

Built to Fail

The Inside Story of Blockbuster's Inevitable Bust

by **Alan Payne**



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THE SUMMARY IN BRIEF

Have you ever wondered why dominant companies fail? How seemingly invincible corporations just fade away? If you were a teen or adult in the 80s, 90s, and early 2000s, you probably spent a fair amount of time at Blockbuster. It was a behemoth for many years, and then...it wasn't.

Alan Payne is the single most successful Blockbuster franchisee in the company's history, and in *Built to Fail* he outlines exactly what Blockbuster did wrong—and how it all could have been prevented. How did Blockbuster go from a sure bet to what Carl Icahn called ‘the worst investment I ever made’?

It turns out that streaming didn't kill Blockbuster—its culture and leadership did. In *Built to Fail* and this accompanying summary, it's time to find out why. Trace the incredible rise, massive domination, and eventual fall of the world's most famous video store and discover how the lessons of what went wrong and what could have gone right can help owners, entrepreneurs, and managers everywhere build more resilient businesses.

IN THIS SUMMARY, YOU WILL LEARN:

- How Blockbuster rose from small video store chain to the leader in video rentals worldwide.
- The management change that led to Blockbuster's initial decline.
- How Blockbuster's own actions (and inaction) were more devastating than anything Netflix or other competitors did.
- What leaders can learn from Blockbuster's mistakes.

Introduction

Despite popular belief, Blockbuster was in severe financial trouble long before Netflix ever streamed a single film. So if streaming didn't kill Blockbuster, what did? How can a company that so dominated an industry be in an almost constant struggle to survive? Because through its brief twenty-five-year history, the only thing Blockbuster ever did better than everyone else was open more stores. But when competitors multiplied and opening more stores was no longer enough, Blockbuster was helpless.

Blockbuster was phenomenally successful in its early years and made thousands rich beyond their wildest dreams. But it was built to grow and nothing else. Even though leaders at the company had ample time to rescue Blockbuster from itself, we all know how that worked out. Blockbuster became one of the most iconic brands in the history of American business, but it cracked at the first sign of a challenge. From its founding, Blockbuster was a company built to fail.

America Goes to the Video Store

In the 1980s, landmark court cases established the right for video rental stores to rent out films to customers. Meanwhile, the video rental industry launched and funded an unprecedented movement for independent films, which could find a home in video rental stores they would have never found in major theaters.

Video rental businesses began to explode. Video Station boasted 500 stores, while smaller competitors like National Video, Adventureland Video, Erol's, Video Concepts, and Video Biz all had at least 100 stores. But none of these companies could keep up, and each of them would fail in the next few years. But in 1987, the owner of a waste management company from Florida was about to take over the industry.

Blockbuster Takes Charge

H. Wayne Huizenga bought controlling interest from Blockbuster when it had just 20 stores, so even though he's not technically the 'founder' of Blockbuster, he is the one who made it what it ultimately became. His strategy? Buy, buy, buy. He opened stores. He purchased production companies. He even bought land and initiated plans to build a theme park in Florida to compete with Disney World.

But in a few years, every one of the businesses Blockbuster had bought to expand the brand had failed. And, of course, BlockbusterLand was never built.

Blockbuster's history could have been very different had it used this time and flood of cash to commit more resources to improve the business instead of having a singular focus on growth. And while Blockbuster sat on the largest movie database in the world and did very little with it, others were already using their own information to develop a superior consumer proposition.

That Little Old Grocery Store Company from Texas

In 1992, Blockbuster's leading competitor was Video Central, a smaller chain owned by retail grocery company H-E-B. There were only 35 locations of Video Central, but almost all competed directly with Blockbuster and dominated their locations in head-to-head competition. Sales at Blockbuster stores near Video Central were half the national average, and Video Central stores across the street from Blockbusters were profitably generating sales two to three times that of Blockbuster.

How did Blockbuster respond? By raising prices for new releases, which helped give rise to Redbox's low-price approach. Even as Netflix was demonstrating how consumer tastes were expanding, Blockbuster's selection of catalog titles was shrinking. Blockbuster's biggest mistake came from its lack of curiosity about competitors. It could have learned from them, but was never interested until it was too late.

Welcome to Blockbuster

For the next decade, venturing out to the video store would become America's favorite way to watch movies. Yet the industry leader, Blockbuster, was already crumbling on the inside, incapable of transforming itself from a growth company to an operating company. But before the extent of the carnage was known to the outside world, Huizenga had sold Blockbuster and was on to his next venture. The problems were left for others to fix. So, would the new ownership turn the company's direction around with some innovative ideas that would change Blockbuster's fortunes? Not exactly. What came next was, in fact, even worse.

The Decline Begins

Although still dominant in 1996 thanks to its sheer size, Blockbuster was in trouble financially. In a stunning decline, average annual store sales in the U.S. had fallen over 20% from \$900,000 to \$700,000 over the course of just three years. Sales growth had not kept pace with new store open-

ings which, given the high fixed costs of business, virtually guaranteed the financial problems that would plague Blockbuster for years to come.

The dramatic decline occurred years before new technologies would pose legitimate threats. Unknowingly, the group that purchased Blockbuster in 1994 had purchased a company that was on the verge of collapse. It had been built to grow and nothing else.

Death by DVD

In 1997, DVD arrived and immediately began to change everything about home entertainment. However, widespread DVD players in homes were still a bit of a ways off. Blockbuster did its best to adapt, but instead of going all-in on DVD instead focused on an increasingly baffling barrage of promotions and raised prices. They created characters, looked for new sources of revenue including a pizza partnership with Round Table Pizza and even an electronics partnership with Radio Shack. Not surprisingly, both failed.

DVD was destined to help destroy Blockbuster. Or rather, it was the weapon with which Blockbuster destroyed itself. Why? Not just because it was superior to VHS in every way, but because it was cheaper. A brand-new DVD could be purchased for just \$20 at retailers. That meant more people could buy movies they wanted versus renting them from Blockbuster.

Did Blockbuster take advantage of lower DVD prices and rent them out to customers at a lower price? Nope. Instead, they kept prices high and continued to offer an increasingly poor selection of movies. They failed to rebuild their inventory to transition customers from VHS to DVD. They thought customers would just shrug off missing DVD titles and instead rent the VHS. Instead, they left and bought the DVD for themselves—cutting out Blockbuster entirely.

The Netflix You Do Not Remember

Netflix didn't start as a streaming giant. They started with an even simpler idea—eliminate the trip to the video rental store and send people DVDs directly. It got attention, but it didn't initially have public approval. Even though Netflix was a Wall Street darling, five times more people still preferred to rent DVDs in stores.

There is no reason to believe Blockbuster could not have run successful stores for several more years. Just as Netflix used its DVD-by-mail business to build a bridge to streaming on the internet, Blockbuster could have done the same

with its stores. Instead, they destroyed them by trying to turn them into Netflix—which was, of course, impossible.

It's Over

By the end of 2005, the degree of carnage at Blockbuster was fully understood. Rental revenue declined by about \$220 million, \$150 million more than Blockbuster projected. But the bigger issue was cost for product. Rental margin declined from 72% to 66%, which reduced gross profit by \$250 million, more than double their expectations. But it was not nearly enough to stop the massive out-of-stocks caused by ending late fees. Sales never recovered—but even if they had, the end of late fees had destroyed the supply chain and had reduced gross margin to an unsustainable level. There were now fewer reasons than ever to go to Blockbuster. The DVDs you wanted were probably not there, which was once Blockbuster's greatest strength—availability.

McDVD

In 2004, McDonalds tested an odd idea at 100 of its locations throughout Denver. It was a series of automated kiosks outside the store, by the parking lot, where people could rent DVDs for cheap. They called it Redbox.

Immediately, Blockbuster stores in the Denver area saw reduced sales. You can imagine what happened when Redboxes started popping up in every Walmart, supermarket, and drugstore around the country. At this point, it should come as no surprise that Blockbuster didn't even attempt to develop their own kiosks. Blockbuster once again ignored a competitor until it was too late.

Fixing What's Broken

A small contingent of Blockbuster franchise owners believed that if the stores were better managed, the bank that was now managing the company at that point could recover much more of its loan balance by simply running the stores as opposed to liquidating them. The bank agreed, so instead of buying the stores, the franchisees entered into a three-way management agreement with the bank, Blockbuster, and new owner Glen Klicker. Immediately, sales and profits improved dramatically and the stores were re-energized.

The immediacy of the turnarounds was a testament to the demand for what they were renting—DVDs. DVDs were still America's favorite way to watch a movie. In 2007, nothing else came close. Once the inventory was there and the pricing was right, customers came racing back to stores.

Unfortunately, every time the store owners in this experiment tried to contact Blockbuster to explain how they'd turned the stores around, they were politely told to go away.

Full Death Spiral

In June 2007, Blockbuster had roughly 8,300 stores. More than half of them were in the U.S. Annual sales were trending at about \$5.5 billion— still almost double the number from a decade earlier.

Yet the company was barely profitable and sales trends were the weakest in its history. Blockbuster could not service its debt, and its stock was trading at one-third of its all-time high. And because of its precarious financial condition, the company didn't have access to new capital, which would be necessary for any hope of survival. Yet the ownership insisted Blockbuster was well-positioned for the future, and just three years later, would blame the company's failure on their successors.

One Last Chance

Throughout the final years of Blockbuster, its demise was defined by well-meaning people making critical decisions from 30,000 feet when those decisions could best be made on the ground, in the stores, listening to operators and customers about what really happened in a Blockbuster store. But from the company's founding until its very end, that was never part of Blockbuster's DNA.

In the years leading to bankruptcy, franchise stores were subjected to untold bad press because of Blockbuster's persistent financial difficulties. They couldn't even have a sale without customers believing it was a 'going out of business'

sale. For every step forward, it was two steps back due to negative headlines about Blockbuster's mass store closures, layoffs, and eventual bankruptcy. In the end, the Blockbuster ticket no longer stood for the proud brand it once was. More than anything else, it was now a symbol of failure.

Conclusion

What can we all learn as leaders from Blockbuster's failures? There are seven core lessons.

Clearly define your company's purpose— and its mission.

Identify what drives your business and pursue it relentlessly

Measure what matters

Respect and learn from competitors

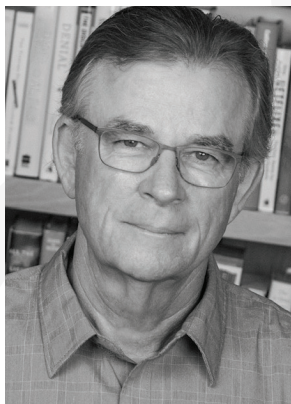
If you're going to do it, be the best.

In difficult times, rely on the fundamentals to survive.

Don't just talk about the future. PLAN for it.

What can we do that Blockbuster failed to do? We can define our own path, our own purpose, and the path we'll take to get there. We'll determine how we measure our progress and stick to those metrics.

No one can do that for us. Every organization has unique challenges that require original ideas, and those can only come from within by following our passion, guide by facts, to the right answers.



Alan Payne spent thirty-one years in the movie rental business, the last twenty-five of those as a Blockbuster retail franchisee. He took over a small group of Blockbuster stores in 1993 and grew it into one of the largest and most successful chains in the company. He finally closed his last store in 2018, more than eight years after Blockbuster filed for bankruptcy.

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