

What went wrong at Atari?

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Contributors

There has always been a certain innocence about Silicon Valley. Yes, high tech is deeply involved in the arms race; there are chemicals in the underground water supply that were never there before; and you have to go back to the '69 Chicago Cubs to find a

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collapse that rivals Osborne Computer's. But for all that, there is a "We're different, we're fresh, this is not business as usual" attitude here.

Think of Corporate America and if a face pops into your mind at all, it's someone like ITT's old Mr. Mean, Harold Geneen. Think of the valley and a very different kind of person comes to mind: Sandy Kurtzig, who started Ask Computer Systems in her apartment; the two Steves, Jobs and Wozniak, who started Apple Computer in a garage; Robert Noyce, inventor of the integrated circuit, vice-chairman of Intel Corp., high-tech's unofficial philosopher. For most Americans, no company represented the essence of Silicon Valley better than Atari. That is because the valley's most important product is not microprocessors or computers, robots or video games. It is the entrepreneurial spirit. Atari is not just another successful company. Atari created an industry where none had existed before.

Back in '72 when Atari was called Syzygy, Nolan Bushnell took a computer designed to do dull things like process bills

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Ray Kassir, the man responsible for Atari's rise and fall

for PG&E and made it play games. Bushnell's first game, *Computer Space*, was a turkey that sold only 2,000 units. People in the coin-operated game business said "I told you so" and went back to figuring out new ways to put girls in bikinis on pinball machines. Bushnell went back to the lab and came out with *Pong*— and the rest is history.

Pong was followed by *Tank* and a string of hit coin-op games. In '77 Atari introduced the VCS (Video Computer System) 2600, the amazing little game machine that plugs into your TV. More than anything else, the VCS was responsible for the success of home video games.

Atari grew faster than a baby whale, and in '76, the year Bushnell sold the company to Warner Communications Inc., Atari had \$39 million in sales. By '82, Atari's sales were more than \$2 billion. Not even the Defense Department grew that fast. People surveyed an American business landscape littered with the wreckage of old industries like steel and autos, thought about Atari and felt better. That is why smart young congressmen who sought to make the restoration of American business their issue were tagged "Atari Democrats." That is why Ray Kassir, who took over from Bushnell and presided over the growth, looked like a

high-tech version of Alfred Sloan, the man who built General Motors.

And then came Dec. 8, 1982, the day that Atari — and Silicon Valley — lost its innocence. With no advance warning, Warner announced that sales of Atari's home video games had taken a sharp dive, contributing mightily to a projected 50 percent drop in Warner's earnings. Wall Street panicked; Warner's stock fell from \$54 a share to below \$30 in seven days, and now it hovers around \$23.

In February, Atari announced that it was closing its domestic manufacturing plants and laying off 1,700 workers. In the first quarter of '83, the company lost \$45.6 million. In the second quarter, it posted a whopping \$310.5 million loss. Insiders expect a third quarter loss of \$80 to \$100 million.

"It's inconceivable that you could lose \$300 million in one quarter," says Gene Lipkin, an Atari founder who is now president of ByVideo. "You can't blow it all in 90 days. Those losses are the cumulative effect of a number of years."

They are indeed. What happened? How did the company that was "the only game in town" start losing the game? How did Ray Kassar, in the words of one high-tech analyst, "blow the most attractive consumer franchise ever created"? For the answer, you have to go back to the beginning.

Gene Lipkin is one of Atari's four founding stockholders (the others are Nolan Bushnell, Joe Keenan, and Al Alcorn). Walking into the Lexington House restaurant in Los Gatos, feeling rocky after a big party, Lipkin looks so scruffy in his washed-out jeans and perpetual three-day beard, you forget he has a reputation as an excellent administrator with one of the finest marketing minds in Silicon Valley.

Lipkin dropped out of Ball State in Indiana to work in the coin-op business in South Florida, and when he first saw *Computer Space*, he knew he was looking at the future. "The distributors didn't realize they were looking at the greatest novelty of all-time, even though they were in a novelty-driven business," Lipkin says. "Instead, they came up with reasons why it would fail — 'They'll break in and steal the TV screen, the X-rays will hurt their eyes.'" Lipkin got in touch with Bushnell and came west to join the fledgling company. In '75, he signed the retailing agreement with Sears that put Atari on the map in the consumer business.

"A large part of our success was because we never took ourselves too seriously," Lipkin says. "Nolan's position was to fund engineering and game design. Our coin-op games utilized a lot of the early technology that was developed in the valley — processors, memory devices.

That attracted a lot of talent, because engineers always want to work with the newest stuff. I'd say the formula was 75 percent luck, 20 percent sheer balls and 5 percent skill. We made a conscious decision to go for the whole banana. We had a lot of opportunities to stay small, but that wouldn't have been a lot of fun."

Nolan Bushnell is as big as an NBA guard, 6-foot-4, and his mind is quicker than the fastest guard's hands. He knows how to read a bottom line as well as any MBA — you don't accumulate a net worth of more than \$70 million by being an absent-minded genius. The rap on him — "brilliant ideas, poor execution" — comes from the fact that he is more interested in "neat" products than in managing a company. (Engineers use "neat" the way valley girls use "bitchen.") The key to his success, to his entire personality, is his

New York Cosmos soccer team, 48 percent of the Pittsburgh Pirates and more. The company is no sterile conglomerate — Warner is Steve Ross's creation, and he controls it by the sheer force of his personality. The rich and powerful are often described as "magnetic" or "fascinating" because they are rich and powerful; Ross would be captivating if he were broke. One ex-Atari executive describes him as "the only man I'd fly across country just to have dinner with."

Ross gives the people who run his subsidiaries total autonomy. He has little or no interest in overseeing daily operations. Though he operates out of New York, he is really the ultimate Hollywood deal maker, bringing creative people together in very creative ways.

He gets excited about deals where there is a chance to turn a 40 or 50

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curiosity. Bushnell is an extremely busy man today, involved in a dozen companies ranging from personal robots ("slaves without guilt") to Pizza Time Theatre, but when he heard about an invitation-only haunted house up in Marin that was really scary, he dropped everything and drove up the next day.

"The exciting thing about Atari was taking a clean chalkboard and getting down on the floor with a group of guys you respected," Bushnell says, taking a pipe out of his mouth to smile. "You'd start with nothing and six hours later, you'd walk out knowing you'd created a product that was really going to be neat."

Between '73 and '76, engineers created the products that were the foundation of the company's amazing growth — the VCS, cartridge games, the 400 computer. The company had a great future, but there was one very significant problem: Atari was not making enough profit to fund its growth.

Enter Emanuel "Manny" Gerard, co-president of Warner Communications Inc. Gerard knew Atari's future was bright as a June morning in Sunnyvale. In '76 he talked his boss, Warner Chairman Steven J. Ross, into buying Atari for \$27 million.

WCI consists of Warner Bros., Seven Arts movies, Warner Amex Cable, Atlantic, Elektra and Asylum records, the Franklin Mint, Malibu Grand Prix, the

percent profit — the kind of bonanza a hit movie brings. Businesses that turn a 10 to 15 percent profit year after year bore him. It costs \$4.50 to \$6 to produce a game cartridge for the VCS; advertising adds \$1 to \$2 more per cartridge. The average wholesale selling price in '82 — and this includes reduced or "distressed" merchandise — was \$18.95.

Furthermore, industry wisdom has always had it that Atari never made money on the video computer system — it was supposed to be the razor that's all but given away so people will buy razor blades. In fact, it costs about \$40 to manufacture a VCS. The average selling price last year was \$125. And that is why Steve Ross bought Atari.

Warner left Atari's management in place, but sent Manny Gerard west to oversee the company. Gerard, an engaging former securities analyst, was amazed at how informally the company was structured. "When we took over," Gerard has said, "it was amateur night in Dixie."

"By New York standards, it was amateur night," Bushnell agrees. "We didn't have the money to put in management structures and data processing. We sold because we couldn't fund the growth we were looking at. A growing company requires more money than an established company. And after five years, I was tired. We all were."

To give the company a corporate structure, Gerard hired Ray Kassar, then 50, a marketing executive who had spent his career at Burlington Industries, the huge textile company. Gerard and Kassar share the same passport to power, a Harvard MBA. Kassar came to Burlington in '48, and left in '74 when he finished second in the race for the top job. He then started a company that made long-staple cotton shirts in Egypt. Long-staple cotton shirts feel like silk; he marketed them under the "Kassar" label.

Bushnell remained chairman, but he was spending a great deal of time away from the company, pursuing the dreams that money can buy. So much time, Gerard fired him.

"Manny told me he was going to make Kassar chairman and said, 'Why not take the vice-chairmanship?' " Bushnell recalls.

Kassar ran Atari like an emperor.

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"I thought vice-chairman was a horseshit title. I didn't want it. I want to be in the thick of things. I was getting more and more involved in Pizza Time, which they saw as a separate business. There were no hard feelings. I still relish the times with Manny. My ideal business scenario would be I cook the deals, Manny negotiates them, Ross does the finances."

Bushnell took his big stuffed bear and his bar with on-tap beer with him when he moved out of the executive suite. Kassar re-did the office in earth tones and modern, less-is-more furniture.

Ray Kassar in his early days epitomized the dedicated executive. He is an articulate, elegant, impeccably dressed man who has refined tastes in wine, food and the arts. "Kassar is smart, he's a good marketer. He has tremendous organizational abilities, and he works long hours," Bushnell says.

At a time when sales were down — the VCS hadn't caught on and consumers had developed an "if you've played one, you've played them all" attitude about *Pong*-like games — Kassar dramatically increased Atari's advertising budget. Gerard decided the future was in hand-held games, not arcade games or programmable cartridges for the VCS, but not long after Atari brought out the hand-held *Super-Break-out*, the bottom fell out of that market. The company was losing money; in New York, Ross was starting to think buying it

had been a disaster. Kassar just worked harder.

The breakthrough came in '79, when *Space Invaders* arrived from Japan. People who had never before stuffed a quarter in a game machine couldn't destroy enough of the itchy-looking aliens. Atari bought the home game license, and programmer Rick Mauer stayed up for four days and nights converting *Invaders* to the VCS. The game converted beautifully, and soon kids all over the country were beginning to play it at home.

And then came *Pac-Man*, the ravenous yellow dot that did for video games what *Monopoly* did for board games. Arcades sprang up like taverns after Prohibition. Atari took the early lead in the coin-op market, cashing in on the *Pac-Man* phenomenon with classic games like *Asteroids* and *Missile Command*. Kassar

had his emissaries aggressively court executives of Namco, the Japanese company that had created *Pac-Man*. After a series of dinners in the finest restaurants in Tokyo and San Francisco, the Atari people wrested the home game rights away from Bally Midway Manufacturing, the Chicago company that manufactured the arcade version.

Largely due to the home version of *Pac-Man*, sales of the VCS rose from 800,000 units in '78 to around 12 million in '82. Atari had more than an 80 percent share of the home game hardware and software market. Despite George Plimpton's earnest commercials, Mattel's *Intellivision*, the company's nearest competitor, had only a 15 percent market share. Atari's 400 and 800 computers led the home computer market.

But beneath all the excitement over sales figures that kept rising faster than top scores on *Pac-Man*, Atari was a deeply troubled company. The seeds of destruction had been sown.

There is a simple reason why Ray Kassar gets so much of the blame for Atari's downfall. He ran Atari like an emperor. Instead of building a tight organization, appointing people he trusted and giving them the support they needed to make important decisions, Kassar kept power to himself. Instead of moving around the giant company and discovering what people were doing and what their

problems were, he stayed in his office, writing memos and making phone calls. Everything had to flow through him; he insisted on being in on every decision.

As a result, Atari never developed a corporate structure. An Atari executive's standing depended not on how well he performed; it depended on whether he was in or out of Kassar's favor. If he liked you, anything was possible; one of his chauffeurs ended up as director of sales for Southern France. If Kassar decided he didn't like somebody, or if an executive began acting too independently and Kassar thought he might be building a power base, he got rid of him. There were, according to one former executive's count, some 17 different presidents of the coin-operated, consumer and computer divisions in less than three years.

"Somebody would make a presentation in a meeting and Ray would nod and smile," the former executive says. "Then the guy would leave the room and Ray would say, 'This is stupid, this is intolerable, get rid of him.' The frustrating thing was, he never said what he expected and what he thought we should be doing. You ended up trying to guess what Ray wanted."

Former executives say that Kassar was fond of pitting people against one another, then sitting back while they fought it out. "Ray has terrible people skills," Gene Lipkin says. "Numbers were more important than people, it was profit at any expense. He had no compassion." The way to win battles at Atari was to go behind a superior's back and appeal directly to Kassar. He would approve a project that a division head had already canceled, then fail to call the division head and tell him he had been overruled, and why. Decisions were made on the basis of who had talked to Kassar last, which led to considerable uneasiness, not to say paranoia, among executives.

"It became a monarchy, and that didn't have to happen," Bushnell says. "Look at G.E.; it's not a monarchy. There were not enough 'no men.' The strong people tended to leave, the weak stayed."

Those who stayed lived well, for Kassar appreciated the best money can buy — nobody had to guess that. The Atari dining room was famous for its superb nouvelle cuisine. Kassar's company car was a Rolls-Royce, though he rarely used it. Usually he rode back and forth from his San Francisco home in his personal car, a Mercedes. While a chauffeur drove, Kassar sat in the back seat, dictating memos. Some days, he flew down in a helicopter Warner had put at his disposal. When he had to go to New York or to some corner of the Warner empire, Kassar flew on a corporate jet, a G-3 Gulfstream, "the Rolls-Royce of the air."

One of the perks for Atari executives was flying with him, but it didn't always work out that way. On at least one flight to New York, Kassar bumped the executives who were supposed to go along and took his friends instead.

The perks were nice, the money was better. The salaries for upper-echelon Atari executives were in the six-figure range, with fat bonuses. It was a real carrot-and-stick situation: You were in constant danger of being fired, but if you stayed, you were rewarded with a nice bonus. The biggest bonuses of all went to Kassar. One executive who worked closely with him for a number of years puts Kassar's annual earnings in the vicinity of \$3 million. That makes it hard to understand why he risked a Securities and Exchange Commission investigation by selling some 5,000 shares of Warner stock, for approximately \$260,000, just 23 minutes before Warner announced its drastically reduced projected earnings last December. The SEC charged Kassar with trading on the basis of insider information; Kassar denied any impropriety, but signed a consent decree requiring him to "disgorge" \$81,875 in alleged profits. That is walking-around money when you are making \$3 million a year.

"The atmosphere became real stuffy, real political," Lipkin says. "Ray suffered from the arrogance of success. He got caught up in thinking he was responsible for the success, for every good thing that happened. The company was a phenomenon, a once-in-a-lifetime thing. It wasn't any one person who did it. But Ray never understood that. Ray understands politics. That's what allowed him to live as long as he did."

The atmosphere Kassar created at Atari was destructive in itself, but it is more important as a frame of reference for the business mistakes he made. These mistakes are crucial to understanding what happened to Atari; they're even more important for the broader lessons they teach.

From his earliest days at Atari, Ray Kassar thought that running a high-tech business was just like running a textile company. Textiles are a mature, stable industry. Because the market neither grows nor shrinks much in any one year, textiles are a "marketing game" — competitors slug it out for a share of the market, coming up with fresh advertising strategies and new designs for old products, like towels.

High-tech is an engineering-driven industry where you must invent and re-invent, or die. (The term "engineer" here includes both the hardware wizards who invent machines like the VCS and the software designers who bring the machines to life with programming.) Kassar

did not understand what engineers did, or how important a role they played at Atari. He made no effort to get to know his engineers.

"When he made Kassar chairman," Bushnell says, "I told Manny he was the wrong man. I didn't think Kassar could get along with engineers. He couldn't get down on the floor with them. Unless you can do that, you're not going to get along with them. An engineer doesn't always come in a body that can talk. But they're not shitheads. You've got to have enough faith in them to say, 'I don't know what you're talking about; here's some money, go show me.'"

"Nolan is one extreme, Kassar is the other," says Larry Kaplan, one of the original Atari game designers. Kaplan is in an interesting judge of Atari under Bushnell and Atari under Ray Kassar,

'Bushnell is one extreme, Kassar is the other,' says Kaplan.

because after leaving the company in '79 to join Activision, he returned in '82 for a brief stint as vice-president of product design. "Bushnell has thousands of ideas — some good, some not so good," Kaplan says. "He loves games. If you did a good game, Nolan would come down and say 'God, I really enjoyed your new game.' Nolan understands engineers; they like working for him.

"Ray had no feeling for the products, no feeling for engineers, and he really didn't have a feeling for the market. Ray didn't play video games. He didn't even have the equipment in his office."

Computers are like words or paint or music: Most people who work in any of those media are craftsmen; a few are artists. Atari in its early days had programmers whose work was so good that they qualified as artists. "Dave Crane, Al Miller and Bob Whitehead are the best designers for the VCS in the world," Kaplan says.

Kaplan designed *Kaboom!*, an early Activision hit. Thanks to his Activision stock and his high-salaried days at Atari, he is well-off financially. He recalls the day in May 1979 that he and the three "best designers in the world" had a meeting with Ray Kassar.

The designers found Kassar at his desk, wearing a well-tailored suit. They were, as usual, in jeans. The four had a lot on their

minds. They wanted Atari to treat them the way Warner treats recording artists. They felt their games had played a large role in the company's success and they asked Kassar for royalties on them. They wanted recognition, too. Musicians got their names and pictures on record albums; why couldn't theirs be put on game cartridges?

"Kassar called us towel designers," Kaplan recalls. "He said, 'I've dealt with your kind before. You're a dime a dozen. You're not unique. Anybody can do a cartridge.'"

Crane, Miller and Whitehead left to form Activision in October of the same year. Kaplan joined them a short time later. "Activision," Kaplan says, "was started to prove that Kassar was wrong."

In '81 another group of game designers left Atari to form Imagic. It appears that neither incident taught Kassar much about engineers, because instead of trying to improve relations with them, he called them "high-strung prima donnas." The remark made its way around Atari and people began wearing T-shirts with a picture of an opera singer and the words "I'm another high-strung prima donna from Atari."

"If he was smart, Kassar would have put on a T-shirt and gone over to the engineering building and talked to those guys," says a former high-ranking Atari executive. "He didn't. In all the years I was there, I can't remember him going over to engineering more than two or three times."

The VCS programmers still working for Atari were very unhappy. The fun of being a game designer is in creating original, playable games — why else be one? But instead of turning his designers loose to do original games, that were great to play, Kassar's marketing sense told him the big money was in licensing movie titles like *Raiders of the Lost Ark* and *E.T.*, and coin-op conversions like *Pac-Man*. The games based on movies turned out to be dull and have bad graphics; despite its enormous sales, the home version of *Pac-Man* is a very pale imitation of the arcade game. The designers were also unhappy about their lack of recognition, both inside and outside the company. Activision's designers had become well-known in the game world because their names and pictures appeared on the games they created. And it bothered the Atari people no end that the designers who had gone off to found Activision became rich when the company went public. ●

Next week: Why Atari and Ray Kassar failed to keep up with the video-game market and why Warner hired another "marketing man" to replace Kassar.