Blockbuster Inc.

BLOCKBUSTER VIDEOS
CASE STUDY

Prepared By,

Mohammad Zardar Waseem

Q.1 What business problems are faced by Blockbuster video?

Ans.

INTRODUCTION AND PROBLEMS FACED BY BLOCKBUSTER VIDEOS

Blockbuster was started by David P. Cook, a Dallas computer expert who wanted to develop a big, bright, computerized video superstore. H. Wayne Huizinga purchased a stake in the company in 1987, became its chairman within months, and was the catalyst for its growth. Huizinga is the son of Dutch immigrants and began his career driving garbage trucks. He started a garbage business in Miami that merged with his grandfather's in Chi-cago. At one point he went on a buying spree and bought 90 garbage companies in nine months. Ultimately, he merged all of his companies together into Waste Management Cor-poration. Huizinga applied the same fervor to the purchase and opening of video stores. In 1987, Huizinga moved the corporate headquarters to Fort Lauderdale, Florida; overseeing 200 stores at that time.

At the end of 1990, Blockbuster owned 787 stores and franchised 795. Even so, it represented only 11 percent of the market. As a result, Blockbuster Company executives planned to open 400 stores per year and double the market share over the following three years.

In 1994, Huizinga sold Blockbuster Video to Viacom for $8.9 billion [Shapiro 1997]. Headed by Sumner Redstone, Viacom is an entertainment industry giant, with ownership in movie studios (Paramount), cable television, television broadcasters (CBS and UPN), and radio stations (Infinity).

By 1997, the business slumped. Redstone eliminated two-thirds of the corporate jobs and moved the headquarters back to Dallas [Shapiro 1997]. Although criticized by many, Redstone defended the merger. One of the more interesting perspectives is that in those three years, Blockbuster generated $1.5 billion in cash flow—largely used to pay down the debt used to purchase Paramount. In other words, Redstone used Blockbuster as a cash cow—milking the revenue stream to pay for his other acquisitions. In 1997, Viacom took a charge of $300 million to write down inventory at Blockbuster [*Wall Street Journal* 1997]. Redstone told stockholders he would sell off Blockbuster within a year.

What happened in three years? The biggest change was changing rental patterns. As more households acquired cable TV, customers no longer wanted to rent older videos. In-stead, everyone wanted to rent the same two or three hit movies on the weekend. Block-buster originally had strength by investing in a wide collection of titles. With the new ap-proach, customers only cared about the new releases. That meant that Blockbuster needed to buy hundreds of copies of a single title. But, at $65 a tape, those costs were high—and after about a month, people moved on to rent the next release, so the store no longer re-ceived money to cover the original purchase price.

In 1997, CEO John Antioco found a solution. He negotiated a deal with the leading Hollywood studios. Blockbuster would purchase tapes for $6 upfront, then give the studios 40 percent of the rental revenue. The deal gave Blockbuster a huge advantage in the mar-ket for new releases. Blockbuster advertised that customers would always find specific new-release titles in stock, or they would get a free rental on the next trip. Competitors could not match the cost savings. About 2,500 of them (10 percent of the U.S. market) went out of business [Harnish 2003].

The deal also required Blockbuster to carry every title released by the studios [*The Wall Street Journal* 2001].

The interesting point of videos is that by 2000, the movie studios were making more money at the rental counter than at the theater. Home video was brining in $2.9 billion in revenue, versus $2.2 billion in the theaters. So, the studios had a huge incentive to build stronger ties with the leading video rental company. Given the new cash flow, Redstone de-cided to keep Blockbuster, having sold off only 18 percent of its shares.

But, entertainment technology rolled on. By 2001, the world was quickly switching to DVDs for movies. In late 2001, Blockbuster again had to write down its inventory of tapes (and many video games) by $450 million [*The Wall Street Journal* 2001]. Eliminating 25 percent of its VHS inventory, the company moved into DVDs. The growth in DVDs con-tinued. By early 2002, U.S. consumers had purchased over 31 million DVD players [Orwall, Peers, and Zimmerman 2002].

The catch with DVDs is that the movie studios radically altered their strategy. In-stead of emphasizing the rental market, the studios released new movies on DVD for sale at $20-$30 each. Additionally, DVDs do not deteriorate with playing, so customers feel it is easier to simply purchase the DVD. The discount chains or Wal-Mart, Target, and Best Buy jumped into the deal and use the big movies to lure shoppers into their stores. DVDs a few months old often sell for as little as $10. Hollywood is torn—while they make money on each sale, the companies no longer receive the ongoing rental income. The deal with Block-buster never applied to DVDs. The big retailers are happy and will fight any changes. Wal-Mart spokesman Jay Allen notes that “Wal-Mart will not be happy if the prices start inch-ing up. Our customers want fresh DVD product for under $20. You can’t put the genie back in the bottle” [Orwall, Peers, and Zimmerman 2002]. Warner-Brothers is one of the drivers for low pricing. In effect, trying to wrest control of the rental market away from Block-buster. Warren Lieberfarb, CEO of Warner Home Video noted that Blockbuster controlled 40 percent of the rental market and often used that clout in negotiations with Hollywood, using “that share to increase their margins at the expense of the studios” [Orwall, Peers, and Zimmerman 2002].

In 2002, customers spent considerably more on DVD purchases than on rentals—a first for the industry. Retail sales reached $12.26 billion and rentals slipped to $9.92 billion [Peers February 2003]. Feeling the squeeze on rentals, in early 2003, Blockbuster re-sponded by moving more into sales. Yet, in 2002, Blockbuster made 80 percent of its revenue in rentals (and late charges). Rentals are profitable, with a margin of 65 percent, ver-sus 15 percent in retail sales. In 2002, Antioco pushed Blockbuster into sales, selling both new movies and previously viewed titles. Antioco knows he cannot compete with Wal-Mart—which has a 20 percent market share in DVDs. He notes that "What we are about is convenience, selection" [Peers February 2003]. Mr. Redstone was not convinced observing that "we have decisions to make. Do we spin (it) off? Do we sell it? There are companies who would buy it. Do we keep it? Do we buy it in? We don't know the ultimate answer. We should be very careful, skeptical, and questioning about the future of Blockbuster" [Peers February 2003]. At the end of 2003, Blockbuster had $4.5 billion in revenue from rentals and $1.3 billion from sales of merchandise [www.blockbuster.com].

By 2003, the DVD rental market became even more tangled. Netflix (ticker: NFLX), an e-commerce startup, threatened the entire rental model. Netflix customers sign up on the website and enter a list of preferred movies. They pay a monthly fee (about $20), and Netflix mails them up to three DVDs. Customers keep the movies as long as they want—with no late charges. When they return a movie (postage paid), Netflix looks at the list and ships them another one. By 2003, Netflix was shipping 300,000 DVDs per day to over one million subscribers; accounting for almost five percent of the U.S. home rental market. Net-flix faces the same problem Blockbuster had—it cannot stock enough of the new release ti-tles to keep all customers happy. However, it simply ships another title on the customer's list, so customers get at least something that they want. The process means that Netflix circulates 98 percent of its 15,000 at any point in time [Null 2003]. Blockbuster (and Wal-Mart) ultimately responded with similar programs. However, Netflix remains the leader—largely from word-of-mouth support by its existing customers.

In 2004, Blockbuster tried a new technique to fight Netflix: trade-ins of DVDs. Since DVDs effectively do not wear out, the quality of used copies is as good as the original. The company tested the system at a few U.S. and Scottish stores, and decided to roll out the program to 2,000 U.S. stores [*Marketing Week* 2004].

In the meantime, Viacom got serious about divesting Blockbuster. In the third-quarter of 2003, the company experienced a 9.1 percent drop in same-store revenue [Peers December 2003]. In a press release on June 18, 2004 [www.blockbuster.com], Viacom announced that it would split off Blockbuster. Viacom shareholders could exchange Viacom shares for the new

Blockbuster shares. The deal was designed to be completed in the third quarter of 2004.

Blockbuster Technology

Blockbuster's original barcode checkout system was written for a Digital Equipment Corporation MicroVAX running FORTRAN code. The checkout terminals were simple DEC terminals. Each MicroVAX is tied to a Digital cashier system, printers, a manager's work-station, and a modem. Blockbuster Video was not online. Each store was called by the corporate headquarters twice a day. Blockbuster maintained this arrangement because it was simple, solid, reliable, replicable, and consistent.

As the CIO of Blockbuster in the 1990s, H. Scott Barret's goal was to keep the or-ganization "technology appropriate." He believes there is a "herd mentality" about client-/server systems and has publicly questioned the financial return on this additional invest-ment. In his opinion, many companies are pressured to implement client-server by the collective weight of hype issued by the press and vendors.

Q.2 What types of data do they need to collect? How is it collected? What types of reports are produced?

Ans.

Video Game Market In 1994, Blockbuster formed a joint venture with IBM called NewLeaf Entertain-ment. The goal was to develop a new way to rent video games and even music. Retail stores, such as Blockbuster, would host a server that contained all of the video games. Customers would select a game, and the system would burn a copy onto a cartridge or possibly a CD-ROM. The NewLeaf system could stamp out any Sega Genesis game on a blank cartridge in less than a minute. The system eliminated the inventory problem and made it possible for every customer to

leave the store with a game in hand and money safely deposited in the cash register.
NewLeaf president David Lundeen, hoped to expand the NewLeaf system beyond the rental market into toy and electronics stores. He envisioned stores being able to sell children their first game on a rewritable cartridge for approximately $70. When children tired of the game, they could bring the cartridge back to the store where a salesperson would use the NewLeaf system to reprogram it with a new game for a lower price, perhaps $30. The stores and game publishers would make more profits through additional sales and lower materials costs. The game players would save money and be able to play more games. NewLeaf would make money selling its system.
NewLeaf’s server was designed to support rewritable CDs as well as cartridges. Lundeen presented this option to the music industry for adaptation to the audio CD mar-ket. However, an earlier proposal to the music industry by a different company was turned down, largely because the industry feared loss of sales due to illegal copying.

Blockbuster Video Enters the CD-ROM Market

Blockbuster Video test marketed a new program in 57 company-owned stores in its San Francisco market. As part of the trial, Blockbuster stocked more than 200 CD-ROM titles from more than 37 software publishers. These included Compton’s NewMedia, Soft-ware Toolworks, and the Voyager Company. Fast-action games proved to be most popular. Titles ranged from games and adventure to education, entertainment, and reference. Each of the stores carried five different hardware platforms: Panasonic's Real 3DO Multiplayer, Sega’s Genesis CD player, Philips’ CD-I platform, Apple’s Macintosh TV and IBM’s PS/1 computer system.
Blockbuster carried a range of action and strategy games, educational programs, and reference works. For $4, any program could be rented for three evenings. Blockbuster charged $14.95 to rent a SEGA, Magnavox, or Panasonic CD player, and $19.95 to rent a player and three programs for three evenings.
Blockbuster’s business model for the pilot was based on extensive research in track-ing consumer profiles and buying habits at its stores. Research indicated that the average Blockbuster customer profile is one that every multimedia publisher desires. Typical cus-tomers are in their mid-thirties, are

married with children, and have median incomes of more than $50,000. The percentage of Blockbuster customers with personal computers in their homes is nearly two times the national average. Additional data that convinced Blockbuster to pursue new media markets came from the game industry. Sega concluded that three out of five of its video games are rented before they are purchased. *Gaming* magazine and *Game Pro* both found that more than 80 percent of the people they ques-tioned would prefer to rent game cartridges and CD-ROMs before buying them.

Blockbuster Video Enters the Modem Market

Realizing that the video rental market is particularly susceptible to technological change, Blockbuster Video became a substantial investor in Catapult Entertainment. Based in Cupertino, California, the venture’s first two products were a modem for 16-bit game con-soles and an online service to connect them. The modem plugs into a console’s cartridge port and includes a port for a second cartridge. It was available for Sega Genesis and Nintendo’s Super NES. Catapult positioned the system to support existing multiplayer games without modification. Players inserted a game into the modem's own cartridge port and then dialed into Catapult’s network. There, they were paired with a connected opponent who had the same game cartridge installed, and with whom they could exchange messages while play-ing. The service was available for a monthly base fee for a fixed number of games.

Blockbuster’s research indicated that players buy games for their competitive as-pects; competing via the phone lines was expected to be popular. Catapult cost $5 to $10 per month to play, paid by check, credit card, or cash using a rechargeable Smartcard that functioned like a debit card. The card was charged at a retail outlet and then debited when inserted into the Catapult modem. Parents could control game play by setting spending lim-its on the account or on the Smartcard.

Games Today

Of course, the problem with all of the fancy game technology is that the underlying hardware world changed. Sega and Nintendo slipped from view as the Sony Playstation and Microsoft X-Box, along with PCs, conquered the gaming world. Additionally, fear of mass copying scared most vendors away from the technologies.

Finally, the Internet made it pos-sible for game machines and personal computers to connect directly to each other or through central game services—without the need for cumbersome services. In the mean-time, Blockbuster still rents games—but they are handled much like DVDs, where everyone rents an original copy.

Blockbuster Experiments

One thing you have to say about Blockbuster management is that they appear to have tried almost every retailing option under the sun. In 1996, new chairman Bill Fields, fresh from a stint at Wal-Mart, decided that videos were not the answer. He even removed the word “Video” from the store’s name in advertising. His goal was to make the stores a neighborhood entertainment center. But, he also stocked the shelves with CDs, movie mer-chandise, and candy [Goll 1996]. Ultimately, the retail attempts were failures and irritated the customers. Fields did not survive long. For a while, the company even tried using its ties to the other companies in the Via-com stable. Blockbuster had acquired several hundred music stores that it tired to merge into the system. Since Viacom owns MTV and VH1, Gerry Weber, one-time president of Blockbuster Music, tried to get help in lining up emerging singers to support the stores. He commented on the failure of MTV to respond “As far as getting any leverage from being as-sociated with MTV and VH1, it just didn’t exist. I often felt I would have been treated bet-ter if I had not been part of the company” [Shapiro 1997]. Ultimately, facing severely declin-ing sales, the music division was sold to Wherehouse.

In 1998, Blockbuster launched an EntertainmentMinder service for customers. Cli-ents could subscribe free and receive weekly messages about new video, music, or game re-leases. They could also receive special offers. Remember that the Blockbuster system tracks all rentals by customers, so the company can evaluate the success of its promotional cam-paigns [Diederich 1998]. Although the name has been changed, most of the features remain with the e-Newsletter system.

In 2001, Blockbuster again turned to retail sales—this time with Radio Shack as a partner. Radio Shack created its own small stores within several thousand Blockbuster stores. The Radio Shack stores will remain independent and have their own sales staff, in-ventory control, and POS systems. The main goal for Radio Shack was stated by Radio Shack's CEO Leonard Roberts as "access to more than 3 million Blockbuster customers each day, including more women and young adults" [Ulfedler 2001]. In exchange, Radio Shack gives Blockbuster a license fee for using the space.

Alternative Video

Almost since the beginning, people have predicted that Blockbuster's life span is lim-ited. In theory, new technologies should remove the need to rent videos—or at least make it easier, so that customers do not have to physically pick up and return the tapes or DVDs. Cable TV, satellites, and pay-per-view have been some of the biggest threats. As the home-delivery systems add channels and multiple pay-per-view movies, people can easily rent the same video directly. Of course, the systems do not provide total control to the viewer—there is still limited selection and a limited number of start times.

For over a decade, technologists have hyped video on demand. A concept where cus-tomers would be able to have any movie delivered digitally at any time—for a fee. Several companies have attempted to create these systems. Some even suggested that videos could be sent down phone lines to a customer's television set. Several companies experimented with sending video over the Internet. It was always a stretch to believe that people would want to watch movies in real time over the Internet on their personal computers. It was even more of a stretch to believe that the bandwidth existed. An early 2000 report sug-gested that if

100,000 people simultaneously watched a 30-minute video online, it would hog five percent of the Internet's bandwidth [Kontzer 2001]. Streaming video technologies have improved since that time, but the Internet was never designed for broadcast signals—where everyone watches the same thing from one server at the same time.

Blockbuster tried to jump into the game and in 2000, signed a 20-year partnership with Enron Corporation to deliver video on demand [Li 2000]. The deal quickly died, even before Enron crashed and burned in the giant accounting scandal. The subsequent ar-rangements left Enron feeling less than satisfied, and it broke off the relationship. "From Enron's standpoint, the main reason for discontinuing the relationship had to do with con-tent," said Enron spokeswoman Shelly Mansfield. "We just felt that, through the exclusive relationship, we weren't able to attract the quality or quantity of movies that is necessary to really make this service thrive." According to media analyst Tom Wolzien, "Nobody has a network to the consumer here, and Blockbuster couldn't get the movies" [Kerschbaumer 2001]. Blockbuster executives were probably happy the relationship fell apart before En-ron's accounting scandal and collapse in 2002.

Blockbuster also tried to setup a deal with MGM in 2000 to stream recent releases from that studio off its website [Tedesco 2000]. The deal never really made it past an experimental test, and downloads of movie trailers (pre-views).

In 2004, you can actually watch some movies from your PC, through Movielink.com, a studio-sponsored site. The system uses Microsoft's digital rights management technology to protect a downloaded video file. You do not have to be connected to watch the movie. In-stead, you download a one-half gigabyte file and can watch it as often as you like within 24 hours. To reduce download times, the quality is substantially below the level provided by DVDs. And, relatively recent releases rent for a whopping $5 [www.movielink.com].

One of the stranger relationships that Blockbuster entered was a partnership with DirecTV, the digital satellite provider. In 2000, the company began signing up subscribers at its Blockbuster Video stores. CEO Paul Antioco stated that "Our goal, which we are highly motivated to achieve under this agreement, is to add significantly to our financial outlook by having as many Blockbuster customers as possible subscribe to DirecTV and en-joy movies over pay per view" [Scally 2000]. Since the movie studios own the rights to the videos and would presumably make most of the money on pay-per-view, it is not at all clear how this step was going to generate money for Blockbuster. On the other hand, at that time, Blockbuster did receive some revenue for selling the base systems. Today, the satellite companies provide the equipment and installation free—and Blockbuster no longer pushes the sales.

In 1990, Blockbuster planned to categorize its 30 million customers according to the types of movies they rented and to "sell information from the database ... to direct mailers, for planning target-marketing campaigns." Blockbuster used sophisticated computer sys-tems to keep records of each individual's transactions. The plans raised difficult privacy is-sues for the same reason it would prove to be a gold mine for direct mailers. Video choices are among the most revealing decisions a consumer makes [*Wall Street Journal* 1990]. While a federal law forbids video stores from disclosing the names of the movies its custom-ers rent, it does not forbid stores from telling direct marketers "the subject matter" of the movies a customer has rented. Blockbuster, whose members represent one out of six Ameri-can households, says its database will be legal because it monitors video categories, not specific titles. In 1990, the chain organized its shelves by 37 categories, with plans to add 30 to 40 more.
Blockbuster ultimately implemented client-server, to recapture the major benefit of-fered by its legacy system, a consistent retail systems architecture. In 1994, Blockbuster acquired a music store business that ran different systems and had different requirements than its video stores. The music stores came with five different PC-based systems. Block-buster Video wanted to get back to a single system for all its stores. To standardize its re-tail systems, Blockbuster worked with Microsoft and Oracle to build a Windows NT-based retail system to be implemented throughout its stores worldwide. As it migrated to client-server, Blockbuster maintained its traditional host architecture. All processing occurs on the server; client computers are relatively dumb. Blockbuster was looking for other benefits from moving to client-server: reduced training; reduced support costs; and access to more advanced technologies, software, and graphical user interfaces.

To further its ability to track its customers, Blockbuster tracks every single cus-tomer’s rental history, every single store’s daily business, and every single store item’s sales record. Data on more than 40 million customers gives Blockbuster an important source of information on consumer demographics and purchase decisions.
With a consolidated database, Blockbuster turned to Hyperion’s Essbase analysis software. The company uses the tools to analyze things like the effects of weather on rent-als and exploiting peak rental times. The company originally estimated that it could save $30 million in operational costs over the life of the project—largely by automating the data analysis [Songini 2001].
In its quest to become the neighborhood entertainment source, Blockbuster uses its extensive consumer database to select the product mix. “The goal is neighborhood retailing and the customization of each product for each store,” says marketing manager, Baskin [Desjar, 2001]. “The key is to cater to the local market and service the local customer.” Baskin says the chain has the “strategic advantage” of knowing the entertainment buying habits of half of the households in the United States. Managers at individual locations will have the most input on which products to stock. “Having unmatched demographic informa-tion is a great guide, but it’s not a silver bullet,” says Baskin.
Blockbuster tried to diversify by expanding into music stores. It even attempted to add book sales, tailoring the titles to specific locations. In 1999, after consistently losing money, Blockbuster sold all of the music stores.
In 1999, Blockbuster outsourced the main order-management services for its website to OrderTrust [Bacheldor 1999]. The company provides the software and security to handle the sales transactions. It also provides links to multiple suppliers. Consequently, the Blockbuster site can advertise many different products, and the orders can be routed to separate suppliers.

Q.3 Why did the games systems fail?

Ans.

Games Today Of course, the problem with all of the fancy game technology is that the underlying hardware world changed. Sega and Nintendo slipped from view as the Sony Playstation and

Microsoft X-Box, along with PCs, conquered the gaming world. Additionally, fear of mass copying scared most vendors away from the technologies. Finally, the Internet made it pos-sible for game machines and personal computers to connect directly to each other or through central game services—without the need for cumbersome services. In the mean-time, Blockbuster still rents games—but they are handled much like DVDs, where everyone rents an original copy.

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Q.4 How could Blockbuster use its customer database to increase revenue or profits?

Ans.

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Q.5 Will video stores be around 10 years from now?

Ans.

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