Sony vs. Apple: Whatever Happened to Sony?

APPLE'S MARKET CAPITALIZATION in 2001 was $7 billion, while Sony's was $55 billion. In other words, Sony was almost eight times larger than Apple. Then most people would have picked Sony as the company to revolutionize the mobile device industry given its stellar innovation track record. Instead that honor goes to Apple, when it introduced the iPod, a portable digital music player, in October 2001, and the iTunes Music Store 18 months later. Through these two strategic moves Apple redefined the music industry, reinventing itself as not only a mobile-device but also a content-delivery company. Signaling its renaissance, Apple changed its name from Apple Computer, Inc., to simply Apple, Inc. Many observers wondered what happened to Sony, the company that created the portable music industry by introducing the Walkman in 1979.

Sony's strategy was to differentiate itself through the vertical integration of content and hardware, driven by its 1988 acquisition of CBS Records (later part of Sony Entertainment) and its 1989 acquisition of Columbia Pictures. This vertical integration strategy contrasted sharply with Sony Music division's desire to protect its lucrative revenue-generating, copyrighted compact discs (CDs). Sony Music's engineers were aggressively combating rampant music piracy by inhibiting the Microsoft Windows media player's ability to rip CDs and by serializing discs (assigning unique ID numbers to discs). The compact disc (CD) became the dominant format for selling music in 1991, replacing analog audiocassettes. The CD had been jointly developed by Sony and European electronics manufacturer Philips.

Media technology, however, soon moved to digital. With the rise of the Internet in the 1990s and use of digital music, illegal file sharing on the Internet was rampant. Napster, for example, allowed peer-to-peer sharing of files, which meant individual users could upload entire albums of music, to be downloaded by anyone, with no payments going to the artists or the record companies. Napster, meanwhile, was shut down in 2001 because of copyright infringements.

Sony's introduction of the Walkman in 1979, the first portable cassette player, revolutionized not only how music was consumed but also launched mobile devices as a new category-defining industry.
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While Sony focused on preventing media players that could rip CDs, Apple was developing a digital rights management (DRM) system to allow for legal downloads of digital music while protecting copyright at the same time. The iTunes Store enabled users to legally download and own individual songs at an attractive 99 cents. Apple's DRM and iTunes succeeded, protecting the music studios' and artists' interests while creating value that enabled consumers to enjoy portable digital music.

Sony had a long history of creating category-defining electronic devices of superior quality and design. It had all the right competencies to launch a successful counterattack to compete with Apple: electronics, software, music, and computer divisions. Sony even supplied the batteries for Apple's iPod. Cooperation among strategic business units had served Sony well in the past, leading to breakthrough innovations such as the Walkman, PlayStation, CD, and VAIO computer line. In digital music, however, the hardware and content divisions each seemed to have its own idea of what needed to be done. Cooperation among the Sony divisions was also hindered by the fact that their centers of operations were spread across the globe: Music operations were located in New York City and electronics design was in Japan, inhibiting face-to-face communications and making real-time interactions more difficult.

Nobuyuki Idei, then CEO of Sony, learned the hard way that the music division managers were focused on the immediate needs of their recordings competing against the consumer-driven market forces. Idei shared his frustrations with the cultural differences between the hardware and content divisions (in 2002):

> The opposite of soft alliances is hard alliances, which include mergers and acquisitions. Since purchasing the Music and Pictures businesses, more than 10 years have passed, and we have experienced many cultural differences between hardware manufacturing and content businesses. . . . This experience has taught us that in certain areas where hard alliances would have taken 10 years to succeed, soft alliances can be created more easily. Another advantage of soft alliances is the ability to form partnerships with many different companies. We aim to provide an open and easy-to-access environment where anybody can participate and we are willing to cooperate with companies that share our vision. Soft alliances offer many possibilities.[1]

In contrast, Apple organized a small, empowered, cross-functional team to produce the iPod in just a few months. Apple successfully outsourced and integrated many of its components and collaborated across business units. The phenomenal speed and success of the iPod and iTunes development and seamless integration became a structural approach that Apple applied to its successful development and launches of other category-defining products such as the iPhone and iPad.

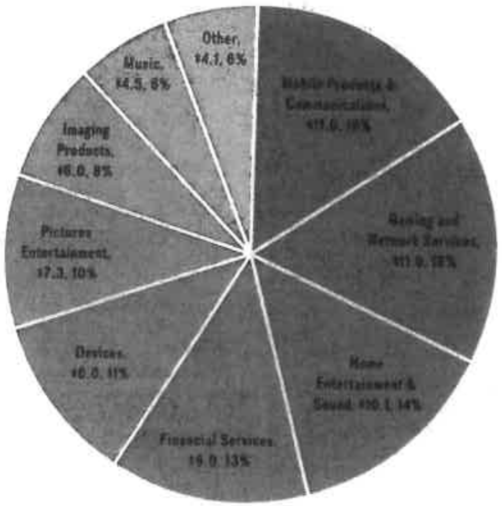
Having fallen way behind Apple and other competitors in the consumer electronics industry, Sony made drastic changes. From its founding in 1946, Sony's CEOs had all come from inside the company and had all been Japanese. In 2005, Sony appointed its first non-Japanese CEO, Welsh-born Sir Howard Stringer. During Stringer's tenure as head of Sony, however, the company endured a number of high-profile hacking instances that repeatedly brought down the network for the popular PlayStation game console and exposed users' private information.

The most damaging hack of Sony, however, came after Stringer had stepped down as CEO. In 2014, Sony was prepared to release a comedy film titled *The Interview*, starring James Franco and Seth Rogen. The plot of the film was about two men who use the premise of an interview to assassinate North Korean leader Kim Jong-un. According to the FBI, the North Korean government, as retaliation for the film, supported a group of hackers who breached Sony Pictures systems and stole a great deal of information, including personal information of employees and stars who worked on films, and intra-company e-mails. The content of the e-mails proved to be damaging to Sony and resulted in the resignation of several Sony Pictures executives for inappropriate statements made in internal e-mails.

To improve Sony's performance, the company is undergoing a major corporate restructuring. In 2014, Sony's revenues were $71 billion, with Sony's Mobile Products & Communications Division ($11.0 bn), Gaming and Network Services ($11.0 bn), Home Entertainment and Sound ($10.1 bn), Financial Services ($9.0 bn), Devices ($8 bn), Pictures Entertainment ($7.3 bn), Imaging Products ($6.0 bn), Music ($4.5 bn), and "Other" business activities ($4.1 bn) (see Exhibit MC25.1). In terms of profitability, however, Sony's core businesses are underperforming (see Exhibit MC25.2). Sony's most profitable division is its non-core business Financial Services ($1.61 bn), producing 95 percent of all of Sony's profits! In contrast, the Mobile Products & Communications Division, once Sony's claim to fame, lost almost $2 billion.

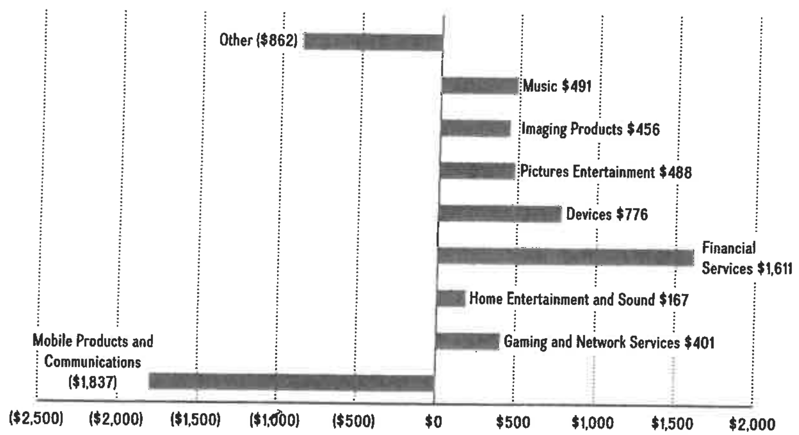
Frank T. Rothaermel prepared this MiniCase from public sources. He gratefully acknowledges research assistance by James Hoadley. A prior version of this MiniCase was prepared in collaboration with Robert Redrow (formerly of Sony Corp.). This MiniCase is developed for the purpose of class discussion. It is not intended to be used for any kind of endorsement, source of data, or depiction of efficient or inefficient management. All opinions expressed, all errors and omissions are entirely the author's. Revised and updated: August 26, 2015. © Frank T. Rothaermel.

EXHIBIT MC25.1 / Sony's Revenues by Segment, 2014 ($ billions)



Source: Depiction of data from Sony annual report.

EXHIBIT MC25.2 / Sony's Net Income by Segment, 2014 ($ millions)



Source: Depiction of data from Sony annual report.

Apple's market capitalization has grown from a paltry $7 billion in 2001 to some $750 billion in 2015. Apple has become the most valuable company ever. In contrast, Sony's market capitalization has dropped from $55 billion in 2001 to some $30 billion in 2015.

DISCUSSION QUESTIONS

1. Why had Sony been successful in the past (e.g., with the introduction of the Walkman, Play Station, the CD, and the VAIO computer line)?
2. What was Idei's assessment of strategic alliances vs. M&As? Do you agree or disagree? Support your assessment.
3. Why do you think Apple succeeded in the digital portable music industry, while Sony failed?
4. What could Sony have done differently to avoid failure in the digital portable music industry? What lessons need to be learned?
5. Activist investors argue that Sony is spread too thin over too many businesses, and that its corporate strategy needs a major refocus. These activist investors request that Sony should combine its music and movie businesses into one entertainment unit, and spin it off as a standalone company. Sony Pictures Entertainment has music artists such as Snoop Dogg, Kelly Clarkson, Justin Timberlake, and Pink under contract. The movie *Skyfall*, Sony's 2012 installment in the James Bond saga, topped the rankings and grossed over $1 billion since its release. This corporate restructuring would allow Sony to focus on its core business in electronics, while unlocking hidden value-creating potential in its entertainment unit, activists investors argue.
   a. What is Sony's organizational structure? Do you agree with the assessment that "Sony is spread too thin over too many businesses"? Why or why not? Explain.
   b. What would be the benefits of splitting Sony as proposed? What would be its drawbacks?
   c. Which recommendations do you have to restructure Sony? Explain.

Endnote

[1] Sony Annual Report 2002, year ended March 31, 2002, Sony Corporation, p. 9.

Sources: This MiniCase is based on: "Sony CEO remains committed to consumer electronics," *The Wall Street Journal*, January 7, 2015; "How Sony makes money off Apple's iPhone," *The Wall Street Journal*, April 28, 2015; "Sony's blunt finance chief takes spotlight," *The Wall Street Journal*, November 16, 2014; "White House deflects doubts on sources of Sony Hack," *The Wall Street Journal*, December 30, 2014; "Behind the scenes at Sony as hacking crisis unfolded," *The Wall Street Journal*, December 30, 2014; "Japan's electronics under siege," *The Wall Street Journal*, May 15, 2013; Hansen, M.T. (2009), *Collaboration: How Leaders Avoid the Traps, Create Unity, and Reap Big Results* (Cambridge, MA: Harvard Business School Press); Sony Corporation Info, www.sony.com; and various Sony annual reports.