REPORT PREPARED FOR: NETFLIX

COMPANY BUSINESS MODEL ANALYSIS

Presented by: Ruzan Ichaporia

Jenny Chong

Sumit Maggon

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ASSOCIATE PROFESSOR DR. NITIN SETH

EXECUTIVE SUMMARY

The report is an analysis of an American based entertainment company called Netflix, which is involved in streaming online media. The report broadly looks into the digital business model and business activities of the company in the enterprise perspective. The report describes the company's business background and briefly described the stakeholders of the business. It also summarizes the services provided by Netflix and the target group for the company.

It is followed by an overview of the online streaming industry and the competition faced by Netflix in this sector. The report also looks at the company's business within the territory of New Zealand.

Next the report explains the business models relevant for Netflix and analyses the company from different perspective.

A cost analysis for Netflix is set out in the later part along with an explanation of the company's revenue generation and cost structure. In the report, we have proposed some recommendations for Netflix that will improve the company's value creation. These include giving prominence to social media for reaching to the public as well as increasing the functionality of the website.

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BUSINESS BACKGROUND

Netflix, is as the New York times call it is the biggest internet television network and the TV network provider of the future. With over 83 million subscribers in 190 countries, 125 million hours of movies and TV shows, it has more media for one lifetime. And unlike other platforms, members just have to buy subscription once and can watch as much, on any device with an internet connection including computers, smart TV, tablet PC and even mobile phones. The users can play pause and rewind media entertainment without advertisements or commercials. It is like an unlimited DVD rental subscription without the DVDs and unlimited media available with a click.

Started in 1997 in California by two software developers Marc Randolph and Reed Hastings. They got the idea of creating Netflix when Hastings forgot to return a DVD by the subscription date and ended up paying 40$ as late fee. They launched the website on April 14, 1998 with a more traditional pay-per-rental method. The website later introduced the monthly subscription method in September 1998. And since then, Netflix operated only on the model of flat-fee for unlimited rentals without any hassles of due dates, late fees, or shipping and handling fees.

After the huge success of DVD rentals business, Netflix started producing its own content of movies and TV series under the banner name of Red Envelop Entertainment, symbolic to the red envelops, the DVD mails came wrapped in.

After reaching the mark of one billionth DVD rented in 2007, Netflix introduced the feature of online streaming via internet and with the rise of internet sensation rest was history and by 2011 Netflix discontinued the DVD mail business due to the lack of demand.

Today Netflix with its hosted and original content, caters to movies and media in 270 languages in over 190 countries and is the biggest online Internet Television service provider.

Stakeholders

Anyone who has an access to internet is a pottential customer for netflix. With its content both orignal and hosted, Netflix targets all age and income groups. Netflix with its wide variety of media including regional and language contents, has gathered attention of masses across the globe. The recent annual report reveiled that the focus of Netflix are “the adults too busy with the lifstles to go out for movies or shop for old favourites” but Netflix has also managed to target movie buffs and the economical customers by offering the hugr content at a very reasonable price of a fixed subscripion fee.

The basic lure for subscription is the low price and access to internet via hotspots, Netflix has created a niche market and clietile of its own. Netflix has even started offering the first month free for attracting new pottential customers and creating habits which would later monitorise for the bsuiness propaganda.

INDUSTRY OVERVIEW

Online streeming is the biggest thing in the media business and with players like youtube and netflix and illegal downloading the competition is big. The customer is aware of the options aware, the customer is price sensitive and free media options are flooding the market. And with the single subscription providing access on multiple devices such as tablets, smartphones, gaming consoles etc, not only Netflix is giving a big challenge to other platforms but also overcoming the challenges of mobility, which means one can carry the TV everywhere in their pocket.

But netflix is not the only one player in the market and the lure has attrached other media houses across globe to step into the game. Lets have a look at the other major global players.

1. HBO GO – Owned by HBO LLC USA, the company is comparitively new in the market place but has its USP of its own unique content and the entertainment quality is such that it is compelling people to buy the subscriptions. The orignal content has shows like Game of Thrones, House of Cards, Orange is the New Black etc. which is running the show for them.
2. Amazon Video – Surprisingly this platform has larger content than netflix but due to lack of user friendly interface and lack of customizationand personal experience like recommendations it is loosing the race.
3. Hulu Plus – Owned by Walt Disney has its USP of offering the current episodes which is not their in Netflix and other service providers. But Hulu Plus has a big disadvantage of not being commercials free and lack of interesting orignal content hence other than family households, people chose other options over netflix.

Other than the above stated three, there are many regional and country specific players as well which offer shared and some unique content like EROS Now (India), Sky TV (global but country specific), Spark Soho Lightbox (New Zealand) etc which are not exactly a threat but are small players focussing on smaller niche customer segments.

The bottom-line is that Netflix dominates its competition in streaming. That’s not a concern at the moment. Looking at the underlying business of Netflix, it should be a long-term winner. It has built a very big lead.

Netflix in New Zealand

Netflix launched its operations in New Zealand in March 2015. Netflix launched its service at a cost $9.99 a month with one month free subscription. This is a lot cheaper than its competition in New Zealand. It’s half the price of Sky TV's Neon, and also cheaper than Spark's $12.99/month Lightbox and the $12.99/month Quickflix. Netflix will be the first streaming video on-demand service to offer ultra high definition, or four times the picture quality of HD. Sky TV's Neon is still on standard definition (SD), let alone HD or Ultra HD.

Netflix also brought its multiplatform approach to NZ, which includes making its content available through apps on various brands of smart TV, Xbox, PlayStation 4, Nintendo Wii, iOS and Android phones and tablets, Google Chromecast and Apple TV. Quickflix, the pioneer in making its content available through multiple devices in NZ can’t match Netflix range of options.

BUSINESS MODEL

Zott et al. (2011) define business model as a framework that looks at a holistic perspective on how a firm downs its business, with an emphasis on firm's activities and importance of value creation.

Netflix with its current style of operations, represents a service business model where users and payers of the service are the single entity. Netflix has only a single source of revenue which is the user base and it does not host advertisements.

The major USP of netflix is the content both hosted and original and hence a high degree of importance is given to the content acquisition part. Content is obtained from studios through direct purchase, rights purchased of revenue sharing model with liscence agrement restrictions which are further delegated to the clients as well.

The business model of Netflix can be studied with the help of Alexander Osterwalder's Business Model Canvas where the multiple elements of a business model such as infrastructure, finances, customers, calue proposition can be studies. Let us look at Netflix in the light of this model.

- **Value Propositions:** According to Osterwalder (2004) a company's value proposition is The distinguishing features which the competition does not have. In case of Netflix, they are:
    - Price
    - Accessibility
    - Convince
- **Customer Segments:** This refers to the different groups/categories of customers which a business wantes to cater. Netflix's target audience is anyone with an active internet connection
- **Channels:** A channel is the medium through which the value propositions are delivered.
  Netflix uses its website, mobile app and inbuild firmware application to connect to the customers
- **Customer Relationships:** This refers to the relationship the company wants to have with its different customer segments. Netflix has broadly two types of CRM models:

- **Self Service:** The type of relationship that translates from the indirect interaction between the company and the clients. Netflix provides all its customers with a very easy to navigate website as well as the app. A costumer can browse and choose what they wish to stream without any difficulty
- **Automated Services:** A system similar to self-service but more personalized as it has the ability to identify individual customers and his/her preferences. Netflix always works very hard to make personal recommendations to each of its customer according to their ratings and browser history

- **Revenue Streams:** As the name suggests, its is refering to the source from where the money is flowing into the business. Netflix has monthly subscriptions rates
- **Key Resources:**This refers to the resourceswhich esentially create value for the customers. For Netflix it is the huge content range which gives the customers the maximum satisfaction for the money spent.
- **Key Activities:**The activities which lead to the realizaation of the value proposition. Netflix depends on its content licensing as majority of the content on the site is not their own.
- **Key Partners:** The partners which contribute directly or indirectly in helping the customer realize the value of the money spent by the customer. Netflix key partners are:
    - **Media Houses**
    - **Internet service providers**
    - **Hardware manufacturers**
- **Cost Structure:** This is the step which determines the cost of the overall business model and value proposition delivered. Netflix spends heaps in acquiring content licensingand library stock maintainence and keeping up with the technology.

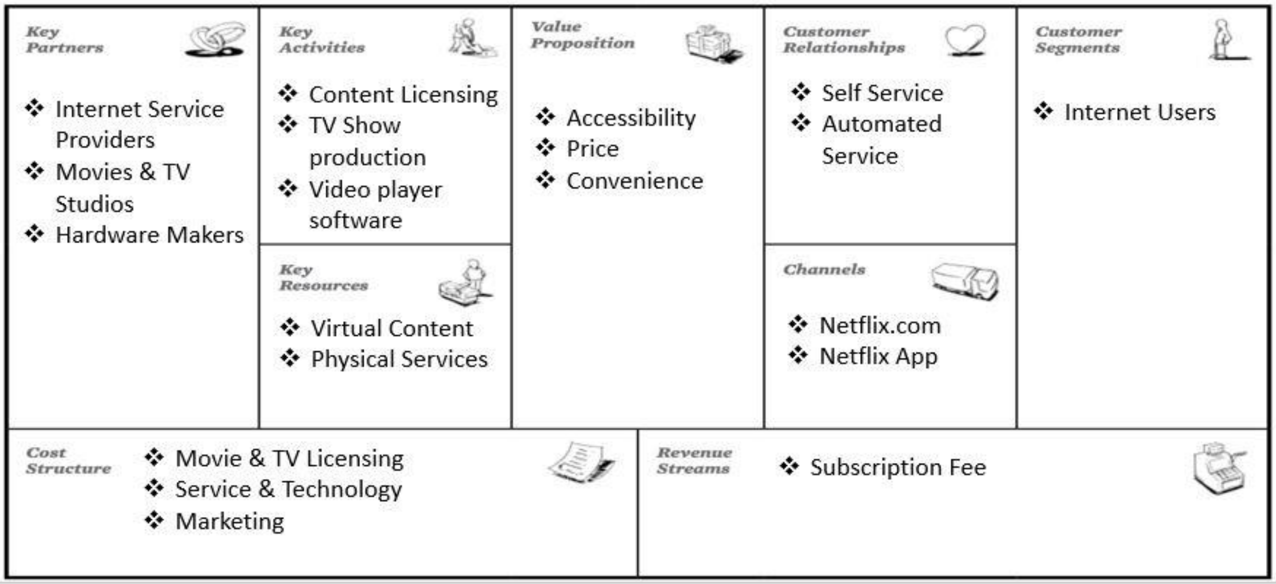

Figure 1: Netflix Business Model Canvas

REVENUE ANALYSIS

Netflix is the market leader in the online media streeming delivering content directly to TVs, PCs, smartphones and other internet connected devices. Netflix generates its business through monthly subscription fee.

Figure 1: Netflix revenue model

Netflix declayered a 24% in Q3 FY16 sales gain in the most recent quarter as the video streaming company's subscriber base topped 60 million worldwide following its launch in countries like Brazil, India and New Zealand. Netflix added a record 6.2 million new subscribers in Q3 FY16, which beat the 4.3 million added Q2 FY16. The company's global streaming membership is now 62.3 million.

Netflix Primarily offers three types of subscription plans which differs by the quality of the content offered and the number of screens that can access the content concurrently:

- The standard definition plan which has the standard definition quality streaming on a single screen/device at a time;
- The high definition (HD) plan which gives the user an access to high definition quality streaming on two screens/devices simultaneously;
- The ultra-high definition (UHD) plan that gives the user an access to high definition and ultra-high definition quality streaming over four screens concurrently

Netflix primarily has three business segments: Domestic streaming (USA), ,International streaming(rest of the world), and Domestic DVD (DVD rentals in USA).

In 2015, Netflix generated $6.3 billion of total revenues. Of these total revenues, Netflix generated:

- $4.1 billion revenues, 68.3% - domestic streaming business
- $1.8 billion revenues, 23.8% - international streaming business
- $463 million revenues, 8.9% - domestic DVD business

In 2015 net revenue was 6.7 billion dollars which showed a CAGR of 13.23% from 2011 which suggests the projected revenue should be close to 7.6 billion dollars.

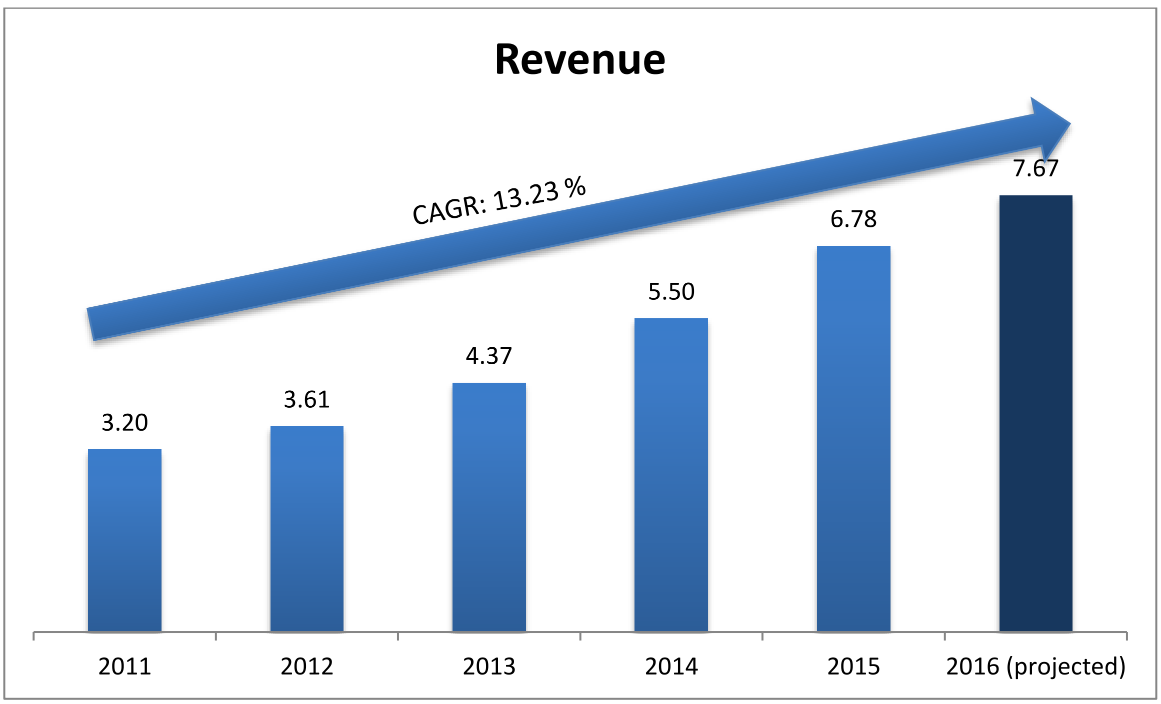

Figure 3: Netflix revenue growth

Netflix Q3 FY15 operating profit was $74.9 million, which tanked from $129.6 million in Q3 FY14. The Q2 FY15 operating margin reached 4.6%, down from 9.7% in Q2 FY14. Netflix Q2 FY15 net profit reached $26.3 million, down from $71.0 million in Q2 FY14. The Q2 FY15 net margin reached 1.6%, down from 5.3% in Q2 FY14.

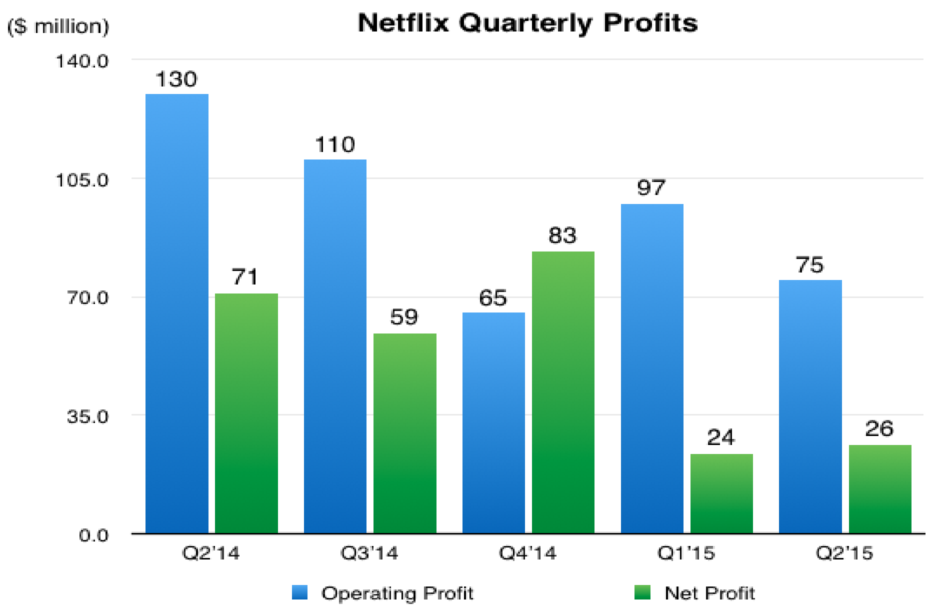

Figure 4: Netflix Quarterly Profits

Analysists have predicted that Netflix revenue is to grow at a much higher rate due to expansion in Europe and domestic subscriber growth. Profitability trends have improved domestically and under most likelyhood the international segment will be profitable in the years to come. Profitability would come as a result of revenue growing at a higher rate than costs, and analysts are predicting an aproximate of 32.3% annual rise in profitability over the next five years.

COST ANALYSIS

Other than the cost to acquire content, Netflix spent around $607 million on marketing, $472 million on technology and $270 of administrative expenses. Lets have a deep dive into Netflix's multiple cost heads:

- **Cost of Revenue (Cost of goods sold):** This is the biggest cost head for Netflix which includes the cost of acquiring content, by either paying royality or purchasing content to the content producers. This cost head also includes thr dilivery expenses, customer services, payment processing etc.
  Cost of revenues in the domestic DVD segment consist of delivery expenses, content expenses, including amortization of DVD content library and revenue sharing expenses
- **Streaming Delivery:** It is one of the major costs as the major part of business is online and videos are streemed from servers to customer's device and hence a massive amount of data flow and powerful servrs are required. A standard movie of 1.8 GB would cost Netflix 6 cents whereas a HD quality movie would cost netflix 9 cents. As much small numbers as they may seem, netflix paid the internet service provider Verizion 1.342 billion dollars for the internet used.
- **Marketing:** Marketing is the key to launch the succesful business in a new market. Netflix is on its expansion spree and is expanding very aggressively in asian and european markets. For Netflix, marketing expenses consist of advertising expenses and affiliation fee. Marketing expenses are immaterial for the domestic DVD segment.
- **Technology and development:** These consist of indirect costs incurred in making improvements to the service offerings, which includes testing, maintaining, and modifying the user interface, recommendation, merchandising, and streaming delivery technology, as well as the telecommunication systems and infrastructures.
- **General and administrative:** These consist of payroll and related expenses for corporate personnel, as well as professional fees and other general corporate expenses.

Financial Risk

Since Netflix opperated in local currencies, a major financial risk is the foreign exchange fluctuation and that sometimes can result in negative influence once reporting is done and margins are calculated in US $.

Netflix cash from operations continues to be negative due to the investments in “originals” i.e. TV series such as Narcos and movies, which are very working capital intensive. Netflix anticipates this trend to continue given their increased investment in originals.

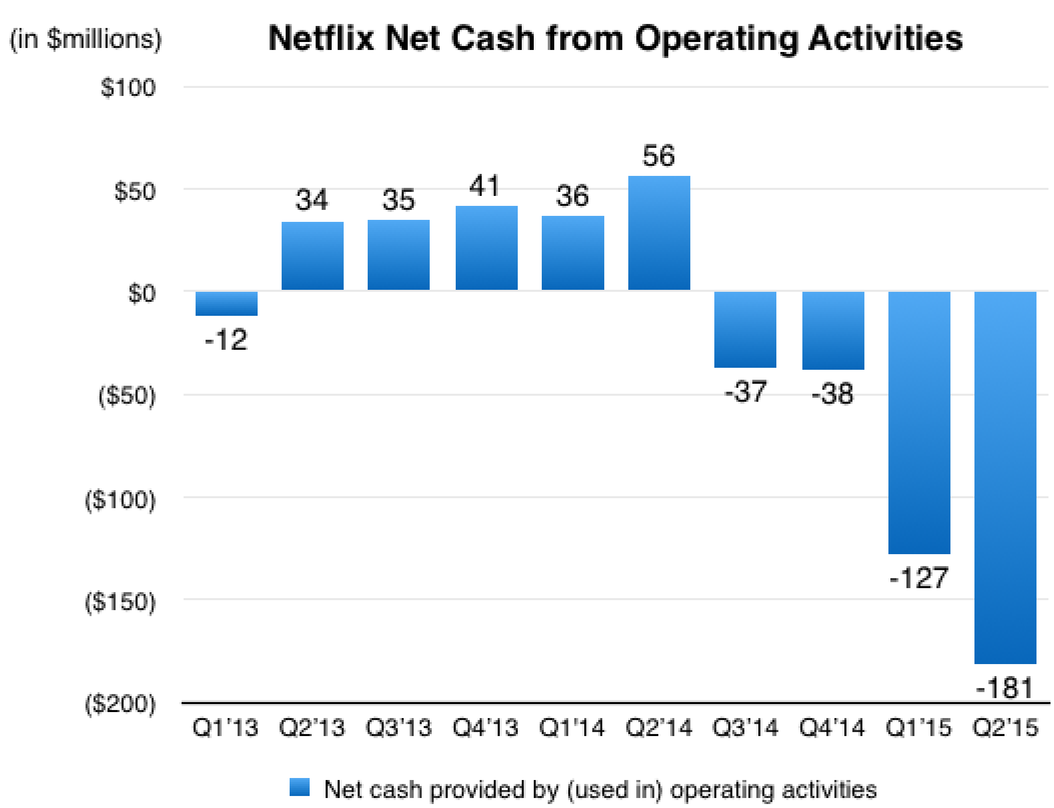

Figure 5: Netflix net cash

VALUE CREATION

Customer value proposition is an imperative tool for effective marketing activities for all enterprises as to represent their foundation in recognising the way products and services will be highly valued through target groups of customers (Hudadoff, 2009). This not only enlists competitive insights but also product valuation and market intelligence and the way companies project their product in the market. With Netflix, thay have projected a clear understanding of the markets and the different customer segments it serves or targets. A digital model which could be applied to Netflix xould be seen as below:

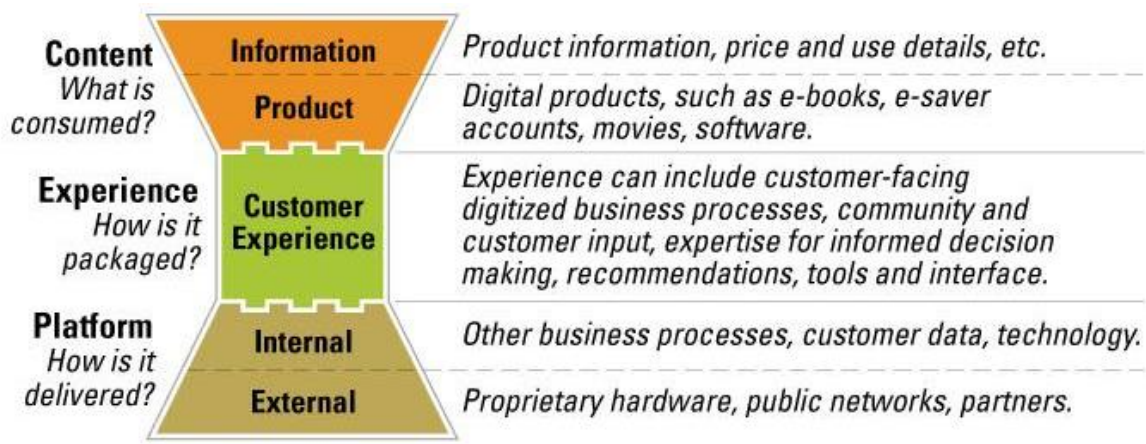

Figure 6: Digital business model

The world of digital technology is ever changing, and it is also influencing the the way companies look at the makets and conducts business. Many business models, netflix as such, exist and earn profil only because of its digital business. But getting into a new business stream with high dependency on digital business could be a little overwhelmingly expensive, risky and challenging.

Going back to the history, companies at the core of the industry, like Netflix and LoveFilm grew out of DVD rental businesses operate a one-sided business model, where user of the service is the one who pays for it and is the primary customer at the same time (Netflix, 2015).

Engagement: The primary Value proposition to online streaming is the legal access to orignal content for movies and tv shows and the algorithms which defines the personal preferences and suggestions and that too without any interuptions of advertising. Netflix also creates value with its high support of multiple devices which gives the customer, an opportunity to stay connected to the media even on the go. Another treat for the binge watchers is that Netflix releases the complete seasons of its series so the watchers do not have to wait for the next week for the next episode.

Delivery: Netflix not only liscences its content from broadcast networks and media houses but produces its own contents as well. Nelflix has a huge data base of the historic content, for which the customer expresses a deaper willingness to pay for the lost time. As the Netfix's model matured, Netflix from being complimentary to television and traditional media, became a substitute.

Netflix is also gaining popularity by the original media it is able to create and their content is usually graded 8+ ratings on IMDB, including House of cards which got 14 Emmy Award nominations and Narcos which is aclaimed as the most intriguing TV series of all times. For such content users don't mind paying extra fee for having the primary access and first hand experience for the entertainment.

Differentiation: Netflix's service for personalization menu and recommendations based on the usage habits is what sets it apart from its competition. This algorithm also is a huge barrier for new enterants in the business. Ans as much as the hardware and software is irreplaceble and integral, Netflix also has personalized ratings over half a billion movies which gives the user a more honest perspective of movie from another one of their kind and not just a paid employee who's decission could be influenced.

Monetization: Since the subscription fee is the only revenue stream of Netflix, which oftren results in negative cash flow for Netflix, other streams of revenue generation are being suggested in the following sections.

Recommendations

Additional Revenue Stream: Currently Netflix focuses only on Subscription for their revenue. Getting an addition revenue from advertisement can really increase their cash flow. As ad free service is one of their main USP, it is very important for Netflix to tackle it carefully. They can have a lower subscription cost or free subscription with ads included. This will help them grow customer data base as well.

Targeting New Movies: Netflix keeps updating their list for movies very frequently. But these movies are either outdating or quite old. Netflix can tie up with new release movie and charge the customer the price of an average ticket. This will give subscribers an additional option to watch new movies at their own time and place. Netflix can also earn through this.

CONCLUSION

The research shows that Netflix has a strong business model and has proven to be very successful at its core business activity. With the propositions, it has been able to diliver the promiseand a high degree of services to its customers. It needs to see that the same story and value is delivered by the staff to the customers (Magretta, 2002).

Netflix has constantly strove to develop and introduce new services and inmproving its value propositions with never ending hosted data and great range of its own orignal content. The company has high interest in providing exceptional experience in serial content, as a result it has a huge variety of serials. If the company wants more customers to join their network they need to have a stronger ecommerce oriented business model and services.

A few managerial implications came up i.e. Netflix should continuously adapt to changing technological dynamism and new market opportunities in reaching various markets. Netflix's management should hire experts on cross culture management to ensure a cross culture component is incorporated in its pursuits. The company should continuously evaluate the role played by information technology in propelling it to its position, the ever changing trends in the industry in terms of provision of services and other related services. Netflix should also focus on new business streams such as advertimements and new movies at a premium prices as it came up during the research that the movie content is usually 6-12 months old which is not lack of attention but company policies or liscence agreements.

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Business Background

83 million members

Available in over 190 countries

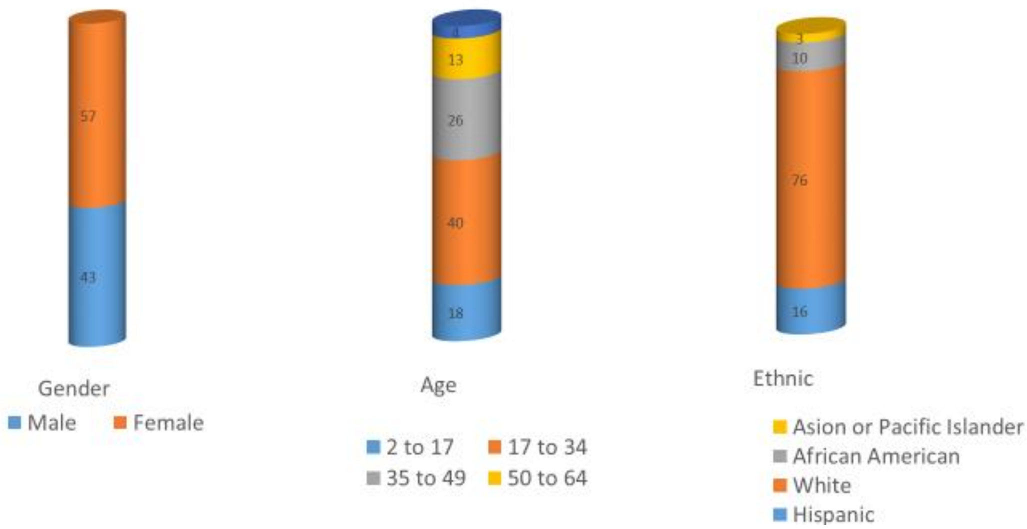
Average of 125 million hours of viewing per day

The Netflix website was launched on August 29, 1997 (March 2015 in New Zealand)

In September 1999 monthly subscription was introduced

Netflix went public on May 29, 2002, selling 5.5 million shares of common stock

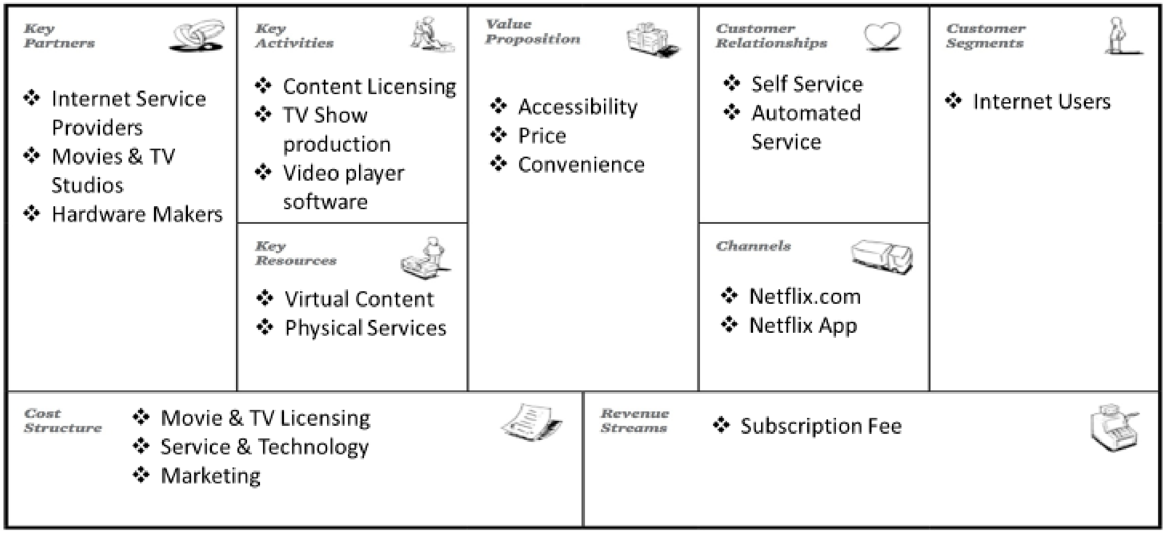
Demographics



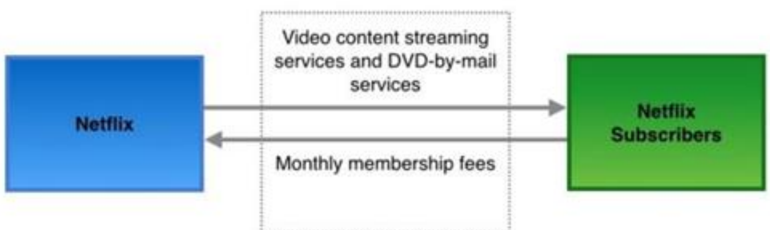
Netflix in New Zealand

- Netflix launched its operations in New Zealand in March 2015.
- Netflix launched its service at a cost $9.99 a month with one month free subscription
- This is a lot cheaper than its competition in New Zealand. It's half the price of Sky TV's Neon, and also cheaper than Spark's $12.99/month Lightbox and the $12.99/month
- Netflix also brought its multiplatform approach to NZ, which includes making its content available through apps on various brands of smart TV, Xbox, PlayStation 4, Nintendo Wii, iOS and Android phones and tablets, Google Chromecast and Apple TV

Business Model Canvas



Revenue Model



Standard definition plan

Access to standard definition quality streaming on a single screen at a time

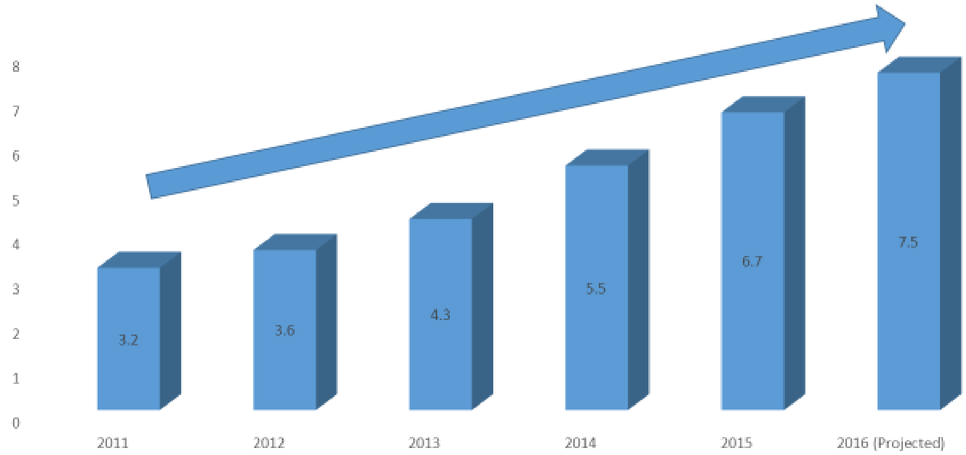
High definition plan

Access to high definition quality streaming on two screens concurrently

Ultra-high definition plan

Access to high definition and ultra-high definition quality streaming over four screens concurrently

Revenue (In Billion)

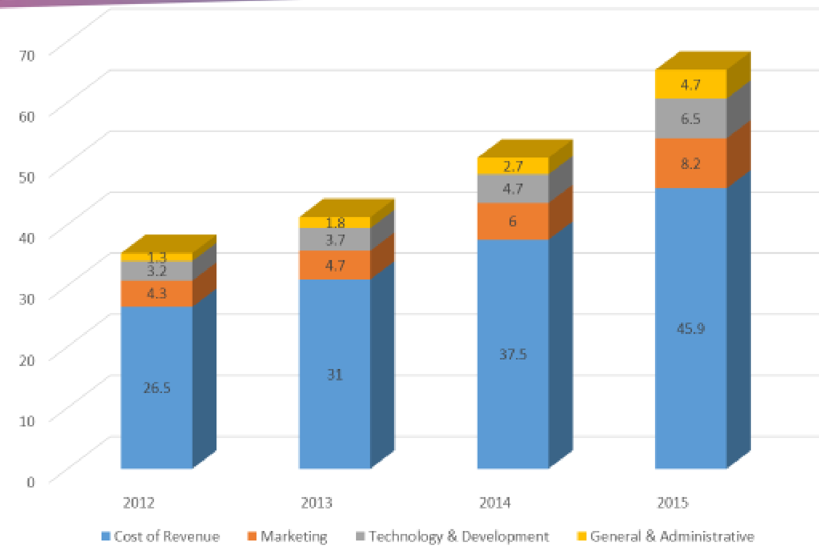


Compounded Annual Growth Rate – 13.23%

Cost Analysis

- Cost of Revenue
- Marketing
- Technology and Development
- General and Administrative

Cost (In 100 Million)



Value Creation

- Netflix have a clear view of their target market and customers, and have concentrated on markets where they have strength and more competitive edge
  - **Engagement**
  - **Delivery**
  - **Differentiation**
  - **Monetization**

Conclusion

- Netflix has a very solid business model and has been very successful at its core business activity
- Netflix has been constantly developing and introducing new services which have been improving the value of the company
- Netflix should continuously adapt to changing technological dynamism and new market opportunities in reaching various markets
- Netflix's management should hire experts on cross culture management to ensure a cross culture component is incorporated in its pursuits