SONY

Lost in Transformation

Sir Howard Stringer has been pushing for years to revive the Japanese conglomerate. Will a youthful (by Sony standards) new team help him realize his digital dream?

BY RICHARD SIKLOS

THESE DAYS HOWARD STRINGER makes his home in a hotel suite in an affluent Tokyo neighborhood not far from Sony headquarters. It's a comfortable but far from palatial space consisting of a bedroom, bathroom, and decent-size living-dining area with a small desk that he has outfitted with a PC and fax machine. Among the few personal touches are photos of his family—his wife, Jennifer, and two children live in the country outside London—some books he is reading, and an intricate Spider-Man sculpture made of chocolate that the staff of the hotel gave him on his 67th birthday in February. The confection, inspired by Sony's hit movie franchise and which Stringer is quite touched by, sits in a plastic case on the coffee table by the sofa. While he could not bring himself to eat it—and it's starting to get a bit discolored at this point—he can't bring himself to throw it out either. With hotel occupancy down amid the deepest Japanese recession since World War II, Stringer is a coveted guest. "This room keeps getting cheaper and cheaper," he says. "They give an incredible price."

Stringer chose hotel living over buying or renting a home in Tokyo because he likes having the bustle of people around him. Besides, he never really planned to be here quite so much: When he became Sony's chairman and CEO in 2005, the plan was for New York, his home for four decades, to remain his primary residence,

and for him to jet to England (where he is Sir Howard) on weekends. He expected to spend only half his time in Tokyo, where he is Stringer *Kaicho* (chairman).

Sony's woes, especially since the global economic crisis rattled Japan, have led to his staying here 11 of the year's first 14 weeks—a situation compounded by his hospitalization over the Christmas holidays with an intestinal malady. "I feel like I'm on the fringes of my old life," he says. "If I had this to all do over again, I don't know sometimes."

But he's here because, he says, he finally has his arms wrapped around the Japanese leviathan, and he thinks he has a clear shot—perhaps his final one—at remaking Sony by transforming its culture, elevating new leadership, and finding new ways to exploit its technology and content. Says William Drewry, a longtime Sony follower who now heads media investments for Diamond Castle, a private equity firm: "This probably is going to be his last chance to run this company back to the top of the mountain."

It's a daunting task. Sony's stumbles in sectors it once dominated (Apple is No. 1 by a large margin in portable music players, and Microsoft and Nintendo have taken swaths of share in gaming consoles) are old news by now, but upstart competitors continue to gnaw away at the Japanese giant. In just two years a startup called Pure Digital (now owned by Cisco) has grabbed some 17% of the video recorder market with its easy-to-use, pocket-size Flip. Sony debuted an e-reader in 2006, but bookseller Amazon swooped in two years later with its Kindle and has won consumers and acclaim largely because it boasted a feature the Sony Reader lacked: a wireless connection for downloading books, newspapers, and magazines.

The culprit in nearly every case has been Sony's tradition-bound mentality, one that remained too focused on building excellent analog machines in an increasingly digital world. And though Stringer has been pushing for transformation since his first days in the top job, by his own admission he has been hamstrung by the management culture in Sony's home market and the repercussions of bad decisions made years ago that still haunt the company.

IT TOOK THE GLOBAL financial meltdown for the notably cheery Sir Howard to finally decide there would be no more—or at least a little less—Mr. Nice Guy. In its last fiscal year Sony swung from a record profit to a loss of $1 billion on revenue of $79 billion, while cash flow in its main businesses whipsawed from $5 billion to minus $3 billion. Some of the blame for Sony's annual loss, its first in a decade, can be attributed to the economy and the rising Japanese yen. But huge Sony businesses like TVs—where new Bravia models have sold well against those of rivals like Samsung—have also bled red ink because of high manufacturing costs and commoditizing retail prices. (One of the bad decisions was to bet against the LCD display format for flat panels—whoops!)

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At an internal management meeting last October, Stringer made a veiled reference to the *Titanic* to illustrate that tougher, more Western-style reforms were coming to Sony. "If the captain hits rough seas, he looks after his crew," Stringer recalls saying. "When you hit the iceberg, you worry about the ship." In February he went to the Sony board and took action, reassigning Sony president Ryoji Chubachi, 61, who had retained authority over consumer electronics, as well as that group's top executive. Stringer, who last year renewed a three-year contract, took the president's title for himself.

At the same time, he reconfigured the company into two new core groups and elevated four English-speaking Japanese executives in their late forties and fifties—relative greenhorns by Japanese standards—to run them. Corporate troubleshooter and former TV division head Hiroshi Yoshioka, the eldest of the group at 56, now oversees a $50 billion

consumer products group that includes TVs, stereos, DVD and Blu-ray players, and camcorders.

Kazuo "Kaz" Hirai, 48, a marketing whiz who had been running Sony's games business, now oversees a much broader networked-products and services group that is home to PlayStations, Vaio computers, and Sony's Walkman audio line. It also is tasked with the critical job of creating a new set of digital services that will tie all of Sony's gadgets and gizmos together. Kunai Suzuki, 48, is Hirai's deputy and will run the Vaio business but will also have responsibility for incubating a next generation of devices for this networked world. Rounding out the four is Yoshihisa "Bob" Ishida, 49, a well-regarded strategist with an outspoken style whose assignment is to revitalize the TV-display business.

Stringer, in a typically impromptu moment at a press conference in February announcing the changes, dubbed the core of his new team the "four musketeers." Beyond the four, Stringer created centralized corporate functions like manufacturing and procurement, and hired an IBM executive, George Bailey, as the company's first "chief transformation officer." And other big but less central businesses, like Sony's film, music, and financial arms, still report to Stringer.

STRINGER PLANNED TO SPEND MUCH OF HIS TIME IN NEW YORK AND JET TO ENGLAND ON WEEKENDS. THIS YEAR HE SPENT 11 OF THE FIRST 14 WEEKS IN TOKYO. "I FEEL LIKE I'M ON THE FRINGES OF MY OLD LIFE," HE SAYS.

All this organizational jujitsu must now yield tangible results: sustained profitability, a more cohesive corporate culture, and the nimbleness to fend off all its new-style rivals. (A single iconic new hit gizmo won't revive Sony, but it wouldn't hurt either.) After the plan was announced, the *Nikkei Weekly* tartly wrote that the moves "smack of desperation." But investors are, for the moment, onboard. While the stock remains well off its mid-2OO7 highs, Sony is up 25% over the past six months, outperforming both the Nikkei and the S&P 500 indexes. "The challenge of changing the culture of an iconic Japanese company is even more difficult than dealing with the current challenges of the consumer electronics industry," says Jonathan Nelson, the head of private equity firm Providence Equity and a Stringer confidante. "He's doing as well as anyone can under the circumstances."

STRINGER'S FOUR LIEUTENANTS last month joined *Fortune* at a sushi restaurant atop a skyscraper near the Tokyo Tower. At first all were reserved, but they loosened up when Stringer joined the table a few minutes later, taking off their ties when he did. The mood lightened even further when Stringer traded in a cranberry juice for a sake. The group swapped tales of isolation in the field—Yoshioka did a lonely stint in Sweden, and Suzuki in the Middle East—and made sport of some Sony executives who resist traveling because they don't want to leave their dogs.

The previous day the four had joined Stringer in presiding over Sony's annual internal management conference, and had driven home the idea of how much is riding on Stringer's latest attempt to reboot the

company. Sony had already announced a fresh round of cuts aimed at slicing some $3 billion in expenses, including closing several plants and laying off 16,000 of Sony's 185,000 workers in the process. At a separate meeting with Sony's top suppliers that same day, Stringer warned that the company had been "too generous"; Sony would now slash the roster of suppliers from 2,500 to 1,200, based on who would give it the best deals.

Amid all the recent changes, the Welsh-born Stringer, who began his career as an accomplished TV-documentary producer, has also emphasized that Sony can't simply cut its way to success. When he ran CBS in the 1990s, Stringer took heat for initiating unheard-of layoffs at the "Tiffany network"—which seems quaint today. But he also emphasized that CBS needed to "produce its way" out of its trouble with better programming—which in those days included launching a weekday morning show and hiring David Letterman away from NBC. In fact, he says, it is "slightly scary" to him that Sony's recent trajectory and cultural issues mirror those of the Big Three networks in those days. Stringer was promoted from running CBS News to managing the entire network after warning of the havoc that the rise of cable and the resulting fragmentation of audiences would have on broadcasting. "As a historian at Oxford and a much-traveled journalist, I'm always afraid of what's going to come next," says Stringer. "If you don't see the patterns of history evolving, you get passed over."

Just as CBS, ABC, and NBC had to contend with upstart cable channels, Sony is struggling against leaner, more focused competitors pursuing new and narrower business models. Sony introduced its gold-plated PlayStation 3 in 2006 with all kinds of futuristic capabilities, including a built-in Blu-ray player, but it was expensive to make and fell short of expectations. Nintendo swooped in with its innovative Wii system and grabbed a big share of the games market—and a nice chunk of investors' mind share. With one-fifth the revenue of Sony, Nintendo now boasts a market cap of $38 billion, more than 40% larger than Sony's $27 billion valuation. (Another head-slapping miss: How was it that mega-hit music games *Guitar Hero* and *Rock Band* were developed elsewhere, while Sony owns one of the world's largest music companies?)

The Sony Reader is the most jarring recent example of the way Sony's internal structures and culture have led to missed opportunities. The device had first been developed in isolation by a group of engineers in the home-audio division; that group's urgent focus was to try to revitalize the Walkman brand in the face of the iPod onslaught. Stringer, who collects rare books, was a strong proponent of the Reader, but earlier versions of the product fizzled in the Japanese market. Limited enthusiasm in Japan curtailed the project, even though more than three-quarters of Sony's sales are outside the country. Stringer blames himself for not pushing harder for the Reader—which also lacked Kindle's deep publisher relationships—and vows to catch up with a new wireless model. "It rankled me," he says of the episode, "because it made me aware of the limitations of my power."

The good news for Stringer is that there's no shortage of innovation at Sony—the company still spends $5 billion a year on R&D, and it has everything from cool new panoramic-image cameras to organic liquid-crystal-display televisions that could be a huge hit if the company can figure out a way to manufacture larger, cheaper models than the 11-inch version it sells for more than $2,000. There is a new line of "eco-Bravia" TVs that turn themselves off when sensors detect that no one is in the room. Sony also is starting to acknowledge that many consumers are happy to take inferior but convenient photos and videos on their cellphones or Flip cameras, by introducing wares like its new line of Webbie cameras. And the Sony brand is extending into professional markets. High-end digital projection systems are starting to sell as cinemas migrate to 3-D, and there are early plans to leverage its expertise into new markets like manufacturing car batteries and medical-imaging devices.

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IT'S ALL VERY PROMISING, but what does it add up to? The real test of Stringer's game plan is a product that doesn't even exist yet, isn't a machine, and has no code name. It is a kind of omnibus web-based software platform that will use the power of the Internet to connect the company's rich library of content and devices, creating a multimedia experience for customers that actually rewards them for buying multiple Sony products and services.

The broad strokes sound a bit like an updated wrinkle on the concept behind the disastrous merger of AOL and Time Warner, but Sony believes it has two advantages that its rivals lacked: it already has a big presence in people's living rooms, and has a template for new Net-based businesses in the form of PlayStation Network, the online service that runs with the game system. The network has 23 million users, and in the U.S. it has been selling TV shows and films as well as music and games. An online service called Life With PlayStation, introduced last year, gives news feeds, weather, and camera feeds from around the world. Another recent product, PlayStation Home,

is a virtual world designed to create communities among gamers. The team of engineers that designed PlayStation Network, like dozens of others around the company, now reports to Tim Schaaff, an Apple veteran who Stringer hired as Sony's first head of software development.

Schaaff's group and others are a central part of Hirai's new division, whose goal is to make sure Sony produces software that's every bit as good as its hardware. (Stringer constantly admonishes executives that Sony will lose its primacy in devices and electronics if it can't compete on applications.)

"WE CAN NO LONGER AFFORD TO ONLY OFFER GREAT TVS," SAYS ONE SONY STRATEGIST. "OTHERWISE, WE SET THE STAGE FOR SOMEONE TO BE THE GOOGLE OF THE TV." (INCLUDING, PRESUMABLY, GOOGLE.)

Michael Lynton, the chairman of Sony Pictures Entertainment, caused a stir recently when he told a panel discussion that "I'm a guy who doesn't see anything good having come from the Internet." But Lynton was only expressing publicly what many media executives have been feeling—and underscoring Sony's lofty goal of creating services competitive with the best of the web and viable alternatives to illegal downloading. In an experiment last year, Sony sold downloads of its movie Hancock, starring Will Smith, to people with Bravia TVs equipped with a new Internet-to-TV gizmo the company sells, several weeks before the movie was available on DVD. In electronics and media, of course, everyone—from Apple to Netflix to startups like Boxee—is looking at ways to easily link web-based video content to TV as the next big thing. But given that it sells 15 million TVs a year, Sony has much to gain—or lose. "TV is where we have to win," says Robert Wiesenthal, the head of strategy for Sony's entertainment businesses and a close adviser of Stringer's. "We can no longer afford to only offer great TVs. Otherwise, we set the stage for someone to become the Google of the TV." (Including, presumably, Google.)

While Sony executives are short on the specifics, Hirai says the new service will overlay the backbone of the PlayStation Network but will be broader and more open. The service would make easier such things as putting images from a camera on TV, displaying and editing video, sharing with friends, and storage. Brand loyalists would be rewarded with incentives like discounts and premium services.

Stringer has intimated that the company is in a position to make acquisitions that will accelerate the effort, and Hirai says the first glimpse of the new service should be seen by next spring. "It's now a matter of what all the services need to look like for each device, and coming up with a rollout plan," says Hirai. "It's like city planning here, and we can start small. We don't need to build New York City overnight."

Speaking of New York, back in Stringer's hotel room, just as he was lamenting his interrupted life, a note from an assistant in Manhattan whirred across the fax machine. It reminded Stringer that he is gone but not forgotten: Peter Chernin, the outgoing president of News Corp., had called. And David Geffen, the billionaire former media mogul, was inviting him to lunch at his home in Malibu. Stringer was coming to Los Angeles in a couple of weeks to host a gala tribute dinner for the actor Michael Douglas on the Sony Pictures lot.

Maybe this was just the kind of break Stringer needed—a chance to kick back with his Hollywood friends and recharge. But that was not how Stringer was viewing it. There would be tightly scheduled side trips to Sony's gaming and software operations up in Silicon Valley, and down to Sony Electronics' U.S. headquarters in San Diego. And the musketeers would be coming with him for all of it. a

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