



CASE STUDY

BA4380

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Will Netflix be able to successfully convince movie studios that they're the best medium for their streaming content?

How will Netflix maintain profits in the face of increased competition and costs?

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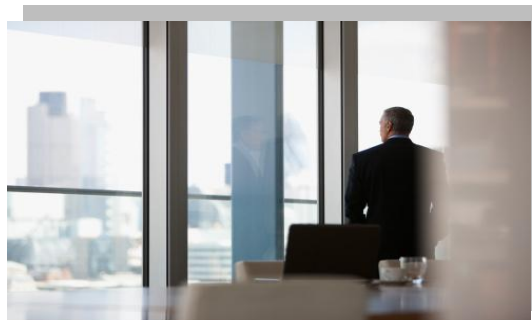
How will Netflix prevent subscriber defection and retain its current customer base?

Will Netflix be able to maintain its foundation of successful innovation and maintain its competitive advantages?

As Netflix grows internationally, will illegal downloads become a bigger issue with Netflix opening the floodgates to more subscribers across the globe?

Can Netflix offer customers an alternative such as the kiosk model currently implemented by Redbox?

Streaming video is likely to assuage the desire for instant gratification that mail delivery does not, but what about subscribers who have not made the shift to streaming video?



Company Profile

Netflix is the world's leading Internet television network with over 50 million members in nearly 50 countries enjoying more than two billion hours of TV shows and movies per month, including original series. For one low monthly price, Netflix members can watch as much as they want, anytime, anywhere, on nearly any Internet-connected screen. Members can play, pause and resume watching, all without commercials or commitments.

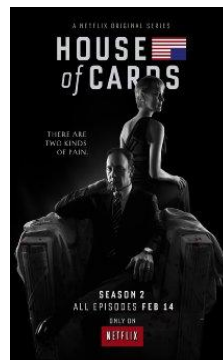


Introduction

Since the company's establishment in 1997, Netflix has drastically adapted and improved its business model to accommodate its customer base. Their vision in forming the company was to provide America with access to thousands of movie titles via an Internet ordering and shipping method. The process has been consistent throughout the years because of their monthly subscription model. However, since the early 2000's, there have been major adjustments that have propelled the company to heights that could not have been foreseen.

As of today, Netflix is the world's leading Internet network and has reached more than 50 countries compiling over 50 world-wide million subscribers. The company's ability to stay ahead of the game while remaining innovative is their driving force behind its attractive profitability. A major game changer for them these days is their monopolized ability in providing its viewers 4K streaming. 4K resolution is the newest in television technology that has hit the market in the recent months. With this extremely high resolution service, viewers are able to immerse themselves while watching their favorite shows and movies. 4K service will not be available for cable or satellite viewers until spring of 2015, giving Netflix a competitive advantage in viewers' experience.

By providing this content early on, Netflix has ensured to gain its maximum revenue from this innovation by charging a premium subscription package for this new content. Alongside streaming in 4K, Netflix has transitioned itself as not only a network provider, but also, a network producer. They have been working with major production companies in producing their own content, with hit titles such as "Orange is the New Black" and "House of Cards".

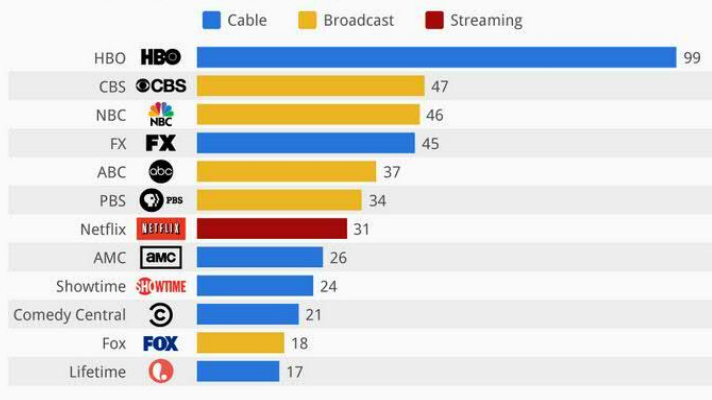


These shows are part of Netflix's huge success that has allowed them to grow in the Internet television industry. Netflix has proved to be a network to be reckoned with when "Orange is the New Black" won a Primetime Emmy Award in 2014. The series is continuing onto its third season that is set to be released in the summer of 2015. House of Cards has also won Emmy Awards.

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Netflix Challenges TV Networks at the 2014 Emmys

Nominations at the 2014 Primetime Emmy Awards



In 2010, Netflix began extending its services to Canada and the Latin American countries. This is after they expanded to a few countries in Europe. These expansions have proven to yield a sustainable amount of growth in subscriber sign ups per month. Netflix is in a continually studying its markets in order to provide content those subscribers want. In September 2014, Netflix had announced that it was going to extend its reach to Germany, France, Austria, Switzerland, Belgium and Luxembourg. These countries have a household broadband access that the company found very appealing since the broadband has capabilities of streaming video content. Netflix is also planning to expand to the Asian Pacific regions of the world in the coming years.

The company's ultimate goal is to be the global leader in Internet television within the next three to five years.

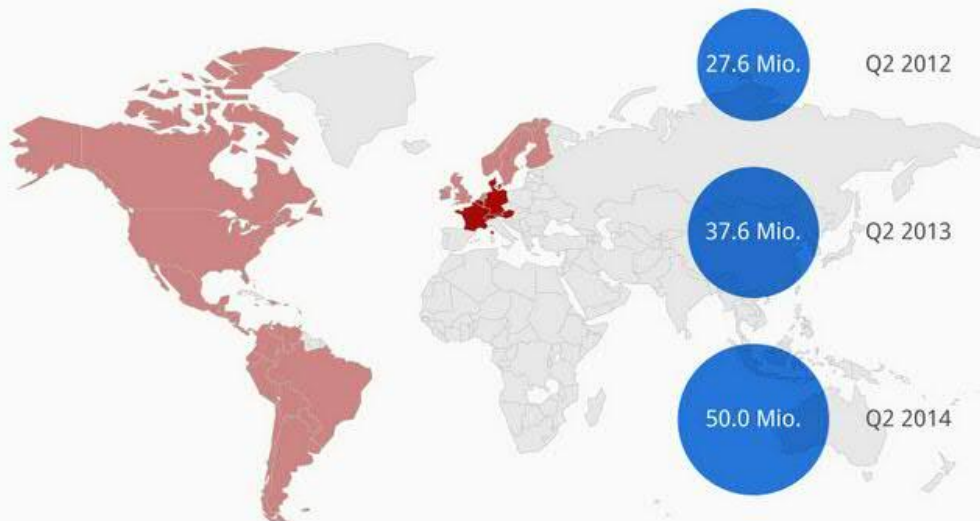


Netflix currently coordinates with its users' Facebook accounts, and analyzes subscribers' viewing history. This has allowed the company to get real-time data that could not be accurately assessed in surveys due to the inconsistency of response rates. By allowing its subscribers to rate content on a one to five star scale, the company is easily able to access what genres are most popular, actors that users prefer, or even specific titles that people would possibly enjoy watching. Netflix has also constructed a simulated A.I. system called "Max" that assist subscribers with finding content that they would possibly want to view based on movies they have rated favorable, personal preference, and history. "Max" asks the viewer questions that help them narrow down a possible movie or show choice in a comedic fashion. It is very interactive. These tools have helped reach a customer base that has exceeded their prediction back in the early stages of Netflix.

Netflix Set to Expand in Europe

Availability and worldwide subscriber growth of Netflix' streaming service

Already available Available starting September 16, 2014



History on a Timeline

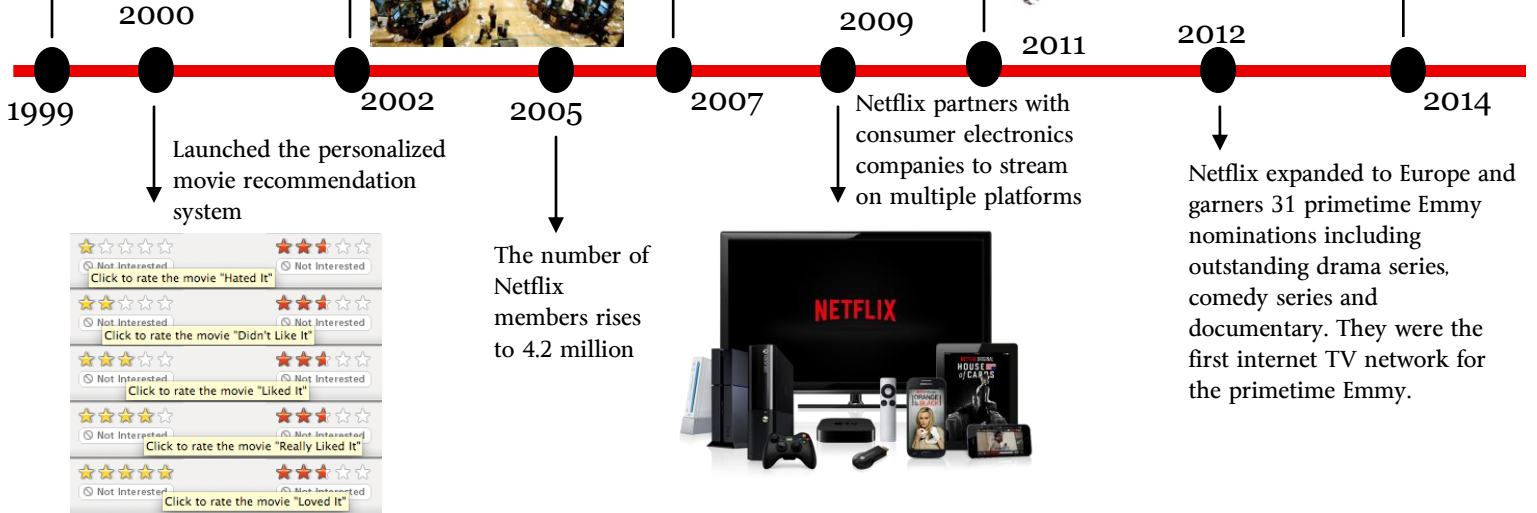
Netflix launches the subscription service, offering unlimited rentals for one low monthly subscription

Netflix goes public (\$NFLX)

Netflix introduces streaming, which allows members to instantly watch television shows and movies on their personal computers

Netflix expands into Latin America

Netflix launched in 6 new countries in Europe and now has over 50 million members globally.



Executive Management



Reed Hastings – CEO

- He founded the company in 1997. What inspired him to start Netflix was being charged \$40 for returning Apollo 13 late at a movie rental store.
- Currently serves as a board member for Facebook
- Served on the Microsoft board from 2007-2012



Kelly Bennett – CMO

- Served 10 years as VP, Interactive at Warner Bros.
- He led World Wild Marketing with the pictures group, leading international online campaigns for Warner Bros. movies.

David Wells – CFO

- Promoted to CFO in 2010 after serving as VP of Financial Planning and Advising from 2008-2010
- Prior to joining Netflix in 2004, he served in progressive roles at Deloitte.



Ted Sarandos – Chief Content Officers

- Has led content acquisition for Netflix since 2000 and has over 20 years of experience in home entertainment
- Recognized in the industry as an innovator in film acquisition and distribution



External Analysis

Competition: Online TV seems like it would be a low competition environment, just by the sound of it. However, with technological enhancements in our modern world, our consumer preferences have evolved on how we seek digital entertainment. Hulu, Amazon, Sony and HBO are among the biggest competitors faced by Netflix. Hulu is a streaming company that provides comparable, if not, almost identical services to Netflix. Amazon is also identical in service, but has two approaches of getting that media. Either you can purchase per streaming item (movie/show) or you can purchase a prime membership that gives you additional shopping benefits, and also unlimited streaming content from their library. Unlike Netflix, where all the content is unlimited, Amazon provides content that is under “Prime” and under “Purchased”. Just because you have a prime membership with Amazon, does not give you unlimited access to their library of titles. However, the items they do stream have a significant flow of viewers. Their content is often more recent, and their production studios include HBO as well as some Showtime programs. Sony Corporation currently allows streaming of movie rental services from their Playstation store. Like Amazon, no monthly service is available for access on all content. Sony does have popular demand due to its big Hollywood titles. Other movie channel services include HBO OnDemand and Blockbuster OnDemand. These services are available upon subscription or individual purchase. As mentioned earlier, none of these providers have 4K streaming resolution on their content, making Netflix ahead of the curve. Another competitor is RedBox, the kiosk renting movie company. RedBox kiosks are placed strategically outside of drug stores and McDonalds, as well as grocery stores where consumers cause a lot of traffic. RedBox does pose a threat to Netflix because of their more recent production titles and cheap, easy to use service.

Barriers to Enter Foreign Market: In order for Netflix to accomplish its international expansion plans, they need to have extensive research to enable them in providing desired content for differentiated tastes around different regions.

Beyond providing desirable content, is how they deliver that content. Netflix needs to ensure they are providing the content that is voiced over or captioned in the accurate languages to avoid conflict and turnover in subscribers. A large barrier for Netflix is getting production rights in a foreign nation. Heavy investment in attaining talented executives that are experienced in the media industry (much like Netflix’s Sarandos, Chief Content Officer) in those foreign lands will give them a political boost in companies handing them over streaming rights of a multitude of production titles that are domestically produced. In accordance with their DVD service, Netflix will also need to provide foreign direct investment in either the vertical or horizontal sense as to establish distribution warehouses for their DVD collection. Netflix is so successful in the U.S. in their DVD distribution segment because they have thousands of warehouses located at least 50 miles from each other, ensuring fast delivery to their customers. Having a strong geographical outlook will ensure they place DVD distribution warehouses in the right places in order to please their new foreign customer base that prefers the DVD option over streaming.

Environmental Threats: Netflix is exposed to significant damage that can arise from Mother Nature’s disasters (tornado/hurricane/tsunami). Their DVD distribution warehouses are worth millions of dollars in assets.

Internal Analysis

Netflix’s focus is very “Brand-Oriented”. Their investor relations page states, “For us to be hugely successful we have to be focused passion brand. Starbucks, not 7-Eleven. Southwest, not United.” Netflix does not believe in ad-supported or pay-per-view content. They are in the business for providing unlimited streaming content at a low monthly price. This has worked out well for them. In 2014, their subscriber based exceeded 50 million! Their freedom with content and on-demand service has attracted these loyal customers. Customers who have been with Netflix rave about the service they get.

Financial Analysis

Netflix recently raised prices, earlier in 2014 causing them to miss Wallstreets estimates on subscriber additions. Their third-quarter results added .98 million domestically and 2.04 million internationally, versus guidance of 1.33 million and 2.36 million, respectively. Netflix is continually investing in marketing and proprietary content which offers solid returns. The third-quarter 2014 results reported revenue of \$1.41B which is up 27% YoY. Their EPS of \$.96 is up 85% YoY. With modest growth in subscribers in the U.S. market, it poses questions to Netflix as to how much bigger their market share can get domestically. A slow growth rate in the U.S. suggests that content cost escalations may hurt them in the long run.

	Year ended December 31		
	2013	2012	2011
Revenues	\$4,375	\$3,609	\$3,205
Cost of Revenues	3083	2626	2040
Gross Profit	1291	983	1165
Operating Expenses:			
Technology and development	379	329	259
General and administrative	684	604	530
Total operating expenses	1063	933	789
Operating income	228	50	376
Other income (expense):			
Interest expense	29	20	20
Interest and other income	-28	0	3
Income before income taxes	171	30	360
Provision for income taxes	59	13	133
Net income	\$112	\$17	\$226
Net income per share:			
Basic	\$ 1.93	\$ 0.31	\$ 4.28
Diluted	\$ 1.85	\$ 0.29	\$ 4.16
Weighted-average common shares outstanding:			
Basic	\$ 58.00	\$ 56.00	\$ 53.00
Diluted	\$ 61.00	\$ 59.00	\$ 54.00

Numbers are represented in \$Millions except for income per share

Stock Price 2009-Present Mid October 2014 (Green squares represents Earnings Report Releases)



Marc Cuban, the billionaire owner, said he is racking up on shares of Netflix Inc. because the online-streaming service will be (according to him) acquired

Netflix is testing out new prices based on the number of people who can use an account, a move that could force customers to pay more for additional family members

Amazon announced that Prime subscribers will soon be able to binge on old episodes of HBO's "The Wire" and "The Sopranos"

Netflix surged to a record after projecting customer growth that topped analysts' estimates and saying it may charge new users more to share accounts

Prospects of "Seinfeld" comedic show coming to Netflix

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Strategy: Hambrick Diamond

Arenas: After their first successful international expansion to Canada in 2010, Netflix proceeded to other markets such as Latin America, the United Kingdom and the Dutch land. Their European expansion is by far their biggest single launch into new territory in the company's history. The online video-streaming company continued their European expansion launching recently into France, following a rollout into six other European countries including Germany, Belgium and Switzerland. Netflix plans to succeed in these international markets by putting a lot of emphasis on their core competencies of superior application and service created by their global technological investment, their process knowledge, data from related markets, and their brand presence. Although international expansion is one of Netflix's main focuses, they also plan on staying the market leader of streaming video on demand in the United States.

Vehicles: Netflix does not own most of the content it provides, their vehicles are through licensing. Their licensing of content is generally time based, which means they pay for a multi-year exclusive subscription video-on-demand license for given titles. At the time of renewal, Netflix evaluates how much a title is getting viewed as well as member rating feedback to determine how much the company is willing to pay. Content is bid for and licensed on a country-by-country basis, in launching Netflix's service in a new international market, the company must license a content portfolio for that country.

Differentiators: Netflix is an increasingly global Internet network offering movies and TV series commercial free, with unlimited viewing on any Internet connected screen for an affordable no commitment monthly fee. Netflix limits the complexity and frustration that embody most MVPD relationships and their customers. An example of their no-hassle online cancellation, members can leave when they want, and come back whenever they want. Netflix is about the freedom on demand and the fun of indulgent viewing. They are about the flexibility of any screen any time. Netflix is about the fantastic content that is available only through them.

Another area of focus is personalized recommendations and merchandising, which drives what content Netflix features on a member's initial screen.

Staging: Netflix's approach is to expand as quickly as possible while staying profitable on a global basis, as long as there are compelling markets to expand into, and the company is continuing to see growth in its current markets.

Economic Logic: Netflix will continue to obtain returns by retaining members and attracting new customers by winning "moments of truth" from these consumers. They win these moments of truth when members expect Netflix to be more pleasurable than their other options, based upon their prior experiences. The satisfaction comes from easy choosing, total control over when to play, pause, resume, etc. and content that suits the taste and mood of everyone in the household. Netflix invests a lot in core advantages such as streaming delivery, sign up, billing and customer service across more than 1,000 devices being used in nearly 50 countries. Netflix is well ahead from their competitors in the operational aspect, but will continue to invest heavily to make sure their service is always available, their streaming never re-buffers and their audio-video quality is pristine.