**Netflix – 2011**

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**A. Case Abstract**

Netflix is a comprehensive strategic management case that includes the company’s year-end 2010 financial statements, organizational chart, competitor information and more. The case time setting is the year 2011. Sufficient internal and external data are provided to enable students to evaluate current strategies and recommend a three-year strategic plan for the company. Headquartered in Los Gatos, California, Netflix’s common stock is publicly traded under the ticker symbol NFLX.

Netflix founded in 1997, Netflix provides DVDs and Blu-ray discs to Internet based subscribers in the United States, Canada, Mexico and Latin America and DVDs and Blu-ray discs delivered to the homes of customers in the United States. Customers, who receive DVDs by mail, keep the media for as long as they wish with no late fees and return the DVD in a prepaid shipping envelope and then are eligible to select their next DVD. Subscription plans start as low as $7.99 per month. The company had 25 million subscribers as of Summer 2011.

**B. Vision Statement** (proposed)

To become the number one mail order and live streaming movie company in the world.

**C. Mission Statement** (proposed)

At Netflix we seek to be the highest quality subscription business that offers Internet streaming and DVD by mail content (2). We believe in offering the best customer service possible by teaching our employees to be honest, respectful and ethical (6) while also valuing every customer’s individual needs. Our employees (9) are provided with the latest technologies, excellent benefits, and the safest working conditions in the industry. We provide outstanding customer service and in return, our customers (1) in our North American and Mexican markets (3) recommend their friends to Netflix (5). Our vast library of DVD’s and streaming service (4) provides a competitive advantage (7) as compared to offering only streaming. At Netflix, we strive to be a good corporate citizen (8).

1. Customers
2. Products or services
3. Markets
4. Technology
5. Concern for survival, growth, and profitability
6. Philosophy
7. Self-concept
8. Concern for public image
9. Concern for employees

**D. External Audit**

**Opportunities**

1. 147 million people in the United States watch online videos.
2. Digital distribution of media is growing at a rate of 30% a year.
3. International markets account for over 50% of spending in US filmed entertainment.
4. US TV market accounts for less than 15% of the world's TV households.
5. China's box office annual growth rate continues to grow over 10% a year.
6. Rivals such as Blockbuster are struggling with their business models.
7. Consumers spent over $20 billion on home video purchases in 2010.
8. More people know English now than ever before.
9. High price of an outing at the movie theater.
10. Weak US Dollar makes global markets more attractive.

**Threats**

1. Poor global economy has reduced personal spending.
2. YouTube owns over 75% of the multimedia web market share.
3. Time Warner Cable's movies on demand.
4. Hulu, an ad based streamer, provides TV shows and movies for free.
5. DVRs are in 40% of US homes as of 2011.
6. Barriers to entry are low as startups can be launched for relatively low costs.
7. By law, Netflix cannot release new DVDs until 28 days after retail release.
8. Increase in US postal fees would reduce profit margins.
9. Infringements on Netflix patents and other proprietary assets.
10. Netflix is the object of complaints regarding collusion with Wal-Mart.

**Competitive Profile Matrix**



**EFE Matrix**





**E. Internal Audit**

**Strengths**

1. Revenues increased 29% from 2009 to 2010.
2. 90% of surveyed subscribers would recommend Netflix to their friends.
3. Library of choices grew 30% in 2010.
4. Currently have over 100,000 DVDs available for customers.
5. Netflix expanded into Canada, Mexico and Latin America in 2011.
6. Netflix is the largest streaming movie company with over 25 million subscribers as of Fall 2011.
7. Recent customer satisfaction ASCI score was 85 out of 100.
8. Unlimited access to internet movies and mail in DVDs for $7.99.
9. Net income doubled from $83B to $161B from 2008 to 2010.
10. Apple uses Netflix to stream movies to its Apple TV, iPhone, and iPad.

**Weaknesses**

1. Reliance on the US Mail System for delivering of DVDs in US Markets.
2. Relies upon Amazon for a majority of its cloud computing services and cannot easily switch to another cloud provider.
3. Only 2 of the top 8 executives are women.
4. Netflix has no publically available vision or mission statement.
5. Netflix deal with Disney and Sony expires in 2011.
6. In 2010, Netflix did not rank in the Top 10 among online video content providers.
7. Netflix charges $95 to Amazon's $79 for unlimited streaming without DVDs.
8. Netflix collects data from subscribers and some firms have received criticism for this practice.
9. Netflix is the object of patent infringement regarding client-server communications.
10. Stock price fell 60% between July 2011 and October 2011.

**Financial Ratio Analysis**

|  |  |  |  |
| --- | --- | --- | --- |
| **Growth Rate Percent** | **Netflix** | **Industry** | **S&P 500** |
| Sales (Qtr vs year ago qtr) | 48.60 | 47.70 | 14.90 |
| Net Income (YTD vs YTD) | - | - | - |
| Net Income (Qtr vs year ago qtr) | 64.50 | 51.70 | 65.70 |
| Sales (5-Year Annual Avg.) | 25.95 | 25.47 | 8.28 |
| Net Income (5-Year Annual Avg.) | 30.79 | 30.32 | 8.77 |
| Dividends (5-Year Annual Avg.) | - | - | 5.67 |
|  |  |  |  |
| **Profit Margin Percent** |  |  |  |
| Gross Margin | 36.6 | 36.5 | 39.5 |
| Pre-Tax Margin | 12.9 | 12.7 | 18.0 |
| Net Profit Margin | 8.1 | 8.0 | 13.1 |
| 5Yr Gross Margin (5-Year Avg.) | 35.7 | 35.7 | 39.4 |
|  |  |  |  |
| **Liquidity Ratios** |  |  |  |
| Debt/Equity Ratio | 0.60 | 0.59 | 1.00 |
| Current Ratio | 1.2 | 1.2 | 1.4 |
| Quick Ratio | - | - | 0.9 |
|  |  |  |  |
| **Profitability Ratios** |  |  |  |
| Return On Equity | 82.0 | 80.8 | 28.1 |
| Return On Assets | 17.4 | 17.1 | 8.8 |
| Return On Capital | 32.8 | 32.3 | 11.7 |
| Return On Equity (5-Year Avg.) | 28.8 | 28.2 | 23.8 |
| Return On Assets (5-Year Avg.) | 14.6 | 14.3 | 8.0 |
| Return On Capital (5-Year Avg.) | 22.1 | 21.7 | 10.8 |
|  |  |  |  |
| **Efficiency Ratios** |  |  |  |
| Income/Employee | 109,175 | 107,624 | 118,037 |
| Receivable Turnover | - | 1.4 | 15.2 |
| Inventory Turnover | - | 0.0 | 12.3 |
| Asset Turnover | 2.1 | 2.1 | 0.8 |

**Net Worth Analysis** (in millions)



**IFE Matrix**





**F. SWOT**

**SO Strategies**

1. Increase advertising expenses by 15% in 2012 and 2013. (S1, S4, S5, O1, O2)
2. Offer first 3 months at reduced price to take advantage of at home movie customers (S8, O7).
3. Aggressively enter the Chinese market. (S9, O5, O8, O10).
4. Provide free month service to any customer who recommends 5 friends. (S2, O1, O2).

**WO Strategies**

1. Extend expansion into Canada, Mexico, Latin America and China by 15% per year (W6, W10, O3, O4, O5, O8, O10).
2. Renew deals with Disney and Sony (W5, O2).

**ST Strategies**

1. Provide a free month of service for anyone who recommends 5 friends (S2, T1).
2. Increase R&D by 25% for marketing of online streaming movies (S6, S8, T6, T8).

**WT Strategies**

1. Form a partnership with UPS to deliver all DVDs (W1, T8).
2. Develop a clear mission (W4, T1, T6).

**G. SPACE Matrix**







**H. Grand Strategy Matrix**



**I. The Internal-External (IE) Matrix**



|  |  |
| --- | --- |
| **Division** | **Profits** |
| DVD Division | $627 M |
| Streaming Division | $441 M |

**J. QSPM**









**K. Recommendations**

1. Increase advertising budgets by 15 percent.

2. Expand by 15 percent into Latin America, Mexico, and China.

**L. EPS/EBIT Analysis** (in millions)

Amount Needed: $1,000

Stock Price: $120

Shares Outstanding: 52

Interest Rate: 5%

Tax Rate: 36%





**M. Epilogue**

Netflix is downplaying problems with its U.S. operations by focusing on its plans to expand into the U.K. and Ireland in early 2012. But the company lost about 590,000 U.S. subscribers in the third quarter of 2011 as a result of a rate increase on customers that get both DVDs by mail and streaming video. In October 2011, the company scrapped its plans to split into two separate businesses: 1) Netflix for streaming video and 2) Qwikster for DVDs by mail. That move would have forced customers getting both services to manage two accounts, passwords, rental queues and websites. Enraged customers flooded Netflix's site with tens of thousands of comments, as well as a barrage of tweets under the hashtag #DearNetflix. Netflix had a wave of cancellations in July 2011 as the company raised rates, and a second wave of cancellations hit the company throughout September and October as the price hikes took effect. Netflix scrapped that idea after facing a major backlash from customers and ridicule from analysts and comedians. Netflix is focused now on growing its streaming video service, especially outside the U.S. Netflix added Canada in 2010 and 43 countries in Latin America and the Caribbean in September 2011.

Netflix’s CEO Reed Hastings recently spoke bluntly about the recent problems in its third-quarter 2011 earnings letter: "The last few months have been difficult for shareholders, employees, and most unfortunately, many members of Netflix. We've hurt our hard-earned reputation and stalled our domestic growth." Netflix said it was focusing on the future, promising customers that "we are done with pricing changes." But the subscriber hemorrhaging may not be over. Netflix had 23.8 million total U.S. subscribers as of September 30, 2011 - down from 24.6 million three months earlier. About 21.5 million customers had streaming subscriptions, and just under 14 million had DVD subscriptions, with most customers mixing the two. Netflix expects those numbers to drop further by year-end 2011 with the total being 20 to 21 million streaming customers and 11.3 million DVD subscribers in the U.S.

In late October 2011, Netflix shares plunged 27 percent in after-hours trading, though the company reported earnings that beat analysts' expectations. Netflix earned $62 million, or $1.16 a share, on a record $822 million in revenue in the third quarter of 2011. Netflix has warned shareholders that it will be unprofitable in coming quarters. Netflix’s expansion into Europe will make the company's overall business unprofitable "for a few quarters" starting at the beginning of 2012. The company plans to halt its international expansion after its U.K. and Ireland launches "until we return to global profitability."

Netflix begins its fiscal fourth quarter 2011 under a dark cloud. In a conference call with analysts, CEO Hastings said Qwikster was a product of "Netflix not listening.” He predicted the next few years will bring "a slow decline" for Netflix's DVD business. The company needs a clear strategic plan for the future since rival firms are large and aggressive, and seizing on the misstep of Netflix.