TECHNOLOGY RIDE SWAMPED BY REALITY

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Imagine that you are going back in time to 1984, when technology stocks were hot, and you come across a particularly glamorous stock with this story to go with it. The company is a pioneer in the manufacture of personal computers and one of the first to give away software with its machines. The California headquarters is near the ocean, and the hip managers sometimes hold meetings in the surf.

Sales have zoomed from $US5 million to $120 million in just two years. The founder is a brilliant engineer with progressive ideas about how to motivate his workers. The press treats him to laudatory reviews featuring his family --he has got his father, two sons, wife and brother working at the company.

That story describes Kaypro Corp, and Wall Street so loved it that it put a market valuation of $US382.6 million on the company. Kaypro is now bankrupt and its market valuation is $2.3 million. The story of how and why it failed is instructive, not only for managers, but for investors in glamor stocks.

One of the warning signs was that profits were always elusive. Investors valued the company at up to five times sales, ignoring the fact that it enjoyed only two profitable years of its nine in the PC business. Since 1986, when Kaypro last made money, losses have piled up to the tune of $US41 million.

What went wrong with this once promising computer maker? Some analysts blame nepotism -- "too many Kays and not enough pros" -- but that is only part of the answer. The truth is, the bizarre dynamics of the

Kay family kept the company from focusing on its main business.

Kaypro began in 1953 as Non-Linear Systems. It was founded by Andrew Kay, now 71, a brilliant if highly eccentric general sciences graduate of Massachusetts Institute of Technology. Kay invented the digital voltmeter and started Non-Linear to market the device to the aerospace industry. He had grown up in New Jersey, but moved to southern California in 1947 to run his profitable little business in electronic test and measurement equipment.

When personal computers appeared late in the 1970s, Kay became fascinated by them and decided to build his own. In the frontier days of the early 1980s, the Kaypro 2 became an overnight hit. The rugged little machine was inexpensive and reliable.

In an industry that celebrates the unconventional, Kaypro earned a reputation for eccentricity. Headquarters resembled a Californian grade school, in a tiny suburb of San Diego, only a mile from the beach. Kay favored the building because it created a healthy environment, allowing ocean breezes and natural sunlight to filter into the offices.

Some of Kaypro's employees were avid surfers and they conducted staff meetings in the ocean. "I wouldn't say the company was run from the water, but we got a lot done in those meetings," one former manager says. "We'd talk when we were sitting on boards waiting for a wave." Kaypro offered employees a free health bar with freshly squeezed carrot, orange and apple juices.

To manage all the growth, Kay turned to his own family. The critical role of marketing vice-president went to his son David, now 44, who spent the 1960s dropping in and out of schools before getting a mathematics degree from the University of California at San Diego. His qualifications included spending time surfing in Hawaii and selling windmills. Other family members on the payroll included Andrew Kay's eldest son, Allan, 46, who was given the fancy title of vice-president of administration; his wife, Mary, 71, who was Kaypro's secretary; Kay's brother Stephen, 69, who still runs the company's print shop; and father Frank, 94, who looks after maintenance.

But family squabbles frequently got in the way of business. Marketing man David Kay found it impossible to rein in his over-optimistic father and cut back on inventories. In 1984 Kaypro had millions of dollars worth of parts it could not use, so the Kays erected a circus tent to serve as a makeshift warehouse to accommodate the glut. But the tent was virtually impossible to guard and components worth several million dollars disappeared that year.

Even though Kaypro had parts to build enough computers to last six months(most computer companies today rarely keep more than half that on hand), Andrew Kay kept on buying more parts. David stopped arguing and went into action. He moved his desk to the loading dock and sent truck drivers away before they could unload their shipments.

Kaypro was so busy coping with its frenzied operations that there was no time for planning. As a result, the company failed to recognise the need to introduce a computer that was compatible with IBM's popular PC family.

When Kaypro woke up in 1985 and brought out a competitive IBM clooe, it was too late. The Kaypro portable was designed around an obsolete operating system called CP/M.

The squabbling between father and son increased. David Kay was named president in 1985, but his father remained very much in charge. "I was the president, but it was strictly a title," David Kay acknowledges today. Andrew Kay had been an authoritarian father. When David was an adolescent, he was discouraged from listening to rock and was constantly pushed to improve his vocabulary after an aptitude test showed up this weakness. Andrew Kay is still obsessed with vocabulary-improvement schemes that his company might market one day.

It seemed as if every decision turned into a fight between the two men. Andrew Kay thought that sales were slowing because computers shipped from headquarters took too long to reach Kaypro's dealers. To shorten the distance to dealers, Andrew wanted to open warehouses around the country. David fought the concept, but his father would not listen until it was tried and had failed.

As the situation became more desperate, the old man's ideas became still more odd. He wanted to augment dealers with Kaypro-owned retail stores and a direct sales force, both costly solutions the company could not afford. He doubled Kaypro's sales force to 42 in 1987. He hired mostly members of the Church of Latter Day Saints recruited by elder son Allan, who earlier had left the Unitarian Church to become a Mormon. When David asked his father to explain, he would say: "You can trust the Mormons. Howard Hughes did it."

"We had a communication problem," says Andrew Kay, who has seen most of his$US100-million paper fortune vanish and who is the largest unsecured creditor in Kaypro's bankruptcy case. "I used to talk to David a lot when he was young. But when we worked together, he didn't talk to me. To him, my questions seemed like threats. We weren't getting along at all."

David Kay sees things differently. "I had no control over what was happening," he says. At the end of 1988, David Kay quit the company to become a consultant.

In March this year the Kays brought in an outsider to handle the reconstruction, but there is not much left to rebuild. David quit a marketing job at Bluebird Systems, a small San Diego software company where he had worked for a month, about that time to advise his father. He now spends much of his time trying to convince lenders that Kaypro has a future. "I feel obligated to do what I can to bring it back," he says.

Its parking lot is empty and the offices are like a ghost town, but Andrew Kay, the founder, remains an optimist. "The seas will be calmer, the holes will be plugged, and it will be full steam ahead." He is quite an idealist and quite an ideas man. But investors are better off with a manager whose feet are firmly on the ground.