Netflix Inc.: Streaming Away from DVD's Case Study #1

Marketing 101, H1 Group #3

Maggie Shimada, Tyler Neil, Joshua Gordon, Loc Kim Ngo, Ahmed Samman

1. Introduction

CEO Reed Hastings and co-founder Marc Randolph founded Netflix in 1997, which was originally named Los Gatos, based in California. The company was quickly identified as a strong competitor for Blockbuster, which was founded 12 years prior. Although both organizations had business in the movie rental business, their methods differentiated. Many consumers quickly adopted Netflix's innovative idea of a mail-in DVD service. Their \$20 monthly fee was more appealing to customers: they were able to maximize time efficiency by not having to drive to the store, and customers were drawn to the convenience of having the DVD for as long as desired and not worrying about late return fees. 3 years later in 2000, Blockbuster decided to enter the streaming service market. In the next couple of years, Netflix's growth was steady, closing an IPO at \$16.75 per share. This would bring their total number of memberships to 600,000, and raising a staggering \$82 million. Blockbuster would continue their efforts to compete in 2004 by also debuting a mail-in service similar to Netflix. At this time, Netflix had reached a peak of 4 million customers, but would see a decline in business over the next couple of years. This was partly due to the illegal file-sharing services that became popular in 2005. Come 2007, Netflix made a strong move: they entered the streaming service, just as Blockbuster had in 2000, and dropped their membership fees to a monthly rate of \$10. In 2008, with the economic crisis in full effect, Netflix was able to stay on top, and see a 25% incline in stock prices. It seems that their decision to enter the streaming market and drop their monthly prices was beneficial, because Blockbuster's

shares declined in value at a drastic 95%. This eventually led to Blockbuster's bankruptcy, posting a loss of \$500 million. With Blockbuster out of the picture, Netflix controlled the majority of the market, and was able to capture their customers hearts and minds with their cheap monthly rates and convenience of their services.

STRENGTHS

Selection:

Customer's have a wider selection of movies compared to other video rental businesses and streaming services. "And Netflix has an advantage over other VOD schemes and rental stores when it comes to obscure movies. Try finding the Hindi classic 'Do Ankhen Barah Haath' at your local video store, for example"

Convenience:

There's no longer a need to drive to the video store. With a computer or video game system, and an Internet connection, customers are able to access their favorite movies right at home. As well, their business is offered around the world from Latin America to Canada all the way to the Caribbean. They are able to reach out to foreign markets where their competition is not as strong, therefore dominating a majority of that market.

Costs:

Netflix's prices are very affordable. The current monthly rate is \$7.99 per month. They have the most affordable rates for the wide variety of selection the customer

is getting.

<u>WEAKNESSES</u>

Lack of New Arrivals:

"I understand why they're making this move toward streaming from a long-term perspective, but the only way they will now be able to make investors believe in them, and subscribers continue to be attracted, is to have a waterfall of new content in the next few months" Although part of their lack of new arrivals is due to their partners agreement, other companies are able to provide newer releases, which is more appealing to many consumers.

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OPPORTUNITIES

Video Game Market:

Netflix has not offered any video games for their customers: this can include video game systems to PC games. One of the only other companies who offer this is Redbox. It is a growing market, especially for their younger consumers. If they can provide these services, they have an opportunity to increase their domination of the market

THREATS

Video Game Market:

Organizations such as Redbox have offered customers video game selection at an appropriate price. This is a market Netflix has not yet ventured, which could have a negative effect towards their number of subscriptions. Customer's who are interested both in renting movies as well as video games might take their business to Redbox: they will be able to fulfill their desires at one location, and will save money by not having to pay the game rental fee at Redbox and the monthly rate from Netflix.

2. Main Problem/Issue(s)

On July 12, 2011, Reed Hastings publicly announced that the company would be splitting their DVD rental business from their online streaming business. He had previously mentioned this idea to a friend of his, who was also a Netflix subscriber. If he had taken his friend's advice and not gone ahead with this decision, he would have been better off. Instead, he had to deal with the sudden decline in business and uproar from subscribers. In total, the company had lost 805,000 subscribers, and their stock had declined by more than 50%, bringing their share price to lower than \$150 per share. Hastings's desperate attempt at an apology and explanation to his customers was too little too late.

At the same time, Netflix began to see a rise in competition: Apple iTunes, Amazon Video on Demand (VOD), Hulu, Google TV, and even Youtube began offering similar services to Netflix. "In addition, cable and satellite providers started to roll out their own streaming services at no extra cost to subscribers. Since most Netflix subscribers relied on cable and satellite to provide them with content not available on the Internet, such as sporting events and vale new programming, Netflix content was becoming increasingly redundant."

3. Alternate Solutions

A) Reed Hastings should not have separated the two services of Netflix. The advantage to not separating the services is that he would have avoided upsetting customers. With a company that is based on customer service, upsetting them was the biggest mistake made. "The company received more than 10,000 comments on its blog site. 'Most of them lambasted him for making life more difficult for about 12 million customers who get both streaming and DVD rentals. Those people will have to visit two websites to make requests and update their billing information.'"

Another advantage to keeping the two services combined is that Netflix would not have

lost the 805 000 subscribers. Lastly if Hastings had not split the DVD rentals and online streaming the companies stock would not have fallen over 50 per cent over one quarter. The Disadvantage to this solution would be that the Netflix would have still had the DVD service in the company, which was slowly becoming a declining demand.

"... some analysts saw the logic in Hastings' decision to separate DVD rental service, as DVD technology appeared to be quickly heading toward obsolescence." 5

B) Looking at the success of Netflix in 2002 to 2011, before the division of services, Reed *Hastings should not have changed the price of both services from \$9.99 to \$15.98*. "In 2011, the California-based company had 20 million subscribers, employed more than 4,000 people and received revenues of approximately \$2.2 billion" An advantage of not raising the prices is that subscribers would have continued to pay the \$9.99 for both DVD rental and online streaming whether they used both services to the fullest or not. Customers might have started only using one service because it was only costing them \$7.99 per month, this would have been a loss in profit for Netflix than if the price had of stayed at \$9.99 for both combined. Another advantage to keeping the price at

the growing popularity of the company.

"On November 25, Netflix stock fell to \$63 per share."

The disadvantage of not changing the service price is the loss in profit of \$5.99 per customer who actually did stay with Netflix and bought both plans for \$15.98."⁷

\$9.99 per month is that the subscribers would not have dropped Netflix and the stock

would not have fallen, in fact the number of subscribers could have gone up because of

4. Recommendations

Netflix has been successful in coming back from their temporary problem. The best solution to this case problem would be solution A. Not splitting DVD rental and online streaming would have been the best way to help the company. Unfortunately what's done

is done, the best thing for Netflix to do now is to promote the two services in the most positive way possible. Using marketing mix, they can open customer's eyes to their products, Netflix and Qwikster, and show them how innovative they were by splitting the two services to better them, the subscribers. The price of both DVD rentals and online streaming combined of \$15.98 is higher than before.

Promoting Netflix and Qwikster will be the best way to get the most positive customer feedback. By showing the customers that Reed Hastings made his decision for the better of the customer will prove how much he really does care about their satisfaction. Also Qwikster should be advertised more, Netflix is already a well-known company but it is in the shadow of Netflix. If Netflix is advertised on a TV commercial and then within the same commercial the services Qwikster provides are advertised as a solution to streaming it may reach out to those customers who are not at the streaming level. Older customers who do not have the computer knowledge to stream movies would benefit from knowing that Qwikster not only has a wide variety of DVD rentals, but that they provide the convenience of not having to leave their house to get them.

In the online streaming department of Netflix, the company could benefit from having tutorials on the website in order to help those customers who are not as technologically knowledgeable of streaming but want to learn how to use it. By providing it for free on the website it would give customers a chance to try it and fall in love with the simplicity of it, thus creating opportunity for more subscribers.

The places aspect of the marketing mix for Netflix could be improved. Netflix is a growing popularity in Canada and the US, though their services for the two countries are different. In order for Netflix to grow as a company in Canada, the option for TV and DVD releases should be more up to date. The subscribers in Canada are aware of the difference in choices for TV shows and movies from the US and by creating the same options for both countries the number of subscribers would go up and the current subscribers would be more satisfied with the services they are already paying for.

5. Conclusion

This case study has focused on Netflix's rise to becoming the largest VOD service worldwide. We have focused on their strengths and weaknesses, their decisions, whether right or wrong and how they have dealt with their competitors. Their greatest downfall was in 2011, when CEO Reed Hastings made a brave and unpredictable move by separating their DVD rentals and their online streaming. Up until this point, their growth was remarkable and they made consumer-interested decisions. Although this mistake proved to be costly, they were able to grow and bounce back from it. They have established a world wide following, and a dedicated customer base due to their convenience and affordable monthly rates. Although the CEO admitted he "messed up" with his decision in 2011 and in the process lost 805,000 subscribers, they have rebuilt their reputation and are always aiming to please their customers. In conclusion, Netflix has earned market dominance and have grown to a point where they will be dominating the market for years or decades to come.

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