Don't Defend Stupid

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In 2013, Len founded Ferman Innovation to help companies develop and leverage insights about customers to generate breakthrough ideas for new product and services.

Prior to founding Ferman Innovation, Len spent 25 years with Fortune 100 companies managing customer research and innovation. Len held senior positions at AT&T, Barnett Bank and at Bank of America where he introduced many new products, led the front end of innovation and served as head of ideation. He developed the Idea Tournament process to identify and select the optimal concepts for development.

Len has significant experience as a qualitative research moderator and brainstorming facilitator. He has been moderating groups and individual sessions for over 25 years.

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In their personal and professional lives most people don't like to be wrong. It is a common knee jerk reaction when confronted with the notion that their actions are flawed for a person to rationalize why they are right. It is the rare person who says, "thanks, can you show me how to do that better?" Yet this is precisely the type of reaction that is necessary to have a culture of innovation.

People and companies that adopt a culture of innovation constantly experiment and learn from failures. They're not afraid to be wrong. They recognize that it's more important to understand the opinions of people around them and their customers than to personally have all the correct answers.

Let's take a look at a tale of two companies: Coca Cola and Blockbuster. Each made a massive mistake and their next move defined the future of the company. For one it led to the best of times and for the other it led to the worst of times. In one case the company wisely pivoted, placing them on a path to historic success. In the other case the company foolishly doubled down on a doomed strategy leading to their total demise.

The New Coke Story

Thirty-five years ago, in the spring of 1985, as the familiar smells of fresh flowers filled the air, the taste palettes of Americans had something different to try. On April 23, 1985, Coca-Cola Chairman, Robert Goizueta, and President, Donald Keough, delivered a press conference in New York that stunned America. The next day the front page of the New York Times featured a headline, "Coca Cola Changes Its Secret Formula In Use for 99 Years." "New" Coke was in and "old" Coke was out. After May 8, 1985 only the "New" Coke would be produced. It was one of the great blunders in American corporate history.

Why would the world's best-selling soft drink, which had dominated the market for the entire 20th century, make such a drastic change? There has been endless speculation, with many articles and documentaries produced on the subject. Malcolm Gladwell even tackled the issue in his bestseller, *Blink*.

Coca Cola executives in the early 1980s were concerned about market share losses to Pepsi which had been steadily gaining ground in large part due to its successful Pepsi Challenge taste test campaign. In blind sip tests, a majority of people preferred Pepsi over Coca Cola. When Coca Cola's own market research staff confirmed the taste test findings it sent shudders through senior leadership. This led Coca-Cola to develop and test a new formula which performed better than Pepsi in sip tests. In the famous 1985 press conference, Goizueta projected confidence in the decision to introduce the "New" Coke formula stating it was "the surest move the company's ever made."

Practices", that was published by Cognella. The book is presently available on Amazon and is in use at several universities. Following publication of the book, Forbes magazine ran a story about Len's unique teaching methods in his university classes.

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Initially "New" Coke sales were good. But consumer reaction soon turned strongly negative. The company received over 40,000 phone calls and letters decrying the decision to eliminate the old Coca-Cola. The company had failed to understand the emotional connection that customers had with the brand.

The decision to reintroduce "old" Coke was made after just one month, in May 1985. It then took two months to execute the decision. When the official announcement was made on July 11, 1985, the ABC television network cut into daytime soap opera General Hospital to deliver the breaking news. And Donald Keough appeared in a conciliatory television commercial explaining, "We read and we listened."

By listening to their customers and recognizing and reversing a poor decision, Coca-Cola reached new heights from which they have benefited to this day. In 1995, Goizueta presided over a company celebration on the 10th anniversary of the infamous failure and admitted that the "New" Coke decision had been a "blunder and a disaster." He also happily noted that thanks to Classic Coke the company value had increased from $9 billion in 1985 to $75 billion (today it stands at $193 billion).

The Blockbuster Story

Blockbuster Video was at one time a classic entrepreneurial success story. Starting from scratch in 1985, they became the largest video rental chain store in America peaking at 4,500 stores across the country and over 9,000 worldwide. Blockbuster thrived initially on a successful retail business model. Many people fondly recall visiting their stores.

Meanwhile Netflix was founded in 1997 by Marc Randolph and Reed Hastings, a Silicon Valley computer scientist who had recently sold his prior company. Netflix built a business model in which DVDs were sold or rented via internet mail order. DVDs had been introduced earlier that year and could be shipped by mail efficiently and cost effectively. A creation myth, perpetuated by Netflix, is that the idea for starting the company came to Hastings when he was charged $40 by Blockbuster for returning *Apollo 13* six weeks late.

The paths of the two companies intertwined on a fateful day in the year 2000 when Hastings, Randolph and Barry McCarthy, Netflix's former chief financial officer, flew to Blockbuster headquarters in Dallas to meet Blockbuster president John Antioco. Netflix pitch was simple: buy us for $50 million and we will become your online DVD rental unit. Randolph recalls, "John Antioco was struggling not to laugh." McCarthy says "they thought we were a very small niche business… they ignored us and that was much to our advantage."

Over the next several years, as Netflix grew, Blockbuster continued to invest in the retail business and did not pay much attention to the online DVD rental market. In 2002, Allen Kose, SVP Marketing of Blockbuster talked to the New York Times about the online DVD rental market and said simply, "we've been looking at this stuff for a couple of years."

Rather than make any serious effort in the Online DVD rental business, Blockbuster doubled down on the retail model. They continued to add new stores, with an increase of more than 1,000 locations from 2000 – 2004. In 2004 they attempted a hostile takeover of the #2 retail chain, Hollywood Video. In 2007, they brought in retail executive Jim Keyes, formerly of the convenience store chain 7-Eleven, to be their new CEO after the departure of Antioco. And in 2008 they made a bid to purchase electronics retailer Circuit City.

When Blockbuster did decide to enter the online DVD rental business, 7 years after Netflix launched and 4 years after rejecting Netflix offer, they did it half-heartedly. Internal management disputes paralyzed the online division over fears that store sales would be cannibalized. The online division was not allowed to leverage customer data from the stores, thus handcuffing them from the one major competitive advantage they had over Netflix.

Another reason for their failure to enter the online DVD rental market in the early 2000s was Blockbuster's reliance on late fees. Late fees at one point accounted for 16 percent of revenue. And late fees were inconsistent with the subscription fee model that Netflix had established for online DVD rentals.

Reed Hastings was not the only customer who was virulently upset by Blockbuster's late fees. A class action lawsuit over the late fee policy was settled in 2001 at a cost of over $400 million. Yet Blockbuster continued to charge late fees until 2004 when they announced a no late fee policy. However their new policy actually charged customers who did not return a rental within 8 days by treating it as a sale of the DVD. Blockbuster subsequently was sued again for false advertising.

Throughout the 2000s, Netflix continued to capture subscribers, enhanced its offering and moved beyond the online DVD rental business into video streaming. By the end of the decade, Blockbuster was unable to compete. In 2010, Blockbuster filed for bankruptcy.

The High Cost of Defending Stupid Actions

Blockbuster's lack of vision in their meeting with Netflix in 2000 could have been corrected. There was plenty of time to start testing their own DVD online rental business model. And they could have used that testing to find ways to wean their business off of the late fees that were a permanent irritation for customers. Yet unlike Coca-Cola, Blockbuster never saw fit to admit they were wrong. Blockbuster defended stupid actions and in doing so did not endear their customers to them the way Coca-Cola did when they listened and changed.

Market experimentation and learning from early failures is a key to innovation. Coca-Cola failed big, but when they listened to what they did wrong, they won big. Blockbuster failed quietly at first by brushing off Netflix and not listening to customers that were annoyed by late fees. But they lost everything when they did not use their failures as an opportunity to learn.

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