

Kodak: digital cameras assignment



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Case 13 Teaching Note Kodak at a Crossroad: The Transition from Film-Based to Digital Photography* Overview In 2003, Eastman Kodak Company faced one of the biggest challenges in its long history: What should the company do now that demand for its traditional film products was rapidly declining. Should the company turn its back on traditional photography (about 70% of company revenues) to embrace new digital photography technologies? Was this strategy too risky for the company given that the digital photography arena was highly competitive and that many competitors had a head start on developing a coherent digital strategy?

It was relatively clear to top management that demand for traditional photography products in the U. S. market would continue to decline, but should Kodak, a company whose name was synonymous with film and photographic papers, really exit a market so central to its identity? Since January 1, 2000, when Daniel Carp took over as chief executive of Kodak, the company's revenues and net income had declined, its shares had dropped by 66%, and Standard & Poor's had cut Kodak's credit rating by five grades. Kodak had reduced its workforce by 49% since 1989, cutting 7, 300 employees in 2002.

Plans were announced to eliminate up to 6, 000 jobs in 2003 to stem future losses, cutting Kodak's traditional photography divisions in Rochester, New York to fewer workers than the firm had employed during the Great Depression. The switch by consumers to digital photography was coming much faster than expected and Kodak's traditional film, papers and photofinishing businesses were declining. By the end of 2003, analysts

expected that digital cameras would begin to outsell film cameras for the first time in the United States.

The digital photography industry was fast-paced and more crowded, offering razor thin profit margins. Kodak was clearly at a crossroads. Stockholders and stock analysts were expressing concerns about Kodak's strategy, questioning whether Kodak was moving rapidly enough into the digital photography market. Management was experiencing pressure to articulate Kodak's digital photography strategy, but much sooner than they had anticipated. As the price for digital cameras and photo printers declined, consumers were embracing the new technologies much quicker than Kodak executives had expected.

Although international photography markets held out some promise for growth in traditional photography, Kodak knew it was only a matter of time before the whole world “ went digital. ” Despite investing over \$4 billion into digital research and related technologies since the early 1990s, Kodak was characterized as a firm struggling to find its footing in the world of digital photography. Analysts gave Kodak only two to three years to find its way or find itself fading into history.

Would Kodak be able to come up with new products and new insights that make sense out of digital? Could the company make the transition to digital fast enough? And how would it be able to differentiate itself from rivals?

Suggestions for Using the Case The Kodak case should prove popular with students because of their familiarity with Kodak film and photography supplies and their probable interest in digital cameras. In addition, the case

offers a nice tie into the accompanying GLO-BUS simulation supplement if you've adopted that option along with the textbook.

The case is suitable for the following purposes and learning objectives:

Drilling students in performing an industry analysis, including the identification of dominant industry characteristics, conducting a five-forces analysis, assessing the impact of driving forces, and identifying industry key success factors. Giving students an opportunity to understand how dramatic industry changes present potential strategic inflection points that require changes in vision and strategy. Giving students valuable practice in deciding how to best pursue growth opportunities outside the company's core business.

We suggest assigning the case after your lectures on Chapters 3 and 4, since the Kodak case calls on students to conduct an industry analysis and examine growth opportunities consistent with the company's competitive capabilities. There's sufficient information for students to analyze the photography equipment industry, assess Kodak's strategy in digital photography, conduct a SWOT analysis, analyze its financial performance, and wrestle with what strategic approach should be taken to improve the company's financial performance and competitive position in the digital photography segment.

Because of the number-crunching possibilities and the case's emphasis on action recommendations, the Kodak case is an excellent choice for oral team presentations or a written case assignment. Our suggested assignment questions are: 1. As a new market analyst with Kodak, you've been asked to

develop an assessment of Kodak's strategy and its ability to allow the company to achieve its goal of becoming a \$20 billion company by 2010. Your assignment involves conducting an analysis of the industry, evaluating Kodak's strategy in traditional and digital photography segments, and assessing its financial performance between 1993 and 2003.

Please prepare a 2-3 page report in executive summary format that recommends any necessary changes to Kodak's strategy to meet its 2010 revenue objectives. Each recommendation must be specific and supported by elements of your analysis. In addition, you should attach exhibits from your analysis (including industry analysis, SWOT, and financial analysis) to your report. 2. Please prepare a 5-6 page report that examines the photography industry and Kodak's strategy for competing in the digital segment of the industry.

Your report should contain an identification of the industry's dominant economic characteristics, a 5-Forces analysis, a list of driving forces and their potential impact on the industry, and a list of key success factors. You should also prepare a SWOT analysis for Kodak, evaluate its digital strategy, and assess its recent financial performance. Your report should also provide a strategic action plan to improve Kodak's performance and competitive position in the digital segment of the industry that is based upon and supported by your analysis. Assignment Questions 1. What are the standout features of the photography equipment industry?

How do economic characteristics differ between the film-based and digital segments? 2. What is competition like in the photography equipment

industry? What competitive forces seem to have the greatest effect on industry attractiveness? 3. How is the photography industry changing? What are the underlying drivers of change and how might those driving forces individually and collectively change competition in the industry? 4. What key factors determine the success in the digital segment of the industry? 5. What is Kodak's strategy to compete in the digital photography industry?

Has the strategy been effective? 6. What are Kodak's key resource strengths and weaknesses? What new market opportunities does the company have? What threats do you see to the company's future well being? 7. What is your evaluation of Kodak's financial performance? Should shareholders be pleased with the performance resulting from Kodak's strategy? 8. What recommendations would you make to Kodak's chief managers to become the leader the digital photography industry? What is the relative importance of camera sales, printer sales, digital photo processing, and printing supplies?

Teaching Outline and Analysis 1. What are the standout features of the photography equipment industry? How do economic characteristics differ between the filmbased and dig ital segments? Students should be able to list many economic characteristics of the photography industry that are presented in the case. Segmentation: The industry was segmented into film-based (or traditional) and digital categories. In 1996, 91 million U. S. households owned a film camera compared to 300, 000 house holds owning a digital camera. In 2003, it was projected that 74 million U. S. ouseholds would own a film camera and 33 million U. S. households would own a digital camera. Industry analysts expected digital photography to nearly replace sales of traditional film-based cameras by 2008. Market size and growth:

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Traditional camera sales declined from \$1.65 billion in 2000 to an estimated \$1.21 billion in 2002. Digital camera sales increased from \$2.1 billion in 2000 to \$2.96 billion in 2002. Film processing declined from \$6.93 billion in 2000 to \$6.68 billion in 2002. Sales of film declined from \$2.978 billion in 2000 to \$2.86 billion in 2002.

Consumer characteristics: Men were more likely to purchase digital cameras than women (58% vs. 42%), although women were more likely to spur the decision to purchase a digital camera. Also, 50% of digital camera purchasers were aged 35-50. Consumer needs: In 2002, consumers printed only 20% of all digital photos taken. Of the 2.1 billion images printed in 2003, 77% were printed with home printers, 6.4% were ordered from online photo services, 8.7% were made at a local retailer, and 3.6% were made using digital self-service kiosks. Other means were used to print 4.2% of digital photos in 2003.

Scope of rivalry: Industry rivalry was global with all major sellers competing in the same markets worldwide. Pace of technological change: Students should readily understand the importance of technology in digital camera design and printing solutions. Economies of scale: The razor-thin profit margins available in the digital camera and printer industries required economies of scale in purchasing, manufacturing, advertising, and other activities. 2. What is competition like in the photography equipment industry? What competitive forces seem to have the greatest effect on industry attractiveness?

Rivalry among competing sellers – a strong competitive force The rivalry of competing companies in the photography industry was very strong. The photography industry had been characterized by extensive alliances, mergers, and acquisitions, blurring previously distinct products, services, and competitors. Rapid market growth and the foundation of strategic partnerships had made a multitude of digital products available to consumers and businesses. Ease of use and accessibility of digital solutions intensified competitive rivalry. However, the photography industry also included traditional photography.

This segment was slightly declining, losing market share to digital photography, but still strong in 2003. Competition in this area was mainly between Kodak and Fuji. Eastman Kodak held the leading position in this segment of the market in leading geographical areas. General trends in the photography industry indicated that eventually traditional photography would be replaced by digital. As the market evolved, digital imaging solutions available to both businesses and consumers communities grew larger and more complex, thus intensifying the rivalry among industry companies.

Threat of new entrants – a moderate competitive force PC makers like HP had entered the digital photography industry but other PC and printer manufacturers presented a threat since these firms possessed the technology to produce digital cameras. Conversion costs for this transformation would be minimal. Also, these firms were already producing computers and printers, which were necessary for printing digital pictures. Better cost management along with better distribution and logistic networks

of these companies allowed them to design and produce cost efficient products, which were competing against Kodak's products.

Bargaining power of suppliers – a weak to moderate competitive force It is important to distinguish two types of suppliers in the photography industry. One category of suppliers was the contractors of raw materials for traditional photography. This sort of suppliers had significant power over companies like Kodak and Fuji. However, due to shift of demand towards digital technologies, the bargaining power of Kodak's suppliers was deteriorating. A second type of suppliers was providers for digital photography. Primarily, these suppliers included lens producers, memory producers, and the producers of circuit boards and processors.

Suppliers tended to be weak since they were typically more concerned with losing market share than with maximizing profits. Bargaining power of buyers – a strong competitive force Most buyers purchased in large volumes and had low switching costs from one camera to another, which gave buyers considerable leverage in their negotiations with sellers. However, consumer demand for the most advanced and best-priced cameras mandated that large retail buyers carry selected brands. Small independent buyers could be expected to have less leverage with global consumer electronics firms specializing in digital camera production and sales.

Threat of product substitutes – a moderate competitive force Cell phones represented a potential threat for digital and traditional cameras since sales of camera-phones were growing dramatically in most country markets. Consumers seemed intrigued by the ability to zap pictures from one handset

to another. 3. How is the photography industry changing? What are the underlying drivers of change and how might those driving forces individually and collectively change competition in the industry? Students should be able to easily identify the following industry driving forces.

Rapid decline in demand for traditional photography equipment in developed economies
Rapid growth in demand for digital cameras in developed economies
Steady decline in demand for film and photo processing
Development of new imaging technology such as photo-enabled wireless telephones and high-megapixel digital cameras
Convergence of technology (PDAs, wireless phones, digital cameras, web browsers)
Declining prices and profit margins in digital cameras
After listing the driving forces on the board, you will likely want to poll the class to determine if the driving forces, either individually or collectively, will increase industry attractiveness or make the industry less attractive over the next few years. The class will universally agree that the attractiveness of the traditional film and film processing segments of the industry will rapidly erode. In addition, students are likely to suggest that even though consumer demand for digital cameras will increase at a rapid rate, competitive rivalry will become increasingly strong as rivals jockey for worldwide market share leadership. 4. What key factors determine the success in the digital segment of the industry?

Students should be able to identify the following key success factors in the digital photography industry. Technological capabilities
Rapid design-to-market cycle times
Reputation for producing high-quality consumer electronics
Reputation for producing high-quality optical devices (cameras, binoculars, microscopes, medical equipment)
Distribution network that

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includes large electronics chains and local camera retailers Involvement in multiple segments of the industry value chain—camera production and sales, printing supplies, professional photo processing 5.

What is Kodak’s strategy to compete in the digital photography industry?

Has the strategy been effective? In 2003, Kodak’s digital photography business was limited to 1) entry-level digital camera production 2) an online photo service, and 3) kiosk-based printing and scanning services that allowed consumers to digitize and reproduce paper prints and make paper prints of digital images. The company had attempted a joint venture with Lexmark in 2000 to introduce a desktop photo printer, but the product failed to gain acceptance in the marketplace—primarily because of a poor camera-to-printer interface.

However, Kodak management expected a new generation product that utilized a printer docking station to generate as much as \$100 million in sales in 2003. Kodak had also experienced great difficulty in the digital minilab segment of the industry with an initial failure, followed by a new joint venture (with Noritsu Koki Co. of Japan) as the case comes to a close. Kodak’s Phogenix JV with HP to develop smaller digital photo printers for retail outlets was another digital printing failure.

The Phogenix digital photo printers were said to be obsolete before they were brought to market because of slow printing speeds. The Phogenix printer only printed about 250 prints per hour, whereas the Noritsu-Fuji minilab printed more than 1, 000 prints per hour. In 2003, Kodak planned to develop improved minilabs and kiosks and expand the number of kiosks to

50, 000 by 2004. Students will note Kodak's number-two ranking in the U. S. digital camera industry, but most likely will suggest its printing efforts have been very non-productive.

Little is mentioned in the case about Kodak's Ofoto online photo service, but students have little reason to believe the service will make Kodak a leader in digital photography. Also, students may comment that even though Kodak is the second largest seller of digital cameras in the U. S. , the case suggests camera sales are accompanied by very low margins—especially in the entry-level segment. Overall, students will find Kodak's digital strategy unimpressive. 6. What are Kodak's key resource strengths and weaknesses?

What new market opportunities does the company have? What threats do you see to the company's future well being? Students should be able to develop a SWOT analysis for Kodak similar to what is presented below.

Resource Strengths and Competitive Capabilities Strong management team Highly recognized brand in photography Good distribution network for both digital and traditional photography Kodak EasyShare cameras were second best-selling digital cameras in the U. S. during first half of 2003, trailing only Sony Strong balance sheet—\$1. billion cash balance at year-end 2003 Cash cow status of traditional photography supply business Resource Weaknesses and Competitive Liabilities Poor production technology Late entrant to digital photography Digital camera line primarily focused on entry-level segment of the industry Kodak's image and reputation in digital cameras does not match that of consumer electronics companies such as HP and Sony “ Behind the curve” in printers Poor track record in alliances to develop new photo and printing equipment (failure of printer co-developed by Lexmark,

abandonment of JV with Phogenix to develop smaller digital photo printers for retail outlets, poor track record with minilab partners) External Opportunities Digital imaging technology expected to grow by 26% annually until 2012. Stable demand from traditional photo equipment, film, and film processing in emerging markets.

Demand for ink jet printing solutions for the home was expected to grow from \$16 billion in 2002 to \$25 billion by 2009. Development of high-quality home printing solution Consumable printing supplies might prove to be more profitable than the sale of digital cameras and other hardware. External Threats to Kodak's Future Profitability Continuing decline in demand for traditional photo equipment, film, and film processing in developed markets. Printing options for digital cameras from Dell, Lexmark, and HP Improving capabilities of wireless camera phones 7. What is your evaluation of Kodak's financial performance between 1993 and 2003? Should shareholders be pleased with the performance resulting from Kodak's strategy?

Students will be able to see how the decline in demand for traditional photography and photo processing has impacted Kodak's sales and profits. Kodak's 1993 financial performance was dreadful in almost every regard. Since 1993, sales have generally declined although the company has a few year-to-year increases. The decline in gross profit has been more steady, with a decrease in almost every year. Other profitability measures have been highly volatile with an overall decline between 1993 and 2003 and a dramatic drop since 2000. Table 1 presents compound annual growth rates for items in Kodak's income statements between 1993 and 2003. Similarly,

the company's gross profit margins have declined almost every year between 1993 and 2003.

The company's other profitability ratios have generally declined since the mid-1990s, but have fallen substantially since 2000. Kodak's liquidity has become unattractive since the late-1990s. The company has added debt since 1999, but its leverage ratios seem acceptable with the exception of 1993. Table 2 provides selected financial ratios for Kodak between 1993 and 2003. Students are likely to criticize Kodak's performance since 2000 and suggest the company has acted too slowly in developing a digital strategy to insulate the company from falling demand for products in its core business. Students will have great difficulty suggesting the company's strategy has yielded acceptable financial performance. Table 1

Compound Annual Growth Rates for Items in Kodak's Income Statements, 1993 – 2003 CAGR 1993-2003 -2.0% -5.8% -5.1% -6.6% -13.7% -6.7% n.

a. Sales Gross Profit Operating Income Before Depreciation and Amortization Operating Profit Pretax Income Income Before Extraordinary Items Adjusted Net Income EPS Excluding Extraordinary Items & Discontinued Operations EPS Including Extraordinary Items & Discontinued Operations EPS Basic from Operations -5.4% n. a. -0.9% Calculated from case Exhibit 1. 8. What recommendations would you make to Kodak's chief managers to become the leader the digital photography industry? What is the relative importance of camera sales, printer sales, digital photo processing, and printing supplies?

Students are likely to recommend that Kodak continue its efforts to build market share in the sale of digital cameras since it helps build Kodak's image

as a digital photography company. However, Kodak cannot rely on the sale of digital cameras to boost its earnings since the case suggests producers of cameras were barely at break even point given the strong price competition in the industry. Students will probably argue a strong name in digital cameras will aid Kodak in selling printing solutions and consumables where profit margins are considerably higher. Also, students are likely to recommend that Kodak acquire companies with strong printer and photo processing capabilities since its efforts in these two critical industry segments have been highly unsuccessful.

These two segments have much higher profit margins than camera sales and better growth rates than that of traditional photography products. There may also be recommendations for Kodak to further develop printing technologies offered in kiosks and to expand the number of kiosks. Readily accessible and easy-to-use self-serve printing solutions for consumers would likely offer considerable growth opportunities as digital camera and camera-phone usage increases. Students may also suggest Kodak should improve services provided by its Ofoto online photography service. Strategic partnership with leading web portals and wireless telephone companies could enhance Kodak's ability to generate revenues from online file sharing or other similar services.

Recommendations concerning Kodak's traditional photography business will focus on maintaining its lead in professional photography and entertainment industry segments and pursue growth opportunities in the consumer segment in developing countries. Few students are likely to suggest Kodak should abandon plans to transition to digital technologies in developed

markets. Epilogue According to industry executives who participated in a panel discussion at the 2004 Consumer Electronics Show in Las Vegas, digital camera phones and digital cameras were set to become the hottest-selling digital imaging products in 2004. Camera phone sales could number 100 million units in 2004, according to Michael Polacek, vice president of imaging at National Semiconductor Corp.

Camera phones, which outsold digital cameras worldwide in 2004, will see higher sales in North America, where the phones haven't yet caught on as well as they have in Japan or Europe, Holch said. Digital cameras, on the other hand, will replace film cameras as they become easier to use, said Scott Nelson, director of product development at Casio Inc. Worldwide digital camera sales numbered 70 million in 2003, raking in revenue of \$10 billion, according to InfoTrends research. InfoTrends also predicted that by 2008, digital cameras would replace film cameras. Digital camera sales were expected to drive the sales of photo printers, said Kathy Dow, communications manager at Hewlett-Packard Co.

Panelists said users would both print at home and use professional photo printers. " It's like deciding between eating out or cooking at home," Furlott said. On November 12, 2003, Eastman Kodak Company announced agreements that would provide mobile imaging services to help people store, share, organize and print their digital images. Kodak had agreed to provide imaging services for Cingular Wireless and had also entered into agreements with wireless leader Nokia to help customers get more out of their camera phones. KODAK Mobile Service ([www. kmobile. com](http://www.kmobile.com)) offered camera phone

users anytime, anywhere access to all of their digital photos and phone-captured video.

Cingular subscribers with camera phones and multimedia messaging service (MMS) were able to store and access their mobile images at KODAK Mobile Service directly through their handsets for a monthly subscription fee of \$2.99, charged through their monthly service bill. Kodak was also expanding its relationship with Nokia, the leading handset maker, to create seamless links from select versions of the NOKIA 3600 Series camera phones to the KODAK Mobile Service. Kodak was expanding its global partnership with Nokia to the U. S. and together they were planning to engage in a number of co-marketing activities in 2004, beginning with the 2004 Nokia Sugar Bowl. Nokia and Kodak also were planning to jointly develop kiosk printing services and other retail printing solutions to empower mobile users to turn their favorite pictures into prints. Whether online or through kiosks at retail locations, Kodak’s mobile imaging services gave consumers places to print all their mobile images,” said Bernard Masson, president, Digital and Film Imaging Systems, and senior vice president, Eastman Kodak Company. Kodak also made acquisitions totaling \$3 billion between 2003 and late-2005 to improve its position in professional digital printing. In January 2005 the company agreed to buy Creo, Inc. , a Canadian producer of commercial printing products for \$980 million. In its consumer business, Kodak planned to introduce a portable image viewer for price-conscious customers wishing to view digital images. At year-end 2004, Kodak had become the leading seller of digital cameras in the U. S. —passing Sony as the leader in the U. S. digital camera market. The table below lists U. S. market shares for the leading

sellers of digital cameras during 2004. Seller Kodak Sony Cano16. 4% Olympus HP Fuji Niko6. 2% Others Total 2004 Market Share 21. 9% 19. 4% 10. 4% 8. 1% 8. 0% 9. 6% 100. 0% During 2004, Kodak's traditional photography equipment sales declined by 16%, while its sales of digital products increased by 40%. Kodak CEO Daniel Carp expected the company's revenues from digital cameras and other digital imaging products to exceed that of traditional photography equipment in 2005. Kodak's sales for 2005 increased to \$14. 268 billion, up 6% from \$13. 517 billion in 2004. But the company continued to struggle mightily to turn the corner to profitability, due to sharper than expected declines in the sales of traditional film-based cameras and camera film—in short, consumers were shifting purchases to digital cameras and digital photography products at a faster pace than Kodak had expected (the worst case scenario that Kodak had hoped to avoid). Kodak reported a net loss of \$1. 371 billion for 2005, compared to net earnings of \$556 million in 2004. The 2005 net loss included a \$1. 1 billion non-cash charge to record a valuation allowance against the net deferred tax assets in the U. S. The establishment of the valuation allowance was required due to the company's continuing losses in the U. S. resulting from the accelerated and extensive restructuring activity required by the decline in the traditional camera and film businesses.

Also contributing to the decrease in earnings relative to 2004 was a year-over-year increase in restructuring charges of \$245 million, a year-over-year decrease in earnings from discontinued operations of \$325 million (due primarily to the gain in 2004 from the sale of the company's Remote Sensing Systems unit), and a charge for a cumulative effect of an accounting change

of \$57 million in 2005. During 2006, Kodak expected digital revenue growth between 16% and 22%, with total revenue growth between negative 2% and a positive 4%. The company also expected to increase digital earnings to a range of \$350 million to \$450 million, with total earnings from operations, of a negative \$500 million to a negative \$850 million.

The anticipated loss from operations was largely driven by Kodak's ongoing restructuring program and its continuing struggle to overcome the erosion and damage done to its investments in film-based cameras and film-based technology. During 2005, Eastman Kodak's stock traded in the \$22-\$34 range, starting the year at around \$34 and ending the year at around \$25—it was trading at around \$28 per share in April 2006. The stock had traded in the \$80 range in the mid-1990s and had traded at around \$60 in early 2000 — so the recent stock price performance continued to be disappointing and reflected the company's ongoing struggle to produce good overall financial results.

And they was little to indicate that the company was making any real headway in becoming a \$20 billion company by 2010—an objective that Dan Carp had set for Kodak. The company's bright spot was that the digital photography part of its overall business was profitable and that its digital cameras were holding their own in the marketplace. You can get the company's latest financials and review strategy-related press releases at www.kodak.com. _____ *Much of this teaching note was developed by case researchers, Boris Morozov and Professor Rebecca J. Morris, both of the University of Nebraska at Omaha. We are most grateful for their insight, analysis and contributions to how the case can be taught successfully.

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