NETFLIX: SUCCESS TO DISASTER AND HOW TO RECOVER?

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Due to the entrepreneurial leadership of CEO and Founder Reed Hastings, Netflix successfully transitioned from a solely DVD-by-mail subscription model to a hybrid Internet streaming and DVD rental subscription model. Recently however, Netflix has made several unpopular decisions that damaged its brand after a change in strategy. Netflix is planning another major change in strategy to focus on TV and streaming with the intent of becoming a global Internet TV network. The company had a strategy that provided a competitive advantage in the past, but changes in strategy, technology, and the requirements of the customers have significantly altered the company's competitive position. In this case, Hastings needs to determine whether the company's new strategy is the best way to go, or whether to adopt alternative strategies. This case can be utilized as a tool to examine the industry and general environment. In addition, it can be utilized as a tool for students to examine an organization's core competencies to determine how an organization's strategic decisions and actions risk eroding competitive advantages, but also potentially renew them.

REED HASTINGS

Reed Hasting founded Netflix in 1997, and was named Fortune's number one choice for "business person of the Year" for 2010 (Newcomb, Peter, 2010). According to Michael Copeland, a Fortune writer, Hastings is a risk taker who is reshaping how business should be run. He even named him "a guru to a new generation of Silicon Valley entrepreneurs". (Copeland, Nov 18. 2010). This case examines this extremely confident entrepreneur to determine what went wrong since that time and what he and others in the organization can do to remedy the situation.

For Reed Hastings, the agenda of business meetings he attends these days are less about DVDs and negotiating movie rights with Hollywood studios, but instead are negotiations with cable providers and TV studios about TV shows and original programming. Indeed, the "flix" in Netflix's does not have the same meaning as it once did. The majority of Netflix's subscribers (50-80%) are viewing TV episodes instead of movies and its video library now has more TV shows than films (Stelter, 2012). Hastings compares Netflix to what he considers its biggest competitor, HBO, which provides a subscription service for viewing movies and original programming on TV, with a significant portion of its content also available on HBO GO for streaming on multiple devices. For the first time, Netflix will also develop original programming, starting with original series like *Lilyhammer* and *House of Cards* and broadcasting the fourth season and revival of FOX's comedy *Arrested Development.* Hastings sees the opportunity to build Netflix as a global Internet TV network (Chozick, 2012a; Netflix, 2012c; Stelter, 2012).

The last time Netflix made such major changes resulted in a downturn that the company has yet to recover from. Netflix had made a series of unpopular decisions from July to October 2011 to separate its plans, increase prices, and re-brand its DVD-by-mail service as a spinoff company named Qwikster. The ensuing negative reactions of customers, investors, and the media to these announcements, compounded with Netflix's poor management of public relations, damaged the brand in ways Hastings could have never anticipated. In mid July 2011, Netflix's stock price was over $304 with a $16 billion market value; by late October, Netflix's stock price was $63 with a $4 billion market value (Wingfield, 2011). Netflix retracted the Qwikster re-branding but kept the revisions in pricing and service plans. Customers cancelled their subscriptions in waves and Netflix lost 800,000 of its 24.59 million subscribers in Q3 2011, about a 3% loss. In 2010, the American Consumer Satisfaction Index ranked Netflix second place among e-commerce companies for consumer satisfaction with a reputation on par with giants like Amazon and Apple. In 2011, Netflix was ranked *last* among e-commerce companies for consumer satisfaction (Edwards, 2012). While Netflix remains profitable and continues to grow in 2012, its market value has yet to reach its peak from summer 2011. In the minds of customers, investors, and analysts, "Netflix has indeed killed the best entertainment deal on the Web. It's gone from an extreme terrific value - to an average one" (Pogue, 2011b, p. 1).

Netflix was one of the pioneers in Internet streaming in 2007. However, by 2012, a number of competitors have sprouted such as HBO GO, Hulu, Amazon, Apple, Vudu, and more. These competitors are gradually building their content library to match Netflix while acquiring exclusive content. Digital movie rights are harder and more expensive than ever to acquire as the number of bidding competitors has increased. One recent contract that expired was a deal with Starz that allowed streaming of Disney and Sony films like Toy Story 3.

Netflix successfully transitioned from a DVD-by-mail subscription model to a hybrid Internet streaming and DVD rental subscription model. Now the company is in the middle of another transition to become a global Internet TV network focused on streaming, original programming, and exclusive content. Netflix firmly believes that its future is in the streaming video business, not the DVD-by-mail business. However, the company still has 11 million customers that use its DVD-by-mail services, almost half of its 26 million total subscribers, and Netflix has pledged to keep serving them. Netflix will probably face its most critical challenges during 2012 due to greater competition and market forces.

NETFLIX'S HISTORY

Netflix is a provider of DVD-by-mail and Internet streaming subscription services for TV shows and movies. Netflix operates in the United States as well as in Canada, the UK, Latin America, and the Caribbean (Netflix, 2012a). The company was established in California by Marc Randolph and Reed Hastings in 1997. Hastings decided to start the company after he was charged a late fee for returning Apollo 13 after its due date (Wauters, 2010). The company's headquarters is located in Los Gatos, California.

The company started its subscription based program in 1999, and since then the company has built its reputation on its unique business model of no due dates, no late fees, no shipping or handling fees, all for a flat monthly rate. As time went on, the movie rental company went from being the fastest-growing first-class mail customer of the United States Postal Service to a source of web streaming for many Americans during peak hours. Netflix began to offer Internet streaming of videos and select movies at no charge for its customers with their regular subscription service. The company had great success and its growth was exponential. Netflix's subscriber base increased from 1 million in 2002 to 5.6 million in 2006 and 14 million in 2010. Netflix continued to move strongly in the emerging market and in February 2007, the company sent its billionth DVD rental to its customers (Associated Press, 2007). Table 1 shows Netflix's total subscribers from 2007-2011 with an average growth rate of 36.8%.

Netflix began offering streaming in 2007 and has aggressively expanded its streaming library. In October 2008, the company announced that it had reached an agreement with Starz Entertainment that expanded its online library by 2,500 movies and television shows. Customers were able to watch them instantly and they called the new expansion Starz Play (Chmielewski, 2008). In August of 2010, Netflix expanded on its online library with a five year contract with Paramount to stream movies online. Netflix spent $117 million in the first six months of 2010, but the deal was expected to bring in $200 million per year for the company (Stelter, 2010). Netflix has also signed a number of contracts for old and new TV shows from FOX, ABC, CBS, Warner Bros., NBC-Universal, and more (Hoover's, 2012b; Netflix, 2012a; Stelter, 2012).

NETFLIX IN 2011

In 2010, "Fortune magazine put Mr. Hastings, 51, on its cover as the businessperson of the year after he seemed to pull off the rare feat of finessing the 'innovator's dilemma' by navigating Netflix to the digital future from its DVD rental business" (Wingfield & Stelter, 2011, p. 1). Netflix was an innovator and industry leader that offered convenient and affordable access to thousands of movies and TV shows to millions of subscribers by mail or streaming. Until summer 2011, many investors and analysts would have had a hard time conceiving how Netflix could falter in its future performance and growth.

On July 12, 2011 Netflix announced it would be revising its available service plans. Instead of offering unlimited Internet streaming and DVD-by-mail for $9.99, Netflix would separate the services into individual plans for $7.99 each. DVD-by-mail would no longer be a $2 add-on charge to Internet streaming ($7.99), but a separate service now costing $7.99. In other words, this revision meant that customers would have to pay $15.98 instead of $9.99 if they desired both services. The price changes would take effect immediately for new customers and in September for current subscribers. Netflix made the announcement on the company's blog and justified the changes with the following statement:

> Why the changes? Last November, when we launched our $7.99 unlimited streaming plan, DVDs by mail was treated as a $2 add on to our unlimited streaming plan. At the time, we didn't anticipate offering DVD only plans. Since then we have realized that there is still a very large continuing demand for DVDs both from our existing members as well as non-members. Given the long life we think DVDs by mail will have, treating DVDs as a $2 add on to our unlimited streaming plan neither makes great financial sense nor satisfies people who just want DVDs. Creating an unlimited DVDs by mail plan (no streaming) at our lowest price ever, $7.99, does make sense and will ensure a long life for our DVDs by mail offering (Becker, 2011, p. 1).

Many Netflix subscribers believed this statement and the entire blog post was an intentionally vague, confusing, and condescending attempt by the company to gloss over what was essentially a 60% price increase overnight. The blog post was flooded with thousands of comments by shocked and angry customers and the negative reaction rippled through mainstream media and social media outlets. Poor economic conditions also heightened customers' sensitivity to price increases. Many subscribers posted to Facebook and Twitter with similar sentiments like, "This is ridiculous. Life's complicated enough already. Netflix just made it worse. Does Mr. Hastings think we're idiots?"(Pogue, 2011a, p. 1). Public perception of Netflix transformed from a positive image, comparable to Apple and Amazon, to another evil corporation that only wanted money. The reaction could also be seen in the company's stock price, which started to drop dramatically as shown Figure 1.

Some analysts contributed the price increase to Netflix anticipating more expensive contracts when negotiating or renewing licensing agreements with content providers. Streaming subscriptions were a relatively new service when Netflix made its initial contracts in 2007-2008. In hindsight, many content providers believed Netflix profited more from these early agreements. Consequently, Netflix's past success and the growing demand for streaming led to many new entrants in the industry bidding for contracts. Now content providers have significant bargaining power and can negotiate more expensive licensing agreements.

Over the next few months Netflix continued to receive ridicule for the changes it had implemented, yet dismissed criticism. On September 15, 2011, the price changes became active for all Netflix subscribers. That day, the company's stock had dropped by almost 19% and closed at $169.25. This exacerbated a season-long selling streak reaching back to July when the stock peaked at $304.79, as shown Figure 1 (Stelter, 2011a). Although the company had anticipated backlash, the media and subscribers' reactions were stronger than Netflix could ever imagine.

Within a few days of the launch of Netflix's new prices, Hastings finally addressed the issues on the company blog, posting:

> …it is clear from the feedback over the past two months that many members felt we lacked respect and humility in the way we announced the separation of DVD and streaming, and the price changes. That was certainly not our intent, and I offer my sincere apology. I'll try to explain how this happened (Hastings, 2011, p. 1).

Hastings goes on to explain how the company was too worried about keeping up with the "new thing," and how "in hindsight, I [Hastings] slid into arrogance based upon past success" (Hastings, 2011, p. 1). However, Hastings only apologized for *how* the company handled the changes in prices and plans, not the changes themselves. Furthermore, in an unexpected twist, Hastings also announced that Netflix would separate its DVD-by-mail service and re-brand it as a spin-off company. The new company, called Qwikster, would also offer video games-by-mail for the first time ever in Netflix's history of operations.

Qwikster would have a separate website, separate login criteria, and show up as a separate charge on customers' credit card bills. Customers saw the announcement as a baffling, additional insult to injury and the company blog was flooded once again with thousands of negative comments. Essentially, customers understood they now had to pay more money to deal with two companies, two websites, two movie queues, and two charges on their credit cards. Investors were also not impressed and the company's stock price continued to drop as shown Figure 1. Since Netflix reduced its advantages in price, convenience, and customer service, customers cancelled their subscriptions and seriously contemplated streaming alternatives.

The company announced it would keep its DVD-by-mail and streaming services within one company on October 10, 2011. In addition, it abandoned all plans for video game-by-mail services. Netflix did not retract its price increases. A Netflix spokesman said, "We underestimated the appeal of the single Web site and a single service…We greatly underestimated it" (Stelter, 2011b, p.1). Many customers were still upset and some now ridiculed Netflix for changing back. Regardless of the overall damage, many analysts and consumers agreed that this was the right decision and that it was sufficient to see a company listen to customer feedback.

On October 24, 2011, Netflix released its third quarter financial results, which did not meet investor expectations, and the company lost $2 billion in market value on that day alone (Figure 1). Over the short span from July to October, the company went from being a market value of $16 billion to $4 billion (Wingfield, 2011). Netflix had lost over 800,000 subscribers in the third quarter. "The fallout among Netflix investors from a string of recent missteps by the company seems to be worse even than the damage it has done to its standing with customers" (Wingfield, 2011, p. 1). However, by the fourth quarter of 2011, Netflix's total subscribers and stock price had begun to increase again.

NETFLIX'S COMPETENCIES

With over 26 million subscribers, Netflix has become one of the leaders in the in-home entertainment video industry. In 1997, Reed Hastings pioneered the in-home entertainment industry by creating a company that would deliver DVDs to customers' front doors. His innovative spirit helped lead the company to incorporate Internet video streaming. Today, Netflix's core strategy is to grow their streaming content in order to continue to satisfy customers' needs (Netflix, 2012a).

To accomplish this, the company must continuously work to gain and maintain contracts with studios and other content providers. These contracts are vital to the success of any company within this industry and Netflix has had favorable contracts in the past. The nature of competition in the industry has changed and these contract negotiations will become more complicated in the future. The laws and regulations concerning property rights have changed and due to the current economic conditions, content providers will be more concerned about their compensation. TV and movie studios now have more options than ever with respect to licensing their content. Recently, Netflix has altered its strategy and decided to focus on providing more TV series to its streaming content which will pose new challenges for the company.

As more companies begin to compete with Netflix, the landscape of the industry has changed. For example, HBO has already announced it will no longer give a discount when selling its DVDs to Netflix while Starz's 3 year contract with Netflix expired so that it can no longer provide its Sony and Disney content for Netflix's streaming library (Stelter, 2012). Nevertheless, Netflix has still been aggressively pursuing streaming content over the last few years, spending $937 million for streaming rights in 2011 and expecting to spend $1.8 billion in 2012 (Barnes, 2012). With the increasing number of companies entering the industry, it will become a more cutthroat competition for these streaming rights and companies will pay higher premiums for exclusive streaming rights of content. Recently, Netflix signed an exclusive deal with DreamWorks Animation to stream box office hits to its customers. DreamWorks usually supplies movies to HBO, but Netflix outbid HBO paying an estimated amount of $30 million per film (Barnes, 2012). The constantly changing environment of the entertainment industry, along with the rapid movement with technology, will always be a challenge for Netflix and so far it has been able to stay ahead of the curve in order to secure its place in the industry.

Netflix's "trademarks, service marks, copyrights, patents, domain names, trade dress, trade secrets, proprietary technologies and similar intellectual property" are also important for its success (Netflix, 2012a, p. 2). Netflix not only has proprietary technology used for streaming but also many new and different competencies, "including processing delivery and return of our DVDs to our subscribers" (Netflix, 2012a, p. 11). Netflix's attention to its recommendation and merchandising technology, along with its various user interfaces, has served them well. Netflix's user interface for its website and other devices has set the standard for the industry. "We are continually refining our recommendation and merchandising technology as well as our various user interfaces in an effort to improve the predictive accuracy of our TV show and movie recommendations and the usefulness of and engagement with our service by our subscribers" (Netflix, 2012a, p. 11).

One of the reasons for the sites success has been the award winning technology developed by Netflix called Cinematch. This program is a recommendation system that helps "people choose taste-based products by comparing their tastes with similar tastes of other people" (Netflix, 2006, p. 1). This allows members to rate movies on a scale of one to five stars and based on the ratings the program can make movie suggestions based on that person's preferences in movies. In 2006, the company made another bold move by creating a contest open to the public to try and improve the Cinematch technology, the grand prize was $1 million. "The threshold required to win the Netflix prize is a 10 percent improvement in accuracy over the current Netflix recommendation system" (Netflix, 2006, p. 1). This unconventional move proved to be worth it. By not having to invest more money in R&D for this project the company was getting individual computer scientists and corporate or university teams well versed in the complexities of "machine learning" to create more efficiency for them. In 2009, a winner emerged and met the 10 percent benchmark. Netflix's innovative thinking and constant attention to improving its service has served them well and made them a financial success.

Over the past decade, Netflix has continued to grow and prosper in its industry with 26 million subscribers by the end of 2011. The company has had significant financial success, generating over $3 billion in revenue with a net income of $226 million in 2011 (Netflix, 2012a). Netflix has three business segments in which it operates: domestic streaming, international streaming, and domestic DVD rentals. For the DVD-by-mail service, Netflix relies on the United States Postal Service to transport DVDs to and from shipping centers. Netflix hopes to maintain its profitability by expanding into new markets. Netflix expanded its streaming service into Canada in 2010, Latin America and the Caribbean in 2011, and the UK and Ireland in 2012 (Netflix, 2012a). Since Netflix has not reached profitability in any of its international markets to date, the company decided to halt further expansions until its new markets are profitable operations. Although the company did anticipate some losses due to the investments made in these new operations, these expansions should prove to strengthen the long-term viability of the company.

Netflix is a company with a functional organizational structure (Netflix, 2012d). The company is divided based on roles and not based on customer segments or different geographical regions. The structure is very much centralized with CEO, Reed Hastings, having direct control over the six business units of the company. Each segment has its own president or manager, which are: Chief Product Officer, Chief Marketing Officer, Chief Talent Officer, Chief Content Officer, Chief Financial Officer, and Chief Communications Officer. Even though the formal structure is a functional organization, very little control is pushed on employees. "Our model is to increase employee freedom as we grow, rather than limit it, to continue to attract and nourish innovative people, so we have better chance of sustained success" (Hastings, 2001, p. 42).

The way that Netflix executes its processes has played a vital role in adding value to every part of the company's value-chain. The firm infrastructure allows for innovative thinking that has motivated creativity of significant product improvements. Human Resources has been able to recruit an intelligent service driven technology staff that will be able to handle the needs of the ever changing and growing business. Netflix has added tremendous value to the technology aspect of its value chain with things like Cinematch and an award winning website. None of this could be possible without the procurement of the exclusive video content that Netflix thrives on. Inbound logistics are enhanced by relationships with content providers, while outbound is by a great relationship with the United States Postal Service and developers of streaming enabled devices and technology. The pioneering spirit of Reed Hastings has been instrumental in the efficiency and progress in operations at Netflix. Although recent events have tarnished the company's reputation, the Netflix brand is still widely recognized in the industry.

NETFLIX'S COMPETITION

The in-home entertainment video industry is intensely competitive and subject to rapid change, especially in Internet streaming. Regardless of the method of distribution, content providers receive revenue from a variation of subscriptions, pay-per-view, and advertising subsidies. "New competitors may be able to launch new businesses at relatively low cost. Many consumers maintain simultaneous relationships with multiple entertainment video providers and can easily shift spending from one provider to another" (Netflix, 2012a, p. 6). Netflix and many competitors offer consumers the ability to receive streaming content through their computer and other Internet-connected devices such as Blu-ray players, digital video players, video game consoles, and mobile devices. What determines a company's ability to attract and retain customers depends on how it provides a valuable and quality experience for selecting and viewing TV shows and movies in addition to its relative service levels, content offerings, and pricing (Hoover's, 2012b; Netflix, 2012a). The principal types of competitors include Multichannel Video Distributors, Over the Top Content Providers and Rental Outlets and Kiosks services.

Multichannel Video Programming Distributors

Multichannel video programming distributors (MVPDs) include cable providers, such as Time Warner and Comcast, direct broadcast satellite providers such as DIRECTV, DISH, and EchoStar, and telecommunication providers such as AT&T and Verizon (Netflix, 2012a). MVPDs can make content available for purchase by subscribers as video-on-demand (VOD) such as pay-per-view or TV Everywhere applications such as HBO GO. Some companies, like Comcast and Time Warner, double as Internet service and cable providers that are heavily involved in the control and distribution of content. Their established network infrastructure allows them to provide consumers Internet access with multichannel video programming (Netflix, 2012a).

Over-the-Top Content Providers

Over-the-top (OTT) content providers are third parties that offer content over the Internet to end-users without the involvement of the Internet service provider in controlling content. In other words, consumers can watch movies and TV online from these content providers anywhere, anytime so long as they have an Internet connection. Netflix falls under this category as well as Apple's iTunes, Amazon.com's Prime Video, Hulu.com and Hulu Plus, and Google's YouTube (Netflix, 2012a). A significant amount of Internet piracy also occurs through OTT services.

OTT content providers rely on one or a mix of subscription, pay-per-view, and ad-supported services. For example, Hulu is a joint venture between NBC Universal (a division of Comcast), Fox Entertainment Group (a division of News Corporation), and ABC (a division of The Walt Disney Company) that offers streaming of TV and movies online. A significant amount of Hulu's library is available for free and Hulu generates revenue through showing short video ads during shows (i.e. brief commercials) (Grimes, 2012). Hulu Plus costs the same price as Netflix's streaming ($7.99), but offers full access to the Hulu library with even fewer ads and is available on as many Internet-enabled devices as Netflix. Many OTT content providers also offer video streaming as a complementary service or as part of a bundle of services. For example, Amazon Prime membership costs $79.99 a year, but the benefits include unlimited streaming of a substantial portion of its film and TV library, shipping discounts on products bought at Amazon.com, and free e-books through its Kindle e-reader. With the growing number of new competitors, along with current and emerging threats that are vertically integrated, the industry is quickly becoming saturated.

Rental Outlets and Kiosk Services

Rental outlets and kiosks provide physical media rentals, although Netflix and Blockbuster (DISH) offer physical rentals and digital streaming. The DVD rental industry has been in decline as more consumers switch to streaming, VOD, and downloadable media (Kaczanowska, 2011). Brick and mortar rental stores will continue to close down as profits decline, However, subscription-based rentals such as Netflix and Blockbuster and kiosk rentals such as Redbox and Blockbuster Express can still maintain profitability by making DVD rentals more affordable and convenient than ever (Kaczanowska, 2011).

NOTABLES COMPETITORS

The in-home entertainment video industry has a number of competitors with respect to both rental and Internet content providers. Some of Netflix's competitors have comparable business models and financials (Coinstar), while for other competitors (Apple, Amazon), video streaming and rental are only small segments of the businesses they compete in. In addition, Netflix must also consider the growing threat and competition from piracy-based models within the industry. Several competitors with different types of business and economic models follow.

COINSTAR INC.

Coinstar competes in the in-home entertainment video industry through its Redbox segment, which generates about 80% of the company's revenue (Coinstar, 2012; Kaczanowska, 2011). Redbox is able to compete with online streaming with its low price point of $1 per day per rental and by placing its vending-machine-like kiosks outside convenient locations such as Wal-mart, McDonald's, gas stations, and grocery stores. Redbox has over 35,000 kiosks; each kiosk has low-maintenance costs but is limited to 200 titles and recent releases (Hoover's, 2012a). Customers can pay by credit card and can go online or use a mobile app to locate Redbox kiosks, check title availability, and reserve titles. Redbox also has Blu-ray and video games available for $2-3 a day. Currently, Redbox does not offer streaming services and does not have the digital rights for its content library. However, in February 2012, Coinstar announced it would partner Redbox with Verizon to provide DVD rental and streaming services. The joint venture hopes to combine the best of both physical and digital by utilizing both companies' infrastructure and customer base. Redbox's conveniently located 35,000 kiosks have over 30 million people renting DVDs and games while Verizon has over 100 million wireless customers and 9 million broadband subscribers (Chozick, 2012b).

DISH NETWORK CORPORATION

DISH Network is the second largest satellite cable provider with over 14 million subscribers and acquired Blockbuster in April 2011. Blockbuster filed for Chapter 11 bankruptcy in September 2010 after failing to compete with Netflix and struggling to adapt to consumers' shift to online streaming instead of physical rental outlets (Kaczanowska, 2011). In order to penetrate both the declining DVD rental market and the growing online streaming market, DISH will continue to utilize the Blockbuster brand as a complement to its core business. Although it has closed over 1,000 Blockbuster stores, DISH will still operate the remaining 600 Blockbuster rental outlets while also selling satellite TV subscriptions in-store. While not widespread as Redbox's kiosks, Blockbuster also has kiosks called Blockbuster Express with features nearly identical to Redbox. Blockbuster also has DVD-by-mail rentals and VOD streaming available for multiple Internet-enabled devices. Thus, DISH offers streaming as both multichannel video programming (DISH's satellite TV) and OTT content (Blockbuster streaming) (Netflix, 2012a, Kaczanowska, 2011).

APPLE INC.

Apple competes in the in-home entertainment video industry through its iTunes Store division. The iTunes Store allows consumers to download and manage an enormous selection of content that includes music, movies, TV episodes, and podcasts. Most content on iTunes has standardized pricing and Apple is the only consistently profitable major paid-content provider. The iTunes Store has been extremely successful with over $6 billion revenue and

25% annualized revenue growth over the past five years (Apple, 2012; Grimes, 2012). Part of Apple's success can be attributed to its uniquely developed transmedia/multimedia platform of devices and services. Apple has leveraged the success of its premium devices, including the iPod, iPhone, iPad, Macbooks, and Apple TV, into use of iTunes as an integrated media player and store (Apple, 2012; Grimes, 2012). While non-Apple computers and devices can run iTunes, "all of these [Apple] devices are designed to work specifically with iTunes, making the iTunes store highly visible to owners of these products" (Grimes, 2012, p. 27).

TIME WARNER INC. (HBO)

Home Box Office (HBO) is part of Time Warner's Networks business, which includes its domestic and international networks, television services, and digital media properties. Specifically, HBO is a multichannel premium pay television service with over 93 million subscribers worldwide including 53.4 million domestic subscribers. HBO's main source of revenue is providing programming to cable companies and other distributors who in turn provide it to customers that choose to subscribe to HBO (Time Warner, 2012, p. 5). HBO's programming consists of recently released movies and original programming, which includes award winning and critically acclaimed series like *Game of Thrones* and *Boardwalk Empire*. HBO gains additional revenue from its original programming through DVD/Blu-ray sales and licensing its shows to other networks for syndication. HBO's streaming service, HBO GO, is available only to subscribers and has over 1400 movie and TV titles available on devices such as the iPhone, iPad, Android phones, Roku, and Xbox. Time Warner does not publish specifics on HBO's financial performance (Time Warner, 2012).

FINANCIAL OVERVIEW

Netflix was still enjoying above average revenue growth even during the economic recession of 2009 and 2010. An inspection of Netflix's 2011 income statement, found in Table 2, shows annual sales increased by 266% since 2007. This increase in sales is attributed to the popular DVD-by-mail and unlimited streaming plan for $9.99 a month. Netflix's sales increased from $1.2 billion in 2007 to $3.2 billion in 2011. The subscriber losses from July-October 2011 did not have a major effect on Netflix's overall sales in 2011 because most of the changes were in the later part of the year (Wingfield & Stelter, 2011). Net income also increased by 41% from $161 million in 2010 to $226 million in 2011. Figure 2 shows the net income trend. Table 3 provides a snap shot of Netflix's balance sheet data for the past five years. In addition, Tables 4 and 5 compare Netflix's financial position to three notable competitors: Apple, Coinstar, and DISH Network (Blockbuster). Figures 3, 4, 5, and 6 are a visual comparison of the information discussed earlier.

STOCK PERFORMANCE

Netflix initiated an initial public offering in 2002 and trades under the NFLX ticker symbol. As a general trend, Netflix's share price appreciated over the past five years. The company's earnings per share almost quintupled since 2007 increasing from 0.9 to 4.27 (see Tables 2 and 4). Even though yearly data looks favorable, quarterly and monthly data do not reflect the same image. After the announcement in July 2011, Netflix's stock price tumbled from

$304.79 to a current price of $109.13 as seen in Figure 1. The stock price reached a low of $63.86 before rebounding to the current price.

INDUSTRY SPECIFIC MEASURES

While Netflix competes in the in-home entertainment video industry, its DVD-by-mail service overlaps into DVD, games, and video rental industry and its streaming service is a segment of the Internet publishing and broadcasting industry (Grimes, 2012; Kaczanowska, 2011; Netflix, 2012a). DVD sales are on a slippery slope with sales decreasing an average of 2.4% annually to less than $14.3 billion in 2011 in the U.S. On the other hand, digital sales sky-rocketed, more than doubled in 2010 to $4.8 billion in the U.S. alone (Kaczanowska, 2011). Over the next five years, total disc sales are expected to decline and digital sales or streaming are expected to grow (Kaczanowska, 2011). While the growth of broadband connections is slowing down, mobile Internet connections, especially from devices like smartphones and tablets, will continue to grow rapidly with over 155 million mobile Internet connections in the U.S. alone in 2011. This growth will drive a greater demand for Internet-based content on multiple devices which already include a number of streaming services such as Netflix, Hulu, and iTunes (Barnes, 2012; Grimes, 2012). Table 6 shows a comparison of popular video streaming services.

Before Blockbuster was acquired by Dish Network in 2011, Netflix and Blockbuster were very similar in nature. Figure 7 compares the revenue of the two companies up to 2010 to show the difference in the current nature of both companies. Netflix understood the wants of the consumers and where the industry was heading. The company evolved to mainly an online streaming company which made it profitable. Blockbuster on the other hand failed to see the trends in the industry and went bankrupt.

Increasing Internet speeds and technological advancements have made streaming video possible and very easy for many consumers. Due to these factors, a large proportion of consumers are switching to video streaming through several subscription providers. The penetration of streaming media is projected to grow and because of this growth, physical rentals will continue to drop. As the profits from these rentals drop, more stores will close, forcing lagging consumers to switch to online streaming. "This vicious cycle will contribute to an estimated 13.0% annualized contraction in revenue over the next five years, reaching $3.3 billion in 2016" (Kaczanowska, 2011, p. 4).

RENTAL AND STREAMING

Netflix and some analysts believe that the evolution of video streaming services will reflect the "legacy of television networks: namely, historical reliance upon exclusive content as a differentiator" (Chozick, 2012a; Netflix, 2012c, p. 3; Stelter, 2012). Film contracts are harder to get and competitors are filling in Netflix's gap in streaming films. Netflix will have to anticipate the vertical integration by the major content producers, such as those in the New York and Los Angeles areas, and the implications it will have on the concentration of the industry. NBC, FOX, and ABC have already proven the ability to affect the industry with their joint venture to create Hulu. Several technology companies have, or are developing, home entertainment devices and more media companies are introducing online streaming services. "Taken together, the moves mean no supplier will have a monopoly over the distribution of films and television on the Internet" (Barnes, 2012, p. 1). Consumers' propensity to stream on newer technology devices such as iPads, Android tablets, digital media players, and smart phones will continue to develop at a fast pace. The predicted sales of around 370 million iPads and other tablet devices by year 2016 make this and other new markets very attractive (Sherr, 2012). For Netflix and its competitors, being a first mover with respect to Internet delivery of entertainment video to these devices is imperative for gaining market share. What will differentiate one streaming service from another is based upon breadth of content, exclusivity of content, customer service, and technologies such as user interface.

For Reed Hastings, DVD rental is a fading differentiator for Netflix and its long term success lies in streaming. Netflix, Redbox, and Blockbuster are the few companies that are balancing old and new technologies. The numbers and trends show that DVD and physical media is on the decline while TV streaming is surpassing movie streaming. The makeup of TV, movies, and exclusive content in Netflix's library determines what differentiates Netflix from its growing competition as well as its overall cost structure. Reed Hastings firmly believes his company is on the right track and that there will not be any more missteps. But Netflix's market and brand value has not fully recovered and who knows how subscribers will react to another major decision. The company pulled off two revolutions with its DVD-by-mail model and then its hybrid low priced rental/streaming model. However, these successes were followed by two failures with its new pricing and Qwikster. Will a streaming, TV focused Netflix turning into a global Internet TV network be a third revolution…or a third failure? As Reed Hastings ponders over the events of 2011, he contemplates whether Netflix is on the path to recovery.

APPENDIX

TABLE 1
Netflix Corporation's Annual Subscribers (2007 – 2011)
(Thousands)

	2011	2010	2009	2008	2007
Paid Unique Subscribers	24,305	18,268	11,892	9,164	7,326
Total Unique Subscribers	26,253	20,010	12,268	9,390	7,479

Source: (Netflix, 2012a).

TABLE 2
Netflix Corporation's Annual Income Statement (2007 – 2011)
($Millions, except per share)

	Dec11	Dec10	Dec09	Dec08	Dec07
Sales	3,204	2,162	1,670	1,364	1,205
Cost of Goods Sold	2,040	1,357	1,079	910	789
Gross Profit	1,164	805	591	454	419
Selling, General & Admin	779	527	403	339	342
Depreciation, Depletion & Amortization	839	338	257	242	224
Operating Profit	385	277	187	115	77
Interest Expense	20	19	6	2	0
Non-Operating Income/Expense	3	10	11	19	30
Pretax Income	360	268	192	131	111
Total Income Taxes	133	107	76	48	45
Net Income	226	161	116	83	67
Earnings per share	4.27	2.96	1.98	1.32	.90
Earnings per share-diluted	4.16	2.96	1.98	1.32	.97
Dividends per share	0	0	0	0	0

source: (Netflix, 2012b).

TABLE 3
Netflix Corporation's Annual Balance Sheet (2007 – 2011)
($ Millions)

	Dec11	Dec10	Dec09	Dec08	Dec07
ASSETS					
Cash	508	194	134	140	177
Inventories	0	0	0	0	0
Receivables	0	0	0	0	0
Total current	1839	641	411	361	416
TOTAL ASSETS	3069	982	680	618	647
LIABILITIES					
Total Current Liabilities	1225	388	226	216	212
TOTAL LIABILITIES	2426	692	480	271	216
TOTAL EQUITY	643	290	199	347	431
LIABILITIES & EQUITY	3069	982	680	618	647

Source: (Netflix, 2012b).

TABLE 4
Top Four Firms' Comparative Income Statement Data for Year 2011
($Millions, except per share)

	NETFLIX	APPLE	COINSTAR	DISH
	Dec11	Dec11	Dec11	Dec11
Sales	3,204	108,598	1,845	14,048
Cost of Goods Sold	2,040	54,076	1,431	8,947
Gross Profit	1,164	44,522	413	5,101
Selling, General & Admin	779	10,028	204	2,490
Depreciation, Depletion & Amortization	839	1,814	148	922
Operating Profit	385	34,494	210	2,611
Interest Expense	20	0	26	558
Non-Operating Income/Expense	3	-289	0.83	56.83
Pretax Income	360	34,205	185	2,410
Total Income Taxes	133	4,413	70	895
Net Income	226	13,064	115	1,516
Earnings per share	4.27	13.87	3.26	3.39
Earnings per share-diluted	4.16	13.87	3.61	3.39
Dividends per share	0	0	0	2

Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

TABLE 5
Top Four Firms' Comparative Balance Sheet Data for Year 2011 ($Millions)

	NETFLIX	APPLE	COINSTAR	DISH
	Dec11	Dec11	Dec11	Dec11
ASSETS				
Cash	508	2,903	45	609
Inventories	0	776	142	0
Receivables	0	11,717	41	795
Total current	1,839	44,988	652	3,748
TOTAL ASSETS	3,069	116,371	1,468	11,470
LIABILITIES				
Total Current Liabilities	1,225	27,970	478	3,221
TOTAL LIABILITIES	2,426	39,756	937	11,889
TOTAL EQUITY	643	76,615	531	-419
LIABILITIES & EQUITY	3,069	116,371	1,468	11,470

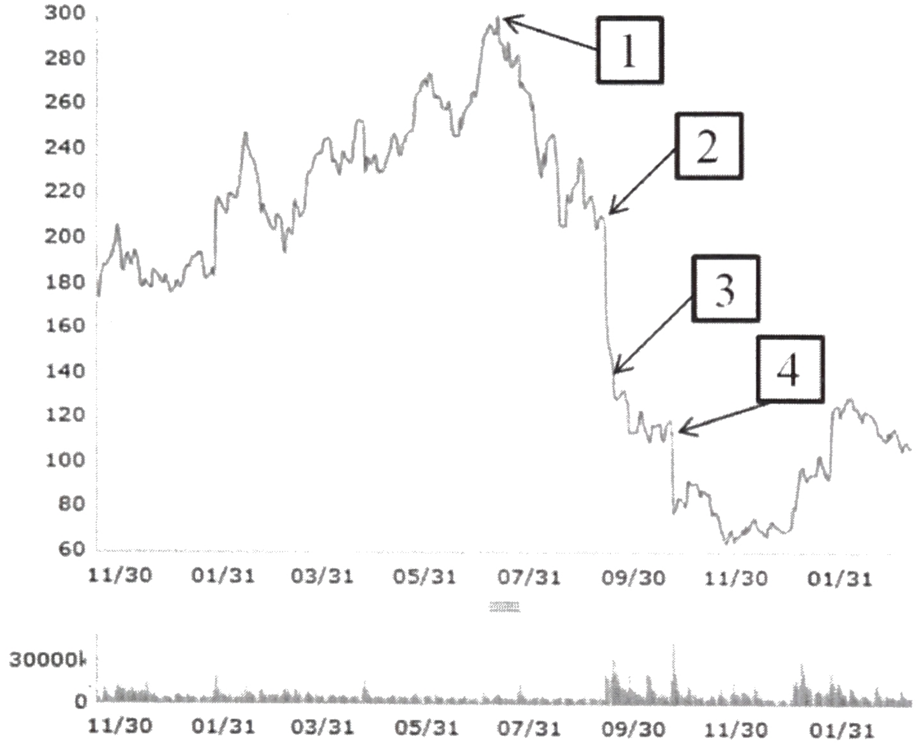
Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

TABLE 6 - Comparison of Video Streaming Services in 2012

	Amazon Instant	HBO GO	Hulu Plus	iTunes	Netflix
Model	All you can watch for select catalog with Prime Membership; rental or purchase for larger catalog	All you can watch for select catalog with HBO subscription	All you can watch for monthly fee with commercials	Rental / Purchase Movies on Apple TV. Purchase available with iTunes.	All you can watch for monthly fee. Now separate plan for DVD by mail
Number of Titles	49,400+ movies and 7,100+ TV Seasons for purchase and/or rental. 1,500+ Movies and 931 TV Seasons (12,100+ episodes) on Prime Streaming.	1400+ HBO titles comprising of movies and TV seasons	2,100+ Movies and 1,900+ TV seasons (32,800+ episodes) Some seasons are incomplete. Some "TV" is Internet-only.	13,400+ movies and ??? TV seasons.	9,500+ movies and 4,100+ TV seasons (41,000+ episodes)
Rental Window	2 days after rental is purchased	N/A	N/A	30 days to	N/A
Cost	Streaming Library included/ Amazon Prime $79/yr; $3.99 to rent new movies; $2.99 to buy TV episodes in HD.	HBO subscription through cable provider	$7.99 per month for unlimited viewing	$2.99 buy HD TV episodes, $4.99 to rent new HD movies. $1less in SD.	$7.99 per month unlimited viewing. $7.99 per month for DVDs mailed to home; Another $2 for Blu-ray
Devices	Over 200: Select Blu-ray, streaming boxes and TVs from Roku, Google TV, Vizio, LG, Panasonic, Sony, Samsung, Panasonic and TiVo (no Prime streaming)	Roku, Samsung, Xbox	Roku, WD TV, Samsung, Panasonic, LG, Sharp, Sony and Vizio, Haier, Blu-ray and TVs. PC/Mac, PS3, Wii, TiVo Premiere, Xbox	Apple TV, PC, Mac	Over 700; Examples include Wii, PS3, Xbox, Roku, Apple, TiVo, Boxee, LG, Samsung, Vizio, Insignia, Philips, Panasonic, Sony and Phillips devices
Mobile Devices	Sony Walkman Video, Amazon Kindle Fire	iPhone, iPad, Android	iPhone, iPad, Nook, Nintendo 3DS and selected Android	iPhone, iPad, iPod Touch	iPhone, iPad, Windows Phone, Android, Nook, Nintendo 3DS, Sony Vita

Source: (Gagliano, 2012).

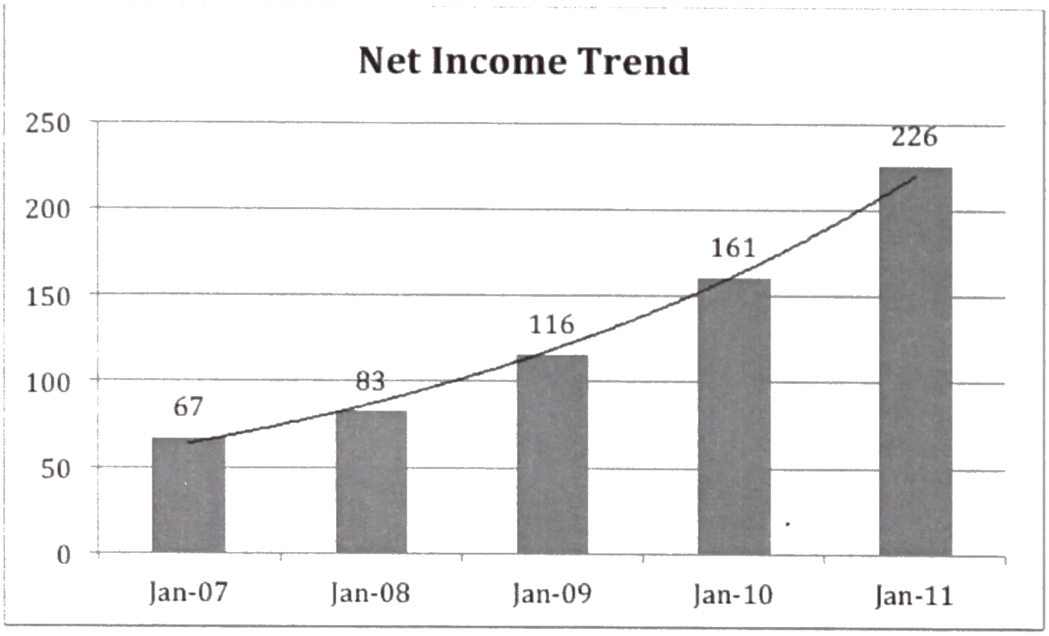
FIGURE 1
Netflix's Stock Price in 2011



Sources: (Netflix, 2012d; Pogue, 2011a; Wingfield & Stelter, 2011).

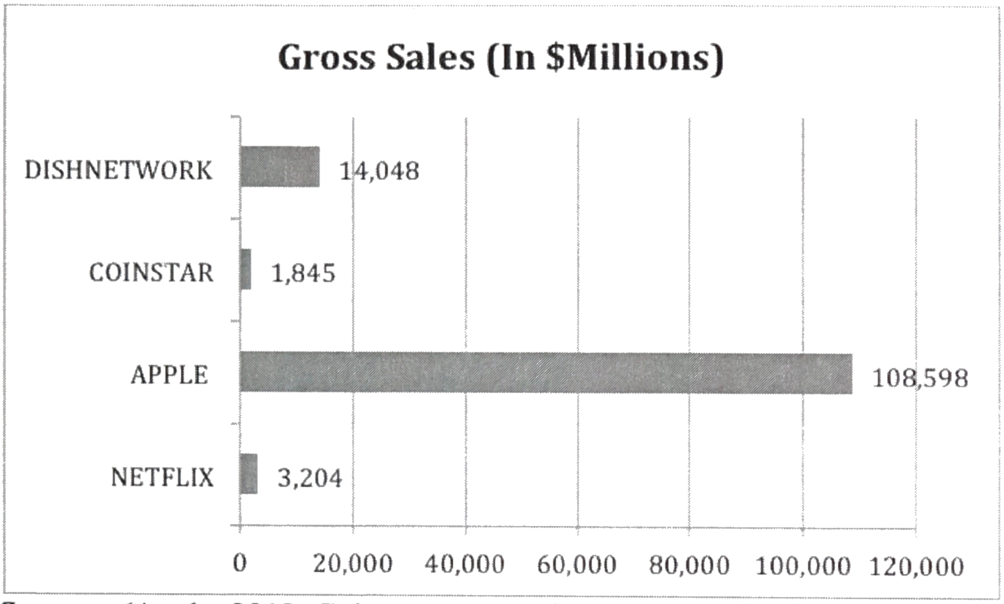
1. July 12, 2011: Netflix announces its will split streaming and DVD-by-mail services and increase the price of the streaming/DVD rental package by 60%.
2. September 15, 2011: Netflix price changes go into effect for previously existing subscribers and Netflix's stock price drops by 19%.
3. September 18, 2011: CEO Hastings apologizes for the way Netflix handled the announcement of the changes in services. Explains the reasoning behind the changes, but announces Qwikster as a rebranding of the DVD-by-mail service.
4. October 10-24, 2011: On October 10th the company announces it will not split up its services into two companies. On October 24th the company's 3rd quarter financial results were below investor expectations and revealed it lost 800,000 subscribers. Investors' reactions to these results lead to the company's market value dropping to 1/4th of what it was in July.

FIGURE 2
Net Income Trend from 2007 to 2011



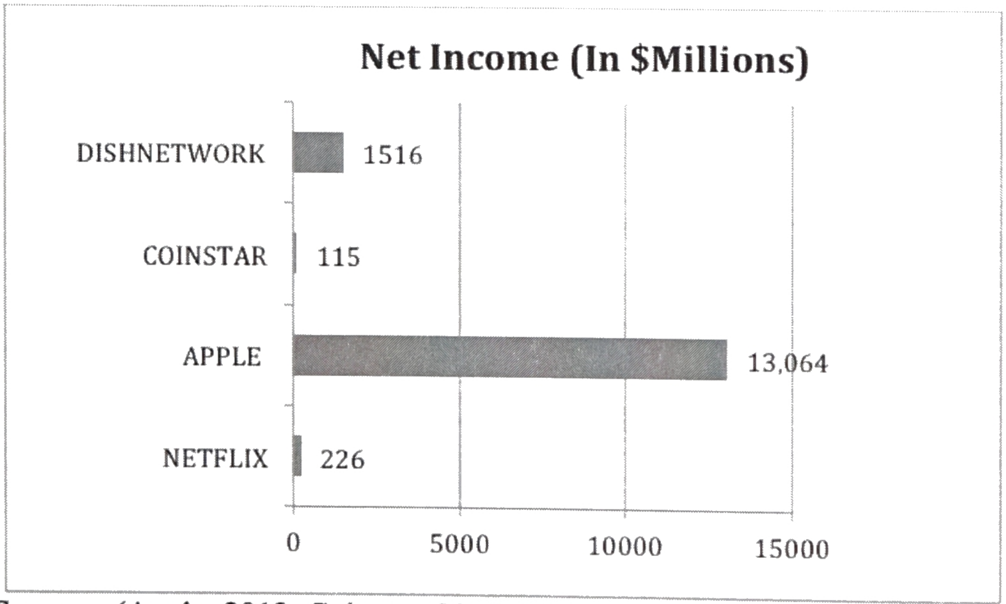
Source: (Netflix, 2012b).

FIGURE 3
Gross Sales Comparison for 2011



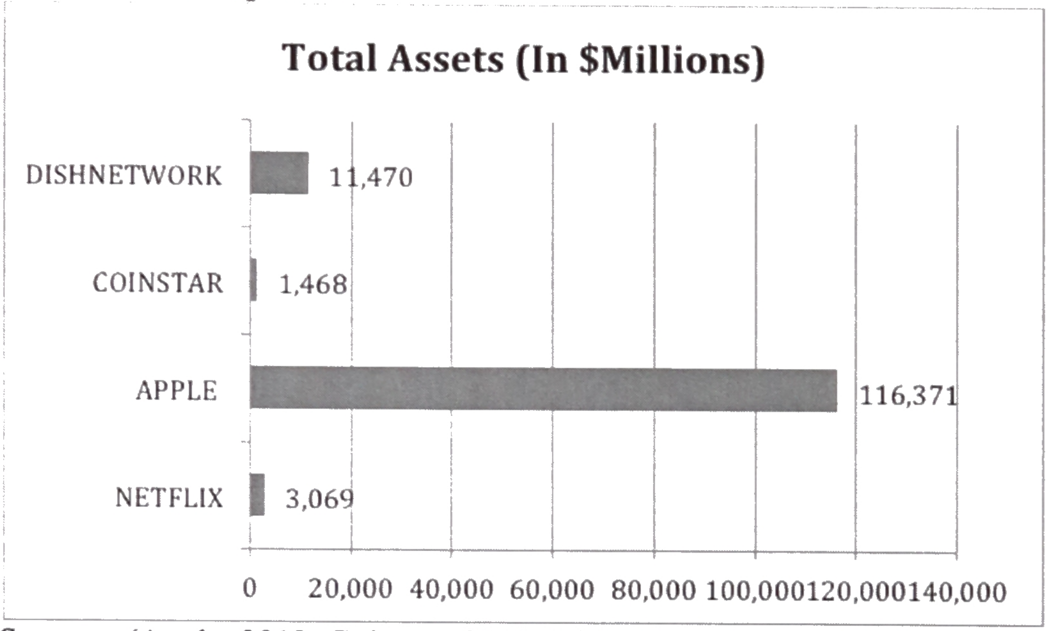
Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

FIGURE 4
Net Income Comparison for 2011



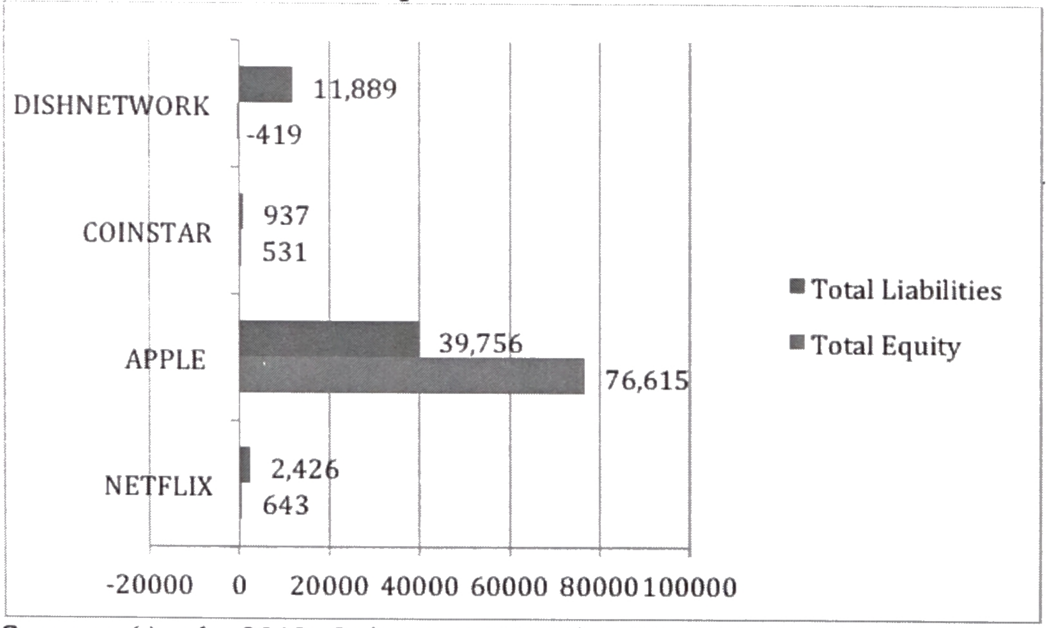
Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

FIGURE 5
Total Asset Comparison for 2011



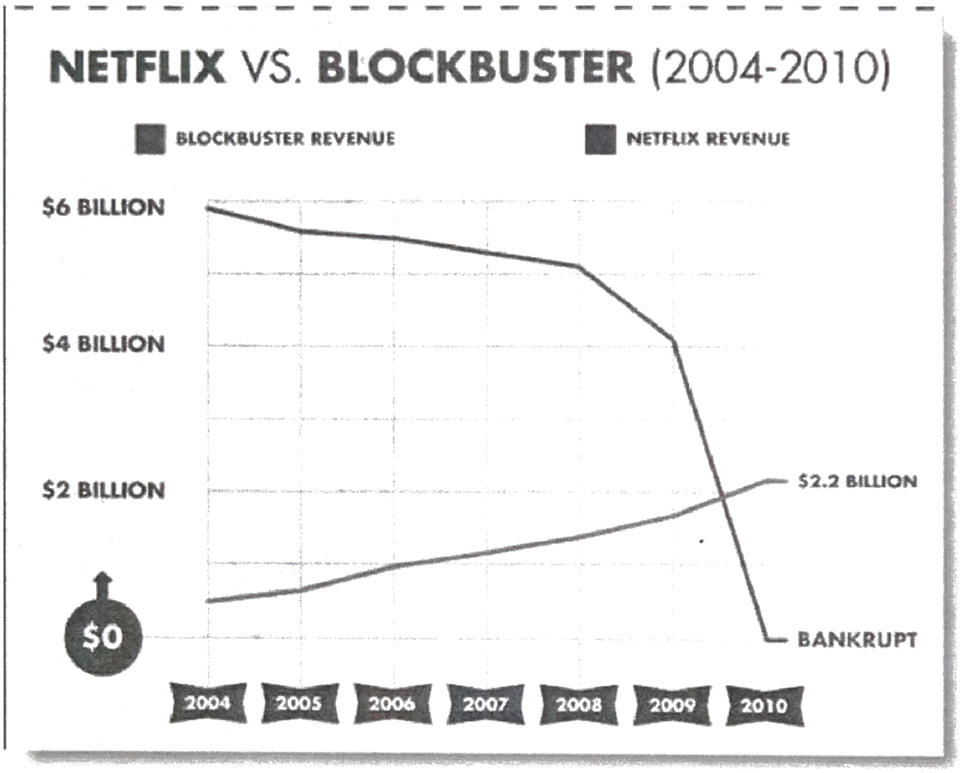
Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

FIGURE 6
Equity and Liabilities Comparison for 2011



Sources: (Apple, 2012; Coinstar, 2012; Dish, 2012; Netflix, 2012b).

FIGURE 7
Netflix and Blockbuster Revenue Comparison



Source: (Fou, 2011).

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