**Netflix's Business Model and Strategy in renting Movies and TV Episodes**

Reed Hastings, founder and CEO, launched Netflix as an online rental movie service in 1999. Netflix is a company that distributes movies and television by streaming online and mail delivery. There are eight different membership options to choose from each varying in number of DVDs rented out at a time. Netflix also offers to stream movies and television series directly from their website to different devices (i.e. PC, Mac, iPad, iPhone, Wii, PS3). The overall goals for Netflix are simple: to build the world’s best Internet movie service and to deliver a growing subscriber base and earning per share every year.

1. **Identify the key elements of Netflix’s strategy. What competitive advantages is Netflix trying to achieve?**

**Key Elements of Netflix Strategy**

- Providing subscribers with a comprehensive selection of DVD titles
- Acquiring new content by building and maintaining mutually beneficial relationships with entertainment video providers.
- Making it easy for subscribers to identify movies they were likely to enjoy.
- Giving the subscribers a choice of watching streaming content or receiving quickly delivered DVDs by mail.
- Spending aggressively on marketing to attract subscribers and build widespread awareness of the Netflix brand and service
- Gradually transitioning subscribers to streaming delivery rather than mail delivery as the popularity of Internet-delivery content grew.

Netflix is using **six** different techniques to gain a competitive advantage.

**1. The wide selection:** In mid-2010, Netflix had about 20,000 movie titles available for streaming.

**2. The extensive information Netflix provided:** Not only did Netflix distribute the movies and television series, but the website also included extensive information about each movie and series in its rental library such as, critic reviews, member reviews, online trailers, cast and crew, length, plot synopses and subscriber ratings.

**3. The ease with which customers could find and order movies:** The recommendation software had an Oracle database. Based on the subscribers previous rentals and rating of each movie, movies similar to that title would appear on the home screen. The recommendations made it easier and faster
for the customer to select movies to rent. Netflix is also creating ties with various entertainment video providers to gain access to new releases as early as possible.

(4) Netflix’s policies of no late fees and no due dates: This technique differentiates Netflix from other local movie rentals with late fees and due dates. Netflix operates on a monthly subscription basis. The three most popular are plans $8.99 (one title out at a time), $13.99 (two titles out at a time), $16.99 (three titles out at a time), all of these subscriptions have unlimited DVDs each month and unlimited streaming.

(5) Convenience of being provided a postage-paid return envelope: There is no cost to the customer for returning the DVDs back by mail. Netflix has 50 regional distribution centers and another 50 shipping points scattered across the US.

(6) The convenience of ordering and instantly watching movies: The emphasis in 2010 had been on acquiring the rights to stream greater number of movies and TV episodes and on expanding the number of devices to which content could be streamed.

2. Analyze the evolution of the US market between 2006 and 2009 and the Netflix subscriber data (exh. 1 & 2). Identify 5 to 6 key success factors (KSF) in this industry?

In the span of 2006-2009 there has been a decrease in about $800 million in in-store rentals of movies and TV episodes on DVDs each year. In turn the by-mail rentals have increased yearly by about $500 million in 2007, grown by $800 million in 2008, and grown $300 in 2009. The digital VOD also grew yearly since 2006. By 2007 it grew by $16 million, by 2008 it grew $189 million, and by 2009 it grew by $65 million. These positive growth amounts correspond with the growth of Netflix subscribers during each period. In 2007 Netflix decreased by about a million members, in 2008 they increased by about 300 thousand subscribers, and in 2009 Netflix’s net subscriber addition during the period grew about one million subscriptions. Vending machine rentals have roughly doubled each year since 2006. With the physical purchasing of DVDs and TV episodes decreasing yearly it shows that the American public has turned to rental and VOD services to view their movies and television series.

Key Success Factors

- Being able to access movies and television series as soon as they become available to the public
Having a secure streaming network so the providers have full confidence that it can’t be hacked and illegally downloaded and distributed.

Having the quickest delivery system with the mailing DVDs to customers in the US

Owing an ample amount of new releases so there is no wait time (revise deals with the production company)

The personalized home screen to what movie Netflix thinks you will like depended upon by previous rentals

Being able to be accessed and viewed on multiple platforms (i.e. iPad, iPhone, tablets, PC, Macs, and televisions)

3. Conduct a five-forces analysis of the movie rental marketplace and define how strong each competitive force is.

Five-Force Analysis

Rivalry among competing sellers: Rivalry among competitors was very high in 2010. More and more companies were turning to streaming online and cheap rentals. Netflix however was gaining the market share of the industry.

Competitive Pressure from Buyer Bargaining Power: The buyer (consumer in this case) has a medium bargaining power. When Netflix became popular it changed the way people watched and rented movies making Blockbuster obsolete. It is also an alternative to more expensive premium channels, thus the premium channel Starz teamed up with Netflix to stream there.

Competitive Pressure from Supplier Bargaining Power: The supplier (in this case the production companies) has a low bargaining power because they want to maximize their profits and doing that means getting the movies to Netflix, VOD companies, and Blockbuster.

Competitive Pressures from Substitutes: The threat of substitution is high among the movie rental market place. A customer can view a movie through a pirated version and actually purchase the movie. Within the industry there are many different services one could use to view a movie or television series, such as, Netflix, Blockbuster, Hulu, iTunes, different cable providers, DirecTV, and premium channel providers.
Potential of new entrants: There is a medium threat of new entrance. Granted it is easy to set up a website to view movies, but it is a little harder to do it legally with the movie production companies consent. It is also a little difficult to compete with level of distribution on a daily basis that the rental companies now are doing.

4. **What forces are driving changes in the movie rental industry? Are these driving forces likely to be favorable or unfavorable in term of their effects on competitive intensity and future industry profitability? Why?**

The driving forces in the movie rental industry are accessibility, cost for the customer, and how close to the release date can they be rented. These driving forces will likely be favorable in the competitive intensity and future industry profitability.

The first driving force is the accessibility of the movies and television series. The industry is moving toward online streaming rather than actual rental. The streaming is much for convenient for the customer because there is no wait time from when they rent the movie to when they can watch it. With streaming a video versus the physical DVD there are many more devices that it can be watched on. If a customer is still viewing it at home then he/she can watch it on the computer or the television. However if the person is on the go the Internet streaming allows the consumer to be able to view the program on an iPhone, iPad, or laptop.

Netflix is especially trying to convert more of their movie rentals to online streaming for three main reasons. First it would cut out having to pay for the postal on DVD orders and returns. Second it would not have to contain and manage an ever-larger inventory of DVDs. Finally it would have to increase its distribution centers due to the increase in DVD rentals to keep it at one business day delivery time.

The second driving force in making changes in the industry is the cost to rent a movie. If the customer feels that a particular cost for a rental is too high then they will simply switch to a different supplier. Redbox is the cheapest way for a customer to rent a movie for one day it is only $1, there is also no monthly fee. It is very easy for someone to go online and watch a movie illegally and that will happen more often than not if the cost to rent a movie is not reasonable.

The final driving force in making changes in the movie rental industry is how close to the release date of the movie can it be rented. For example the VOD services provided by different cable companies can stream the movies as soon as they can be rented. On the other hand it take Redbox more time for all the DVDs be get distributed to
each kiosk for the customer to purchase. In general if you are going to rent a movie then you will view it once and then return it. You are not likely to rent it again with in the next month or two. With the VOD cable companies getting first "dibs" on the distribution of the content a consumer is more likely to choose what is first offered to them.

5. **Develop a strategic group map of the movie rental industry** *(Netflix, Blockbuster, Redbox, and VOD providers as a group). How attractively is Netflix positioned on the map? Explain.*

![Strategic Group Map](image)

Netflix is positioned quiet attractively on the strategic group map. Netflix is the new industry leader in video rentals. Blockbuster was once one of the leaders in the industry and now it is at the very bottom. Netflix has the highest market share due to its innovative way of distributing DVDs and allowing the consumer to view them. Never having to leave your house to rent a DVD was not thought of until Netflix was founded. Their quick delivery, extensive reviews, and personalized membership recommendations are the reasons for the increasing subscribers and market share. The only way it could become more accessible is to have more movie being streamed online versus mailing. All the new releases for
Netflix movies and television series can only be watched if you have the DVD mailed to your house with a wait time of one business day, while the VOD providers of new releases can be watched instantly.

6. What is your appraisal of Netflix financial performance based on the data in Exhibits 2, 3, and 4? What positives and challenges so you see in Netflix’s financial performance?

### Netflix Financials

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<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>$1,670.30</td>
<td>$1,364.70</td>
<td>$1,205.30</td>
<td>$996.70</td>
</tr>
<tr>
<td><strong>Growth rate</strong></td>
<td>22.39%</td>
<td>13.22%</td>
<td>20.93%</td>
<td></td>
</tr>
<tr>
<td><strong>Net Subscriber Additions during the period</strong></td>
<td>2,878</td>
<td>1,911</td>
<td>1,163</td>
<td>2,137</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$115.9</td>
<td>83</td>
<td>66.7</td>
<td>49.1</td>
</tr>
<tr>
<td><strong>Profitability</strong></td>
<td>6.94%</td>
<td>6.08%</td>
<td>5.53%</td>
<td>4.93%</td>
</tr>
<tr>
<td><strong>Cost of goods sold</strong></td>
<td>$1,079.30</td>
<td>$910.20</td>
<td>$786.20</td>
<td>$627.00</td>
</tr>
<tr>
<td>% of revenue</td>
<td>64.62%</td>
<td>66.70%</td>
<td>65.23%</td>
<td>62.91%</td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
<td>$399.10</td>
<td>$332.90</td>
<td>$327.40</td>
<td>$305.50</td>
</tr>
<tr>
<td>% of revenue</td>
<td>23.89%</td>
<td>24.39%</td>
<td>27.16%</td>
<td>30.65%</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$679.70</td>
<td>$617.90</td>
<td>$679.00</td>
<td>$608.80</td>
</tr>
<tr>
<td><strong>ROA</strong></td>
<td>17.05%</td>
<td>13.43%</td>
<td>9.82%</td>
<td>8.07%</td>
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</table>
Revenue Growth

The year-to-year growth for the range of 2006 to 2009 is very substantial, which makes sense because it is in the early years of the company and there is much expansion in this time. With the exception of 2008 (due to market recession) Netflix was growing at 20% every year. Even with the recession they were still able to have some growth by just over 13%. Again with the exception of 2008 the revenue of Netflix grew by $300 million each year. One of the main causes for this change was the population switched for normal DVD rental to online streaming. The population also wanted a faster and cheaper way to watch DVDs, and Netflix was the company to supply that service. Another reason for the rapid growth was that Netflix was a very individual company, meaning that there were not many like it, so it had the opportunity to grow so quickly. The trend of the revenue is satisfactory from 2006 to 2009.

Net Profitability

The profitability percentage of revenue of Netflix has increase every year in the range of 2006 to 2009. Netflix has always made a profit from 2006 to 2009, but some years were better than others. The highest net income was in 2009 with over $115 million in profitability. This can be attributed to many different factors. The first would be the growth in the number of subscribers over the four-year span. Another would be that the growth of the company was very rapid. The trend of the profitability is positive because it is ever increasing.

Analysis of Major Cost Categories

Every year the dollar amount of cost of goods sold and operating expenses increases. However this is due to how much the company has expanded in the four years, they need to purchase more DVDs and open more shipping locations for fast delivery. These major cost categories have been pretty consistent in terms of the percentage of the revenue it is using over the four-year span of 2006 to 2009. In order to increase the profit Netflix has to decrease of the major costs, just cutting down 3% or 4% of the revenue used can make a big difference over all.

Assets

In the four-year span the assets have been positive. In 2008 it dipped because of the recession but it recovered nicely the next year have more assets than ever before. The numbers are not that substantial for the assets because the cost of the inventory is relatively cheap. The return on assets is increasing every year because the

<table>
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<tr>
<th>Total Equity</th>
<th>$m</th>
<th>$199.10</th>
<th>$347.20</th>
<th>$429.80</th>
<th>$414.20</th>
</tr>
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<tbody>
<tr>
<td>ROE</td>
<td>%</td>
<td>58.21%</td>
<td>23.91%</td>
<td>15.52%</td>
<td>11.85%</td>
</tr>
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</table>
number of subscribers in increasing and their company has to grow with the customers.

7 Conduct a SWOT analysis of Netflix. How attractive is Netflix overall situation?

<table>
<thead>
<tr>
<th><strong>Strengths</strong></th>
<th><strong>Weaknesses</strong></th>
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</table>
| ❖ Personalized home screen that provides recommendations for the customers next DVD rental or stream  
❖ The extensive background Netflix provides for each movie or TV series, (critic reviews, member reviews, online trailers, cast and crew, length, plot synopses and subscriber ratings)  
❖ Length of the delivery of the DVD being only one business day  
❖ Just with the streaming titles alone there were 10,000 movies to choose from in 2010  
❖ Ample types of membership variations  
❖ Affordable cost per month  
❖ Unlimited movie rentals  
❖ Strong brand image  
❖ 50 distribution centers and an additional 50 shipping points’  
❖ No late fees or due dates, the longer you have a DVD only hurts you because you can only have a certain amount of DVDs out at a time | ❖ Some of the DVDs arrive scratched  
❖ Sometimes there is the wrong DVD in the sleeve  
❖ Only older movies are available to be stream instantly |

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<th><strong>Opportunities</strong></th>
<th><strong>Threats</strong></th>
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| ❖ Start to distribute video games to widen customer base  
❖ Have other premium channels like HBO, Showtime, and Cinemax stream their series and | ❖ If VOD providers lower the cost to rent a movie it would hard to compete with the instant stream of a newly released movie  
❖ More and more people could just |
movies through Netflix
- Work with movie providers to get new movies quicker
- Set up their own kiosk where member have free access, but it still takes up one of their titles out.
- It is more than likely that a family has a subscription to Netflix, to have a personalized page for recommended choices per family member. There is still only one Que, but the search is narrowed down because the individual that is trying to find a movie can be provided for his/her.

Netflix has a very attractive situation in the SWOT analysis. There are more opportunities than threat for Netflix, which indicates that there is more room for growth in the company than what has already been achieved. Netflix has a lot of strengths and needs to keep creating a strong brand name with loyal customers. Its biggest weakness is the lack of new movies and television series available to be instantly watched. If Netflix wants to complete shift its customers to being streaming videos than it needs to update its library in that category. As long as Netflix keeps innovating they will be a successful company and an industry leader.

8. **Conduct an un-weighed competitive strength assessment comparing Netflix, Blockbuster, and the VOD providers as a group, using the methodology presented in Table 4.4 of Chapter 4 and the 5 KSF’s you indentified above. How does Netflix’s competitive strength compare against that of Blockbuster and rival VOD providers?**

<table>
<thead>
<tr>
<th>Key Success Factors</th>
<th>Netflix</th>
<th>Blockbuster</th>
<th>VOD Providers</th>
</tr>
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<tbody>
<tr>
<td>Providing subscribers with a comprehensive selection of DVD titles</td>
<td>10</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Acquiring new content by building and maintaining mutually beneficial</td>
<td>9</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>Strength</td>
<td>Rating 1</td>
<td>Rating 2</td>
<td>Rating 3</td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Relationships with entertainment video providers.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Having the quickest delivery system with the mailing DVDs to customers in the US</td>
<td>9</td>
<td>4</td>
<td>10</td>
</tr>
<tr>
<td>Owning an ample amount of new releases so there is no wait time (revise deals with the production company)</td>
<td>8</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>The personalized home screen to what movie Netflix thinks you will like depended upon by previous rentals</td>
<td>10</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Being able to be accessed and viewed on multiple platforms (i.e. iPad, iPhone, tablets, PC, Macs, and televisions)</td>
<td>10</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>56</strong></td>
<td><strong>18</strong></td>
<td><strong>48</strong></td>
</tr>
</tbody>
</table>

Netflix has much more competitive strength against the other competitors. Netflix’s innovative selection and distribution method sets them apart from the other competitors. It has the largest library of available movies that any other company.
9. Are you satisfied with Netflix overall performance? Do you have any concerns? What 3-2 top challenges and priority issues does Netflix management need to address?

I am satisfied with Netflix’s overall performance in the years 2006 to 2009. Their rapid growth is a sign that the company is headed in the right direction. Netflix is not only gaining millions of member every year but they are also retaining membership from previous years. Netflix sets itself apart from the competition by being so personalized in the movie election process. With over 20,000 titles a program to narrow down the search to the ones that the customer is really interested in viewing is extremely beneficial and makes the company run more efficient. The extensive reviews of the film is also extremely beneficial to the customer, rather than having to go to multiple different websites to find the information, it is all bundled into one. My concerns would have to deal with the switching the customer from renting the DVD hardcopy to streaming online. I do not think that Netflix should be 100% online streaming. They would have to acquire many more newly released films to make the customer want to switch over to streaming. Another top concern is distributing new movies faster to the consumer. With VOD providers there is no time gap between when the movie is released and when the consumer can rent it. With Netflix there is a lag in time and with the lag in time Netflix loses potential customers to VOD providers. My final top concern is that Netflix with not be able to make deals with more premium channels and thus not expanding their movie and television series even more.

10. What recommendations would you make to Netflix CEO to insure it meets it objectives in the future and to address the top challenges and issues indentified in question 9.

1.) To set Netflix apart from the competitors it needs to become more personalized. Each member of the household that has the subscription has a sub page with their own interests and past picks. First the customer would log in as normal, but then they would click on their own tab to view their personalized page.

2.) Netflix needs to expand to having more premium channels such as HBO and Showtime streaming online.

3.) Make certain deals with the production companies of the films to receiving the DVDs before they are released to the public so they can immediately send them out once they can be released. In other words it cuts out the lag time from when they are released to when Netflix gets them.

4.) There is not a way to make the delivery of the hard copy of the any faster than one day, but there needs to be more of the DVDs of new releases to get out to the customer so they don’t get sold out. Netflix would renegotiate their current deals with the providers with the license agreement. For the first two months other the release there would be
triple the amount they normally have to reach all the customers. After the two months Netflix could sell the extra DVDs to Redbox or Blockbuster and gain a small profit.

5.) Netflix should set up their own kiosk where members have free access, with a membership card, but it still takes up one of their titles out. The quicker the customer gets the DVD back the more points he/she will get and adding up with points the customer can receive an additional movie title rental for an upcoming month.

In conclusion Netflix is a quickly growing company with more and more customer loyalty. Over 90 percent of surveyed subscribers said that they would recommend the Netflix to a friend. This high customer satisfaction is rare in the movie renting industry and it shows a huge potential for growth in upcoming years with new subscribers. Reed Hasting had personally engineered the company’s creative but simple subscription-based business model and strategy that had catapulted Netflix into becoming the world’s largest online entertainment subscription service and revolutionized the way that many people rented movies.
Netflix Case Study

Taylor Nisbet
2/21/2012
Strategy