

# WHAT WOULD YOU DO?

## Netflix: Push and Pushback in Streaming Video

### CASE STUDY

Reed Hastings, along with fellow software executive Marc Randolph, co-founded Netflix in 1997. The business, becoming operational in April 1998 in Scotts Valley, California, offered seven-day online rentals of movies in the then-relatively unknown DVD format. Netflix.com, Netflix Company Timeline, <http://www.netflix.com/MediaCenter?id=5379#about> (accessed on June 16, 2011). Netflix.com, Netflix Company Timeline, <http://www.netflix.com/MediaCenter?id=5379#about> (accessed on June 16, 2011). Although Netflix's DVD rentals business has prospered, Hastings, the Netflix CEO, thinks this core business is doomed. N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): .N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): A1. Hastings believes that Internet video streaming will substantially displace online DVD rentals; he forecasts that as soon as mid-2013, "the business that generates most of Netflix's revenue today [mid-2009] will begin to decline, as DVDs delivered by mail steadily lose ground to movies sent straight over the Internet." N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): .N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): A1.

Hastings aims to have Netflix be a key player in this emerging market. So he is "quickly trying to shift Netflix's business—seeking to make more videos available online and cutting deals with electronics makers so consumers can play those movies on television sets." N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): .N. Wingfield, "Netflix Boss Plots Life after the DVD," *The Wall Street Journal* (Eastern edition) (June 23, 2009): A1. The Netflix initiatives are not taking place without some pushback from actual and potential competitors and suppliers.

The company's Web site provides an interesting perspective on Netflix's ambitions. The Web site states: "With more than 23 million members in the United States and Canada, Netflix, Inc. ... is the world's leading Internet subscription service for enjoying movies and TV shows. For \$7.99 a month, Netflix members can instantly watch unlimited movies and TV episodes streamed over

the Internet to PCs, Macs and TVs. Among the large and expanding base of devices streaming from Netflix are Microsoft's Xbox 360, Nintendo's Wii and Sony's PS3 consoles; an array of Blu-ray disc players, Internet-connected TVs, home theater systems, digital video recorders and Internet video players; Apple's iPhone, iPad and iPod touch, as well as Apple TV and Google TV. In all, more than 200 devices that stream from Netflix are available in the U.S. and a growing number are available in Canada." Netflix.com, Media Center, <http://www.netflix.com/MediaCenter> (accessed on June 16, 2011). Netflix.com, Media Center, <http://www.netflix.com/MediaCenter> (accessed on June 16, 2011).

As it seeks to transform its business model from the online rental of DVDs to subscriptions for streaming video, Netflix is encountering and responding to at least four major challenges: technology deployment; growing competition in the streaming video market; getting involved in original programming and the associated reaction of major media companies; and the cost of accessing content.

One challenge involves fostering the deployment of technology that enables user-friendly, ease-of-access to the Netflix streaming service. Netflix has been entering into deals with game-console makers, television manufacturers, and Blu-ray disc player makers to include software in their respective products that would provide access to the Netflix streaming service. Netflix has similar applications that run on iPhones and iPads. N. Wingfield, "Corporate News: Netflix Adds Polish with Apple," *The Wall Street Journal* (Eastern edition) (September 2, 2010): .N. Wingfield, "Corporate News: Netflix Adds Polish with Apple," *The Wall Street Journal* (Eastern edition) (September 2, 2010): B2.

Another challenge is the growing competition that Netflix faces from businesses such as Amazon.com. In February 2011, Amazon "amplified its competition with Netflix by offering Amazon Prime members the ability to stream videos at no extra charge." Anonymous, "Amazon Challenges Netflix with Streaming Service," *Informationweek — Online* (February 22, 2011). Anonymous, "Amazon Challenges Netflix with Streaming Service," *Informationweek — Online* (February 22, 2011). "Amazon's subscription push is a challenge to rivals such as Netflix Inc. and Google Inc. as they race to dominate digital delivery of TV shows and films, encroaching on

turf traditionally controlled by cable- and satellite-television providers." S. Schechner and G.A. Fowler, "Amazon Makes Grab for the TV Remote," *The Wall Street Journal* (Eastern edition) (September 1, 2010): . S. Schechner and G.A. Fowler, "Amazon Makes Grab for the TV Remote," *The Wall Street Journal* (Eastern edition) (September 1, 2010): B1. However, Netflix is still in a superior competitive position. At over 20,000 titles, Netflix's library of streaming titles is four times as large as Amazon's library, but that differential is likely to decrease as Amazon enters more deals with movie studios. Anonymous, "Amazon Challenges Netflix with Streaming Service," *Informationweek* — Online (February 22, 2011). Anonymous, "Amazon Challenges Netflix with Streaming Service," *Informationweek* — Online (February 22, 2011).

Still another challenge is the initiative of Netflix to get into original programming. "Netflix recently struck a deal for exclusive first-run rights to a new show created by David Fincher called 'House of Cards.' That deal marks Netflix's first foray into original programming and has been viewed as another step in the company's challenge to the pay-TV industry, which has become a key source of revenue for major media companies." N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March 24, 2011): .N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March 24, 2011): B5. The major media companies, not particularly happy with this Netflix initiative, are pushing back. For instance, "CBS Corp.'s Showtime unit said it will remove some of the premium cable network's shows from Netflix Inc.'s streaming video service." N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March 24, 2011): .N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March 24, 2011): B5. Yet CBS has not pushed back too hard. Netflix has proven to be an important source of new revenue for major media companies like CBS. In fact, "CBS recently signed a separate, two-year distribution deal with Netflix for hundreds of millions of dollars, providing mostly older library content to its streaming service, such as episodes of 'Cheers,' 'Star Trek' and 'The Twilight Zone.'" N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March

24, 2011): .N. Worden, "CBS Diverts a Netflix Streaming — Network to Pull Some Showtime Programs as Web Service Encroaches on Pay TV," *The Wall Street Journal* (Eastern Edition) (March 24, 2011): B5.

A final challenge faced by Netflix is the fees that studios charge Netflix for access to the studios' content. "The studios are clearly ready to raise charges. Once intrigued by Netflix, ... [the studio executives] now see it as a threat to the value of their content and are tightening the screws." N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): .N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): 26. The level of studio reaction ranges from relatively mild to quite vitriolic. Time Warner's CEO Jeff Bewkes describes it as an era of experimentation that is coming to an end. N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): .N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): 26. The president of home entertainment at Universal Studios, Craig Kornblau, has a diametrically opposed view; he characterizes Netflix as "cannibalistic." *The Los Angeles Times* reports that "Kornblau told a gathering of studio executives that Netflix 'can pay us more or we can reduce the quality of what we give them.'" N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): .N.A. Martin. "Time to Hit the Eject Button?," *Barron's* 90(52) (December 27, 2010): 26.

As Netflix pushes into the video streaming market, how will competitors and other related business push back; and how will Netflix and Reed Hastings handle the pushback?

## DISCUSSION QUESTIONS

- 1 Briefly describe each of the four major challenges that Netflix faces. Which of these four challenges will be the most difficult to address? Why? Which challenge will be the easiest to address? Why?
- 2 How do each of the four major challenges faced by Netflix relate to the generic managerial challenges of dealing with globalization, diversity, and ethics?
- 3 Explain how Netflix already has or might be able to convert the four major challenges into meaningful opportunities for the company.
- 4 What advice would you give to Reed Hastings regarding handling the pushback from competitors and other affected businesses?

SOURCE: This case was written by Michael K. McCuddy, The Louis S. and Mary L. Morgal Chair of Christian Business Ethics and Professor of Management, College of Business Administration, Valparaiso University, Michael K. McCuddy, The Louis S. and Mary L. Morgal Chair of Christian Business Ethics and Professor of Management, College of Business Administration, Valparaiso University.