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Strategy – Case Study
Spring Semester 07/08

Case study: Netflix vs Blockbuster vs Video-on-Demand

Rules

- **5% of final grade** (included in the class participation 10%).
- **Two pages**: 12 Font. Times New Roman. 1.5 line spacing.
- **Deadline**: 15th April at 22h00'.

Guideline

1) Describe briefly Netflix's business model and comment about its strategy. You should take into account how Netflix does change the video distribution industry.

2) What is the key for Netflix to succeed in the face of direct competitors from established distributors such as Blockbuster?

3) According to some analysts, VOD is a huge threat to Netflix, however, Red Hastings believe that Netflix's prospects are exceptionally bright. Is VOD really a menace or an opportunity to Netflix?

How was the case study graded?

In this case study (Netflix vs Blockbuster vs Video-on-Demand) the grade criteria used were:

a) the correct use of the information provided in the case;
b) the correct analysis of the situation presented in the case using strategy concepts given in class.
c) **Creativity**! The difference between a good work and an excellent work is creativity.

Most of you did a fine job on part a) and b), however few of you have shown creative solutions (real new strategies) for Netflix.

For those who followed my guideline I was expecting to see the descriptive part in question 1) and some creative solutions in the second part (question 2 or question 3, depending on your choice).

In general the grades were fine but could be a lot better if you were a bit more creative and not stick so much to the words on the case. The grade distinction among case studies is mainly due to criterion c).

Now that you are aware of the grading criteria, you can take a look at the vital topics that I have selected. Recall that I respect all your ideas and suggestions as long they are consistent and within the compass of the Strategy course.

And remember that there’s no such thing as 100% correct answers…

Topics that you may have taken into account in the case analysis

1) ***Describe briefly Netflix's business model and comment about its strategy. You should take into account how does Netflix change the video distribution industry.***

- Netflix is an **online movie DVD rental firm** founded in 1997.
- It's **strategy** and market success have been predicated on providing an expansive selection of DVD's, an easy way to choose movies, and fast, free delivery – the goal was to deliver customer value by eliminating the hassle involved in choosing, renting and returning movies.
- Netflix's **Cinematch software** technology, which enabled to provide subscribers with customized movie recommendations every time they visit Netflix web site.
- **Fast shipping**: with 37 regional shipping centers scattered across the US, giving it one-business-day delivery capability for 90% of its subscribers. Netflix had developed sophisticated software to track its inventory and minimize delivery times.
- **Target customers and customer satisfaction**: 3 types of customers and an offering of 8 subscription plans which allow for self-selection.
- **Growth Strategy**: a) Continue to innovate and enhance consumer experience; b) use Netflix's market-leading position to lead the transition to high-definition DVDs and eventually digital downloading; c) focus on rapid subscriber growth in order to maintain market leadership, exploit **scale economies**.

2) ***What is the key for Netflix to succeed in the face of direct competitors from established distributors such as Blockbuster?***

- Work with music labels

They figured out how to mail that little envelope fast, and to get customers to send it back. So what else can they put in the envelope on a shared basis? If I were them, I would **sign licensing deals with developed music artists** who are having a harder time selling music these days. CD players are still the norm in most cars and Netflix could help music labels tap into the drive-to-work market.

- Rethink the price

Lowering the price was a mistake because it positioned Netflix's service as a commodity, one for which price is the only measure of value. Netflix needs to focus on offering a higher quality service both from a technology perspective and in terms of customer service. And when they make clear improvements in these key areas, they should charge more. The top brand in most industries should enjoy at least a 10 percent price premium over the nº 2 brand. Netflix created this category and it needs to reclaim its status as the market leader.

- Find a new CEO[1]

[1] I also accept if you defend the idea that Reed Hastings should stay being a building block in Netflix's strategy. You could have argued that the Netflix's engineer is open-minded and is the mastermind behind Netflix's software. It's not hard to find some information in the case about R. Hastings and some other reasons why he should remain.

Netflix needs a management change. The countermove by Blockbuster was pretty obvious and Netflix should have seen it coming. And dropping prices suggests to me that the company is now trying to fight back by creating a more efficient buggy whip, rather than by focusing on innovation. Focusing on physical media is not thinking ahead. **They need to think about delivery**, including movie downloading, and how they can get entertainment in front of people whenever they want it. All of that goes back to the management team. This company needs a new one.

- Go beyond Hollywood

Netflix should distribute more obscure films. **Targeted niche outreach** of this kind is harder to do than mass outreach, but if you develop a lot of loyal little audiences over time, in the way that eBay did, you often end up with a larger audience than if you go after the mainstream. Some of you talk about **partnerships with Walt Disney and Warner Bros**.

- Pursue a cable suitor

Netflix needs to remind customers through aggressive **advertising and marketing** why it's the easiest and most convenient service out there. In the long run, it should move more quickly into VOD by locking up relationships with two or three large cable operators, which can offer access to capital, personnel, and large pools of customers. The company might even consider **merging** with a partner that can help it get into video on demand faster. Today, the technology isn't perfect but with the right investment, it can be dramatically improved.

3) ***According to some analysts, VOD is a huge threat to Netflix, however, Red Hastings believe that Netflix's prospects are exceptionally bright. Is VOD really a menace or an opportunity to Netflix?***

At this stage I expect you to identify and balance the VOD threats and opportunities.
Threats: VOD may kill the DVD market (cannibalization effect). Piracy problems (illegal file sharing); DirectTV menace where there's no time waiting for download. Economics are far more favourable to the studios for VOD than for physical rentals. In a rental model, revenues are split 70/30 in favour of the retailer; in a VOD model, the revenue split is 60/40 in favour of the studio.

Opportunities: Instantaneous delivery dates reducing mail costs. Selling movies to a much wider range of customers from different geographical areas outside US. Explore economies of scale. No more constraints about the stored quantity of movies – savings in the media storage process. Provide media contents for mobile gadgets. The opportunity to provide media to everyone, anywhere and anytime – fantastic growth explosion – ubiquity and globalization as key words. Some of you argued well that Netflix could expand much more in Europe.

Here you can talk about very basic things that we discuss at the practical classes such as the Netflix's mission, the long term goals, the company's vision. **The problem was that you thought small when you should have thought big**. **Why don't sell media to the entire planet (in the long run)? According to my view the opportunities will outweigh the threats.**

This was the type of creative reasoning that I had expected to find in the case. Unfortunately, most of you didn't make it. These are just some examples, you could think about many other ideas.