Management Lessons from a Kodak Career

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Economics texts would have you believe that corporations are efficient, profit maximizing organizations. I'm here to tell you that corporations are run by people and are at times neither efficient nor profit maximizing. The following are examples of situations I encountered in my career at Eastman Kodak which should serve as examples of decisions with unfortunate consequences.

1. Organizational Design Affects Operational Performance – or – Could Your Best Customer Could Be Your Worst Customer?

When the Eastman Kodak Company entered the office copier market it was primarily a rental market. The copier user paid a certain amount per copy which covered the cost of the equipment, consumables (film belt and toner for Kodak's Ektaprint copiers) and necessary service and repairs. The market leader (Xerox) maintained a fairly standard pricing policy which provided an "umbrella" for the new entry Kodak. During the first few years the Copy Products Division returned a fairly healthy profit to the corporate coffers. However the office copier market became more competitive and the rental market soon changed to one of equipment sale and maintenance agreement. Now rather than paying a flat fee per copy, the copier user purchased the copier and then, for most customers, agreed to pay an amount per copy for repair and maintenance (an Equipment Maintenance Agreement or EMA in Kodak's terminology). Before continuing with this tale, we need to understand a bit about Kodak's organizational structure as it applied to the copier division. Although equipment service is an integral part of the copier business, this was the responsibility of the Customer Equipment Services Division (CESD) and not of Copy Products. CESD serviced equipment across many business lines (amateur cameras and projectors, microfilmers, etc.) as well as copiers and transferred its cost to these organizations. CESD was not responsible for the pricing of these services, as that was the responsibility of the respective business lines. With the advent of the sale and maintenance business model for office copiers, the pricing of maintenance agreements became more competitive and was a major advantage or disadvantage for the sales representative when attempting to close a sale.

The pricing of equipment and EMA's was the responsibility of the sales and marketing organization in Copy Products. The compensation of the copier sales force was based on maintenance of the existing installed base and the placement of new copiers. Since a good portion of the sales reps' pay was determined by how many new copiers they could place in their territory, pressure was placed on the pricing organization to provide special rates for both the equipment purchase and the ongoing maintenance in order to close the deal. From the point of view of the sales organization, the more copiers placed with customers the better. As the market changed from rental to sales-and-service, the profitability of the copier organization began to decline. Since the manufacturing cost of the copiers was fairly well known and the profitability of the equipment sales could easily be analyzed, attention turned to the cost of service and a question was asked about service cost effectiveness. I was working as a business analyst for CESD when these questions arose and was asked to analyze copier service cost. There were numerous special rental and EMA rates created by the copy pricing organization in addition to the standard rates listed in the price catalog. Since CESD was only responsible for the cost of service and not for the income stream, I needed to find some revenue calculation which was not affected by the creative individuals in the copier pricing organization. I decided to use a standard EMA offering from the published price catalog and ignore the actual price that the customer was paying. This served to place all copiers on a "level playing field" from a service perspective.

In doing this analysis (standard EMA minus actual service cost) I determined that most of the installed copier base had calculated "standard" revenue that covered their service costs and that copier service could be considered as reasonably cost effective.

Based on this analysis, it didn't seem that the decline in overall Copy Products profitability was caused by excessive service cost, so attention turned to the revenue stream. I took my analysis of service costs and replaced the standard EMA that I had been using with the actual revenue from the customer's specific plan. I also added the equipment depreciation for rental plans and the equipment manufacturing cost for sales plans to get a complete picture for both rental and sales-and-service situations. So what I had was actual billed revenue for both equipment and service minus equipment and service costs. Note that my analysis did not include the cost of the sales and marketing organization, notably the sales reps' commissions, so it was only an approximation to individual copier profitability, not the complete picture.

The results of this analysis were striking. The most unprofitable copiers belonged to Kinkos, the customer with the largest installed base of Ektaprint copiers and thus Copy Product's "best customer". In analyzing why this was so, it seemed that the pricing organization used average service costs for each model of copier in calculating individual pricing plans. Since Kinkos was the best (largest) customer, they were given more favorable EMA rates than others due to this large volume. However, since Kinkos was in the business of selling copies to its customers, they were decidedly fussier about copier quality than the usual business office would be. Someone making a copy of an inter-office memo for his files would probably overlook a small smudge of toner at the bottom of the page. Since Kinkos' product was the copy, a toner smudge would occasion a service call. The result was that the cost of service on copiers at Kinkos was substantially higher than at almost all other locations and their pricing plans resulted in less revenue due to the generosity of the pricing organization in formulating the specific plans for Kinkos. Result: The "best" customer was actually the worst customer from a profitability perspective. Had I been able to include the cost of sales and marketing (which was not readily available at an equipment serial number or customer number level), the cost/revenue picture would obviously have looked even worse. Kodak soon tired of the continually deteriorating copier financial position and sold the copier business.

Lessons learned:

- Keep the sales and pricing functions organizationally separate
- Be cautious when applying average values to very specific situations
- Be careful when determining which customers deserves special pricing

2. Silos Are For Farms, Not Business

At Kodak the major business lines were almost separate companies. Each had a marketing organization and sales force and kept their own customer information. If you were, for example, running a photographic supply business, you could be dealing with a sales rep from Consumer Markets, another from Professional, yet a third (if you had an Ektaprint copier) from Copy Products and (if you used microfilm)a rep from Business Imaging Systems. None of these sales reps coordinated their sales calls with reps from other divisions so it would be theoretically possible that they would all descend on you on the same day. Each organization had a unique customer identification number for your business which you needed to use when placing orders. Since the customer numbers were not common across business units, it was difficult (if not impossible) to determine how much revenue, and thus profit, Kodak was generating from a customer who dealt across business lines.

Lesson learned: As customers see the various business units belonging to one company, the company should be able to see all of the customer's business, regardless of the organization responsible for the sales, as belonging to a single identifiable customer. There should be at least a unique customer identification that is shared across business units and some coordination among sales forces that sell to the same customer.

3. Outside Views Can Be Useful

Sometime in the 1980's Kodak management decided that the organization that manufactured most of the company's equipment, known then as the Kodak Apparatus Division (KAD), needed a new title. Since there were manufacturing plants in other countries, it was decided that the new title for the plants in this country would be the United States Equipment Division. With great fanfare the powers that were proudly announced this name change to the Company. It was immediately obvious to those of us reading the memo that the division would be abbreviated to its initials "USED" just as Kodak Apparatus Division was familiarly known as KAD.

Just great, now we would be working for the ***USED** Equipment Division*! The name change was quietly withdrawn by management. Lesson learned: It may be worthwhile to get the opinion of someone outside the group that came up with the idea as a sanity check. Also; sometimes the workers can be smarter than the bosses!

4. Small Changes Usually Don't Produce Big Results

Sometime in the early 90's Kodak started to experience the problems that eventually led to bankruptcy. Corporate management was not used to problems of this sort so they flailed around attempting to put Band-Aids on the situation. One of their bright ideas was to stop stocking the numerous office supply cabinets in place around the company in order to reduce costs. An announcement to this effect was made and the immediate result was a run on the supply cabinets and the hording of office supplies by the employees. Another cost saving effort was to cancel the contract for the company that serviced the decorative plants in place in the open office environments and offer these plants for sale to employees. So, did they save any money? Possibly, but it was peanuts compared to the shrinking sales and excessive administrative overhead that were the real problems. What these efforts really did was signal to the employees that management didn't have a clue how to approach the actual problems of the company and to reduce their confidence in the ability of management to steer the company through these rough waters. One wag circulated a phony management memo indicating that a reduction in the use of toilet tissue was necessary to save money. He stated in this 'memo' that in the future it would be necessary to "Swipe your pass to wipe your a**".

Lesson learned: When you are faced with big problems, you shouldn't just try small measures. They probably won't significantly address the problems and will reduce confidence in your ability to manage the organization during a difficult period.

5. Ride the Wave or Go Under

In the late 90's it was evident that digital photography was becoming more popular. Kodak had actually been a pioneer in digital cameras but, since there was no film and thus no film profit with these cameras, decided not to proceed with development of a digital product line. Instead they spent multiple millions of dollars establishing traditional film in China. The basis for this approach was that people in the less-developed world would be more likely to continue to use film for a number of years in the future then would those in more developed countries. Since I was not a member of Kodak top management, I don't know what they based this philosophy on but I expect it was more likely wishful thinking than it was market research. Regardless, their approach was wrong. Digital photography soon made traditional silver halide film obsolete in all parts of the world.

Lesson learned: If your primary product line is being impacted by new technology, you shouldn't keep pouring money into a soon-to-be-obsolete line of product. Instead, use the profits from that line (as long as it lasts) to transform your products.

6. Don't Be Greedy

For many years, Kodak produced sensitized film base for Polaroid which that company used to produce its "pictures in a minute" film. Kodak was making a reasonable profit on this but decided that it needed to be in the instant print business. The decision was made to stop producing film for Polaroid and start a Kodak instant print product line. Polaroid cried foul and sued Kodak for anti-trust violations. The court found for Polaroid and Kodak had to pay them $1 Billion to settle. In another instance, the Customer Equipment Services Division (CESD) was servicing most Ektaprint copiers (see example number one) under Equipment Maintenance Agreements (EMAs) and making fairly sizeable profits, at least in the early years. Seeing this, a number of independent equipment service organizations decided that they, too, could service these copiers at a price lower than Kodak was charging. However, in order to service equipment you need parts to replace those that have broken and Kodak was the only source for these parts. Thinking to maintain its effective monopoly in Ektaprint service, CESD refused to sell parts to the independents. The independents cried "Restraint of Trade!" and successfully sued Kodak.

Lesson learned: As the title says, don't be greedy. If trying to maintain or improve your existing profitability involves shutting out potential competitors, you may be involved in an expensive lawsuit which might cost you more than the possible profit you would lose to those competitors.

7. Beware of Unintended Consequences

During one of Kodak's many downsizing exercises in the 90's, the IT organization decided to eliminate its poorest performers as a way of decreasing headcount. To understand what they proposed and how it went wrong, you need to understand Kodak's wage structure.

For professional employees, there were four wage grades: 39, 41, 43 and 45. Within each grade performance was rated on a scale of one to seven, with one being the lowest and seven the highest. There was overlap between the grades with, as an example, someone performing as a six in wage grade 41 being equivalent in performance to an individual rated as a three in wage grade 43.IT management decreed that a certain number of employees in each wage grade needed to be separated from the company and that the criteria for separation would be their most recent performance evaluation score. This had the following unintended consequence: Individuals who had recently been promoted to the next highest wage grade would have lower performance ratings in their new grade than in their previous grade. Example: A wage grade 41 individual previously rated as a 6 in that grade (superior performance) and recently promoted to wage grade 43 would be rated as a 3 (standard performance) in the new grade. Since management had made no provision for this situation and made no effort to change their criteria for employee separation after learning of this problem, many recently promoted employees were terminated due to their relatively low performance ratings in their new grades. So in addition to removing many of the poorest performers in the organization they also eliminated some of the best!

Lesson learned: When you make a mistake, you should make an effort to correct it and not just continue with the flawed plan. Correcting the mistake in this situation would have kept a number of excellent employees in the organization.