School of Computer Science
Faculty of Engineering & IT

ASSIGNMENT/PROJECT COVERSHEET - GROUP ASSESSMENT

Unit of Study: **ISYS 2160**

Assignment name: From Product Business to Platform Business: The role of Digital Technologies

Tutorial time: Monday 1PM **Tutor name: Ms. Revanthi Shinde**

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ISYS2160 Report

Introduction

Netflix over the years has completely revolutionised the way we absorb content. From its conception in 1997 by Marc Randolph and Reed Hastings in California, it has made huge disruptions in the video content industry. Initially, Netflix was a product based business and provided films and tv shows in the form of DVDs.(1) The founder was charged $40 and thus wanted to form his own platform (this could be a “apocryphal” story) and thus Netflix was created.

It was the era of Blockbuster where physical stores were the norm. Blockbuster was a major chain during its Netflix’s conception which operated through physical stores world wide. It provided not only films and TV shows but they also rented games and TV box sets(3). Along with that they provided confectionery products and popcorn which Netflix could not provide. However, the whole world was going into the new age of the internet and convenience through the web was slowly creeping in as people prefer their products to come to them rather than having to make trips to the video rental store to pick up and return movies.

Netflix entered into the film rental business at a fantastic time, during the dot-com boom when businesses were growing wildly on the web. The rates they initially offered were similar to the ones that Blockbuster offered but with added convenience of getting them through the web. A great benefit of Netflix was that it was able to recommend titles to its users derived from their previous rental history, this would increase the interaction that customers had on their website(12). This simple algorithm they used to recommend products their customers may like has been carried on until now into their streaming services which was a huge benefit they had over Blockbuster from when it was introduced in 2000.

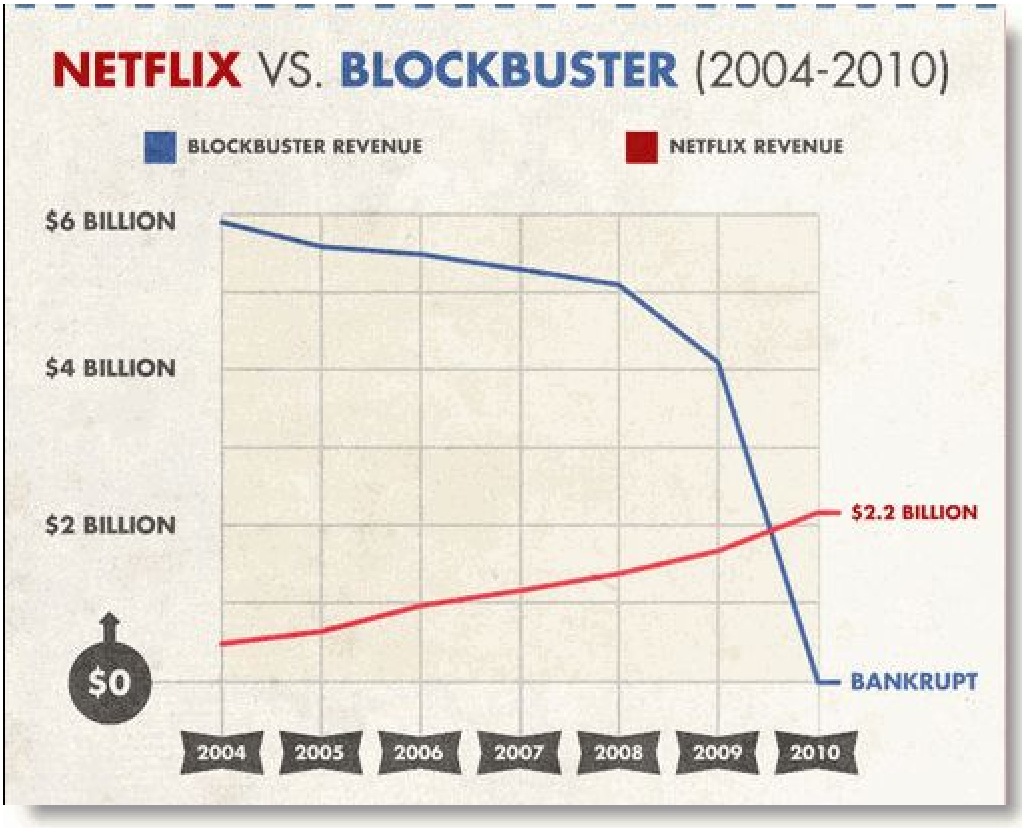
In 2000 even thought they had approximately 300,000 subscribers, they were still losing revenue and as a result offered to be acquired by Blockbuster for $50 million. Blockbuster refused this offer. The next year the dot-come bubble had burst, however DVD players were becoming cheaper and became one of the most popular christmas gifts of 2001. This perhaps saved Netflix from going bankrupt and breathed fresh life into the company. By early 2002, Netflix had a great influx of new customers onto their platform(15). That same year they had their IPO debut at $15.00 per share.

In 2005 they had approximately 35,000 titles of TV shows and films, and over 1 million DVD’s all over the USA. By 2006 DVD sales had slowly started to dwindle, Netflix had already begun its transitioning from its core business model of DVD sales and begun to prepare to enter the video-on-demand industry. Netflix slowly grew all around the world and also onto various platforms such as TV’s, other streaming devices and even gaming platforms such as Xbox and Playstation. This was the beginning of a new era for not only how consumers absorbs content through a platform but a complete shift in how movies and tv shows are produced.

2. Analyse the original product-based business model.

2.1 Discuss the competitive environment of the business

Netflix was founded in 1997 by two software engineers Reed Hastings and Marc Rudolph (Oomen, 2018). At the time the home entertainment market was dominated by multi-billion dollar company Blockbuster whose main business was providing a movie and video game rental service through a video rental shop. Hastings, the creator of Netflix and essentially the person who brought vision to Netflix, thought the home entertainment market or Blockbuster in particular was not customer-friendly with their charging of customers with high fees for late returns (Oomen, 2018). So he went on to create Netflix with Marc Rudolph and by April 1998 Netflix was renting out DVDs by mail on a subscription based model. This type of business model was the first of its kind. Instead of the traditional single-rental model used by most businesses in the industry, including blockbuster, Netflix opted for a monthly subscription model that provided it's customers with unlimited rentals at a fixed rate with extended due dates (Samson, 2018). By 1999 Netflix launched its internet-based membership service and boasted an incredible number of 239,000 users who had subscribed just in the first year. During Netflix's first 10 years they developed 50+ regional warehouses to distribute the DVD's to its users (Sharma, 2018). Blockbuster was too slow to catch up to Netflix's innovative strategies as it took years for them to finally start offering a similar service to Netflix. By the time Blockbuster had introduced the subscription model Netflix had already started transitioning away from the DVD rental business and focused on shifting their customers to streaming subscribers (Oomen, 2018).



(Tyler, 2017)

Although things were looking good for Netflix the fact that Blockbuster was a global multi-billion dollar company seemed to loom over their heads. (Their difference in revenue is pictured in the figure above). In 2000, Netflix had around 300,000 subscribers but still relied on the U.S. Postal Service to distribute the DVDs. Due to the costs of dealing with the US Postal Service the company was starting to lose money. Netflix's founder Hasting's organised a meeting with Blockbuster to propose a deal. He offered to sell a 49% stake and take the name Blockbuster.com, essentially proposing that Netflix handles the online business, while blockbuster would take care of the DVDs and their logistics which would allow them to rely less on the US Postal Service (Auletta, 2014). Blockbuster declined most likely because executives at the time did not have the foresight or vision to feel threatened by digital media. Eventually Blockbuster released their own online subscription service in 2004 but by then it was too late as Hastings quotes "If they had launched 2 years earlier, they would have killed us" (Auletta, 2014). By 2005 Netflix had 4.2 million subscribers and was still growing steadily (Auletta, 2014).

2.2 Discuss what the values to the customers are

The basic values that Netflix creates for the customer is the high quality, wide coverage and authorized DVD rental service. It rent out 4 billion DVDs in the single year of 1998 in the United States and had the stock of 925 titles available through pay-per-rental-model. The model determined that a customer should pay for any single rental he/she made and also leave bonds for returning on time. It was instead by monthly subscription model in the early 1999.

The biggest value that Netflix's DVD business model provided customers was convenience. As customers would select the movies online and receive the DVD's through the mail, Netflix had created a system where customers didn't even have to leave the comforts of their homes to order a movie. But when buying with Blockbuster, customers would have to travel to the nearest store and choose a physical copy from that store's available collection. This theme of convenience is still a strong foundation holding up the value that makes Netflix's platform today.

The in-store service was praised when Netflix was founded in the first year. The store staff can clearly and fluently introduce and explain the whole rental process to the customers. Also, they have a basic knowledge of the most movies they rent out so that they can not only find the movie that the customer knows the name, but also recommend and introduce the content for customers. This created values for the customer who wanted to rent a movie but did not have a clear version of what they want. The efficient and comfortable service was the value to customer as well.

After creating an internet-based member service, the free delivery model also creates value for their customers. Since there are 50+ regional stores in America, Netflix can offer a fast and free delivery so that the customer can not only wait at home but also not pay for additional fees. In these days' delivery, the delivery fees took an amount of money compared to the rental fees. It is a very humanize decision which can strengthen customers royalty. Customer would think the company not only made convenient for them, but also sacrifice some profit for them.

Netflix's product-based model took advantage of the flaws of their competition to create more value for their customers. Netflix gave themselves an edge when they were more generous with their late fees by getting rid of them as opposed to Blockbuster whos fees were substantially high, around $45 in the late 90's early 2000's (Redwine, 2019). A simple difference like this made customers feel more valued and less pressured when they did return a late movie. Providing loyalty to their customers was crucial in their future growth.

Netflix's subscription model allowed customers to order as many movies as they wanted at a fixed monthly rate. This was very valuable to regular movie borrowers as Netflix had essentially created a 'buffet' style offering of entertainment. Customers didn't have to worry about paying too much for too many movies anymore so it allowed them to order more films and use more of Netflix's services.

2.3 Discuss how information systems and information technologies were used strategically

Netflix used two main kinds of information systems which are Customer Relationship Management (CRM) system and Supply Chain Management (SCM) system.

In 1997 when Netflix was founded, the information systems were established by the data from store to store which records specific information with customers, products and store staff. These data would be collected manually and uploaded to the headquarter for further analyzation and decision making monthly. This showed customers' behaviors and demands for the different kinds of products for external management. Also, it showed the store staff's behaviors and performance for internal management.

In these days, the monthly data helped headquarters to make demand forecasting for next month and the popularity of different types of movies. This kind of SCM system made the company has targeted supplement for different movies but it also causes the periodic ordering monthly and pushes ordering. Netflix chooses U.S Postal Service for DVDs incoming from the supplier which ensures the good enough purchase guarantee in transportation.

The first CRM system was applied by a monthly subscription model by mail instead of the single-rental model for solving customers' high rent fees and later return fees. It used the subscription instead of traditional sales which greatly strengthen customer loyalty and cut down customers' unnecessary payment. It allowed customers to have an unlimited rental at a fixed rate and extended return dates (Samson, 2018). It also killed the price fluctuations situation between different movies.

After that, an online membership service was implemented for customers to rent and check the availability of the product in-store. The member could freely look through the website which contains movies' information, related nearest store, and his/her personal details, rent situation, and member situation. The member also had the priority order rights compared to normal customers. This system significantly enhanced the efficiency of booking a product for the customer, reduced the manpower of shop staff and cut the cost of hiring more staff since the users are increasing steadily. It directly interested more new customers and consolidated the foundation of original customers. What's more, this system could help the company find out which movie is out of stock in advance so that it can be restocked more efficiency.

The appearance of online payment, online customer service and auto-mail for receipt and feedback processing further simplified demands for physical resources and improved customers' satisfaction. They helped customers to interact with the application directly and be able to progress at any time without company representation.

Since the data was processed online, a built-in data warehouse was completed and run automatically. The interaction of customers or staff and systems created the data needed and collected by technical staff. After process and integration, the data warehouse could contain data covered any sales area and real-time data. This let the company had a better version of customers' demands and preferences so that they could provide a different strategic plans for different customers to transform a short-term profit to a long term one through email.

A custom-built intelligent agent was created as an upgrade of the CRM system. It performed as a shop staff role in realistic by not only finding and introducing the designated movie but also recommending and inspiring customers' desire to buy. It extracted data from the data warehouse and matched the same users. Its recommendation followed either one of two rules: adaptive filtering and collaborative filtering. The former one depends on the customers' rating, evaluation or other behavior on a movie. The longer the information is monitored the customer's preference is revealed more precise. For the latter one, it will recommend the movie for the customer depend on other customers who have the same tastes. What's more, the member could have several lists of movies so that the buyer agent can recommend the movies depend on the list. It enhances the experience of the customer who shares one account with friends or families. Through technology, Netflix developed a personalized website.

The data warehouse also helped the company in the SCM system. By sharing the real-time information of the customer, the supplier can make new orders or replenishment more accurately. Of course, Netflix had own internet systems with its suppliers to monitor the manufacturing, delivery, and fluctuation in price. There were several applications that Netflix applied to the SCM system. First is inventory upkeep, it is important for Netflix to keep its product updated and fresh since both movies and TV shows will lose value over time (Safeducate, 2019). Netflix carefully kept track of the new products and got a license from the owner. On-demand Delivery is also important because the customer wanted to get the DVDs as soon as possible (Safeducate, 2019). Netflix shared the real-time data of data warehouse to the supplier to ensure the supplier is sufficient. The damage control is added as an application (Safeducate, 2019). Since the product like DVD is vulnerable, the damage in transportation could be calculated and prepared for the future by collecting the data from experience. Kept on the trend of supplier was also important so that the source of the supply chain could be controlled. What's more, risk management should be planned comprehensive and detailed before.

3. Analyse the transformed platform business model

3.1 Discuss the competitive environment of the business.

As a platform business, Netflix' main competitors fall into a multitude of categories: general media consumption, streaming video, as well as competition yet to launch, which Netflix will have to focus on in the future.

The first of three general media consumption competitor's is cinema. Despite an ever increasing amount spent on web-provided entertainment, US cinema ticket sales have stayed constant and are projected to remain relatively constant, from $10.7 billion to an estimated 12.2 billion through 2021 due to blockbuster films. During the same period, the amount spent of internet-sourced videos in the US will have risen from $4.4 billion to $18.8 billion (Snider, 2017).

The second general media competitor is cable television. 70 percent of consumers do not think that traditional tv offers good quality content for its cost. Cable subscriptions dropped 2% in 2018 to 556 million worldwide. Revenue increased by $6.2 billion to $118 million. Second was satellite tv, followed by streaming services. More Americans were still watching cable (80%) in 2018 than streaming video (70%) but the tide is shifting (Liptak, 2019).

The third general media sector to discuss in premium television channels, all except for Cinemax available as stand-alone subscriptions (Supan, n.d.).

- HBO Now: $14.99/month, 30 million subscribers

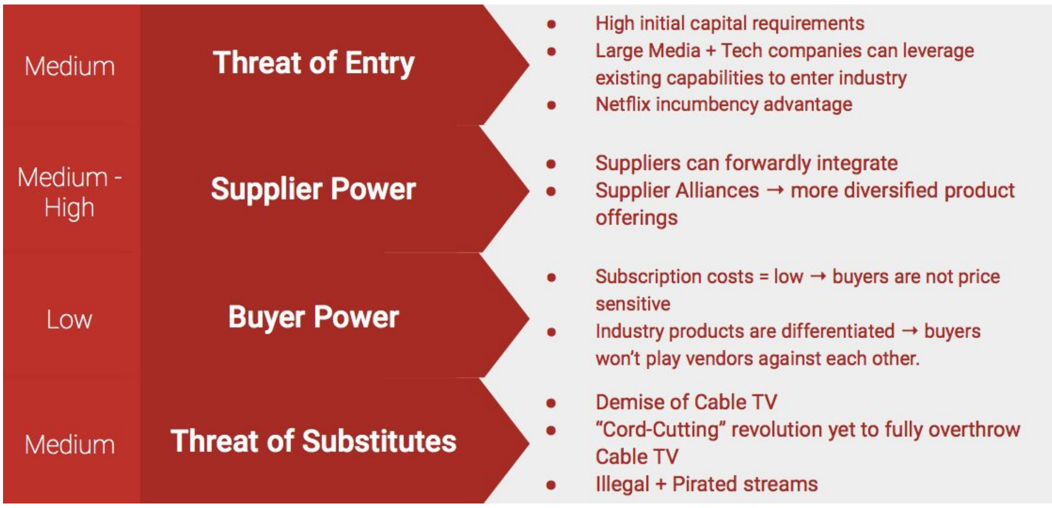
- Starz: $8.99/month, 21.4 million subscribers
- Showtime: $10.00/month or 8.99 as an add-on to Hulu or Amazon Prime, $10.4 million subscribers
- Cinemax: $20.00/month as part of cable package

Other streaming video platforms serve as Netflix' main competitors. Was once a capability limited to a few firms, but has grown exponentially in the past decade and continues to grow. The five different categories are subscription-entertainment (direct-to-consumer), streaming TV hubs and hardware, sports, free or ad-supported streaming, and online cable TV bundles. Netflix currently occupies the subscription-entertainment sphere. Its competitors like Amazon, Disney, Apple, Google, have developed products in more than one sphere. Hulu serves as one of Netflix' largest competitors. They offers an $11.99 per month subscription for access to Hulu's on-demand video library, as well as a $44.99 a month package for on-demand videos and 60 live-TV channels. Hulu received less than $3 billion dollars in revenue in 2018, with 25 subscribers. However, and its IT only operates in the US (Comparitech, 2019). Amazon Prime video is another major competitor to Netflix, with the 2nt most subscribers in the streaming service industry. Amazon Prime had less than $3 billion in revenue in 2018, with a $12.99 a month membership (Comparitech, 2019). Amazon Prime has the largest library with over 200,000 movies and tv shows and 100 million subscribers (Comparitech, 2019).

<u>Competition still to launch:</u>

1) Apple
2) Disney
3) NBCUniversal
4) WarnerMedia

Netflix own price model sits at $12.99/month. Netflix had its best year in 2018, with revenue of $15.794 billion, 35% more than the previous year, making it the highest earner of the top streaming services. Its third quarter revenue in 2019 showed a year over year increase of 31.14%. it has had over 30% year over year revenue growth since 2015 (Macrotrends, n.d.). Netflix is the most popular streaming service in the world, with over 148 million subscribers. It was the top non-gaming app by consumer by spend in 2017 and 2018.



Porter's 5 Forces can be used to analyze Netflix's competitive strategy as a platform business (Chappelow, 2019). Netflix' major threat of entry is Media and tech companies. Their incumbency advantage, however, is brand loyalty, as netflix already has the largest customer base. In addition, netflix' proprietary algorithm and user preference database allows them to deliver high quality product offerings. Netflix stocks dropped 4.5% after Disney's Investors Day in which they formally released their streaming platform. Netflix also has buyer power. The subscription price of about $13 a month is a small proportion of a buyer's total expenditures which means they are not price sensitive. Lastly, netflix poses a threat to substituting cable television. The demise of cable tv gives rise for companies to capitalize on streaming. However, the "cutting the cord" revolution has failed to overthrow Cable TV yet, thus consumers can still utilize their cable provider login to access streaming for free or no additional cost.

As of 2018, the majority of Netflix's new releases, 51%, were original Netflix productions as opposed to acquired shows or films. 11% of all titles available on Netflix are now Netflix productions vs. 4% measured as such in 2016. (Deadline, 3/21/19). This move toward self-sufficiency ensures control over its video supply and to prepare itself for a loss of titles once other media companies launch their own services or license them to others. About 30% of Netflix current content is from major US studios (Hayes, 2019).

3.2 Discuss the values to the users

The rise of streaming services created phenomena known as “cord-cutting”: people abandoning their traditional cable tv packages and opting for less expensive online streaming services (Economist, 2016). The benefits to users of platforms over watching live television are as follows:

1) Content is available at any time, anywhere. This is one of the most important value to the users as they are not limited by a physical product (DVD’s) and can rather access content from anywhere at any time rather than having to go into a store to get and return DVD’s.
2) No commercial breaks or ads. This increases the amount of time that the user stays on Netflix and continues to watch shows or movies as their attention to the content is not broken.
3) The option to watch content on multiple devices. There can be several users logged into the same account yet be watching different content. This content is curated to each specific individuals preferences which increases interaction and watch time, eventually leading to more business.

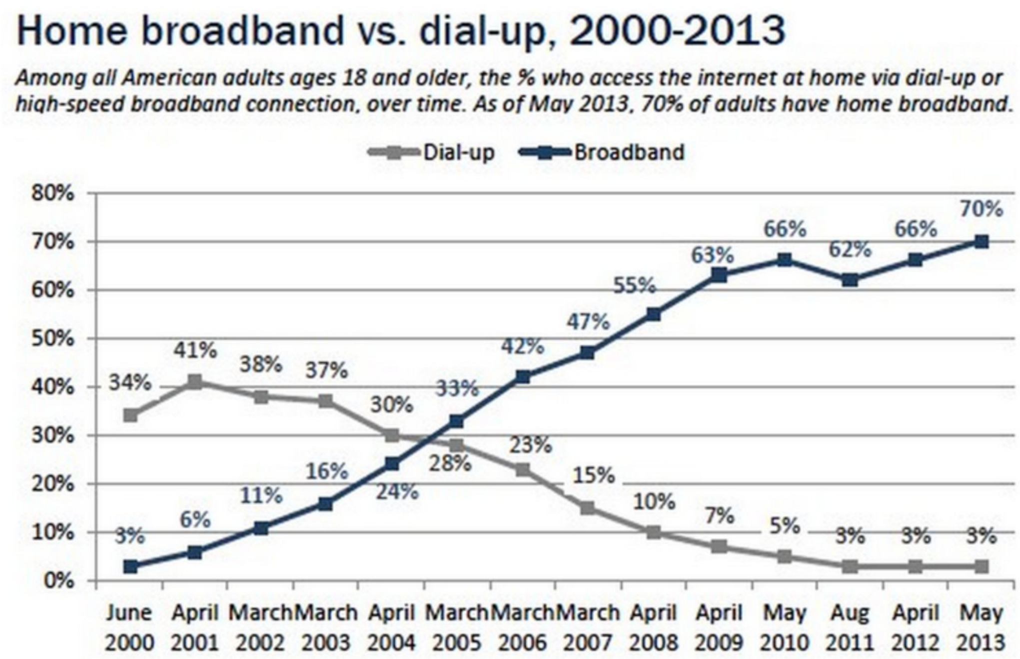
A very unique aspect of Netflix is that they introduced interactive films and shows where the viewer could choose the outcome of the film. The user is able to choose the specific scenario that they want played out. For example, if the character in the film was to make a choice between two cereals, the user could select which specific cereal they prefered. This provides a realistic market survey on which individuals from which areas prefer which kind of cereal. This could potentially be a huge tool for

Netflix to sell its marketing data. This format of content is also much more difficult to effectively pirate as the interactiveness of the show/film is diminished.

3.3 Discuss the role of digital technology

Digital Technology is one of the most common way's modern platform businesses are made and this is exactly what happened to Netflix. They shifted from selling DVDs through the internet to producing a platform to allow anyone from around the world to view a variety of types of content. Even even though DVD sales in the USA, Netflic made $212 million as some families still do not have effective internet access.

Digital technology has played a huge role in the success of Netflix's transition over time to their platform based business. Netflix had several stages of transitioning which would not have been possible without the availability of digital technology. The conception of the company was based on the new internet of the dot-com boom. During the initial product based business model, they had dial-up internet as the norm and slowly the world transferred to dsl and soon adsl which could provide much higher bandwidth more suitable for streaming.

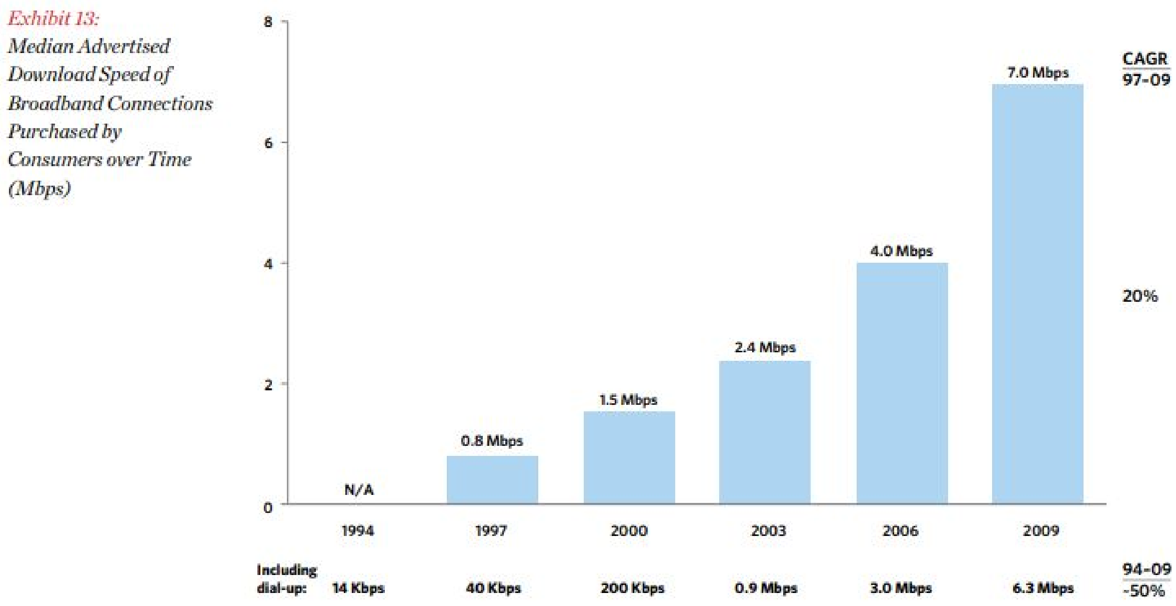


Thus in the above graph you can see that in 2007 when they launched their streaming platform, approximately 50% of American adults had switched over to broadband. This gave them a huge market to tap into as they were one of the first to offer this type of streaming platform. In the following years as the types of technological devices expanded, they had an even larger market to expand into so they went into other platforms such as:

- Gaming platforms such as Xbox and Playstation
- Smart tv's as well as tv boxes such as Apple TV and Roku
- Mobile Devices
- Even on a few types of cars
- Gym machines such as treadmills

4. Discuss the drivers of the change

Change was always a big part of Netflix's business strategy. Even in the early days they seemed to always have one eye on the shift of technology as they searched for ways to innovate their business. So although they recognised the potential in utilising the internet, they were also mindful of the negative reviews consumers gave to early online entertainment-distribution systems (Littleton et al, 2018). The technology was not quite there so it would take sometimes hours to download films. Thus the decision to be completely online weighed more on timing than anything. Broadband speeds and streaming technology had to be built into consumer devices and made mainstream before Netflix could make its move (Littleton et al, 2018). The founder Hasting had said that " [The] postage rates were going to keep going up and the internet was going to get twice as fast at half the price every 18 months, At some point those lines would cross, and it would become more cost-efficient to stream a movie rather than to mail a video. And that's when we get in" (Littleton et al, 2018).



(Federal Communications Commission, 2009)

As shown in the chart above by the mid 2000’s data speeds and bandwidth costs had improved well enough for the average consumer to be able to download films at reasonable speeds. The transition away from DVD’s had begun and Netflix started exploring different avenues. One idea that nearly came into fruition was the “Netflix Box”. The idea was that the box would download entertainment overnight and would be ready to be watched in the morning. They had finished the designs, acquired movie rights and were about to go public with it when they noticed the rising popularity of Youtube. The popularity of Youtube indicated that users were willing to sacrifice high definition videos for convenience and speed, which was a shift in paradigm because Netflix and the whole industry at the time were focused on delivering the highest quality films (Kyncl, 2017). Netflix describes witnessing the popularity of Youtube a ‘revelation’ as it made them stop their launch of the Netflix Box and change to a service were users would be able to stream videos remotely without downloading them (Kyncl, 2017). It took a whole 2 years to renegotiate all the rights and build up new tech to host and serve the videos but in 2007 Netflix released their online streaming platform (Kyncl, 2017).

5. Discuss the benefits of the change

Since Netflix decided to move from product to platform, the business model has changed a lot. Although the main value is still created by customers' payment for monthly subscription to Netflix, the platform has more benefits on increasing the chance of value creation, reducing the cost, innovation of the business and enhancing the competitiveness.

Increasing the chance of value creation

Netflix changed its product to platform as click-and-mortar business to a click-and-order business which means customers who pay a monthly subscription can interact with products directly on the internet. They can get the experience on the spot instead of waiting for the transportation of the DVDs and returning them on time. Customers can also avoid concerning if the DVDs will be broken on the way or during rent time, and there is no one at home when the delivery arrived. It significantly enhances the convenience, royalty and experience quality of customers so that more people are willing to join the plan and original customer may not lose except for the few people who are not able to use the internet.

The long tail strategy can be applied easily in the digital platform without the limitation of store size and with the help of search, filter and recommendation tools. With the online channels, the demand curve is changed that the tail becomes flatter and longer which means it causes more sales (Na, 2019, P28). Because the value of a movie or TV shows is decreasing over time and depends on its popularity, Netflix can import more different types of movies and TV shows with a low price. It can interest a large number of customers with unique vision about products and satisfy the further search from original customers.

Reducing the cost

The original business of a product to the Netflix is complex and massive. It firstly makes contract with the producer and then contacts with the manufacturer to confirm the demands. After producing the CDs, they are transported to the store and wait for customers' booking. Finally, they are transported to the customer and then returned to the store. Compared to that, Netflix only needs to make contract with producer and customers without manufacture and transportation. It directly cut the cost of manufacturing fees, transportation fees and maintaining fees of CDs so that it can offer a more reasonable price with both producers and customers while ensuring the profits. The digital platform also lets Netflix reduce a large fee for rent fees of the physical stores instead by website, salaries for store staffs instead by internet customer service staffs and intelligent bot, and energy fees to maintain the stores instead by IT staff.

Innovation of the business

The digital platform cuts the middle fact which is manufacture between producer and Netflix. This brings more interaction between Netflix and producer. Netflix created its own studio after changing to the digital platform as the role of corporate or individual producer of the movie or TV shows depends on the cooperating experience and in-depth understanding of the film industry from the interaction. By abandoning the physical store, Netflix can be more concentrate on inventing new technology depends on the software or website which meets the concept of modern life. As a result, Netflix may make a more accurate and detailed strategy plan for company.

Enhancing the competitiveness

Before entering the platform, the main competitor to Netflix was the Blockbuster which did not change the product to platform and ceased operation in 2013. The result comes out to this industry, compared to the product business, the platform business takes more advantage on profit and attracting customers. Netflix is still the biggest company in this industry due to the early and visionary decision of platform business.

Conclusion

During Netflix's period of being a product based model they provided the service of posting DVD's to customers on a monthly subscription fee. They initially caused quite a stir in the entertainment distribution industry and caught the attention of media retail giants Blockbuster. But Netflix's innovative prowess and their vision for long-term change helped them outpace Blockbuster, and Netflix are now the billionaire giants whilst Blockbuster has gone bankrupt. Netflix's product-based model was successful enough to lead an initial steady growth but the owners foresaw that the business model was unsustainable, mainly due to factors such as a shift in technology and a rise in transportation costs. So by the mid 2000's Netflix had already begun experimenting with different avenues to pivot their business strategy to best take advantage of the growth in technology, eventually transitioning to the platform based model we have today.

Netflix was founded in 1998 with the traditional single-rental model and changed it in 1999 with a monthly subscription model. It changed to platform business in 2007 since the product business started to lose money in 2000 because of the expensive cost of DVDs, physical store rents and transportation fees. Netflix uses their built-in CRM and SCM system to strategically support their business.

The value is created by customers' monthly subscription with 3 different plans. Compared to product business, platform business has more benefits which lead Netflix to profit. It also treats both producer and customer with a better cooperate experience.

The most important competitors to Netflix are the ones that haven't been proven yet, like Apple and Google. Every major company is jumping into the business, which is why in the future Netflix will have to rely on their experience in producing quality products (TV shows or movies) that people will pay for. They are thus going away from the platform model which has become so popular and moving back towards the product model to distinguish themselves.

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