CASE STUDY

The Demise of Blockbuster

After struggling with debt and strong competition from Netflix and Redbox, Blockbuster, Inc. filed for bankruptcy in September 2010. This was a sad end for a company that had dominated the movie rental business in the 1990s. Blockbuster Inc. was founded by David Cook in 1985 with its first rental outlet in Dallas. Cook planned to take advantage of a highly fragmented video rental market, in which most of the stores were relatively modest family operations that carried a small selection of former big hit movies mainly due to the high cost distributors typically charged (about $65 per tape). With 8,000 tapes covering 6,500 titles, Blockbuster had a much broader and deeper inventory compared with that of its nearest competitor. The store operations were also greatly streamlined by a computerized system for inventory control and checkout. The store was a huge success, which prompted the addition of three more locations by mid-1986.

In 1986, because of liquidity problems, Cook was forced to turn over the whole company to a group of investors led by Wayne Huizenga. Between 1987 and 1993, Huizenga grew Blockbuster into an enormous success. During this period, Blockbuster opened stores around the globe at the rate of about one every 24 hours. By 1993, Blockbuster was the leading global provider of in-home movie and game entertainment, with more than 3,400 stores throughout the Americas, Europe, Asia, and Australia. Blockbuster stores were a ubiquitous neighborhood feature that stayed open 365 days a year, generally from 10 a.m. to midnight. Merchandise selection, quantity, and formats were customized at the store level to meet the needs and preferences of local customers.

In the early 2000s, though, Blockbuster began to see real competition from the burgeoning online rental market as DVDs started to replace tapes. Its major competitor was Netflix, launched in 1997. In addition to being cheaper to purchase than tapes, DVDs were well suited for shipping by mail because they were less expensive to ship and less fragile than tapes.

Netflix challenged Blockbuster on two key dimensions—variety and late fees. Whereas Blockbuster stores generally carried about 3,000 titles, Netflix initially offered more than ten times that amount. In addition, Netflix did not charge Blockbuster's greatly disliked "late fees," instead allowing customers to keep titles as long as they wanted. Netflix's monthly subscription plan offered unlimited mail-order rentals for $9, the cost of two rentals at a Blockbuster store.

Meanwhile, Redbox, a unit of Coinstar Inc., operated vending machines that rented DVDs for as little as $1 a night. Despite its best efforts, Blockbuster's brick-and-mortar stores could not match the low-cost operating models of Netflix and Redbox, leading to its bankruptcy (see financial results in Table 2-5).

Netflix

Netflix was founded in 1997 by Reed Hastings as a pay-per-rental mail-order video rental company. After experimenting with both pay-per-rental and subscription, the company settled on a subscription-based strategy by the end of 1999. By 2010, Netflix had 13 million members and was the world's largest subscription service, sending DVDs by mail and streaming movies and television episodes over the Internet. For $8.99 a month, Netflix members could have any of more than 100,000 DVD titles delivered to their homes and could instantly watch a smaller set of television episodes and movies streamed to their televisions and computers. Netflix shipped some 2 million discs daily in the United States.

Netflix focused its strategy around offering a large variety of titles, helping customers navigate titles with a sophisticated recommendation engine, and ensuring that titles reached customers quickly. Whereas a bricks-and-mortar rental store typically carried about 3,000 titles, in 2010 Netflix offered its customers a selection of more than 100,000 DVD titles, most of which were old releases. In 2009, about 70 percent of the DVDs shipped by Netflix were titles with release dates older than thirteen weeks.

In 2010, Netflix had about 60 regional distribution centers across the United States, with sophisticated systems to track customers' DVD queues. As the distribution center processes were linked to the recommendation software, movies that were likely to be in stock were recommended to customers. When the distribution center received a watched DVD back from a customer, a new one from the customer's rental queue was shipped out. These distribution centers were highly automated for rapid processing and were located within driving distance of several U.S. Postal Service processing facilities. Netflix estimated

TABLE 2-5 Financial Results for Blockbuster, Netflix, and Coinstar in 2009 (in millions of dollars)

	Blockbuster	Netflix	Coinstar
Revenue	4,062	1,670	1,145
Cost of revenue	1,884	1,079	793
Gross profit	2,178	591	351
Operating expenses			
Sales, general, and administrative	2,020	289	150
Total operating expenses	2,533	399	267
Operating income	(355)	192	84
Net income from continuing operations	(518)	116	29
Net income	(558)	116	54
ASSETS			
Receivables	79	—	61
Inventories	639	37	104
Total current assets	1,060	411	391
Property and equipment at cost	2,374	266	759
Accumulated depreciation	(2,125)	(134)	(358)
Net property, plant, and equipment	249	132	400
Total assets	1,538	680	1,223

that it would spend about $600 million in 2010 on shipping expenses.

Netflix's ability to rent older titles was very appealing to studios that had historically seen little revenue from this content. Netflix bought older DVDs from studios at cost and, in turn, provided them a percentage of the subscription revenue based on utilization for rentals over a specified period (typically 6–12 months). For newer content, Netflix did not attempt to serve the entire initial rush of rental demand. Given the higher initial cost of purchase, the company purchased only a limited number of new release DVDs, preferring instead to wait a few weeks and buy the bulk of its supply at lower cost. Customers could put new titles into their queues and receive them when the DVDs became available in stock.

Between 2005 and 2009, Netflix delivered excellent financial results and grew revenues by 150 percent and profits by about 175 percent. Despite the strong performance of its DVD rental business, however, the company was focused on increasing the fraction of digital content it delivered. Its streaming service, launched in 2007, allowed customers to watch select movies and content on the Netflix website via their PCs. By 2009, the Netflix service offered more than 17,000 titles (although most new releases were not included in the selection) streamed through a variety of devices. By 2013, the streaming service contributed majority of Netflix's revenue, although most of the profits still came from the DVD mailing business.

Redbox

The concept of Redbox originated in 2002 within McDonald's Ventures, LLC, which was working to identify new ways to drive traffic to its restaurants and provide added convenience and relevance to customers. Redbox's first kiosk was launched in 2004 in Denver. Coinstar, Inc. purchased Redbox in early 2009.

Redbox's strategy was based on targeting the budget-conscious movie renter who wanted to quickly rent a DVD for immediate use. Redbox met this need by placing its automated red kiosks at easily accessible locations, where customers could rent movies for $1 per night. Movies could be returned to any Redbox machine and no membership was required.

By early 2010, Redbox had approximately 23,000 kiosks nationwide, including in select McDonald's restaurants, leading grocery stores, and Walmart, Walgreens, and 7-Eleven stores. Redbox planned to more than double the number of its kiosks by 2012. Retailers, who were struggling to keep people shopping, realized that having a DVD kiosk in a store created foot traffic. In some cases,

retailers even offered discounts that essentially made it free for Redbox to install a kiosk.

Each Redbox kiosk carried about 630 discs, comprising 200 of the newest movie titles. A Redbox kiosk rented its average DVD 15 times at an average of $2 per transaction. After that, the used DVDs were made available for sale to customers for $7.

By mid-2010, Redbox accounted for 25 percent of DVD rental volume, more than Blockbuster. The company was on course to generate more than $1 billion in annual sales, faster than Netflix was able to achieve that milestone.

Study Questions

1. In what ways did Blockbuster achieve better strategic fit than local stores?
2. How did Netflix and Redbox achieve better strategic fit than Blockbuster?

CASE STUDY

Rise and Fall of Subhiksha

A Classic Case of Lack of Strategic Fit

The meteoric rise and equally dramatic fall of Subhiksha, one of the earliest entrants in the Indian organised retail sector spanning about a decade (1997–2008), makes an educative case study of mis-match between the competitive and supply chain strategies. The no-frills deep discount store offering a whole range of branded consumer items from its 1,665 stores in the country, at prices lower than any of its competitors at any of those locations presented a replica of Wal Mart, the world's largest and most successful discount store. The image was appealing and the offers most attractive for the Indian consumer which led its promoters in their early years to believe that they had come up with the right solution for the burgeoning Indian retail industry in its transformation from traditional to organised format and could spread their presence throughout the country. This belief was strengthened by the investments that poured in from some of the largest corporate houses in the country reflecting their confidence in the viability and growth of this strategy and format in Indian conditions.

However, by 2006–2007, Subhiksha found itself in deep trouble due largely to cash crunch and failure to sustain its wide spread distribution network, including meeting its obligatory requirements like wages for the staff, leading to its demise in 2008.

While some experts attribute the failure of Subhiksha to global recession and credit squeeze resulting in problems of liquidity, they failed to realise its fundamental failure to achieve and maintain a strategic fit between its competitive and supply chain strategies.

Subhiksha started off basically as a food and grocery store, selling branded items in this category. It went on a diversification drive to add more consumer goods, including mobile phones, which operate at rather low margins in a highly competitive market environment.

Subhiksha failed to realise that the factors that led to the success of Wal Mart went far beyond the simple operational cost reduction measures, such as non-AC, small-sized stores, but was based on more strategic approach to cost reduction essential to support a low-price leadership competitive strategy. It failed to see the impact on inventory carrying costs in a wide spread network where the square root law of inventory operated. It also lost sight of the fact that the larger the number of facilities, higher their maintenance and staff costs. Transportations costs also increase beyond a certain level of increase in number of locations to be served and the control of such a widely spread network of facilities has its own problems. Above all, its lacked communication network and infrastructure, like Point of Sale Capture of Data (POS) and Cross Docking that ensured continued and seamless flow of material from end to end in a highly efficient supply chain without any intermediate storage point to support their Every Day Low Price (EDLP) claims.

Subhiksha is now reported to be staging a comeback and will hopefully appreciate that major adaptations in foreign models are necessary to suit Indian conditions due to a large number of infrastructutural infirmities, less than fully reliable deliveries, frequent disruptions in the supply chains.