Video
Entertainment

Video entertainment was delivered to consumers via three different technologies. Satellite and cable broadcasters were declining rapidly while so-called over-the-top (OTT) content providers – which did not require consumers to pay cable or satellite broadcasting fees – were booming. Satellite and cable broadcasters were shrinking because compared to OTT content providers, their prices were too high and the quality and variety of their content were relatively poor. Satellite and cable TV providers could compete with OTT service providers by trying to offer their own high-quality content. Yet their profit models were dependent on consumers paying satellite and cable fees and advertisers “polluting” the content consumers were viewing. Meanwhile OTT service providers were in a constant battle to spend on new content that would enable them to increase the number of subscribers each month. The video entertainment industry’s dynamism offered excellent examples of how important a CEO’s strategic mindset is to achieve long-term success. Lessons for leaders include

- **Evaluate your strategy through the eyes of customers:** Since leaders are surrounded by members of their executive team, it is natural for them to view their company from the inside out. In all industries, leaders with this perspective are at a competitive disadvantage because they are more likely to evaluate
options for the future from the perspective of how much they will increase the value of the company’s largest lines of business. That perspective could work well if those business lines are all leaders in rapidly growing markets. However, if the markets from which the company derives its revenue are stagnating or shrinking, this inside-out perspective could result in decisions that position the company poorly for the future. To avoid this problem, leaders must identify, listen to, and target their video entertainment business strategies to customer groups that represent the most significant future growth opportunities for the company.

- **Resist the urge to defend old business strategies:** Viewing a company from the outside in can be particularly painful for leaders of companies that offer a weaker selection of over-priced video entertainment content. Such companies will try to preserve this competitively inferior customer positioning because they will see the alternative — offering an industry-leading collection of content at a lower price — as producing weaker financial results. In the long run, defending an outmoded and uncompetitive business strategy could endanger the company’s long-term survival.

- **Choose your successor wisely:** Leaders of legacy video entertainment companies — for example, those that broadcast via satellite or cable — who cannot abandon their increasingly uncompetitive business strategies should appoint successors who can. Such successors are likely to be CEOs with Create the Future or Follow the Leader mindsets. As we will see in the following Blockbuster case, leaders who turn their company into a dominant player risk endangering its future if they appoint a Head in the Sand CEO who keeps doing what worked in the past — thereby making the company increasingly irrelevant to customers and sending it into bankruptcy.

These implications emerge from examining how the video entertainment industry is changing.

Rapidly evolving technologies for producing, delivering, and displaying images and sound have transformed the video entertainment industry over the last 70 years. In the 1950s, television was a box that displayed black-and-white videos including quiz shows, soap operas, news, and scripted comedies. Until the 1980s, ABC, CBS, and NBC — which started off as radio broadcasters and were granted television licenses by the FCC — produced and distributed free
video entertainment to viewers while charging companies to advertise to their captive audiences. By 2013, the audience of these broadcast networks had plunged by two-thirds. HBO, ESPN, CNN, and Nickelodeon won a chunk of that audience by delivering their own programming via coaxial cable. Cable companies monetized their investments by charging monthly fees and selling ads. The Internet and streaming video brought new competitors to the fore. In 2011, Amazon gave away its Instant Video streaming service at no charge to customers who signed up for its Amazon Prime delivery service. YouTube had the most unique visitors, and it made money when viewers opted in to watching ads displayed with the content. Netflix’s online streaming service – with its low monthly fee for commercial-free streaming – dominated the new generation of video entertainment by taking advantage of viewers’ “managed dissatisfaction with the 20 minutes per hour of traditional television consumed by commercials and promotional messages for other network programming.”

Such streaming services were dubbed over-the-top (OTT) media because they delivered video entertainment to consumers without requiring them to pay cable or satellite fees. OTT was a large and rapidly growing market with revenue expected to grow at a 15.2% compound annual rate from $67.8 billion in 2018 (over 10 times the 2010 level) to $158.8 billion in 2024. Netflix dominated the OTT market with an estimated 150 million paying users out of the 180 million US total in December 2019. US-based OTT users spent an estimated 17.5 hours with these services per week in 2019. Surprisingly, OTT users were expected to be more receptive to advertisers who could target their ads more precisely to specific consumer groups. The OTT market attracted numerous rivals. Prior to the November 2019 entry of rivals Disney+ and Apple TV+, Forrester Research analyzed OTT services based on user experience and functionality – concluding that Netflix led the industry on user experience (which included measures of effectiveness, ease, confidence, freedom, and aesthetics), while Hulu prevailed on functionality (meaning problem and account management, content selection, content discovery, and viewing experience). Rivals that trailed these two included Amazon Prime, HBO Go, ESPN+, CBS All Access, and others. In the absence of a major technological innovation – as online streaming was to video stores – the industry was likely to become less profitable due to intense price competition and escalating content investment by rivals seeking to gain market share.

The Covid-19 pandemic led to a surge in demand for video streaming – even as incumbents began to offer their own streaming services. By May 2020, NBC’s Peacock and HBO Max were preparing to launch. In April, Quibi launched a ten-minute video service (with disappointing results). Other incumbents acquired their way into video streaming – Viacom bought streaming service Pluto TV; Comcast took control of XUMO and Fox merged with Tubi, an ad-based video-on-demand platform. These new rivals were entering the industry just as demand for streaming surged – up 12% – a trend
expected to continue as consumers were quarantined at home, leading to higher engagement and faster subscriber growth. The surge in demand benefited Netflix in the first quarter of 2020 which added 15.8 million subscribers – about 80% more than J.P. Morgan had estimated. The higher level of demand for streaming services was likely to persist – depending on the pandemic’s duration and whether the work-at-home trend continued or abated once the pandemic ended.

Strategic Mindsets of Video Entertainment Industry Winners and Losers

Gaining market share in this rapidly growing industry required leaders to envision and execute an effective competitive strategy to provide an industry-leading consumer experience. Whether a strategy yielded market share gains or losses depended to a large extent on which of the three strategic mindsets – Create the Future, Follow the Leader, and Head in the Sand – the CEO adopted. Here are some general observations based on the collision of these three mindsets with video entertainment industry reality explored in the following case studies:

- Leaders with Create the Future and Follow the Leader mindsets are winners:
  
  - Create the Future works well if leaders are intellectually humble in pursuit of delivering consumers ever more benefits for the money than rivals do. As we will see in the following, Netflix’s Create the Future mindset was notably distinct from Steve Jobs’s mindset at Apple. Jobs envisioned how evolving technology could be harnessed to create new hardware that would delight consumers. Jobs maintained tight control over all aspects of the new products – such as the iPod and the iPhone. By contrast, Netflix’s CEO Reed Hastings created similarly revolutionary services – DVD-by-Mail and online streaming. However, he prided himself on delegating much of the decision-making and execution to talented and empowered executives and employees.

- Follow the Leader is a mindset of CEOs who see an upstart’s rapid growth and decide to do something about it. In video entertainment, many incumbents have this mindset – seeking a middle ground between
ignoring online streaming and betting the company on a rival online streaming service. In this chapter, we examine one such Follow the Leader approach by Hulu – a partnership between rival broadcasters ABC, NBC, Fox, and others – which made some of their old content available to consumers via online streaming. Over time, each partner learned enough about the potential risks and opportunities of online streaming to decide whether to invest in it more heavily or to sell out. Disney emerged as Hulu’s dominant owner.

- **Head in the Sand leaders preside over failure:** In video entertainment, Blockbuster’s demise was due to its Head in the Sand mindset. While it did eventually try to create its own versions of Netflix’s DVD-by-Mail and online streaming services, Blockbuster was locked into an idea that enabled it to gain a large share of the video store market – by acquiring rivals. The debt Blockbuster took on to pay for those acquisitions ultimately caused it to file for bankruptcy. Ironically, Blockbuster’s fate might have been different had it not turned down the opportunity to acquire Netflix before it achieved online streaming market leadership.

### Video Entertainment Industry Startup and Incumbent Success and Failure Case Studies

These general observations play out in the following case studies. Netflix’s Create the Future mindset enabled it to create two new industries – DVD-by-Mail and online streaming – which attracted competition from rivals with a Follow the Leader mindset. Hulu, a joint venture of TV incumbents, has progressed to the point that it is a formidable Netflix rival. Collectively, traditional TV industry players are chipping away at Netflix’s online streaming market leadership. Leaving unanswered the question of whether Netflix must invent a third new industry to revive its growth in the decade ahead. Meanwhile a Head in the Sand mindset contributed to Blockbuster’s 2010 demise after it was unable to survive the heavy debt load it took on to acquire video store rivals while responding with too little, too late to Netflix’s online streaming threat.
Success: Netflix Twice Creates the Future of Video Entertainment

Introduction

While it is common for companies to come up with one industry-transforming innovation, it is rare for it to come up with a second one in a row. Apple introduced the iPod in 2001 and six years later launched the iPhone which incorporated what the iPod did and added more. The mindset of Steve Jobs—he envisioned where technology and consumers were heading and designed and built handheld devices that would tap into those trends to provide consumers with more benefits—was critical in creating the future of personal technology. Fortunately, Jobs was not the only entrepreneur with such a mindset. Indeed, Netflix’s CEO Reed Hastings created the future twice in a row: first by presiding over the successful 1999 launch of its DVD-by-Mail service and in 2007—after developing a new set of corporate capabilities—introducing an online streaming service that by 2019 had attracted 166 million paying subscribers. Yet Hastings’s approach to creating the future differed radically from Jobs’s. Unlike Jobs, Hastings did not exercise total personal control over the service’s design. He created a culture that attracted excellent talent, gave people the power to make and execute decisions, and held them accountable by widely sharing detailed performance data—including with the board of directors.

Case Scenario

Hastings was a math whiz who started and sold a software company, Pure Software. After exploring numerous startup ideas with Marc Randolph, who was Netflix’s first CEO, they settled on the idea of ordering DVDs via the Internet and delivering them from a warehouse directly to consumers’ mailboxes. In the decade ending December 2019, Netflix’s stock led the S&P 500—soaring 4,100%, over 21 times faster than the S&P 500’s 190% rise. Netflix’s success can be traced to Hastings’s strategic mindset—based on operating Netflix so that he made very few decisions himself. In a 2018 interview, Hastings said he prided himself on making so few decisions that he could go an entire three months without making one. Netflix operated effectively because of one of the most significant decisions he made years before—to give “each employee agency to make their own wise decisions on behalf of the organization.” Netflix’s most important cultural value was “independent decision-making by employees”—based on a belief that people “thrive on being trusted, on freedom, and on being able to make a difference.” Hastings believed that information sharing across Netflix made it the opposite of Apple—which famously compartmentalized information. Netflix also shared far more information with its board of directors than did most companies—whose boards met only four to eight times a year and reviewed dense PowerPoint slides which were controlled tightly by
CEOs. By contrast, Netflix board members attended monthly and quarterly senior management meetings as observers and received 30-page memos full of analysis and data. As a result, Netflix board meetings featured “an intelligent and informed conversation” giving the board the confidence to make hard decisions, according to Hastings.8 Hastings pre-Netflix experience led him to an intense dislike of process – which he viewed as a “python” that would stifle talent. To that end, Netflix’s culture was envisioned as a force for empowering people, giving them a sense of responsibility, and enabling them to operate without chaos – despite the absence of process. Employees seemed to like this – a 2017 study found that Netflix topped the rankings for employee satisfaction and employee pay. Hastings expressed delight that “big decisions at Netflix were made frequently without his input.”9

Hastings’s origin story reveals that he was a math and software aficionado whose experience starting and selling a software venture made him realize that success depended far more on recruiting and motivating the world’s best talent than on building an excellent product. He attended private school in Cambridge, Massachusetts; earned an undergraduate degree in math at Bowdoin College; taught high school math in Swaziland; earned a master’s degree in computer science from Stanford; and became a Silicon Valley software entrepreneur. In 1991, he started Pure Software, a software debugging program. By 1996, Pure employed 600 people. Hastings gave Pure’s product high marks and his management style a far lower one. In 1997, Rational Software acquired Pure Software – and IBM acquired Rational for $700 million. Hastings felt like a failure which led him to an insight – it is better to think more about recruiting and motivating talent than product engineering – which influenced how he ran Netflix. Hastings and Randolph founded Netflix that year to deliver DVD-by-Mail with help from Neil Hunt, who used his math skills to develop software to recommend the next DVD a subscriber should rent based on the subscriber’s viewing history. In 1999, Hastings hired Ted Sarandos, a former vice president of product and marketing for video rental store, West Coast Video. Sarandos added to Netflix’s product selection, and by 2002, Netflix was profitable and had gone public.10

Five years later, Netflix had launched its second act – online streaming to PCs. The new service preceded premature predictions of Netflix’s demise at the hands of Walmart’s later-aborted DVD-by-Mail service and services offered by Apple and Amazon to download movies to TVs – which did not gain traction with consumers. In January 2007, Netflix delivered its response to those who realized that DVDs were not a “hundred-year format” by launching a service which would enable consumers to stream video to their PCs without downloading and saving it there. Investors panned Netflix’s online streaming launch – citing the high investment required to introduce the service, the large number of rivals, and Netflix’s lack of competitive advantage (its DVD-by-Mail logistics skill would be of no use). In 2007, Netflix saw two big barriers to widespread adoption of online streaming: technology had not advanced sufficiently to stream and display video quickly and with high visual quality and the reluctance of movie and TV content producers to cannibalize their theater, cable, and advertising revenues. Blockbuster, which had
launched its own DVD-by-Mail service in 2004, was the biggest potential rival to Netflix. Hastings was prescient when he remarked that investors were rightly skeptical of Silicon Valley companies that could not innovate a second “generation of computing.” It was not until 2011 that Netflix announced it would do something about its inability to stream new content – spend $100 million to produce 26 episodes of House of Cards. In September 2011, Hastings – who was afraid of being too slow to move away from DVD-by-Mail – blundered by announcing the company would split into two: one offering DVD-by-Mail and the other online streaming. Moreover, Netflix boosted the combined subscription fee by 60%. Subscribers balked and Netflix quickly rescinded the price increase. When House of Cards launched in February 2013, its popularity soared, and Netflix’s stock price ended the year three times higher than it had begun.

By November 2019 when Disney and Apple launched their competitive services, the threat to Netflix’s market leadership in online streaming had become palpable. Netflix and YouTube ranked first and second in time spent viewing. However, new services like Disney+, WarnerMedia’s HBO Max, and Apple TV+ were expected to erode the dominance of Netflix and YouTube. More specifically, the pair’s share of US adults was expected to decline as the average time watching them per day increased. For example, in 2020 eMarketer expected that the average US adult would spend 6% more time – or 29 minutes per day, while its share of daily video time was expected to decline from 27% in 2019 to 25.7% in 2021. eMarketer analyst Ross Benes told Variety, “The video streaming landscape will get crowded, which will drive down the share of time that people devote to Netflix.” These crowds threatened Netflix’s domestic revenue growth which had risen 122% between 2015 and 2019 with a relatively slow 44% increase in the number of domestic subscribers abetted by a 54% increase in average revenue per user – from about $9/month in 2015 to more than $13/month in 2019. With rivals pricing competitively, Netflix would risk losing more market share if it increased prices. In 2019, only HBO Max ($14.99/month) was more expensive than Netflix. Hulu ($5.99/month), Apple TV+ ($4.99/month), Disney+ ($6.99/month), and Amazon Prime ($8.99/month) all charged less than Netflix did. Meanwhile, Netflix’s spending to produce original content had risen 25% from $12 billion in 2018 to $15 billion in 2019. Competitive pressure would likely cause that investment to rise even faster in future years.

Case Analysis

Reed Hastings achieved the remarkable feat of reinventing the video entertainment industry twice. His approach to creating the future was made all the more interesting because in many ways he did the opposite of what Steve Jobs did in creating the future of personal technologies such as the MP3 player (iPod) and smartphone (iPhone) – the latter playing a key role in the success of Netflix’s online streaming. Unlike Jobs, who hoarded control over the design, manufacturing, delivery, and service of its innovations, Hastings
was content to hire world-class talent, push responsibility for strategy and execution to those people, and create a culture in which people would take responsibility and be held accountable for their actions. This culture enabled Netflix to reinvent itself as it transitioned from DVD-by-Mail to online streaming. By 2020, competitive pressure from incumbents raised the question of whether Netflix’s continued success would depend on reinventing itself a third time.

Success: Hulu Helps Incumbents Hedge Their Bets As They Define Their Futures

Introduction

When a startup introduces a new service that quickly takes on masses of new customers, longtime industry giants are likely to notice. The reaction of these goliaths could range from dismissing the startup as too small to warrant their attention to scrambling to acquire it. Two logical middle ground solutions come to mind for a traditional industry incumbent: each company starts its own service to compete with the upstart or a group of incumbents forms a partnership which starts and operates as a rival to the upstart. Each option has its advantages and disadvantages. The advantage of the first option is that it gives each company control over the destiny of the new service; the disadvantage is that the investment required is relatively large. The second option spreads that investment over all the partners; however, its governance is complicated by the blend of shared and competing interests of all the partners. However, if such a partnership is structured so that participants have clear paths for exiting or investing more deeply based on their different goals and resources, these complications can ultimately be resolved.

Case Scenario

This comes to mind in considering the creation and evolution of Hulu – a joint venture begun in October 2007 between AOL, Comcast, Facebook, MSN, Myspace, and Yahoo – to combat Netflix’s then-newly introduced online streaming service. Initial distribution partners included NBC and Fox (ABC joined in 2009). Hulu – which launched in March 2008 – was a website that streamed then-current and many past television shows which required viewers to watch commercials seen on the broadcasters’ websites. Hulu Plus, a service launched in November 2010, delivered more shows, with fewer commercials, on multiple devices – at a price of eight dollars per month. By 2013, Hulu Plus had attracted five million viewers. Despite Hulu’s fast growth and $1 billion worth of revenue, Jason Kilar, Hulu’s CEO from 2008 to April 2013, quit to start his own venture because Hulu’s parent companies resisted his vision – a service which let consumers watch programs at a time convenient for their schedules with few, if any, advertisements.
Hulu ended 2019 with roughly five times more subscribers and one dominant owner. In the ensuing six years, Hulu's ownership structure became far simpler with Disney emerging as the dominant owner ending 2019 with over five times more subscribers. At that time, Hulu's services included a $5.99/month version with limited advertising, $11.99/month with no advertising, and a $44.99/month service with no advertising on over 60 live channels. Hulu had 28.5 million subscribers and 2018 advertising revenue of $1.5 billion (up 45% from 2017). Majority-owner Disney projected a 2019 loss of over $1.5 billion and between 40 million and 60 million subscribers by 2024. While Hulu was the only streaming service combining live TV and on-demand, being owned by Disney cost it control of its strategy – for example, in 2019 it lost bidding wars to keep reruns of “Seinfeld” and “South Park.” Disney's takeover of Hulu stretched in multiple transactions spanning December 2017 and May 2019. In December 2017, Disney announced a deal to acquire 21st Century Fox. By the deal's close in March 2018, Disney's stake in Hulu doubled to 60% – as it added Fox's 30% share. In March 2019, AT&T sold its 9.5% share in Hulu back to Disney for $1.43 billion. In May 2019, Comcast also gave up its shares of Hulu to Disney while maintaining a 33% Hulu stake through NBCUniversal.

By the end of 2019, Hulu had announced that it would raise prices to offset the rising costs of producing live TV. However, its role within Disney remained a work in process. In December 2019, Hulu raised the price for its Hulu + Live TV offering by $10 a month to $55. While growing rapidly, researcher MoffettNathanson estimated in November 2019 that Hulu + Live TV's subscriber count had more than doubled to 2.7 million from 1.2 million the year before. However, Disney's losses were also skyrocketing. Losses at its direct-to-consumer and international segments more than doubled to $740 million in its fiscal fourth quarter. Hulu was expected to house older and original programming from FX networks. Disney introduced that month a bundle – including Disney+, ESPN+, and ad-supported Hulu – for $12.99 a month. Ten million people had signed up including those using its seven-day free trial.

Case Analysis

Over the course of 12 years, Hulu's ownership and strategy evolved, and its subscriber based grew rapidly. Yet during that same timespan, Netflix had more five and a half times the number of subscribers. Both companies attracted these subscribers while losing billions. The relatively slow growth of Hulu reflects the way the mindset of an established incumbent – trying to sort out differences with other incumbents – slows down the process of setting and executing growth strategy. With Disney emerging as the dominant owner of Hulu, decisions and execution are likely to speed up – yet still be impeded by potential conflicts between Hulu, Disney+, and Disney's other entertainment businesses.
Failure: Blockbuster Goes Bankrupt As Debt-Fueled Deal Doing Delays Its Response to Industry Changes

Introduction

Innovators often perish when they stop innovating. More specifically, a company that invents a new product or service that gains popularity often adapts poorly to the later emergence of an even better product or service. A case in point is Digital Equipment Corporation (DEC), a Massachusetts company that invented the minicomputer, which grew popular with organizations that were frustrated by the high cost and inflexibility of mainframe computers. DEC did well for decades until the 1980s when PCs emerged. DEC CEO Ken Olson could not understand why people would need PCs, and his inability to adapt effectively to the growing popularity of the PC led it to be acquired by Compaq, a PC industry leader, in 1998. DEC's failure to adapt highlights three essential conditions that often impede innovators from adapting to a new wave of technology:

- **CEO confirmation bias**: Leaders develop mental models to explain and communicate how they achieved their initial success. Often these mental models ascribe the success to the CEO's superior talents – while underweighting the importance of luck. Nevertheless, these mental models shape the way leaders process information – causing them to seek and accept information that reinforces their mental models and reject information that contradicts them. Such confirmation bias makes it difficult for CEOs to adapt well to change.

- **Failure to see the company through the customer's eyes**: Confirmation bias can prevent a CEO from viewing the company from the customer's perspective. For example, when the PC became popular – as office workers used it to create documents or create spreadsheets – Olson was unable to perceive how much more valuable the PC was to workers who used DEC's minicomputers. He viewed the minicomputer as the ultimate product and ignored evidence from consumers that the PC could be a better value – by providing consumers with far greater benefits for the price.

- **Inability to create new capabilities**: Confirmation bias can also block leaders from recognizing that to take advantage of new opportunities, they must develop new capabilities. For example, as we saw earlier in this
chapter, Netflix was able to develop new capabilities – such as creating its own popular shows and partnering with broadband service providers – to be successful in online streaming. At the same time, it jettisoned some of the people who were essential to its DVD-by-Mail business – who ordered, stored, and retrieved DVDs – as demand for its original service declined. Leaders beset with confirmation bias are often so slow to recognize the need to add new capabilities and subtract some old ones, that their response comes too late to keep the company from failing.

This comes to mind in considering Blockbuster – which rented out videocassettes and DVDs in thousands of stores around the United States and perished in 2010 as Netflix’s combination of DVD-by-Mail and online streaming took away too many of Blockbuster’s customers. While Blockbuster had a string of owners and CEOs, they all seemed to share the same deal-oriented mindset which impeded the company from inventing new services that customers would value more than Netflix and other competing services.

Case Scenario

Blockbuster was founded in 1985 by an oil services equipment distributor. 25 years and five CEOs later, it filed for bankruptcy. While Blockbuster’s journey was full of interesting twists and turns, its failure was ultimately the result of its loss of leadership in the business of supplying video entertainment to consumers. In 1978, that database expert, David Cook, founded Cooks Data, a supplier of tools and software to Texan oil and gas companies. In the mid-1980s, the oil market collapsed, and Cook’s wife pushed him to enter the video rental market. In October 1985, he opened the first Blockbuster store in Dallas. After the collapse of the oil market in the mid-1980s, Cook, at the urging of his wife, decided to try his luck in the video rental market. He opened the first Blockbuster store in Dallas in October of 1985. Blockbuster grew quickly because it offered consumers a family-friendly atmosphere with longer operating hours, wider selection (8,000 VHS tapes in over 6,500 titles) displayed on shelves instead of behind the counter, and more efficient checkout via a computer system and scanner. Cook wanted capital to grow Blockbuster, but an article questioning his knowledge of the industry quashed a public stock offering planned for September 1986. Losing over $3 million, in February 1987, Cook sold a third of the company to Waste Management founder, Wayne Huizenga, and other investors for over $18 million. Huizenga bought more of the company and abandoned Cook’s strategy of growth through franchising in favor of acquiring Blockbuster’s competitors.22

Huizenga’s acquisition strategy achieved rapid growth – but ultimately overstepped the limits of what the company could afford. The first murmur of trouble came in May 1989 when investment analysts at the now-defunct Bear Stearns called
Blockbuster's accounting practices “inaccurate and grossly misleading.” Though Blockbuster refused to change its accounting practices, its largest shareholder, United Artists Entertainment, dumped its 12% stake and sold its 28 franchised stores. But analysts noted that the industry was maturing fast – while in 1988 monthly Blockbuster revenue growth was 35%, in 1989 and 1990 growth plunged to around 8% each year. Huizenga decided to look globally for growth. By 1993, Blockbuster had over 3,400 stores and was acquiring music retailers such as Sound Warehouse and Music Plus to broaden its product line. He envisioned Blockbuster as an entertainment center that would rent movies and sell music, computer programs, video games, and virtual reality entertainment. In September 1993, Blockbuster bid offered to pay $4.7 billion for Viacom which was in a bidding war with QVC for Paramount. By the time it was over, Viacom had acquired Blockbuster for $8.4 billion.23

Blockbuster went on to suffer plunging cash flow under the supervision of three CEOs – one a year between 1994 and 1997. Huizenga left in September 1994; next up was Blockbuster President Steven Berrard who left after 18 months to be replaced by Walmart Executive Bill Fields who lasted until spring 1997 – three months before John Antioco took over. Antioco faced the challenge of turning around a company whose cash flow tumbled 70% in the second quarter of 1997 as new releases were not getting to stores. He tried to right the ship by cutting people, selling Blockbuster Music, shutting international stores, and exiting the PC business. Viacom had acquired Blockbuster hoping that its cash flow would help finance the money it borrowed to acquired Paramount. Instead Viacom was injecting cash into Blockbuster and tried to minimize the damage by offering 18% of Blockbuster in what turned out to be a disappointing public stock offering.24

This furious financially focused deal making distracted Blockbuster from technological and business trends that would ultimately drive video stores out of existence. The rapidly growing Internet was making it easier for consumers to obtain videos ordered from their PCs – without requiring them to pay late fees. Amazon had moved from selling books to DVDs online; Netflix introduced its DVD-by-Mail service. Despite forming partnerships with AOL, TiVo, and DIRECTV to explore streaming video and home delivery of DVDs, it was not until August 2004 that Blockbuster introduced its own DVD rental program. In the interim, Blockbuster turned down a spring 2000 chance to acquire 49% of Netflix – which was then losing money and had a mere 300,000 subscribers. Hastings offered to change Netflix’s name to Blockbuster.com and operate Blockbuster’s online service. Blockbuster declined the offer since it did not yet see a threat from digital media.25 In December 2004, Blockbuster was itching to make a hostile bid to acquire its biggest rival, the now-defunct Hollywood Video. Greenmailer Carl Icahn decided that this deal needed to be done, so he bought about ten million shares of Blockbuster. But in January 2005, Hollywood Video accepted an offer from Movie Gallery.26

Icahn’s entry led to Antioco’s departure who was replaced by James Keyes, former head of 7-Eleven, who presided over Blockbuster’s 2010 bankruptcy filing. Icahn got himself onto Blockbuster’s board and challenged Antioco’s huge pay package. Icahn
also pushed Antioco – who wanted to end late fees and transform Blockbuster into an online video store – to sell the company to a private equity firm. Antioco left in 2007 and Keyes took over as CEO. Keyes cut costs, changed Blockbuster’s service, and achieved growth and profitability by pushing its online and digital services. Sadly, for Keyes, by the time he took over in 2007, Blockbuster had borrowed more than it could repay. Its $400 million line of credit expired, and the financial crisis took hold – contributing to its uncertainty about whether by September 30, 2009, Blockbuster would be able to make a $42 million payment on its $1 billion in debt.27 A year later, still operating 3,300 stores, Blockbuster filed for bankruptcy.28

Case Analysis

When the only tool you know how to use is a hammer, every problem becomes a nail. This is essentially the problem that Blockbuster faced – one which became fatal after it borrowed too much money to acquire other chains of video stores. While its first CEO, Cook, had a Create the Future mindset – harnessing database technology to give customers a better video store experience – his successor, Huizenga, knew one thing: growth through acquisition. The imperatives of doing deals and paying back the debt borrowed to finance them were of preeminent importance. Blockbuster’s leadership – which sprang from Cook’s ability to stay ahead of changing technology and evolving customer needs29 – was lost the day he ceded control of the company to Huizenga.

Video Entertainment Industry Case Study

Takeaways

The takeaways from these case studies have varying implications depending on where you sit.

Incumbent Executives

• **Do:** Based on the Netflix and Hulu cases, bricks and mortar executives may create competitive advantage by

  • Creating a culture that attracts, empowers, and holds accountable world-class talent in functions that are critical to the company’s success

  • Experimenting with a new business model that monetizes a content library to gather data on whether to invest further in its development

  • Choosing which customers to target for their services and using data analytics to evaluate which specific content will attract the most subscribers
• Partnering with talented producers, writers, actors, and others to produce such content

• Investing in technology – based on factors such as Forrester’s user experience and functionality – to enhance the quality of their target customers’ online streaming service

• Using knowledge of their customer’s buying behavior and unmet needs to develop industry-transforming new services

• **Do not:** Based on the Blockbuster case, bricks and mortar executives should avoid its self-destructive tactics such as

  • Minimizing the strategic significance of an upstart’s rapidly growing service and delaying the introduction of a competing service

  • Placing a higher priority on growth through a previously successful but now-outmoded strategy than on observing and responding to changing consumer behavior and new technology

  • Borrowing extensively to execute the outmoded growth strategy

  • Making the company vulnerable to activist investors by endangering its financial condition

**Incumbent Employees**

• **Do:** Based on the Netflix and Hulu cases, incumbent employees may seek to stay at the incumbent based on whether

  • The CEO seeks to invest in a video streaming service that leads the industry in the quality of its content and delivery, ease of navigation and use, and price.

  • The company’s culture attracts world-class talent and empowers the talent to innovate.

• **Do not:** Based on the Blockbuster and Hulu cases, incumbent employees should consider seeking employment elsewhere if the company’s CEO

  • Focuses on borrowing too much money in pursuit of a now-outmoded growth strategy

  • Straddles an effort to protect an old declining business while investing cautiously in creating a new one
Startup CEOs

- **Do:** Based on the Netflix and Hulu cases, Startup CEOs may scale their companies by
  - Creating a culture that attracts and inspires talented people to capture growth opportunities
  - Investing in a new service that provides customers with industry-leading quality of content and delivery, ease of navigation and use, and price
  - Investing in or partnering with a provider of consumer hardware that delivers a much higher-quality viewing experience than do HD TVs, smartphones, and/or tablets

- **Do not:** Based on the Blockbuster case, Startup CEOs should avoid its self-destructive tactics such as
  - Diminishing the significance of fast-growing rivals with different business strategies
  - Acquiring companies or building products based on what the CEO believes without listening to customers

Business Students

- **Do:** Based on the Netflix and Hulu cases, business students may seek employment with companies that
  - Create a culture in which top talent is encouraged to take responsibility for innovation and generate measurable benefits for customers
  - Invest in new services that will provide consumers with superior content, wider selection, and excellent transmission and image quality

- **Do not:** Based on the Blockbuster case, business students should avoid companies that
  - Seek to preserve a declining business while starving new services for resources
  - Place a higher emphasis on quarterly financial results than on investing in growth opportunities that will pay off in the longer term
Do You Have the Strategic Mindset of a Video Entertainment Industry Winner?

If you answer in the affirmative to these questions, you have a winning strategic mindset. If not, you must decide whether to change your mindset, strategy, and execution or find a job that better suits your strengths and interests:

- Do you know what delights your customers about buying from your company?
- Are you providing your customers an ever-improving video entertainment experience?
- Does your company have a compelling culture that attracts talented people?
- Do you encourage your people to take responsibility for conceiving and implementing innovations that benefit customers?

Conclusion

The video entertainment industry is large and growing rapidly. This growth is creating opportunity for upstarts and many incumbents. The incumbents have considerable financial resources and libraries of old content – some of which can be streamed online to generate new revenue. Netflix – which is an upstart in the minds of traditional TV broadcasters – has created two generations of industry-dominating business models. However, the slow emergence of competing services from incumbents who have followed the leader may impinge on Netflix’s growth. It remains to be seen whether Netflix’s unique culture can spawn a third industry-transforming innovation that again leaves slow-moving followers in the dust. In Chapter 4, we will examine how such interactions play out in the newspaper industry.