Netflix

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Entertainment content, and the ways in which consumers engage with that content, have evolved rapidly in recent years. There have been a few transformational advances, including analog to digital and physical media to online delivery. With each advance, new technologies have emerged to accommodate the new method at scale. With Netflix, the introduction of a media streaming service prompted the development of new methods for managing streaming resources. As streaming became more popular, so too did the consumption of that content on mobile devices. Consumer trends show online delivery mechanisms continuing to replace physical media. The competitive landscape is still very segmented, with each competitor focusing on niche content. Licensing and contract negotiation with content producers presents one of the biggest challenges to the growth of online streaming of digital entertainment content. Critical success factors in Netflix's growth include content production, content licensing and stabilization of streaming infrastructure to reduce vendor dependence.

Industry Trends and Upcoming Trends

Physical Media

The first consumer friendly distribution medium for movies was magnetic tape. Two competing formats of magnetic tape, Sony's Betamax and JVC's Video Home System (VHS) (Various, 2014b), were delivered to market withing a few years of each other. These made it possible for movies, previously confined to film and requiring projection technology, to be viewed in the home on a standard television. Some pitfalls of magnetic tape included relatively low quality, further degradation of quality with age and wear and limited duration.

In time, the magnetic tape media was replaced with optical discs. Whereas magnetic tapes used an analog signal technology, optical discs used a digital signal technology. This improved quality and eliminated the type of age degradation that affected magnetic tapes.

Of the competing optical formats, the DVD disc, developed by a consortium of technology companies, became the dominant format (Various, 2014a).

Other significant distinctions between magnetic tapes and optical discs included the complexity to manufacture and replicate as well as the weight and size. Optical discs have no moving parts, are made up of a single unit and are manufactured from inexpensive plastic. They are also thin and small. These characteristics made it practical to deliver DVD media by mail in a cost effective way.

Movie Rentals

Initial costs of producing tape versions of movies and playback devices capable of displaying them on television sets were high. As a result, the prices were beyond the reach of most consumers. This price barrier was answered by the movie rental industry. In the beginning rental options include the playback device in addition to the movie tapes. As the playback technology became ubiquitous, rental stores focused only on the tapes. The transition from one physical media to another (VHS to DVD) had little impact on the rental market, since most consumers still came to brick and mortar locations to rent movies. However, the introduction of DVDs made mail order movie delivery practical, which opened a market for companies like Netflix in the late 1990s (Wesley, 2012).

Internet

The advent of the Internet made possible the transmission of a variety of data in digital format from one location to another. Digital formats quickly expanded to accommodate still images, audio and video. These digital formats, also referred to as codecs, were inefficient and immature when it came to compression and transmission of data. This limitation was compounded by the fact that initial connections from one computer to another transferred data at very slow rates and at a high cost to consumers.

Advancements in networking technology improved over time making additional bandwidth available to average consumers. In the early 2000s, traditional telecom companies began to offer consumer grade broadband service to the US market (Stats, 2014). Cable and satellite companies followed suit and offered broadband over their communication networks. By 2010, nearly 80% of the US population had access to the Internet with a third of those (85,287,100) using high speed connections.

The trend toward higher speed Internet connections enabled data sharing in ways that were not possible before. The first illegal peer to peer file sharing services began in 2005. Two years later, Netflix introduced an Internet Streaming service as a part of their standard subscription. (Wesley, 2012)

Strengths and Weaknesses of Netflix's Position in the Market

Netflix USP

Several characteristics make Netflix's market offering unique from competitors. Consumers are able to browse movie titles from the convenience of their own homes. Using the Netflix website, the consumer can create a list of desired movies and arrange them in the order that best interests them. When one movie is returned, the next movie in line is automatically sent out.

Another benefit to the customer is that the service is a fixed cost. The consumer never pays more than the monthly subscription, regardless of which movies or how many movies are viewed. Netflix also offers a large selection of movie titles, which increases consumer choice. This is made possible in part by the centralized nature of their warehouse.

Agile

At the time Netflix was founded, Blockbuster, the market leader for movie rentals, had twelve years of history and success. Larger companies have a tendency to get mired in bureaucracy and complacency, which can retard the process of innovation (Astley, 1985). The fact that Netflix was a younger and smaller organization enabled them to make decisions with more agility and flexibility than competitors, like Blockbuster.

Weaknesses

One thing going against Netflix was lower market share. Despite fast growth, Netflix competitors held dominant market positions. Unlike their competitors, Netflix didn't have any physical presence in the communities it served. This meant that some traditional methods for establishing brand and taking mind share were unavailable to them.

Analysis of Netflix's Competition

The competitive landscape working against Netflix includes a few different categories. Some of these categories are local rental stores that rent physical discs, such as Hastings, Automated rental kiosks, such as RedBox, on demand streaming services with a broad library of titles, including new releases, like Vudu and network associated streaming services, such as Hulu.

Capital

The capital structures associated with these competitive categories varies significantly. Some have very minor requirements, like automated rental kiosks, while others have significant personnel requirements, like Hastings, or highly complex technical and contractual requirements like Vudu. This makes capital analysis and comparison difficult and may add little value.

Market Share

Measuring market share will also be different. Most of Netflix's competition does not offer a subscription service. Market share will vary from month to month. The absence of contracts also makes movement within the market easier for the consumer. Brand loyalty may be more difficult to garner in the absence of a subscription. In all these respects, Netflix has an advantage, although network associated services, like Hulu, are beginning to offer monthly subscriptions as well. In those cases, content diversity will be a primer driver in determining market share.

Brand

In terms of household presence, or more specifically, family room presence, Netflix logo appears on more devices than most of their competitors. This is changing with the latest generation of app enabled devices, such as smarter televisions and BluRay players. In the case of apps, there is still a strategic opportunity for Netflix to partner with OEMs to build support for their service into consumer devices in a conspicuous way. Netflix's competitors have been unable to gain the same traction, despite similar efforts with OEMs. One example is the Vudu service. In these cases, the customer perceived value remains low compared to kiosk rentals and even brick and mortar rental stores. Netflix needs to maintain the low cost, high value perception it has established.

Threats and Opportunities for Netflix

Infrastructure

Among media companies, Netflix delivers an enormous amount of content online. The technical solutions to accomplish streaming of data at this level is still very immature and complicated. Even sites like YouTube were founded only a couple of years before Netflix introduced its streaming service, and most YouTube videos were only a few minutes long.

Traditional broadcast television use a single powerful antenna which transmitted a single signal over the air. There is no limit to the number of devices that can receive the signal. In other words, if one television or one hundred million televisions receive the signal, no additional resources are required. The nature of streaming digital content over the Internet is quite different. Every device that wants to consume media requires it's own connection and stream of data. This means that the for every streaming customer, additional hardware resources are required. Whereas traditional broadcasting could scale without additional cost to any number of viewers, online streaming requires dedicated resources for every viewer.

This dependence on hardware has created some technological risks for Netflix. Matching resource allocation to peak and low viewing patterns is complicated. Burst capacity to accommodate unexpected spikes in traffic is also required. Network latency can affect viewing quality which necessitates geographic collocation of streaming servers. Note that the complexity of these issues caused Blockbuster to partner with Enron Broadband Services rather than develop the expertise in house (Wesley, 2012). The initial failure of Blockbuster's streaming service was blamed in part on Enron's failure to successfully respond to these issues.

Netflix approach to these problems came in the form of a partnership with Amazon by way of the Amazon Web Services offering. This allowed Netflix to provision new resources in minutes, in a number of regions globally and to decommission those same resources when the capacity was no longer needed. This fluid access to compute and network resources enabled Netflix to create a flexible streaming offering in a cost effective way.

The partnership between Amazon and Netflix hasn't been without its issues. There have been some notable instances where the Netflix service became unavailable due to failures with the Amazon cloud service (Clay, 2012). Netflix may be well positioned to create a more tailored cloud offering designed specifically for streaming intended to accommodate a portion of their capacity needs and completely under their control. This would help mitigate unexpected failures with vendors like Amazon and may even become a product they could sell to other media companies interested in streaming content.

Device support

Another common initial approach to streaming content over the Internet was to require special hardware or be tethered to a personal computer (Wesley, 2012). Netflix understood early on that consumers wanted to consumer their streaming content on any device, anywhere. To address this, they worked closely with hardware manufacturers, including game console makers, DVD player manufacturers and other OEM hardware vendors to make it possible to stream the Netflix service easily. By meeting this challenge with vision and innovation, Netflix became available on many devices already connected to home television sets.

Another tendency that Netflix pushed aside was to abandon the paranoia typical with companies like Microsoft and Blockbuster that want to charge for every aspect of the service and control the user's access. For example, Blockbuster wanted to charge a premium for their streaming service (Wesley, 2012), whereas Netflix's offering was always unlimited. This was appealing to consumers.

Recommendations for Netflix's Distribution Strategy

Physical media

The Netflix business began with the distribution of physical DVDs by mail. Over time their service grew to include BluRay discs and video games. There are reasons to maintain these physical offerings, at least for now. For example, streaming of video games over the Internet is prohibited due to licensing and console design. Physical discs contain more media than just the movie, including commentary, special features, different languages, etc. Not all movies stream in HD, and those that do require very high bandwidth to accommodate the amount of data transfer. In spite of these benefits of physical media, subscriptions to Netflix's mail service are declining (Roettgers, 2013).

Online

Increasing availability of high speed Internet, including fast data available on mobile devices, like phones and tablets, suggest that streaming will continue to increase in popularity. Netflix needs to maintain it's commitment to a variety of form factors, including devices as small as cell phones and as large as big screen televisions.

Many customers would like to be able to download content while they are near a fast connection and the view that content even when their device is offline. This may include situations like downloading while in an airport to view while in the air. This added flexibility would give viewers more choice regarding when and where they consume the content that's available through the service.

Netflix has remained committed to a fixed cost offering. Unfortunately this has prevented them from streaming a wide selection of popular movies. As more viewers subscribe to the streaming service, pressure to offer more movies is likely to increase. One way to address this is by adding a pay-per-view option for certain content. Offering both fixed cost and pay-per-view represents a number of challenges, including contract negotiation and digital content protection.

Recommendations to Increase Market Share and Customer Base

Unique content

One aspect of the Netflix business over which they have no control is the actual content that they stream. For this content they rely on movie producers to create the content and then they must navigate the complex legal and contractual environment to make that content available to their subscribers. One way to expand mitigate this problem and expand their customer base is to create programming that is unique to their platform. This would be similar to the way that broadcast networks created unique content to expand their market share and customer base.

Even without creating unique programming for their platform, they can still provide some niche programming, such as old movies that may not be popular enough to justify broadcast over traditional networks or educational programming. In the case of niche programming, the fact that each viewer consumes a streaming resource works to the advantage of Netflix. They only incur costs associated with the small number of viewers interested, but to those viewers, the Netflix service becomes a necessity.

Play to strengths

Good will and good reputation

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