Analysis of Netflix

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NETFLIX

**SECTION I: OVERVIEW**

**Company Information**

Netflix is the world’s leading video rental company that offers both physical disc rentals and streaming video on demand service. The company was founded in 1997 in Scott Valley, California by Marc Randolph and Reed Hastings. It is headquartered in Los Gatos, California and has over 44 million members in more than 40 countries enjoying more than one billion hours of TV shows and movies per month, including original series (Netflix.com). With a low monthly price per month Netflix customers can watch TV shows and movies anytime, anywhere and can even play, pause and resume watching without commercials and commitments. Members can even rate the movies or the TV shows they have watched in the website so that Netflix can predict and pair them accurately to movies and TV shows they will enjoy.

**Principal Industry**

The principal industry and primary NAICS code under which Netflix operates is DVD, game and video rental in the US (#532230).

**Products/Services offered**

Product/services provided by Netflix:

* DVD or Blu-ray section of movies or TV series by mail service with no late fees ever and free shipping both ways
* Unlimited online streaming of movies and TV series
* Accessible in Wii, PS3 and Xbox 360, Roku, Windows and Mac laptops, as well as your regular television and internet-connected television, and all hand-held devices such as smartphones, iPad, iPod Touch and iPhone
* One month free trial to prospective customers
* No cancellation fee
* Parental control features

**Competitors**

In the industry of Music and Video stores Netflix principal competitors are Amazon, Comcast, Hastings Entertainment Incorporation, and Verizon Communication Incorporation. Netflix has a market capital of $20.29 billion, well above the industry average of $8.83 billion. Amazon has a market capital of $146.40 billion, Comcast $132.52 billion, Hastings Entertainment $23.94 million, Verizon Communication Incorporation $195.30 billion (Yahoo Finance). Compared to the industry average the relative worth of Netflix and its four competitors are high.

Netflix price to earnings ratio of 175.81 indicates a higher expected earnings growth in the future for investors compared to its competitors. Amazon was the only company that surpassed Netflix in the price to earnings ratio with a price to earnings of 527.01. This can be due to the fact that Amazon is a bigger company than Netflix and or Amazon is trading at a higher share than Netflix (Yahoo Finance).

**Market Share**

The above competitors including Netflix has formed an industry average of $92,040,983.00. Of that industry Netflix has a market share of 4.75% (Value Line Investment). Verizon has a market share of 15.95%, Amazon 8.90%, Comcast 69.90%, and Hasting 0.05% (Value Line Investment).

Note: Information from Value Line Investment, Annual Reports.

**Industry Trend**

Depending on how competition evolves, Netflix could possibly reach a subscriber base of 40 million by the end of the forecasted period, 2019. Even though companies like Amazon and Comcast may be a challenge to Netflix, Netflix can sustain if these companies do not continuously improve their content.

Netflix experienced rapid growth up until 2011. The company started as a by mail DVD rental company which transformed the U.S. movie rental market. Netflix added convenience to customers experience by delivering DVDs to their front door, which eliminated the hassle of traveling a rental stores such as Blockbuster. In 2009, the company went from having 12.3 million to 24.4 million subscribers within two years. This led to a push into streaming, which was initially added as a free add-on service for DVD subscribers and later became Netflix’s mainstream offering. Netflix adapted from a by mail DVD rental company to an online streaming service provider, which increased its revenues from $270 million in 2003 to 3.12 billion in 2011.

The growth for Netflix stimulated the growth for U.S. movie rental market. The total movie rental market in the U.S. grew from $9.4 billion in 2006 to $9.8 billion in 2009 and continues to grow. The growth of Netflix also contributed to the shutdown of traditional DVD rental stores, such as Blockbusters. Blockbuster’s U.S. revenues declined from $2400 million to $970 million during Netflix’s growth. The devastating decline force Blockbuster to close underperforming stores (Trefis).

**Major Challenges**

The first challenge facing the online streaming industry is content. With streaming content becoming more common, companies will have to pay substantially higher prices. The rising price is due to increasing consumer demand and competitive bidding from other providers, but also the result of streaming-content solely having evident value to the content owner.

The second challenge is competition. Companies within the industry have many strategies to try to gain a competitive advantage. If another company offers a service that is equal or better content at a competitive price, consumers will typically choose the option that will best benefit them. Many companies are hoping to create a new option for improved quality and value-conscious consumers that are looking for a simple and affordable way to access the video entertainment they desire.

**Possible Opportunities**

 Netflix and its competitors are well aware of the demand for their products. As viewing trends continue to emerge, and the idea of stabilization in the streaming video market is unclear, the continued success of these industries will depend largely on the company’s ability to react to changing viewing habits and new technologies in a timely manner.

**SECTION II: FINANCIAL ANALYSIS**

**Gross Revenue of the total industry**

According to Ibis World Netflix’s industry had total revenues of $189 Billion dollars in 2013. Ibis World also reported that the industry has been growing at approximately 4.3% for the last 5 years (IbisWorld).

**Gross Revenue for Netflix and its major competitors in 2011, 2012 and 2013**

|  |  |  |  |
| --- | --- | --- | --- |
| **Company** | **2013** | **2012** | **2011** |
| Netflix | $4,374,562 | $3,609,282 | $3,204,577 |
| Amazon | $74,472,000 | $61,093,000 | $48,077,000 |
| Comcast | $64,335,000 | $62,570,000 | $55,842,000 |
| Hastings Entertainment | $462,501 | $496,387 | $521,055 |
| Verizon | $120,550,000 | $115,846,000 | $110,875,000 |

Note: Information from Value Line Investment, and Hastings Entertainment Inc., Annual Report

**Profit Margins for Netflix and primary competitors**

|  |  |  |  |
| --- | --- | --- | --- |
| **Company** | **2013** | **2012** | **2011** |
| Netflix | 2.90% | 0.50% | 7.10% |
| Amazon | 0.40% | 0.20% | 1.30% |
| Comcast | 9.70% | 9.60% | 7.80% |
| Hastings Entertainment | -2.01% | -3.54% | 0.33% |
| Verizon | 6.60% | 5.52% | 5.50% |

Note: Information from Value Line Investment, and Hastings Entertainment Inc., Annual Report

Note: Information from Value Line Investments



Note: Information from Yahoo Finance

Note: Information from Yahoo Finance

**SECTION III: BASES OF COMPETITION:**

Internet TV has been very popular in recent years because viewers can have unlimited access to television and movies online without any ads and also because the subscription fee is less than Linear TV subscription. Netflix was the first company to make internet TV successful and as the internet TV grows from millions to billions Netflix is leading the way. Netflix has its advantages over its competitors in terms of subscriber base, content quantity and quality, device reach and brand image, the potential strength of the competitors and its intentions cannot be ignored. Furthermore, to draw attention from customers and attract them to sign up with Netflix has been adding some originals and exclusive programming to its website such as House of Cards, Lily Hammers and Arrested Development.

For Netflix to be a hugely successful they are focused to be a passion brand.(Netflix.com) The company is all about flat rate fee unlimited viewing commercial free. Members have no hassle of online cancellation and they can leave and come back whenever they want.

**Competitive Advantages of the Company and Principal Competitors.**

As, Morgan Stanley analyst Scott Davit states Netflix competitive advantages are:

1. Iconic brand in streaming video

2. Significant lead in over the two device distribution

3. An unrivaled portfolio of subscription- based digital content rights

4. Best in class technology architecture

Amazon’s competitive advantages is that it offers Prime members its services for $79 a year which is equivalent to $6.58 per month this includes two day shipping, unlimited streaming of movies and TV episodes and available to borrow eBooks for kindle owners (Amazon.com). According to Tom Taylor, Vice president of Amazon Payments, “Amazon has more than 215 million active customer accounts.” So if Amazon can convert 20% of its member to Amazon Prime than 40 million people have access to online streaming video of movies and TV episodes.

Verizon operates the most advanced broadband network in the US. It delivers 100 % fiber technology with 300-megabit capacity for homes and small business (Verizon.com). With the FIOS it provides powerful technology with fast and reliable broadband, high-quality HD video and rich interactive service.

Hasting Entertainment is leading multimedia entertainment retailer. Customers can buy, sell, trade and rent various home entertainment products in wholesale price. They offer lower price than charged by other retailers in the market (Hasting.com).

Comcast has a first mover advantage in introducing DOCSIS 3.0/wideband which provides high speed internet over the cable line which enhance its internet and VOIP offerings. They offer advance services including high definition television (HDTV) and digital video recorder (DVR). Beside range of premium channels that broadcasts films, concerts and sporting events without any commercial it also gives it costumer’s option of “on demand service”. This service provides selection to more than 10,000 standards and high definition programs for full month and are charged on pay per view basis (Comcast.com).

**Role of technology and intellectual property in this industry**

Blockbusters used to rule the movie rental business, but as Netflix came into the market the company gained dominant leadership in the industry due to its Internet streaming, convenient customer service and a virtual organization to deliver it cheaply and flawlessly. The company is more focused on spending resources on technology that can spread over many more markets and households as the company expand. As CEO Mr. Hasting stated, “Our advantage internationally is our global tech spending for improving app and service, our process knowledge, our data from related markets.”

**SECTION IV: LOGISTICAL MANAGEMENT and VALUE CHAIN**

**Mission of the Company**

During the Dublin Founders Conference in October 2011, co-founder and CEO Reed Hastings expressed a clear vision for Netflix: “becoming the best global entertainment distribution service, licensing entertainment content around the world, creating markets that are accessible to film makers, helping content creators around the world to find a global audience.” Netflix has also published its company values: judgment, productivity, creativity, intelligence, honesty, communication, selflessness, reliability, and passion.

**Core Competencies of the Company**

Netflix’s core competencies include their originality and distribution. Not only does Netflix provide newly released movies, they have a very large variety of movies to attract different target markets which they make available to customers for one flat fee per month. Netflix uses a “Netflix Recommendations” approach in targeting the interests of their customers. The Netflix website generates these recommendations by using an algorithm which instructs Netflix’s servers to process information from its databases to determine which shows/movies a customer is likely to enjoy. Netflix has original programming including House of Cards, Orange is the New Black, Lily Hammers and Arrested Development. Netflix provides customers both discs and online content to satisfy the customer’s preference.

**Inbound Logistics and Supplier Dependencies.**

For Netflix’s inbound logistics they must be able to have ownership of content for online streaming. They must also keep certain numbers of discs ready for distribution at all times.

**Outbound Logistics and Principal Distribution Channels of the Company.**

For Netflix’s outbound logistics the content must be accessible to stream online. The United States Postal Service (UPS) delivers discs to customers.

1. **Netflix’s Vertical Integration**

Netflix partakes in vertical integration through their introduction of their own television shows.

This allows them to enter the television production market in addition to their existing place in the distribution market.

1. **Netflix’s Outsourcing**

Netflix outsources by using Amazon’s Web Services (AWS) for services and delivery of online

Video streaming. This enables Netflix to quickly deploy thousands of servers.

1. **Netflix’s Off shoring**

With the current structure and strategy of Netflix there are no “offshoring” operations. The company does operate internationally, and in each international domain the company has an operational headquarters.

**SECTION V: MARKETS and MARKETING**

In the International streaming segment, Netflix launched their streaming service in Canada in September 2010 and have continuously expanded their services internationally with launches in Latin America in September 2011, the U.K. and Ireland in January 2012, Finland, Denmark, Sweden and Norway in October 2012 and most recently the Netherlands in September 2013. According to their annual report Netflix plans to continue to expand their services internationally and expects a substantial European expansion in 2014 (Netflix Annual Report.)

|  |  |  |  |
| --- | --- | --- | --- |
| **Membership Basis (in thousands)** | **2013** | **2012** | **Percentage Growth** |
| Domestic Customers | 33,420 | 27,146 | 23.11% |
| International Customers | 10,930 | 6,121 | 78.57% |

Note: Netflix 2013 Annual Report

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Revenue Distribution (in thousands)** | **2013** | **2013 % of Total Revenues** | **2012** | **2012 % of Total Revenues** |
| Domestic Revenues | $2,751,375 | 79.43% | $2,184,868 | 88.37% |
| International Revenues | $712,390 | 20.57% | $287,542 | 11.63% |

Note: Netflix 2013 Annual Report

**Marketing Strategies: Identify Primary Marketing Strategies of Netflix & Competitors**

Netflix and their competitors utilize a broad mix of marketing and public relations programs, including social media sites such as Facebook and Twitter, to promote their services to potential new members. Additionally, Netflix uses well-placed ads on such movie sites as the Internet Movie Database, Fandango and Rotten Tomatoes. These efforts are also combined with direct mail efforts (Netflix Annual Report.)

**Product Life Cycles: Comment on the life cycle of the Company’s Primary products**

The market segment for online subscription-based entertainment video has grown significantly. Much of the increasing growth can be attributed to the ability of Netflix’s members to stream TV shows and movies on their TVs, computers and mobile devices. Netflix offers two very different services: streaming and physical media delivery. Netflix was one of the first to enter the online video rental industry in the introduction stage. The company gained more than 25% of market share within its first ten years and is currently experiencing both growth and maturity in the product life cycle (Netflix Annual Report). If we separate the products, we see that the streaming market shows a pattern of growth while physical DVD and Blue-Ray rentals show a pattern of maturity.

Within the next 12-18 months Netflix will work in the growth stage of the media streaming product life cycle. It plans to develop and introduce new streaming technology to the market that will increase revenue and market share; especially in the international market (Netflix Annual Report). Netflix will do this by offering more licensed internet TV and even producing its own content to strategically differentiate itself from other streaming services and compete with cable providers (Netflix Annual Report). It will do this while phasing out the weak performing video media delivery service that has declined in subscriptions since 2011 and appears to be on the tail-end of the maturity stage (Netflix Annual Report).

**SECTION VI: STRATEGIC ANALYSIS**

**Horizontal Integration and Globalization**

Netflix uses horizontal integration by acquiring services and controlling main industries interested in video distribution in order to dominate digital distribution. The company has also utilized the strategy of globalization, they have expanded their services to other parts of the world, totaling of about 42 countries. Netflix has developed their own original television programs, which exhibits the company’s efforts of vertical integration (Netflix Company Profile).

**Related and Unrelated Diversification**

In order for a company to implement corporate diversification strategy a firm has to buy multiple businesses within its boundaries. Netflix has a limited corporate diversification, most of their business transactions are in a single industry, which is movies and television. Netflix started as a DVD rental service, diversified into allowing consumers to stream movies and television shows on their personal computers. They partnered with electronic companies, which allowed consumers to stream on any electronic with internet capabilities.

In relations to unrelated diversification Netflix’s plan is to branch out into music and to become a one-stop entertainment shop. By Netflix being able to stream music and movies the company will add to its value and also capture a higher user base. Possible ways of Netflix branching into music is to provide sound-tracks for the movies it streams as well as mainstream music. Netflix will also look into expanding into e-books, which would be tailored to the consumer’s interest in movies based on similar themes or characters. Diversification will allow Netflix to increase customer satisfaction and allow them to stay competitive through these additional products (Global Strategic Management).

**Strategic Alliances/Joint Ventures**

Netflix has formed partnerships with various technological device companies such as Apple, Xbox, PlayStation, Wii, etc. that stream Netflix’s movies and television shows. The partnership allows for each company to have marketing leverage. This has allowed owners of Apple TV set-top boxes to sign up for the video streaming service directly and pay through their iTunes accounts. An alliance with cable companies will help Netflix reach more customers, and eliminate the fears of cannibalizing paid television (Daily Tech).

**STRATEGIC RECOMMENDATIONS**

**Strategic Imperatives**

* **Netflix needs to continue to attract and retain subscribers.** If the available marketing channels are curtailed, Netflix’s ability to attract new members will be adversely affected. The company also acquires a number of members that rejoin their services after having previously cancelled their membership. If Netflix is unable to maintain or replace their sources of members with similarly effective sources, or if the cost of their existing sources increases, the company’s member levels and marketing expenses could be adversely affected (Netflix Annual Report).
* **Netflix needs to continue its relationship with internet service providers.** With consumers decreasing demand for physical copies of mediait is imperative that Netflix continue to be able to remain in good standing with internet providers.Netflix recently signed a contract to pay Comcast in order to use Comcast’s internet to reach Netflix customers. If internet providers that currently provide Netflix’s services, such as Verizon and Comcast, decide that they are negatively impacting their business, or that they want to compete more directly with Netflix, Netflix may no longer be given access to their current marketing channels (Bachman, J.).
* **Netflix needs to continue to increase its ownership of media property.** As a distributor of content, Netflix faces potential liability for negligence, copyright, or trademark infringement or other claims based on the nature and content of materials that they produce, license and distribute. They also face potential liability for content used in promoting their service, including marketing materials and features on their website such as member reviews. As Netflix expands their original programming, they will become responsible for production costs and other expenses, such as ongoing guild payments. They will also take on risks associated with the production, such as completion and key talent risk. It is very difficult to accurately anticipate costs or mitigate risks if we become liable for content we produce, license and distributing. Litigation to defend these claims would be costly and the expenses and damages arising from any liability or unforeseen production risks could harm the company’s operations (Netflix Annual Report).

**RECOMMENDATIONS:**

1. Our first recommendation to management is to obtain a long-term relationship with Internet service providers. Currently, Netflix has a contract with Comcast to carry its traffic by paying Comcast a nominal fee. However, both Comcast and Verizon having recently developed their own streaming content services could decide to push Netflix out of the industry. Therefore, we encourage management to seek out other Internet providers such as Cablevision Systems to find another source of Internet. Yet, due to the enormity of Verizon and Comcast, Netflix must obtain a long-term contract with these providers if they are to survive.
2. We recommend that Netflix keep their streaming plan price a flat fee, which will give customers access to unlimited content. The Netflix website reads, “Watch TV shows & movies anytime, anywhere at only $7.99 a month.” Whether you watch one program or a hundred programs, you will only pay the flat fee of $7.99. Competitors such as Comcast offer On Demand which lets customers watch whenever they would like, restart it, pause, rewind, but the catch is you have to pay typically anywhere between $3.99 to $6.99, and that’s just for one program. On top of that, the customer only has either 24 or 48 hours to watch the program. If Netflix were to switch from their flat fee to a “pay-per-view” we feel they would lose a good portion of their loyal customer base. (Needs to be worded differently and or changed)
3. Netflix has launched its streaming online service in Canada, Latin America and in some European countries. However, looking at the annual report 2013 its international revenue is 20.57%. Our 3rd recommendation to Netflix is expand more internationally to increase its revenue. Entering into new market is expensive with spending large amount of dollar into launching and licensing to attract members and build its subscriber base. But, if the company analyze country’s culture and its local competitors before entering the new market to meet its local taste than Netflix can have an idea of where to grow and invest internationally.
4. Netflix should retain rights to their original content such as House of Cards, Lily Hammers and Arrested Development in order for Netflix to retain existing viewers and attract new customers. Not providing content to our competitors will be a great opportunity for the company to increase customer base and sales. If Netflix original series were provided through competitors like Comcast or Amazon viewers would have the option to go for “pay-per-view” and pay less to watch it. Sticking to our original content Netflix can attract uninterested customers as well. These customers who do not wish to have a Netflix account but is interested in their popular series will be forced to become a member, which lead to benefits. The company in terms of a larger consumer base. For customers it leads to them paying less. Customers are not subjected to watching only the series, but they will discover an array of options, more than what competitors can offer.

**SECTION VIII: SOURCES/REFERENCES**

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