Netflix in 2011

GEE - Third Case Study

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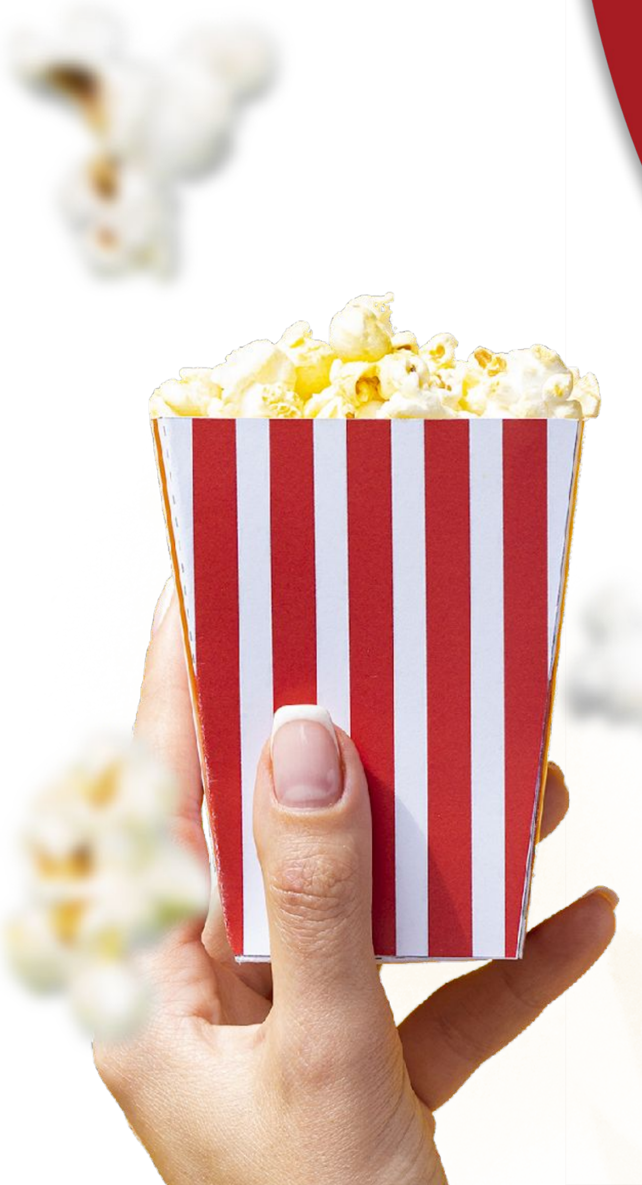

Case Study Introduction

Reed Hastings, founder and CEO of Netflix, announced in July 2011 that Netflix would start charging its streaming video services and DVD services separately.

Hastings explained that streaming and DVD-by-mail were becoming two quite different businesses, with different cost structures and benefits that needed to be marketed differently. In addition, each business needed to be able to grow and operate independently.

The bigger challenge facing Hastings and his team was how to cope with the very different business model for streaming in a company built on the higher margins of DVD-by-mail. **How would they manage that transition within a single business**, and more importantly, with the company's 20 million customer relationships? That was the question he now had to be honest about.

Problem Identification

This case study analysis aims to provide recommendations to Reed Hastings, the CEO of Netflix, regarding the adopted business model and his decision to separate the DVD-by-mail business from the streaming business, creating Qwikster.

By analyzing Netflix's and its competitor's business models, as well as their evolution, consequences and changes brought by some decisions, we aim to understand whether Reed Hasting took a beneficial decision for his company.

Did Reed Hastings make the right move in trying to separate the DVD-by-mail business from the streaming business? How should he proceed now?

1. How would you characterize **Netflix's business model for DVD-by-mail** business?

Key Partners

- Content Providers;
- Manufactures/sellers of DVD players;
- Postal Service (USPS);
- Red Envelope Entertainment;

Key Activities

- Mail-order processing;
- Content licensing;
- Platform & recommendation system management.

Key Resources

- Recommendation algorithm;
- Movie content (inventory/library).

Value Proposition

Value

- Deliver by mail of DVD's for home use, making it convenient;
- Unlimited (having a movie at all the time);
- No late fee payments;
- Prepaid subscription, with no additional costs;
- Trading old DVD's for new ones at any time;
- Personalization: relevancy of the movies to the customer, through the recommendation system;
- Diversity by promoting lesser-known movies;
- Reviews (collaborative filtering system).

Value for

- (Initially) Early technology adopters who had recently purchased DVD players;
- (Later) Regular movie watchers.

1. How would you characterize **Netflix's business model for DVD-by-mail** business?

Customer Relationships

- Self-service/Automated Services: customers can search through the website, add to the movies to the queue and get access to tailored movies;
- Retaining customers, by keeping information about movies they liked leading them to return.

Channels

- Website: where the customers can get recommendations and request the movies;
- Movies delivered at home through the DVD-by-mail system.

Customer Segments

- (Initially) Early technology adopters who had recently purchased DVD players;
- (Later) Regular movie/serie watchers;
- (Later) Customers looking for lesser-known movies and series, tailored to their preferences.

Cost Structure

- Distribution costs: sending DVDs by mail;
- Website maintenance;
- Acquiring new DVDs;
- Centers around the country for a faster DVD delivery.

Revenue Streams

- (Initially) Individual DVD sales;
- (Later) Prepaid Subscription Service.

2. How would you characterize **Blockbuster's business model?** And how would you characterize the differences between Blockbuster's and Netflix's DVD-by-mail business models?

Key Partners

- A lot of Content Providers (movies, video-games, music);
- In 1987, Blockbuster received 18.5 million dollars from a trio of investors;
- In 2000s, Netflix CEO proposed a merger with Blockbuster, which never saw the light of day.

Key Activities

- Sell VHS tapes;
- Started its own online DVD-by-mail service;
- Added music and video-game rental to its stores.

Key Resources

- Stores at multiple locations;
- Huge range of titles (inventory/library);
- Kiosks.

Value Proposition

Value

- Watch hit movies in the comfort of their homes;
- Provide consumers local access to thousands of movie titles all in one place;
- Convenience of a one-stop shop for nearly any video title one would hope to watch;
- Possibility of combining the mail service with the store service.

Value for

- People of all ages who enjoy watching movies or playing games in the comfort of their home;
- Regular movie watchers who are not adapted to the new technologies.

2. How would you characterize **Blockbuster's business model?** And how would you characterize the differences between Blockbuster's and Netflix's DVD-by-mail business models?

Customer Relationships

- Hospitality through in-store personal assistance;
- Cross-promotions, in-store rental coupons, and stocking online rental requests out of its store inventory;
- Introduced Blockbuster Total Access, which is a disc-by-mail program that allows customers to exchange DVDs by mail or in a store, if they prefer immediate satisfaction to waiting for the mailman;
- Possibility to combine the mail service with the store service.

Channels

- Bought physically in the stores;
- Delivered at home through Blockbuster Total Access.

Customer Segments

- Movie, television, and game lovers;
- Those who seek to get a hold of the latest release without incurring the expense of buying it or trying to find space to store a collection of DVDs;
- Those hoping to catch an oldie that has been on the shelf for a while;
- Due to the diverse nature of their product assortment, Blockbuster caters to most market segments.

Cost Structure

- Occupancy (retail stores);
- Payroll;
- Website maintenance;
- Rental Library Purchases;
- Distribution costs: sending DVDs by mail.

Revenue Streams

- Movie rentals;
- Late fees (until it was unveiled in 2005);
- Timely return allow it to be rented by another customer.

2. How would you characterize Blockbuster's business model? And how would you characterize the **differences between Blockbuster's and Netflix's DVD-by-mail business models?**

- Netflix focused on an **online business model**, exploring and constantly improving user experience and satisfaction in order to continue to attract customers and, this way, achieve profitability **VS** BlockBuster focused on **in-store resale of DVDs** and their business model depended on maximizing the days that a movie was out for rent;
- Netflix focused on providing a **quality selection of movies**, mainly lesser-known movies that attract a diverse audience, and on promoting demand on this movies rather than in new releases **VS** New releases were one of the main revenue sources for BlockBuster which meant that the selection **available in-store was limited**;
- Pricing models were mainly different: Netflix quickly adopted a **prepaid subscription model** **VS** Blockbuster **rented movies individually** and had **late return fees** as a great source of revenue. When Blockbuster removed this fees in an attempt to battle Netflix, the result was increasing costs with marketing and implementation which did not offset the loss of revenue;

2. How would you characterize Blockbuster's business model? And how would you characterize the **differences between Blockbuster's and Netflix's DVD-by-mail business models?**

Services:

Netflix innovated in several ways:

- ordering was done online;
- flat-rate monthly subscriptions (possibility to keep three/four DVDs at a time);
- no late fees;
- 7.99$ for each service (DVD and streaming).

Blockbuster established the Total Access program (disc-by-mail program):

- offers movies and video-game discs;
- enables customers to exchange DVDs by mail or in-store.

Prices:

Monthly Pricing:

- Netflix: 7.99$ for one disc at a time (after separation of their two services)
- Blockbuster: 9.99$ for one disc at a time

Key differentiators:

- **Netflix:** Unlimited online streaming (for additional 7.99$ per month). Partnership with great distribution companies such as USPS. Promotes lesser-known titles, adding review system and recommendation algorithm.
- **Blockbuster:** Integrated its online offering with its traditional store-based business. Music and video games rental also available in the stores. Availability in Kiosks.

Limitations:

- **Netflix**: No stores, no video-games
- **Blockbuster:** All in-store rental exchanges must be returned to the Blockbuster store where they were originally rented

3. How would you identify and explain the **key changes in Netflix business model over time?** What were the **consequences** of those changes in the evolution of Netflix's business?

1997

Initial Business Model:

- **Customer Segment:** early technology adopters who had recently purchased DVD players (niche);
- **Value Proposition:** movie rental solution for new DVD-player owners;
- **Revenue Streams**: charge per movie rented and imposing late return fees.

1999

From Charge per price & late-fees
To Prepaid Subscription fee

- **Customer Segments:** regular movie watchers;
- **Value Proposition:** unlimited exchange of movies, no late fees;
- **Revenue Streams:** prepaid subscription.

Consequences:

- Resist to the fast adoption of DVD players and to the wide availability of DVDs both for purchase and for rental, which was putting Netflix's value proposition in danger, as well as its profitability.

2000

From Traditional Merchandising
To Proprietary Recommendation System

- **Customer Relationships:** Self-Service and Automated services (customer's tastes allow the system to make recommendations); Keep consumers by always recommending new movies.
- **Customer Segments:** (+) People looking for a personalized experience and that want to explore lesser-known movies with great quality; Focuses on niche audiences;
- **Value Proposition:** (+) movies tailored to the user (personalized experience), collaborative filtering system that represents the tastes of all users;

Consequences:

- better balance customer demand (by stimulating demand on older and less-known movies);
- better understanding of customers' preferences (reflected by the ratings);
- brings value in comparison with stores;
- growth in customer-generated ratings.

3. How would you identify and explain the **key changes in Netflix business model over time?** What were the **consequences** of those changes in the evolution of Netflix's business?

2001

From One distribution center
To Multiple distribution centers + USPS relationship

- **Key Partners:** (+) USPS;
- **Key Resources:** (+) new distribution centers and staff;
- **Cost Structure:** (+) distribution centers and salaries;
- **Value Proposition:** (+) one day delivery.

Consequences:

- "reach profitability for the first time in the quarter ending June 2003";
- customer satisfaction through the improvement of the delivery time;
- increase of the subscriber base.

2002

From Unsubscription by phone
TO Online Unsubscription

- **Customer Relationships:** (+) Retention Strategy: Keeping queue of unsubscribers, leading them to return.

Consequences:

- Face high churn, with a new retention strategy.

2006

Independent movies

- **Key Resources:** (+) independent films;
- **Cost Structure:** (+) pay for distribution rights;
- **Value Proposition:** (+) high-quality source of independent films.

Consequences:

- Popularity: source of quality independent movies.

3. How would you identify and explain the **key changes in Netflix business model over time?** What were the **consequences** of those changes in the evolution of Netflix's business?

2007

From DVD resale
To Streaming

- **Value Proposition:** (+) "View Instantly" option;
- **Cost Structure:** (+) Streaming costs + Licenses;
- **Revenue Streams:** (+) Subscription based streaming.

Consequences:

- Increase of the entry cost (due to licenses instead of first-sale doctrine);
- Keep up with technology trends and evolution (VOD).

2008

From Computer Streaming
To Streaming in all devices

- **Channels:** Diversity of digital devices;
- **Key Partners:** Roku, Microsoft (Xbox), brands of mobile devices,...

Consequences:

- Improved Accessibility (anywhere at any time);
- Attachment to the service.

2009

Original Content

- **Value Proposition:** Original and exclusive movies and series;
- **Key Activities:** Production of original content;

Consequences:

- Differentiation from competition like Apple and Amazon through original content.

NOTE:
Over the years new **Key Partnerships**, mainly streaming deals, were established with Starz Entertainment (Walt Disney + Sony Pictures), Paramount, Lionsgate, and MGM, which enriched the quality of provided content.

4. How different would you say Netflix's DVD-by-mail and streaming business models are? Does Netflix's role change in streaming compared to DVD-by-mail?

Key Partners

- Content Providers;
- Red Envelope Entertainment;
- Paramount;
- Lionsgate;
- MGM;
- Roku;
- Microsoft.

Differences

- New partners like big studios and streaming related companies.

Key Activities

- Presently, content licensing and original content development;
- Engage with the audience;
- Analyze data.

Differences

- With the new streaming service, the importance given to original content development and engagement with the audience increases.

Key Resources

- Recommendation algorithm;
- Movie content (inventory/library);
- Exclusive content.

Differences

- Key resources stay the same, with the addiction of exclusive content.

4. How different would you say Netflix's DVD-by-mail and streaming business models are? Does Netflix's role change in streaming compared to DVD-by-mail?

Value Proposition

Value

- Diversity / Original Content;
- Personalization and user experience;
- Recommendation system;
- Usable in many different devices;
- TV attachment;
- Personalization: relevancy of the movies to the customer, through the recommendation system;
- Diversity promoting lesser-known movies;
- Reviews (collaborative filtering system).

Differences

- The value proposition remains similar, but with emphasis in confort, usability and technology;
- Original content.

Value for

- Anyone with a compatible device and internet connection;
- Regular movie watchers.

Differences

- The value increases a lot as the customers are not forced to use one specific device.

4. How different would you say Netflix's DVD-by-mail and streaming business models are? Does Netflix's role change in streaming compared to DVD-by-mail?

Customer Relationships

- Get: advertisement and inicial free trial;
- Keep: marketing emails, notifications of new seasons of shows, recommendations.

Differences

- Strategies are the same in their core but more technology based and advanced.

Channels

- Own website;
- Application.

Differences

- Application becomes of paramount importance and the delivery channel disappears.

Customer Segments

- Regular movie / TV show watchers;
- People who want to watch movies / TV shows in a variety of places and situations;

Differences

- The increase in possible devices to enjoy the service enables the company to expand its market.

Cost Structure

- Building film library;
- Licensing;
- Cloud infrastructure;

Differences

- DVD acquirement and distribution costs are no longer part of the business model;
- Licensing replaces the first-sale doctrine.

Revenue Streams

- Monthly Subscription Service;

Differences

- The streaming business model never had a system allowing the purchase of individual movies / shows.

4. How different would you say Netflix's DVD-by-mail and streaming business models are? Does Netflix's role change in streaming compared to DVD-by-mail?

Netflix's role remains the same!

The change from DVD-by-mail to streaming only changes the way the product is delivered.

The goal has always been to give the customer the best home video viewing experience (as a VOD service)

- "Our hope is that we'll eventually be able to download more movies. It's why we named the business Netflix and not DVD-by-Mail."

5. Did Reed Hastings make the right move in trying to separate the DVD-by-mail business from the streaming business? How do you think he should proceed now?

Yes! Reed Hastings made the right decision.

- He was starting to lose market and changing to streaming helped their service to distinguish itself from competitors and to grow more since it is a new way of watching movies at home.
- In 2010, Netflix passed a significant milestone with the majority of subscribers viewing more of their TV shows and movies via streaming than DVDs-by-mail. They believe focusing on streaming will enable Netflix to grow rapidly and profitably.
- Most companies that are great at something do not become great at new things people want (streaming in this case) because they are afraid to hurt their initial business. Eventually these companies realize their error of not focusing enough on the new thing, and then the company fights desperately and hopelessly to recover.

Advantages

Operational Advantage

Each business can have its independent CEO, with its own strategic decisions, hence allowing businesses to gain organizational focus.

Different Prices

Splitting the business in two allows different pricings so that one does not interfere with the other, given each business requires its own resources and cost structures.

Focusing On New Markets

If a company wishes to change direction, a spin-off company provides a way of continuing to meet the needs of current clients whilst allowing the parent company to focus on new markets.

5. Did Reed Hastings make the right move in trying to separate the DVD-by-mail business from the streaming business? **How do you think he should proceed now?**

Focus On **Streaming**!

- Keep The DVD-by-mail market operational as long as it is profitable.
- This keeps a profitable business running and avoids further investment in a falling market.

- Focus investment on Streaming, given that it is the market that seems to be rising and as of 2010 is already leading netflix's profits.
- This gives Netflix room to grow and a safer place to invest.
- It also eases Netflix's goal of becoming the number one streaming platform, which could generate a monopoly and therefore large profit margins.