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Teaching concepts in direct marketing and distribution can be interesting and rewarding. Using a case that highlights advances in direct marketing technology and offers significant customer value can help overcome lack of currency and integration of direct marketing and distribution strategies in the introductory marketing curriculum. The Redbox case provides a contextual background for using direct marketing via kiosks, re-engineering of their functionality and advances in distribution to make the product offer attractive and profitable. Follow up class discussion questions (Teaching Note available from the authors) focus on analyzing growth and efficiency opportunities as well as competitive challenges possible in the future.

Key Words: Distribution, Direct Marketing, Case Study Instruction
Disciplines of Interest: Marketing

INTRODUCTION

Distribution has followed traditional lines from manufacturer to wholesaler and retailer to end consumer for many years. A main issue has been balancing the distribution costs associated with customer satisfaction with the resultant increased revenue. Getting to know customer expectations and the level of importance they place on various aspects of distribution including delivery speed, convenience, communication and price is vital. This kind of data can be gathered from secondary sources or via consumer survey research. Meeting customer needs is clearly a priority while balancing customer satisfaction with the associated costs can make distribution both efficient and profitable.

Much advancement, mainly in technology has changed distribution channels today to the point where marketing intermediaries are left out altogether. Direct marketing has also changed dramatically in terms of using technology to reach consumers at the right place and time with the right marketing offer. Redbox, a video rental company that operates over 30,200 kiosks nationwide, has capitalized on developments in both areas to become the market leader in the video rental kiosk

industry. A brief background on kiosks, which are used as a means of distribution and direct marketing will help put the Redbox case in its historical context.

KIOSKS: NOT JUST FOR VENDING ANYMORE

Kiosks are self-contained units, most commonly found in public locations. They were traditionally used for dispensing consumer goods such as snacks, beverages or small merchandise items. Thus earlier versions of kiosks were essentially vending machines. More recent developments have made kiosks more sophisticated by allowing users to interact through touch screens, sound and motion video [Colle and Hiszem, 2004].

Kioks reduce costs while delivering better customer service. As a result consumers have adapted to self-service as a way of life. North American consumers utilize self-service technology for various transactions. Kiosk revenue grossed $775 billion in 2009 and should surpass $1.6 trillion by 2013 [Ketner, 2009]. Many consumers actually prefer using a self-serve kiosk than receiving assistance from a store employee. This is evident in the kiosk video rental industry in particular as revenue grew 94% in 2009 [Stableford, 2010].

Kiosks have gone beyond the ubiquitous installation of self-service check outs at most big store or grocery retailers. They are now used in other areas within stores to supplement service departments to avoid having to hire more employees. For example, Schnuck Markets, Inc. has installed self-service kiosks in its deli departments, enabling shoppers to place their orders and have them ready for pick-up at checkout. These kiosks are not meant as a replacement for the deli employees, but rather a customer service enhancement. The kiosk reduces wait times, affords customers more control over their order, recalls customer order history and offers product suggestions [Mitchell, 2009].

Intel Corporation has also built prototypes of kiosks designed for department stores. The kiosks recognize a customer when a store reward card or credit card is flashed in front of the touch screen, greeting the customer by last name. Previous purchase history is then brought up with the kiosk presenting the latest specials and promotions for products of likely interest. These kiosks have the ability to suggest items that may go with items that the shopper is about to purchase. For instance, if a customer scans a blazer by passing its price tag across a screen, the kiosk may recommend several styles of pants and shirts to go with it, along with prices and possible discounts. This is very similar to the typical online shopping experience [Eisenberg, 2009].

Another prototype in the works is the Virtual Mirror kiosk. Created by IBM and EZface, the kiosk allows customers to experiment with beauty products such as hair coloring and cosmetics on the touch screen. A camera on the kiosk takes a picture of the customer. The customer can then scan the barcode of a product of interest to see how it would look [Eisenberg, 2009]. Figure 1 shows a Virtual Mirror kiosk located in a L'Oreal cosmetic wall at retail.
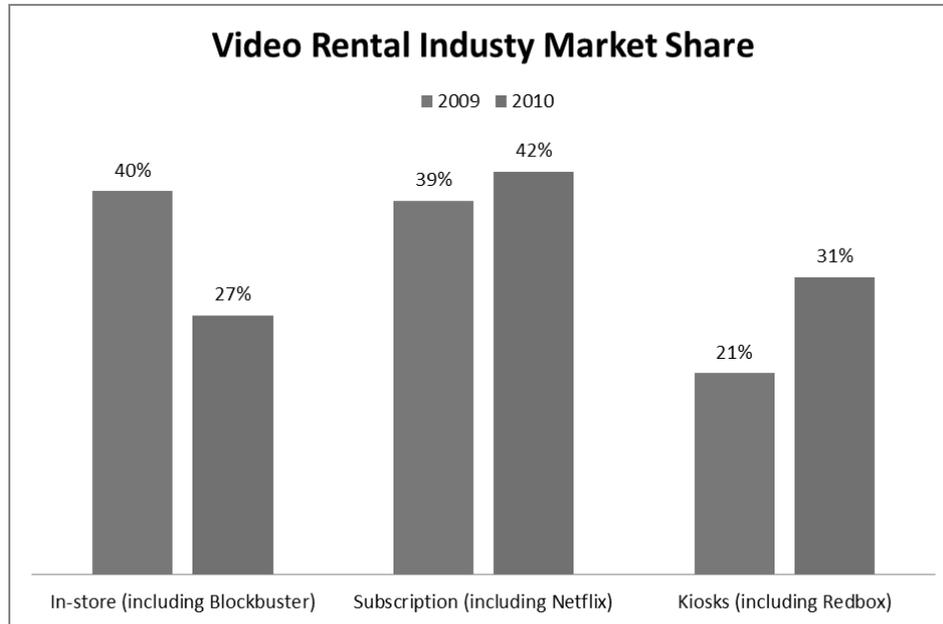
Figure 1. Virtual Mirror kiosk

Clearly this level of interactivity goes well beyond transactional exchanges originally associated with product dispensing vending machines. Redbox uses a similar approach by connecting with consumers online and with kiosks. Although opportunities for increased interactivity to spur future growth are evident, the increased cost associated with such enhancements could be a challenge.

THE REDBOX CASE

Company Overview

Redbox Automated Retail, LLC, or more widely known as simply Redbox, is a wholly owned subsidiary of Coinstar, Inc. Under the leadership of President Mitch

Figure 2. 2009 and 2010 Video Rental Industry Market Share

Video Rental Industy Market Share

■ 2009   ■ 2010

- In-store (including Blockbuster): 40% / 27%
- Subscription (including Netflix): 39% / 42%
- Kiosks (including Redbox): 21% / 31%

(Graham, 2011)

Lowe, the company has an expansive collection of over 30,200 kiosk locations [Coinstar, 2011]. In fact, an estimated 200 million people walk past a Redbox each week. It is no surprise then that Redbox is currently the leading vendor of DVD rentals through automated kiosks ["Redbox announces top," 2009]. Nationwide distribution includes major retail locations such as McDonald's, Jewel Osco, Wal-Mart and Walgreens.

Redbox today has become a market leader, only second to Netflix in the video rental industry through combining two fast-paced, consumer driven distribution strategies: direct online ordering and self-service kiosk distribution. Their place compared to major retail and subscription service competitors such as Blockbuster and Netflix in 2009 and 2010 is displayed in Figure 2. Redbox continues to make inroads on the retail brick and mortar operations gaining 9% in 2010 for a total of 28% market share [Graham, 2011; Kane, 2010].

The company's ability to quickly adapt to fluctuating demand for newly released movies has given them a clear advantage over the competition. Consumers quickly embraced Redbox's new concept of self-service kiosks because of the company's location choices and built-in convenience. Redbox used its seamless

Figure 3. Redbox Kiosk Unit

behind the scene distribution model to carve out a niche in the entertainment industry.

Rental Process

Each Redbox unit is fully automated and holds up to 630 DVDs. The bright red units are covered with movie title advertisements, known as boxart, enticing potential customers to investigate. Once logged in, the touch screen allows easy access to view titles and overviews of individual movies. By simply pressing, *add to cart* and *checkout* the DVD is dispensed to the customer. Transactions average 20 seconds assuming the rental was determined before approaching the Redbox unit. A typical Redbox unit is depicted in Figure 3.

When returning the DVD, the customer selects on the touchpad *return a DVD* and feeds the DVD in the slot. Again, this transaction only takes a few seconds. The retuned DVD in the unit is placed back into inventory for availability within eight seconds of the return. This fast paced, highly flexible automated service handles on average 70 to 80 transactions per second nationwide on an average Friday or Saturday evening [Lieberman, 2009]. Theft is minimized in that the Redbox units

Figure 4. Fourth Quarter 2010 Coinstar (Redbox) Financials

	2009 (4Q)	2010 (4Q)	Change
Video Rental Revenue	$232 mil	$320 mil	+38%
Operations Profit	$29.5 mil	$55.4 mil	+188%
Operating Margin	12.7%	17.3%	+36%
	2009 (year)	2010 (year)	Change
Total Revenue	$774 mil	$1.16 bil	+39%
Operations Profit	$102 mil	$193 mil	+89%
Operations Margin	13.2%	16.6%	+26%

(Coinstar, 2011)

only accept credit or debit card payment and bar code technology is used to record dispensing and receiving DVDs.

Location and Convenience

All Redbox kiosks are located at or near the entrance of various retail stores. The daily rental rate is one dollar per DVD. Redbox allows its DVDs to be returned to any of the Redbox locations. Customers who would like to keep their rental longer may do so for an additional one dollar per night, up to $25 when Redbox assumes that the DVD has been purchased.

Redbox's approach to video rentals has put the buying experience in the hands of the customer. Each kiosk contains a sophisticated inventory-management system that determines how many copies of different new titles to order based on past performance of similar movies at that location [Farhad, 2009]. Generally, Redbox receives and makes all DVDs available for customers as soon as they are released for video rental. This is typically 28 days after the video is available for purchase. Redbox also has patents for both its hardware and software technologies, with a heavy emphasis on software. The software used in Redbox kiosks was custom designed and allows inventory analysts to pull real time data directly from units four to five times a day.

This attention to customer convenience and efficient distribution channel continues to support the rapid growth in revenue and profit margin. Redbox's video rental revenue grew 38% in the fourth quarter of 2010 to $320 million, up from $232 million in the fourth quarter of 2009 [Coinstar, 2011]. Other Redbox financials for 2010 are shown in Figure 4.

Figure 5. Redbox Distribution Channel
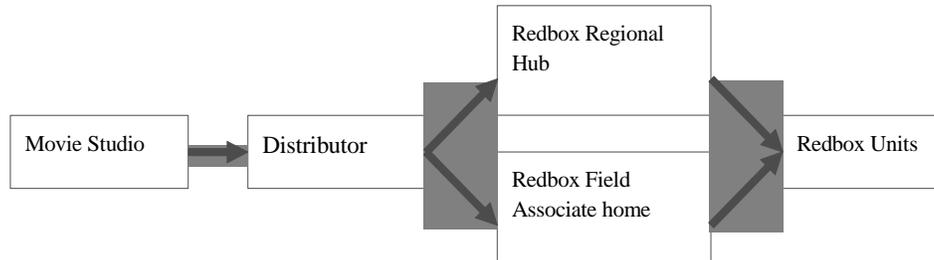
Direct Online Ordering

Every Redbox machine is connected to the internet via DSL or a 3G cellular modem, allowing customers to view and reserve movies online [Farhad, 2009]. Also incorporated into the Redbox website (www.redbox.com) is the specific availability of the movies by location. If the desired DVD is not at the location closest to home, customers may choose to either drive to a different location where it is available or pick a different movie for the night. After making a pre-paid reservation online the customer is guaranteed the DVD will be available upon arrival at the unit. This has simplified the video rental experience through innovative distribution and customer convenience.

Staffing and Inventory Flow

Success or failure at the box office is a major determinant of the movie's success in the video rental industry [Das, 2008]. Therefore, each of the Redbox units are stocked at least once a week, on Tuesdays, the day that newly released movies become available. The effectiveness of this model relies on efficient product distribution. The DVDs are housed in regional warehouses and are sent directly to the homes of regional field associates that stock the kiosks. The field associates are a mix of internal personnel who also work in the field with some outsourced associates. Field associates have the ability to fix the units and are cross-trained on software troubleshooting. Typically, parts are also mailed directly to the home of the field associate or the regional warehouse. The distribution model for Redbox is shown in Figure 5.

Major metropolitan areas maintain internal field personnel that manage the inventory flow of DVDs. This method is combined with detailed reporting from the corporate office, instructing exactly what routes to run to maintain optimum inventory levels.

Figure 6. Netlflix Financials

	2007	2008	2009	2010
Subscribers (in thousands)	7,479	9,390	12,268	20,010
Revenues (in millions)	$1,205	$1,365	$1,670	$2,162
Net Income (in millions)	$67	$83	$116	$160

("Netflix 2010 Annual Report," 2010)

COMPETITION

Netflix

Although Redbox has experienced substantial growth, Netflix has kept pace with its own unique business model. Netflix offers customers unlimited access to DVD rentals sent by mail based on a monthly subscription rate. The lowest package currently available is $9.99. This also includes direct streaming of television episodes and movies via internet connected computers, HDTVs, mobile devices, Blu-ray players as well as video game consoles including Microsoft's Xbox, Sony's Playstation3 and Nintendo's Wii. In the third quarter of 2010 two-thirds of all Netflix subscribers used the direct streaming service ["Netflix facts," 2010]. In fact, Netflix now offers subscribers a streaming-only option for $7.99 per month. It is no surprise then that more than half of all Netflix subscribers stream more content than they receive in the mail [Kane, 2010]. In 2010 Netflix expanded internationally by offering the streaming-only option in Canada and expects the operation to be profitable by the middle of 2011 ["Netflix 2010 Annual Report," 2010]. Its dual distribution approach to home entertainment has spurned growth in terms of customer subscriptions and revenue. Netflix financials for 2010 are shown in Figure 6.

Netflix offers an expansive selection with over 100,000 titles on DVD and more than 15,000 movies online. Operationally Netflix utilizes 58 regional distribution centers. DVDs typically arrive in one business day including Saturday delivery ["Netflix investor relations," 2010]. As is the case with Redbox, availability of newly released videos for rent is also subject to a 28-day delay after movie release for retail purchase. Netflix utilizes an online system that makes use of a very effective adaptation of behavioral targeting. Subscribers receive movie recommendations based on the personal ratings of prior movies and those of other subscribers with similar interests. This movie recommendation feature is used by more than half of Netflix subscribers ["Netflix facts," 2010]. The in-home delivery,

Figure 7. Blockbuster Express Kiosk Unit

direct streaming and automated payment system, as well as personalized movie recommendations offer superior customer convenience and value.

Blockbuster

Blockbuster began traditional retail store operations in 1985. It has since added Video On Demand service with direct streaming on a pay per download basis, typically $2.99 or $3.99 per feature. Blockbuster By Mail is similar to the business model utilized by Netflix with 95,000 movie titles available. However, Blockbuster offers many new video releases at the same time they are available for purchase at retail, which is typically 28 days before Netflix and Redbox ["Blockbuster by mail," 2010]. Blockbuster also offers over 3,000 video games through this service with the lowest package currently available at $11.99 per month. This plan also includes five in-store exchanges.

In 2008 NCR introduced Blockbuster Express video rental kiosks under a license from Blockbuster. It uses a reservation and operations system to compete directly with Redbox. Unique features include online movie recommendations,

Figure 8. First Quarter 2010 Blockbuster Financials

	2007	2008	2009	2010 (1Q)
Number of US Stores	5,431	5,212	4,356	3,525
Revenues (in millions)	$5,542	$5,288	$4,062	$939
Net Income (in millions)	($85)	($385)	($569)	($65)

("Blockbuster corporate," 2010)

more than 950 DVDs per kiosk and movie rentals 28 days in advance of Netflix or Redbox. However, these select titles are available for a premium of $2.99 the first night and then $1 for each night thereafter ["The hot list," 2010]. Blu-ray format is also available for $3.99 the first night and $1 for each additional night. Current distribution is also limited with only 7,500 Blockbuster Express kiosks in operation nationwide.

Blockbuster's complete access approach may resonate with some customers; however from a cost standpoint it is not very efficient. In addition, its entry into the subscription service by mail, direct streaming Video On Demand and kiosk distribution was simply too late. Blockbuster sought protection from creditors under Chapter 11 in September, 2010 ["Blockbuster reaches agreement, 2010]. Although store closures continue to plague the parent company Blockbuster Express is mounting a challenge against Redbox with plans to add 3,000 more kiosk units in 2011 [Massoud, 2011]. See Figure 8 for an overview of Blockbuster's financials.

Future Developments

Redbox carries a large overhead cost from switching graphics in and out of its units once a week. These graphics inform customers about upcoming DVDs and release dates. Installing a LCD screen at the top of each unit could offer digital signage for inventory promotion or brand advertising ["NCR lauches," 2009]. This technology not only allows them to switch advertising on the fly, but would also improve the supply chain by offering early movie distribution if available. Currently Redbox cannot stock its boxes with movies until the date on the hard copy graphic insert. The implication here is that Redbox could look for time efficient and cost saving methods to promote the movies already in its distribution channel.

Some of Redbox's technology opportunities include hardware upgrades to reduce waiting time in line. Customers returning DVDs spend time in front of Redbox units figuring out the correct orientation to insert the DVDs in the return slot. The DVDs must be inserted in a certain direction because there is only one camera mounted internally to scan the barcode on returns. Redbox is testing multiple hardware setups involving two cameras mounted inside the units, and moving the

return and vend slots to separate locations on the box. Customer confusion and the time needed to return a DVD will decrease when a DVD can be inserted in any direction.

From a software standpoint, Redbox is currently testing having customers return and rent DVDs at the same time. This would involve keeping the same touch screen size, but splitting the screen on the interface to allow concurrent customer transactions. There is also a test application, which would allow the Redbox unit to find a requested DVD faster as soon as the credit card is swiped.

Challenges for Future Growth

Redbox's growth may slow as customer expectations and possible competition increase. For example, customers may see greater value in the selection and movie recommendation service offered by Netflix. The Video On Demand feature by many cable providers such as ComCast is attractive to customers who want instant, in-home access to movie entertainment. In fact, some analysts forecast that video kiosk vending will peak in 2011 as more consumers opt for Video On Demand service [Gruenwedel, 2010]. Redbox has responded by looking for a partner to launch digital distribution of its movie titles to compete with Netflix, whose customers now stream more content than rent via postal distribution. Other partnerships to increase kiosk rental include Orville Redenbacher popcorn with a free kiosk rental included with each popcorn box purchase [Kane, 2010]. Blockbuster is ahead of Redbox with a greater distribution and selection of video game rentals and premium Blu-ray movie versions via NCRs Blockbuster Express. Redbox has been quick to respond by adding Blu-ray DVD rentals to its kiosk line up in 2010 at a $1.50 per night premium. Video game rentals for $2 per night are also available in select Redbox units [Kane, 2010].

Customers express concern that although they may reserve a DVD already available at a certain kiosk, there is no way for them to request that a DVD be delivered to a particular Redbox unit. DVDs must also be inserted into the unit in a certain direction for the kiosk to register the return. This causes delays or customer line-ups because customers cannot return and process a DVD rental transaction at the same time.

CLASS DISCUSSION QUESTIONS

1. Analyze the direct marketing strategies utilized by Redbox and its main competitors Netflix and Blockbuster Express.

2. How could Redbox improve customer interactivity to challenge competitors who use behavioral targeting to provide video rental recommendations?

3. How could Redbox assess whether the hardware and software enhancements designed to improve its direct marketing efforts by reducing customer transaction and wait time be worth the financial investment?

4. What competitive advantage would Redbox gain by enhancing distribution through offering movie transferability (i.e., customer can request a DVD to be

transferred to a particular Redbox unit)? Would this potential gain in customer convenience be worth the added cost?

5. How aggressively should Redbox pursue offering Video On Demand to expand its market share?

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