

Strategic Analysis and Recommendations



Team 2

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Internal Analysis

Mission, vision and value

Netflix does not have a mission statement but instead has constructed a vision statement in its place. The vision statement is to become the best global entertainment distribution service. Netflix wants to license content all around the world and create markets accessible to filmmakers. Netflix also has a quest statement that states, “we promise our customers stellar service, our suppliers a valuable partner, our investors the prospects of sustained profitable growth, and our employees the allure of huge impact.” Netflix is creating a company for the future of the entertainment industry and for their customers.

- <https://www.thebalancesmb.com/tech-companies-mission-statements-4068549>

Financial Analysis

Netflix has experienced high growth in the last couple of years with revenue skyrocketing within the last few years. Netflix has grown from revenues of \$6.8 billion in 2015 to nearly double that in 2018 with revenues at \$15.8 billion. The impressive growth doesn't stop there with Netflix having a net income of only \$122 million in 2015 to \$1.2 billion in 2018. However, one of the most staggering statistics is that over the last 10 years Netflix has shown EPS growth of 403.4% with no years of a negative EPS. Although this growth is tremendous Netflix still has some downsides within their financials. They pose a current ratio of 1.49, which means they may struggle with meeting short term debt obligations. Historically, their current ratio has hovered around 1.3 to 1.5 meaning they are not decreasing the amount of short-term debt they are holding and increasing current assets.

Netflix has experienced unparalleled growth but to maintain this growth they must make sure to keep a clean income statement and balance sheet. They need to be wary of adding any additional long-term liabilities as they have increased significantly within the last few years. Netflix needs to focus on driving down some of their long-term debt and focus on stable growth going into the future.

	2015	2016	2017	2018
Revenue	\$6.78B	\$8.83B	\$11.69B	\$15.79B
Net Income	\$122.64M	\$186.68M	\$558.93M	\$1.2B
EPS	\$0.29	\$0.44	\$1.29	\$2.78

Current Strategies

Business Level Strategy

Netflix's primary business level strategy is centered around differentiation. As a provider of entertainment, Netflix develops and markets its services to an extremely broad target market. Netflix benefits from the first-mover advantage as it was the first to launch the subscription streaming service and still maintains the largest market share within the streaming industry. The number of titles that Netflix offers far exceeds competition. The company provides superior quality to its members through its well organized and add-free streaming platform. Netflix is continuing to innovate by providing its members with original content.

Corporate Level Strategy

Netflix is engaged in related diversification through the process of expanding its product line into similar areas. Described as a leading internet entertainment service, Netflix manages its original DVD-by-mail service along with its streaming service that delivers TV series and movies directly over the internet. In recent years, Netflix has been devoting more resources towards the production and distribution of original content.

Functional Level Strategy

Marketing Strategy

Netflix utilizes digital marketing through its authentic presence on social media using Twitter, Facebook, and YouTube. With an increase in original content creation, Netflix is also increasing promotional material on social media platforms as well as internet ad placements. By tracking browsing trends and the content that is viewed, Netflix is able to market internally by making suggestions that keep members returning. This data helps influence a lot of the company's marketing. Promotional strategies are used by Netflix including a one-month trial period that attracts new users to subscribe.

Research & Development Strategy

Netflix uses data collection to predict consumer behavior and create a better experience for its users. Through machine learning, the Netflix platform uses previous viewing patterns to make recommendations for subscribers. Through data collection, Netflix is able to improve the quality of its streamed content. Netflix focuses on software development and regularly updates the platform to enhance user experience.

Key resources

Netflix has four key resources, which are physical, intellectual, human, and financial resources. For physical resources, Netflix has successfully built its own IT infrastructure providing the best quality of streaming services to its customers. The company has warehouses, offices, and facility that allow it to operate effectively at the back end of the business. Another key resource is intellectual property, including both original and licensed content. With over 15,000 different titles changing frequently in its streaming platform, Netflix provides its customers a broad selection of movies. However, one challenge to this key resource is the licensed content. Many competitors like Disney or NBC has decided to end the licensing contract with Netflix, which can negatively impact the future of the company. For human resources, Netflix has over 3,700 employees and benefits from the top management team, who have rich experience in the movie and streaming industry, especially its CEO, Reed Hastings. The last key resource is Netflix's healthy financial condition. Netflix revenue stream provides the company with a large amount of cash. This can help Netflix with future acquisitions or strategic changes to stay competitive in the market.

Strengths & Weaknesses

Strengths

Netflix is the leader in all of the video streaming industry with 51% of the market and a massive customer base at 139 million globally. They are the first mover in the industry and top-of-mind

for all customers. Netflix has also been really successful in creating their own original content. One of their biggest assets is their brand equity and easy recognition amongst consumers. They focus most of their energy towards technology advancement and innovation for their product. Netflix has also amassed an incredible amount of viewer data that informs their decisions in content creation and platform enhancements.

Weaknesses

Most of Netflix's weaknesses revolve around their dependence on suppliers of content. Netflix faces extremely high costs for content licensing, costing them \$13 billion in 2018. Due to the high cost of licensing, competition, and the need to differentiate itself, Netflix began investing in original content creation. This area of the business creates a weakness due to the extremely high costs associated with the production of original content. Lastly, Netflix's platform requires users to have access to high speed internet.

External Analysis

General Environment (economic, political, societal, technological)

Technology

The movie streaming industry relies heavily on new technology to improve the overall quality of streaming with less data. There is also a trend in improving customer experience through convenient payment and personalization of the movie rating system. Moreover, with the new Virtual Reality technique, many companies are working to apply it into their streaming platforms to enhance customer at-home experience. Apparently, there are many technological trends in the industry, which are opportunities for companies to focus on R&D and develop sustainable competitive advantage.

Economic

One of the main revenue of movie streaming industry comes from subscription rate. Therefore, fluctuating exchange rate can negatively impact revenues. In some countries, target customers find it luxury to subscribe for streaming services so there are still opportunities for growth and expansion in the future. In addition, the video streaming market, which was valued at \$22.6 billion last year, is estimated to grow to \$30.6 billion by 2022.

Political

There are many government regulations that prevent companies in the movie streaming industry from expanding globally. For example, US has restrictions on countries like Crimea, North Korea and Syria thus leaving a potential market untapped. Especially, China is a potential market but due to permission issues from the government, most streaming companies cannot get into this country. Furthermore, there is an issue with content restrictions so not all movies are available in every country. Since on-demand streaming service is growing, some US telecom giants like AT&T want to pass stricter usage regulation. If this regulation is passed through Congress, internet prices can increase, which will threaten movie streaming companies.

Social

Younger viewers are watching less traditional television and now turn to online streaming services for entertainment. More customers also prefer streaming services because of the pricey cable options compared to low subscription rate offered by streaming companies. In addition, customers are watching video content on their smartphones than traditional larger screens. This trend shows a demand for online content that is convenient to watch through mobile devices, which is an opportunity for streaming industry.

Industry growth

The popularity of online streaming is not a fad but rather simply, the future of television. The global video streaming market size was valued at \$36.64 billion in 2018 and is still expected to grow anywhere between 19% - 21% to approximately \$82 billion. User penetration is currently at 14.6% globally and is anticipated to rise to 16.3% by 2023. Blockchain and AI technologies that are arising in the industry for anything from video editing to “smart” recommendations are encouraging growth in the industry. The TV and movie streaming industry that Netflix is in as a particularly interesting stake in not only the entertainment industry but also changes in the tech industry; both having major impacts on the company’s success.

One of the biggest development in the industry for the consumer is the ever-increasing number of options. With each new company launching their own platform with their own content, the user is forced to make more decisions - do they get the new platform, do they get rid of the one they currently use, how much are they willing to spend per month on TV when the purpose of streaming was to nix the astronomical cable bills. In order to combat this, industry players must work to differentiate and position themselves in the market.

Nature of competition

The online streaming market has increased its popularity over the years as people have shifted from watching cable to instead signing up for different online services that provide access to films and television content. There are a growing number of competitors in the current online streaming market that compete directly with Netflix. Amazon Prime, Hulu, HBO Go, and YouTube are all of just some of the major competitors. While each platform is very similar, they each have their own large to small differences. For example, Amazon Prime is not just for movies and television shows it is also linked to users main Amazon accounts where they can buy just about anything. Netflix however only offers users television shows and movies. According to the Business of Apps article “Netflix Revenue and Usage Statistics”, Netflix currently dominates the market with a 51% market share while Amazon Prime comes in second with a 33% market share.

Surprisingly, Fortnite is also one of Netflix biggest competitors in terms of screen time. Online video games are starting to affect the online streaming service business significantly. According to Polygon, Fortnite has been beating Netflix in terms of views and even competes harder than popular online streaming service, HBO Go.

The online streaming industry has a strong barrier to entry especially without strong technology. If one has the technological advancements set in place however, the barrier to entry is quite easy which is why there are so many different providers out there today. The most complicated part of becoming an online video streaming service is creating and acquiring the proper licensing for different content.

Threats & Opportunities -

Threats

One of the major threats for Netflix is the intense competition in the movie streaming services. Disney and other big key players are entering the market and taking away Netflix's licensed content and current subscribers. There is also copyright infringement challenge which many countries do not have strict regulations to solve the issue. Therefore, some Netflix movies can be watched without subscription. Below is the summary of potential threats:

- Increased competition
- Digital piracy
- Different country government regulations

Opportunities

Netflix has many opportunities they can look to explore. Their biggest opportunity would be looking to expand globally. Netflix could use niche marketing to their advantage and consider producing region specific content in their local languages. Another opportunity for Netflix is the emergence of AI and blockchain which could allow Netflix to make closer connections to their users. Lastly, Netflix could possibly increase their revenue from increased advertising.

KEY ISSUES

1. Loss of content-

Recently, Netflix has been hit with the news many of the tv shows and movies Netflix consumers love will be taken off the platform. Largely, this is due to the fact that there are many new competitors entering the market, which we will talk more about in the next section. Companies such as Disney have begun to develop their own streaming services, which means they will take their content off of Netflix. Disney owns companies such as 20th Century Fox, Marvel Studios, Lucasfilm, and Walt Disney Pictures that all compromise much of the content on Netflix. Many of the most watched tv shows and movies on Netflix are produced by Disney and they are just one of the many companies creating their own streaming platform.

Netflix must prepare for this loss of content that will occur within the next year. They have already begun by purchasing their own studios to produce original content. The problem is Netflix does not produce enough hit tv shows and movies to offset the loss of content they face. Netflix must produce better content in the future if they wish to mitigate the content they will lose and not diminish their subscribers base.

2. Multiple new competitors-

As mentioned before, Netflix faces many existing and potentially new competitors. As of right now, their main competitors are Amazon, Hulu, and HBO. Netflix dominates the current market with majority of the market share. In the short-term, Netflix is projected to maintain their majority market share, but the fear is that they may lose subscribers to the other emerging streaming platforms, Apple and Disney.

Apple and Disney are two of the largest companies in the world and the emergence of both of these companies creating a streaming platform is something for Netflix to worry about. Apple

has already released footage and begun to do promotions for the shows and movies that will be released on their platforms. Disney has plans to move their content such as Star Wars, the Marvel movies, and Fox TV shows to their platform. Netflix needs to be prepared in the long-term to develop a strategy to compete with these giant companies that have far vaster resources.

3. Low diversification

Although Netflix is always known for online streaming services, there is still lack of diversification within the company. Netflix only focuses on movie streaming and production, which cannot become sustainable competitive advantages in the future. As the market gets more competitive, Netflix needs to expand its portfolio to stay ahead of the game. For example, Disney produces its own movies, opens its own theme parks, and performs multiple acquisitions that make it become one of the largest mass media and entertainment companies in the world. When Disney, and other entertainment companies, enter the streaming industry, Netflix needs to be more creative and expand its portfolio to diversify the risks and become more flexible in strategic thinking.

4. Subscriber growth

Netflix Board of Directors and stakeholders are also worried about subscriber growth. As the developed market in the U.S. is saturated, acquiring new customers is going to be a challenge. Although the company has recently added nearly 10 million subscribers in the first quarter, the growth will slow down in the future. This growth is important for Netflix because the company needs stable flow of revenue to fund for future expansion or content creation. Since many new competitors will enter the market, Netflix needs to plan a strategy that can maintain its loyal subscribers so the company will not lose its current market share and continue to grow.

FINAL RECOMMENDATIONS

Movie Theater Test Market

In order for Netflix to create and maintain a sustainable competitive advantage, it is crucial for the company to differentiate themselves from other streaming platforms while remaining authentic to the Netflix brand. Our first recommendation is for Netflix to pursue a movie theater test market in order to collect information, create interest regarding original content, and legitimize Netflix's rising influence among those in the entertainment industry. Although there are concerns regarding the public's remaining interest in traditional movie theater experiences, the consulting team assures that the movie theater industry remains popular. In fact, according to The National Association of Theatre Owners (NATO), movie ticket sales increased 5.5% in 2018.

Just as Nutella has made cafes and Amazon now has bookstores, Netflix should capitalize on their brand equity and begin to pull in revenue in new ways that is in line with their creative and innovative image. In order to test the market, the consulting team recommends Netflix build or - if possible - purchase a single movie theater in Los Angeles, California, the entertainment capital of the world. The choice of Los Angeles is also relevant because according to the Oscar rules of eligibility, a movie must run for at least seven consecutive days in Los Angeles county to be nominated for the majority of awards. Our research suggests it would cost around 3

to 4 million for Netflix to build a four screen movie theater. The consulting team suggests a heavy investment in marketing surrounding the opening of the theater and then consequently the releases of Netflix original content.

One of the main test points we want to explore is how to price this experiment in its infancy, however, we believe that we want to have a low price for current subscribers and then a higher but competitive price for non-subscribers. Planned content releases would be similar to traditional movie releases and would not be available on the netflix platform for a specified amount of time. The entire test market would run 6 months to a years and at the end of this period Netflix would then evaluate the information collected and move into phase two of the recommendation.

If the test movie theater is successful, it will create a large amount of social media attention and buzz. This success will also establish credibility to existing movie theater chains. The first option recommended by the consulting team is that the company slowly builds or purchases Netflix owned movie theaters across the country. The second option would be a partnership with an existing movie theater chain, Cinemark or AMC for example, and would involve the designation of specific Netflix screens within their theatres across the country. This decision would depend heavily on the information collected following the test market and would depend on the feasibility of a partnership with a movie theater chain. The cost for customers would most likely remain the same as the test market, unless information collected or the designated partner in this venture suggests a more appropriate option. A third option we explored and can be done separately or in tandem would be to have more of an event venue option with smaller movie screens in “party rooms” differentiating from the traditional movie experience.

As Phase 2 is to be informed by Phase 1 we cannot make a concrete recommendation for this, but any option will be a foot-in-the-door to the brick and mortar cinema scene. The recommendation for Netflix to enter the film exhibition industry would differentiate them from other content streaming platforms and would create greater interest surrounding Netflix’s original content. Netflix’s content would also be eligible for award show nominations and would no longer carry the stigma of being streamed only content. Lastly, Netflix would increase its revenue stream to include box office sales.

Benefits and Value

Netflix has already captured over 50% of the American population as subscribers and 120 million subscribers worldwide, however, in the last few years have recognized that this number will either grow very little or plateau. They were the first to market, but they need to be innovative and dynamic to stay at the top. We believe that in order to continue to grow in profit they need to pursue different revenue avenues.

The Netflix Movie Theater option begins with the benefit of publicity for the brand, its new, exciting, noteworthy, and somewhat funny as Netflix is seen as the downfall of the theater industry. This will also allow the Netflix Original content to gain traction and buzz. Additionally, in order to be eligible for an Academy Award, a film must run for 7 days in Los Angeles. We believe that once Netflix Original films are eligible for Oscars, they will attract better talent (i.e. award-winning actors, producers, directors).

We believe that a test market is crucial for this venture as the information gathered will be invaluable for deciding whether to move forward with this fairly capital intensive investment. A test market gives us time to make changes in pricing and product offering for a low risk. It garners attention and increases desire as a “limited edition” and “exclusive” product. And finally, gives us credibility in any possible contract negotiations with large theater companies in the future.

Costs and Risk

The initial investment would be roughly 3 to 4 million dollars to build a new 4 screen theater, this investment would fluctuate based on whether we could find a cool, independent theater for sale. We would also have to factor in staffing the location and any variable costs such as concessions and all utility costs. There would also be a need to invest in creating new, box-office worthy films to show prior to releasing on the Netflix platform.

The risks that we encounter are ones that are apparent in almost all test markets; giving competition an inside look at your plans and the possibility of getting skewed data based on location chosen or economic impacts during the allotted testing time. Additionally, we run the risk of not being able to keep up with the content production schedule necessary to fuel a movie theater. However, our consulting team believes that the information gathered is worth the risk and movie theater release date deadlines would encourage the content creation process.

Valve Acquisition

We recommend that Netflix acquire Valve Corporation. Valve Corporation produces games, hardware, and Steam. The primary motivation for this acquisition is its platform Steam. Steam is a digital distribution platform for purchasing, playing video games, and streaming video games. Valve is currently estimated at 2-4 billion dollars. Netflix will use $\frac{1}{3}$ cash and $\frac{2}{3}$ long term debt to finance the acquisition.

The acquisition of Valve will allow Netflix to immediately enter into the video game market. Steam contains a wide variety of content in many different languages. It is currently estimated to have about 17.5 million daily users. With the acquisition, Netflix will be able to increase their customer base which was seen as a key issue brought up by the board of directors.

Once Netflix owns Steam, they can create a monthly subscription plan. This plan would allow users to play a diverse range of games. If the user cancels the subscription then the games would no longer be playable. The option for customers to buy games will remain available. Once a customer purchases the game it will always be playable. Steam is widely recognized across the gaming industry so there will be no rebranding. Netflix can now provide three different monthly subscription options which include Netflix access only, Steam access only, or the discounted bundle of Steam and Netflix.

The acquisition of Valve fits in well with Netflix's vision and quest statement. Netflix's vision statement includes their quest to growing their subscription business domestically and globally. Netflix would also like to continually put efforts into improving their customer experience by increasing content and enhancing the user interface. Owning Valve will allow Netflix to reach their mission by giving their customers a different type of content. In terms of their visions statement, Netflix vows to become the best global entertainment distribution service. Diversifying into the video gaming market will allow them to reach this goal. The gaming industry is on the rise and combing their services with a gaming platform is exactly what they need to combat the current key issues they are facing.