SONY PICTURES ENTERTAINMENT

Whatever movies Sony ends up making, it will be hard-pressed to match its first production: the comic epic that was the [Columbia Pictures] acquisition itself. It could be called, 'Sony Goes to Hollywood,' the story of a respected electronics company, that, despite the Japanese style of deliberation and understatement, arrives in Hollywood with a loud thud."[1]

Sony: The Early Years and the Betamax

Masura Ibuka and Akio Morita founded Tokyo Tsushin Kogyo (Tokyo Telecommunications Engineering Company) in 1946, with a mission to be "a clever company that would make new high technology products in ingenious ways."[2] With the development of the transistor, the cassette tape, and the pocket-sized radio by 1957, the company renamed itself Sony, from the Latin word *sonus* meaning "sound." In 1967, Sony formed a joint venture with CBS Records to manufacture and sell records in Japan. Norio Ohga, an opera singer by training, was selected to head the CBS/Sony Group, quickly growing the joint venture into the largest record company in Japan.

When Sony was preparing to launch the Betamax home videocassette recorder in 1974, it invited representatives from rival consumer electronics companies to preview the new technology but did not accept any advice or offers for joint-development. Two years later, Sony was surprised to learn that Matsushita subsidiary JVC was preparing to introduce its own Video Home System (VHS) to compete with Betamax. While JVC licensed VHS to other electronics firms, Sony chose to keep its Betamax format to itself – and its prices even higher – insisting that Betamax was superior in quality. When the less expensive VHS started to take hold, motion picture studios began to release a larger number of their library titles on the format. The more expensive Betamax failed despite its technological to release a larger number of their library titles on the format. The more expensive Betamax failed despite its technological advantages. "We didn't put enough effort into making a family. The other side, coming later, made a family," Morita later said, referring to the fact that Matsushita had licensed its technology and created an electronics industry-wide effort to unseat Betamax.[3]

[1]Boyer, Peter J., "Hollywood Banzai," *Vanity Fair,* February 1990, p. 135.

[2]Griffin, Nancy and Kim Masters, Hit and Run: How Jon Peters and Peter Guber Took Sony for a Ride in Hollywood, New York: Simon & Schuster, 1996, p. 190.

[3]Griffin, Nancy and Kim Masters, Hit and Run: How Jon Peters and Peter Guber Took Sony for a Ride in Hollywood, New York: Simon & Schuster, 1996, p. 196.

This case was written by Andrew Brownell, (T'00) under the supervision of Professor Sydney Finkelstein.

The Betamax failure was an embarrassment that intensified Sony's competitive feelings toward rival Matsushita and became a watershed for what was to come.

CBS Records

> *"In the late 1970s we began to recognize the need to take Sony beyond hardware. Through our experience with Betamax, we discovered that the compelling motivation for the purchase of hardware is software."*[4]

In 1986, Larry Tisch purchased a controlling interest in the CBS Corporation, the parent company of CBS Records. Tisch made it known that, in his opinion, records and television had little to do with one another and was looking for a way to divest the recording division of CBS for the right price: $1.2 billion.[5] Walter Yetnikoff, the head of CBS International, had arranged the CBS-Sony joint venture years ago while working as a staff attorney. His rise up through CBS Records had paralleled Ohga's rise up the ranks of Sony, and the two had forged a friendship. After failing to put together a management offer to purchase CBS Records, Yetnikoff turned to Sony.

Convinced that its record library had helped guarantee the success of the Compact Disc, Sony believed that the purchase of CBS Records would provide the software necessary to ensure the success of its new Digital Audio Tape technology. Sensing Sony's commitment to purchase CBS Records, Tisch increased the asking price to $2 billion. Despite noise from critics, including Yetnikoff, that $2 billion was too much to pay, Sony agreed to purchase CBS Records in 1988. Yetnikoff remained in charge of CBS Records and, under Sony's hands-off management, grew the business to be “worth $1 billion more" than Sony had paid for it.[6]

Columbia Pictures

> *"We can’t guess where hardware innovations will lead, but we will be prepared with the software.”*[7]

Almost immediately after the CBS Records deal was finalized, Yetnikoff urged Sony to make a studio acquisition to complement its music business. The Japanese yen had increased in value versus the dollar by more than 50% in the second half of the 1980s, which made it an attractive time for Sony to take such a plunge. After some time, Sony settled on

---

[4]Quote attributed to Michael (“Mickey”) Schulhof in Perry, Nancy J., “Will Sony Make it in Hollywood?” *Fortune*, September 9, 1991, p. 162.

[5] Barnes, Peter W., “CBS is queried on possible sale of record unit,” The Wall Street Journal, November 12, 1986, p. 4.

[6] The Economist, “Who Ya Gonna Call (The Merger of Sony and Columbia),”September 30, 1989, p. 70.

[7] Gross, Neil, “Why Sony is Plugging into Columbia,” *Business Week*, October 16, 1989, p.56.

Columbia Pictures, which came with two production units, Columbia and Tri-Star, and a significant library that included classics like *Lawrence of Arabia* and contemporary titles like *Tootsie* and *Ghostbusters*. Also under the Columbia umbrella was a syndicated television operation that included hits like *Married...with Children* and *Wheel of Fortune* Importantly, Coca-Cola, which owned a 49% stake, seemed willing to sell. Columbia President and CEO Victor Kaufman, however, informed Sony that he would not stay on to run Columbia after the merger. Sony had its candidate for a studio, but did not want to proceed without what it viewed as a capable management team in place.

Guber-Peters Entertainment Company

Sony North America chief Mickey Schulhof, charged with recruiting a studio chief to run Columbia Pictures, settled on Peter Guber and Jon Peters, who ran the Guber-Peters Entertainment Company. It had just produced the mega-hit *Batman* for Warner Bros, and had credits for *Rainman* and *The Color Purple*. Guber was the part of the team that had "high- brow tastes and an uncanny knack for fast-paced deal-making."[8] He started his career at Columbia Pictures after graduating from NYU law school and developed a resume that included *The Way We Were*, *Taxi Driver, and The Deep* (which went on to become the second-highest box-office success of 1977 behind *Star Wars.* Peters was a high school dropout and former hairdresser who had made a name for himself co-producing *A Star is Born* with then-girlfriend Barbra Streisand. In the wake of his success, Peters started the Jon Peters Organization and went on to produce *The Eyes of Laura Mars* and *Caddyshack.*

In May 1980, Guber and Peters joined forces and secured credits on many successful projects including *Flashdance*, *The Witches of Eastwick*, and *The Color Purple*. Hollywood insiders, however, were critical of the team, especially of Peters' notorious temper.[9] Steven Spielberg reportedly would not let the two on the set of *The Color Purple*. Despite having his picture taken with the duo for the Oscar *Rain Man* won, ex-Columbia boss Frank Price claims, "they were never around while it was being made."[10] Nonetheless, there was no question that Guber and Peters had hands-on involvement in the highest grossing picture in Warner Bros. History, *Batman*.

SOLD!

> *"Columbia met our minimum criteria of an excellent library, and we felt their television and theater sides (consisting of 820 Loews screens) were all in very excellent shape. The one*

[8] Easton, Nina J. and Alan Citron, "So Happy Together…Then Sony Made Three," *The Los Angeles Times*, March 10, 1991, p. 8.

[9] "The stories of [Peters'] tempestuous explosions are available on every corner in Hollywood, stories of tantrums and bullying and even physical violence." Boyer, Peter J., "Hollywood Banzai," *Vanity Fair*, February 1990, p. 190.

[10] The Academy Award for *Rain Man* was given to producer Mark Johnson, who allowed Guber and Peters to borrow it for the photograph. Klein, Edward, "Lost Tycoon," *Vanity Fair*, May 1995, p. 68.

negative part of the company – which was box-office share – was something that could be changed with the addition of good people."[11]

The recent success of the Guber-Peters Entertainment Company (GPEC), along with Yetnikoff's persistence (he was the one who introduced Guber and Peters to Schulhof) and Guber's polished demeanor, was enough to convince Sony that it had found a suitable management team for their studio – even though Guber and Peters had just signed a five-year contract with Warner Bros. This meant that to get Guber and Peters, Sony would have to purchase their production company, which they did for $200 million, nearly 40% above its market value. Guber and Peters split $80 million from the sale of their stock and, as studio chiefs, would receive a salary of $2.7 million, a share of any increase in the studio's market value, and a $50 million bonus pool (to be parceled out at their discretion) at the end of five years.

Columbia Pictures was sold to Sony for $27 per share, or $3.4 billion. Sony assumed an additional $1.4 billion in debt, bringing the total cost to nearly $5 billion. Coca-Cola made out handsomely given that Columbia Pictures stock had not traded higher than $17 in 1989 and had dropped as low as $7 in the first quarter of that year. The total cost to Sony, however, continued to escalate. Although Guber had assured Sony otherwise, Warner Bros. chief Steve Ross refused to let Guber and Peters out of their contract and sued Sony for breach of contract. "Ross said he believed the pair had cut a deal behind his back,"[12] making him look especially bad in the wake of Warner's recently consummated merger with Time Inc. Warner put forward three demands, and with the threat of a protracted legal battle hanging over its head, Sony capitulated. Warner (1) got to reclaim the portion of its Burbank lot controlled by Columbia in exchange for the old MGM lot it owned, which was located in Culver City; (2) received a 50% equity stake in Sony's lucrative Columbia House mail-order music club; and (3) obtained the rights to distribute Columbia's library over its cable networks. The settlement terms were "deemed so disadvantageous to Sony that for weeks afterward they are the talk of the lunch crowd at Le Dome, where they are referred to as 'Pearl Harbor Revenged.'"[13] The total value of the settlement was estimated to be over $500 million.

The Guber-Peters Regime

Sony's total acquisition bill for Columbia Pictures reached nearly $6 billion when Guber and Peters took control.[14] Almost immediately, the two embarked on a lavish spending spree. The old MGM lot received in the Warner exchange went through an extensive renovation

---

[11]Quote attributed to Mickey Schulhof; Easton, Nina J., "Behind the Scenes of the Big Deal," *The Los Angeles Times*, December 31, 1989, p. 8.

[12]Easton, Nina J., "Behind The Scenes of the Big Deal," *The Los Angeles Times*, December 31, 1989, p. 8.

[13]Boyer, Peter J., "Hollywood Banzai," *Vanity Fair*, February 1990, p. 135.

[14] $3.4 billion cash plus $1.4 billion in debt for Columbia, $200 million for GPEC, and $500+ million settlement with Time Warner. The $6 billion figure is quoted by Mickey Schulhof in Klein, Edward, "Lost Tycoon," *Vanity Fair*, May 1995, p. 58.

costing around $1.25 billion. Offices were decorated with antique desks and chairs costing up to $26,000 each. In one instance, then Columbia Pictures head Frank Price turned down producer Steve Roth's request for a private bathroom.

Roth pleaded his case to Peters, who then approved a $250,000 decorating budget for "silk wall coverings and couches with leather piping."[15]

Over the next two years, spending on production, management, and television also ballooned. Overhead increased $100 million, or 50%, to $300 by 1991. Sony's overhead spending was $50 to $70 million greater than other major studios, and its $700 million production budget was nearly twice that of its competitors. The average Sony motion picture cost $40 million versus the industry average of $28 million. The excessive overhead and production costs pinched the company in 1991 as the motion picture industry saw year-over-year box-office sales slump 25% in the worst box-office take in 20 years. Executive management was also unstable. A succession of studio chiefs came and went, invariably with very generous severance packages. Even Yetnikoff (with $25 million) and Peters ($50 million and funding for a new production company) left. The executive turnover at Columbia caught the eye of the media and prompted Spy magazine to write, "the hottest sport in Hollywood is Sony Lotto – a get-rich-quick scheme in which the lucky player is fired by the studio in exchange for a fortune."[16] Even the television business experienced trouble, with expected profits from the syndication market never materializing:

> *" 'We had an extremely good selling season on (former Columbia chief) Victor [Kaufman]'s last go-round,' says one television executive who was at the studio then. 'That was a big factor in selling the company – not only the success that the company historically enjoyed, but that big burst right before [the sale]. We did eleven pilots and sold nine. Most of them didn't stay on the air. But the Japanese didn't understand the business…I just don't think they looked into how television works and who was going to run the company. They were hustled and they were willing to be hustled because they had a theory that you needed software to make hardware work.' "*[17]

Guber, however, argued that the $2 billion of Sony's money he spent had finally paid off: Sony was number one at the box-office in 1991.[18] In truth, Sony's ranking in the early 1990s

---

[15] These lavish expenditures are ironic in light of Morita's sentiments at the time Sony was founded: "We do not believe in posh and impressive private offices. Too often I have found in dealing with foreign companies that such superfluous things as the physical structure and office décor take up a lot more time and attention and money than they are worth." Griffin, Nancy and Kim Masters, Hit and Run: How Jon Peters and Peter Guber Took Sony for a Ride in Hollywood, New York: Simon & Schuster, 1996, p. 198.

[16] Griffin, Nancy and Kim Masters, Hit and Run: How Jon Peters and Peter Guber Took Sony for a Ride in Hollywood, New York: Simon & Schuster, 1996, p. 320.

[17] Griffin, Nancy and Kim Masters, Hit and Run: How Jon Peters and Peter Guber Took Sony for a Ride in Hollywood, New York: Simon & Schuster, 1996, p. 309.

[18] Technically, they were not. Guber grouped Columbia and Tri-Star together. If Disney or Warner grouped together all of their production units, they each would have had a higher box-office share than Sony.

was largely the result of distribution agreements with two small production companies, Castle Rock and Carolco (Carolco's *Terminator 2* alone was responsible for one-half of Sony's box-office take in 1991). However, even in Sony's best year, 1992, its $400 million operating income was entirely eroded by interest and goodwill charges. With the Japanese recession, a slump in hardware sales, and the yen rising against the dollar, Sony executives in Tokyo started to put pressure on the studio to improve its results.

Sony decided to pull out all the stops for its most anticipated film of 1993, Arnold Schwarzenegger's *The Last Action Hero*. The $90 million movie was to be the showpiece for every type of synergy that existed between the hardware and software sides of Sony: a Sony motion picture filmed using Sony HDTV equipment; Sony products prominently featured; a soundtrack released through Sony Music; and a premiere in Sony Theaters equipped with Sony's proprietary SDDS surround sound. After a test audience previewed the movie, word spread fast: one of the most expensive motion pictures ever made was a box-office bomb. A string of less publicized but expensive losers followed, paralyzing the studio. By autumn 1994, Guber had gone nearly six months without approving a script for production. All together, 17 of the 26 movies Sony released in 1994 lost money, bringing the loss on filmmaking for 1994 to $150 million.

That was enough for Sony. On September 29, 1994, trade magazine *Variety* proclaimed, "Guber Resigns as Sony's CEO." He was sent packing with a $275 million production package that included an annual salary estimated between $5 and $10 million. Sony Picture's market share, after climbing significantly in 1991-92, had returned to where it was in 1989, but the financial damage was yet to be revealed. The Guber-Peters era finally ended in November 1994, as Sony announced a $3.2 billion write-off related to Columbia Pictures that wiped out nearly 25% of Sony's shareholders' equity. Not long after, Ohga and Schulhof would be ousted as Sony set out to rebuild its motion picture operations.