

CHAPTER CASE STUDY

THE NETFLIX ROLLERCOASTER⁶⁴

Founded in 1997, Netflix revolutionized the movie rental industry, attracting 36 million subscribers in over 40 countries today. With no brick-and-mortar stores, the marketing strategy relied on taking customer orders online and mailing the movies to their homes. Reed Hastings, the CEO of Netflix, came up with the idea after being charged late fees for keeping a rental movie past its due date. His concept offered convenience and no late fees; users could keep the movies as long as they wanted. The company quickly grew, reaching 1 million subscribers by 2002. Customers could choose from several flat-rate monthly subscription options and keep up to eight movies out at a time. Videos were returned using a prepaid and preaddressed envelope. Netflix then automatically mailed the next video on the customer's video queue. Customers could change and update their queues as often as they wanted.

The growing number of customers and profits made Netflix's management and stockholders quite happy. Observers praised it as a top company, a great investment, and a stellar example of how innovation could drive profits and growth.

Netflix was innovative, yet careful analysis of the situation suggested some serious threats. First, several competitors had entered the market to compete directly with Netflix. In the United States, Blockbuster, which enjoyed great name recognition, added mail delivery services to its existing brick-and-mortar stores. Redbox came onto the scene, allowing patrons to borrow first-run, popular movies from conveniently located boxes for just \$1 per day. Second, the U.S. Postal Service noted the need to shut down hundreds of local branches and possibly halt Saturday service. This threat was significant since Netflix relied heavily on the mail to help it get movies to customers quickly. Third, some cable companies and satellite operators were doing more with pay-per-view options. Not limited to special events or boxing matches, this model was being applied to movies immediately after their video release.

In response, Netflix started down a new path: Customers could view unlimited streaming of movies and TV shows for the same monthly fee they were paying for receiving discs in the mail. The new offering was a nearly instant hit, picked up and enjoyed by most of its subscribers. This response encouraged Netflix to expand the option. In addition to streaming through their computers, users could use platforms that would deliver its titles to the Nintendo Wii, Xbox 360, PlayStation 3, and TiVo. Hardware options from Panasonic, Insignia, and Seagate soon joined, though even these were outshone when Netflix also introduced an iPad application.

While the company responded to these threats, it made a series of strategic missteps. Netflix realized it was leaving money on the table by providing both mail and streaming service for the same price it had previously been charging for just the mail service. It was offering more value and reasoned that it could charge a higher price.

It launched a streaming-only plan for \$7.99 per month in November 2010. At the same time, it increased the cost of each of its DVD plans by \$1 each. If customers wanted both, they could sign up for the streaming plan and add DVDs for \$2. Netflix anticipated that most users would drop the mail service, because so many consumers seemed heading toward streaming. But they discovered that subscribers wanted both. The selection of titles for the mail service was significantly greater than that available through streaming, so customers still found value in it.

In July 2011, Netflix announced a disastrous new pricing plan. For unlimited streaming, customers paid \$7.99 per month. For one-disc-at-a-time (the most basic mail plan), customers would pay \$7.99 per month. If they wanted both, they paid \$15.98. Customers were furious. For many of them, the new plan represented a 60 percent price hike. About 1 million customers dropped the service. The negative press about the company, especially in social media, was intense. On Netflix's own blog, more than 12,000 comments were posted in response to the announcement, and readers would be hard pressed to find one with a positive tone. But investors considered the price move a smart one, and Netflix's stock prices rose.

Two months later Hastings tried to spin the DVD rental business off under a new name, "Qwikster" and use Netflix for the streaming business. Now, in addition to paying more, customers would need to visit two separate Internet sites to manage their movies, rather than just handling streaming and mail services on Netflix.com. It took less than a month for Hastings to back down and reverse the split. Both services would stay with Netflix, though the price increase would remain in place. But the damage had been done. More customers left and Netflix's stock price plummeted.

Canadians, of course, were not impacted as this drama unfolded in the United States. That's because when Netflix launched its service in Canada in September 2010, only streaming was offered. Introductory offers allowed Canadians to get one month free and then pay \$7.99 a month thereafter. While many customers signed up, some were disappointed to learn that the large selection of movies and TV shows their American friends could choose from was not available in Canada due to licensing issues. Although there are 10,625 unique titles available in the United States, the Canadian library offers only 2,647. With over 2.5 million Canadian subscribers, it's not surprising that Netflix followed this first foray into international waters by expanding further: Latin America and the Caribbean in 2011, the United Kingdom and Ireland in early 2012, and Finland, Denmark, Sweden, and Norway in late 2012.

Competition, particularly in the United States, has further intensified. Netflix faces multichannel video programming distributors such as HBO GO and Showtime Anywhere in the States and SkyGo and BBC iPlayer in the United Kingdom. Cable companies Time Warner and Comcast provide on-demand content. Additionally, direct broadcast satellite providers (DIRECTV, Echosat) and telecommunications providers (AT&T, Verizon) are hot on Netflix's heels. More recently, Amazon.com, iTunes, Walmart, and Best Buy have all introduced online movie viewing. That competition has been slower to materialize in Canada.

While Netflix believes that international expansion will provide a significant source of growth in the future, for the time being, having to grow a member base from scratch takes time. The marketing and licensing costs involved in establishing new markets has resulted in bottom-line losses and the company expects significant losses for the near future. As the company pursues a strategy of market development, the ups and downs of international expansion must feel a little like being on a roller coaster.