Blockbuster
SID # 532682

BLOCKBUSTER VIDEO®

Make It A BLOCKBUSTER Night™

Article Summary:

Blockbuster© recently announced that they acquired "Movielink, a leading movie download service."[1] This major strategic action indicates that Blockbuster is well aware of the competition hot on their heels and is willing to do what it takes to stay on the cutting edge of technology. As Blockbuster "checks" its arch rival, Netflix©, earlier move to offer "a download service"[1], it appears that they are also focusing on their competitive advantage of brick and mortar locations that Netflix could not easily match without buying out one of their other contenders. Unlike Netflix, with Blockbusters mail subscription service, ***Total Access***, sealed envelopes that would normally be shipped back for your next movie in ***Queue*** can be simple taken to your local store and traded for any movie on the shelf at no additional charge. They are heavily advertising the flexibility of their product offering by pointing out that "you can hit the local store, order it up by-mail subscription service, or download to your PC."[1] "The acquisition allows customers to download movies for rental or purchase."[1] When this article was written, Blockbuster was pouring massive amounts into advertising and even cutting prices to pursue their adversary in gaining market share. With Blockbusters foundation in the industry, the newbie Netflix has made more than a dent in their profits. It is evident that they underestimated their opponent.

Netflix had already been offering downloadable movies and had been eating up market share much faster than anticipated. Blockbusters reaction to advertise heavily and cut prices had ultimately "stung its bottom line, swinging a loss of $38.1 million."[1] They were banking that the ultimate advantage of brick and mortar exchange coupled with, "***Total Access***, which is by-mail subscription service, would ultimately prove a smart move, compensating for the sluggish sales its stores" had suffered.

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[1]Joshua Lipton, *"Download A Movie…Legally"*, 2007, Market Scan, **Forbes.com**, 9 08 2007 <http://www.forbes.com/markets/2007/08/09/blockbuster-netflix-movies-markets-equity-cx_jl_0808markets12.html>

Company Description

10 K – Business & Product Lines

Blockbuster operates as a "global provider of in-home rental and retail movie and game entertainment."[2] The industry of retail specialized consumer service stores is very competitive. Blockbuster offers movie, video game, television series, and even some electronic video game consoles for rent. After rental some of the items are made available for sale. They currently offer "in-store and online rentals."[2] Blockbuster currently operates approximately 3,166 stores, some of which are franchised.[2]

Some of the products and services offered are competing on different playing fields. With the availability of on-demand rental through cable service providers, such as ***Cox Communications***, and vending machine movie rentals, such as ***redbox***, the competition has increased immensely.[2] Of course the biggest competitor for the Block is arch rival, ***Netflix***. Netflix is currently listed as the industry leader with 1.52 billion verses Blockbusters measly 689.77 million market capitalization.[3] The acquisition of Movielink should help meet these competitors' demands.

Business Level Strategy

Blockbuster obviously leads a differentiated strategy of providing more value to the consumer by offering not only online movie rentals, but also the ability to trade, movies that were mailed, for movies in one of their conveniently located, brick and mortar outlets.[2] As competition mounts, the key to keeping up with the pack is innovation. They must anticipate what consumers want now and what they will want in the future and explore ways to provide it.[4]

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[2] Blockbuster, Inc. "Form 10 K." United States Securities And Exchange Commission. Online database. 2006. 11 November 2007. <http://www.sec.gov/Archives/edgar/data/1085734/000119312507044360/d10k.htm>
[3] Yahoo Finance. "Profile: Blockbuster, Inc." Yahoo, Inc. 2 December 2007. <http://finance.yahoo.com/q/in?s=BBI>
[4] Riper, Tom Van. "Blockbuster On Demand." Forbes.com. 3 July 2007. <http://www.forbes.com/business/2007/07/02/blockbuster-video-dvd-biz-cx_tvr_0703blockbuster.html>

Corporate Level Strategy

Blockbusters corporate level strategy is highly related. They are able to share the resources of their marketing department throughout their product lines. Movies and video game rentals are highly related in the way they are obtained from suppliers and the way they are packaged and displayed inside each store as well as the way they are transported through the mail service. They have operational synergy with not only marketing, but also with their research and development unit that can utilize market surveys to develop new ways to attract subscribers.[4] All stores are open from 10 AM to 12 PM, 365 days per year to make the stores more convenient for our cultures new busy lifestyle consumer.[2] The new ***Total Access*** plan also allows the company "to reach customers located in a geographic area where" retail outlets are too far to travel.[2] Inventory management is one of the most challenging tasks in this industry.[4] "Inventory management, advertising, marketing, distribution, and training" are helping to achieve the economies of scope necessary to succeed.[2]

Financial Analysis

Return on Assets

Although ROA has increased from -15.36%[5] in 2005 to -1.54% (ttm)[3] in 2007 managements effectiveness is questionable since the ousting of CEO John Antioco, the company has had many subsequent changes in management.[6] It is yet to be seen if the new CEO James Keyes, from 7-Eleven, will bring his "sophisticated inventory management" to work here with the assets Blockbuster currently has at it's disposal.[6]

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[2] Blockbuster, Inc. "Form 10 K."
[3] Yahoo Finance. (ttm) = Trailing Twelve Months
[4] Riper, Tom Van.
[5] Blockbuster, Inc. "Annual Ratios Report Information." Thomson ONE Banker. 22 November 2007. <http://banker.thomsonib.com.proxy.lib.odu.edu/ta/tadashboard.aspx>
[6] Farrell, Andrew. "Blockbuster's CEO Ousted." Forbes.com. 2 July 2007. <http://www.forbes.com/markets/2007/07/02/icahn-blockbuster-closer-markets-equity-cx_af_ra_0702markets36.html>

Financial Analysis Continued

Gross Profit Margin

With the acquisition of Movielink, Blockbuster had better hope that sales increase their gross profits without scorching the bottom line. With the gross profit margin up from 50.92 in 2005[5] to 51.4 in 2006[5] it is obvious that heavy emphasis must be put on the gap of revenues and the costs associated with reeling them in.

Operating Profit Margin

The operating profit margin increased from -1.00 to 1.85[5] indicating that the company is effectively controlling costs and expenses associated with their normal business operations. It is essential that the company focus on lowering normal business operation expenses to control costs.

Net Margin

Net margin increased from -10.03[5] to .99 from 2005 to 2006. This indicates the company's return on every dollar. As compared with the industry's net margin of -.30[7], Blockbuster comes in at -2.83[7]. This indicates that Blockbuster's return on assets per dollar is lower than the industry average.

Total Debt as a Percentage of Total Assets

Although the leverage ratio shows an improvement since 2005, 32.72[5] is an excessive amount of debt to be used as leverage. This number is still much higher than the ratio in 2003 of 4.53[5]. This indicates that Blockbuster is running a higher risk of defaulting on loans by utilizing more credit to finance business transactions than actual revenue profits.

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[5] Blockbuster, Inc. "Annual Ratios Report Information." Thomson ONE Banker.
[7] Yahoo Finance. "Industry Browser - Services - Music & Video Stores." Yahoo, Inc. 2 December 2007. <http://biz.yahoo.com/p/743conameu.html>

Financial Analysis Continued

Quick Ratio

Unlike the other financial ratios, the quick ratio indicates that the company is becoming more capable of paying off short-term obligations without liquidating their assets. In 2006, the quick ratio was .38[5], this is the best it has been since 2002[5].

Current Ratio

Much like the quick ratio, the current ratio shows much promise for Blockbuster. The company's ability to service each dollar of current debt has steadily increased from 2002 at .65 to 2006 fiscal year's current ratio of 1.12.[5]

Trends

Although it appears that most financial trends show a decline in the overall financial situation of Blockbuster, the multiple, major strategic actions could prove extremely beneficial for the firm's long-term profitability. It appears that the advancements in availability provided by the Movielink acquisition and the advantage of brick and mortar locations could lead to ultimate success if management capitalizes on these advantages and utilizes them to their advantage promptly.

Industry Analysis

Porters Five Forces

The acquisition of Movielink has affected some parts of Blockbusters industry suppliers, while leaving other parts with little-to-no impression.

Suppliers:

Suppliers may find less purchase power if the acquisition of Movielink leads to more online downloads. This will leave Blockbuster with little need for plastic cases and DVD's as well as the use of distribution channels such as the United States Postal Service.

[5] Blockbuster, Inc. "Annual Ratios Report Information." Thomson ONE Banker.

Porters Five Forces Continued

Potential Entrants:

With the current competition of Netflix, ***redbox***, and Cox Communications the market does not seem appealing or lucrative. The industry is mature and we are currently in the height of the product/service life cycle where the *shake out* is occurring. The only way to gain new revenue is to take it from the competition. This has followed a typical scenario with Movie Gallery, who filed for Chapter 11[8], after acquiring Hollywood Video.[9]

Buyers:

Conversely, this type of competition is ideal of consumers. As Netflix, Blockbuster, and others battle for market share, they are utilizing methods of price reduction to ultimately gain market share.[10] This gives buyers much more power over the firms competing.[10]

Substitute Products:

While Blockbuster combats Netflix, others are gaining ground in substitutable product offerings.[4] "Is it only a matter of time before video-on-demand" takes over?[4] "Video on demand has grown at double-digit rates over the past two years."[4] Having movies at your finger tips through your digital cable subscriber is much more convenient than any online DVD or in-store DVD rental service could ever be.

Rivalry:

Wow, talk about a bull fight! In this market we definitely have rivalry. In this corner long standing champ Blockbuster competing against newcomer undefeated champion Netflix. Blockbuster must keep their eyes open for other industries who can take away market share with vertical integration like Cox Communications. Then we have ***redbox*** the vending machine supplier of DVD rentals. I have seen them popping up outside local grocers. Are they a contender? They are extremely convenient and cheaper at only $1 per night and much cheaper than brick-and-mortar stores to put up.

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[4] Riper, Tom Van.
[8] Lindner, Melanie. "Blockbuster Goes Bust." Forbes.com. 1 November 2007. 4 November 2007. <http://www.forbes.com/markets/2007/11/01/blockbuster-movies-entertainment-markets-equity-cx_ml_1101markets19.html>
[9] Farrell, Maureen. "The Rebirth Of The Small Video-Rental Shop." Forbes.com. 15 August 2007. 7 October 2007. <http://www.forbes.com/entrepreneurs/2007/08/15/blockbuster-walmart-netflix-ent-manage-cx_mf_0815video.html>
[10] Steverman, Ben. "Netflix Battle with Blockbuster Gets Ugly." BusinessWeek. 24 July 2007. 11 November 2007 <http://www.businessweek.com/investor/content/jul2007/pi20070724_961205.htm?chan=search>

Industry Analysis Continued

Porters Five Forces Continued

Industry Analysis in 10k

In the "Blockbuster Overview" section of the 10k, Blockbuster indicated that they were aware of the competition and stated: "increasing availability of in-home entertainment through delivery methods other than traditional in-store models and other leisure activities have led to significant challenges for us and resulted in the continued decline in the in-store home vide rental industry."[2] However, they did not seem to be too threatened by the on-demand convenience factor's long-term effects should cable companies come up with a "sweet revenue-sharing deal with producers."[4]

RBV

Blockbusters brick-and-mortar stores are the number one supplier of walk-in movie and game rentals.[11] "There is just something about the social experience of going to a store people like."[4] This proves the brick-and-mortar rental store ***valuable*** and ***rare*** since the Movie Gallery, Inc. filed Chapter 11,[12] "the second-largest video rental chain, with 4,600 locations."[11] Movie Gallery announced that it would subsequently be closing another 1,000 Hollywood video stores which it acquired in 2005.[12] Although, Netflix popularity and recent success could ***imitate*** Blockbusters Total Access offer with enough capital to make the remaining Movie Gallery stores an attractive take-over, for now, Blockbuster has a temporary competitive advantage. The ***redbox*** chain provides an idea for ***substitution*** as well as the recently mentioned on-demand cable downloads, but it does not appear that either is making much of a mark in the industry. They are certainly viable competitors that the organization should keep a close eye on.

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[2] Blockbuster, Inc. "Form 10 K."
[4] Riper, Tom Van
[11] Ogg, Erica. "News.com - Video Rental Chain Buys MovieBeam." CNET Networks, Inc. 8 March 2007. <http://www.news.com/Video-rental-chain-buys-MovieBeam/2100-1047_3-6165664.html>
[12] Reeves, Jim. "Movie Gallery files for bankruptcy; store closings likely." USA Today.com. 16 October 2007. <http://www.usatoday.com/money/industries/retail/2007-10-16-movie-gallery_N.htm>

Appendix

Thompson Financial Anuual Ratios Report Information

Profitability Ratios	12/31/06	12/31/05	12/31/04	12/31/03	12/31/02
Return on Assets	N/A	(15.36)	(28.36)	(17.34)	(22.80)
Gross Profit Margin	51.40	50.92	55.54	55.21	53.42
Operating Profit Margin	1.85	(1.00)	4.15	7.78	6.06
Net Margin	0.99	(10.03)	(20.63)	(16.64)	(29.24)
Leverage Ratios					
Total Debt % Total Assets	32.72	38.34	30.33	4.53	8.67
Liquidity Ratios					
Quick Ratio	0.38	0.31	0.35	0.31	0.23
Current Ratio	1.12	1.08	0.84	0.72	0.65

Shares Out (Thousands)	193,213	
Market Cap (Thousands)	736,143	
Sector	Consumer Services	
DJ Industry	Consumer & Household Services	Specialty Stores

PE Ratio	-6.35
Total Return 1 Year	34.18
BETA	0.051

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http://banker.thomsonib.com.proxy.lib.odu.edu/ta/tadashboard.aspx

http://www.blockbuster.com/ads

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[2] Blockbuster, Inc. "Form 10 K." United States Securities And Exchange Commission. Online database. 2006. 11 November 2007. <http://www.sec.gov/Archives/edgar/data/1085734/000119312507044360/d10k.htm>

[3] Yahoo Finance. "Profile: Blockbuster, Inc." Yahoo, Inc. 2 December 2007. <http://finance.yahoo.com/q/in?s=BBI>

[4] Riper, Tom Van. "Blockbuster On Demand." Forbes.com. 3 July 2007. <http://www.forbes.com/business/2007/07/02/blockbuster-video-dvd-biz-cx_tvr_0703blockbuster.html>

[5] Blockbuster, Inc. "Annual Ratios Report Information." Thomson ONE Banker. 22 November 2007. <http://banker.thomsonib.com.proxy.lib.odu.edu/ta/tadashboard.aspx>

[6] Farrell, Andrew. "Blockbuster's CEO Ousted." Forbes.com. 2 July 2007. <http://www.forbes.com/markets/2007/07/02/icahn-blockbuster-closer-markets-equity-cx_af_ra_0702markets36.html>

[7] Yahoo Finance. "Industry Browser - Services - Music & Video Stores." Yahoo, Inc. 2 December 2007. <http://biz.yahoo.com/p/743conameu.html>

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[10] Steverman, Ben. "Netflix Battle with Blockbuster Gets Ugly." BusinessWeek. 24 July 2007. 11 November 2007 <http://www.businessweek.com/investor/content/jul2007/pi20070724_961205.htm?chan=search>

[11] Ogg, Erica. "News.com - Video Rental Chain Buys MovieBeam." CNET Networks, Inc. 8 March 2007. <http://www.news.com/Video-rental-chain-buys-MovieBeam/2100-1047_3-6165664.html>

[12] Reeves, Jim. "Movie Gallery files for bankruptcy; store closings likely." USA Today.com. 16 October 2007. <http://www.usatoday.com/money/industries/retail/2007-10-16-movie-gallery_N.htm>