

Focus on past glory kept Kodak from digital win

(Reuters) - Eastman Kodak Co's long decline that culminated in a bankruptcy filing on Thursday can be traced back to one source: the former king of photography's failure to reinvent itself in the digital age.

The more than 130-year-old American icon filed for Chapter 11 protection in the U.S. Bankruptcy Court for the Southern District of New York, saying it had obtained a \$950 million credit facility to stay afloat while it tries to cut more than \$6 billion in liabilities.

The filing was not unexpected: Kodak has already become a cautionary tale for anyone considering a career in business.

Students at top M.B.A. programs read a case study each year that explores, in painful detail, the strategic mistakes that led to the company's slide as digital photography overtook film.

Unlike peers such as IBM and Xerox Corp, which managed to create new revenue streams when their legacy businesses declined, critics fault Kodak for abandoning new projects too quickly, for spreading its digital investments too broadly, and for a complacency in its Rochester, New York, base that blinded the company from technological leaps elsewhere.

"The seeds of the problems of today go back several decades," said Rosabeth Kanter, the Arbuckle professor of business administration at Harvard Business School.

"Kodak was very Rochester-centric and never really developed a presence in centers of the world that were developing new technologies," she said. "It's like they're living in a museum."

CRIPPLED BY NOSTALGIA

In 1888, George Eastman invented a machine that captured images on large plates of glass. Not content with that breakthrough, he went on to develop roll film and later the Brownie camera.

His company became a household name by helping Americans record their most important life events, first in black-and-white prints and then in Kodachrome color, coining the ubiquitous phrase "It's a Kodak moment."

In the 1960s, Kodak began to study the potential of computers and made a big break in 1975, when one of its engineers, Steve Sasson, invented the digital camera -- a toaster-sized image sensor that captured rough hues of black and white.

But Kodak did not immediately recognize its mass-market potential and focused instead on high-end cameras for niche markets. Executives also feared cannibalizing their core film sales.

"When (George Eastman) died, he had exerted such an influence on the company that one of the things that Kodak immediately became bound up in nostalgia," said Nancy West, a University of Missouri

professor who wrote a history of Kodak's early years. "Nostalgia's lovely, but it doesn't allow people to move forward."

Sony Corp launched its own digital camera in 1981, a development that sent "fear through the company," according to a Kodak case study written by Harvard professors Giovanni Gavetti and Rebecca Henderson. The paper is studied at Columbia, the University of Chicago and other top business schools.

Despite those chills, it was not until a decade later in 1991 that Kodak's first digital product for every-day use hit the market, and it was not a camera, but a Photo CD.

Kodak introduced a line of pocket-sized digital cameras in 1996 with the DC20, but made its biggest push into the marketplace in 2001 with the Easyshare brand. By then, the field was already crowded with products from Canon Inc and other Asian manufacturers.

MISSED OPPORTUNITIES

Kodak said in its filing that it hoped to emerge from bankruptcy in 2013. It tried to restructure in the past by closing 13 film plants and 130 photo labs between 2004 and 2007, slashing its workforce by 50,000.

The loan and bankruptcy protection from U.S. trade creditors may give Kodak the time it needs to find buyers for some of its 1,100 digital patents -- key to its remaining value -- and to reshape the business while continuing to pay its 17,000 workers.

Kodak Chief Executive Antonio Perez, who had once called digital cameras a "crappy business," said bankruptcy was a necessary step. "Now we must complete the transformation by further addressing our cost structure and effectively monetizing non-core intellectual-property assets," Perez said.

At the annual Consumer Electronics Show in Las Vegas last week, Perez and Kodak introduced two new cameras it said could connect wirelessly with printers and post pictures to Facebook.

But some gadget reviewers were unexcited, saying the new cameras could not connect to the Web without piggybacking on a smartphone or Wi-Fi connection.

"People aren't just intrigued by new features unless it's something revolutionary. These are incremental features," said Suzanne Kantra, editor of the tech blog Techlicious and a former tech editor at Popular Science.

"Being able to get to the front of the pack again is going to require a much-bigger leap."

Analysts said Kodak could have become a social media powerhouse if it had successfully convinced consumers to use its online service to store, share and edit their pictures. Instead, Kodak focused too much on devices, and lost the online battle to social networks like Facebook.

ATTEMPTS AT DIVERSIFICATION

Over the years, Kodak has dabbled in different products to diversify its business. In 1988, it bought Sterling Drug for \$5.1 billion, best known for making Lysol cleaning products. That deal saddled Kodak with too much debt, which had swelled to \$9.3 billion by 1993.

Kodak spun off its chemical arm Eastman Chemical Co in 1994 to help reduce debt, only to then sell Sterling off in parts the same year.

"All these attempts to sort of move the company in different directions, that's a problem of not wanting to embrace change," West said.

By 1993, Kodak had spent \$5 billion on digital imaging research, but the funds were being diverted to 23 separate digital scanner projects.

The money did help Kodak capture an early lead in the market and it had a 27 percent market share by 1999. But that slipped to 15 percent by 2003 and 7 percent by 2010, as Kodak ceded ground to Canon, Nikon Corp and others.

Kodak was losing \$60 for every digital camera it sold by 2001 and it was trying to quell a war that had erupted between its digital and film staff, according to the Harvard case study.

By 2007, the company realized it needed to put more resources into the consumer camera market so it sold its healthcare imaging unit, which made X-ray equipment for hospitals and dentists and had been highly lucrative since 1896.

Kodak pocketed \$2.35 billion from the sale to private equity firm Onex, but analysts said it was a mistake to get out of the business when baby boomers were about to retire in droves and demand for X-rays would increase.

Kodak's logic for the deal: it did not want to spend the money to evolve the health business to all-digital technology.

"In the law we call it, 'a bird that likes to fly backwards.' Because, it's more comfortable looking where it's been than where it's going," said Dan Alef, the author of a biography on George Eastman.

"George Eastman never looked back," he said. "He always looked forward to doing something better than what he had done, even if he had the best on the market at the time."

Eastman, who had suffered from a painful spinal disorder, committed suicide with a bullet to the heart in 1932 at age 77, leaving a note that said: "My work is done."

PATENT SALE

Financial analysts consider Kodak's technology patents to be its most valuable asset, saying its best hope is the sale of imaging patents that could fetch more than \$1 billion.

Most digital cameras in the world use technology patented in part by Kodak, making the holdings highly lucrative. Kodak recently sued Apple Inc and HTC Corp, complaining of a breach of those patents.

The bankruptcy filing puts Kodak in the company of movie rental chain Blockbuster and bookstore owner Borders, which both collapsed after struggling to compete with digital rivals.

"They'll hopefully come out a much leaner, more financially stable company that will allow them to focus on whatever their core business is going to be," said Craig Welin, a restructuring attorney at Frandzel, Robins, Bloom & Csato law firm in Los Angeles. "But it'll be very interesting to see what's left at the end of the day."

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