Post

The ‘Netflix Effect’: An Excellent Example of ‘creative Destruction’

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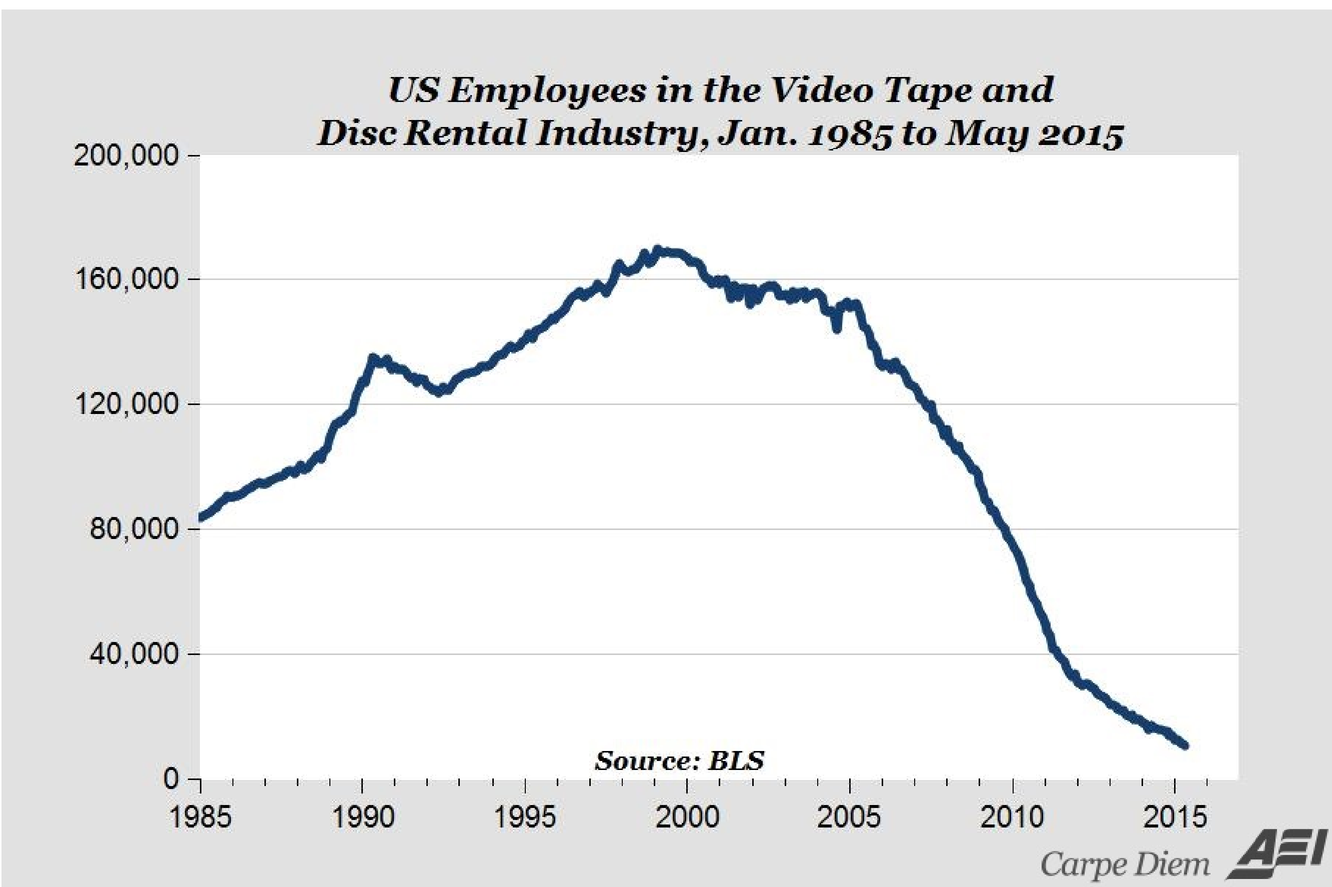


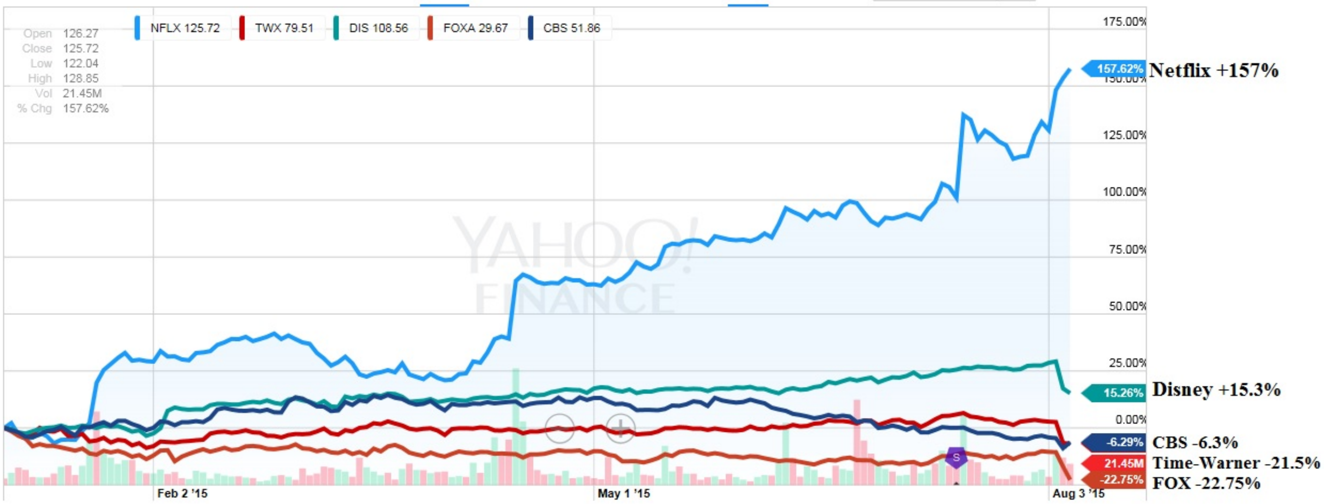
From the article “50 Amazing Netflix Statistics and Facts“:

> Netflix is an amazing digital success story. Starting out almost 15 years ago as a predominantly DVD subscription service, Netflix was able to pivot along the way and take advantage of rapidly evolving mobile technology and ever-improving internet speeds to become one of the largest video distribution networks on the planet.

The success of Netflix is an excellent example of "creative destruction," a term originated in the 1940s by economist Joseph Schumpeter, who described it as the "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new structure. This process of creative destruction is the essential fact about capitalism." In fact, Netflix has been so disruptive to existing industries, that its impact is now being referred to by some as the "**Netflix effect.**" Here are a few examples of the "**Netflix effect**" and the industries that have been "**Netflixed**."

1. **Video Tape and Disc Rental Industry**. The chart above shows how Netflix has almost driven the video tape/disc rental business, along with companies like Blockbuster, into extinction. (Interestingly, Blockbuster passed up a chance in 2000 to purchase Netflix for $50 million — it's now worth $54 billion.) By the time the BLS started tracking the number of jobs in the video tape rental business in 1985, there were more than 80,000 employees nationwide, and that number more than doubled to 170,000 by early 1999. Blockbuster was the dominant firm in the industry and employed nearly 60,000 employees at more than 9,000 stores at its peak in 2004. But in the last decade, employment in the video/disk rental industry has collapsed from 153,000 jobs in 2005 to fewer than 11,000 in May of this year – that's a 93% decrease in a decade! That could arguably be the largest percentage employment decline in any US industry over the last decade — even employment in the newspaper industry hasn't cratered nearly that fast over the last ten years!

Year-to-date Returns: Netflix (+157%) v. Disney (+15.3%), CBS (-6.3%), Time-Warner (-21.5%) & FOX (-22.75%)



2. Traditional Media Companies. After challenging Blockbuster, which filed for bankruptcy in 2010 and was subsequently acquired by Dish Network at auction in 2011, Netflix (along with other online viewing platforms like Hulu, Amazon and Apple TV) is now challenging cable networks, traditional network TV channels, and pay-TV services. The "**Netflix effect**" can be seen in the chart above that compares the year-to-date stock returns for Netflix (up by 157%) to Disney, which owns the cable networks ESPN, Disney Channels and ABC Family (+15%), CBS (-6.3%), Time-Warner, which owns CNN, HBO and Cinemax (-21.5%), and FOX (-22.75%).

Here are several recent news reports that provide some details about the "Netflix effect" illustrated in the chart above.

3. The Street: "Cord-Cutting Fears Spark Big Selloff at Disney, Fox, CBS":

> Call it the **Netflix effect,** or fear of streaming, but media companies are shaking like never before. Investor concerns about the changing nature of video viewing have morphed into fear and loathing on signs that consumers are fast ditching pay-TV for streaming video. It's not just Netflix, of course, but the increasing amount of time people of all ages are spending on **Facebook**, **Google**'s YouTube and countless other Web sites that supply video.
>
> **Walt Disney** shares tumbled 9.2% on Wednesday after the company reported record profits but acknowledged there had been "modest subscriber losses" at ESPN during the second quarter. The decline resulted from some households switching to so-called skinny bundles — smaller cable packages that don't include the high-priced sports network, according to Disney CEO Bob Iger

> Disney's nosedive triggered broader investor worries about consumers opting for skinny bundles or dropping cable TV completely as shares of other traditional media giants also plummeted. **Time Warner**, despite beating revenue and earnings expectations for the quarter, closed down 9%. **Viacom** was down 7.5%; **21st Century Fox** fell 7%; and **CBS**, 4.6%.
>
> Compare that with Netflix, whose stock climbed 2% Wednesday to more than $123 a share. The company's stock had more than doubled this year before it announced a seven-to-one stock split in June. Netflix stock was rising in Thursday trading.
>
> The contrast with Netflix highlighted investor jitters about the viability of the traditional cable bundle in the face of heightened competition from on-demand video services like Netflix, **Hulu** and **Amazon**, which are investing heavily in high-quality programming.
>
> Nearly half (46%) of U.S. homes have access to a streaming service as of July, according to Nielsen data. That figure rises to 62% for homes with people age 18 to 34, underscoring the allure of on-demand video especially among Millennials.

4. **Wall Street Journal**: "Cord-Cutting Weighs on Pay TV (Stocks of media firms with cable channels are hit on subscriber losses)":

> Cable TV's signal is getting shaky on Wall Street. The latest round of earnings from major media companies is stoking fears that as more consumers drop their traditional pay-TV services, the long-term health of the industry's biggest players will be threatened. The growing unease about the state of the pay-television ecosystem has been on display this week, as media stocks have gotten battered.
>
> For years, a key driver of media companies' earnings and stock prices has been the promise of steadily rising subscription fees from pay-TV providers. Even as the U.S. TV market matures, the theory goes, pay-TV distributors will continue to dole out increases in per-subscriber fees to carry cable TV networks. But if the number of subscribers in the ecosystem shrinks substantially due to cord-cutting, those growth assumptions start to fall apart, putting significant pressure over time on revenue and profits.

> Many consumers, particularly millennials, are opting for online platforms such as Netflix, Hulu, Amazon and Apple TV over a traditional cable or satellite subscription. That, in turn, is hurting traditional distributors and programmers.
>
> Viewers are gradually being conditioned to seek out online platforms for their favorite network shows rather than watching them on linear TV, which means lower ratings and audience cannibalization.
>
> "Netflix is the most powerful content aggregator in the world today and there's nobody that's even close," Dish Chief Executive Charle Ergen said Wednesday on the company's earnings call. He said kids are "happy to watch SpongeBob from 2007 and that's just as fresh to them as SpongeBob from 2015. So the world has changed."

5. **Reuters**: "Wall Street slumps as media stocks hemorrhage":

> Wall Street slumped on Thursday (today) as weak earnings reports from media companies raised fears that more viewers are ditching cable TV, dragging the sector to its worst two-day loss since the financial crisis.

MP: The ultimate winners of creative destruction and the "**Netflix effect**" are the consumers, who reap the benefits of intense, disruptive, cut-throat market competition in the form of a constantly-evolving, never-ending bonanza of innovative consumer products that get better, faster, and cheaper all the time. Thank you Netflix for the gale of market disruption you have brought to the media industry, and thank you to the yet-to-be-identified disruptive Firm X in the future that will eventually challenge Netflix with something that might be called the "Firm X effect." We live in a much better world because of the "essential fact about capitalism" known as creative destruction, illustrated in recent years by the "**Netflix effect**."

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