3

INNOVATION FAILURE

A Case Study Analysis of Eastman Kodak and Blockbuster Inc.

Richard A. Gershon, Ph.D.

Introduction

The lessons of business history have taught us that there is no such thing as a static market. There are no guarantees of continued business success for companies regardless of the field of endeavor. Schumpeter (1942) introduced the principle of *creative destruction* as a way to describe the disruptive process that accompanies the work of the entrepreneur and the consequences of innovation.[1] In time, companies that once revolutionized and dominated select markets give way to rivals who are able to introduce improved product designs, offer substitute products and services, and/or lower manufacturing costs. The resulting outcome of creative destruction can be significant including the failure to preserve market leadership, the discontinuation of a once highly successful product line, or, in the worse case scenario—business failure itself.

This paper presents a unique opportunity to look at modern media and information technology and the problems associated with preserving market leadership. Specifically, it will address the following question: Why do good companies fail to remain innovative over time? This paper will further consider some of the contributing reasons that lead to business failure. The arguments presented in this research inquiry are theory-based and supported by case-study evidence. Special attention is given to two media companies: Eastman Kodak Corporation and Blockbuster Inc. These companies were selected because they directly experienced the effects of a disruptive and changing technology that eventually resulted in business failure. A major argument of this paper is that the warning signs of a troubled business often exist for long periods of time before they combine with enabling conditions to produce a significant business failure (Collins, 2009). Both Eastman Kodak and Blockbuster knew they were at risk of failing well in advance of their eventual decline. If two

9780415818155c03_p46-68.indd 46 2/14/2013 4:30:07 PM

Table 3.1 Successful Innovation: Feature Elements

The innovation is based on a novel principle that challenges management orthodoxy.	Sony: Walkman portable music stereo and Apple iPad computer tablet
The innovation is systemic; that is, it involves a range of processes and methods.	Dell Computer: Direct-to-home sales delivery, Just-in-time manufacturing, 24/7 customer support.
The innovation is part of an ongoing commitment to develop new and enhanced products and services.	Apple: iPod iTunes iPhone iPad

Source: R. Gershon, adapted from Gary Hamel (2006).

such highly respected media companies can go from iconic to irrelevant, what might we learn by studying their downfall and how do other companies avoid a similar fate?

Innovation and Lasting Advantage

Innovation is important because it creates lasting advantage for a company or organization (Hamel, 2006). It allows a business to develop and improve on its existing product line as well as preparing the ground work for the future. Successful innovation occurs when it meets one or more of the following conditions. First, the innovation is based on a novel principle that challenges management orthodoxy. Second, the innovation is systemic; that is, it involves a range of processes and methods. Third, the innovation is part of an ongoing commitment to develop new and enhanced products and services. There is natural progression in product design and development (Hamel, 2006). Table 3.1 provides a clear illustration of the above principles.

While most organizations recognize the importance of innovation, there is a wide degree of latitude regarding the method and approach to innovation. For some business enterprises, innovation is deliberative and planned. It is built into the cultural fabric of a company's ongoing research and development efforts. Other times, innovation is the direct result of a triggering event; that is, a change in external market conditions or internal performance that forces a change in business strategy (Wheelen & Hunger, 1998).

Understanding Business Failure

We begin by asking the question: What is business failure? At first glance, business failure is typically associated with bankruptcy or poor financial performance. But at a deeper level, business failure is also about the proverbial "fall from grace." A company that once dominated an industry no longer finds itself the market leader. The company is faced with a public perception that it has lost all relevancies in an otherwise highly competitive business and technology environment (Charran & Useem, 2002). The fall from grace is best illustrated by a dramatic downturn in the company's stock value.

The consequences are very real both symbolically as well as financially. There are several reasons that help to explain why companies experience business failure. They include:

- The Tyranny of Success
- Organizational Culture
- Lengthy Development Times and Poor Coordination
- Risk Averse Culture
- Executive Leadership Failures
- The Challenges of a Disruptive Technology

The Tyranny of Success

Past success can sometimes make an organization very complacent; that is, they lose the sense of urgency to create new opportunities (Tushman & O'Reilly, 1997). Collins (2001) makes the point unequivocally when he writes that, "good is the enemy of great" (p. 16). Companies, like people, can become easily satisfied with organizational routines. They become preoccupied with fine-tuning and making slight adjustments to an existing product line rather than preparing for the future. They are engaged in what MIT's Negroponte (1995) describes as the problem of "incrementalism." Says Negroponte, "incrementalism is innovation's worst enemy" (p. 188). The history of business is filled with examples of past companies where senior management failed to plan for the future. Such companies did not anticipate a time when a substitute product (or changing market conditions) might come along and dramatically alter the playing field.

IBM

As an example, IBM made its name and fortune in the development of mainframe computers. At the start of the 1980s, IBM recognized that the computing needs of the modern business organization were undergoing a major change. More and more, business computing was shifting away from the centralized mainframe towards the standalone desk top computer. Initially, IBM got it right with the development of the IBM PC. But the wild success of the IBM PC also began to undermine the company's core mainframe business. Instead of adjusting to the future, IBM became a victim to its own corporate bureaucracy and past success (Carroll, 1993). In the end, the company could not let go of mainframe computer design principles despite the numerous studies commissioned by senior management arguing to the contrary.

Organizational Culture

Organizational culture (or corporate culture) refers to the collection of beliefs, values, and expectations shared by an organization's members and transmitted from one generation of employees to another (Schein, 1983). Organizations (even large ones) are human constructions. They are made and transformed by individuals. Culture is embedded and transmitted through both implicit and explicit messages such as formal statements, organizational philosophy, and adherence to management orthodoxies, deliberate role modeling, and behavioral displays by senior management (Pilotta, Widman, & Jasko, 1988).

But what happens when organizational culture stands in the way of innovation? What happens when being tied to the past (and past practices) interferes with a company's ability to move forward? The combination of past success coupled with an unbending adherence to management orthodoxy can seriously undermine a company's ability to step out of itself and plan for the future. Suddenly, creative thinking and the ability to float new ideas gets caught up in a stifling bureaucracy. Sometimes what passes for management wisdom and experience is inflexibility masquerading as absolute truth (Hamel, 2006).

AT&T

Following the break-up of AT&T in 1984, one of the company's most salient issues was how to address the organization's own internal culture. The management at AT&T understood the external challenges. The problem was how to overcome the company's institutionalized bureaucracy dating back to the days of Alexander Graham Bell.

Business journalist Leslie Cauley (2005) irreverently refers to AT&T's organizational culture as "the Machine."

> Literally a century in the making, the culture was so omnipresent that it even had its own nickname: the Machine. It was an apt moniker. Almost impenetrable to outsiders … the Machine steadfastly resisted change, and embraced those who did the same.
> (pp. 116–117)

The new AT&T was faced with competitive challenges on a number of fronts including competitive services from the Regional Bell Operating

Companies (RBOCs) Verizon and SBC as well as the advent of cellular telephony which proved insurmountable. Long distance telephony was fast becoming a commodity and was no longer a sustainable business. Talented employees who attempted to test the boundary waters of AT&T's organizational culture were met with such well worn corporate phrases as "that's not the AT&T way." It would only be a matter of time before AT&T would be sold off in pieces to the highest bidder. One of those companies was Southwestern Bell Corporation (SBC) which would later rename itself the new AT&T.

Lengthy Development Times and Poor Coordination

The combination of changing technology and shifting consumer demands makes speed to market paramount today. Yet companies often can't organize themselves to move faster. Too often, companies that are highly compartmentalized can become immobilized when it comes to fast turnaround times given the entrenchment of existing departments and area silos. This, in turn, results in a lack of coordination that can seriously impair product innovation and development times. Lengthy development times and poor coordination are closely tied to the execution of strategy. The problem often starts with executive failure to properly articulate the goals of the strategic plan to the organization as a whole.

Microsoft Vista

In January 2007, after years of hype and anticipation, Microsoft unveiled its Windows Vista operating system (OS) to a decidedly lukewarm reception by the PC community, IT pros, and tech savvy users alike. Instead of a revolutionary next-generation operating system, Vista was plagued with performance and compatibility problems from the start.[2] Following its immediate launch, Vista proved significantly less stable than its predecessor XP OS. Computer users experienced more hard locks, crashes, and blue screens. In time, Windows Vista lost all credibility. It was not until Microsoft introduced its Windows 7 operating system that the company could effectively start over again and restore public confidence in its software products.

Risk Averse Culture

Successful businesses with an established customer base find it hard to change. There is a clear pattern of success that translates into customer clients, predictable revenue, and public awareness for the work that has been accomplished to date. The adage "why mess with a winning formula" slowly becomes the corporate norm. There are no guarantees of success when it comes to new project ventures. The difficulty, of course, is that playing it safe presents its own unique hazards. Even well managed companies can suddenly find themselves outflanked by changing market conditions and advancing new technologies.

Sony

Consider, for example, the impact that the Apple iPod had on the Sony Walkman portable music player. Sony's co-founder Akio Morita was the quintessential marketer. He understood how to translate new and interesting technologies into usable products (Nathan, 1999). Nowhere was this more evident than in the development of the original Sony Walkman portable music player in 1979. The Walkman created an entirely new market for portable music systems. By combining the features of mobility and privacy, the Walkman contributed to an important change in consumer lifestyle (Gershon & Kanayama, 2002).

But even a company as respected as Sony was not invulnerable to the problems associated with innovation failure. As illegal music downloads exploded in popularity in the late 1990s, Sony, like the rest of the music industry, was unable or unwilling to adapt to the changing technology environment. Instead, the company was committed to its existing mini-disk technology. The introduction of the Apple iPod in 2001 proved to be a watershed event in digital music. The Apple iPod in combination with its iTunes music store in 2004 created the first sustainable music downloading business model of its kind and redefined the music industry forever (Gershon, 2009). Sony, for its part, knew about the research and development work being done at Apple. Yet it was not prepared to move quickly enough and adjust strategy in order to preserve market leadership in the area of portable music.

Executive Leadership Failures

Leadership is a process that involves influence and the art of directing people within an organization to achieve a clearly defined set of goals and outcomes. Successful leaders know what they want to accomplish in terms of organizational outcomes. In his book, *Leading Change*, Kotter (1996), suggests that a leader's strategic vision should convey a picture of what the future will look like as well as appealing to the long term interests of organizational members, customers, and others who have a stake in the enterprise.

Celebrity Leaders

The challenge for a company occurs when the executive leader loses perspective on his/her own role within the organization. In time, the executive leader becomes bigger than the organization itself. They become an example of what Collins (2001) describes as celebrity leaders. Examples might include Ted Turner, former CEO of Turner Broadcasting and Steve Jobs, Apple. According to Collins, fellow managers and board members are less likely to challenge the strategic vision of a charismatic leader out of respect for the CEO's past success and/or by not wanting to appear contrary.

Corporate Governance

Closely tied to failures in executive leadership are the problems associated with corporate governance. The role of a corporate board of directors is to provide independent oversight and guidance to the CEO and company's staff of senior executives. This can include everything from approving new strategic initiatives to reviewing CEO performance. One of the important goals of corporate governance should be to prevent significant mistakes in corporate strategy and to ensure that when mistakes happen, they can be corrected quickly (Pound, 2002). The problem occurs when a corporate board of directors ignore their fiduciary responsibility by failing to challenge questionable corporate strategy and/or by permitting unethical business practices to occur. More problematic is when a corporate board loses its sense of independence. In the worst case scenario, failures in corporate governance can lead to a diffusion of authority, where neither company nor person is fully aware of or takes responsibility for the actions of senior management (Cohan, 2002).

Activist Shareholders

The opposite issue can be equally problematic. Instead of board members being too passive, they can sometimes become too active in their responsibilities.

Typically, such members tend to have an equity stake in the company and are sometimes referred to as activist shareholders. The reasons for shareholder activism can vary in size and purpose from differences in management strategy to disagreements concerning executive compensation. Shareholder activism can take different forms including proxy battles, publicity campaigns, shareholder resolutions, and litigation.

The Challenges of a Disruptive Technology

Rogers (1995) defines innovation as "an idea, practice or object that is perceived as new by an individual" (p. 11). In principle, there are two kinds of innovation; namely, sustaining technologies versus disruptive technologies. A sustaining technology has to do with product improvement and performance. The goal is to improve on an existing technology by adding new and enhanced feature elements (Christensen, 1997, 2003). In contrast, a disruptive (or breakthrough) technology represents an altogether different approach to an existing product design and process. A disruptive technology redefines the playing field by introducing to the marketplace a unique value proposition.

Authors Collins and Porras (1994) make the argument that highly successful companies are those that are willing to experiment and not rest on their past success. In time, tastes, consumer preference, and technology change. It's hard for even the most innovative companies to stay current. The decisions that lead to failure are sometimes made by executives widely regarded as the best in their field.

The Innovator's Dilemma

Researcher Clayton Christensen (1997) suggests that even the best managed companies are susceptible to innovation failure. In fact, past success can sometimes become the root cause of innovation failure going forward. The main reason is that such companies are highly committed to serving their existing customers and are often unable (or unwilling) to take apart a highly successful business in favor of advancing unfamiliar and unproven new technology and service. Christensen (1997) posits what he calls the *innovator's dilemma*; namely, that a company's very strengths (i.e., realizing consistent profits and being responsive to customer needs) now become barriers to change and the agents of a company's potential decline.

Accordingly, strength becomes weakness, and the same reasons that enabled a company to become successful are now responsible for its failure. Advancing new technologies and services requires expensive retooling and whose ultimate success is hard to predict. Such companies lose because they fail to invest in new product development and/or because they fail to notice small niche players who enter the market and are prepared to offer customers alternative solutions at better value. The anticipated profit margins in developing a future market niche can be hard to justify given the high cost of entry; not to mention the possible destabilization of an otherwise highly successful business. Therein lies the innovator's dilemma. As we shall see, the innovator's dilemma was a major contributing factor to the events that led to the downfall of Eastman Kodak and Blockbuster Inc.

The Eastman Kodak Company

The Eastman Kodak Company (commonly known as Kodak) is a pioneering company in the field of photography. The company was founded by George Eastman in 1889 and is headquartered in Rochester, New York. Kodak is best known for a wide range of photographic and imaging equipment. Throughout most of the twentieth century, Kodak was singularly the most important company in the production and sale of film equipment. The company's visibility and dominance was evidenced by the phrase "Kodak moment" which became part of the public lexicon to describe a personal event worthy of being recorded for posterity (Jasper. 2012). On January 19, 2012, the 131-year-old company filed for bankruptcy. It was several years in the making, but Kodak steadily faltered beneath the wave of advancing digital media technology (DeLaMerced, 2012).

The Start of Kodak

Founded in 1880 by George Eastman, Kodak became one of America's most notable companies, helping establish the market for film and instamatic cameras which the company dominated for most of the twentieth century. Eastman did not invent photography. He did, however, make it accessible to large numbers of people by introducing a simple camera called the Kodak. As Genzlinger (2000, p. 15) points out,

> Before Eastman, photography was like portrait painting. Subjects would sit prim and still while a photographer wielding a bulky camera, glass plates and assorted chemicals caught the moment. The moment, though, had to last some seconds to allow for exposure, and the life captured by these early photographers was one without spontaneity. Eastman changed all that . . .

Eastman would eventually replace the wet-plate process, in which the photographer used chemical additives, to a dry-plate system which involved using a kind of precoated glass. Later, he replaced the glass plates with rolled paper film. The goal was to make shooting a photograph a much simpler process. By 1884, Kodak had become a household name. One of the company's first marketing campaigns contained the slogan, "You press the button, and we do the rest" (Gavetti, Henderson, & Giorgi, 2005).

Eastman's work led to the creation of the "Kodak" camera. The Kodak was a fairly expensive camera in the beginning stages of its design. It would eventually give way to the Brownie family camera designed by Kodak's Frank Brownell. Throughout the years, Kodak has led the way with an abundance of new products and processes, including the introduction of Kodachrome which set the stage for color photographs. Kodachrome became the color film standard throughout the 1950s and 1960s. In the 1960s, Kodak also introduced the "instamatic camera." The company achieved $1 billion in sales in 1962. By 1976, Kodak captured the majority of the US film and camera market (90 percent and 85 percent, respectively). Kodak's photofinishing process quickly became the industry standard for quality ("Kodak legacy," 2012). As a result, a major focus of the company was on its massive film-making plant. Traditionally, most of the company's CEOs had a strong manufacturing background.

The External Challenges: Rivalry with Fujifilm

Starting in the 1970s, Kodak was faced with a number of foreign competitors; most notably, Fujifilm of Japan, which undercut Kodak's prices. In the beginning, Kodak did not take the competitive threat seriously. That complacency proved to be costly when the company passed on the opportunity to become the official film sponsor of the 1984 Summer Olympics in Los Angeles. That decision gave Fuji high visibility, sponsorship rights, and a permanent foothold in the US film market. Soon thereafter, Fuji opened up a film plant in the US, cut prices, and aggressively marketed its film product. Fuji's US market share went from 10 percent to over 20 percent by the late 1990s. At the same time, Kodak was unsuccessful in penetrating the Japanese market; then considered the second largest market for film and paper after the US.

In 1995, Kodak filed a petition with the US Commerce Department (and later the World Trade Organization, WTO) arguing that its poor performance in the Japanese market was the direct result of unfair trade practices adopted by Fuji and the Japanese government. The WTO soundly rejected the Kodak petition. Kodak's financial results for fiscal year 1997 showed that corporate revenues dropped more than 10 percent from $15.9 billion to $14.3 billion. Kodak experienced a simultaneous drop in market share from 80.1 percent to 74.7 percent in the US, a one year drop of five percentage points (Finnerty, 2000). Kodak was rightly criticized for being slow to react and for underestimating its rivals.

Kodak also found itself at odds with its chief camera rival, the Polaroid Corporation. In October 1990, Kodak found itself on the losing end of the largest patent-infringement case of its kind. The company was forced to pay Polaroid $909.4 million for infringing on seven of Polaroid's instant photography patents. That decision forced Kodak out of the instant photography business ("Kodak legacy," 2012).

The Shift to Digital Cameras

As early as 1981, Kodak recognized that a shift in digital camera technology was underway. That year, Sony Corporation announced the launch of a new digital camera called Mavica. At the time, it was described as a filmless digital camera that would display pictures on a television screen

9780415818155c03_p46-68.indd 55 2/14/2013 4:30:08 PM

(Gavetti et al., 2005). Kodak had some prior experience with digital cameras having invented one of the early prototype designs as early as 1975. Starting in the early 1980s, Kodak began the process of entering into digital cameras and film. Throughout most of that decade, Kodak introduced more than 50 products that were tied to digital photography and the storage of images. Yet the company was unable to successfully commercialize them (Lucas & Goh, 2009). At the same time, Kodak was fully committed to traditional film technology and processing. By the 1990s, the onset of digital photography started to erode the demand for conventional film and processing, thereby, putting a squeeze on Kodak's business.

The Advantages of Going Digital

Digital photography has many advantages over traditional film. Digital photos are convenient and allow the user to see the results instantly. Digital photos don't require the costs associated with film and development time. Digital cameras enable the user to take multiple shots at no additional cost. They can be stored on a variety of digital devices, including personal computers, smart phones, tablets as well as being uploaded on to the Internet. All this points to the fact that the transition to digital media is not just about a single product; but, rather, about significant changes to communication display and storage processes (Gershon, 2009). Digital photography proved to be the ultimate disruptive technology. It was only a matter of time before traditional film processing would become obsolete.

Executive Leadership Challenges

Between 1983 and 1993, Kodak underwent seven organizational restructurings. In 1993, Kay Whitmore (a Kodak insider) stepped down as CEO and was succeeded by George Fisher. Fisher was recruited from Motorola where he had successfully revitalized that company. As Kodak's newly appointed CEO, Fisher began steering the company to embrace a digital future. The goal was to enhance, not replace, conventional film. He brought more outsiders into the company and began investing heavily in China and other emerging markets. Fisher began the first in a set of new initiatives to reach out to companies like Microsoft and Apple. Most proved unsuccessful. Kodak executives could not imagine a world without traditional film (Gavetti et al., 2005). Despite a clear understanding of the problem, Kodak couldn't seem to shake off its complacency.

Fisher clearly recognized that the organizational culture at Kodak had to change. The importance of digital media and communication had to be understood and embraced at all levels of the organization. To that end, he hired Dr. John White, a former US government official with extensive private sector experience, to serve as one of his change agents. The challenge, however, would prove formidable. While Kodak recognized the importance of digital media to its future, the company wanted to engage the process in its own way while staying within the confines of its Rochester, New York headquarters. This was ultimately a recipe for failure. The creativity demands for producing digital media are so vastly different than traditional photography. Kodak's leadership was not prepared to impose the kind of disruptive changes on the organization that would have been required (Swasy, 1997).

Kodak eventually settled on a combination strategy whereby it created a separate digital and applied imaging division while still preserving its core capabilities in traditional film. By 1993, Kodak had spent $5 billion to research and develop digital cameras and imaging equipment.

While Kodak had the right intentions, the company's middle management resisted the move toward digital photography for a variety of reasons. At issue were the high costs associated with developing new production facilities as well as a genuine concern that such changes might result in a loss of jobs. In the meantime, Kodak continued to miss critical target dates and experienced multiple setbacks in research and development. The company was unable to bring significantly new products to market. Former Hewlett-Packard CEO Carly Fiorina made the following observation:

> Kodak sat on a mountain of cash and profitability in their traditional photography business and I believe their thinking was digital photography will eat into my traditional and most profitable business. I don't want that to happen ….
>
> Kodak miscalculated about [who was in charge] …. Consumers were in charge. Individuals were in charge …
>
> (quoted in Lucas & Goh, 2009, p. 54)

The Challenges of Staying Competitive

The year 2001 proved to be an important cutover point. The company experienced a significant drop in film sales. CEO Daniel Carp (Fisher's successor) continued the process of moving the company into digital cameras. It began by introducing the EasyShare family of digital cameras. Kodak spent tremendous resources studying customer behavior, finding out that women in particular loved taking digital photos but found it difficult to transfer them to their computers. This unmet need presented a major opportunity for Kodak. The goal was to manufacture multiple digital camera designs that made it easy for people to share photos with friends and family members via their PCs. One of their

9780415818155c03_p46-68.indd 57 2/14/2013 4:30:08 PM

major innovations was a printer dock, where consumers could insert their cameras into this compact device, press a button, and watch their photos roll out. By 2005, Kodak became the number one digital camera manufacturer in the US with sales having risen 40 percent to $5.7 billion.

Despite its impressive start, Kodak's digital camera line became quickly copied by Asian competitors that could produce equivalent cameras at lower cost. Digital cameras soon proved to be a low profit margin item. In order to stay competitive, Kodak found itself losing money on every digital camera sold. Consumer electronics companies like Sony, Panasonic, and Canon could afford to be patient and lose money on select line items because they have hundreds of other products to offset potential losses. Not so for Kodak which had a limited product line. The final *coup de grâce* came with the onset of cellphones equipped with cameras. In one sense, the cellphone camera represents the dumbing down of picture-taking since the quality is not as good as a camera. That said, a younger generation of users are willing to sacrifice picture quality for convenience. By 2010, Kodak ranked seventh behind Canon, Sony, Nikon and others in digital camera sales. Today, cameras have become a standard feature on all smart phone devices.

Adjusting to Market Realities and Bankruptcy

Today, Kodak's financial reserves have reached a critical stage. The company has $5.1 billion in assets and nearly $6.8 billion in debts. Its biggest group of unsecured creditors were bondholders represented by the Bank of New York Mellon who are owed $658 million. Kodak filed for Chapter 11 protection in January 2012 and has exited select operations by closing 13 manufacturing plants and 130 processing labs while reducing its workforce by 47,000 employees (DeLaMerced, 2012). In a final effort to stabilize its finances, Kodak hired asset management firm Lazard Ltd. to sell its 1,100 digital imaging patents. This proved too little too late. Kodak had failed to generate enough potential interest, driven in part by fears of the company's deteriorating financial health.

In the end, George Fisher was unable to transform Kodak into a high-tech growth company (Lucas & Goh, 2009). Fisher's belief in the future of digital communication lacked urgency and did not permeate all levels of the organization. Nor were successors Daniel Carp (2000–2005) and Antonio Pérez (2005–2012) any more successful. Under Pérez's leadership, Kodak tried to reinvent itself by focusing on printers, packaging, and work force software. That strategy proved unsuccessful as well. The price of Kodak shares decreased from around $25 in 2005 to less than $1 by September 30, 2011. It was emblematic of the fall of a great American company.

Blockbuster

Blockbuster Inc. (formerly Blockbuster LLC) is an American-based DVD and videogame rental service. Blockbuster was founded by David Cook who used his experience with managing large database networks as the foundation for Blockbuster's retail distribution model. At its peak in 2009, Blockbuster had an estimated 7,100 retail stores in the US with additional locations in 17 countries worldwide, and employed over 60,000 employees in the US and worldwide. The company is headquartered in McKinney, Texas (Blockbuster Inc., 2012).

Because of competition from other video rental services, most notably Netflix and RedBox, Blockbuster has sustained significant revenue losses in recent years. The company filed for bankruptcy just shy of its 25th anniversary on September 22, 2010. In April 2011, Blockbuster was acquired by satellite television service provider Dish Network at an auction price of $233 million and the assumption of $87 million in liabilities and other obligations.

The acquisition was completed on April 26, 2011 ("Dish network wins bidding," 2011).

The Start of Blockbuster Video

The first Blockbuster store opened October 1985 in Dallas, Texas. Shortly thereafter, the company's founder David Cook opened several additional stores and later built a $6 million warehouse in Garland, Texas that could service them all. The key to Blockbuster's early success was the convenience and ease of renting film entertainment for consumer use. Another important factor to Blockbuster's early success was its timely access to recently released feature films combined with films on VHS geared to the neighborhood demographics of its local retail outlets.

In 1987, Waste Management president Wayne Huizenga and his business partner John Melk paid Cook $18 million for a controlling interest in the new startup company. Together, they used the lessons from their experience with Waste Management to build Blockbuster into a global enterprise. Huizenga took the company public in 1989 and aggressively transformed it from a $7 million business with 19 stores to a $4 billion global enterprise with more than 3,700 stores in 11 countries. They also bought every video rental franchise they could reasonably acquire and spent the better part of the late 1980s acquiring several of Blockbuster's key rivals (DeGeorge, 1996).

Viacom Acquires Blockbuster Video

Despite Blockbuster's success, Huizenga felt that it was only a matter of time before technology advancements would directly challenge Blockbuster's bricks and mortar approach. In 1994, Huizenga sold Blockbuster to Viacom Inc. for $8.4 billion. The Blockbuster acquisition was seen as a way to use the company's healthy cash flow to service the massive $10 billion debt that Viacom incurred when it acquired Paramount Pictures. The idea was correct in principle but the Blockbuster business model had one serious flaw. The problem in part had to do with the high cost of acquiring videotapes from various Hollywood studios which made it difficult to stock the shelves with an adequate level of inventory at Blockbuster's multiple store outlets. The movie studios sold VHS cassettes to rental companies for about $65 apiece. In practical terms, a rental store would have to rent out each tape about 30 times in order to be successful. That represents a significant upfront cost for a product whose consumer appeal is temporary; that is, the first few weeks after the movie has been released (Antioco, 2011). Add to the retail mix that stores like Blockbuster have to maintain a diverse inventory where the rental numbers are not likely to offset the cost of acquiring less popular titles. This, in turn, forced a strict limit on the number of tapes that Blockbuster was able to afford per store site. As a consequence, many customers would leave Blockbuster empty handed; unable to find the tapes they wanted. By 1997, this strategy fell apart as Blockbuster sustained a pre-tax loss of $323 million ("The vindication of Sumner Redstone," 1998). To make matters worse, Viacom had to write off two-thirds of Blockbuster's tape inventory valued at $315 million.

The untenable situation led to the firing of Blockbuster's then CEO, Bill Fields, who was replaced by John Antioco. During the next six months, Viacom President and CEO Sumner Redstone, working with Antioco and his management team, was able to redesign the company's business model. They came up with an alternative revenue sharing scheme, whereby Blockbuster would buy tapes from the studios at one to two dollars per tape. Blockbuster, in turn, would give back approximately 40 percent of the rental revenue per tape to the studios. The new revenue sharing model resulted in a dramatic turnaround at Blockbuster and, by 1998, the company saw a 17.6 percent increase in revenues. For the next six years, Blockbuster experienced steady growth and performance with revenues reaching in excess of $6 billion in 2003 and 2004 (Antioco, 2011).

Netflix and Business Process Innovation

Today, innovation is about much more than developing new products. It's about reinventing business processes and building entirely new markets to meet untapped customer needs. Business process innovation involves creating systems and methods for improving organizational performance (Gershon, 2011). The application of business process innovation can be found in a variety of settings and locations within an organizational structure, including product development, manufacturing, inventory management, customer service, and distribution (Davenport, 1993). It renders two important consequences. First, a highly successful business process is transformative; that is, it creates efficiencies that benefit the organization as well as the end user. Second, it sets into motion a host of imitators who see the inherent value in applying the same business process to their own organization (Gershon, 2011).

Blockbuster was the right technology for the time. It was a 20-year interim technology that provided a practical solution in meeting the needs for home television viewing. As early as 1994, Wayne Huizenga understood the limitations of Blockbuster's bricks and mortar approach when he sold the company to Viacom. His concerns were shared by any number of observers throughout the industry. The Blockbuster retail model was going to be difficult to sustain in the wake of advancing technology (DeGeorge, 1996). On the immediate horizon was cable television and its promise of video-on-demand service. Less obvious was the future of e-commerce and the disruptive technologies made possible by the Internet. One of those disruptive technologies would take the form of a unique business process innovation and a company called Netflix.

Netflix

Netflix is an online subscription-based DVD rental service. Netflix was founded by Reed Hastings in 1997 during the emergent days of electronic commerce (EC) when companies like Amazon and Dell Computer were starting to gain prominence. The challenge for Hastings was whether he wanted to duplicate the traditional retail model that was currently in place. The alternative was to utilize the power of the Internet for placing video rental orders and providing online customer service (Shih, Kaufman, & Spinola, 2007).

Neflix offers its customers a great value proposition; namely, two to three DVDs per week (depending on the service plan) for a fixed monthly price. In practical terms, Neflix provides greater value to the consumer when compared to a traditional video rental store which charges by the individual DVD rental unit. Second, Netflix offers consumers greater convenience in the form of "no late fees." The subscriber is free to hold on to a specific video as long he/she wants (E-Business Strategies, Inc. 2002).

Third, a big part of Netflix's success is the direct result of personalized marketing which involves knowing more about the particular interests and viewing habits of one's customers. Netflix utilizes the power of the

Internet to promote a proprietary software recommendation system. A common complaint with Blockbuster was the experience of renting an unfamiliar movie and being dissatisfied with the viewing experience later on. The Netflix software recommendation system, on the other hand, makes suggestions of other films that the consumer might like based on past selections and a brief evaluation that the subscriber is asked to fill out. Netflix's interactive capability and proprietary recommendation system changed the basic relationship between retailer and consumer by shifting the emphasis from traditional retail sales to relationship building (Gershon, 2011).

Moreover, the proprietary software recommendation system has the added benefit of stimulating demand for lesser known movies and taking the pressure off recently released feature films where demand sometimes outstrips availability. This is in keeping with Anderson's (2006) long tail principle.[3] Finally, Netflix has adapted to changing technology by offering a "watch instantly" feature which enables subscribers to stream near-DVD quality movies and recorded television shows to those subscribers equipped with a computer and high speed Internet connectivity. The "watch instantly" feature is delivering in real time and in greater numbers what cable television failed to achieve in terms of its video-on-demand system feature (Gershon, 2011). Netflix has proven to be the ultimate game changer by revolutionizing the DVD rental business through the use of business process innovation and its EC technology platform.

Blockbuster's Failure to React

Blockbuster had more than sufficient time to react to the competition and revise its business model. As early as 2001, Blockbuster was in a position to strategically reposition itself. The company could have possibly acquired Netflix or modified its strategy by duplicating many of the same EC efficiencies that Netflix's business model had already demonstrated. Alternatively, it could have opened kiosks (i.e., similar to RedBox) and begun closing stores. This would have reduced capital costs and improved convenience (Woloszynowicz, 2010). Instead, Blockbuster chose to ignore the competitive threat posed by Netflix. It was were doing quite well for the moment and didn't want to destabilize an otherwise successful business enterprise (i.e., the innovator's dilemma). In practical terms, Netflix was allowed to go unchallenged for six years before Blockbuster launched its own EC service in 2004. By then, Netflix had brand recognition, 3 million customers, and a strong business momentum ("How Blockbuster failed," 2010). Critics point to the fact that CEO John Antioco should have taken the Netflix threat more seriously. Blockbuster's business complacency coupled with a failure to appreciate the future of electronic commerce would prove costly in securing the company's long term future.

Blockbuster's Executive Leadership and Activist Board

John Antioco proved to be a capable CEO for the first six years of his tenure at Blockbuster. Between 1998 and 2004, the company achieved steady revenue growth. Most outside observers, however, were convinced that Blockbuster was a flawed business model that had reached the climax of its business run. This is reflected in a 1999 IPO offering where Blockbuster stock received a lukewarm reception on the first day of trading.

In 2004, Blockbuster finally launched its own online DVD rental service to compete directly with Netflix. In a bid to slow the competition, Blockbuster introduced a flat monthly fee and later eliminated late fees as well. Subscriptions did increase, but not enough to offset the $300 million loss the company absorbed by eliminating late fees. The combined strategy wound up costing the company an estimated $400 million (Poggi, 2010).

In 2004, Viacom (which still owned 80 percent of the company) chose to sell its stake in Blockbuster and took a $1.3 billion charge to reflect the declining value of the business. Later that same year, a second major change occurred that affected the company's organizational dynamics when activist investor Carl Icahn bought nearly $10 million shares of Blockbuster stock. The goal was to leverage his investment at a time when Blockbuster was trying to negotiate the purchase of its chief rival, Hollywood Video. The Federal Trade Commission, for its part, rejected the proposed merger. Shortly thereafter, Icahn began giving interviews to the press and writing letters to Antioco as well as shareholders claiming that Blockbuster had spent too much money on developing its online business and eliminating late fees. He was critical of Antioco's attempted merger strategy and claimed that the CEO was making too much money. Icahn proceeded to launch a proxy fight. At the 2005 shareholders meeting, Icahn proposed two new directors to the company's board of directors, which won approval. Blockbuster's eight board of directors now consisted of Icahn and the two newly elected activist board members (Antioco, 2011).

For Antioco and his management team, a set of contentious directors meant having to constantly justify and explain each business decision. To the public, Blockbuster's evolving business strategy seemed disjointed, almost random. First, Blockbuster offered a no late fee policy, but charged the consumer a restocking fee if the movie was returned too late. The company then excluded certain products, like video games, from the offer. Eventually, Blockbuster did away with the no late fees policy altogether, but without really telling anybody or making any announcements. All this points to the fact that Blockbuster was a company in trouble. The problem was made worse by the fact that Antioco and the company's board of directors were at serious odds with one another. Icahn routinely battled with Antioco about how to revive the company. Antioco wanted to keep the company independent while Icahn wanted to sell it to a private-equity firm (Poggi, 2010).

In December 2006, the situation came to a head over executive compensation. The board decided to significantly reduce Antioco's bonus compensation. Antioco chose to negotiate a severance deal with Blockbuster rather than accept the reduced bonus amount (Antioco, 2011). Set against the backdrop of some highly intense corporate infighting, the board approved the hiring of Jim Keyes who was the former head of 7-Eleven. He had a difficult assignment that included quelling the unrest at Blockbuster while trying to develop a strategy for the future. Unfortunately, the hiring of Jim Keyes was too little, too late. By now, it was clear to everyone that Blockbuster was in a slow death spiral. In the end, Blockbuster failed because the company chose not to change ("How Blockbuster failed," 2010). It was too slow in reacting to the competitive challenges posed by Netflix and RedBox. This, in combination with a highly contentious board of directors, proved to be a toxic mixture. Reflecting on Blockbuster's Chapter 11 filing, former CEO John Antioco (2011) concludes: "The day the company's failure will hit me hardest is probably when my own neighborhood store closes" (p. 42).

Discussion

A major argument of this paper is that the warning signs of a troubled business often exist for long periods of time before they combine with enabling conditions to produce a climactic business failure. Collins (2009) refers to this as "the silent creep of impending doom" (p. 1). The business failures at both Kodak and Blockbuster share one thing in common. Each failed to recognize the early warning signs of advancing technological change. Kodak was paralyzed by an organizational culture that was highly resistant to change. While Kodak had the right intentions, the company was not prepared to make the costly changes needed to fully embrace the business of digital media and information technology. As Lucas and Goh (2009) point out, when a business is confronted with a highly disruptive technology, senior management has to be a catalyst for change at all levels of the organization. Although Kodak recognized the external threats, the company's organizational culture prevented it from moving forward. Kanter (2012) suggests that Kodak was very Rochester-centric and never really developed an innovation presence in other parts of the world that were developing leading edge media technologies. Instead, Kodak adhered to a kind of old-line manufacturing mentality. It was in the film business plain and simple. It was, after all, what made it profitable in the past.

In retrospect, it seems clear that the practice of driving to a store to rent a movie was a business process destined to fail as the Internet became more of a factor in the world of electronic commerce. For years, business analysts and professional observers have recognized that Blockbuster was a flawed business model that would be difficult to sustain in the wake of advancing technology. As early as 1994, Wayne Huizenga understood the limitations of a bricks and mortar approach when he sold Blockbuster to Viacom Inc. Ten years later, Viacom CEO Sumner Redstone came to the same conclusion when he sold his 80 percent stake in the company as well. Both Huizenga and Redstone operated at a time when the conventional wisdom and smart money was on cable television and its highly touted video-on-demand service. Despite many attempts, video-on-demand television has never realized its full potential (Gershon, 2009). It too failed. The Internet, however, is an entirely different story. Joseph Schumpeter (1942) long ago noted that entrepreneurs disrupt. For Blockbuster, the disrupter indeed was a company called Netflix. The situation at Blockbuster was further complicated because of failures in executive leadership coupled with a highly contentious board of directors. The standoff between CEO John Antioco and the company's board resulted in business strategy gridlock and a public loss of confidence in the company.

The lessons of business history have taught us that there is no such thing as a static market. This is especially true in the field of media and telecommunications where today's high-flying company can quickly become yesterday's news; supplanted by the next communication start-up with a good idea. Think America OnLine (AOL), the Sony Walkman, AT&T long distance telephone service, Kodak film, and of course Blockbuster video. The resulting effects of creative destruction can be significant, including the failure to preserve market leadership, the discontinuation of a once highly successful product, and ultimately business failure itself. Both Eastman Kodak and Blockbuster were highly successful companies that once dominated their respective specialty area. Their previous strengths and one-time success ultimately laid the groundwork for their eventual decline.

Each was susceptible to the innovator's dilemma. In the end, the requirements for change proved too formidable an obstacle.

Notes

1 The principle of disruptive technology owes its aegis to the work of Joseph Schumpeter who argued that innovation leads to the gales of "creative

destruction" as new innovations cause old ideas, technologies and skills to become obsolete.

In Schumpeter's view, creative destruction however difficult and challenging, leads to continuous progress moving forward. A good example of this is the impact that personal computers had on mainframe computers. In doing so, entrepreneurs created one of the most important technology advancements of the twentieth century.

2 Work on Vista began in 2001 under the code name Longhorn. The release of Windows Vista occurred more than five years after the introduction of Windows XP, thus making it the longest time interval between two releases of Microsoft Windows. Even still, Vista became the subject of numerous criticisms by various user groups who claim that Vista is hard to load and can make computers less stable and run slower.

3 The focus on lesser known films is in keeping with Anderson's (2006) principle of the "long tail." The term describes the niche strategy of businesses, such as Amazon or Netflix, that sell a large number of unique items, in relatively small quantities.

References

Anderson, C. (2006). *The long tail: Why the future of business is selling less of more*. New York: Hyperion.

Antioco, J. (2011, April). How I did it? Blockbuster's former CEO on sparring with an activist shareholder. *Harvard Business Review*, 39–44.

Blockbuster Inc. (2012). *Funding universe*. Available at: http://www.fundinguniverse.com/company-histories/Blockbuster-Inc-Company- History.html Retrieved: March 7, 2012.

Carroll, P. (1993). *Big blues: The unmaking of IBM*. New York: Crown Publishers.

Cauley, L. (2005). *End of the line: The rise and fall of AT&T*. New York: Free Press.

Charran, R. & Useem, J. (2002, May 27). Why companies fail. *Fortune*, pp. 50–62.

Christensen, C. (1997). *The innovator's dilemma*. Boston, MA: Harvard Business School Press.

Christensen, C. (2003). *The innovator's solution*. Boston, MA: Harvard Business School Press.

Cohan, J. (2002). I didn't know and I was only doing my job: Has corporate ethics governance careened out of control? A case study of Enron's information myopia. *Journal of Business Ethics*, 40(3), 275–299.

Collins, J. (2001). *Good to great*. New York: Harper Collins.

Collins, J. (2009). *How the mighty fall*. New York: Harper Collins.

Collins, J. & Porras, J. (1994). *Built to last*. New York: Harper Collins.

Davenport, T. (1993). *Process innovation*. Boston, MA: Harvard Business School Press.

DeGeorge, G. (1996). *The making of a Blockbuster: How Wayne Huizenga built a sports and entertainment empire from trash, grit, and videotape*. New York: John Wiley & Sons.

DeLaMerced, M. (2012, January 19). Eastman Kodak files for bankruptcy. *New York Times*. Available at: http://dealbook.nytimes.com/2012/01/19/eastman-kodak-files-for-bankruptcy/ Retrieved: February 20, 2012.

Dish Network wins bidding for assets of bankrupt Blockbuster. (2011, April 7). *Los Angeles Times*. Available at: http://articles.latimes.com/2011/apr/07/business/la-fi-ct-dish-blockbuster-20110407 Retrieved: March 7, 2012.

E-Business Strategies, Inc. (2002, October). Netflix: Transforming the DVD rental business. *Published Report*, 1–10.

Finnerty, T. (2000). Kodak v. Fuji: The battle for global market share. Unpublished report. New York: Lubin School of Business, Pace University.

Gavetti, G., Henderson, R., & Giorgi, S. (2005). *Kodak and the digital revolution*. Cambridge, MA: Harvard Business School Press.

Genzlinger, N. (2000, May 22). Television review: He changed photography and transformed society. *New York Times*. Available at: http://www.nytimes.com/2000/05/22/arts/television-review-he-changed-photography-and-transformed-society.html Retrieved: March 5, 2012.

Gershon, R. (2009). *Telecommunications and business strategy*. New York: Taylor & Francis.

Gershon, R. (2011). Business process innovation and the intelligent network. In Z. Vukanovic & P. Faustino (Eds.), *Managing media economy, media content and technology in the age of digital convergence* (pp. 59–85). Lisbon, Portugal: Media XXI / Formal press.

Gershon, R. A. & Kanayama, T. (2002). The SONY corporation: A case study in transnational media management. *The International Journal on Media Management*, 4, 44–56.

Hamel, G. (2006, February). The what, why and how of management innovation. *Harvard Business Review*, 72–87.

How Blockbuster failed at failing. (2010, October 11). *Time*, pp. 38–40.

Jasper, R. (2012, January 20). The end of our Kodak moment. *The Telegraph*. Available at: http://www.telegraph.co.uk/family/9025257/The-end-of-our-Kodak-moment.html. Retrieved: February 20, 2012.

Kanter, R. (2012, January 14). The last Kodak moment? *The Economist*. Available at: http://www.economist.com/node/21542796. Retrieved: February 20, 2012.

Kodak legacy. (2012, January 19). *New York Times*. Available at: http://www.nytimes.com/interactive/2012/01/19/business/dealbook/dbgfx-kodaks-legacy.html Retrieved: February 20, 2012.

Kotter, J. (1996). *Leading change*. Boston, MA: Harvard Press.

Lucas H. & Goh, J.M. (2009), Disruptive technology: How Kodak missed the digital photography revolution. *Journal of Strategic Information Systems*, 18, 46–55.

Nathan, J. (1999). *Sony: The private life*. New York: Houghton-Mifflin.

Negroponte, N. (1995, April). The balance of trade of ideas, *Wired*, 188.

Pilotta, J., Widman, T., & Jasko, S. (1988). Meaning and action in the organizational setting: An interpretive approach. *Communication Yearbook*, 11, 310–334.

Poggi, J. (2010, September 23). Blockbuster's rise and fall: The long, rewinding road. Available at: http://www.thestreet.com/story/10867574/1/the-rise-and-fall- of-blockbuster-the-long-rewinding-road.html Retrieved: March 8, 2011.

Pound, J. (2002). The promise of the governed corporation. *Harvard Business Review on Corporate Governance*. Boston, MA: Harvard Business School Press.

Rogers, E. (1995) *Diffusion of innovation*. Fourth edn., New York: Free Press.

Schein, E. (1983). The role of the founder in creating organizational culture. *Organizational Dynamics*, 11, 13–28.

Schumpeter, J. (1942). *Capitalism, socialism and democracy*. New York: Harper & Row.

Shih, W., Kaufman, S., & Spinola, D. (2007, November). Netflix: *Harvard Business School Case Study Series* (9–607–138), 1–15.

Swasy, A. (1997). *Changing focus: Kodak and the battle to save a great American company*. New York: Times Business—Random House.

The vindication of Sumner Redstone. (1998, 15 June). *Forbes*, pp. 105–111.

Tushman, M. & O'Reilly, C. (1997). *Winning through innovation*. Boston, MA: Harvard Business School Press.

Wheelen, T. & Hunger, D. (1998). *Strategic management and business policy*. Reading, MA: Addison Wesley Longman, Inc.

Woloszynowicz, M. (2010, September 22). Business Lessons from Blockbuster's Failure. *Web 2.0 business and development lessons*. Available at: http://www.w2lessons.com/2010/09/business-lessons-from-blockbusters.html Retrieved: March 7, 2012.