



Internal & External Analysis

By: Anand Master

Bargaining Power of Buyers

Strong

Strong because...

- ❖ **Strong:** Buyer costs of switching content providers or utilizing multiple of them is very low.
 - Free trials available
 - Netflix and Hulu Plus \$7.99 per month, Amazon Prime \$79 per year
 - Redbox \$1 per day
- ❖ **Strong:** Buyers are well informed about prices, libraries, and quality of content providers.
- ❖ **Strong:** Buyers exhibit price sensitivity and have ability to influence prices, features, or services. Although prices are relatively low across content providers, sensitivity is indicated by buyer reactions to changes in subscription structures and pricing plans.
- ❖ **Strong:** Buyers can delay the purchase of the subscription from Netflix or they can choose any other alternative.
- ❖ **Weak:** Seller products are differentiated based on unique content libraries and customer experience.
- ❖ **Weak:** Buyers are small and numerous relative to sellers.
 - In 2012, 134 million U.S. households with high speed internet service and connected TVs, tablets, smartphones, etc, were streaming movies and TV shows online. [C-132]

Bargaining Power of Suppliers

Strong

Strong because ...

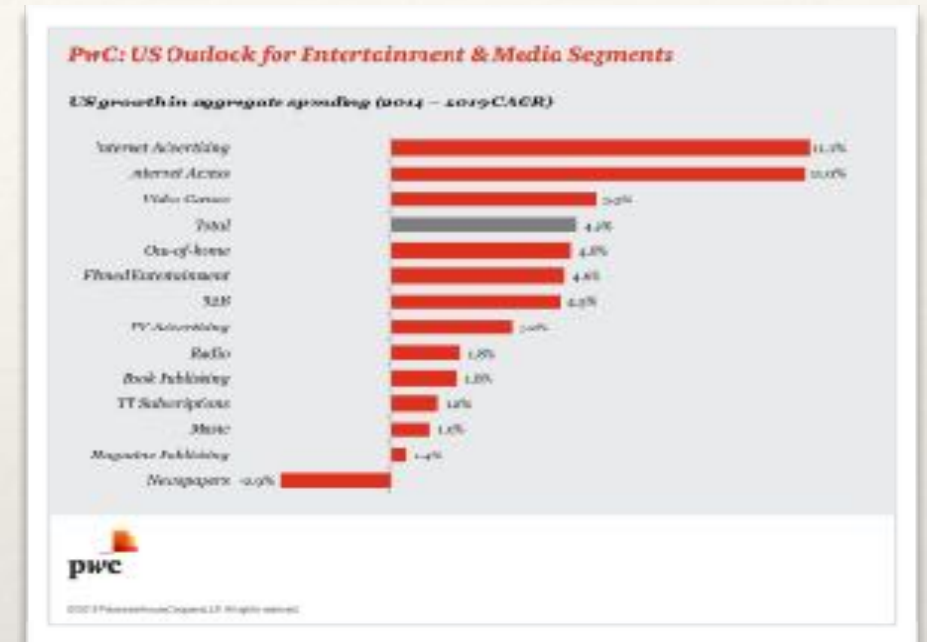
- ❖ **Strong** bargaining power of suppliers comes from their limited number in the U.S. There are only few large providers of entertainment video (movie studios such as Walt Disney Studios, Paramount Studios, Sony Picture Television, NBCUniversal, MGM, Lionsgate, Summit, Relativity [C-130], Universal Studios, Fox Entertainment [C-134]). The supplier side is more clustered than the side represented by Netflix and other streaming and content providers, where competition is brisker and abundant. We scored this point as 'strong', in the light of the following point.
- ❖ **High differentiation** in terms of products offered by suppliers: our assumption is that each movie or tv-show is controlled only by one supplier, namely the movie studio that recorded it. As a result, every buyer has to go to that specific studio, increasing the latter's power remarkably.
- ❖ **High switching costs:** "New content was acquired from movie studios and distributors through [...] revenue sharing agreements, and licensing agreements to stream content." [C-141] This weakens the power of Netflix and other focal firms, given also the commitment to honor the revenue-sharing period. Moreover, "[c]ertain [...] licensing agreements [...] included renewal provisions that were solely at the option of the content provider." [C-141]
- ❖ **Low threat of backward integration:** Although possible, it would be very hard for the suppliers to execute a backward integration and produce (control from the origin) the content that they will stream or offer to their customers.
- ❖ **Low threat of substitution:** there is no real surrogate as of now for what the suppliers provide. They are in a strong position, since they not only provide a differentiated product, but also are the only providers.
- ❖ Overall, **strong bargaining power** as reported also on page C-141: "In 2010-2011, Netflix's rapidly growing subscriber base gave movie studios [...] considerably more bargaining power to negotiate higher prices for the new content that Netflix sought to acquire for its content library."

Threat of Substitution

Weak - Medium

Weak to Medium because....

- ❖ **Weak:** Based on evidence from the case, good substitutes at attractive price are not present at this point of time. However, we see comparable or better features in the gaming industry as well as in the book industry. We assume that there is no more than 15% of the buyers who completely switch from one industry to another.
- ❖ **Weak:** Switching cost is higher for the consumers if they prefer to entertain themselves other than watching movies. Subscription of the Netflix is on an average \$7.99 for a month. An average cost of a good graphic games is about \$11.99. Although there is no evidence in the case that buyers prefer one or more ways to entertain themselves, we believe that Netflix has identified its demographics and we see no threat from the different industries for 8 to 10 years. It is to be noted that Just for Kids section introduced by Netflix was introduced so as to attract gaming enthusiasts to switch their preferences [C-141]. This evidence shows that we see overlap between the consumers and between these two industries.
- ❖ **Weak:** Threat from the Book Industry is weak. **Switching cost** for a buyer is lower. Consumers can shift for few months or prefer to be a part of both industries. Movie industry has found a way to attract readers by making movies based on different novels or series. We see that the book industry and movie industry complement each other.
- ❖ Disruption in the service industry is inevitable in the long run. In the end everything depends on the supply and demand relationship that exist between these industries and consumers. As of now we do not see any threat to the movie industry because the contents they provide to the consumers are welcomed by a group, affordable and, easily accessible.
- ❖ **Weak:** Pirated movies, songs and illegal downloads contribute to the movie industry by making people dependent on movies for entertainment. However, evidence in the case suggests that piracy actually hurts sales of the movie industry. [C-133]



Source: PricewaterhouseCoopers.

- TOP 5 REASONS PARENTS PLAY GAMES WITH THEIR KIDS:**
- 1 It's fun for the entire family: 85%
 - 2 Because they're asked to: 75%
 - 3 It's a good opportunity to socialize with their child: 75%
 - 4 It's a good opportunity to monitor game content: 58%
 - 5 They enjoy playing video games as much as their child does: 54%

Source: The Environmental Software Associations.

Threat of New Entrants

Medium - Strong

Medium to Strong because ...

- ❖ **Strong:** Industry members are not willing to contest, many companies already started to provide the service via various methods and devices.
- ❖ **Strong:** Buyer demand increases, the market is growing fast especially after mobile devices [C-132]. Streaming content is expected to exceed 3.4 billion views in 2012 [C-134]. 15% of US customers aged 13 and older used pay-TV services [C-136].
- ❖ **Strong:** There are many content producers and technology companies and these are potential entrants.
- ❖ **Strong:** 43 countries have high-speed broadband services and companies want to expand their services [C-130]. Companies offer new content such as kids programs [C-141].
- ❖ **Strong:** The service does not depend on unachievable technology or exclusive knowledge.
- ❖ **Medium:** Content can be accepted as product differentiation because industry members have agreements with the content producers. However, content providers can easily end contracts and sell the content to new entrants.
- ❖ **Medium:** The new entrants need agreements with content producers which is a high cost for a new entrant (except for those who are in case already content creators).
- ❖ **Weak:** It takes around 2 years to have a sufficient number of subscribers to generate contribution profit in international markets [C-130]. It is even more difficult in the US market because of much more stiff competition.

Competitive Rivalry

Strong

Strong because...

- ❖ **Strong:** Many competing players (Netflix, Hulu, Amazon Prime, Redbox) and methods exist for focal firms to provide content to customers (online, on-demand, mail delivery, in store).
- ❖ **Strong:** Competition to acquire licensing agreements and exclusive rights to content with entertainment video providers.
- ❖ **Strong:** Focal firms heavily market and advertise to promote content libraries, even offering free subscriptions to attract new subscribers.
 - As market leader, Netflix spent \$298.8 million in 2010 and \$402.6 million in 2011 on advertising (C-144).
- ❖ **Strong:** Focal firms are competing heavily for market share lost by spiraling brick and mortar stores Blockbuster and Movie Gallery.
 - Blockbuster filed for bankruptcy in 2010 having lost over \$4B from 2002-2010 (C-135).
 - Movie Gallery filed in February 2010 (C-135).
 - Redbox acquired 9,000 Blockbuster branded kiosks in February 2012 (C-135).
- ❖ **Strong:** Focal firms competing for market share in new markets such as Canada, Latin America, UK, Ireland (C-144).

Resource / Capability 1: Licensing Agreements and Content Acquisition

❖ Value - Yes:

Building and Maintaining relationships with suppliers was an important way to get access to various contents through licensing agreements [C-140,141]. Netflix was able to provide its services to Just For Kids and expand globally [C-130] because of its agreements. Every firm in the industry was aware of the situation that payments will exceed the costs of acquiring DVD distribution rights [C-141]. They went ahead with the deal because they knew that if they want to expand in Latin America, Ireland, UK or Canada they will need to have customized contents, which involves acquiring rights. As of April 2012, Netflix had approximately 140,000 titles in its DVD library [C-141]. In order to gain access to new contents Netflix negotiated through revenue-sharing with its distributors, suppliers and various studios. This added value to Netflix as now they can pay low charge and increase their library [C-141].

❖ Rarity - Yes:

Netflix has an attractive content and it is rare. Even though Netflix knew that they were paying more for the contents they continued to negotiate and build their libraries with contents [C-141]. This shows that it understood the importance of content acquisition with the help of agreements. We assume that in 2012 Netflix has the strongest capabilities to negotiate with suppliers because of its brand recognition it had in the market.

❖ Inimitability - No

- **Time Constraints:** No: Netflix took years to gain access to films of new releases. We cannot ignore that it will be difficult for some other company to negotiate with big suppliers like Lionsgate to get hands on new releases within 1 year's time [C-141]. But, in 10 years competitors can have new agreements with other companies.
- **Path Dependence:** No: There is no path dependence because acquiring licenses and contents is achievable by any company within 8 to 10 years.
- **Social Complexity:** Yes: Netflix has good relations with content providers, but content providers can easily have agreements with other companies. On the other hand, their members may have addiction to their content, and they may not want to change the service. This creates social complexity as long as Netflix continues to provide good content.
- **Tacit Knowledge:** No: Negotiations with content producers are not tacit knowledge, any company can hire good content experts and negotiators.

As a result, the resource/capability is a source of Temporary Competitive Advantage.

Resource / Capability 2: Netflix Proprietary Software

❖ Value - Yes

User friendly, improves quality of member experience by:

- allowing users to easily scan movie length and other features such as ratings, cast
- providing satisfying recommendations (about 50% of the titles selected came from the recommendations)
- instant queue which is also helpful for subscribers to find and manage their interests.

Minimize Cost: On average about 85% of the titles in Netflix's content library were rented each quarter. Contents are like inventory for Netflix and content price is increasing. So, software helps for the efficient use of inventory and it decreases costs for the company considerably.

❖ Rarity - Yes

Yes, except from Google TV [C-134] and Netflix, this kind of software is not mentioned for any other company. So, we can assume that it was a rare resource in those years.

❖ Inimitability - No

- **Time constraint:** No, it may take some time for competitors to develop similar software but it is not a very long time.
- **Path Dependence:** No, even though Netflix is one of first movers in the industry, there is not a real path dependence barrier.
- **Social complexity:** No, it sometimes takes time for customers to understand and accept new softwares, but after widely use of mobile devices and apps most users are open to change and to use new softwares.
- **Tacit knowledge:** No, even though the software depends on a high technology, it is not an unachievable technology for competitors.

As a result, the resource is a source of Temporary Competitive Advantage.

Resource / Capability 3: Distribution & Logistics

- ❖ **Value - Yes:** Allows the company to capture customers from two market segments: those interested in renting physical DVDs, and those interested in online streaming through their electronic devices. The company's 50 distribution centers and 50 shipping points in the U.S. allow the firm to offer 1-day delivery with no shipping fees and deadline for returning the items [C-137]. The DVD-by-Mail Option, along with the online service towards which everyone was flocking to, has enabled Netflix to build capability and its customer basis over time.
- ❖ **Rarity - No** - Netflix is not the only one that has such distribution and logistics capabilities. Customers could rent “[...] DVDs from Blockbuster and other local retail stores or from standalone rental kiosks like Redbox and Blockbuster Express” [C-132]. Customers had also the option to rent “[...] DVDs online from Netflix, Blockbuster, and several other subscription services that either mailed DVDs directly to subscribers' homes or streamed the content to subscribers via broadband Internet connections [C-132].”
- ❖ **Inimitability - No**
 - **Time constraint:** No, others can buy or outsource a mailing and tracking system. Such a system can also be built within 10 years, given the resources.
 - **Path dependence:** No, distribution and logistics capabilities are not the outcome of unique historic opportunities, apart from the natural evolution of the industry.
 - **Social complexity:** Yes, subscribers and their relationship with Netflix empower the distribution and logistics capability of the firm.
 - **Tacit knowledge:** No, there is no support to the fact that tacit knowledge is needed for a distribution and logistics infrastructure. Knowledge can be externalized.

As a result, distribution and logistics capabilities are a source of competitive parity: other players within the industry have developed the same capabilities, and there is no strong barrier to economic players to replicate it.

Resource / Capability 4: Marketing & Advertising

❖ Value - Yes

A key driver of Netflix's business is spending aggressively on marketing to attract new subscribers and build awareness of the brand. Netflix utilizes free trials and a number of marketing channels such as paid search listings, print ads, TV ads, web ads on sites such as AOL, Yahoo. They also have a number of cooperative advertising programs with movie studios.

❖ Rarity - No

Netflix is not the only firm with this type of marketing and advertising strategy. However, it is important to note that Netflix does have a very large advertising budget and can capitalize on their ability to provide both streaming and physical DVD's within their advertising initiatives.

❖ Inimitability - No

- **Time constraint:** No, similar efforts can be developed overnight, given sufficient capital.
- **Path Dependence:** No, these capabilities have not been developed through a unique path. Competitors use similar advertising channels and free trials.
- **Social complexity:** No, no evidence indicates relationships with advertising channels cannot be replicated.
- **Tacit knowledge:** No, no evidence indicates tacit knowledge applies here.

As a result, Netflix's marketing and advertising capabilities are a source of competitive parity.

Summary of VRI Analysis

Netflix has a temporary competitive advantage because of:

- ❖ Temporary Competitive Advantage on Licensing Agreements and Content Acquisition.
- ❖ Temporary Competitive Advantage on Proprietary Software.
- ❖ Competitive Parity on Distribution & Logistics.
- ❖ Competitive Parity on Marketing & Advertising.