

# What went wrong at Atari

BY JOHN HUBNER AND  
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Contributors

In February 1982, when another group of VCS programmers threatened to leave, Kassar panicked. If they quit, Atari would have had no VCS programmers left. "Kassar was desperate. He was running scared," Kaplan says.

**Atari's VCS game designers became secretive because they did not want to share their royalties.**

He responded by throwing money at the designers. Salaries were increased and a hastily-created bonus plan was instituted.

But because the bonus plan rewarded sales and not quantity or originality, it created more problems than it solved. The big question became, "Who gets to do the hot coin-op and movie titles? Tod Frye, who did the *Pac-Man* conversion, earned between \$1 and \$1.2 million for his efforts. The other designers felt any one of them could have done it. They became secretive, not talking to each other or to marketing people because they did not want to share their royalties. When the company brought in a New York compensation analyst to find out why the designers weren't producing, the analyst called them "the wealthiest, most unhappy group of people I've ever met".

"What's amazing is that all that mon-

*This is part two of two parts of an article that first appeared in West, the Sunday magazine of the San Jose Mercury News. John Hubner is a staff writer for West. William F. Kistner Jr. is a free-lance writer based in San Francisco.*



James J. Morgan, chairman and chief executive officer of Atari

ey didn't get people to be more productive," Kaplan says. "Programmers just sat around worrying about how to get more money. They'd approach a project with a 'how much am I gonna make off this game?' attitude. There was blackmail. A guy would say, 'I'm not gonna finish this game unless you give me X amount of money right now,' and he'd get it."

The morale problem wasn't confined to the VCS designers. "There was tons of animosity," Kaplan says. "Coin-op and consumer hated each other, the marketing groups hated engineering. It was empire builders fighting empire builders. None of them had any idea what was go-

ing on. It was all knee-jerk. They wanted sports games because Mattel had sports games, even though the VCS doesn't do them well. Somebody would say, 'Let's do a new game system.' Somebody else would say, 'Let's do a new computer,' or 'Maybe we should go with AtariTel' (a new system that connects the phone with a computer so you can do things like call home and turn on the lights). All the good people were gone. The people who were left had no idea what it takes to do a quality piece of work. It was really depressing."

Kassar was as liberal with contracts as he was with the programmers' bonus plan. He would sign a long-term contract



with an executive, and then fire him a few months later. A number of people who have left Atari agreed to talk about the company only on the condition their names not be used. The reason is that their long-term contracts are still in effect. Instead of simply saying "You're fired," one of Kassir's people would tell a high-echelon executive to take a month off while he was reassigned. A month later, the executive would call and be told his new assignment hadn't been worked out. The condition became known as "being at the Beach Club." From Atari's point of view, it makes sense. Instead of firing people and facing court battles over breach of contract, the company counts on former executives — all of whom are high-achievers, or they wouldn't have made it to Atari in the first place — to tire of their Beach Club

to tell them which games were good. The market, which had grown in great spurts like an adolescent, leveled off. The projected growth for 1983 is about 50 percent, instead of the 200 to 300 percent rate of past years. Video games are not a fad. They are here to stay, like records. But like the record business, video games have become a hit-driven industry. *Dragon's Lair*, the first laser-disc video game, was last summer's hit; who knows what next year's will be?

Kassar thought the industry was still booming, and that any game with the word "Atari" on it would sell. So many *Raiders* and *E.T.s* were produced that even if they'd been hits, there would have been excess inventory. *Beserk*, *Defender*, and *Ms. Pac-Man* were hits, but they too were overproduced. Atari was churning out games as if it still had bet-

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status and find other jobs.

"I want to help, this is an important story," one former executive said. "But if you use my name, it'll cost me my contract. Atari is vindictive, they've got lawyers, they'll find a way to get out of it. They've got us all by the wallet."

Not all of Atari's inferior games can be blamed on the designers. Some of what Bushnell calls "cramped executions" resulted from designers not being given enough time to do the job properly.

"Kassar called me one day and said he'd bought the rights to *E.T.* for \$22 million," a former Atari executive says. "I said, 'OK, we'll take our time and really do it right.' Ray said he'd guaranteed the game would be out at Christmas. I said, 'Ray, that gives us about seven weeks to program the game.' It usually takes nine months to do a really good game. Ray said, 'This is such a hot property, whatever we put out will sell.' We ended up putting out a piece of junk that sold far below Kassar's expectations."

Meanwhile, Activision's success had led to others entering the video game software market — Parker Bros., 20th Century Fox, Fisher-Price, CBS. With more than 200 titles to choose from, kids no longer bought a game just because it was new. They became more selective, waiting for a friend or a magazine article

ter than a 60 percent market share. Actually, its share of the home game market had dropped to 40 percent. Suddenly, retailers' shelves were full of Atari games, and so were Atari warehouses.

"Atari overstuffed the pipeline," says one competitor. "We're all suffering from that. There are so many unsold games out there, retailers aren't ordering any new ones. When Atari gets drunk, we all wake up with a hangover."

When things were going well at Atari, nobody paid much attention to the distributors. There was little reason to: every game the company shipped sold. Distributors were little more than sophisticated truckers, moving cartridges from the warehouse to the retail shelf.

But over the years, while nobody was looking, some nasty problems developed. Atari had between 130 and 140 distributors across the country, far too many. Territories overlapped, distributors got into price wars competing for customers. When business was booming, Atari couldn't churn out games fast enough, and retailers' orders were allocated. So, figuring they wouldn't get all the games they needed from one distributor, retailers would place identical orders with a second distributor, hoping that between the two, they would get the games they wanted. When business slowed down, the double orders were still on the books.

"You looked at the backlog of orders and you thought business was still booming," a former Atari executive says. "Then you looked closer, saw all the duplicates, and realized how much water there was in the inventory. The orders for some titles were larger than the installed base of VCSs."

Things really got messy early last winter when Atari decided to restructure its distribution. The company sent a letter to distributors on November 1, informing them their contracts were canceled. The letter said that on December 12, a small number of exclusive distributorships would be awarded. Theoretically, Atari should have grabbed the top 40 distributors and sent other manufacturers scrambling for what was left.

"The biggest error was that the original distributors didn't have exclusive contracts," says a former Atari official. "They weren't preempted from carrying other manufacturers' products. So when Activision, Coleco and Imagic came along, they went to the same distributors. Atari put everybody else in business."

"And when the company cut the number, they failed to audit the distributors they dropped. You know what happens when you don't audit distributors? If I'm a distributor and I just lost my district, I'm going to ship everything back. I'm going to call on my accounts and say, 'I want you to carry this new line of products I've got. As an incentive, you see all that Atari inventory that's not moving? I'll take it back and give you full credit.' Because Atari didn't keep track of what was out there, they bought back lots of merchandise they didn't have to. A big chunk of the \$300 million they had to write off was because they failed to audit distributors when they canceled them."

Atari is still trying to dig its way out from under the inventory avalanche. Late in September of this year, people around Alamogordo, N.M., were amazed when 20 trucks filled with Atari games, VCSs and home computers ended up in the local dump, where they were crushed by a bulldozer. Atari says they were defectives, but kids who scavenged the dump said the games were playable.

During the past six years, Atari has spent millions on engineering, but the company has few new products to show for the money. This isn't because "net" new products weren't being developed. Atari co-founder Al Alcorn, for example, developed an innovative holography game called *Cosmos*. But the game was never released. The reason, according to Bushnell, is that the company became "risk averse" and suffered from the "paralysis of perfection." Gene Lipkin is more blunt: "Ray Kassar wouldn't know



a good product if it hit him in the ass."

"They've probably got more good products gathering dust on shelves than any 10 companies," Bushnell says. "Why not release them? You never know what a product is going to do until you get out there and mix it up in the marketplace."

Most of the money Atari spent on engineering, however, did not go into developing new products. That's one reason why the hardware engineers were as unhappy as the game designers.

"Engineers were doing revisions of the VCS motherboard to save 3 cents a board on the next run," Kaplan says. "Things like that are maintenance engineering, they're fire-fighting. There were no new ideas at Atari, no innovations, no brainstorming sessions, no 'Let's tackle this new technology.' The attitude was, 'Let's cut back. Let's keep

range plan, and long-range strategic thinking was never Ray Kassar's strength. He was good at what Bushnell calls "harvesting."

"When Kassar thought about home computers, he didn't ask himself, 'Where will the market be in two years and how can I dominate it?'" says a former executive. "He said, 'Forget tomorrow. How can I sell as many of these machines as I can today?' Everything was today, today, today."

To sell as many machines as quickly as possible, Kassar put the 400 and 800 in K-marts and Toys-R-Us. The result is that they are perceived as sophisticated game machines, not computers. Nobody who gets serious about computers and wants to upgrade is going to shop for disk drives or printers in a toy store.

Atari is jumping back into the comput-

was going on out here. The numbers were so good, Kassar looked like a genius and they never questioned him. It's easy not to question success. I guess the lesson for Warner is, ask as many questions when things are going well as when they are going bad."

Just how out of touch Warner officials were with Atari is shown in a letter to Warner shareholders signed by Ross and dated March 3, 1982. Ross wrote that "the long-term outlook of WCI has never been better," and predicted that Atari would have a "further dramatic increase in revenues and operating income in ... 1982."

There was instead, of course, a dramatic *decrease* in Atari revenues. Warner has not recovered; Wall Street is full of rumors of a possible takeover, and Ross, according to a close associate, "is trying to hold up walls that are falling in on him."

In February of '83, the chairman flew to Sunnyvale in a Warner G-3, and he was not his usual charming self. He spent three days here attending business review meetings, and "really took Manny and Ray apart, berating them in front of everybody," a former executive says. "That's not his style. Usually, he never raises his voice."

Ross got back aboard the G-3 and was in the air, headed for San Diego, when he turned around and radioed Atari that he was coming back to Sunnyvale. "My God, now what!" went through the mind of every Atari executive, but Ross had returned only to apologize. He was afraid that he had demoralized the entire company and he didn't want to leave things that way.

Despite the gesture, Ross had Kassar's resignation by spring. He replaced him with James J. Morgan, 41, a former executive vice-president of marketing at Phillip Morris U.S.A. Ross made the decision in an incredibly short time, given how important the job is. He met Morgan on a Wednesday and hired him that Friday.

Despite repeated requests, Atari, Warner and Ray Kassar chose not to cooperate with this article. Bruce Entin, vice-president for corporate relations, said that "Atari now has a new chairman and chief executive officer, and the key management team is relatively new. In short, Atari is setting its sights on the future — not the past." But there is no clear line of demarcation between present and past. Morgan must deal with the problems left by his predecessor. How well he performs this Herculean task will determine what kind of future Atari has.

Almost everything about Atari, including whether it will survive is in doubt.

## ***Atari is back in the market with its new XL line, but it may be too late.***

the profit margin high and the costs reduced.' The company became very conservative. It retrenched. It lost its bias to action, its ability to take innovation and run with it."

Because Atari didn't release products that were better than its old ones, other companies did. For five years Atari sat on the 5200, the "Super Game System." The 5200 is a sophisticated version of the VCS; it has bigger chips, so games played on it have more action and better graphics. At \$189, the 5200 would have been the first and only high-priced game machine on the market. But while Kassar debated releasing the system, Coleco, a floundering swimming pool and electromechanical game company in Hartford, Connecticut, beat Atari to the punch. ColecoVision, a high-priced, high-resolution machine, was an immediate hit; the company shipped more than 500,000 units in 1982.

Coleco's success caused a panic at Atari. Playing catch-up ball, the company rushed the 5200 into production. The haste hurt. The controls are very sloppy and do not self-center. The 5200 is not compatible with VCS software, so people who own the cheaper system have to buy the game twice if they upgrade to the 5200.

There is something sad about the Atari 400 home computer. It is a great little machine, but it never grew up. The 400 and its cousin the 800 could have grown into a personal computer that would have challenged the Apple II. But that would have meant developing a long-

er market with its new XL line, but it may be too late. Commodore has become the VW Beetle of low-price computers. IBM is coming out with the Peanut, Apple the Macintosh, Coleco the Adam.

"Atari has an uphill battle to regain the consumer's confidence that its product line will offer competitive value for the money," says Clive Smith, research director for advanced consumer electronics at the Yankee Group, a Boston consulting firm. "The new line of computers has been consistently plagued by late deliveries. Despite some attractive features, the line is still not price competitive in a market that is going to get even more price competitive. Whether they stay in the market or not in large part depends on whether management has the stomach to continue the struggle."

It is one thing for Kassar to let his best programmers escape; it is quite another for Warner to let it happen. The company is famous for treating talent like royalty. When David Geffen, the superb record producer, threatened to go off on his own, Warner gave him his own company, a studio on its Hollywood lot and a ton of money; and told him to go make records. Geffen's label is now the most prestigious in the business.

"Atari should have set up a company for Crane and Miller and those other guys," Bushnell says. "Why didn't they do that, I don't know."

"It just shows how much power Warner gave Kassar," adds a former Atari executive. "They had no idea what



There are rumors that Warner will sell the company. Only one can be substantiated: Last winter, Nolan Bushnell tried to buy back his old firm. Warner rejected the offer. Bushnell is taciturn about why he made the offer, and will not say if he is going to make another.

"I saw it as an opportunity," Bushnell says. "The company represents an inter-

one Atari official. "People have been holding their breaths, going around asking each other 'Are we going to stay in business?' We still have a lot of market presence. People are proving to be surprisingly loyal, despite all that's happened."

There are those who have exactly the opposite view, those who think the com-

pany's future isn't much better than Osborne Computer's.

"I think that Atari's future is very, very bleak," Kaplan says. "They're too late on the laser disc, and there's no doubt in my mind laser games like *Dragon's Lair* are the future. They're too late on personal computers, they missed portable computers, they're too late on a high-end game machine. My guess is that the only things that are going to be left are coin-op and software."

*Pole Position* is a perfect metaphor for the high-tech industry. It moves at a race car pace; there are plenty of dangerous corners; it is easy to crash; and once you've crashed, you've lost your innocence. You don't drive with the abandon you once did.

The trick is to *use* the crash, to *use* the loss of innocence. If you hit the wall and survive, you are wiser and take more calculated risks when you get back on

the track. The problem is, cigarette executives don't make the best race car drivers. Like textiles, tobacco is an old industry that moves at a cautious pace. Changing the colors on the Marlboro package is a major decision that every department from marketing to product design gets involved in. Introducing a new product like Players in the distinctive black pack — when all that's new is the package — is considered revolutionary. One wonders if Warner hasn't repeated the mistake it made with Kassir. Can a man who is used to a market as steady as the traffic on a suburban street make the right decisions in a market as fluid and ever-changing as a Grand Prix race?

"They have an opportunity to stay in business, but they have to come up with a new plan," says Ted Costello, an investment specialist who is a vice-president at Dean Witter Reynolds in Palo Alto. "Conventional wisdom says it takes three years to make a major management change. They could do it in a year and a half, but my guess is, it will be closer to a three-year process. It will take Morgan six months to get the damage report and access the marketplace. To end up with a game plan will take another six to 12 months. It will take another 12 months to get the new methods into operation. We're in for another three to six quarters before we begin to get an indication of what the company is capable of doing."

That is an awfully long time to an industry where last year was 100 years ago. ●

## If Atari drops out of home computers, it will still be a force in software.

esting set of capabilities, even now. It has a future if they can stop the flow of red ink. There's some good engineering going on. It's a do-able task."

Atari has some definite strengths. Everyone, inside and outside the company, thinks that John Farrand, 39, president of coin-op, is a superb manager. Software and hardware engineering have recently been placed in Farrand's division. The company has some excellent coin-op games out: *Kangaroo*, *Star Wars* and *Dig Dug*. The best racing game ever, *Pole Position*, is licensed by Namco.

If Atari does drop out of home computers, it will still be a force in software. The company has an excellent line of educational software it is now beginning to sell to schools. Ted Hoff, who invented the microprocessor at Intel, and Alan Kay, Atari's chief scientist, are two of the most inventive minds in electronics.

"I think we have a good future," says

## IBM seeks millions from National Semiconductor

BY JEFF BEELER  
Contributor

IBM will ask National Semiconductor Corporation and its National Advanced Systems (NAS) subsidiary to pay up to \$2.5 billion in damages for allegedly aiding Hitachi Ltd. in stealing the computer giant's trade secrets.

National Semiconductor and NAS "got their hands on about a year's worth of IBM's research and development" while acting as Hitachi's "principal collectors" of stolen U.S. technology, according to IBM attorney Thomas Barr. As compensation for the disclosure of its

purported trade secrets, IBM is seeking damages ranging from \$750 million to \$2.5 billion, Barr said during a mid-November hearing in U.S. District Court in San Francisco.

Announcement of the damage estimate brought a sharp reply from National Semiconductor and NAS lawyer Fred Furth, who accused Barr of "using this courtroom to conduct a press conference" and of focusing on "irrelevancies." Furth disputed the opposition's repeated contention that National Semiconductor and NAS received stolen IBM technology and reminded the court that neither defendant has ever been charged with any criminal wrongdoing in the case.

Barr's disclosure marked the first time IBM has publicly specified the dam-

ages it will request in its year-old civil lawsuit. Filed in September 1982 in U.S. District Court, the suit was triggered by the discovery of a Japanese conspiracy to swipe documents containing some of IBM's most sensitive trade secrets.

In addition to National Semiconductor and NAS, defendants in the suit included Tokyo-based Hitachi and 16 of its employees or alleged agents. Hitachi's involvement in the suit ended in October when the Japanese vendor and IBM resolved their dispute out of court. Provisions of the settlement purportedly include \$300 million in secret payments to IBM and give the U.S. firm the right to scrutinize its Japanese competitor's new systems products for the next five years.

The civil suit took yet another turn later, in November, when Barr announced his intention to redraft IBM's original complaint to include specific damage figures and clarify some previously unspecified allegations. Barr expressed confidence that an amended suit could be filed "within 10 days." ●

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