

# Netflix

Aniel Nieves-González

Fall 2015

# Introduction I

- 1 When Netflix went public, financial disclosure rules forced the firm to reveal how profitable it was.
- 2 Rivals such as Blockbuster and Wal-Mart showed up.
- 3 Competitors underestimated Netflix because:
  - 1 It was an Internet pure play without a storefront.
  - 2 Its overall customer base was microscopic in comparison.
- 4 Netflix survived big competitors, a price war, and spending on the rise.
- 5 Netflix is transitioning from DVD-by-mail business to Internet streaming.

# How Netflix works I

- Originally Netflix settled on a DVD-by-mail service model
  - It charges a flat-rate monthly subscription
  - Customers don't pay mailing expenses and late fees
- Videos arrive in Mylar envelopes containing:
  - Prepaid postage
  - Return address
- After watching the video, consumers:
  - Slip the DVD back into the envelope
  - Drop the disc in the mail
- Users make their video choices in their “request queue” at Netflix.com
- Consumers use the Web site to:
  - Rate videos
  - Specify movie preferences

## How Netflix works II

- Get video recommendations
  - Check out DVD details
  - Share their viewing habits and review
- Netflix operates via a DVD subscription and video streaming model.

- Building a great brand online starts with offering exceptional value
- Advertising builds awareness, but brands are built through customer experience
- Subscribers expectations from Netflix:
  - Huge selection
  - Ability to find what they want
  - Timely arrival
  - Ease of use and convenience
  - Fair price
- All of the above is driven by technology

# The Long Tail I

- Netflix offers its customers a selection of over 125,000 DVD titles.
- Traditional retailers cannot offer this because of shelf space constraints.
- Internet firms can have just a few highly automated warehouses
- *Long tail*: A phenomenon whereby firms can make money by offering a near-limitless selection.

## The Long Tail II



- The long tail works because:
  - Cost of production and distribution drop.
  - It gives the firm a selection advantage that traditional stores cannot match.

## The Long Tail III

- Geographic constraints go away and untapped markets open up.
- Netflix has used the long tail to create close ties with film studios.
  - Studios earn a percentage of the subscription revenue
  - Netflix gets DVDs at a very low cost
  - Studios do not spend on additional marketing



# Cinematch I

- Netflix uses a proprietary recommendation system called Cinematch
- Each time a DVD is returned or streamed, Cinematch asks the customer to rate it.
- *Collaborative filtering*: A classification of software that monitors trends among customers and uses this data to personalize an individual customers experience.

# Cinematch I

- The data provided by Cinematch is a switching cost
- To see how strong switching costs are is to examine Netflix's churn rate
  - Churn rate: The rate at which customers leave a product or service
  - Churn rates for Netflix's most active regions were below 4 percent
- Netflix's marketing costs benefit from satisfied customers, as referrals are a better choice than advertisements
- Netflix launched a crowdsourcing effort known as The Netflix Prize

## Technology lies at the heart of Netflix's warehouse operations

- Netflix has a network of fifty-eight ultra high-tech distribution centers.
- Distribution centers are all located close to U.S.P.S. facilities
- Trucks collect DVD shipments from these U.S.P.S. hubs and return the DVDs to the nearest Netflix center.
- Scanners pick out incoming titles.
- Netflix presorts outgoing mail before dropping it off at U.S.P.S. facilities.
- All DVDs are hand-inspected for cracks and smudges.
- Warehouse processes are linked to Cinematch.

# Shift from mailing to streaming I

The shift from DVD-by-mail to the streaming business poses new challenges for the firm. When the DVD dies, Netflix's high-tech shipping and handling infrastructure will be rendered worthless.

- When Netflix launched its streaming video option, only 17% of the DVD catalog was available.
- Legal issues involved in securing the digital distribution rights.
- Windowing restricts the number of titles available.
- Wal-Mart uses its bargaining power to encourage studios to:
  - Hold content from competing windows.
  - Limit offering titles at competitive pricing during the new release period.

## Shift from mailing to streaming II

- Advantages of streaming are the elimination a huge chunk of its shipping and handling costs, and that the bandwidth costs are minimal.
- Disadvantage of streaming is wrangling licensing costs is a challenge
- Bandwidth caps can be a threat.