Sony Looks for New Ways to Play

The company has struggled to blend its entertainment and electronics units, but its new CEO plans changes.

By Jon Healey and Alex Pham, Times Staff Writers

If any company can find a way to usher entertainment into the digital era, Sony Corp. would appear to be it.

The massive Japanese electronics and entertainment conglomerate owns a movie studio and co-owns a record label, backing blockbuster films such as “Spider-Man” and hit-making artists such as Bruce Springsteen.

"For a period there, they defined the consumer-electronics space," said Michael Goodman, a senior analyst at Yankee Group in Boston. "They were the quintessential electronics. Their name personified quality. They were a heck of an innovator."

But Sony's efforts to parlay its engineering and entertainment assets into compelling products and services for the Internet Age have yielded little to crow about. In particular, its online music store, downloadable movie service and digital music players have fallen flat in a market primed for new ways to play.

Sony's difficulties highlight the challenges facing the entertainment industry as it tries to find its footing in an era when cheap digital technology gives consumers more power and choices. If the one company on the planet that produces movies, music and games as well as the devices that play them can't figure out how to make them work profitably together, who can?

This week, Sony's new chief executive, Welsh-born Howard Stringer, is expected to announce a shake-up at the 59-year-old icon. It's the latest in a long series of efforts to generate fusion, not fission, from Sony's creative and gadget-making units.

"Silo walls between business units that impede cooperation and communication need to come down," Stringer said when he took control of Sony in June.

Analysts said Stringer would probably outline steps to break down those walls Thursday. They also said Stringer would probably propose significant staff reductions and plant closings as the company struggles with plummeting consumer electronics prices, particularly in the TV segment. But because the diagnosis is easier than the cure, Stringer's plan may initially involve baby steps rather than revolutionary changes.

"There has been a tall curtain between what the entertainment people want and what the consumer electronics guys want," said Rick Doherty, analyst with Envisioneering Group in Seaford, N.Y. "Howard's lowered the curtain several times, but there's still a very big cultural difference, and Howard understands this. He'll work slowly to lower the curtain further over time, but he knows it's not the easiest thing on earth."

Changes Ahead

Stringer gave a foretaste of the changes Wednesday when he created a chief marketing post for the corporation and put an honest-to-goodness marketing whiz in it: Andrew House, one of the executives responsible for making the PlayStation a global phenomenon. Like Stringer, House is from Wales, not Japan.

Yair Landau, vice chairman of Sony Pictures Entertainment, said Stringer's ability to bring factions together makes him the best person at Sony to pull off the task. But it's no mean feat.
"As the technological barriers have fallen away, they've exposed the cultural and political barriers" inside Sony, Landau said. "That's his biggest challenge, bridging those cultural and political barriers."

Sony began the process of reinvention in March, when it shunted its top corporate officers aside in favor of new leaders. In a richly symbolic break from past practice, the board chose the company's first non-Japanese chief executive.

Formally installed in late June, Stringer inherited an idiosyncratic company in which engineers historically competed to outdo each other with the most elegant and powerful gadgets. This infighting was exacerbated by years of distrust and resentment between the electronics and entertainment units.

"When they have interacted, it's been because one division didn't like what another division was doing," Goodman said. "And depending on who won that debate, bad decisions were made."

For years, creating irresistible products in new categories was Sony's stock in trade. It won massive, loyal followings with its Walkman portable music players, its Trinitron color televisions and, more recently, its CyberShot digital cameras and PlayStation game machines.

Although Sony remains king in some important product lines, it is an also-ran in several major, fast-growing arenas, such as flat-panel televisions and MP3 players. What's worse, the company is no longer seen as the leading innovator in consumer electronics. The great leaps forward are just as likely to come from Silicon Valley as from Tokyo.

Meanwhile, the company's financial performance has been lackluster and its stock stuck in neutral. With the electronics unit slumping and its studio riding the Hollywood roller coaster — up some quarters, down in others — the most dependable source of profit has been the PlayStation unit.

"The marketplace is very different today than it was 10 years ago when Sony dominated the industry," Goodman said. "It's not a clear-cut case of, if they get their act together, they'll own this space.... The space has become too competitive."

Sony was founded in 1946 by Masaru Ibuka and Akio Morita, who brought a team of inventive engineers and repairmen together in a workshop on the third floor of a bombed-out Tokyo department store. After dabbling in a wide variety of gadgets, Sony developed a hit: a radio powered by transistors, not valves.

It was the first of what would be many inventions that created whole new categories of products for the industry.

Some of those devices were fiercely resisted by entertainment companies, which feared they would encourage bootlegging. The clash came to a head in 1976, when two Hollywood studios sued to block Sony's Betamax videocassette recorder. The Supreme Court ruled eight years later that Sony could not be held liable for copyright infringement because the VCR had substantial legitimate uses, establishing a principle that technology companies rely on to this day.

Morita, however, believed that the company needed to be something more than just a gadget maker: He wanted the public to feed its Sony products with Sony programming. By controlling a major movie studio and record company, Sony could have a leg up in future battles over audio and video formats because it had built-in allies in Hollywood and the music industry — an advantage it didn't have when its Betamax lost the battle with VHS.

Those convictions led Sony to two blockbuster acquisitions, thrusting the company into the major leagues of music and movies. It purchased CBS Records in 1987 for $2 billion and Columbia Pictures two years later for $3.4 billion — a breathtaking premium for a company carrying $1.6 billion in debt.

The union was rocky.

"There was not much love lost between electronics and the movie company because 10 years ago, the movie company was busy losing money and the electronics company was very angry about that," Stringer said in an interview last year, before being named CEO. "The technology people said, 'Those people in Hollywood are spending all the money!'"

The distrust was mutual, and not just inside Sony.

The entertainment industry bristled at gadgets that gave users increasing control over how, when and where they consumed music and video, changes that chipped at the studios' and labels' business models. The VCR was just the ante; soon, consumer-electronics companies would be manufacturing products that duplicated CDs with the push of a button, helped viewers skip TV commercials and piped free music onto the Internet.
This kind of conflict was deeply ingrained within Sony, and not just between the entertainment and electronics units. Each of the many groups — at one point, Sony had 39 — had a tradition of acting autonomously. These “silos” were so independent, they sometimes built rival versions of the same device.

“In a company where jobs were for life, it created competition that made Sony the great company it is,” Stringer said. “It created artificial competition, which you needed.”

Through the late 1980s and 1990s, Sony's electronics and entertainment divisions coexisted in an uneasy peace. Executives on each side knew that a good quarter by the other could mask a bad quarter on their end, yet they had trouble uniting behind a common goal. The electronics units agreed to hobbled new devices with technologies that limited copying and deterred piracy, but the entertainment divisions gave lukewarm support to the new formats Sony's engineers developed. The whole was clearly less than the sum of its parts.

The MiniDisc, which was introduced in the U.S. late in 1992, is a case in point. Sony hailed MiniDisc as the next great audio format, combining the sound quality of CDs with the recording ability of cassettes in a more compact package. But Sony's labels released only a fraction of their catalogs, which included such legendary artists as Bob Dylan, Bruce Springsteen and Miles Davis, in the new format. And the rest of the industry put out even fewer titles on MiniDisc.

Once images, movies and music had migrated to the PC, it wasn't long before computer users were uploading them to the Internet. The arrival of the original Napster file-sharing network in 1999 turned the PC into an indispensable piracy tool, a key that could unlock a global library of illicit song downloads. And the library of bootlegs soon expanded to offer Hollywood films, TV shows, computer games and software programs — including some of Sony's most valuable titles.

On the Defensive

Sony's response to Napster and the skyrocketing popularity of MP3 files online was to play defense. It joined in the music industry's unsuccessful efforts first to block MP3 players, then to handicap them with cumbersome anti-piracy technology. It also developed its own "digital rights management," or DRM, software to limit copying of music files and deter piracy on portable music players.

Hoping to make this cumbersome software — called "Open Magic Gate," or OpenMG — an industry standard, Sony put it into all its products that could play digital music files. "Otherwise," Kimura said, "who will follow?"

Sony learned the answer: No one.

By contrast, Apple Computer Inc. included minimal security features in its original iPods, which made their debut about the same time. Backed by an extensive and clever marketing campaign, iPods gained a stranglehold on the market for portable digital-music players.

Napster's phenomenal growth was one of several hints that a huge market for downloadable music was emerging in the late 1990s and early 2000s. Most of the major record companies, however, were slow to make their music available to legitimate online services, and none was slower than Sony Music.

Some former Sony executives say the music company wasn't opposed to online distribution, it just wasn't convinced that anyone had a workable business model. But other critics say Sony's corporate culture — its tendency to move at a maddeningly deliberate pace, trading urgency for contemplation — turned it into a follower.

The burgeoning piracy problem finally sounded a wake-up call at Sony Music in 2001, when it hired Phil Wiser to be its chief technology officer. Having spent six frustrating years trying in vain to talk major record companies into embracing the Internet, Wiser came in determined to shift Sony Music from defense to offense.

Embracing the Net

He soon recognized that Sony had a unique opportunity to combine music, the Internet and gadgets seamlessly into a package more compelling than its competitors — or free sources of bootlegged music online — could offer. So one morning in 2003 he strode into the Madison Avenue office of Stringer, who was leading Sony Corp. of America at the time, and made his pitch to create a downloadable music service that would be bundled with every new gadget.

Wiser was preaching to the choir. Stringer asked Wiser to pull together the elements of a music downloading service that would be supported by every one of Sony's product groups. To make a project of such unprecedented breadth work, though, Wiser found that he would not only have to win over music fans, but also change deeply ingrained habits and dispel skepticism within Sony.

Other Sony executives said Wiser made huge strides within the far-flung company, winning over key allies and uniting disparate pieces of the company in joint efforts. But while the new service was still in the workshop, a new leader brought the online music industry out of its torpor.

The breakthrough came when Apple launched its iTunes Music Store in late April 2003. Apple offered more songs at lower prices and with far fewer restrictions on copying than its predecessors had done, and it sold more in its first week — 1 million tracks — than the entire industry had ever sold online, analysts estimate.

Sony launched Connect in May 2004, but it landed with a thud, as did the "iPod killer" devices that were introduced shortly thereafter.
Connect and the diminutive music players were handicapped by the same, all-too-familiar Sony tics: They supported only Sony's proprietary music format and anti-piracy software.

Goodman of Yankee Group said the most galling flaw in the music players was the lack of support for MP3 files, which he said was done at the request of Sony music executives. "That's an example of the internal backbiting and fighting ... that led to bad decisions," he said.

Sony has put out two new generations of players since then, adding support for MP3 and other formats. Yet Connect remains stuck in the Sony proprietary ghetto, wedded to Sony's unpopular DRM and clunky software.

Although clearly singed by the harsh reviews for Sony's digital music players, Steve Haber, senior vice president of Sony's personal, mobile and imaging division, tried to cast it as a valuable experience. "We heard the feedback, OK? We have to learn. You can wait forever, frankly, to get something absolutely perfect. But you can never get perfect unless you learn."

Sony Pictures was quicker to embrace the Internet, but its results have not been much better than Connect's.

Even before Napster burst onto the Net, Landau, then head of corporate development, had seen some of Sony's movies pop up on Internet Relay Chat channels — which allow users to copy files from other computers at high speeds — and other back alleys of the information superhighway. So in early 1999, he persuaded Mel Harris, then president of Sony Pictures Entertainment, to give him $1 million to build a prototype of a website offering downloadable movies.

The following summer, Sony put the site, called Moviefly, through a successful test with 300 users. But the public version of the service, dubbed Movielink, did not launch until the end of 2002. Meanwhile, video compression software greatly improved, the number of homes with high-speed Web connections multiplied, and online music and movie piracy proliferated.

The delay may have been the least of Movielink's problems. Fearful of spurring piracy and undermining DVD sales, the studios supplying Movielink have insisted on a host of restrictions that make it unappealing. For example, the service bars users from putting a downloaded film into a living room DVD player and watching it on TV.

Landau said he was still hoping that Movielink can fix its shortcomings, but Sony Pictures' priorities have shifted. The studio's energies are focused on PlayStation as an entertainment platform, both in the living room and as a mobile device.

As flawed as they may be, Connect and Movielink are still signs of an important change at Sony: the growing effect that the U.S.-based entertainment and marketing forces are having on the company. Under Stringer's lead, Sony Corp. of America asserted itself as the glue that could bind the entertainment and electronics segments.

Stringer says he sees no inherent conflict between the entertainment and hardware sides of Sony — no matter how many Vaio computers are shipped with high-speed DVD recorders.

"I don't think any of us sit here like King Canute and say, 'We can turn the tide back.' Technology is part of the tide, and therefore it's not a conflict here at the company. We know the tide is coming. What we can do is help all of us swim with it."