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Early flirtations

PolyGram's first flings

At its height, PolyGram was the biggest music company in the world with music operations in 42 countries, revenues in excess of US\$6 billion and an implied value to shareholders of US\$10 billion.

The origins of this company were so characteristic of the slow and rather archaic growth of multi-nationals based in Europe, that they are worth recalling.

In the very early 1960s, among the old guard Titans of European owner/managers, two figures stood out above the rest. Frits Philips of the Dutch Philips Group and Ernst von Siemens, of Siemens Group in Germany were figures of world-renown in the business community. Each of them had a small but similar problem in that both groups owned small music companies which had not much to do with their core business. Philips owned Deutsche Grammophon and Siemens owned Philips Records.

The two Presidents agreed to merge their entertainment activities with effect from 1st October 1962. For tax reasons, it was decided, rather than to set up one holding company, to have a joint venture with equal and distinct head offices, one in Hamburg, West Germany and the other in Baarn in the Netherlands. To begin with they didn't even have a common name – the name PolyGram not coming into being until 1972. The joint venture went under the extraordinary acronym 'GPG', which everyone at Philips called 'Group Philips Grammophon' while their German colleagues preferred to call it 'Grammophon Philips Groupen'.

Although the name was unwieldy, the operations of the two companies fitted neatly together. Philips had been strong in the Netherlands, but with such a small home base, it had to look to the other territories in

order to gain size and as a consequence was relatively strong internationally. Deutsche Grammophon, on the other hand, was extremely strong in the very large and profitable territories of Germany, Austria and German speaking Switzerland but was very weak internationally.

At the management level the traditional and rather rigid management style inherited from Siemens matched quite well with the more lax but English speaking international style of the Philips management. Siemens lacked a consumer touch, given that their customer base was principally in heavy industry, whereas a large part of Philips' business had to do with the normal retail consumer of their electronics products.

The merger of the two entities, however, was not in itself a guarantee of success. Perhaps of more interest was that in 1963 the Beatles topped the UK charts for the first time with their second single *Please Please Me*. From then on the modern record industry happened with a vengeance and the PolyGram joint venture benefited from the tremendous growth in revenues and profitability of the record business.

One of the greatest acquisitions during that period, was of the wonderful music publishing company, Chappell Music. This was acquired in 1967 for US\$42.5 million (and its subsequent sale in the mid 80s for in excess of US\$100 million saved PolyGram at a time of penury).

The uneasy legal structure tainted by tax needs had, however, failed to produce a management structure capable of riding the turbulent growth that had overtaken PolyGram through the 1970s. Things came to a head at the end of the decade.

In 1977 PolyGram released the sound track to the movie *Saturday Night Fever* and in 1978 the sound track to *Grease*. Each of these sound tracks shipped in excess of 20 million units, but the important word to note is 'shipped'. In the United States, where a large percentage of the shipments were made, business was done on a 'sale or return' basis. So while apparent prosperity on an unprecedented scale showed up in PolyGram's books in 1978 and 1979, by 1980 and 1981 returns of unsold shipments began to have a negative impact on the results of the company. This might have been less of a problem had it not been for the fact that, at the same time, one of the worst recessions ever experienced in the music business

had taken hold on a world-wide basis. Furthermore, an ill-advised move into feature film production in Hollywood had led to financial disaster.

The lack of a cohesive management, insufficient infrastructure to track and deal with the problem of returns of records from retailers and the large losses in the film operations combined to produce a crisis.

As 1979 turned into 1980, another problem loomed. 1982 was the end of the 20 year joint venture between Philips and Siemens. While the partnership remained, PolyGram's results were not consolidated on either the books of Philips or of Siemens. However, should one party buy out the other party's interests, it would also have to take all results (positive or negative) on to its books. Neither was keen to do this. For Siemens there was no reason whatsoever to buy out Philips. For Philips, however, there was an important need to retain PolyGram's significant music catalogues since Philips, together with Sony of Japan, were about to launch the compact disc and needed PolyGram's catalogues for that purpose.

Most of the management of PolyGram, who had been in place since its beginnings in 1962, left at the end of 1981 and, after an interim period of two years, capably presided over by Dr Wolfgang Hix, Philips appointed their Head of Operations in South Africa, Jan Timmer, to take over at PolyGram. Timmer spent his first three years trying to find a joint venture partner to replace Siemens in PolyGram – without success.

He also successfully launched CD Audio as a system and the introduction of CD as a replacement for black vinyl discs revolutionised the fortunes of the music business, which was to enter a new period of prosperity. Jan Timmer's ability to convince Philips not to shut down PolyGram but to retain it without a partner, instituted the last very successful period of the PolyGram story. After an earlier abortive attempt to have a public offering of 20 per cent of PolyGram's shares, it was eventually floated in 1989 at US\$ 16.5 (NLG 31.5) a share. It's interesting to note that immediately prior to the sale of PolyGram to Seagram in 1998, the shares were at US\$ 60.5 (NLG 115).

Jan Timmer's ability to save PolyGram from being sold or shut down and save the record industry by the introduction of CD, was only possible because he had a very able second lieutenant in the shape of David Fine, a fellow business man from South Africa, whom had been brought in initially to run the UK business and subsequently to serve as President of PolyGram in the late 1980s.



JAN TIMMER

Timmer talent-spotted Alain Lévy, an executive at CBS (initially CBS International and then CBS France). He brought him in to run PolyGram France and turn it from a loss making entity into the jewel of PolyGram's crown. He then nominated him his successor and it was Alain Lévy who led the company until its sale in 1998. During that period the shareholder value of PolyGram grew from US\$ 2.8 billion to US\$ 10.4 billion (the price for which it was sold to Seagram).

The new regime under Alain Lévy was the one I joined to start PolyGram Films. It was clear to this new generation of management of PolyGram, that the CD boom could not last forever; eventually everybody would have a CD player and would have replaced their black vinyl catalogue and the music business would plateau. However, shareholders had grown used to a double-digit growth in revenues and profits and would not be satisfied with any less. Where was that continued growth to come from? The internet was not even a glint in the eye of Bill Gates. The massive consolidations of the film, television and music industries that were to happen in the latter part of the 1990s had not yet occurred.

The business of PolyGram was entertainment content. We began to explore the possibility of either buying or building a filmed entertainment division. We went into it with our eyes open, knowing that it would require a massive amount of capital and a long-term commitment. It was judged that the cash flow from the music operations was so substantial and the management at PolyGram so sound in combining creative licence and financial discipline, that there was a reasonable chance of success, provided it was embarked upon in a careful and step-by-step manner. So, with the approval of my plan by the boards of PolyGram and Philips in the latter part of 1991, I began the odyssey of PolyGram Filmed Entertainment.

Before we get to that point (taken up in Chapter 4), it is interesting to look at PolyGram's various flirtations with the film business.

PolyGram's first disastrous entry into film

Wolfgang Hix was President of PolyGram for one year in 1983. Before that he was General Counsel for PolyGram and was with the company for most of its history from its very earliest years. He started his professional career at UFA (Universum Film AG), one of the greatest names in German motion picture history. From his experience at UFA he knew in an era that pre-dated home video and pay television, that the film business was extremely risky. However, in the mid 1970s when PolyGram seemed to be growing strongly and had considerable cash flows, the management began to consider expansion into filmed entertainment. There seemed some superficial synergies – soundtracks were a very big business and soundtracks came from movies. There seemed to be some cross over between music artists and film acting and, perhaps most importantly, some of the important producers were common to both the film business and the music business.

Nonetheless, to begin with, PolyGram was extremely cautious and the engagement with film came about almost by accident. In the mid 1970s PolyGram was introduced to a very successful record producer, Neil Bogart and his partner Peter Guber. The two were related by marriage. Peter Guber having worked in Hollywood, had set up as an independent and produced the hit movie *The Deep*. Bogart had managed the successful independent record company Budda Records and had recently signed Donna Summer. Charmed by Bogart and fired by the need to ally with American producer talent, PolyGram bought into Casablanca Record and Filmworks in 1977 (a company created by merging Bogart's Casablanca Records with Peter Guber's Film Company).

According to Nancy Griffin and Kim Masters' book on John Peters and Peter Guber, *Hit and Run*, it was estimated that PolyGram paid between US\$10 million and US\$15 million for a half share in Casablanca Records and Filmworks. Having just acquired the United Artists music distribution system, it was necessary to 'fill up the pipeline' and the product of the joint venture company would be a useful addition. Despite incredible corporate profligacy at Casablanca, the company flourished and a plethora of successful disco records in the late 1970s made it increasingly hard to control the company. Two movies made by Casablanca

but not financed by PolyGram (*Thank God, It's Friday* (Robert Klane, 1978) and *Midnight Express* (Alan Parker, 1978)) had successful soundtrack albums, Donna Summer was huge and Casablanca was a hot bed of disco records. To this day, The Village People remain emblematic of an era of theatrical hedonism and popular success. Never afraid of diversity, Casablanca signed acts such as *Kiss* in addition to disco.

The end of the 1970s and the beginning of the 80s saw several interesting developments: as PolyGram fought to get control of Casablanca, Guber persuaded them to back him in setting up a fully fledged film studio called PolyGram Pictures. Quite separately, a terminally ill Bogart was eased out of the company and Guber teamed up with his long-term friend and business partner, John Peters. The venture was ill thought out as PolyGram sought to control two of the most mercurial talents in Hollywood, through the affable but quite unsuited figure of Eckhart Haas, a German TV executive who had worked for PolyGram for some years. In addition, a seasoned film executive, Gordon Stulberg, had been hired to bring some sense to the organisation, but it was difficult, if not impossible, for anyone to control Guber and Peters.

Lessons from disaster

As I looked back on this episode some years later, several interesting aspects of what was to turn into a significant financial disaster struck me:

- Even people with a record of success in the movie business were not guaranteed success by volume production.

PolyGram Pictures made *King of the Mountain* (Noel Nosseck, 1981), *Endless Love* (Franco Zeffirelli, 1981), *Deadly Blessing* (Wes Craven, 1981), *An American Werewolf in London* (John Landis, 1981), *Six Weeks* (Tony Bill, 1982), *Split Image* (Ed Otcheff, 1982) and *Pursuit of D.B. Cooper* (Roger Spottiswoode, 1982). Even though *Werewolf* was a successful film, the structure of the business was such that the main beneficiary was the director, John Landis.

- One couldn't control a Hollywood entity from Europe.
- The film business would only make financial sense if one produced a sufficiently large portfolio of movies. Five movies were unlikely to be enough. However, one of the movies developed by PolyGram Pictures was *Batman* and had that been produced by PolyGram, it might well have been that the total slate would have been a success.
- PolyGram Pictures did not have its own US distribution (it distributed its pictures through a deal with Universal Studios), nor did it have international world-wide distribution. Inability to capture the world-wide profits of the slate of movies and inability to market the movies on a world-wide basis was a fatal flaw in the plan.
- It was certainly unwise to award executives or producers excessively for getting movies into production: volume rather than quality would inevitably result.

The movie business had changed significantly since the beginning of the 1980s in that two very significant revenue sources had developed in the meantime; pay television and home video. When PolyGram Pictures was at its height, if a movie failed at the box office (as the majority of PolyGram Pictures' movies had) there was little fall back.

As it was, by the end of 1981, PolyGram had had enough, threw in the towel and Guber and Peters left the film company. The episode cost PolyGram some US\$100 million (at the time) and important assets were either undersold – for example the very big film *Flash Dance* (Adrian Lyne, 1983) was sold as a development property for a paltry sum to Paramount, while Guber and Peters took *Batman* to Warners, leaving PolyGram Pictures with only a small royalty. Fortuitously the sound track album for *Flash Dance* remained with PolyGram Records and was a huge hit in 1983.

As a result of this first disastrous foray into film, the film business was considered forbidden territory within PolyGram for most of the 1980s and I used to joke that even record sleeves were suspect because of their visual content.

Robert Stigwood

Before moving off the ancient history of the group, there is one other character that needs an introduction: Robert Stigwood. Born in Australia, he had at one point set out to become a priest but after a spell as a copywriter for an Adelaide advertising agent, he left for London in 1955 and became an independent record producer. He worked for



Courtesy RGA

ROBERT STIGWOOD

Brian Epstein, the manager of the Beatles and by the mid 1960s had joined Epstein as co-manager of his company NEMS (originally the North End Road Music Stores), which had record rights to the Cream and the BeeGees. Stigwood also had an option to buy shares in NEMS. In the mid 1960s PolyGram began negotiating to buy NEMS – a process that was ended with Epstein’s death on the 27 August 1967. In this way

PolyGram came to know Robert Stigwood and agreed to finance him in a new venture – The Robert Stigwood Organisation (RSO). In addition to launching the BeeGees' career, promoting Cream and other successful artists such as Eric Clapton, he backed Andrew Lloyd-Webber and Tim Rice in their productions of *Hair* and *Jesus Christ Superstar*.

Halved by Polygram, RSO went public in the late 1960s, but almost immediately discovered that the volatile nature of the record business does not fit easily with the obligations of a public company and the flotation was very unsuccessful. Stigwood soon found he had no taste for running a public company. In due course this led to a delisting and Stigwood leaving for the United States of America. In 1977 Stigwood produced *Saturday Night Fever* (John Badham) and in 1978, *Grease* (Randal Kleiser). The sound track albums for these two films were distributed by PolyGram and shipped out a staggering total in excess of 40 million copies world-wide, generating hundreds of millions of dollars in revenue and tens of millions in profit. Unfortunately, the charismatic Stigwood became very difficult for PolyGram management to control and understand.

Putting together the Casablanca story with that of Stigwood and adding in the establishment of PolyGram Pictures, results in a tale of extraordinary highs and lows. This obscure European joint venture called PolyGram had grown like Topsy on the back of the success of the music business. Led by a Philips nominee, Coen Solleveld, who managed to keep a Dutch/German joint venture strong, it had become a significant world-wide operation. At the end of the 1970s, it was enjoying the fruits of two of the biggest hit albums ever seen in pop history. At the same time, buoyed by an unjustified confidence in their future success, the management gambled in the film business and lost heavily.

But the bad news had only just begun. A world recession started in the music industry; in large markets such as the United States, where records were sold on a 'sale or return' basis, returns exceeded sales; the market leader, CBS records, responded by price cutting, which other companies had to follow and the result was a reduction of profits in the record business to an extent never before experienced. PolyGram, with its less developed infrastructure, suffered more than many and

new management, new visions, new disciplines were called for. It was about this time that I stopped being a record company lawyer and took my first faltering steps on the executive ladder.