NETFLIX
Moving Forward

A STRATEGIC PLAN

MBA9150 Professional Challenge
By Geoffrey M. Miller
12 May, 2005

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NOTE: Additions, corrections or other changes that were made to these analyses since they were originally submitted appear in this report in ***bold italic***.

NETFLIX MOVING FORWARD: A Strategic Plan
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Part I: WHAT we should do and WHY we should do it.
(An executive summary of our strategy and the justification for it)
Since its creation in 1997, Netflix has grown steadily to become the leader of the online subscription movie rental market. Our initial strategy worked well, but like all strategic initiatives, the plan must be reevaluated frequently to account for changes in the company, its competitors, the market in general and the economy as a whole. "A company's vision, objectives, strategy and approach to strategy execution are never final" (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.29) Those evaluations are complete and we are prepared to make recommendations for a strategy that will move us forward.

If our business journey were a NASCAR race, we would have made good time through the twists and turns of the chicane and are now accelerating onto the back straightaway. Just as a driver approaches tight turns differently that he or she would approach a long, straight stretch, Netflix must also alter strategy to make the most of our changing situation.

Having met the challenges of getting our business started, we must now turn our attention to the demands of the future. That strategy is to build on our current momentum with the goal of achieving exponential **growth in both subscribers and revenues**. There are three important reasons why strong growth must be our focus:

1. Because we can. The stockholders that helped to build this company should now enjoy some reward for taking that risk. We are up and running; are able to build our subscriber base and revenues; and we must not hesitate to do so.

2. To make Netflix financially strong in order to respond to an aggressive assault from deep pocket competitors. Our online subscription service is already being copied by rivals such as Blockbuster.com and Walmart.com. They have the financial clout to launch an aggressive marketing assault on our brand equity and market leadership. The more of a threat we become to them, the more likely it is that such an attack will come. The sooner we can build our financial resources to counter such a move, the safer our market position will be. This will require a focus on smart **financial management**. Also, the more subscribers we can attract, the fewer there will be for our competitors to recruit. We must focus on smart, aggressive **marketing** to claim those customers FIRST. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.160)

3. To invest NOW in attaining our future success. We rent movies but the real service we provide is convenience. Therefore, any method of renting movies that is more convenient than our model is a potential threat. The advent of digital movie downloads is just such a threat, since the delay needed for shipping DVDs would be eliminated. Just as we seized first-mover advantages for our current model, we must do whatever it takes to be a first-mover with mass market movie downloads. This will require significant investments in **research and development**. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.327)

Moving forward, Netflix will employ a three pronged strategy, focusing on: Smart **financial management**, strong **marketing** and significant investments in **research and development**.

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Part II: HOW we will do it

(An Implementing Analysis: Management changes to achieve strategic goals)

These are the things that we must either do differently or better if our new strategy is to succeed: (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.319)

1. Build a more capable organization

Given our new goals, some internal realignment is called for in order to better meet them. In order to be a market leader of digitally downloaded movies, our research and development capabilities must expand to include people and/or alliances with those who have expertise in video compression and high volume file transfer systems. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.143) Our ecommerce expertise is strong and current employees will be able to design a customer interface for our digital download offerings.

To further build our subscriber base, foreign expansion will be pursued in Canada and the U.K.

Marketing will be critical to building our subscriber base. The marketing department will expand, either by new hires or through training, to include greater skills of **marketing analysis**. We must ensure that our advertising dollars are spent in the most effective manner. That requires that we develop the ability to analyze response rates and to direct ad dollars to those media that produce the best results.

2. Link budgets to strategy

The finance department will be called upon to balance the demands of daily operations with strategically-critical initiatives such as foreign expansion and the work being pursued by the Marketing and R&D departments.

3. Establish strategy-supporting policies

To support the goal of gaining subscribers, Netflix existing customer referral and website alliance programs will be enhanced and advertised more aggressively. We will also promote a new policy of rewarding customers who come to us with suggestions or problems. The goal is to encourage subscribers to address any problems they may have rather than simply cancel their subscription. Also, all employees will be given free

Netflix subscriptions and be encouraged to be active users of the service. This will help us to find and fix more problems and help us to be more understanding and responsive to our customer's needs and concerns.

4. Establish best practices for processes and procedures
Three categories of subscriber problems will be tracked and measured: complaints, technical problems and cancelled subscriptions. A system of goals and rewards will be established for those who make significant, quantifiable reductions in those problem areas.

5. Support systems, communications and infrastructure
One major strategic goal here is to develop systems to allow the storage and transfer of digitally downloadable movies.

To encourage open communication in accordance with our corporate culture, (see below), a centralized system will be created that not only contains phone and email contacts for every Netflix employee, but also contains a "Help" program through which employees can find the resources they need to solve problems. (For instance, a customer service representative has an idea for improving a section of the website. The Help Directory would guide her to the people who could implement her idea.)

6. Strategy-supporting reward systems.
Members of the research and development team will be offered a significant financial incentive for the successful deployment of our digital download capability. This incentive will be even larger for bring it to market ahead of any other major competitor. Members of the marketing department will be rewarded based on the percentage of growth in our subscriber base. Profit-sharing and a stock incentive program will be extended to all employees.

7. Shaping corporate culture to support our strategy.
Convenience, entertainment, leisure, enjoyment and family fun are central to our customer's Netflix experience. Those attributes should be reflected in our corporate culture. Going forward, we want every employee to understand that we very much want them to truly enjoy their work and to gain satisfaction from it. A sense of community, created through mutual stock ownership and Netflix membership should exist in every office and distribution center in every region and country that we serve. Our open communications should give every employee a sense of empowerment and the knowledge that his or her opinion really does matter. Creating such a corporate culture will compliment our strategy in that everyone will understand the objectives, will feel empowered to act and has a stake in the strategy's ultimate success.

8. Strategic leadership to drive these changes forward.
Given the geographically dispersed nature of Netflix workplaces, the openness of our internal communication systems, and the ways we use it will be extremely important in framing and preaching our strategy and culture. Although "Managing By Walking Around" (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 392) may not be

possible on a daily basis, regular communication rituals will take its place. First, a small group of employees from each individual workplace will attend a strategy & culture "teach-in". Those individuals will then be charged with communicating and championing our strategy to their co-workers. Our video conferencing capabilities will be enhanced and organized to make internal communication as easy and frequent as possible. Email announcements and a weekly newsletter will highlight examples of individual accomplishments that directly move our strategy forward. Whenever it is appropriate, employees will be addressed by corporate leadership as the stockholders and customers that they are. This will reinforce our commitment to growing our customer base, keeping those subscribers happy and to creating value and equity for our shareholders.

References for Parts I & II:

Thompson, A. A., Strickland, A. J., & Gamble, J. E. (2005). Crafting and Executing Strategy: The Quest for Competitive Advantage w/OLC/Premium Content Card (14th ed.). New York: McGraw-Hill/Irwin.

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Part III: WHAT IS HAPPENING IN THE WORLD AND HOW IT AFFECTS US (An Analysis of Environmental Factors)

1. Economic Analysis

Netflix and its competitors:

Netflix operates in the realm of pure competition. While they are the leading DVD *online subscription* service, Netflix competes directly with traditional DVD rental outlets. After pioneering the online subscription model, competitors such as Blockbuster and Walmart have introduced their own versions of the service. Netflix was able to patent its business model. However, competitors with such deep pockets may have the resources to develop their own systems and wait years for them to become profitable. CEO Reed Hastings admits that "Walmart has the ability to mount such a steady, relentless attack." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005 C-33)

Netflix and the business cycle:

Netflix has no long-term track record, making it hard to gauge how the company will ride the ups and downs of the business cycle. However, examining overall entertainment spending during those cycles and movie rental performance in particular should provide a clue.

I began with two assumptions. First, that entertainment spending of all sorts would decline during a recession. I found evidence of this, or at least others who shared that assumption: A year into the recession of 2000, Christian Weller of the Economic Policy Institute wrote, "entertainment and recreation are easier to cut than financial services, medical services and education." http://www.usatoday.com/tech/news/2001-04-03-tolls-info-superhighway.htm In October, 2001, the Detroit News said of the then-current recession: "Among categories hit the hardest, demand for airline tickets fell 23 percent; travel spending, which dropped 20 percent and entertainment spending, which decreased 8 percent." (http://www.detnews.com/2001/business/0110/02/a01-308498.htm)

My second assumption-- that movie rentals are entertainment and would therefore decline during a recession-- appears to be wrong. Entertainment spending may rise and fall, but the demand for DVD rentals has done nothing but grow. Taken as a benchmark, Blockbuster net sales rose steadily through the most recent recession. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005 C-38) The entertainment press concurred: "Growth in the filmed entertainment market was driven mainly by home video growth in 2003, fueled by strong growth in the DVD segment, which grew 13.8 percent to $33.1 billion in 2003." (http://www.veronissuhler.com/articles/articles_2004/article_080204.html)

It appears that recessions cause people to reduce entertainment spending by shifting it to less expensive options. While the $3,000.00 cruise or the $120 per game NFL ticket may go by the wayside, low cost movie rentals may offer the biggest entertainment bang for the buck. Therefore, Netflix is working in an economic environment that is relatively unaffected by the business cycle.
Another example of the movie rental business' ability to grow during hard times can be seen in the aftermath of the 9/11 terrorist attacks. The notion of "cocooning - the desire to perform the majority of social and cultural interactions from home, rather than by going outside the home. This trend was strongly reinforced by the 9/11 tragedy." (http://ezinearticles.com/?Taking-Advantage-of-Trends:-Cocooning&id=3431) Clearly, the tendency of people to "cocoon" will have a positive effect on the growth of movie rental revenues, as they are a popular form of in-home, family entertainment.

2. Technology
The technological change most likely to effect Neflix' future is the shift to electronic downloads as their primary distribution channel. (http://ir.netflix.com/downloads/2003AR_screen.pdf) If market penetration of broadband internet service continues to rise, or new video compression formulas deliver high quality images in smaller files sizes, downloading could become a practical delivery option for most customers. If so, the company's distribution centers would march toward the tar pit.

The most threatening technology change appears to be "movies on demand" offered by studios via satellite or cable. As the name implies, movies on demand provide instant access to content that Netflix customers must wait at least a day to receive. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-39)

3. Sociodemographics
Netflix market is limited to those groups that are affluent enough to own both computers and DVD players have internet access, and reliable sources of electric power and mail delivery. Netflix' future plans include expansion into foreign markets, but for now, those

markets are to be limited to Canada and the U.K., (http://ir.netflix.com/downloads/2003AR_screen.pdf), where such conditions exist. As DVD component prices continue to fall and DVD content becomes more widely available, (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-33) favorable business conditions for Netflix should exist in more and more international markets.

4. Political, Legal, and Regulatory Issues
Beyond domestic regulations that any U.S. company must adhere to, Netflix expansion abroad brings a new set of legal and regulatory issues: trade agreements such as NAFTA or those made with Britain or the European Union; issues of international shipping as well as labor, safety and tax laws affecting distribution centers in those markets.

5. Natural Resources
Netflix is not an especially heavy user of natural resources, (as compared to, say, a coal-fired electric power plant). However, there are some natural resource issues to consider. Fuel prices could impact shipping costs. DVD's themselves require a thin layer of copper, silver or gold. (http://ir.netflix.com/downloads/2003AR_screen.pdf) Shortages of those minerals could have an adverse effect on video disc production, although that seems unlikely. ***Such shortages could be moderated slightly by the use of recycling. "Obsolete or unrepairable CD's and cases can be recycled. Recordable CD-R's have about 20mg of gold that can be recovered, and some processors can actually remove the data layer, and reuse the plastic disc." (http://www.obviously.com/recycle/guides/hard.html)***

References for Part III:

Thompson, A. A., Strickland, A. J., & Gamble, J. E. (2005). Crafting and Executing Strategy: The Quest for Competitive Advantage w/OLC/Premium Content Card (14th ed.). New York: McGraw-Hill/Irwin.

Website: Netflix, 2005. http://ir.netflix.com/downloads/2003AR_screen.pdf

Website: Veronis Suhler Stevenson - Media Merchant Bank, 2004. http://www.veronissuhler.com/articles/articles_2004/article_080204.html

Website: Compact Disc Repairman, Inc., 2005. http://www.cdrepairman.com/about-discs.php

Website: Obvious Implementations Corporation. (electronics and computer consulting & manufacturing firm) http://www.obviously.com/recycle/guides/hard.html

Website: Soni Pitts, 2005, Ezinearticles.com. http://ezinearticles.com/?Taking-Advantage-of-Trends:-Cocooning&id=3431

Part IV: WHAT IS HAPPENING IN THE INDUSTRY
(An analysis of the movie rental business and of our competitors)
This analysis is based on the premise that movies are commodities, identical from vendor to vendor; and that customers will base their rental choices on convenience and low price. Looking into the future, what delivery methods are most likely to provide those two key success factors?

1. TECHNOLOGICAL CHANGE: Two delivery methods appear to be superior in terms of convenience and price: pay-per-view movies and downloaded movies. Both provide customers with almost immediate access to inexpensive movies and can be obtained without leaving the house. It seems reasonable to assume that these methods will prevail over business models that require trips to the store or waiting a day for the mailman. The rapid rise and success of Apple's I-Tunes may provide a glimpse at the future of movie rentals. I-Tunes offers both low cost and greater convenience as compared to online music stores such as CDNow.com or to retail chains. "Forrester Research expects that within just four years, online music will account for 33% of music industry sales." (www.itfacts.biz, 2003).

2. RIVAL FIRMS: So who are the current competitors? How much will their current structures have to change in order to adapt to a pay-per-view or a digital download business model and how much will those changes cost?

Traditional Retail Competitors: Blockbuster, Walmart, Movie Gallery and others will need to re-focus their marketing in order to drive customers to their websites. There, customers can enjoy greater convenience while the firm benefits from lower operating costs when downloading becomes the dominant rental method. "The web (allows companies to provide) 24/7 access and support at a much lower cost than that of employing live service representatives." (Freeland, J.G., 2003) Unlike Netflix users, traditional rental customers are in the habit of visiting retail stores, not renting online. Traditional retailers must establish an online presence, (as Blockbuster.com has done with their online subscription service), so that an online relationship with their customers already exists when downloading becomes the norm. To use I-Tunes as an example, existing music retailers were not prepared to offer a similar service and have been forced to either play catch-up or maintain their current models in the face of this new challenge. NOTE: An alternative strategy is currently being employed by Blockbuster. They have entered the pay-per-view market in partnership with satellite service, DirectTV. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. C-36)

Netflix: Netflix should continue the development of their movie download service and begin to advertise it as soon as possible. Their customers are already in the habit of renting via the website. Making the switch from shipped DVDs to downloaded movies should be a comparatively easy change for their customers to make.

Pay-Per-View Services: Cable and satellite TV services should continue to promote the convenience and low cost of their pay-per-view services. This method of movie rental is already a viable alternative to retail stores, online subscriptions and downloads. It is convenient, immediate and inexpensive. Unlike online subscription or download services, no computer or internet access is required. The only shortcoming most pay per view services need to address is the limited number of titles that are typically available.

Movies-On-Demand: Services like MovieBeam provide the same advantages as pay per view, but have the disadvantage of requiring special equipment, while pay-per-view services use the cable and satellite receivers users already own. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. C-39)

Movie Link: This is a cooperative venture between several major movie studios that already offer downloadable movie titles. They should increase their advertising and promotion in order to firmly establish their brand in the minds of consumers before emerging competitors do. Aggressive advertising could provide the brand identity strength that Netflix has achieved as the leader of the online subscription market.

3. NEW ENTRANTS: As movie rentals move toward an all-digital future, competitors may face a situation similar to that faced by the media production business in which I work. Twenty years ago, entry into the professional video production business required a minimum $100,000 investment in roomfuls of electro-mechanical equipment. Today, commercial-grade production is possible with a capitol investment of under $20,000, mainly in computers and software. In the same way, the cost of entering the movie rental business will fall exponentially as chains of retail outlets are replaced by online storefronts. Lower entry costs could open the door to many new competitors.

4. BUYER BARGAINING POWER:
Movies are commodities, identical in every way if purchased from any seller. While it is true that "individual consumers rarely have much bargaining power", (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 64) they do have the power to choose the vendor that offers the lowest price. In fact, they have no reason NOT to choose the lowest cost vendor, which in turn forces all competitors to offer comparable, low prices.

5. SUPPLIER BARGAINING POWER:
It is possible that one or more competitor could enjoy a significant advantage by forming strategic alliances with movie studios, distributors and parent companies. Such opportunities should be aggressively pursued. Blockbuster, for a number of years, was owned by entertainment giant, Viacom.

6. SUBSTITUTE PRODUCTS:
Movies are movies and there are no substitute products, per say. However, piracy presents a similar type of threat in which the substitute product is a less expensive or free copy of a DVD. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. C-40)

KEY SUCCESS FACTORS for Netflix:
Netflix CEO Reed Hastings said, "Our vision is to change the way people access and view the movies they love." Doing that requires two key success factors:
1. Make it convenient.
2. Make it cheap.

References for Part IV:
Thompson, A. A., Strickland, A. J., & Gamble, J. E. (2005). Crafting and Executing Strategy: The Quest for Competitive Advantage w/OLC/Premium Content Card (14th ed.). New York: McGraw-Hill/Irwin.

Freeland, J.G., (2003). The ultimate CRM handbook. New York: McGraw-Hill
Website: IT Facts, 2005. www.itfacts.biz/index.php?id=P480

Part V: WHERE ARE WE NOW?
(A Company Situation Analysis)

NETFLIX CURRENT STRATEGY

Judging the effectiveness of Netflix business strategy can be done on two levels. First, what is their big-picture vision and how is the company progressing toward attaining it? Second, what specific objectives has management established and how well is their current strategy achieving them?

Netflix Vision:

According to CEO Reed Hastings, "Our vision is to change the way people access and view the movies they love" ((Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-41) The company's 2003 Annual Report contains statements of a similar nature: "The best movie experience. Period".

If Netflix overall strategy is to provide customers with an attractive alternative to current modes of renting movies, then yes, their strategy is working. Their customer base shows consistent growth and satisfaction is rated at 95% (Netflix.com, 2003 Annual Report- http://ir.netflix.com/downloads/2003ARscreen.pdf) The success of their strategy was predicated on the continued penetration of DVD discs and players, rising internet usage and the public's growing comfort making purchases online. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-41) All of those trends have continued to grow, thereby supporting Netflix business strategy.

Netflix Stated Objectives:

These goals were compiled by reviewing both the case study in the text and the 2003 Annual Report, downloaded from the Netflix.com website.

Goal #1: Consistent Growth of Subscribers

Reed Hastings stated the following in 2002: "We have set a long-term goal to acquire 5 million subscribers in the U.S., or 5 percent of the U.S. TV households over the next four to seven years." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-41) According to the 2003 Annual Report, that goal is on its way to being achieved: "Netflix added 630,000 net subscribers in 2003, bringing our total subscriber count to 1,487,000, an increase of 74 percent year over year. We now expect to reach five million subscribers in 2006 to 2007— one to two years faster than we estimated just a few months ago."

Goal #2: Consistent Growth of Revenue

Rising subscription rates will naturally result in rising corporate income. However, that can only be translated into increased profit if costs do not also rise. That appears to be happening. "Netflix has become not only one of the very few dot-com success stories but also a highly profitable one, growing substantially in the face of increasingly strong competition." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-33)

Their 2003 Annual Report provides more details of their success in increasing corporate revenue: a 78% increase in revenue to $272.2 million for net profit of $6.5million, compared with a loss of 20.9 million for the previous year. More recently, the Netflix.com press room provides data that shows continued improvement through the first quarter of 2005: "For the first quarter, revenue increased 54 percent year-over-year to $154.1 million. Subscribers increased 56 percent year-over-year to 3.02 million, at the upper end of management's guidance. GAAP* net loss was $8.8 million, significantly better than management's guidance for the quarter." *(Generally Accepted Accounting Practices) (www.netflix.com)

Goal #3: Category Leadership
Netflix has taken good advantage of their position as a first-mover and pioneer of the online movie subscription business model: "At year-end 2003, we believe Netflix had approximately 95 percent of the fast-growing market for online DVD movie rentals." (Netflix.com, 2003 Annual Report)

Goal #4: Deep Title Selection
"Deep" is a relative term, but offering the largest possible movie title selection is certainly key to attracting and retaining a broad range of customers. One can assume that the more often a customer is unable to find the film they are looking for, the less likely it is that they will return for future orders. Although I could find no comment stating a goal of a specific number of titles, their library continues to expand rapidly. "Netflix set out to be the world's largest online movie rental service — and we now provide nearly 1.5 million subscribers access to a library of more than 18,000 DVD titles." (Netflix.com, 2003 Annual Report) In 2005, the "about us" section of Netflix.com states that "Netflix is the world's largest online DVD movie rental service offering more than three million members access to more than 40,000 titles."

Goal #5: Customer Satisfaction
Any company, regardless of the quality of their customer service, can present anecdotal evidence or cite the testimony of allegedly-satisfied customers. However, to prove that the goal of customer satisfaction is being met, hard, verifiable numbers must be presented. The 2003 Annual Report states that their customer satisfaction rating has reached "an all-time high of 95%" Also, "9 out of 10 customers said they were so satisfied with the service that they were willing to pitch it to family and friends." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-35) "This growth, in turn, improves our efficiencies and margins. We're reaching economies of scale that contribute even more to the bottom line." (Netflix.com, 2003 Annual Report)

Conclusion: Yes, Netflix current strategy is proving to be effective. That is not, however, a guarantee of future success, as the rest of this paper will reveal.

NETFLIX SWOT ANALYSIS
Table 1

POTENTIAL RESOURCE STRENGTHS & COMPETITIVE CAPABILITIES -------------------------	POTENTIAL RESOURCE WEAKNESS & COMPETITIVE DEFICIENCIES -------------------------
E-commerce expertise, including proprietary "Cinematch" movie referral software. Competitive "first-mover" advantages, including knowledge base and strong brand identity. Economies of scale that accrue from being the largest online subscription player. Competitive advantage gained from Netflix ability to offer low prices, no late fees, no due dates, free shipping, and large selection. This includes high customer satisfaction levels and referrals. Physical Assets: Warehouse network, communications network, transportation network. Skills and experience of employees in all areas. Flexibility and comparative low cost of operating as a web-based interface. Strong position if movie downloads become the delivery method of choice.	Financial resources small compared to competitors such as Blockbuster & Walmart. Dependant on USPS as forward distribution channel, vulnerable to postage increases, etc. Customers must wait at least one day to receive their movies. Current customers limited to those with internet access and DVD players. Vulnerable to technological change.
POTENTIAL OPPORTUNITIES -------------------------	POTENTIAL THREATS -------------------------
Continued expansion of domestic customer base Expansion into foreign markets Development of movie download capability Continued international growth of DVD component sales, internet access and acceptance of ecommerce.	Vulnerable to frontal assault by deep-pocket rivals, such as subscription services offered by blockbuster.com or walmart.com Pay-Per-View Movies Other firms who are rushing to perfect movie download capabilities "Cost of entry" lower for web-based online subscription competitors than it is for brick

Small meteor crashes into Blockbuster Corporate Headquarters	& mortar entry. "Out-of-the-Blue" technology changes Movie Piracy Giant meteor destroys the Earth

Leveraging Strengths Against Opportunities:
This can be considered in both the present and near future, and again for the long-term periods of the next five to ten years.

For the present, strengths such as ecommerce expertise, top-of-mind brand awareness, customer convenience features, high rates of customer referrals and an established infrastructure can work in harmony with opportunities such as the growing number of potential customers, (those with DVD players and internet access), and expansion into international markets. In other words, their strategy is working. Netflix should continue to build on their strengths and basically just KEEP DOING WHAT THEY'RE DOING.

However, the adage that "the only thing that remains constant is change" certainly applies to the online movie subscription business. Netflix MUST use their experience and e-commerce expertise to be the first major player to offer and promote digital downloads as a primary distribution channel. The fact that ALL of their customers are already online buyers, (as opposed to Blockbuster or Walmart), could prove to be a huge advantage. Netflix customers will not have to be trained to move from one point of contact to another, while traditional retail customers will have to migrate from brick and mortar locations to the vendor's website, assuming that they have access to both the internet and a DVD player.

Overcoming Weaknesses to Protect Against Threats:
Continuing efforts to grow their customer base and increase revenues may provide the best protection from immediate threats. If they chose, competitors such as Blockbuster or Walmart could direct considerable marketing resources at stealing Netflix leadership of the online subscription business. Imagine a 12-month ad campaign that touted unlimited movie rentals for $9.99 from Walmart.com. If the first name that comes to mind when the public things of "online movie subscriptions" is Walmart, walmart.com will likely be the first online subscription site that customers visit, (a benefit that Netflix now enjoys). Every new customer Netflix can obtain from the ever-shrinking pool of potential new customers, (and do so NOW), will help protect them from such an attack. Also, if digital downloads come to fruition, Netflix would lose competitive advantage if Blockbuster or Walmart already had millions of customers accustomed to renting via their websites.

I don't mean to keep harping on this, but maintaining their goal of being the most pleasant, convenient, hassle-free source of rental movies will <u>end</u> the day that competitors can offer what Netflix offers, without the 24 hour delay required by postal shipping.

Again, being the first off the starting line with a faster delivery method such as digital downloads will protect them from that threat.

Pay per view services already offer the ability for customers to shop from home and view movies immediately. Their biggest weakness, however, is the relatively small number of titles that are available. If that changes, Netflix would have to find another weakness to exploit that would make their own service more convenient or less expensive.

While it is true that the cost of entry is generally lower for web-based businesses than it is to establish a national chain of brick & mortar locations, any competitor in the online subscription business would face many of the same costs and obstacles that Netflix has already overcome. Newcomers are therefore a limited threat.

Out of the Blue Technology is another matter. Mall-bound sellers of packaged music CD's have few options in the face of business models such as I-Tunes. They will likely go the way of the Dodo. Theoretically, any business could be blind-sided by such sudden changes to the playing field. And as for meteors… well… whatchagonna do?

NETFLIX COST COMPETITIVENESS

This aspect of the analysis provides a good opportunity to raise the issue of TIMING. Ten years ago, the Netflix business model would have been unworkable. Internet access had not penetrated the market sufficiently enough to allow a large customer base for an online movie subscription service to survive. DVDs and DVD players were not even on the market until 1997 (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-33) VHS tapes are comparatively bulky and delicate, making repeated shipment expensive and loss-prone. It appears that Netflix CEO Reed Hastings launched this business model at just the right time. He was early enough to gain first to market advantages yet not so late as to be beaten to the punch. Compared to traditional retail renters, such as Blockbuster, the cost structure of Netflix business model is very lean, as shown in this side-by-side comparison of their respective value chains:

Table 2

Value Chain of Retail Movie Renters:	Netflix Value Chain:
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1. Supply Chain- Products and shipping arrangements made with DVD publishers. 2. Advertising 3. Workforce at corporate headquarters, logistics and retail locations 4. International network of distribution centers and retail store locations. 5. Communications network that connects all parts of the company.	1. Supply Chain- Products and shipping arrangements made with DVD publishers 2. Advertising that drives customers to the website 3. Netflix.com, including their proprietary software and technical expertise of the people who design, operate and maintain it. 4. Workforce at company headquarters, logistics and distribution centers 5. Communications network that transfers order information from the website to distribution centers.

	6. Transportation capabilities that deliver new products to warehouses 7. Distribution Centers, located across the country in locations that provide next-day postal delivery to most customers. 8. Forward channel ally: the U.S. Postal Service
Retail Value Chain Costs that Netflix does not incur: ------------------------- 1. A much larger workforce would be required to operate a brick & mortar retail chain than would be needed to operate online and to staff distribution centers. 2. Netflix must ship DVD's to its distribution centers, but competitors must also ship from warehouses to retail stores. 3. The biggest cost advantage for Netflix is probably avoiding the cost of operating and staffing retail locations.	**Value Chain Costs that Netflix incurs but competitors do not.** ------------------------- 1. Postage used to ship DVD's to customers using the USPS. 2. Traditional retailers that are not trying to compete with Netflix for online subscriptions would not be required to make significant investments in ecommerce technology. However, competitors such as Blockbuster and Walmart are doing so and are therefore incurring similar costs.

THE STRENGTH OF NETFLIX COMPETITIVE POSITION
At this point in time, Netflix competitive position is strong and getting stronger. While there are sound reasons for this assessment, my own opinion is that the company's future prospects are good but by no means are they guaranteed.

The 2003 Annual Report includes a letter to the stockholders from CEO Reed Hastings in which he outlines the company's top three strengths: The continued rise of DVD adoption; the growing acceptance and use of ecommerce; and competitive entry barriers created by Netflix first-mover advantages. (Netflix.com, 2003 Annual Report)

I agree with his third point. Combined, the strengths listed earlier in Table 1 provide Netflix with a considerable entry barrier for potential competitors. Netflix has first-mover advantage in online subscriptions. Their services, along with the expertise and infrastructure needed to deliver them are hard to duplicate. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.167) This makes their current position strong.

Perhaps because he was addressing stockholders, Hasting's remarks did not address Netflix competitive weaknesses. Netflix limited FINANCIAL RESOURCES are certainly one of them. When raising the issue of entry barriers, he notes that "Very large companies have tried to gain a foothold in our market and have not succeeded after more than 15 months of effort." That is true and a good sign for Netflix. However, I still maintain that Blockbuster and Walmart, already competing for online subscriptions, have the financial resources to rob Netflix of their market leadership by out-marketing and under-pricing them. Netflix has stood up well to their competition so far, but to the best of my knowledge, neither Blockbuster nor Walmart has launched a truly aggressive attack.

I agree with Hasting's first two points, regarding DVD adoption and ecommerce acceptance. However, they are external factors and therefore cannot be considered to be company strengths. They are factors that can benefit Netflix but that Netflix has no control over. Both are subject to TECHNOLOGICAL CHANGE which I consider to be both an opportunity and a threat for Netflix. Consumer's switched from VHS to DVD very rapidly. When the next movie format arises, will Netflix be able to benefit from it or will their marriage to DVDs be their downfall, as happened to music retailers with the rise of I-tunes and digital music downloads? Will Netflix keep up with change if ecommerce customers migrate away from desktop computers in favor of wireless phone-based web surfing? Such bedrock shifts are threats unless the company is being proactive in preparing for them. If they are aggressive in their plans to develop digital download capabilities, this threat can be turned into an opportunity.

The development of downloadable movies is one probable technological shift. This also raises the possibility of increased piracy of movies, as happened to music files, shared through peer-to-peer services such as Napster and Kazaa.

Pay-per-view movies are already available and offer greater convenience than online subscription because they do not require shipping. At present, pay per view services can offer only limited selection. Forming a strategic alliance with a cable or satellite TV company is one way that this threat could be countered, the idea being that "if ya' can't beat 'em, join 'em." (The TV service gets access to Netflix vast library. Netflix gets a cut of the ppv market, just as Blockbuster allied themselves with DirectTV.) (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. C-36)

Downloading movies can be done now, via services such as MovieLink (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-39) but high-speed internet access is required. As broadband becomes more prevalent, downloading will likely become more and more prevalent.

STRATEGIC ISSUES AND THE FUTURE OF NETFLIX:
Again, it is appropriate emphasize the fact that the product Netflix provides is CONVENIENCE. The company's focus has been on improving and maintaining the QUALITY OF THE EXPERIENCE of renting movies. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. C-41) In that regard, their online business model is working. Netflix customer base continues to grow, often with the help of referrals from satisfied customers. In order for a competitor to pull those satisfied customers away from Netflix, they would have to either offer the same level of convenience at a lower price, or offer greater convenience. The question then becomes, "who is in a position to do that and what exactly would they do?"

Potential Threats based on price:
1. Deep-Pocket competitors offering similar online subscription services at discounted prices. (Rivalry among sellers)
2. "Free" movies available through peer-to-peer file sharing services or DVDs available on the black market. (Presence of available substitutes)

Potential Threats based on convenience: (Presence of available substitutes)
1. Downloadable movies that do not require a delay for shipping.
2. Pay-Per-View services, especially if their title selection is able to match that of traditional and online subscription services.
3. "Out of the blue" technological or process changes.

The purpose of identifying potential threats is to align company resources to deal with them. For Netflix, the best defense is a good offense. Beating competitors to the punch with downloadable movies could turn that threat into an opportunity. Continuing to build their profits and customer base will give Netflix the resources it needs to counter an aggressive attack by competitors. Strategic alliances could be established with Pay-Per-View providers to all Netflix to profit from that sector of the industry.

Overall, I think Netflix prospects are good. I would be willing to be that somewhere in a Blockbuster board room; some executive is shaking his head and wishing they had moved sooner and more aggressively against this growing, successful new rival.

References for Part V:
Thompson, A. A., Strickland, A. J., & Gamble, J. E. (2005). Crafting and Executing Strategy: The Quest for Competitive Advantage w/OLC/Premium Content Card (14th ed.). New York: McGraw-Hill/Irwin.

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NETFLIX

Part VI- What are our options?
(Strategic Alternatives and Recommendations)

This is a summary of the strategic options available to Netflix, the pioneer and current leader of the online subscription movie rental business. It includes a brief overview of the company's current situation, a review of strategic options and concludes with recommendations of which options should be pursued or continued.

Information for this report was gleaned from three primary sources: A case study by the University of Alabama's Braxton Maddox, reprinted in Thompson, Strickland & Gamble's "Crafting and Executing Strategy", which is the second source. Further data was secured via the Netflix.com website, including articles from their online press room and from a downloadable copy of the firm's 2003 Annual Report.

NETFLIX OVERVIEW:
Netflix online subscription is a method of renting movies by which customers pay a monthly fee to access DVDs they have placed on a wish list. Those DVDs are shipped to the customer in groups of two to four, depending on the chosen subscription plan. The next group ships when the first has been returned. In this way, Netflix is able to offer customers a high level of convenience, access to over 40,000 titles with no due dates, late fees or shipping costs. (www.netflix.com)

Their web-based business strategy provides Netflix with low operating costs, compared to brick & mortar rivals, as well as convenient access for customers anywhere. As the pioneer of this business model, Netflix has enjoyed many first-mover advantages and is now the world's leading online subscription service, serving over three million members. Netflix has consistently met or exceeded projections of growth in their customer base, library size and gross sales. (www.netflix.com 2003 Annual Report)

Since movies are commodities, rental prices are forced to be uniformly low. Netflix has therefore chosen to differentiate itself on the basis of convenience. Netflix faces two primary threats. One is from online subscription competitors that may try to overtake Netflix market leadership, gaining brand-name awareness by out-advertising, under-pricing or both. The second threat comes from any technology or business model that provides greater convenience for customers. Pay-per-view and movie downloads are examples.

STRATEGIC ALTERNATIVES:
Many of the strategies available to Netflix have already been implemented. Others are being planned or could be applied in the near future. Those that have already been employed seem to compliment each other and to be well-suited to achieving management’s stated goal to "change the way people access and view the movies they love." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.C-41)

Online Enterprise Strategy- As a web-based rental business, Netflix delivers unique value to buyers, "attracting buyers on more than just low price". (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 164). Their value chain is simple, efficient and inexpensive. The website itself is highly functional, engaging and user-friendly. Netflix's focus is narrow and their revenues derive from their core rental business, rather than ancillary sources. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.165)

First Mover Strategy- Netflix was launched in 1997, PRIOR to the rise and market penetration of DVD's. Though risky, this strategy put Netflix far ahead of competitors who have since imitated but have not been able to improve on the Netflix model. The result is that Netflix leads the online subscription business with a high degree of customer loyalty and satisfaction. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 167)

Functional Area Strategy- the Company's core competency is ecommerce, including proprietary software that is both highly-functional and adds significantly to customer's enjoyment of and satisfaction with the service. The Netflix model and software are proprietary, making their unique features difficult to imitate.

Exceed Competitor's Strengths and Capitalize on their Weaknesses- ***Netflix is facing down established competitors such as Blockbuster by matching or exceeding their movie selection and building a strong brand identity as a leader in their version of the movie rental business. At the same time, Netflix offers greater convenience while eliminating customer inconveniences such as due dates and late fees that are clearly weaknesses for traditional retail movie rental firms.*** (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005 pg. 156)

Offensive End Run Strategy- Netflix was able to bring an entirely fresh approach to the movie rental business by introducing "different attributes and performance features to better meet the needs of selected buyers." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 158)

Outsourcing: ***Netflix is not a shipping company. "Outsiders can perform certain activities better or cheaper."*** (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005 pg. 153) ***The U.S. Postal Service already has the necessary resources and capabilities in place to provide shipping services at lower cost and greater efficiency than would an internal delivery service. Outsourcing the shipping function allows Netflix to "better concentrate on a narrower, more strategy-critical portion of the overall value chain."*** (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 153***)***

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Strategies that are being planned or could be applied to Netflix's current situation include: **Multi-Country Foreign Expansion-** Netflix plans to extend their expertise into the culturally-similar Canadian and British markets. **Strategic Alliances** could be pursued in order to "access valuable skills and competencies" and to "open up broader opportunities". (see below) (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg.145)

Other Strategies that were Considered and Rejected:
Brick & Click Strategy: As the Netflix brand name becomes more firmly established, the odds that company brick & mortar outlets could succeed increases. However, the added expense and departure from the established business model would defeat the purpose of the model in the first place. This idea was rejected precisely because it offers, as the text says, "an appealing middle ground." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005 pg. 162) ***Dumb idea. Investing in retail stores would negate the current cost advantage the online model allow, nor would it provide any additional geographic market penetration, as the net is***

already a global store front and distribution centers adequately serve our target markets. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 162)

Vertical Integration: This is simply an inappropriate option, given the short and simple nature of Netflix value chain. The firm does not possess the skills or resources needed to be a movie producer or the established distribution channels to be a movie distributor. On the forward channel of the value chain, we have already discussed the benefits of continuing to outsource shipping functions.

Broadening Netflix Product Offerings by Expanding into DVD Sales: This option was explored as both an internal expansion project and as a MERGER OR ACQUISITION of an existing retail movie seller. The appeal of this idea is that Netflix could position itself as a "try before you buy" source of both movie rentals and sales. It soon became clear that this idea was simply off-target. Being commodities, margins on movie sales are extremely small. Investing in DVD's that can be rented over and over again provide a better return. Also, expanding Netflix offerings in this way could have the adverse effect of diluting the brand image. It is better at this time to remain focused on rental only. "Focusers seek to build customer loyalty based on attractively low prices, better value, wide selection of models and styles within the targeted category, convenient service, nifty options or some other differentiating attribute. They pay special attention to the details that will please their narrow target audience." (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 166)

STRATEGIC RECOMMENDATIONS:
While the online subscription model is young and technologically advanced, the movie rental business itself can be considered to be a **maturing industry**. Therefore, strategies such as **Expanding Internationally** and **Building New Capabilitie**s are appropriate strategies for continued growth. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 212) As an **industry leade**r, Netflix should both **Stay-on-the-Offensive** and **Fortify-and-Defend** their position. This combination of strategies should help them gain strength and market share while fending off potential threats. (Thompson, A.A., Strickland, A.J. & Gamble, J.E., 2005, pg. 219) Those threats are frontal assaults on market leadership from deep-pocket competitors such as Blockbuster.com or Walmart.com and the possibility that other competitors will gain market share with a more convenient movie rental model such as digital downloads or pay per view.

Netflix must continue some existing strategies to build their coffers and customer base to defend against attack. They must aggressively pursue a competitive position in more convenient movie rental models that may become the future norms. Specifically:

CONTINUE to leverage larger market share using the **Online Enterprise Strategy**, building on momentum created by the first-mover and end run techniques. Continue to perfect **Functional Area** competencies in ecommerce. Follow through on plans to pursue the **Multi-Country** strategy to broaden market reach.

ADD a stronger emphasis on the **R&D Functional Area** and build **Strategic Alliances** with companies such as Sorenson, (www.sorenson.com) whose expertise in video-to-digital conversion could speed the development of downloadable movies. Alliances should also be sought with satellite or cable television providers in to make the Netflix title library available via pay-per-view.

References for Part VI:

Thompson, A. A., Strickland, A. J., & Gamble, J. E. (2005). Crafting and Executing Strategy: The Quest for Competitive Advantage w/OLC/Premium Content Card (14th ed.). New York: McGraw-Hill/Irwin.

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