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FINANCIAL AND NON-FINANCIAL REASONS FOR BANKRUPTCY: BLOCKBUSTER AS AN EXAMPLE

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I hereby declare that I have compiled the thesis paper independently
and all works, critical standpoint, and data by other authors
have been properly referenced, and the paper
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ABSTRACT

Blockbuster valuation at its peak was around 8 billion dollars, but eventually it had started to decrease to the point of bankruptcy. The research questions the differences between financial and non-financial reasons of Blockbuster's bankruptcy. The purpose of this paper is to apply those reasons on Blockbuster and see their impact. The results indicate that both financial and non-financial are reasons for the bankruptcy. However, non-financial reasons are numbered, it includes technology, competition, and personal. On the other hand, there is only one financial reason which is high debt.

Keywords: bankruptcy, financial statements, financial ratios, annual report, Blockbuster.

INTRODUCTION

Blockbuster could have bought Netflix for $50 Million, but the CEO John Antioco thought it was a joke, and did not believe it was an idea worth considering, according to (Molinaro 2020). The deal that would have changed the industry happened in 2000, the age of the dot-com bubble in the United States. Ten years later, Netflix ended the year 2010 with a valuation of more than $9 billion, while Blockbuster filed for bankruptcy in the same year. The fall of a giant company like Blockbuster totally deserves a study so we learn from the reasons that caused the fall.
“At its peak in the late '90s, Blockbuster owned over 9,000 video-rental stores in the United States, employed 84,000 people worldwide, and had 65 million registered customers. Once valued as a $3 billion company, in just one year, Blockbuster earned $800 million in late fees alone” (Ash 2020). However, Blockbuster had a tumultuous decade, beginning with the discovery of Netflix in 1998, followed by filing for bankruptcy in 2010.

Firms differ widely in the types of products and services they offer, and they all have a common denominator: selling the product and generating revenue to survive. However, this is not always easy, especially for small or new companies. Most ideas need capital to become a company in the real world, and capital can come from equity (shareholders) and debt (borrowing money). When a company is not profitable and cannot generate revenue for extended periods to pay its shareholders and debts, owners might consider going into bankruptcy to exit the market (bankruptcy liquidation) or reorganize the business (bankruptcy reorganization). These two types of bankruptcy are explained in the literature review paragraph. Lack of profitability is the primary cause of most bankruptcies. However, several underlying factors can inhibit a business's ability to profit and lead to bankruptcy.

Bankruptcy is a topic that is frequently discussed. The activities of a business are affected by external and internal variables that might impact the corporation´s performance and ultimately to bankruptcy. There are several reasons for bankruptcy. However, they can be classified into two categories. The first section deals with financial factors, the second with non-financial reasons. It is not possible to link the non-financial reasons to the external causes of a company, nor the financial reasons to the internal causes of a company. For example, a wrong strategy and high debts are internal reasons, but the first is classified as non-financial, while the second is for financial reasons. We can also find the exchange rate and competition for external reasons, but the first is classified with financial reasons, while the second is classified with financial reasons.

Financial and non-financial factors are both crucial to the management for essential decision-making. Both of them affect the profitability of a company. However, they differ. Financial factors are linked to expenses and revenues, such as return on investment along with cost and benefit. In contrast, non-financial factors have to do with strategic decisions such as market research and competition.

When a corporation wishes to avoid bankruptcy, it should not just focus on the financial reasons and ignore the non-financial ones, as some traditional models do. However, it should also focus on non-financial reasons to increase forecasting accuracy and extend horizons (Altman et al. 2015).

Similarly, while studying a company's bankruptcy, it is impossible to focus only on the financial reasons and ignore the non-financial causes, or vice versa. However, both must be included because they are complementary.

This research is both qualitative and quantitative. The qualitative method analyzes non-financial reasons, while the quantitative method analyzes financial reasons for bankruptcy. Sometimes they can be mixed since both approaches support one another. However, most of the work is going to analyze the company’s reasons for bankruptcy. The basis to analyze the company’s financial statements is the balance sheet and the income statement. Hence, it is possible to compute sets of financial ratios.

The purpose of this research is to determine and examine the main reasons that can lead to business bankruptcy, either financial or non-financial, taking Blockbuster as an example. As well as having an overview of the external and internal challenges that the companies might face. In order to do that, this paper will collect enough data from reliable resources such as annual reports of Blockbuster and also academic sources.

This research explores the answers for the following:

1) Was the direct reason for bankruptcy financial or non-financial?
2) What is the overall financial performance of Blockbuster according to its financial statements?
3) What were the major events that led to Blockbuster's bankruptcy?

1 LITERATURE REVIEW

The big problem that a corporation can face is bankruptcy. Bankruptcy is a legal proceeding in which a corporation or person makes a formal request to the federal court declaring an inability to fulfill its financial obligations and stops paying debts. It is slightly different from going out of business. However, there are six different types of bankruptcies in the US Bankruptcy Code. And they are under chapters 7, 9, 11, 12, 13, and 15. So when a company finds itself in an unstable financial situation where bankruptcy is the only or best option, it has two basic choices: either Chapter 7 bankruptcy known as" Bankruptcy liquidation" or Chapter 11 bankruptcy known as " Bankruptcy reorganization." In a nutshell, bankruptcy law constitutes ways for creditors to collectively sort out their claims by liquidating debtor's assets (Chapter 7) or reaching an agreement in an insolvency or reorganization plan (Chapter 11).

When a business declares bankruptcy, it has two options for dealing with its assets: The first is liquidation also known as "Chapter 7", "This chapter of the Bankruptcy Code provides for "liquidation" - the sale of a debtor's non-exempt property and the distribution of the proceeds to creditors" (USCourts.gov). A business is going through this type of bankruptcy, when a company will not make any profit in the future and decide to liquidate and sell its assets to pay debt and equity, with secured debts taking precedence over unsecured ones, following the absolute priority rule (APR), It explains the basic payment order in corporate bankruptcy.

When a firm files for bankruptcy, a trustee is appointed to shut down and liquidate its assets. The proceeds net of transactions costs[1] is distributed to creditors so as of priority. Creditors may have different priority rights so that creditors are either paid in full or not paid at all (White 1983). These creditors are split into two sections; secured creditors and unsecured creditors.
Secured creditors can include lenders that hold a charge over some of the company's assets. These creditors have a perfect lien on the specific company's assets, including inventory, equipment, building, and account receivable. In bankruptcy, they can reclaim the assets or their value (White 1983).

[1] Net Transaction Costs: (i) any income or expense amounts recorded in connection with or required to be recorded to give effect to the Transactions or (ii) any cash proceeds or expenditures related to the Transactions, whether such amounts pursuant to (i) or (ii) occurred prior to, on, or after the Closing Date.

The priority rule in liquidation is the absolute priority rule (APR). It gives priority first to the transaction costs of the bankruptcy process, second to taxes, rent and wages, third to unsecured creditors (trade creditors, bondholders and often banks), and last, to equity (White 1983). Unsecured creditors are favoured creditors who do not have any security interests in the debtor's assets and do not benefit from any security interests in the debtor's assets if the debtor files for bankruptcy. The unsecured creditors will usually realize the most minor proportion of their claims in some legal systems. The unsecured creditor category includes suppliers, customers, contractors, and HMRC... According to the rules of “absolute priority,” unsecured creditors are among the last groups to be paid from the distribution of assets once all other creditors groups have been paid. Therefore, this group is placed below the secured creditors and above the shareholders of the company. Usually, this section of creditor receives little money, if any (White 1983).

The last group of (APR) are shareholders, when a corporation decides to liquidate its assets, shareholders are mostly powerless, they have a greater danger of losing money invested in the company than creditors, who have a lower chance of losing money. Dividends provide shareholders with a piece of the company's profit, whereas creditors only get interested in the debts they took out (White 1983).

The second most popular option a company can do to its assets is the reorganization or restructuring, also known as chapter 11. “This chapter of the Bankruptcy Code generally provides for reorganization, usually involving a corporation or partnership. A chapter 11 debtor usually proposes a plan of reorganization to keep its business alive and pay creditors over time. People in business or individuals can also seek relief in chapter 11” (USCourts.gov). The company might file for bankruptcy reorganization when the assets generate money and keep running but could not pay all debts in the present. A company is ready to restructure in debt and equity.

The difference between bankruptcy liquidation and bankruptcy reorganization is that the company goes out of business and liquidates assets to pay its debts for bankruptcy liquidation. For bankruptcy reorganization, the creditors believe that there is a chance that the company might survive in the long run. And continue operating in the same line of business with an agreement to a plan for the reorganization.

As an example of a company that filed for bankruptcy reorganization and came back to life, we can take Six Flags as a successful example. Six Flags filed for bankruptcy after the great recession

that hit in 2008. The company was in debt of $2.7 Billion, though it only has the capacity of managing a deficit of no more than $890 million of debt, as the company declared (Hals 2010).

The company, which operates 19 amusement parks in North America, enters its peak season without the constraints of bankruptcy and with less than half the debt it had when it filed for Chapter 11 last June (Hals 2010). The corporate managed to exit bankruptcy as Six Flags Entertainment Corp and under the control of hedge funds. The funds owned its bonds and invested $725 million to recapitalize the company (Hals 2010).

1.1 Causes of bankruptcy

When a company's assets are less than its liabilities and the owners are unable to find a way out, the company goes bankrupt. In the United States, between 35000 and 40000 small firms file for bankruptcy each year (Bradley, Cowdery 2004). What are the most common causes of business failure and bankruptcy?

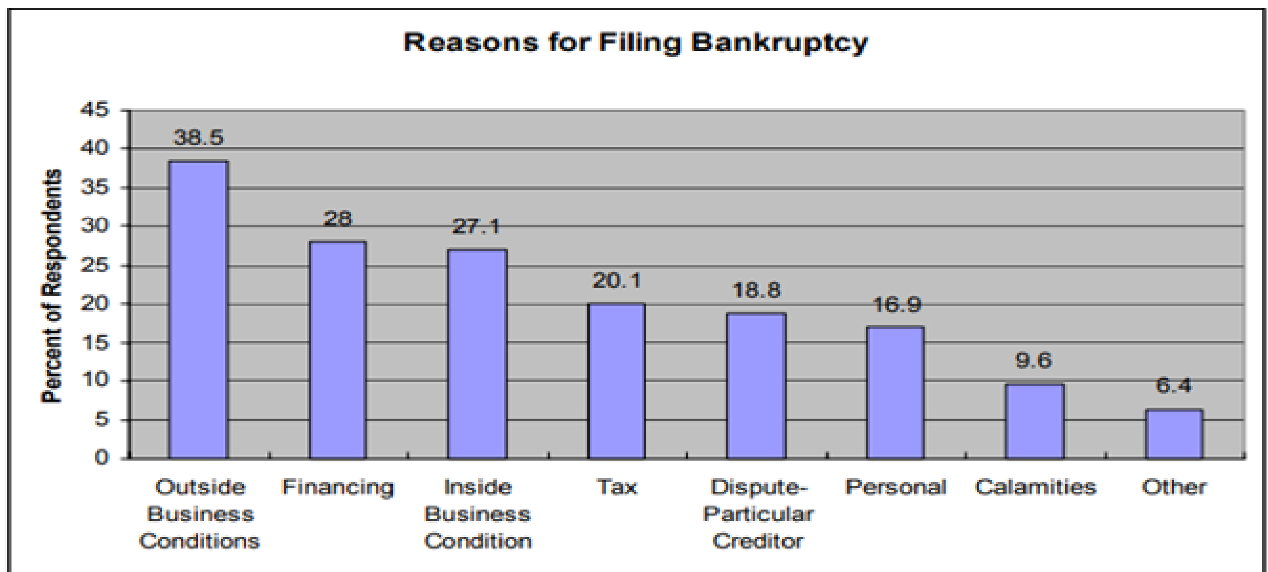

Figure 1. Reasons for Filing Bankruptcy
Source: Sullivan, T. A., Warren, E., Westbrook, J. (1998)

Several reasons could lead the corporation to bankruptcy; as (Figure 1) shows, these reasons can be split in general into two groups; financial reasons and non-financial reasons.

1.2 Financial causes of bankruptcy

The corporate finance departments' mission includes how companies deal with sources of financing, capital structuring, investment decisions, and whether to pay for equity investment, debt, or both. Any major mistake among these tasks may lead to the bankruptcy of the company. Financing causes of bankruptcy can include capital loss, high debt service, inability to secure capital.

A company can lose capital once a capital asset decreases in value. This situation can happen when a capital asset is sold for a lower price than the original purchase price. Loss of capital is the difference between the purchase price and the sale price of any investment, where the purchase price is higher than the sale price. In other words, "The capital loss (or gain) is defined as the change in expectation that happened during the holding period in regard to the future flow of income; a negative change results in a capital loss, while positive change results in a capital gain" (Edrey 2004).

The other financial reason for bankruptcy is high debt service, also known as loan payment, which refers to the cash required by a company to repay interest plus principal on a debt obligation. Debt service is essential when a company needs to raise additional capital to operate the business. Before taking the loan, the company should compute its debt service coverage ratio (DSCR). DSCR helps to evaluate the ability to service debt. The higher the ratio, the more accessible for the company to obtain a loan. "Debt service is an unavoidable side effect of borrowing. Borrowers improve their current spending power by taking on new debt, but they also commit to a predetermined future debt service plan, which includes interest payments and amortizations. Keeping track of debt service shows why credit-related expansions are routinely followed by downturns several years later in the presence of long-term debt" (Drehmann et al. 2017).

Inability to service debt can lead a company to bankruptcy once the debt service is high and creditors do not hope the company will generate money in the future to repay its debt. In this case, creditors might press the company to fall into bankruptcy and liquidate its assets to pay the debts.

The third financial reason for bankruptcy is the inability to secure capital or lack of capital, a common reason why small businesses fail. An expressive saying sums it up: "people do not plan

to fail; they just fail to plan.” Instead, the company relies heavily on its ability to sell goods or services, get paid, and fulfill obligations to increase inventory and grow the business.

However, factors within this interdependent chain threaten the ability to meet future obligations, which leads to bankruptcy. For example, if a company's existing liabilities are higher than existing assets, it may have trouble growing or paying back creditors or even go bankrupt. So many businesses put in a lot of effort to increase capital. However, there is more work to be done in order to secure it.

The last financial reason for bankruptcy is foreign exchange rates. Exchange rate (also known as a foreign-exchange rate, forex rate, FX rate or Agio) between two currencies is the rate at which one currency will be exchanged for another (Trivedi et al. 2019). For example, how many U.S. dollars does it take to buy one euro? As of November 22, 2021, the exchange rate is 1.13, meaning it takes $1.13 to buy €1”. Subsequently, Changes in exchange rates drive changes in cash flows and, ultimately, the firm’s value.

One of the challenges that multinational corporations faced is foreign exchange rates. Exchange rate fluctuations can alter the dollar value of a company's assets and liabilities denominated in foreign currencies. However, few people realize that currency fluctuations can have a significant impact on operating profits (Lessard,_Lightstone, 1986). In a study (De Jong, Ligterink, Macrae 2002) They examined the relationship between exchange rate changes and stock returns for a sample of Dutch firms over 1994-1998. They found that over 50% of the firms are significantly exposed to exchange rate risk. Moreover, (Bodnar and Gentry 1993) examined exchange rate exposure at the industry level for Canada, Japan, and the US over 1979-1988. For the US and Canada, they find, respectively, 11 out of 39 industries (28%) and 4 out of 19 (21%) have significant exchange-rate exposures.

1.3 Non-financial causes of bankruptcy

Most non-financial reasons for bankruptcy come outside of the business, making it hard to control it. The corporations need an excellent strategic plan to compete and continue in the market.

Non-financial reasons are considered one of the main reasons that lead to bankruptcy, as (figure 1) shows. Among the most critical non-financial reasons that may lead to bankruptcy, we mention Competition, Technology and Personal and Calamities.

Competition is a conflict between businesses that are attempting to attain a certain objective in a specific industry, and it has been marketed as a legal method of winning the market. This competition may include the quality, price, sales, location, design, target group, and every business process (Ibragimov, Xurramov 2015). The competitors directly or indirectly affect each other by decision-making. For example, now companies are competing to provide high-quality products at reasonable prices.

Competition increases or decreases and sometimes does not exist, depending on the industry and the competitive environment. Competition benefits the consumer more than companies.

Table 1.Characteristic of Different Types of Markets

	Perfect Competition	**Monopoly**	**Monopolistic**	**Oligopoly**
Number of firms	Many	One	Many	Few
Type of product	Homogeneous	Unique/Single/ Limited	Differentiated	Differentiated
Entry condition	Very easy	Impossible	Easy	Difficult
Pricing	Price Taker	Price Maker	Price Taker	Price maker
Innovative Behavior	Weak	Potentially strong	Moderate	Very Strong

Source: Krishnan, R. (2011)

The second reason for bankruptcy is Technology. Recently, companies' competition is increasing with the increase in technological development. As a result, companies are investing in developing the latest and most recent technologies to become leaders in the market.

Technology boosts the quality of services and products, whether in terms of merchandise, advertising, or delivery facility. “As technology rapidly advances, firms must operate in highly competitive environments full of gradual and radical innovations. These scenarios provide firms with an opportunity to become market leaders if they develop the most recent, updated, and well-adopted technologies” (Eisdorfer, Hsu 2011).

A study by (Eisdorfer, Hsu 2011) analyzes the association between technology competition and corporate bankruptcy. Firms operating in technology-driven industries could quickly find themselves in trouble with a real risk of failure if they do not keep pace with the recent innovations. Moreover, Severe technology competition leads to a higher frequency of bankruptcy, and firms that perform poorly in technology competition are more likely to go bankrupt. In addition, bankruptcies that are driven by technology competition are less sensitive to the business cycle and the industry growth and result in greater declines in earnings and stock prices than ordinary bankruptcies. The findings in the study, therefore, suggest an essential role of technology competition in corporate bankruptcy.

The last non-financial reason that this research will cover is Personal and calamities. Personal reasons that affect business owners can quickly reflect on the business's financial status, such as: not being able to pay bills, divorce, poor financial management, or unexpected emergencies. "In a sample of nothing but identified business bankruptcies, the number of personal problems that drive these filings is significant. About one out of six (16.9%) so-called business bankruptcies are initiated because of a personal problem of the business owner" (Sullivan et al., 1998).

However, personal reasons are more common in small businesses "... in the case of small businesses-the bulk of the business bankruptcy cases-the business/ personal distinction breaks down" (Sullivan et al., 1998).

Calamities are not personal. Calamities can be accidents that occur and cause sudden damage. Examples of calamities are natural disasters, explosions, or death...Thus, 9.6% of the study files for bankruptcy are driven by calamity reasons (figure.1).

2 METHODOLOGY

This research looks at the causes of bankruptcy, both financial and non-financial, using Blockbuster as an example. Which for the most part, is pretty significant, for several reasons, this study would help future entrepreneurs in avoiding the challenges that affected Blockbuster and ultimately led to its bankruptcy. We specifically picked Blockbuster as an example: At its inception, the company was growing horizontally and profitably, basically contrary to popular belief. In addition to being a well-known multinational corporation, it provides in-home movie and video game rental services. However, the type of the research is case study. It is comparing and evaluating different aspects of our research problem. It is also a detailed study of a phenomenon in an organization.

This research's data is collected from a case study, the actual annual reports of a firm in the first place, and some academic sources, to generally examine the reasons that led to the company's bankruptcy. Furthermore, this study will generally gather secondary data, which definitely is available and has previously been obtained from very primary sources, instead of primary data (questionnaire).

Due to the wide number of causes of bankruptcy, the research will not cover all of them, but it will cover the essential ones. It will stand on all of the previously listed reasons, one by one, and specifically apply it to Blockbuster to show direct and indirect causes for which Blockbuster went bankrupt. And to essentially find out which ones had the most impact.
Due to the lack of recent descriptive studies, we decided to use the results from the study of Sullivan, who have studied 3 377 business bankruptcies, in 14 districts, that filed for bankruptcy in the United States during calendar year 1994. The purpose of their study was to determine the factors that cause small firms to file for bankruptcy (Sullivan et al. 1998). The result of their study is in (figure 1). we decided to use the results from this study as a reference. The reasons from the study will be applied on the case of Blockbuster and analyzed. Then we figure out if those reasons or some of them are accurate in our case.

The research is divided into two parts. The first part focuses on analyzing the financial causes of bankruptcy mentioned and applying them to Blockbuster. This part will focus on studying the financial statements and ratios, depending on the company's financial statements. The majority of the data in this paragraph comes from the company's annual reports; the second part is about non-

financial reasons, in this part, we will use the academic resources to analyse the non-financial reasons that lead Blockbuster to bankrupt. Afterwards, we see the nature of the relationship between financial and non-financial reasons.

However, this research will combine qualitative and quantitative data. Because the research will specifically cover both financial and non-financial issues, as for financial reasons, we are focusing more on quantitative data. In parallel, we will focus more on qualitative data for non-financial reasons. The two combined provide a much better and more comprehensive understanding of the research.

3 Empirical study

In this part, the previously mentioned financial and non-financial reasons will be analyzed and focus on the reasons that led to the Blockbuster Company's bankruptcy. The empirical part will begin with a review of financial causes for bankruptcy, which will be presented one by one. The non-financial factors will be examined and demonstrated one by one in the second part, with some figures to aid our understanding. This section will also emphasize the answers to the research questions.

3.1 Examination of financial reasons

We will use available annual reports of the company throughout the lifetime of the corporation and other reliable sources to examine the financial reasons that led to Blockbuster's bankruptcy. We will focus on its first years when it achieved a great profit—followed by an astonishing decade in the '90s. At that time, the company was worth $4 billion, with over 3,700 stores in 11 countries (Lucas 2012).

It is also important to note that other factors directly cause bankruptcy. Therefore, the reasons mentioned above are not the only factors that lead to financial failure. However, they are the most common.

There are three reasons to examine the financial statements, they are:

1. To analyze the main activities of Blockbuster in the reported years to determine its business structure.
2. To examine the financial position of Blockbuster in different years; especially in 2009 and 20010; where the company recorded a huge loss
3. To analyze the reasons that caused Blockbuster to be in bankruptcy.

Among the financial reasons leading to bankruptcy, there is a **Capital loss**, which occurs when the value of a capital asset, such as an investment or inventory falls. This loss will not be recognized until the asset is sold for less than the initial acquisition price.

When discussing the company's capital loss as a cause of bankruptcy, it is important to remember its early years, when the assets were performing effectively and generating profits in the short and long term. Although the loss of capital cannot be the primary cause of bankruptcy, other variables contribute to the loss of capital, which subsequently leads to bankruptcy.

In our situation, the Blockbuster corporation makes a profit in its first years. For example, in 1994 and 1995, the company's net income was 146 million and 142.9 million, respectively. Between 1994 and 1999, the value of assets did not drop from 8249,7 million dollars (Blockbuster Inc. 1999). When we compare these years to the year of bankruptcy in 2010, we can see that the value of the company's assets fell to 1538,3 million dollars, resulting in a 558,2-million-dollar loss in profit (Blockbuster Inc. 2011).

Based on the preceding, it may be concluded that a corporation's loss of capital is not the direct cause of bankruptcy, even though the corporation suffered a loss of $20.4 million in non-financial assets such as property, equipment, and franchises restored in 2010 (Blockbuster Inc. 2011).

The second reason for bankruptcy is **High debt**, which is included in the financial group. When a company faces financial difficulties and wants to solve them, it frequently considers injecting capital into the company through a loan or selling its assets, which either helps the company overcome the problem or places it into debt. Was servicing high debts a cause of Blockbuster bankruptcy?

To answer this question, we will utilize a company's balance sheet to determine certain ratios, including the debt ratio. This ratio indicates the percentage of a company’s assets are financed with debt. In other words, it indicates a company’s ability to pay off its liabilities with its assets. In general, a higher level of debt ratio is more leveraged and highly risky for lenders. However, the total liabilities and total assets for Blockbuster, respectively in 2010 in millions, are $ 1852.6 and $ 1538.3, which gives a debt ratio of 1,2 or 120%, as (Blockbuster Inc. 2011) stated. The number shows that the company will not cover its debts even if it liquidates its assets because liabilities are higher than assets by 20%. Therefore, it explains the huge debts of the company, in contrast to 1987 and 1998 when the debt ratio was only 43% and 31.8%, respectively, according to (Blockbuster Inc. 1999; Cangemi, Lopez 1997). Hence, it is evident that the business is in debt. Furthermore, it became clear when Blockbuster filed for bankruptcy with a debt worth over $900 million (Ash 2020).

According to Blockbuster's voluntary bankruptcy petition, the company has over 100,000 creditors, $1,017,035,832 in total assets, and $1,464,939,759 in total debt. In addition, the corporation has an almost unknown number of unsecured creditors, with $486 million (Davis, Higgins 2013). The Bank of New York Mellon topped the list of unsecured creditors, With roughly $315 (Teinowitz 2010).

The third element of financial causes of bankruptcy is the **Inability to secure capital**. According to the Blockbuster income statement, the sales fell by 36.64%, from $ 5551.1 million in 2005 to $ 4062.4 million in 2010. This negative performance affects the profits of the company.

According to the balance sheets for 2009, the current ratio was 1, showing that current liabilities and current assets are equal. It means that the company has difficulties fulfilling its current, short-term obligations and cannot invest in future activities and growth. As a result, it will need to infuse extra capital to stay in the market. For the same reason, “the company recruited Kirkland & Ellis for assistance with its ongoing fundraising and capital raising initiatives,” According to the Blockbuster spokeswoman Karen Raskopf (Merced 2009). In addition, the corporation decided to take actions to minimize its indebtedness. Specifically, it reduced general and administrative expenses, which led to general and administrative cost savings of nearly $300 million, closing underperforming stores, and terminating its lease contract. (Blockbuster Inc. 2010).

The company has also tried to avoid falling under Chapter 7 bankruptcy and heading for Chapter 11 bankruptcy reorganization when arguing with major bondholders with a capital injection to rebalance the company (Davis, Higgins 2013). These steps led to a slight increase in the working capital ratio by 0.1 in January 2010. However, as 2010 progressed, Blockbuster's business continued to deteriorate. Regardless, the company did not appreciate meeting its long-term debts. Moreover, “the value of the company's shares sank 77 per cent to only 22 cents before the New York Stock Exchange halted trading in response to allegations that it was considering bankruptcy” (MacIntosh 2009). It indicates that the corporation cannot secure its capital the same way it did at the start of its existence.

The last financial reason that this research will analyze is the **Exchange rate**. International businesses are exposed to various market risks, as operating in international markets involves exposure to movements in currency exchange rates. The exchange rate is a headache for

multinational companies because it is impossible to foresee future changes in a currency. Thus, the thing imposes risks on those businesses, and Blockbuster is one of them.

According to (Blockbuster Inc. 1999), Blockbuster's operations outside the United States constitute 20.6% of its total revenues. And in Europe alone, its revenues constitute 11.0% of the total revenues. The majority of these sales were from Great Britain, which has not adopted the Euro. In 2010, the operations outside of the United States increased, as reported by (Blockbuster Inc. 2011); operations outside the United States, mainly in Europe and Canada, constituted 34% and 30% of the total revenues in fiscal years 2010 and 2009, respectively.
To combine the domestic and international segments, "The assets and liabilities are translated at exchange rates in effect at the balance sheet date, while results of operations are translated at average exchange rates for the respective periods. According to Blockbuster, the cumulative effects of exchange rate changes on net assets are included as a part of accumulated other comprehensive loss".

However, translation of the statements of operations of international businesses into U.S. dollars may affect year-over-year comparability and could cause adjustments to financing and operating strategies. For example, revenues and operating income would have decreased by $29.9 million and $0.0 million, respectively, for 2010 if foreign exchange rates in 2010 had been consistent with 2009. Likewise, Blockbuster has recorded a $2.9 million loss and a $10.4 million loss for foreign currency transactions in fiscal years 2010 and 2009, respectively, primarily related to intercompany loans denominated in foreign currencies (Blockbuster Inc. 2011).

3.2 Examination of non-financial reasons

The non-financial factors cannot necessarily be external, as previously explained. However, they share some aspects. Both of them are uncontrollable by a company, but it must develop strategies to respond to them. Non-financial factors are significant because they can directly or indirectly impact business operations, personnel, and revenues. These variables are constantly altering in ways that are beyond the company's control.

As demonstrated in (Figure 1), many of the company's issues originate from abroad, pushing it to bankruptcy. Unfortunately, Blockbuster did not escape from these and other problems that led to

its bankruptcy in 2010. In addition, the company faced several non-financial problems, including competition for markets and the quantum leap in technological development.

The first non-financial reason for bankruptcy that this research will examine is **Competition.** When Blockbuster came into existence, the competitive market consisted of many local and regional small businesses. Its most significant competition in 1999 came from non-videocassette providers of home viewing entertainment and video stores and other retailers that rent or sell movies. Other forms of competition were introduced in the 2005 financial report, such as online rentals and other sources of in-home entertainment, such as digital video recorders and other devices that can download content for in-home viewing. And in 2010, piracy, movie theatres, and the internet became part of the competition that Blockbuster was facing (Blockbuster Inc. 1999, 2005, 2010).

In recent years, Blockbuster has faced competition from almost 21 competitors. In addition, Blockbuster continued to face tough competition from Netflix, Movie Gallery, Hastings Entertainment, Redbox, and several online-only services such as Amazon, Apple, and Hulu and large retail firms such as Target, Walmart, Best Buy, and Time Warner (Ferrell, Hartline 2011).

According to the same source, when Blockbuster's competition heated up, the business reacted by fulfilling online rental requests through 1,000 local stores, allowing it to reach customers in faraway locations rapidly. Moreover, it has adjusted its strategy by offering new users a free weekly movie or game rental. Blockbuster attempted to stifle Netflix, one of its most important and prominent competitors, with these modifications, but they were unsuccessful. Blockbuster also abandoned its "no-late fee" policy in 2005, due to heavy competition with Netflix, which resulted in a $400 million revenue loss for Blockbuster (Ferrell, Hartline 2011).

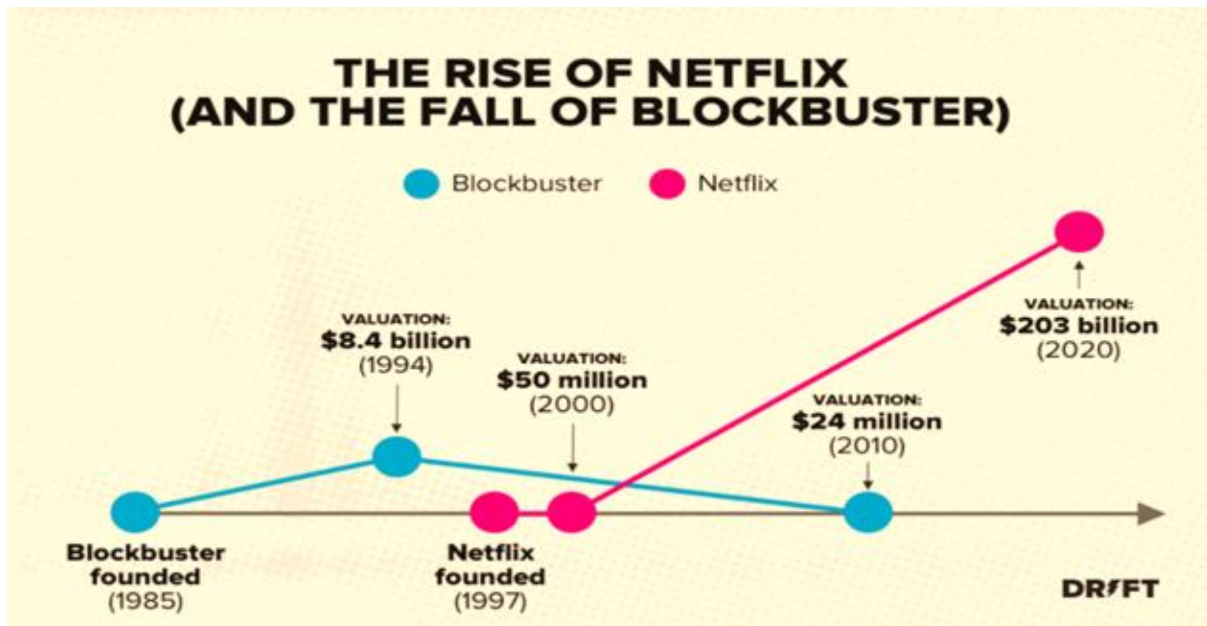

Figure 2. The rise of Netflix and the fall of Blockbuster
Source: Sloan (2020)

A new company has entered the market twelve years after Blockbuster. When Netflix was founded, Blockbuster was the unchallenged leader in the video rental industry. In 1994, Viacom and Blockbuster estimated their stock swap merger at $8.4 billion. After Six years, Blockbuster had a once-in-a-lifetime opportunity to wipe out Netflix and save itself from extinction, when Netflix co-founder Reed Hastings made them an offer to buy the company for 50 million dollars (Dias, Navarro 2018). However, Blockbuster did not take advantage of this opportunity. Five years after the founding of Netflix became the biggest competitor to Blockbuster, this competition lasted 13 years and ended with the surrender of Blockbuster, as (figure 2) shows.

Blockbuster has been seeking new ways to compete with sophisticated technology, particularly electronic distribution, and has launched several new strategic initiatives, including:

- BLOCKBUSTER On Demand is coming to mobile devices thanks to a partnership with Motorola.
- Customers may now search and explore product catalogs, locate locations, search store inventories, and manage their email queues using an iPhone app developed by the company.
- One of the leading cable broadband carriers, Suddenlink Communications, launched a Blockbuster-branded video-on-demand ("VOD") service (Blockbuster Inc. 2010).

These actions may be successful in the short term, but the company must be the first to look for newer and better alternative ways to grow. “On September 23, 2010, Blockbuster filed voluntary petitions for exemption under Chapter 11 US bankruptcy code in response to the challenges of increasing competition in industry and retail.” as (Blockbuster Inc. 2011) stated. It confirms that Blockbuster suffered greatly from the competition and led to its collapse in the late 2010s, which led to the liquidation of its assets to pay off debts.

The second non-financial reason for bankruptcy is **Technology**. According to Blockbuster's 2010 Annual Report, the company was not hiding its concern about the negative impact of its business with new technologies. The company suffers a lot in this field. Although piracy is illegal, it has become a severe impediment to Blockbuster's success because updated technology allows for speedier copying and downloading of DVDs for free. Piracy takes several forms, from illegally copying theatrical films at their first showing to copying DVDs licensed from studios solely for retail sale. The most hazardous of which is illegally downloading films on the internet. Viewers may watch films concurrently or before they are made available for rent at home video stores. Piracy also harms blockbuster revenue.

In addition to piracy, another issue that has arisen due to technological advancement is the number of additional channels on satellite cable systems and direct broadcast through satellite. These companies also provide pay-per-view movies and other specialty movie services, which allow subscribers to pay the price to watch a certain movie. While the DVD is being mailed to the subscriber, some cable providers allow the subscriber to purchase and watch a DVD movie via the cable system. According to Blockbuster’s 2010 financial report, this has a detrimental impact on customer demand for Blockbuster products.

In addition to the mentioned problem, Blockbuster did not have much knowledge of how to harness technology in its favor, compared to Netflix. Which always precedes it with steps forward, which made Blockbuster trail Netflix. Netflix preceded it by sending its products by mail, downloading movies via the Internet, and gradually dispensing with classic stores. So, Blockbuster followed this plan (Hosch, Blockbuster Inc. 2005).

Moreover, at the beginning of the 1990s, digital technology saw rapid expansion in in-home movie and video game rental services. Blockbuster's management and owners were not eager to adapt to the new environment. The management believed that it was just a passing trend that would have

no significant impact on the company and its business model in the long term, due to its dominant market position and the strong level of consumer trust in it (Vučeković, Gavrilović 2021).
After Blockbuster management rejected an offer to buy Netflix, the latter turned to exploit the technology, as opposed to Blockbuster, which did not take advantage of the new technological innovations. Netflix's entire business model is based on the utilization of digital service sales channels, which have been well received by customers. On the other hand, Blockbuster continued to rent and sell cassette tapes and discs in its stores in the traditional way (Vučeković, Gavrilovic 2021).

Delays in responding to technological advances and market demands may result in severe penalties and even bankruptcy, as Blockbuster faced. In 2004 Blockbuster finally recognized the value of technology and began adopting several of Netflix's ideas (Gotberg 2017). Despite Blockbuster’s adjustments to its physical media model in the form of its DVD-by mail service brought in in 2004 to compete with Netflix, development focused on retaining the waning local optimum focusing on elements such as choosing Blu-ray over HD DVD and bringing in “Additional Daily Rates,” or “ADRs,” for rentals not returned by their due date in the United States, making their physical model even less attractive (Baker 2015). Moreover, Blockbuster continued to lose market share to its competitors. In 2008, Netflix began to offer movie streaming services to subscribers, who could stream movies directly from the internet. At this time, Netflix was generating $115 million in profit, while Blockbuster was recording losses of $517 million (Gotberg 2017).

As a consequence, Blockbuster’s market was hollowed out by Netflix. Because the Netflix founder Reed Hastings was a Stanford computer scientist, he knew it would soon be feasible to stream movies. He also knew that having employees run shops, charging for rentals, late fees, etc. were outmoded relics of the past, while online service delivered by a virtual organization offered unbeatable value (Baker 2015).

The last non-financial reason for bankruptcy, in this case, is **Personal and Calamities**. David Cook founded the company in 1985, a moment when the rental business was rapidly expanding (Herbert 2016). Cook recognized that a computerized system for inventory control and checkout might substantially streamline operations, and his software expertise qualified him to design it. Cook developed Blockbuster as a chain that would grow through franchising, making the Blockbuster brand and business model open to other participating entrepreneurs. At that time,

Huizenga was an investor, and after investing in a number of Blockbuster locations in 1987, Huizenga grew so confident that he purchased the company outright later that year (Herbert 2016).

According to the same source, Huizenga set out to transform Blockbuster into the industry's dominant player. However, the controversial deal with Viacom turned out to be a disaster for Blockbuster. In 1994, Viacom agreed to buy Blockbuster for $8.4 Billion to use Blockbuster's cash to finance the bid for Paramount (Kamar 2008). The deal caused the company's stocks to decline (figure 2). In addition, leadership at Blockbuster seemed unstable. Huizenga was replaced as president by Steven Berrard in September 1994. To sum up, Blockbuster had gone through many different strategies with different CEOs. However, these are the main important ones:

1- David Cook founded Blockbuster in 1985, Huizenga purchased a 35% stake for $18 million. However, Cook and Huizenga had different philosophies of how Blockbuster would be run. And by April 1987, Cook was bought out for $20 million, and the Blockbuster headquarters were moved to Fort Lauderdale, Florida (Frinkle 2013).

2- In Huizenga's period, the Black Monday happened in September of 1987. the company's valuation dropped drastically. However, Huizenga helped to stop it by convincing his friends and wife to invest in the company (Frinkle 2013). Seven years later, Redstone, the chairman of Viacom, bought the company from Huizenga (Meryl 1997).

3- Then Antioco was appointed as a CEO by Redstone. In Antioco's period technology was rising massively, but he underestimated it and did not invest in technology as much as other industry competitors. Another non-strategic decision that was made by Antioco was refusing to buy Netflix for $50 million (Ferrell, Hartline 2011).

3.3 RESULTS

As a result of this research, we found that Blockbuster has begun to decline since 1994, as shown in (Figure 2), due to several reasons that resulted in the company's bankruptcy under Chapter 7 of the United States Bankruptcy Law in 2010. That forced it to liquidate its assets in order to meet its obligations.

Non-financial and financial reasons led to the bankruptcy of Blockbuster. Non-financial reasons that led it to bankruptcy are mainly technology, competition, and personal. One of the most significant issues that led to Blockbuster's bankruptcy is that the company is affiliated with Viacom, which causes the company to lose its independence in decision-making. The latter exploits it to pay off its debts. After Viacom dropped Blockbuster into debts amounting to $1 billion, the two companies separated. During this period, Blockbuster moved out from its original mission and began selling books, toys, and clothing in its stores, which Antioco corrected during his presidency and put back blockbuster to its field (Davis, Higgins 2013).

Aside from Viacom's exploit of Blockbuster, another issue that contributed to the company's bankruptcy is technology. However, Huizenga, former CEO of Blockbuster, emphasized it in the late 1990's, emphasizing that Blockbuster must adapt to current technology or risk becoming obsolete (Finkle 2013). That happened at the time of John Antioco, who had not yet realized how technology could ruin a company and render it obsolete. (Antioco 2011) said, “I did not believe that technology would threaten the company as fast as critics thought.” However, this technology led to the development of piracy and the increase in additional channels on satellite cable systems, which negatively affected Blockbuster (Blockbuster Inc. 2005).
Competition is another factor that contributed to Blockbuster's bankruptcy. The company faced competition from 21 competitors (Ferrell, Hartline 2011). The most important of which is Netflix. The competition between the two companies forced Blockbuster to make some wrong decisions, the most important of which was the “no late fee” policy, which caused a loss of $400 million in the company’s income in 2005. Furthermore, Blockbuster failed to take advantage of an opportunity offered to it by Netflix, who stated a desire to sell all of its shares to Blockbuster for only $ 50 million, a decision that Blockbuster regrets in the future (Ferrell, Hartline 2011).

On the other hand, the financial reason that pushed Blockbuster to bankruptcy is mainly high debt A large number of debts was another reason for the bankruptcy of Blockbuster Company. They

could not pay their debts despite the liquidation. That is confirmed by the debt ratio, which reached 120%. Moreover, the company had more than 100,000 creditors and $1,464,939,759 in debt (Blockbuster Inc. 2011; Davis, Higgins 2013).

Blockbuster recorded a loss of $2.9 million and $10.4 million in foreign currency transactions in fiscal years 2010 and 2009, respectively (Blockbuster Inc. 2011). However, the exchange rate was not the biggest problem for the company; it can be considered a secondary cause of the company's bankruptcy.

The loss of capital and the inability to secure capital can be related to the causes mentioned above. In its beginnings, the company had a profitable strategy of how to use its assets to generate revenue and secure its capital until the problems that led to the Company's bankruptcy.

As previously stated, there are various reasons for Blockbuster's bankruptcy. The direct reasons can be stated as technology, high debts, competition, and personal. However, its inability to adapt to the new technological innovations that the world observed in the late 1990s and early 2000s could be the fundamental factor. “Although the company had an extremely good market position, adequate resources, and enough time to properly implement a digital transformation of its business, the company's management and its owners were not ready to adapt to changes in the environment” (Vučeković, Gavrilović 2021). If the corporation favorably utilized technology, it would be able to compete successfully for markets and pay its debts.

CONCLUSION

Blockbuster used to be the giant of in-home movie and video game rental services. Founded in 1985 and had enormous success in the 90s. Before it was hit by bankruptcy in 2010, to understand why it failed and filed for bankruptcy, it is essential to define the causes of bankruptcy in the case of Blockbuster, both financially and non-financially.

The purpose of the thesis is to define the financial and non-financial reasons behind Blockbuster's bankruptcy and analyze them one by one. In this thesis, the data has been gathered to analyze the financial and non-financial factors. Data is gathered from various sources such as case studies, online sources, but the most important ones are the financial reports of Blockbuster in the years 1999, 2005, 2010, and 2011.

The research introduced the financial and non-financial factors and analyzed them with the assistance of data collected from the company's financial reports and other various sources. The most important financial factors in the case of Blockbuster were capital loss, high debt service, inability to secure capital, and foreign exchange rate. On the other hand, non-financial factors are listed as competition, technology, and personal & calamities.

However, Bankruptcy liquidation, also known as "chapter 7", is when a business will not make any profit in the future and decide to liquidate its assets to pay debt and equity, with secured debts taking precedence over unsecured ones, following the absolute priority rule (APR) (White 1983). While bankruptcy reorganization, also known as "Chapter 11", is required when the assets generate money and keep running but cannot pay all debts in the present. A company is ready to restructure debt and equity.

All the factors, whether financial or non-financial, had pushed the corporation to file for bankruptcy. A financial factor that outstandingly affected Blockbuster the most is high debt service. It shows a company's ability to pay off its liabilities with its assets. In general, a higher level of debt ratio is more leveraged and highly risky for lenders. However, the total liabilities and total assets for Blockbuster, respectively in 2010 in millions, are $ 1852.6 and $ 1538.3, which gives a debt ratio of 1,2 or 120%. This number shows that the liabilities of Blockbuster are higher than its assets by 20% (Blockbuster Inc. 2010). Even if the corporation liquidates its assets, it will not be able to cover its debts.

Non-financial reasons had exceptionally affected Blockbuster also. Such as technology, competition, and personal. Blockbuster's most significant competition in 1999 came from non-videocassette providers of home viewing entertainment and video stores. Blockbuster continued to face tough competition from Netflix, Movie Gallery, Hastings Entertainment, Redbox, and large retail firms such as Target, Walmart, Best Buy, and Time Warner (Ferrell, Hartline 2011). When the competition heated up, the business reacted by introducing a "no-late fee" policy in 2005, this strategy became a problem for Blockbuster, resulting in a $400 million loss in revenue (Ferrell, Hartline 2011). On the other hand, Blockbuster neither took advantage nor invested in new technologies as its counterparts. Due to its inability to understand the effects that the development of digital technologies had on the business in which it operated and the inadequately implemented digital transformation of its business processes, Blockbuster experienced bankruptcy. In other words, the owners and management did not understand the importance that the digital transformation of business has for the future of this company (Baker 2015).

Moreover, Blockbuster’s management had made many non-strategic decisions. In 1994, Huizenga agreed to merge with Viacom to win the merger with Paramount Pictures (Kamar 2008). As a result, the valuation of Blockbuster started declining. In addition, Antioco underrated the role of technology and did not invest in new technologies (Antioco 2011).

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