I live in a tiny village in New Hampshire, which permits us to do the deep dives, to do the necessary research and keep the sanity in the course of a 10-plus-year project.” Some paths require proximity; New York for finance, Silicon Valley for computers, Detroit (formerly) for auto. Other times the insidiousness makes doing new things hard.

In 1983 George Lucas began a divorce and sold the company to Steve Jobs in 1986 for five million dollars and a promise to invest five million more (it would go on to be fifty million more). Catmull reflected that his conversations with Steve Jobs were like the Maxwell Cassette commercial. Steve Jobs was the speaker, everyone else was the guy.

Pixar's product was the Pixar Imaging Computer and Catmull was president of a hardware company. "There's nothing quite like ignorance combined with a driving need to succeed to force rapid learning." Today we can 'Google it' and Catmull did the 1986 equivalent, he visited the library. However, the needles of good advice were buried in haystacks of platitudes. Simple questions like 'What to price a computer?', "had distracted me and kept me from asking more fundamental questions." This led to one of the most valuable lessons from the early days of Pixar.

Catmull found out about the Deming/Toyota innovation. "The responsibility for finding and fixing problems should be assigned to every employee." When American Express hired Annie Leibovitz to shoot print ads they said, "I would have the freedom to do what I wanted to do," Leibovitz wrote in *At Work*. Before Pete Carroll was the Seattle Seahawks head coach he was an assistant who went to his players and asked them what they thought they should do. Carroll recalled, "it was the best meeting I'd ever had." He explained this epiphany to his head coach who scolded, "you don't ever ask your players what they want to work on."

The decentralized structure that Catmull was introduced to in New York worked just as well in California and Japan. Those people with their hands - sometimes literally - on the problem are the best equipped to fix it.

In 1987 and 1988 Pixar had some success in making commercials, short films, and providing special effects. They were visually beautiful and financially ugly. Later, Steve

Jobs would hire Lawrence Levy as CFO for the IPO it was Levy who had to figure out what business Pixar was in. But in the late 80's Pixar was finding out that you can't eat Oscar's. Restaurateur David Chang remarked, "Just because you're a busy restaurant doesn't mean you're making money."

In 1989 Disney's *The Little Mermaid* launched the second golden age of animation. This was as "animation explosion that would ultimately enable Pixar to make *Toy Story*," wrote Catmull. The environment was open. People were primed for feature films. Pixar had a tailwind and was ready.

In his book about Milton Hershey, Michael D'Antonio wrote, "Young Milton Hershey could not have chosen a better time and place to put what he had learned from Joe Royer into a business of his own." Hershey had apprenticed at candy shops on the east coast and in the rocky mountains. After these experiences, he moved back to the Pennsylvanian dairy country. "In 1870 America had begun an immigration boom that would last fifty years and triple both the country's population and the number of potential customers for products like Hershey's caramels." Milton Hershey also got the boom of technology improvements, a vast railroad network leftover from the Civil War, and a consumer class that was "looking for consistent quality at a low price." Pixar, like Hershey, had clear conditions.

In 1991 Pixar inked a three-picture deal with Disney. Negotiated by Steve Jobs and Jeffrey Katzenberg, both would reflect that it was the worst deal each had ever made.

John Lasseter and his Pixar staff begin work on the script. Years later Lasseter told Charlie Rose that Toy Story took four years to make, the first year and a half just to get the story straight. That's when it happened.

In 1993 Pixar had their 'Black Friday' when the Toy Story project was nearly shuttered by Disney because the script was so bad. Why was it so bad? A lack of decentralized command. What Catmull had learned about a decentralized command Disney had undone. The notes sent to Lasseter and his staff were creativity poison. At Seinfeld, Larry David and Jerrys Seinfeld flouted them. In Seinfelda, Jennifer Alexander wrote, "At the hundredth-episode party stood a centerpiece, a ten-foot-tall blowup of NBC executives' list of requested changes to the pilot way back when. Almost none of them had been made." This was true too for The Simpsons. Writer and Showrunner Mike Reiss wrote, "The true secret to The Simpsons' success is the valuable input of network executives. We don't have any."

Without the meddling, Lasseter went back to work, reworking the script, pulling Woody out of the rubble. Walter Isaacson wrote in his biography of Jobs, "After many rounds of notes from Katzenberg and other Disney execs, Woody had been stripped of almost all charm."

In 1994 Steve Jobs called Lawrence Levy out of the blue and said he needed help with his company. Levy thought Jobs was calling about NeXT computers, but it was Pixar who needed him. He was intrigued, but reflected, "I didn't have a feeling for this

business,” and “As the CFO, it was almost embarrassing to not know the basics...If I buy a movie ticket and popcorn who gets the dollar?”

Levy started asking questions. He asked Catmull how the finances worked, and Catmull said, “Every month we go to Steve and tell him the shortfall and he writes us a check.” That was how the five million turned into fifty. Levy kept walking the halls. He sat in every meeting he can for the first two weeks. At the time he’s seen as Steve’s Guy and is told, “Keep that guy (Jobs) away from us.” Levy had to change the financial future without cracking the creative culture.

Pixar had four businesses; feature animation, hardware, software, and commercial animation. Levy had to sell the same product to more people or to sell a more expensive product to the same people.

First, he stopped the bleeding. Pixar had valuable patents and Jobs thought they could sue the violators for fifty million dollars. Levy countered and suggested a licensing deal. “We’re better off making it easier for them to make a deal than go to war for every penny that we think we’re entitled to.” ‘Why?’ asked Jobs. Levy explained that Pixar needed “to make this quick and gain a cash infusion...Patent licensing was not a business strategy for Pixar. It was a financing strategy.”

Next up were commercials. These were good but had limited growth. Pixar’s quality was ten times as good as the next company but no one was going to pay ten times the

price. This was the story too for hardware and software. They had done work for Terminator 2 and Jurassic Park but aside from James Cameron and Steven Spielberg, few in Hollywood had the clout to insist on Pixar's tech.

That left feature animation, the least terrible of four bad options.

The (first) of the bad news. Levy told his wife, "The best we can hope for is a tiny profit, and that's only if our films are among the most popular animated films ever made."

That 'terrible' contract gave Disney the bulk of returns.

The (first) of the good news was that movies could be valuable beyond the box office. As Levy inquired about who pocketed each box office dollar, Joe Roth told him to "think of it as a portfolio business." Sonal Chokshi on the a16z podcast compared it to venture capital. But, it's even better. Levy wrote, "even if a film does just okay in its theatrical release, it may have value for years in a film library. That's the opposite of tech products that become obsolete quickly."

A decade later this would be Bob Iger's main point to the Disney board. It was the animated characters that populated the house of mouse. If there weren't hit movies then there couldn't be plush toys, busy theme parks, or television spinoffs. Disney's businesses are like the ripples from a stone dropped into a pond, and Bob Iger wanted bigger stones.

But in the mid-90s this wasn't a dream or a wish your heart makes. Levy had more bad news to exhume, and wrote, "If this (an entertainment company) were to be a serious strategy, I would have to understand the economics of the business in detail." Like Catmull, Levy left for the library.

Let's all go to the movies. A joke among theater owners is that they aren't really in the movie business, they're in the candy business. Another said the cupholder was the most important technological invention since sound. Theater revenue comes from three sources; tickets, concessions, and ads. Captive audiences for local dentists and high margin concession items drive theater economics.

On average, theater owners send sixty percent of the cost of a ticket back to the studios, but it's not an even half, it's a sliding scale. Opening weekend tickets might earmark 80% to the studios with steps down from there, depending on the movie and studio. The opening weekend box-office for Star Wars Episode II, Attack of the Clones returned 100% of the ticket revenue to the studio.

The studio's heavy half gets (roughly) split among marketing (25%), production (15%), distribution (10%), actors (6%), and the balance to the studios (4%). For each \$10 you spend, the studio gets \$0.40. But that's just the start. A WSJ estimate said that studios can double their earnings (over a decade) with streaming and resale markets. Bob Iger needed theme park characters too. But first, more bad news.

Remember that contract that Jobs and Katzenberg thought was bad? It was more bad for Jobs and Pixar. Levy calculated that if Pixar's first movie (Toy Story) were as good as Beauty and the Beast - the third highest grossing animation movie EVER - their share would be about four million dollars a year for the four years it took to make. That's the best case scenario. Disney's average domestic box office for an animated movie was about half that. If Toy Story were an average Disney movie they wouldn't be profitable. Levy wrote, "at \$150 million in domestic box office revenues, the business began to work. But it didn't really take off until box office revenues exceeded \$180 million per film." So, this business is awful unless every movie they made was one of the best animated movies ever.

In one book on the economics of film that Levy read, Hal Vogel wrote, "...ego gratification rather than money may often be the only return on an investment in film."

Levy, Catmull, and Jobs's situation reminded me of Nassim Taleb's suggestion for a National Restaurateur day. Isn't it grand that we get to enjoy the riches of restaurants and the creativity of cinema with none of the risk? Keep in mind that Levy's analysis was that animated feature films were Pixar's best option!

Much later Bob Iger will appreciate Pixar but right now the Disney CEO is Michael Eisner. Eisner did many good things for Disney, but his Pixar interactions were not among them.

Disney was the mouse, nee elephant, in the room. What kept Disney from watching Pixar then taking all their good stuff? Thanks to their contract they owned the characters. Levy stumbled upon one possible answer, culture. Ben Horowitz said the culture is, “what your people do when you’re not giving them a direction.” Pixar had a magnificent culture. Levy even grew to appreciate the drive to work (more than two hours with traffic). “Maybe my grumbling about Pixar’s lonely outpost in Point Richmond, California was misplaced. Perhaps it was a good thing, making it easier for Pixar to forge its own way.”

Levy and Jobs constructed a plan. They needed a bigger share than the 12% or so Disney would give them from the movies. To get a bigger share they needed a new deal. To get a deal in Hollywood they needed two things; cash or clout. Pixar had neither.

Toy Story had to thrive at the box office and they had to go for an IPO. Levy knew that animated feature films are a terrible business but advisor Larry Sonsini said, “Investors will figure out the risks anyway. But it’s better if it comes from you up front.” Jobs wasn’t crazy about this idea but went along.

This was typical of an encounter with the Steve Jobs of this book, who reminded me of how Gene Wilder recalled an incident with Mel Brooks while working on Young Frankenstein. This scene could have happened at Pixar, Levy pouring over financials rather than a script. Wilder said on NPR Fresh Air:

"I was writing every day and Mel (Brooks) would come to the house and read what I had written...One day when he read the pages I had written about Dr. Frankenstein and the creature sings and dances to Puttin' on the Ritz he said, 'Are you crazy? This is frivolous.' Well, my temperature rose and after twenty minutes of arguing my temperature went from red to blue or purple. I started screaming. All of a sudden he said, 'Okay it's in,' I said, 'Why did you put me through this?' He said, 'I wasn't sure it was right and if you didn't argue for it it was wrong and if you did it was right.'"

Part of the IPO problem was the different ways Levy and Jobs saw the world. Levy looked at what could go wrong. Jobs looked at what could go right. It's probably why they suited each other. Failing to see both sides is why Bill Gurley didn't invest in Google. He told Kara Swisher:

"I think it came down to the price at the time was remarkably high and the team was remarkably self-confident in a way that would cause you to question whether they could pull it off but they did. I go back and the learning is that if you have remarkably asymmetric returns you have to ask yourself, 'how high could it be and what could go right?' because it's not a 50/50 thing. If you thought there was a 20% chance you should still do it because the upside is so high."

Jobs's tendency was termed his 'reality distortion field,' but Lawrence wasn't enraptured. Roz Hawsenian manages an investment trust and told Ted Seides about looking for capital allocators, "Do they recognize their own shortcoming and do they pair themselves with somebody who's sane?" That was Levy and Jobs. Though the

balance wasn't easy, Levy wrote, "Working with Steve can be exasperating. Some of his ideas are brilliant but others are off the mark. It's hard to rein him in sometimes." The duo managed to argue well, which is like picking fruit. Too gentle, and there's no harvest, too rough and there's a mess on your hands.

Besides his parries with Jobs, Levy had to prep the IPO. In a podcast with Barry Ritholtz, Levy said, "Great work requires a much longer period of gestation than we think...a lot of things have to come together." That was true for not only the birth of Toy Story but Pixar's financial christening too. After both Morgan Stanley and Goldman Sachs passed, Pixar ended up with a trio of boutique firms.

In 1995 Pixar completed the rare double blockbuster, an IPO and movie premier. CFO Levy hoped the movie would gross eight million dollars the opening weekend. Jobs RDF'd it to fifteen. The movie did thirty. The IPO did so well that Steve Jobs became a billionaire. For Catmull this November was bittersweet. Besides the success there was "a hollow, lost feeling," he told Tim Ferriss. He'd done it! Now he needed a new goal.

That next goal would be to figure out why good companies went bad. Now it was Catmull's turn to sniff around Pixar. He noticed a divide between the creative and production staffs. "I started sticking my head in people's offices, pulling up a chair and asking them for their view on how Pixar was and wasn't working." Each open-ended question provided a puzzle piece answer. Catmull pieced everything together to see that while making Toy Story and readying an IPO they were so busy they didn't have

time to think how they were working. Now they needed a new structure. We'll come back to this.

In 1997 Pixar has cash and clout and renegotiated their 'terrible deal' with Disney. As part of it, Disney tells Pixar that Toy Story 2 will be straight to video. At the time this was a logical choice for both Pixar and Disney. Disney had had success with the direct to video market and Pixar didn't have the resources to make two movies (A Bug's Life was being made at the same time). But Catmull saw the cultural erosion this engendered. It created an 'A team' and 'B team' attitude.

It wasn't the computers that made Pixar great, it was the creativity. In an interview with Charlie Rose, John Lasseter said that animation can't save a bad story. Pixar's secret was the people and the culture around them. Catmull wrote, "Getting the team right is the necessary precursor to getting the ideas right." And not necessarily a dream team. "Even the smartest people can form an ineffective team if they are mismatched," Catmull wrote. Jobs and Levy and Jobs and Catmull were examples of this. Catmull and Levy were like water and Jobs was like a rock. One bends, one doesn't. One stands, one lies flat.

Whereas Jobs had terrible relationships with Jeffery Katzenberg, Michael Eisner, and Alvy Ray Smith Pixar's co-founder. "Alvy was not as willing to make peace and overlook things as Ed was," said Pam Kerwin, who spent nine years at Pixar.

In 1998 Pixar releases *A Bug's Life* and it's a hit. In 1999 Pixar releases *Toy Story 2* - in theaters. It's better than the first. It's around this time that that 'brain trust' enters the Pixar lexicon. The premise Catmull writes is to "Put smart, passionate people in a room together, charge them with identifying and solving problems and encourage them to be candid with one another." Catmull wants them to argue well. He's purposeful in his language, choosing 'candor' and not 'honesty', which has too much emotional baggage.

Words, wrote IDEO founder David Kelley, matter. "Language is the crystallization of thought. But the words we choose do more than just reflect our thought patterns—they shape them. What we say—and how we say it—can deeply affect a company's culture."

In brain trust meetings there's no magic wand. They are "not foolproof and sometimes the interaction only serves to highlight the difficulties in achieving candor." Catmull's book has good brain trust stories and suggestions but never solutions. "The brain trust has no authority." Directors don't want notes "because they are usually coming from people who aren't filmmakers and are seen as ignorant and interfering." As we saw with *The Simpsons* and *Seinfeld*.

The brain trust lasted because the brain trust offered helpful feedback. Director Brad Bird recalled it this way during a June 2018 podcast on *Variety's Playback*. The brain trust "means you have fellow filmmakers looking over your shoulder and saying 'maybe

here we're a little confused about this.' It's cool because everybody who's giving suggestions has been in the trenches before."

In Bird's *The Incredibles*, he got notes that one scene didn't work. In an argument between Mrs. and Mr. Incredible, the latter looked like a bully. The brain trust suggested Bird change the dialogue, but it was left up to him. Instead of linguistically changing the dialogue, Bird physically changed the characters. Elastigirl became taller and it solved the issue.

These brain trust meetings save money said, John Lasseter. He told Charlie Rose that the animation and production are expensive so, "In story development, you edit your film in advance."

Simply, Catmull wrote, the brain trust meetings are: "frank talk, spirited debate, laughter, and love." Steve Jobs was never invited. This was "mutually agreed upon," Catmull wrote. CFO Lawrence Levy wrote that he and Jobs had conversations about how they could enjoy movies but that didn't mean they knew anything about making them. Hence, Jobs was kept out of the meetings.

But this didn't stop Jobs's feedback. When he stalked around the studio during *A Bug's Life*, he debated with the director whether the movie should be in widescreen or standard format. Jobs relented on this one and many reviews would go on to praise the widescreen cinematography. His written notes began, "I'm not really a filmmaker, so

you can ignore everything I say....” and then go on to say something anyway. Yet, Catmull wrote, “Then he would proceed with startling efficiency, to diagnose the problem precisely.”

Brain trust meetings develop movies. Catmull compared Pixar movies to ugly babies. They need to grow into something. In *Up*, for example, all that survived the first version was the title the tall bird.

So much is like this. Many small choices culminating in large outcomes. There are so many small inputs that these kinds of events are impossible to predict. Jobs introduced the iPhone as “three revolutionary products in one” but Brian Merchant’s book, *The One Device: The Secret History of the iPhone* shows the mountains - sometimes literal - of work that went into it.

Iteration is good, Catmull wrote. “Mistakes aren’t a necessary evil. They aren’t evil at all. They are an inevitable consequence of doing something new.” Pixar has created the conditions that allow this. They are a greenhouse for stories. “Directors are allowed to spend years in the development phase of a movie, where the costs of iteration and exploration are relatively low.”

As Pixar thrived Disney Animation faltered. From 1994-2010 no Disney animation would open number one at the box office.

In 2001 Pixar released *Monsters, Inc.* and in 2003 Pixar released *Finding Nemo*.

Part of what made these movies great was the field trips. “It is impossible to overstate how strongly John (Lasseter) believes in the power of research,” Catmull wrote. Like? “Many on the crew of *Finding Nemo* also became scuba certified.” For *Monsters University*, the crew visited MIT, Harvard, Princeton, U.C. Berkeley, and Stanford. Years later Lasseter and Catmull insisted the Disney animators go to New Orleans before making *The Princess and the Frog*. “Attending the Krewe of Bacchus parade on the Sunday before Mardi Gras gave them a vivid frame of reference when they animated a sequence based on that festival.” Catmull explained, “The authenticity it fosters in the film always comes through, even if moviegoers know nothing about the reality the film is depicting.”

Back at the office, Pixar kept trying stuff. Lasseter and Catmull had restarted shorts, which helped in unexpected ways. Catmull thought the shorts would forward the company technically and foster new directors. It didn't. Features hatched technical innovations and managing a small group for a short was nothing like managing a large group for a long time. But, there were unexpected benefits. Smaller groups brought people together. Fewer people meant expanding expertise - everyone chipping in. It was also a message, that Pixar still prized art.

‘Trying stuff...’ might be the Pixar subtitle. There are drawing classes to help people see things in new ways. Catmull wants people to be more artistic because “(Artists) see

more because they've learned how to turn off their minds' tendency to jump to conclusions." He praises the ideas in the book, *Drawing on the Right Side of the Brain*. Pixar also runs postmortems. Like the brain trust, these processes are what matters, not the products. "There was no 'Aha!' moment, no epiphany that would turn our processes inside out." It's about trying stuff and learning from it.

Framing things like this, like experiments, like small bets, matters. Pete Docter (*Inside Out*, *Up*) told Catmull, "Sometimes in meetings, I sense people seizing up, not wanting to even talk about changes. So I'll trick them. I'll say, 'This would be a big change if we were really going to do it, but just as a thought exercise, what if....'" This, Docter said, opens people up.

David Kelley of IDEO said about this mindset, "What we find is that you have to have support from the top of the company that experiments are allowed to happen. It's all about small experiments. It's about starting little brushfires all over the company and hoping they catch on and grow together." That's the Pixar culture.

In 2003 Jobs was diagnosed with pancreatic cancer.

In 2005 Jobs told Catmull and Lasseter he was thinking of selling Pixar to Disney.

In 2006 he did.

There were new lessons at Disney Animation for Catmull and Lasseter. Disney got a 'story trust.' Animators were empowered. Systems were restructured. And hits (again) emerged from the house of mouse.

In 2011 Jobs passed away. Catmull titled his afterword, "The Steve We Knew," and wrote, "To this day, for all that has been written about him, I don't believe that any of it comes close to capturing the man I knew."

Each step from an experience is an abstraction, and we tend to prioritize memorability, not honesty. Jobs, Catmull wrote, went through his own story arc. His fall from grace at Apple. His toiling at NeXT. His resurrection at Pixar. His triumph at Apple and his ringing iPhone.

But it's a hard story and it has to dislodge the one of a temperamental genius. We should remember that this happens all the time. Annie Leibovitz saw war photographers rearrange bodies for more dramatic pictures. Andre Agassi said the 'Attitude is everything' slogan was added as an afterthought at a photo shoot. Mike Reiss was in a college classroom, where before being introduced, heard a professor explain how Homer of Springfield was named after Homer of the Odyssey. Reiss stood up and said, 'uh, that's not it at all, he's named after Matt Groening's dad.'

Pixar succeeded despite being in a terrible industry. The company navigated these waters because of the people at the oars. Jobs, Lasseter, Levy, Catmull, and all the

others not only were highly skilled in their own areas but more importantly, they worked well together. That's the Pixar story. A band of characters comes together for the journey of a lifetime.