ENTR 3600 - Business Essentials for Technology Entrepreneurs

Case Study 2 - Netflix Inc.: Streaming Away from DVDs

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Executive Summary:

This case study explores the history of Netflix, a startup that revolutionized the way we consume television series and films. They started by mailing DVDs to people back in 1997. Then, it moved into online streaming in 2007, letting people watch instantly. But Netflix hit some bumps, like when it tried changing prices and splitting its DVD and streaming services. This upset a lot of customers and caused Netflix to lose subscribers and money. Netflix nevertheless had chances despite these obstacles, such as growing into new nations, securing deals for exclusive content, and utilizing cutting-edge technology to enhance its offering. In summary, despite certain challenging circumstances, Netflix has opportunities to continue expanding and succeeding.

Problem Statement:

Netflix, led by CEO Reed Hastings, faced significant backlash and criticism after announcing plans to split its DVD rental and streaming services into two different entities. The decision to rename the DVD mail-in service as Qwikster while keeping the Netflix brand for streaming resulted in widespread challenges and negative reactions from customers, industry experts, and the media.

Netflix experienced **overarching issues** with how it communicated modifications to its consumers. The way they announced the restructuring left people confused and annoyed. Customers found the adjustments challenging, like having to deal with separate accounts for streaming and DVD rentals. Critics were upset because Netflix renamed the DVD service Qwikster, claiming it hurt the company's strong brand image. Besides, the timing of the announcement which coincided with the decline of DVD rentals, made people uncertain about Netflix's future in that business.

Users and Objectives:

Reed Hastings:

- CEO of Netflix
- Aims to provide strategic leadership, expand market presence, enhance customer satisfaction, drive innovation and technology, maintain financial performance, and foster a positive corporate culture.

Netflix Subscribers:

- To enjoy entertainment through Netflix's services, including streaming and DVD rentals, while ensuring value for their subscription fees.

Investors:

- To evaluate Netflix’s financial performance and strategic direction aiming for profitable returns on investment.

Industry Analysts:

- To analyze Netflix's business choices, market position, and financial health, offering valuable insights to investors and stakeholders.
- Michael Liedtke: Reported on Netflix's restructuring and the negative feedback it faced from customers.
- Rebecca Rosen: Investigated the reasoning behind Netflix's decision to separate its DVD rental and streaming services.

Technology Journalists:

- To report on Netflix's decisions, progressions, and their influence on the industry and consumers.
- Harry McCracken (Technologizer): Criticised Netflix's selection of the Qwikster name and emphasized potential brand confusion.
- Robert McMillan (Wired Enterprise): Discussed the impact of internet streaming on conventional DVD rental services, including Netflix.

United States Postal Service (USPS):

- To understand Netflix's impact on their operations, specifically regarding DVD mail delivery, to adapt their services accordingly.

Competitors:

- To monitor Netflix's strategies and market dynamics to adjust their strategies and to maintain competitiveness.
- Blockbuster: Directly competed with Netflix in the DVD rental market and later in streaming services.
- Amway (Quixtar North America): Mentioned indirectly due to similarities in naming conventions, highlighting potential brand confusion.
- Illegal file-sharing services: Offered alternative means of accessing video content, posing a challenge to legitimate streaming platforms like Netflix.

Company Analysis:

1. External Environment
    - Opportunities:
        i. **International Expansion**: By exploring unexplored markets such as Latin America and the Caribbean, Netflix successfully utilized its established brand awareness and streaming proficiency to attract new members and augment its income growth.

        ii. **Partnerships:** Netflix collaborated with content producers and distributors to secure exclusive deals for enhancing their online content library. These new exclusive deals led to new partnerships and helped them boost their market share and draw in more clients.

iii. **Technology Advancement**: With the advancement in technology, Netflix was also able to deliver content through more devices and make picture quality sharper, which would make people want to use their product more.

- Threats**:**
  i. **Competition:** Netflix had to compete with several companies that also offered streaming services. This competition made it tough for them to keep their customers happy.

  ii. **Content Availability:** Netflix was sometimes unable to obtain the newest films because the studios demanded higher fees. Because of this, Netflix was less enticing than competing providers.

  iii. **Changing Consumer Preferences:** Netflix's DVD rental business suffered as more and more customers switched from renting DVDs to streaming them. They had to adapt to the changing needs of the public or else they would lose more clients.

2. Internal environment
- Strengths**:**
  i. **Loyal and Large Customer Base:** Netflix provided customers with a vast variety of content including multiple critically acclaimed movies and series which helped them build a large and loyal customer base.

  ii. **First Mover Advantage In Streaming Services:** Netflix became successful since they capitalized early on streaming technology and set themself apart from their competitors. It helped them become pioneers in the industry and set benchmarks for their competitors.

  iii. **Extensive Content Library:** Netflix provided customers with an extensive content library that included highly rated/acclaimed movies and series besides exclusively licensed content.

- Weaknesses**:**
  i. **Increasing Competition:** Netflix was facing tough competition in the streaming space. Rivals such as Amazon Video on Demand (VOD), Hulu, Apple iTunes, Google TV, and YouTube started offering exclusive content which increased the battle for viewership.

  ii. **Separately Offering DVD Rental and Streaming Services:** Netflix's decision to separately offer DVD rental and streaming services led to a significant loss in customers and a sharp decline in their stock price.

iii. **Customer's Responsiveness to Pricing:** Due to an increase in the subscription pricing, Netflix lost 805,000 subscribers leading to the stock dropping by more than 50 percent. It shows how price-sensitive the customer base is.

Sub-Issues:

Branding and Communication Errors:
The introduction of Qwikster as the name for Netflix's DVD rental service resulted in customer discontentment and confusion. This situation emphasized the need for clearer communication strategies and displayed the importance of brand consistency. To lower the negative impact on customer trust, Netflix could improve its communication strategy by consulting with customers before making major brand modifications. This would guarantee brand coherence and foster customer loyalty.

Pricing Policy and Views of the Client:
The news of price increases and the separation of streaming and DVD rental services was viewed negatively by customers, which resulted in a decline in the company's stock price and a loss of subscribers. Netflix could take a slow approach to pricing adjustments in the future, communicating clearly and highlighting the benefits of these changes to customers.

Reliance on Delivery Infrastructure:
Netflix's DVD delivery strategy was at risk due to changes made to the US Postal Service's operations. The company's vulnerability to changes in the delivery infrastructure could be mitigated by growing its distribution networks and enhancing its streaming services. Increasing the quantity of content available on the streaming platform may encourage users to rely less on physical media.

Intensified Competition and Industry Evolution:
With many new players providing streaming content, the competitive environment of video-on-demand services is evolving. This change is a threat to Netflix's existing business model. To remain competitive, Netflix might have to make investments in original content creation, secure exclusive content deals, and expand its streaming library. By doing this, the service might stand out from the competition and possibly even acquire market share.

Alternatives to the Problem:

1. **Retention-focused Pricing Strategy:** Netflix could have also reduced subscriber churn by changing prices without increasing them as much and as fast. Adding a little every quarter gives subscribers plenty of time to adjust to the new small price and causes much less of a shock than the sudden substantial increase elsewhere. Apple prices increase just enough every quarter for subscribers to get used to it, which means that the percentage of customers that quit each year decreases. By reducing the churn rate, they

reduce the drag on the user base and eventually their stock price.

2. **Collaborative Content Acquisition:** Instead of sticking to flat-fee contracts with content owners when acquiring content, it could have collaborated with content distributors to negotiate a path to get access to the best recent releases for its streaming service; experimenting with revenue-sharing or pay-per-view models to expand the streaming library without increasing costs too much, which would have made the streaming service stickier and differentiated it from the cable-based competition.

3. **Hybrid Business Model:** The company could have evolved its hybrid business model to include members who stream, members who rent physical media, and members who do both. By providing consumers with multiple options suited to different preferences and consumption patterns, the company would have managed to meld its existing infrastructure for physical media distribution with the growth of its streaming library. It would also have helped ease its subscribers into streaming, providing a transition period for consumers who were not yet ready to make the complete switch. Targeted

4. **Marketing and Education:** This brings us to what could have been done. Why hasn't Netflix explained the changes on its website and via blog posts and newsletters? Targeted marketing campaigns and educational work with subscribers would have given them the time to understand the reasons behind the changes. This kind of assessment process with customers would have made it clear to Netflix just how difficult it was going to be to change the perception that it was overcharging its subscribers. A more extensive explanation of its pricing schedule would help to avoid confusion within its entire user base. This kind of added value towards customers will be indicative of Netflix's commitment to transparency.

5. **Diversification of Revenue Streams:** Netflix could have diversified its revenue without raising subscription fees significantly. It could offer ad-supported content and premium add-on services for a higher fee, maintaining lower subscription prices while enhancing the user experience. This strategy would increase revenue streams and improve the overall service offering.

Recommendation:

Netflix should take a two-pronged approach to solving the challenge of splitting its DVD and streaming services seamlessly.

Firstly, the retention-focused pricing strategy - the sudden change in both the subscription model and its pricing was a huge shock to the customers of Netflix. Drastic changes elicit drastic reactions, which is what exactly happened in the situation of Netflix. Instead of doing both of these massive changes at the same time, Netflix should have taken a phased approach, where they would first split the brands and identify the impact on the customers while offering it as a bundle without increasing prices. Once that was confirmed, the second phase of changing prices would have to start. A key point to note here is that the pricing should change gradually, and not a 50% hike all of a sudden.

Secondly, a more root cause analysis would help Netflix to identify why exactly such measures were needed to begin with. This brings collaborative contracts to the table where instead of paying a flat fee, a percentage could potentially be chosen over a longer term. This might result in greater fees being kicked back to the content owners if Netflix grows rapidly, but it also ensures that periods of low viewership do not bring the business down. Another case study on how detrimental fixed-fee contracts are can be found by exploring Spotify's business model - when the business grew big, it simply could not keep up with the costs.

Impact on Users and Objectives:

Netflix Subscribers:

The proposed changes would significantly affect the user as the splitting of two companies is still suggested. However, the pricing would be in the favour of the users since a phased approach will be used. This is likely to benefit them as the hike would not be so sudden. Moreover, with better contracts, Netflix could potentially offer better prices to the users compared to their competitors.

Reed Hastings:

Reed Hastings' initial plan would still be followed but in a different way. The approach Hastings has taken left the customers feeling significantly isolated. If the new approach works as expected, it might put the leadership of Reed Hastings into question and might affect his motivations.

Investors:

The investors will be negatively affected in the short term since there will be costs associated with splitting the brands and conducting user research. However, a systematic approach like this will keep their investments safer, rather than causing the share value to dip by 50%.

Industry Analysts / Journalists:

Netflix's systematic approach might set the industry standard for brand "demergers" and become a positive case study for industry analysts and journalists.

United States Postal Service (USPS):

In the event that the research results show that the income from DVDs does not outweigh the costs of operating that arm of the business, the USPS shipping might be significantly reduced. Moreover, with more and more last-mile delivery options being available, USPS might lose the business of Netflix altogether.

Competitors:

Netflix will still be actively competing in both DVD and online streaming spaces. However, with better contracts and a tiered approach to price increases, they can take market share from their existing competitors. Also, the systematic approach will make Netflix seem like a more sensible investment. This will harm their stock value and make Netflix a better option for investment as well.

Conclusion:

The case reflects on Netflix’s trajectory from a DVD rental to a streaming platform which shows the importance of adapting and catering to customer needs. It shows Netflix's initial failure with Qwikster which led to a significant loss in subscribers and stock price. To tackle these problems, our recommendation would be for Netflix to stick to a customer-centric retention strategy where the company should cater to the customer’s sensitivity to pricing and perform a root cause analysis to avoid repeating their mistakes. Overall, the expansion and growth of the company are a part of Reed Hasting’s vision for the company which has tremendous growth potential.