

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.



¹ Case written by Esen Kılıç, Mohamed Hatem, Reem Lofty, Turkislam Hopa and Yehia Balbaa; with the collaboration of Oriol Amat, Barcelona School of Management, Universitat Pompeu Fabra, 2013.

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

- 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

Exhibit 1. Kodak's Milestones

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).

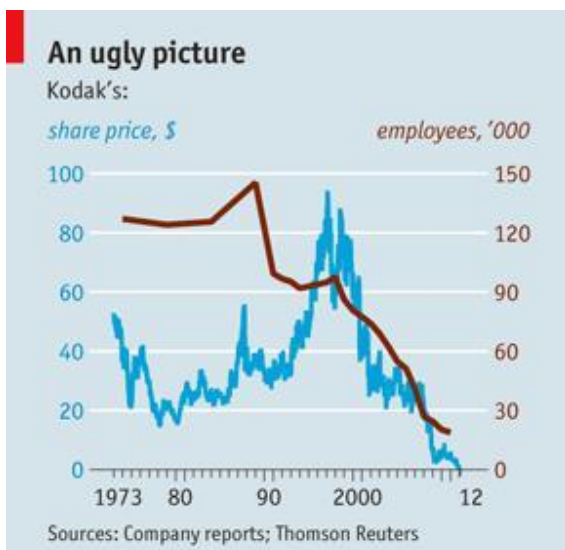


Exhibit 2. Share price and number of employees evolution of Kodak

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.

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.

² PR Newswire (<http://s.tt/1d19c>)

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

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.

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.

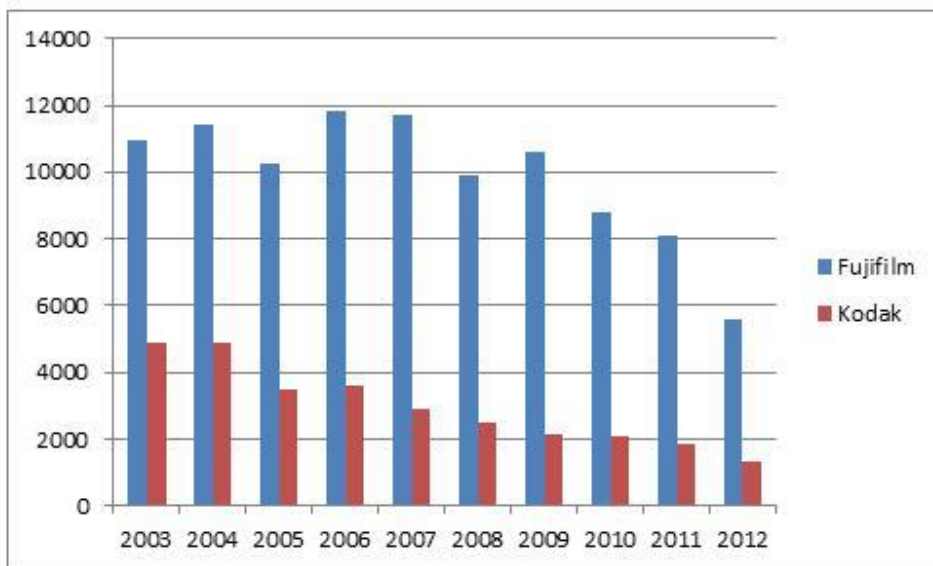


Exhibit 3. Patent documents published by Kodak and Fuji during the last 10 years (2003-2012)

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 its 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.

(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	\$ 6,022	\$ 7,167	\$ 7,609
Cost of sales			
Products	\$ 4,534	\$ 4,618	\$ 5,247
Services	601	603	603
Total cost of sales	\$ 5,135	\$ 5,221	\$ 5,850
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	\$ (764)	\$ (687)	\$ (210)
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	\$ (2.84)	\$ (2.56)	\$ (0.78)

Exhibit 4. Kodak's Profit & Loss accounts

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 5. Kodak's Balance Sheets

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 6. Kodak's Cash Flow Statements

	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

Exhibit 7. Kodak's main ratios