

Eastman Kodak Co.¹

*“You can't stop the future.
You can't rewind the past.
The only way to learn the secret
...is to press play.”*
Jay Asher

Introduction

Eastman Kodak is an American company founded in 1889 by George Eastman in Rochester, New York. Later became the leading manufacturer for image and photographic equipment, materials and services. From the very first day the company followed the strategy of selling inexpensive cameras and making large margins from consumables (film, chemicals and paper). In 1976, Kodak commanded 90% of film sales and 85% of camera sales in the U.S. During most of the 20th century, Kodak held a dominant position in photographic film and had 90% market share of photographic film sales in the U.S.

Kodak's operating structure is centered around strategic product groups. The strategic product groups are segments that share common technology, manufacturing and product platforms and customer sets.



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The next exhibit provides a list of the main milestones of Kodak.

Exhibit 1. Kodak's Milestones

- 1878 - George Eastman was one of the first to demonstrate the great convenience of gelatin dry plates over the cumbersome and messy wet plate photography prevalent in his day.
- 1879 - George Eastman invented the dry-plate process and filed patent for a machine that coated dry photographic plates.
- 1884 - Introduced paper roll film.
- 1885 - EASTMAN American Film was introduced - the first transparent photographic "film".
- 1900 - The first of the famous BROWNIE Cameras was introduced. It sold for \$1 and used film that sold for 15 cents a roll. For the first time, the hobby of photography was within the financial reach of virtually everyone.
- 1935 - KODACHROME Film was introduced and became the first commercially successful amateur color film.
- 1976 - Invented the digital camera.
- 1980 – FUJI emerges as a serious competitor and Kodak developed their first digital camera.
- 1997 – Kodak was a high-cost manufacturer with a growing portfolio of digital products but earnings started to decline.
- 1981 - Company sales surpassed the \$10 billion mark.
- 2003 - Kodak introduced the Kodak EasyShare LS633 Digital Camera, the first camera to feature an AMOLED display, and the Kodak EasyShare Printer Dock 6000, the world's first printer-and-camera dock combination.
- 2004 - Kodak announced that it would stop selling traditional film cameras in Europe and North America, and cut up to 15,000 jobs (around a fifth of its total workforce at the time)
- 2005 - The Kodak EasyShare-One Digital Camera, the world's first Wi-Fi consumer digital camera capable of sending pictures by email
- 2009 - Kodak posted a \$137 million fourth-quarter loss and announced plans to cut up to 4,500 jobs

Financial struggles

Eastman Kodak's financial struggles began in the late 1990's as a result of the decline in sales of photographic film. Kodak's share price fell down to \$23 from \$90 in 1999. In the end of the year 2002 Kodak's workforce had been reduced by 5,000, to 70,000 workers, which represents half the company's 1984-employment-level of 145,000. In January 2004, Kodak announced that it was going to stop selling reloadable film-based cameras in the U.S, Canada, and Western Europe at the end of the year. Another announcement was made that it planned to end up to another 15,000 jobs

worldwide, more than 1/5 of its total workforce, during a three year period in order to cut annual operating costs of its film business with an amount of \$1 billion.

As it continues its restructuring efforts, Kodak also turned outside its ranks for its next leader, bringing Antonio M. Perez in the board during mid 2003 as President and COO. Perez was a former vice-president at Hewlett-Packard Company. He was in charge of the firm's consumer business, which delivered products such as laptops, digital cameras and printers. Kodak empowered its imaging division by purchasing Practice Works, Inc., a leading provider of dental practice management software and digital radiographic imaging systems, for about \$475 million. During this time, Kodak also reduced its semi-annual dividend by more than 70 percent to make available cash of about \$1.3 billion in cash through 2006 to its transition to digital technology. Then, the company estimated that removal of its traditional film business would cost \$1.8 billion in earnings between 1998 and 2006.

Film sales were falling faster than it was expected to, and the hope for growth from film in emerging markets was proven wrong. Consumers in China, for example, were gravitating toward digital cameras at a quicker pace than Kodak had expected. At the end of 2006, Kodak laid off 23,000 workers since the beginning of 2004, reducing its total workforce to 40,900. Another 7,000 more jobs were mentioned to be cut as part of this multiyear restructuring, which was estimated to involve total charges of around \$3.5 billion. Such matters lead to the net losses that Kodak posted for both 2005 and 2006.

A remarkable amount of the investment funds that had been earmarked for digital technology was subsequently used on acquisitions to transform the graphic communications division to have a bigger role in the world wide market including supplies, and peripherals to commercial printers. In January 2004 Kodak acquired Scitex Digital Printing, a producer of high-speed, variable-data inkjet printers. This company, acquired for \$239 million, was subsequently renamed Kodak Versamark Inc. In May 2004, Kodak became the sole owner of a former joint venture with Heidelberger Druckmaschinen called NexPress Solutions LLC. This entity specialized in high-end, on-demand digital color printing systems. Later, Kodak spent about \$720 million in order to buy out another joint venture partner which is Sun Chemical Corporation and to take full control of Kodak Polychrome Graphics, and acquired Canadian firm Creo Inc., which produced devices to directly convert computer-generated printing files into printing plates, via the \$967 million purchase. Integrating all of these deals took place in 2006, by which time Kodak's graphic communications business was generating \$3.6 billion in revenue, more than one-quarter of the company total.

In 2005 more than half of the company's revenues were derived from digital products and services. Then in 2006, the earnings regarding digital products increased to \$343 million. This increase was larger than the \$214 million decline in earnings posted by Kodak's traditional business. In 2007, Kodak sold its health imaging unit for \$2.35 billion in cash and potential additional performance-based payments of \$200 million. Part of payments was used to pay down a large portion of Kodak's long-term debt of around \$3.3 billion. Removing the health unit also created extra funds for Kodak's

risky and expensive entry into the consumer inkjet-printer market. 3 years in the making at a cost of \$300 million, the new printer showed a good success.

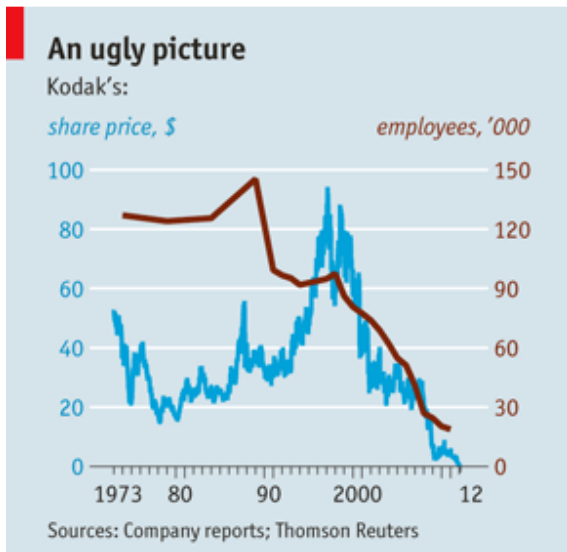
During the first half of 2007, Kodak's losses narrowed, providing some hope that this goal might be met and that the company might still manage to successfully complete its wrenching transition into a digital-based company. 2007 was the most recent year in which the company made a profit. As part of a turnaround strategy, Kodak focused on digital photography and digital printing and attempted to generate revenues through aggressive patent litigation.

In January 2012, Kodak filed for Chapter 11 bankruptcy protection and in February 2012, Kodak announced that it would cease making digital cameras, pocket video cameras and digital picture frames and focus on the corporate digital imaging market.



In August 2012, Kodak announced it is planning to sell its film, commercial scanners and kiosk divisions. All these events have affected the share price of Kodak and the number of employees (see Exhibit 2).

Exhibit 2. Share price and number of employees evolution of Kodak



The Digital Image Market

Just 20 years ago very few people understood the opportunity for digital photography, and even fewer people could have foreseen the impact that digital photography would have on related markets. Even fewer would have predicted the rise of the micro-stock photography market and the proliferation and growth in Internet photo sharing sites. While the impact on the photo processing market could have been predicted, most were surprised by how rapidly digital photography has displaced film. When digital cameras were introduced, the concept of customizing merchandise with personal photographs was in its infancy. A few firms offered customized products to customers who mailed in photographs. The market at that time was constrained by cumbersome and lengthy processes.

Today, the digital photography market—inclusive of cameras, lenses, printers and complementary products—is an industry valued at more than \$68 billion. Photography services account for several hundred billion more in revenues and the opportunities for providing these services digitally have become big business.²

Before the advent of the digital camera, photography related markets would have included the cameras, interchangeable lenses, film, film processing equipment, photo printers, scanners, and some storage products. However, the introduction of the digital camera changed all of these markets in some way. Overall, the markets are substantially larger than they were in the past because a much greater number of people are more passionately involved with digital photography than ever were with silver halide photography.

² PR Newswire (<http://s.tt/1d19c>)

Additionally, digital cameras have made possible new applications in areas such as online photo sharing, customized digital photo products, micro-stock photography and camera cell phones³.

Immensely successful companies can become myopic and product oriented instead of focusing on consumers' needs. Kodak's story of failing has its roots in its success, which made it resistant to change. Its insular corporate culture believed that its strength was in its brand and marketing, and it underestimated the threat of digital.

Kodak did not fail because it missed the digital age. It actually invented the first digital camera in 1975. However, instead of marketing the new technology, the company held back for fear of hurting its lucrative film business, even after digital products were reshaping the market.

Unfortunately, the company had the nearsighted view that it was in the film business instead of the story telling business, and it believed that it could protect its massive share of market with its marketing. Kodak thought that its new digital technology would cannibalize its film business. Sony and Canon saw an opening and charged ahead with their digital cameras. When Kodak decided to get in the game it was too late. The company saw its market share decline, as digital imaging became dominant. This blind faith in marketing's ability to overcome the threat from the new technology proved fatal. Kodak failed to adapt to a new marketplace and new consumer attitudes.

So, although Kodak's digital camera business was a roaring sales success, it turned out to be a crushing profit disappointment. Perez, who arrived at Kodak in 2003 and became chief executive last year, had championed a dramatic change only to find it wasn't the right model for turning the company around.

In the Digital & Film imaging segment, Kodak revenues fell by -39.1% and company lost market share, to approximate 6.06 %

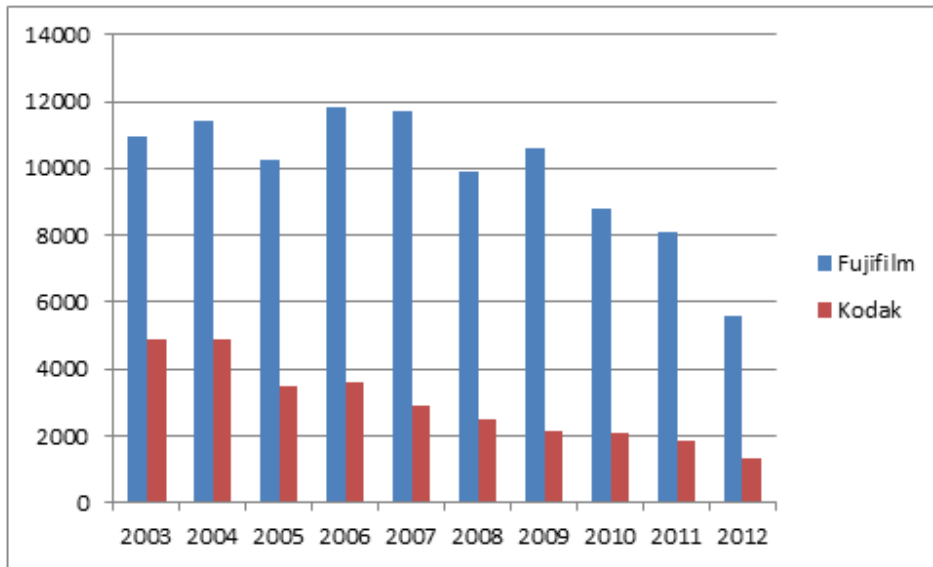
Ironically, Eastman Kodak the company who invented the first camera was unable to adapt to the technological era of cameras, thinking that it will eventually disappear and instead continued to focus in film and printing. They discarded the technological change thinking that it's too expensive, too slow and too complicated. Kodak didn't base their strategies around markets' wants and consumers' needs, instead it based it on its own business model which wasn't open for any upgrading.

Rivals such as Fujifilm, Nikon, Sony, Canon and many others managed to continue innovating their products and services over the years. Competitors came up with many services such as face detection, smile detection, red eye-fix. Unlike Kodak, wasn't able to lead technological trend but rather followed.

³ BCC Research, Camera and Imaging Products Association (CIPA)

Fuji Photo Film has followed over the years an intensive IP orientated strategy with thousands of patents being registered every year. Exhibit 3 below compares the overall evolution in the number of patents during the last ten years between the two companies.

Exhibit 3. Patent documents published by Kodak and Fuji during the last 10 years (2003-2012)



All this shows two things. Fujifilm and KODAK have been working for years in areas traditionally related to the photography industry, such as medical imaging. But, only Fujifilm has been investing in new market opportunities such as cosmetics and the food industry. The Japanese company reacted earlier and more efficiently to the threat of digital photography. They did this by designing a consistent strategic plan that included the development of new business lines. Kodak was able to invent the world's first Wi-Fi camera in 2005. Users could easily email photos using a SD card which was user-friendly despite it's bulky size. But the camera didn't sell well and Eastman Kodak killed it. The company failed to have a projected vision to even realize that sharing was the popular method of interaction between people. It seems that Kodak got into the game too early; when it purchased Ofoto in 2001 they took more than 4 years to re-launch the service under their own name 'Kodak Easy Share' but it wasn't as good as competitor's products such as Flickr and Photobucker. This is just another typical 'Kodak' unexplainable slow approach.

Questions:

1. Identify Kodak's main strengths and weaknesses related to the strategy and the operations.
2. Identify Kodak's main strengths and weaknesses in the financial statements.
3. Design a cause and effect diagram for Kodak.
4. Propose recommendations to solve the main weaknesses of Kodak.

Exhibit 4. Kodak's Profit & Loss accounts

| (in millions, except per share data) | For the Year Ended December 31, | | |
|--|---------------------------------|------------------|------------------|
| | 2011 | 2010 | 2009 |
| Net sales | | | |
| Products | \$ 5,113 | \$ 5,485 | \$ 6,326 |
| Services | 781 | 778 | 788 |
| Licensing & royalties | 128 | 904 | 495 |
| Total net sales | <u>\$ 6,022</u> | <u>\$ 7,167</u> | <u>\$ 7,609</u> |
| Cost of sales | | | |
| Products | \$ 4,534 | \$ 4,618 | \$ 5,247 |
| Services | 601 | 603 | 603 |
| Total cost of sales | <u>\$ 5,135</u> | <u>\$ 5,221</u> | <u>\$ 5,850</u> |
| Gross profit | \$ 887 | \$ 1,946 | \$ 1,759 |
| Selling, general and administrative expenses | 1,159 | 1,275 | 1,298 |
| Research and development costs | 274 | 318 | 351 |
| Restructuring costs, rationalization and other | 121 | 70 | 226 |
| Other operating (income) expenses, net | (67) | 619 | (88) |
| Loss from continuing operations before interest expense, other income (charges), net and income taxes | (600) | (336) | (28) |
| Interest expense | 156 | 149 | 119 |
| Loss on early extinguishment of debt, net | - | 102 | - |
| Other income (charges), net | (2) | 26 | 30 |
| Loss from continuing operations before income taxes | (758) | (561) | (117) |
| Provision for income taxes | 9 | 114 | 115 |
| Loss from continuing operations | (767) | (675) | (232) |
| Earnings (loss) from discontinued operations, net of income taxes | 3 | (12) | 17 |
| Extraordinary item, net of tax | - | - | 6 |
| NET LOSS | (764) | (687) | (209) |
| Less: Net earnings attributable to noncontrolling interests | - | - | (1) |
| NET LOSS ATTRIBUTABLE TO EASTMAN KODAK COMPANY | <u>\$ (764)</u> | <u>\$ (687)</u> | <u>\$ (210)</u> |
| Basic and diluted net (loss) earnings per share attributable to Eastman Kodak Company common shareholders: | | | |
| Continuing operations | \$ (2.85) | \$ (2.51) | \$ (0.87) |
| Discontinued operations | 0.01 | (0.05) | 0.07 |
| Extraordinary item | - | - | 0.02 |
| Total | <u>\$ (2.84)</u> | <u>\$ (2.56)</u> | <u>\$ (0.78)</u> |

Exhibit 5. Kodak's Balance Sheets

| In Millions of USD | 31/12/2011 | 31/12/2010 | 31/12/2009 | 31/12/2008 |
|---|-------------------|-------------------|-------------------|-------------------|
| <i>Cash & Equivalents</i> | 861 | 1624 | 2024 | 2145 |
| Total Receivables, Net | 1,103 | 1,196 | 1,395 | 1,716 |
| Total Inventory | 607 | 746 | 679 | 948 |
| Other Current Assets, Total | 132 | 220 | 205 | 195 |
| Total Current Assets | 2,703 | 3,786 | 4,303 | 5,004 |
| Property/Plant/Equipment, Total - Gross | 5,485 | 6,022 | 6,432 | 6,805 |
| Accumulated Depreciation, Total | -4,590 | -4,985 | -5,178 | -5,254 |
| Goodwill, Net | 277 | 294 | 907 | 896 |
| Intangibles, Net | 87 | 124 | 184 | 247 |
| Other Long Term Assets, Total | 716 | 985 | 976 | 1,422 |
| Total Assets | 4,678 | 6,226 | 7,691 | 9,179 |
| | | | | |
| Accounts Payable | 706 | 959 | 919 | 1288 |
| Accrued Expenses | 604 | 742 | 870 | 936 |
| Notes Payable/Short Term Debt | 0 | 0 | 0 | 0 |
| Current Port. of LT Debt/Capital Leases | 152 | 50 | 62 | 51 |
| Other Current liabilities, Total | 688 | 1069 | 1045 | 1163 |
| Total Current Liabilities | 2150 | 2820 | 2896 | 3438 |
| Total Long Term Debt | 1363 | 1195 | 1129 | 1252 |
| Total Debt | 1515 | 1245 | 1191 | 1303 |
| Minority Interest | 2 | 2 | 2 | 3 |
| Other Liabilities, Total | 3515 | 3286 | 3699 | 3501 |
| Total Liabilities | 7030 | 7303 | 7726 | 8194 |
| Common Stock, Total | 978 | 978 | 978 | 978 |
| Additional Paid-In Capital | 1108 | 1105 | 1093 | 901 |
| Retained Earnings (Accumulated Deficit) | 4071 | 4969 | 5676 | 5903 |
| Treasury Stock - Common | -5843 | -5994 | -6022 | -6048 |
| Other Equity, Total | -2666 | -2135 | -1760 | -749 |
| Total Equity | -2352 | -1077 | -35 | 985 |
| Total Liabilities & Shareholders' Equity | 4678 | 6226 | 7691 | 9179 |

Exhibit 6. Kodak's Cash Flow Statements

| Cash Flow | 2011 | 2010 | 2009 | 2008 |
|--|---------------|-------------|-------------|-------------|
| Cash Flows From Operating Activities | | | | |
| Net Income | -764 | -687 | -209 | -442 |
| Depreciation and amortization | 294 | 378 | 427 | 500 |
| Deferred income taxes | 12 | -91 | -99 | 16 |
| Accounts receivable | 96 | 118 | 363 | 148 |
| Inventory | 131 | -28 | 276 | -20 |
| Other working capital | -729 | -580 | -799 | -847 |
| Other non-cash items | -38 | 671 | -95 | 798 |
| Net cash provided by operating activities | -998 | -219 | -136 | 153 |
| Cash Flows From Investing Activities | | | | |
| Investment in property, plant and equipment | -128 | -149 | -152 | -254 |
| Acquisitions Net | 126 | 32 | 139 | 54 |
| Purchases of investments | -84 | -70 | -36 | -150 |
| Sales/Maturities of investments | 83 | 74 | 39 | 162 |
| Other investing activities | -22 | 1 | -12 | 0 |
| Net cash used for investing activities | -25 | -112 | -22 | -188 |
| Cash Flows From Financing Activities | | | | |
| Common stock issued | 0 | 0 | 0 | -301 |
| Dividends | 0 | 0 | 0 | -139 |
| Other financing activities | 246 | -74 | 33 | -291 |
| Net cash provided by financing activities | 246 | -74 | 33 | -731 |
| Net change in cash | -763 | -400 | -121 | -802 |
| Cash at beginning of period | 1,624 | 2,024 | 2,145 | 2,947 |
| Cash at end of period | 861 | 1,624 | 2,024 | 2,145 |
| Free cash in flow | | | | |
| Operating Cash Flow | -998 | -219 | -136 | 153 |
| Capital Expenditure | -128 | -149 | -152 | -254 |
| Free Cash Flow | -1,126 | -368 | -288 | -101 |

Exhibit 7. Kodak's main ratios

| | 2011 | 2010 | 2009 | 2008 | Industry |
|--|-------------|-------------|-------------|-------------|-----------------|
| Equity / Assets | -0,50 | -0,17 | 0,004 | 0,10 | 0,39 |
| Current ratio (CA / CL) | 1.26 | 1.34 | 1.48 | 1.45 | 1,59 |
| Fixed Asset Turnover (Sales / FA) | 3.05 | 2.94 | 2.29 | 2.29 | 2,99 |
| Current Asset Turnover (Sales / CA) | 2.23 | 1.89 | 1.77 | 1.88 | 2,12 |
| Stock Turnover (Sales / Stocks) | 9.92 | 9.61 | 11.21 | 9.93 | 9,71 |
| ROI (EBIT / Assets) | -0.16 | -0.09 | -0.015 | -0.089 | +0,099 |
| ROE (Net result / Equity) | Negative | Negative | Negative | Negative | +0,12 |