

*Examining success encourages imitation – but examining failure encourages invention.
So the authors contend in . . .*

Managing Organizational Decline: Lessons from Atari

Robert I. Sutton
Kathleen M. Eisenhardt
James V. Jucker

*T*he Atari Corporation introduced the world's first programmable home video player in 1976. This product, the VCS 2600, ushered in the explosion of the home video game industry, and it became the largest-selling home electronics product of all time. Over 10 million 2600s were sold between the product's introduction in 1979 and the end of 1982. During that time the industry grew from a handful of competitors to hundreds of competitors and billions of dollars in sales. Atari grew along with it: Between 1976 and 1980, the firm's sales multiplied tenfold from \$39 to \$415 million. Most of this growth was attributable to the VCS 2600 and video games for that machine.

The VCS 2600 was developed under

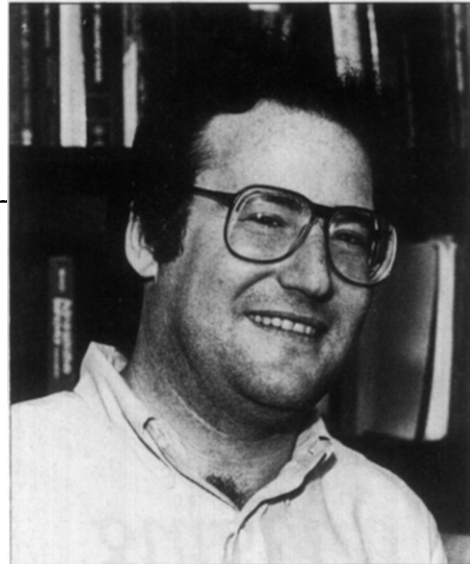
the guidance of Nolan Bushnell, Atari's founder and first president. Bushnell sold Atari to Warner Communications for \$28 million in 1976. Atari's next president was Ray Kassar, a former textile executive. In 1981, under Kassar's leadership, Atari controlled 75 percent of the video game market and accounted for almost two-thirds of Warner's profits that year. Atari closed 1982 with \$2.7 billion in sales and more than 7,000 employees.

But 1982 was a pivotal year. By the end of that year Atari found itself in an environment very different from the one that it had enjoyed from 1976 through 1981. Many new, aggressive firms had entered the video game business, consumer preferences were

shifting away from video games, and the home computer business was becoming a cutthroat price war.

In 1983 Atari's sales dropped by 30% and the company lost more than half a billion dollars. James Morgan, an executive from the tobacco industry, replaced Kassar in July of 1983. Morgan was unable to stem Atari's collapse. In July of 1984, Warner Communications sold its Atari subsidiary to Jack Tramiel, the founder of Commodore Computers. The Atari labor force at the time of the sale had dwindled to only 1,000 people. It should be noted that Jack Tramiel's "New Atari" bears little resemblance to the Atari we describe here and is not part of our story.

The history of Atari before Tramiel's takeover accentuates a lesson that managers in the "smokestack" industries learned in the deep recession of the late 1970s and early 1980s: Leaders not only must know how to avoid organizational decline, they must also know how to manage retrenchment if decline occurs. Despite this need, experience with Atari and other troubled organizations confirms Raymond Zammuto's observation that managers are poorly educated to cope with decline. American leaders, taught to believe that corporations must grow, usually lack the knowledge, experience, and training needed to manage an organization that is out of step with its environment. Managing decline is a difficult task—regardless of whether that decline is part of a cyclical industry pattern, a permanent erosion, or even a collapse of the market niche. Decline usually forces managers to struggle with a pair of competing tasks: reducing the size of the business and managing the remaining portion of the business effectively. Decline thus places a severe burden on managers who seek to maintain productivity and innovation. Moreover, retaining the best employees is especially difficult under conditions of decline.



Robert I. Sutton is an assistant professor at Stanford University's Department of Industrial Engineering and Engineering Management. He earned a B.A. from the University of California at Berkeley and earned his M.S. and Ph.D. degrees in organizational psychology from The University of Michigan. His primary research interests include organizational decline and death, job stress, and the expression of emotion in organizational life. His publications include articles in the *Academy of Management Journal*, the *Journal of Applied Psychology*, *Human Relations*, and *The Organizational Behavior Teaching Review*.

Some of Atari's leaders and competitors—and some industry analysts—have argued that the corporation's sudden drop in sales could have been avoided by appropriate managerial action. Others have argued that financial losses were inevitable because of the collapse of the video game market. There seems to be a consensus, however, that the decline could have been managed better once it began.

We did not join in this consensus casually. Extensive interviews were conducted with many former and current Atari executives and managers, as well as with consultants to Atari and other knowledgeable participants in the Atari story. We also studied media reports, public documents, and literature produced by Atari—such as company newsletters, advertising brochures, and organization charts. Atari is an especially in-



Kathleen M. Eisenhardt is assistant professor at Stanford University, Department of Industrial Engineering and Engineering Management. She earned her Ph.D. in organizational behavior from the Graduate School of Business, Stanford, and she holds a Master's degree in computer systems and an undergraduate degree in mechanical engineering from Brown University. Eisenhardt is engaged in research on innovation and stagnation, high-technology management, and high-velocity environments. Her publications include articles in *Management Science* and the *Columbia Journal of World Business*.

triguing example because of the high quality of its executives, managers, and technical wizards. One consultant argued that they were among America's finest. And they were having a great time at Atari. As one executive put it:

There was lots of high commitment and loyalty, lots of job satisfaction, except for the political dissatisfaction. I stayed [after December 1982] because it was one of the most exciting things I've ever done, with lots of opportunity and great people until the end.

We heard statements like this over and over from people at all levels of the management hierarchy. The Atari case reaffirms our point that many American managers, even the best, are ill-equipped to cope with decline.

This article uses evidence from the Atari story to illustrate eight aspects of managing human resources during decline. Philip Mirvis and David Berg argue that essential lessons can be garnered from the anal-

ysis of managerial mistakes. Analysis of success encourages managers to imitate and use established procedures. In contrast, Mirvis and Berg remind us that analysis of failure encourages managers to abandon old practices and invent new ones. And, for the most part, managers of declining organizations need to abandon old practices.

Our experience with an array of industries—including automobiles, computers, and health care—suggests that many of the inappropriate strategies used at Atari are also used widely in other declining and dying organizations. Moreover, the Atari story is about the decline of a high-technology company. Lessons from this case are especially pertinent in light of the recent drop in demand for high-technology products—a drop that threatens an array of widely praised firms, including Apple Computers, Advanced Micro Devices, and Hewlett-Packard.

EIGHT STRATEGIES FOR MANAGING DECLINE

The remainder of this article explains the eight strategies for managing decline that are illustrated by the Atari story:

1. Be even-handed in implementing layoff policies.
2. Allow employees to leave with dignity.
3. Help displaced employees find new jobs.
4. Avoid belittling people who have been laid off.
5. Be cautious when hiring outside executives.
6. Keep employees informed.
7. Set realistic expectations.
8. Use ceremonies to reduce anger and confusion.

These lessons address diverse aspects of managing human resources in declining organizations. Nevertheless, as a set, they illus-

trate that organizational decline often creates a dilemma: How does management reduce the size of the business while maintaining a productive and high-quality workforce in the remaining portion of the business? Layoffs affect not only those who lose jobs; layoffs also influence the attitudes, motivation, and commitment of those who remain.

1. Be Even-handed in Implementing Layoff Policies.

A common characteristic of declining organizations is that they become increasingly top-heavy as layoffs are focused at lower levels of the organization. We do not know why this happens; one plausible theory is that the senior executives who make layoff decisions are reluctant to lay off their colleagues. Regardless, Atari executives fell prey to this practice and its subsequent problems.

Atari managers adopted a troublesome, though perhaps unavoidable, management style during the period of rapid growth. Many people whom we interviewed asserted that Atari had too many top executives and too many people in staff positions. Atari was structured, for example, so that video game players and games were made by one division and home computers and computer software were made by another division. Because these products are very similar, the divisions had a variety of redundant functions, including research, marketing, finance, and management information systems. The overlap was confirmed by a prestigious consulting firm that helped Atari executives reorganize and shrink the company – they recommended that the two major divisions be merged.

The top-heavy structure and the practice of hiring excessive numbers of managers haunted Atari during the decline. According to our interviews, excessive layers of management obscured the economic fun-



James V. Jucker is professor of industrial engineering and engineering management at Stanford University. Previously he taught at the Catholic University in Rio de Janeiro and at the Harvard Business School. His background includes research and teaching in the modeling and analysis of production systems, but in recent years his primary interests have been in job design and the organization of production.

damentals of the business. Both Kassar and Morgan were reluctant to lay off top-level managers. Morgan, for example, fired only one top executive during his ten-month tenure. Sociologists have demonstrated that, as organizations shrink, managers and support staff are usually removed more slowly than other personnel are. But the combination of this tendency with Atari's already top-heavy structure was especially damaging. The inability of the firm to keep managerial overhead in line with sales drained financial resources. The most expensive employees remained and the least expensive were removed.

The focus on layoffs of lower-level employees, especially in the early phase of decline, also hurt the company because it sent a symbolic message to lower-level people. The message: Management (especially top management) would not share equally in what James Morgan (Atari's last president) described as "painful and bloody" workforce

reductions. Morale was seriously damaged by the apparent inequities. Finally, perhaps most insidious was the effect on middle managers. Many remaining managers had fewer subordinates and had lost responsibilities. Those interviewed repeatedly said that remaining managers had little to do and that it became all too tempting for them to fill their days with organizational politics rather than constructive work. Our advice is to spread layoffs throughout organizational ranks. It makes economic sense, it is best for morale, and it leaves less time for middle managers to practice organizational politics.

2. Allow Employees to Leave with Dignity.

It is best to manage workforce reduction without resorting to layoffs. Layoffs hurt the people who lose jobs and they frighten and anger surviving employees. Layoffs can reduce motivation and, as mentioned earlier, they can encourage the most valuable employees to jump ship. Yet when an organization's niche suddenly collapses, as Atari's did, layoffs are often unavoidable. If layoffs are necessary, employees need to leave the firm with dignity. Employees need to say good-bye to their co-workers. They need to express their sadness and anger. And the way in which laid-off employees are treated sends important messages to survivors about how much the company does or does not value them as human beings.

Our experience suggests that the methods used most frequently by Silicon Valley firms to lay off workers, engineers, and managers are humiliating; these methods convey to ousted employees that they cannot be trusted. Unfortunately, layoffs at Atari reflected Silicon Valley standards. Hourly employees who were selected to receive a "RIF" (reduction in force) notice were removed from their work groups without warn-

ing. Former Atari employees who are plaintiffs in a class action suit against Atari assert that the layoff process was humiliating:

On February 22, 1983, after the production workers in the plaintiff class arrived at work, they were told by [a production manager] that they were being laid off as of that moment. The production workers had no prior knowledge that the layoffs were going to take place. In fact, like the quality assurance workers, they had been told repeatedly that their jobs at Atari were secure. [The manager] gave the production employees directions to Sunnyvale High School and told them to be there on Friday, February 25, to pick up their final checks. He then collected their badges and the production workers were escorted off the premises. (Second Amended Complaint for Damages, Case No. 530743, Santa Clara County Superior Court, pages 7-8).

The story was similar in other layoffs at Atari. Hourly (and sometimes salaried) employees were often escorted off the premises by security guards, a procedure that was alleged to have accentuated the humiliation.

The demeaning layoff process produced several results. The most obvious are class action suits against Atari. But there are more subtle effects as well. Robert Kahn, an expert on occupational stress, has proposed that unemployment is more damaging to human well-being than is any form of on-the-job stress. Moreover, Kahn has argued that a source of stress, such as unemployment, causes further damage when the employee cannot predict when it will occur, does not know why the stress is occurring, and has no control over the way in which the stress is encountered. In short, the way in which hourly employees were laid off at Atari is a potent recipe for psychological distress.

Such layoff practices also had negative effects on survivors. This demeaning process encouraged remaining employees to get out as fast as possible—before they, too, faced this humiliation. And practices of this

kind hurt Atari's reputation in the community. Newspaper stories conveyed that Atari was laying off hundreds of employees through a process that appeared haphazard and unkind. Such reports may have contributed to the drop in Atari's sales and hurt Atari's recruitment of future employees.

In short, managers should remember that employees need to leave the firm with dignity—it is better for departing employees, better for remaining employees, and better for the company.

3. Help Those Displaced Find New Jobs.

The compensation for laid-off Atari employees was generous. Managers received several months' pay and hourly employees were given two weeks' pay plus an extra week's pay for each year of service. Yet, as with many troubled high-technology companies in Silicon Valley, only modest efforts were made to help displaced Atarians find new jobs or deal with the trauma of layoffs. To illustrate, a manager from another firm told us that during the height of the layoffs, she telephoned Atari to obtain names of skilled employees whom she could interview for several job openings. She was told that Atari could not help her.

Moreover, little coordination existed across departments in connection with displaced employees who might be absorbed by other departments. The coordination of layoff lists with workforce needs was haphazard. For example, the head of a computer design team at Atari told us, "It was very common for one division to lay someone off and another division to call him a week later and hire him. It got my secretary that way." His secretary received two months' severance pay from Atari even though she was unemployed for only about a week. In other words, Atari gave this employee a one-week vacation at eight times her usual pay. But more than eight weeks of pay were squandered here. The opportunity to demonstrate the concern for and loyalty to an employee that produce reciprocal loyalty was lost as well.

The weak efforts to help displaced Atarians certainly had a negative effect on those who were unable to find new jobs. But such weakness also may have had a subtle (yet potent) negative influence on the effectiveness of a declining organization. It conveyed to people inside and outside the firm that Atari was insensitive to the needs of its employees. This may have hampered recruitment efforts. It also encouraged those who survived workforce reduction to mistrust the

"Managers should remember that employees need to leave the firm with dignity—it is better for departing employees, better for remaining employees, and better for the company."

company and to leave at the first opportunity.

4. *Avoid Belittling People Who Have Been Laid Off.*

Psychologists tell us that many people believe in a “just world” and that this leads them to blame innocent victims when misfortunes arise. In the case of decline, this leads some managers—and we have seen some of them—to belittle the people whom they have laid off by using such terms as *deadwood* and *rotten apples*. Sometimes blaming the victim assuages guilt. Sometimes managers mistakenly think that such blame-placing encourages surviving employees since it praises them by contrast. Yet it has the opposite effect.

Some Atari managers fell prey to the practice of belittling former employees. The first major layoff at Atari occurred in February 1983: About 600 employees lost their jobs in a single day. We were told that top executives at Atari compounded the negative impact of these layoffs:

Top management went around and spoke to everybody. What they said was, “Now we’ve gotten rid of all rummies and the company’s strong and all the good people are left.” And they never should have said that. They should have said, “Because of business problems, we have to let people go.” But they said, “We’ve gotten rid of all the scum,” and that wasn’t the case at all. And everybody knew it and everybody resented it. So it just got worse and worse.

We are not certain whether or not top managers actually made these statements. But this rumor was confirmed by other former Atari managers. We do know that such statements, if made, are damaging. Belittling former employees obviously hurts these employees, but it also damages top management credibility among survivors. The statements attributed to top management suggest that Atari had been inept in hiring

such people in the first place. Atari paid high salaries and such statements implied that the money was not wisely spent. Top management’s credibility suffered.

Such statements were also contrary to the firsthand knowledge that most survivors had of some of the laid-off people. Many Atari employees perceived that the layoffs were aimed primarily at getting rid of people who were known to be competent, but who were politically weak. Those laid off were not seen as inept. Thus top management was perceived to be lying—which again reduced its credibility. Most employees also worried (with good reason) about further rounds of layoffs and about how those to be laid off would be chosen. Rumors about top management’s intentions encouraged employees who had the option of leaving.

Finally, top management’s actions also evoked fears about the randomness with which people appeared to have been laid off. Many saw themselves as no different than displaced co-workers. They wondered, openly, “Am I next?”

Managers in other declining organizations might be wise to heed the advice offered above by a former Atarian. Announcements about layoffs should convey this message: “Because of business problems, we have to let people go.” Moreover, the basis for determining who is to be laid off should be made clear to all.

5. *Be Cautious When Hiring Outside Executives.*

Hiring outside executives can bring fresh ideas and new skills to a declining firm. Iacocca’s dramatic transformation of the Chrysler Corporation illustrates the virtues of hiring an outsider to save a troubled corporation. Nevertheless, outside executives need time to understand the business problems and the or-

ganization, especially when they are from a different industry.

The hiring of high-ranking executives from outside the corporation was a practice that began after Atari had been acquired by Warner. Ray Kassir, Atari's second president, was hired from the textile industry in 1977. Kassir continued the practice of hiring managers from other industries as he orchestrated Atari's rapid expansion and change to a marketing emphasis. Kassir could have hired people from outside with extensive managerial experience. By contrast, he could have promoted people from within the company who understood Atari's business, but who had less managerial experience. A programmer (and manager) described this dilemma:

The problem was there were no outsiders to bring in with any experience. Where could you find someone who really knew the VCS (video cartridge system) industry? Atari had them all. So what do you do? Well, you hire somebody from the paper cups industry and another guy who makes wine.

More often than not, Atari hired the outsiders.

It is unclear whether the practice of hiring outsiders hastened or stalled the onset of Atari's decline. The managers we interviewed were split on this point. But it is clear that this tradition caused problems once the trouble began. For example, James Morgan was brought in to succeed Ray Kassir. A successful marketing executive from Philip Morris, Inc., he was perceived by co-workers at Atari as a fine human being and a competent manager. Our interviews revealed, however, that Morgan did not have a firm understanding of either the video game or the home computer businesses. He had to spend precious time learning about Atari's products, competitors, and consumers. The corporation needed to change rapidly, but educating Morgan likely delayed the planning and implementation of Atari's transformation. We

offer criticisms of Morgan's actions in the remaining sections—yet, in fairness, he had little time to learn about the nuances of the organization that he led.

The practice of hiring outsiders also meant that managers making a decision about who should be laid off often had little knowledge about their subordinates. This caused mistakes. Moreover, it meant that even when such choices were reasonable, the victims of layoffs (and surviving co-workers) were more likely to believe that the cuts were unfair. Such perceptions lowered the spirits of remaining employees. Our advice is to be cautious when hiring outside executives after decline begins.

6. Keep Employees Informed.

Decline is frequently a time of great uncertainty and thus creates a dilemma for management. Typically, because managers are unsure of the future, they say nothing. But people fill information vacuums with rumors—and such rumors are often more dire than the truth.

Atari was in a volatile organizational environment. The rapid rate of change meant that managers often made decisions and promises on the basis of poor information. One executive compared Atari with his previous employer:

[At the previous company I worked for] you definitely did not make a decision rapidly. If 10 pieces of data were needed and you had 9, you were still risking your job if it didn't work out. At Atari decisions were made with only 2 of these data points.

The presence of uncertainty did comparatively little harm during the period of rapid growth. It led to excitement and fun because things usually turned out better than everyone expected.

But the presence of such uncertainty was anything but fun during the downturn. It meant destructive confusion for indi-

viduals at all levels of the organization. Uncertainty during the decline undermined organizational effectiveness and employee well-being. Top management fed this uncertainty with extended periods of silence, particularly during Atari's most troubled periods. Perhaps leaders were mute on some issues because they were trying to keep secrets. Perhaps silence occurred because top management was waiting to see what was going to happen—because they didn't know. One reason for silence from top management occurred in January of 1983. Sales during the holidays were far lower than had been projected and Atari was swamped with inventory. There were now many competitors, and the size of the video game market had shrunk drastically. Rapid changes were in order. Yet members of top management spent much of this critical period in Washington, D.C., because several top executives faced Securities and Exchange Commission charges of insider trading. These hearings meant that accused key executives, as well as other members of top management, spent large chunks of time in Washington away from Atari. A vice-president who was not charged, but who testified, complained:

They took a week to get me ready. Weekends, the whole nine yards. Then, every time somebody testified, they wanted me to be involved in the debriefing. . . . How can you run a business in that mode? You know you really can't.

The absence of key executives meant that information was lacking throughout the organization. The top executives exacerbated this problem by refusing to delegate authority for strategic decision making to subordinates. As one young Atari manager said, "The company was like a 'rudderless ship.' "

Research by psychologists teaches us that rumors are unavoidable when employees lack information from management. All human beings seek to discover the causes of im-

portant events in their lives, and to predict the onset of such events. People develop and promulgate theories in an effort to make sense of ambiguous (or insufficient) information. Hence, rumors—mostly false rumors—were rampant at Atari during this period. Stories were spread about new products that never existed, about massive layoffs, and about changes in top management. Lack of information did not stop talk—it encouraged talk.

This uncertainty was also stressful for individual employees. As one project manager told us, "The curse of the whole experience was the anxiety that one always felt over what was going to happen." People worried about being fired, about being demoted, about pay cuts, and about loss of "perks."

Finally, we were told that uninformed Atarians spent so much time swapping stories and trying to interpret rumors that their work suffered. Work stopped as employees compared various stories about what might happen. In short, the Atari experience suggests that managers of declining organizations should keep employees fully informed, and we suggest that managers err on the side of too much rather than too little information. Some declining organizations we have studied installed "hot lines" so that employees could get the latest information and inquire about the validity of rumors. Other organizations used weekly mass meetings in which top management spoke about the organization's troubles candidly and answered employees' questions. Since employees *will* talk, it is wise to give them the best available information to squelch wild rumors and let them get on with doing their jobs.

7. Set Realistic Expectations.

Uncertainty was caused by the things Atari's top management *said*, as well as by the things they didn't say. Our interviews, along with

newspaper and magazine articles, suggest that Atari management frequently made promises that they were unable to keep.

Some actions of James Morgan, who relieved Kassar as Atari's president in July of 1983, illustrate handily why leaders had trouble keeping promises during the steep decline. Morgan frequently promised that things were going to get better after many employees had been laid off in January of 1984. One manager told us that Morgan had assured everyone that no more layoffs would occur, because the company had cut costs dramatically. The manager reported that, in fact, until March of 1984 he and his co-workers were confident that Atari had turned the corner:

We'd gone three months without any layoffs—well, two and one-half—and everything looked really good. Then we had a management dinner and everyone expected that Jim Morgan would say, "We did it, folks! We pulled out of the hole. Hurrah for us!" In fact, rumors were that Alan Alda was coming to the management dinner and he would be giving a talk about how much he liked Atari.

The manager remembered that before the dinner began the "survivors" were congratulating each other and slapping one another on the back. A table for "old survivors" was formed. An "old survivor," by Atari standards, was someone who had been with the company more than three years! The survivors' toasts were rudely interrupted by Morgan's speech. Morgan said he had more bad news. He said that more layoffs were coming. He sounded depressed and psychologically defeated. He told surviving managers, "Some of you are gonna be laid off too."

There is no evidence to suggest that Jim Morgan and other Atari executives were trying to deceive their subordinates. Rather, these managers faced two difficulties. The first is what Robert Sutton has described as the dilemma of giving hope vs. taking it away.

In declining organizations, executives must be optimistic if they are to inspire employees to work hard in order to save the company. Hope is also important because it convinces talented employees to continue working for the organization.

But giving subordinates too much hope or false hope is fraught with hazards. Trust is lost when things turn out worse than expected. Employees also need to know how bad things are going to get so that they can take realistic steps to save the company. And the surprise of sudden demotions or layoffs may have negative effects on employees' financial and psychological well-being.

The second difficulty faced by Atari's top management was getting an accurate picture of the market. These managers had created phenomenally successful products like the VCS 2600, "Asteroids," and "Space Invaders"; thus there was a natural tendency to think that the market was still there—that it was only a matter of finding the product that would hit big again. The organization was still growing during the latter half of 1982, and executives were unaware that the market was disintegrating. Developing an effective means for scanning and understanding this volatile market would be difficult for any management team. But when management fails to understand the extent to which a firm is out of step with its environment, the task of setting realistic expectations for employees is difficult if not impossible in such an information vacuum.

Our observation is that, when organizations are declining, executives tend to offer excessive hope to employees. This response arises, we believe, because it is rewarding in the short run to assert that everything is wonderful. No one likes breaking bad news to others. Moreover, it is convenient for leaders to deceive themselves, at least for a time. Self-deception was a special hazard for Atari executives because the collapse was so

sudden and so complete that it was easy to believe that they were in the midst of a passing crisis. But, in the long run, realistic (or even slightly pessimistic) predictions appear to be most effective in declining organizations. We recommend realism because it engenders trust and helps employees plan both for the organization's future and for their own.

8. Use Ceremonies to Reduce Anger and Confusion.

Recent writings on organizational culture encourage managers to use ceremonies to maintain and enhance organizational effectiveness. The timing, content, and style of formal occasions sponsored by management conveys essential symbolic messages to employees. Harrison Trice and Janice Beyer explain that ceremonies serve essential functions including reducing conflict, spreading good news, venting emotion, and acknowledging that an employee has passed from one role to another.

Some of Atari's managers used ceremonies skillfully. One marketing manager told us:

I'd have wine parties on Friday afternoons. We'd hash over the week and what was good and what was bad and what problems still needed to be solved. Sometimes we'd have a guest. Eventually the parties became tutorials on how to do a demand forecast, but we'd still be drinking wine.

But our interviews suggest that Atari's management also used ceremonies during the decline in ways that did harm. This is consistent with Trice and Beyer's assertion that ceremonies can be dysfunctional, particularly when they are implemented without skill or at the wrong time.

We noted earlier that James Morgan planned a big party for managers during which he announced that things had turned even worse and more layoffs were needed. This announcement did serve to reduce un-

certainty. Delivering bad news in an otherwise festive setting, however, upset the party-goers. The fancy setting, nice dinner, and free drinks were interpreted as symbols that things were getting better. Morgan did not intend to upset the managers; he was just not sufficiently sensitive to the unspoken messages conveyed by the ceremony.

Top management sponsored other parties in an apparent effort to raise the spirits of employees. But some of the managers whom we interviewed told us that these ceremonies also backfired.

People were getting laid off and they (Atari's top management) decided to have a party on a Friday afternoon. People were saying, "How silly." I guess they were trying to improve morale, but they really weren't.

The same manager told us that she and her co-workers resented the parties because it was inappropriate to celebrate during such times and, perhaps more important, many of the employees resented the afternoon bashes because they were a waste of money.

We do not mean to suggest that ceremonies, especially parties, should not be used in declining organizations. They should be used, but it must be remembered that any kind of ceremony conveys a variety of subtle messages, and such messages may be different from those intended. The Friday afternoon bash was intended to enhance effort and commitment among party-goers, but most party-goers interpreted it as additional evidence that Atari was wasting money.

Managers in economically strapped companies who wish to use parties to enhance employee commitment and enthusiasm must be aware of such alternative interpretations of their actions. One strategy we have seen used effectively is for management to be intentionally frugal with the trappings and to make such announcements as, "Next year, when times are better, we'll go all out."

Alternatively, employees can pay 27

for their own parties. This strategy can be disastrous if suggested by top management—generating complaints such as, “Management won’t even pay for a lousy party.” But it can be effective if employees suggest such an approach and implement it themselves. By paying their own way, employees convey to each other that they are committed to the company and to one another.

CONCLUSIONS

Leonard Greenhalgh asserts that an organization is declining when it is out of step with its environment. In the case of Atari, this meant that its products were no longer perceived as desirable by customers. Consumer preferences shifted from video games, and machines that played only video games, to personal computers and accompanying software. Atari made personal computers—decent personal computers—but there were three problems that Atari failed to overcome: First, many consumers associated the Atari name with games. Second, Atari was unable to lower its manufacturing costs enough to fend off Commodore. Third, from December of 1982 until July of 1984, Atari failed to introduce any significant new products. New computers were designed during the period, but there was no agreement on how these machines would fit into the Atari product line and the marketplace.

Barry Staw and his colleagues argue that when human beings, groups, or organizations are under stress, there is a tendency for them to rely on well-rehearsed responses and to avoid, or to stop carrying out, less familiar responses. This proposition, which Staw and his associates describe as the threat-rigidity hypothesis, may help explain why Atari’s top management continued to believe in and market products that had once been

successful, but were no longer. After Christmas of 1982, the bulk of Atari’s development, manufacturing, and marketing resources continued to be devoted to home video games and home video game players. By contrast, it appears that top management did not pay sufficient attention to the development, and especially manufacturing and marketing, of home computers.

While computers were the firm’s primary hope for the future, initial financial cuts and lay-offs focused on the division that produced home computers. Leaders retained tried-and-true paths to success (i.e., video games and players) and deemphasized less familiar paths (i.e., home computers). The threat of organizational decline appears to have caused Atari executives to become rigid—in other words, to have trouble unlearning old lessons. As Paul Nystrom and William Starbuck suggest, leaders who wish to avoid organizational crises should be as skilled at unlearning as learning.

Thus layoffs resulted from the failure to adapt to a changing environment. The need for workforce reductions was a symptom of decline, not a cure. Yet over and over again, Atari’s leaders and official spokespersons made statements suggesting that layoffs would fix Atari’s problems. This spirit continued throughout the struggle to save the company. At first, top management acted as if the drop in demand for video games was only temporary. Then they predicted that the drop in demand had leveled off when it was still falling. James Morgan continued this practice of assuring his colleagues that each round of layoffs meant that the company was not in fighting shape. Yet Atari continued to be out of step with its environment.

Atari’s management should have viewed the first indication that workforce reduction was needed as a symptom of decline. When decline is viewed as failure to

adapt to the environment, the "cure" is adaptation, and that may require shrinkage. But it also requires other changes, such as new products and new marketing strategies. Managers in other declining organizations can profit from the lesson that adaptation, not layoffs, is what arrests decline.

The difficulties of managing decline at Atari are especially intriguing and puzzling because of the excellence of the people at the firm. How could such competent managers make so many mistakes? In part, the reason is that we do not know much about decline. The discussion here offers some initial, and inadequate, answers to this question. But scholars and managers must learn more about this phase of an organization's life cycle before a truly satisfactory answer can be offered.

We can learn much about the management of typical organizations by examining the extraordinary. Literature for managers, such as *In Search of Excellence* and *The Art of Japanese Management*, emphasizes what can be learned from extraordinarily successful companies. We contend that the Atari story illustrates that lessons of equal quality can be learned by examining failures. Examining success, as we asserted at the outset, encourages imitation. But examining failure encourages invention.

ACKNOWLEDGMENT

We wish to thank Stanford University's Center for Teaching and Research in Integrated Manufacturing Systems for funding this study of Atari, Inc., and Linda Argote, Leonard Greenhalgh, David Jalajas, Marina Park, and Anat Rafaeli, who made suggestions and comments that improved this paper. We also wish to thank the trio of wonderful research assistants who helped us gather these data: Pamela Epstein, Paul McCright, and Zehava Rosenblatt.



SELECTED BIBLIOGRAPHY

This article draws on the emerging literature on declining organizations. Relevant writings include David Whetten's article "Organizational Decline: A Neglected Topic in Organizational Behavior" (*Academy of Management Review*, Volume 5, 1980), Leonard Greenhalgh's article "Managing Organizational Effectiveness During Retrenchment" (*Journal of Applied Behavioral Science*, Volume 18, 1982), and Raymond Zammuto's "Organizational Decline and Management Education" (*Exchange*, Volume 7, 1982). We also refer the interested reader to Volume 22, Number 4 of *Human Resource Management* for a collection of articles about the management of organizational decline.

In addition, see Robert Kahn's *Work and Health* (John Wiley & Sons, Inc., 1981) for a discussion of the stress caused by unemployment. The threat-rigidity hypothesis is outlined by Barry Staw, Lance Sandelands, and Jane Dutton in "Threat-Rigidity Effects in Organizational Behavior: A Multilevel Analysis" (*Administrative Science Quarterly*, 1981, Volume 6). Also see Paul C. Nystrom and William H. Starbuck's "To Avoid Organizational Crises, Unlearn" in *Organizational Dynamics*, Spring 1984. A useful discussion of ceremonies in organizations is offered by Harrison Trice and Janice Beyer in "Studying Organizational Cultures Through Rites and Ceremonials" (*Academy of Management Review*, 1984, Volume 4). Finally, readers who are interested in how organizations, consultants, and managers can learn from their mistakes should read Phillip Mirvis and David Berg's *Failures in Organization Development and Change* (John Wiley & Sons, Inc., 1977).

If you wish to make photocopies or obtain reprints of this or other articles in ORGANIZATIONAL DYNAMICS, please refer to the special reprint service instructions on page 80.