A SPLIT DECISION:

The Critical Analysis of Netflix's Communication Strategy during the Development of Qwikster

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Abstract

The Netflix Corporation began as a movie and television show rental company in 2000 and has since expanded into the leading DVD-by-mail and online video streaming company in the world. In 2011, Netflix began a yearlong downward spiral. It all began on July 12, 2011 when Netflix announced that Netflix customers who were subscribed to both DVD-by-mail and online streaming services would see a monthly price increase of almost 60 percent. People were shocked and outraged at the drastic price difference.

After two long months and virtually no explanation from Netflix, CEO Reed Hastings finally issued an apologetic email to subscribers and on the Netflix blog. In the message, Hastings announced yet another change in the fundamental structure of the company – the two services would in fact become two separate companies. Hastings explained that over the next few months, Netflix would rename their DVD-by-mail service to “Qwikster,” a name designed to represent the quick and speedy DVD service. The Netflix name would continue only as an online streaming business.

Ultimately, the change meant that Netflix DVD-by-mail subscribers would have to use a separate website with separate billing information and invoices to maintain their rental accounts. Consumers could continue using the Netflix website for all of their online streaming needs, but they would no longer have access to the DVD-by-mail service unless they signed up for Qwikster. The “apology” and the latest announcement did nothing to calm down the outraged customers and in fact made Netflix customers even more upset.

After a great deal of media attention and several professional and amateur videos released by Netflix executives, the Netflix team settled the public uproar by announcing that they were no longer pursuing their plans with Qwikster. Netflix has struggled to recover ever since.

I. Table of Contents

THE HISTORY OF NETFLIX

Netflix Corporation, founded in 1997 by current CEO Reed Hastings alongside software executive Mark Randolph, is the leading online subscription service streaming television shows and movies (Netflix Corporation 2012). In 1999, Hastings and Randolph launched their idea of allowing consumers to rent up to three DVD movies and television shows at a time via their DVD by mail service. An online queue allowed users to list their top movie rental choices in the order they wanted them delivered. The idea was revolutionary in that users could keep the movies as long as they wanted without incurring late fees (Netflix Corporation 2012). Their monthly subscription, flat-rate rental system with no late fees, shipping fees or due dates was very different from the traditional video store model notorious for charging high-priced late fees and consumers loved it.

In 2000, Netflix launched the personalized movie recommendations system that uses members' ratings of movies to predict choices for future rentals. At this time, there were more than 600,000 Netflix members. By 2005, that number increased to 4.2 million subscribers (Netflix Corporation 2012).

When the company announced its initial public offering (IPO) in May 2002, stock prices opened at $15.00 per share on NASDAQ with 5.5 million shares available (Netflix Corporation 2012). By July of 2010, the price per share had risen to $304 (Grover, Edwards and Fixmer 2011).

In 2007, with more than 6.3 million members, Netflix introduced online streaming which allows users to watch unlimited movies and TV shows instantly over the Internet on their personal computers (Netflix, 2012). By 2009, they added streaming to PS3 devices, Internet-connected TVs and other Internet-connected devices.

Real-Time

The actual time elapsed during which a process takes place or an event occurs.

ONLINE STREAMING AND DIRECT-MAIL DVDS

According to the Online Dictionary of Computing, video streaming is the process of decompressed sound and video data that is transferred to an individual's computer or digital device and played in real-time as the data is being downloaded (Howe 1996). The prime contenders to Netflix when it comes to online video streaming are Hulu Plus and Amazon Prime (Laird 2012). "Netflix and Hulu offer greater video selection than Amazon, though Amazon is spending hundreds of millions of dollars buying more content from Hollywood and TV studios" (Barr, 2012). Blockbuster Video has become a major player again with the launch of Blockbuster Total Access. RedBox, the biggest competitor to the video store model, is also considered a competitor (Laird, 2012).

Hulu and Hulu Plus

In 2007, former vice president and general manager of Amazon's businesses in North America, Jason Kilar, began the formation of the company we all know now as Hulu (2012). Kilar's dream for Hulu was that it would be the leading resource of premium online television streaming. Currently, Hulu has formed partnerships with more than 410 content providers, maintains approximately 38 million unique monthly viewers and more than 1,000 advertisers (HuluPlus 2012). Kilar oversaw the launch of Hulu Plus, as well, which became the fastest-growing video subscription service in American History with more than two million subscribers. Hulu's services include free instant video streaming as well as Hulu Plus, which includes unlimited movie and television streaming for $7.99 per month (HuluPlus 2012).

Amazon Prime

Netflix's other major competitor is Amazon Prime which was launched by Amazon.com in the United States in February 2005 (Amazon Prime 2012). Founded in July 1995 in Seattle, Washington, Amazon's mission is "to be Earth's most customer-centric company where people can find and discover anything they want to buy online" (Amazon Prime 2012). Amazon (2012) currently has more than 65,600 full-time and part-time employees internationally. Amazon Prime allows its members to receive direct-mail DVD rentals and instant online streaming for an annual membership fee of $79, which is approximately $6.58 per month. "As Amazon continues to add movie and TV content to Prime, we see it likely adding more competitive pressure to the legacy online video services," said Colin Sebastian, an analyst at R.W. Baird in a note to investors in November 2012 (Barr 2012).

BLOCKBUSTER Total Access

When it comes to DVD rentals, Netflix's competition includes Blockbuster's Total Access program and Redbox. Blockbuster launched Total Access on November 1, 2006

(Blockbuster Total Access 2012). This program allows its members to receive and return DVD rentals through the mail or in stores. Blockbuster Total Access has three membership options with all of them allowing for unlimited DVD rentals. Members can rent one DVD at a time for $9.99 per month, two discs at a time for $14.99 per month or three discs at a time for $19.99 per month. In 2011, the DISH Network Corporation acquired Blockbuster after the company filed for Chapter 11 bankruptcy in September 2010 (Falcone 2011). Since the acquisition, Blockbuster Total Access allows subscribers to choose between DVDs, Blu-ray movies or video game discs with the option to exchange discs in a Blockbuster store for immediate satisfaction (Falcone 2011). Blockbuster also offers Blockbuster Express, a kiosk-based disc-rental service. This service only charges $1 per night with new releases ranging from $2.99 to $3.99 and is completely separate from Blockbuster stores and Blockbuster Total Access (Falcone, 2011).

RedBox

Finally, there is Redbox, a company unlike any of the companies previously mentioned except Blockbuster Express. Redbox isn’t a retail store company or an online video streaming service, Redbox is a movie rental kiosk with approximately 200 featured titles and 630 DVDs available for rent per kiosk (Redbox Fun Facts 2012). In 2002, the first Redbox kiosk was placed in a McDonald’s restaurant (Redbox Timeline 2012). Now RedBox kiosks are available in grocery stores, convenience stores, pharmacies and other mass retailers nationwide (Redbox Timeline 2012). Today, Redbox has approximately 31,500 locations and 38,500 kiosks (Redbox Fun Facts 2012).

Redbox has rented more than 2 billion DVDs, video games and Blu-ray discs to date starting at $1 per day. This accounts for approximately 34.5-percent market share of disc rentals (Coinstar 2011).

LEADING UP TO THE SPLIT

As can be seen from the evaluation of Netflix's competition, there are not many other available services out there that really match the services Netflix brings the consumer other than Amazon Prime (2012). Competition in the world of instant online video streaming is becoming more cutthroat by the day (Richwine 2011). On top of the competition in 2011, increasing royalty costs from Hollywood hit Netflix hard but pressures from consumers to keep prices low are also increasing (Richwine 2011).

The First Sale Doctrine

Netflix had to deal with the extreme pressure to be innovative in two very different markets, video streaming and DVD-by-mail, with two very different pricing structures (Richwine 2011). The DVD-by-mail service is affected by the 1908 United

Royalties

Compensation for the use of property, usually for the use of copyrighted works, patented inventions, or natural resources.

States Supreme Court decision known as the "first sale doctrine" (Gurley 2011). However, this doctrine does not apply to online streaming. This means that for Netflix to have the permission to stream a particular movie or television show they must negotiate with the copyright owner (Gurley 2011). The only fluctuating cost factor that has to be considered for DVDs-by-mail is the continuously increasing shipping costs (Associated Press 2011).

Market Analysis

On top of the legal implications, Netflix had to evaluate the consumer-base for video streaming and DVD-by-mail, as well. In 2011, Netflix had approximately 23 million subscribers; with more than half of those subscribers paying for the combination of video streaming and DVD-by-mail (Jacobson and Desk 2011). Therefore, at this time, Netflix had a significant amount of customers subscribing to the DVD service, but the future of DVDs was predicted to steadily dwindle (Laird 2012). In 2012, it was predicted that more movies will be viewed online than any other method with an estimated 3.4 billion online movie views and a mere 2.4 billion disc movie views (Laird 2012). To pay the rising sums Hollywood was demanding for online rights to movies and TV shows, Netflix needed to keep revenue flowing from the DVD rental business even though it expects revenue to decline as much as 10 percent a year (Grover, Edwards and Fixmer 2011).

It was obvious to many industry experts that Netflix could not sustain itself while offering the DVD-by-mail service (Carr 2011). CEO Reed Hastings made the implication of a transition in 2010 when he said that Netflix was no longer a DVD-by-mail company but a streaming company that also offers DVDs (Carr 2011). Michael Pachter, an analyst with Wedbush Securities, noted to Bloomberg that streaming movies online without the burden of postal fees and warehouses generates a 65-percent gross profit margin compared with 37 percent for DVDs (Grover, Edwards and Fixmer 2011).

New Plans for DVDs-by-mail

On July 12, 2011, Netflix, considering all the previously mentioned variables, announced that it would begin offering DVD-only plans to its consumers (Becker 2011). It just so happened that these new plans came in conjunction with a major rise of prices (Becker 2011). Netflix announced that they would be offering a one disc at a time plan for $7.99 per month or a two-disc at a time plan for $11.99 per month (Becker 2011). However, if consumers wanted both streaming and DVD-by-mail services, they would charge customer accounts for both plans $7.99 per month for unlimited streaming plus $7.99 for one-disc at a time DVD-by-mail or $11.99 per month for two-discs at a time. In other words, Netflix customers with combination DVD and streaming plans would see at least a 59-percent increase in their monthly service prices. In response, an estimated 800,000 DVD-by-mail customers cancelled their Netflix services, and an estimated 200,000 streaming customers did the same (Carr 2011). Over the next two months, stocks prices declined a whopping 44-percent (Carr 2011).

INTRODUCING QWIKSTER

On September 18, 2011, CEO Reed Hastings sent an apologetic email to Netflix customers (see Appendix 5 to read the message from Hastings). In the email, Hastings addressed the public about the increase in prices and the separation of DVD-by-mail and streaming services with a sincere apology for the way Netflix announced the price increase, but he did not apologize for the price increase itself (Hastings, 2011). Instead, Hastings further explained the rationale behind the price increase (Hastings, 2011). That explanation quickly turned into another bombshell announcement about a major change in Netflix's service structure (Hastings 2011).

First, Hastings explained that the service and use of DVDs for watching movies is probably not a method that would last forever, but his goal was to keep it going "as long as possible" (Hastings 2011). He further explained that video streaming has a drastically different structure than a DVD-by-mail service and as such requires its own unique marketing strategy (Hastings, 2011). In order to do this, Hastings announced that Netflix would be splitting the two services into two companies with two different brands (Hastings, 2011). Video streaming would continue under the Netflix brand, while a new company would be developed for the DVD-by-mail service (Hastings 2011).

Hastings dubbed this DVD-by-mail company Qwikster (Hastings, 2011). He continued by disclosing that Andy Rendich, head of Netflix's DVD-by-mail initiative, would become the CEO of Qwikster (Hastings 2011). Furthermore, Qwikster would have its own website where consumers can subscribe to DVD-by-mail services, and it would be of a similar structure to Netflix's current DVD-by-mail page (Hastings, 2011). Hastings went on to add that to keep some consistency, Qwikster, although a different logo and brand, would keep the same distinctive red color used by Netflix (Hastings 2011). Qwikster's services would also have its own payment procedures and would show up as a separate credit on customer accounts than Netflix (Hastings, 2011).

Therefore, if a customer needed to change their account details, they would need to go to both websites and change two different accounts (Hastings, 2011). In conclusion, Hastings thanked current members for sticking with the company and apologized again to former Netflix subscribers (Howe 1996).

THE PUBLIC UPROAR

Netflix drew immediate criticism from subscribers and the media for raising its monthly rates by nearly 60 percent and hundreds of thousands of people canceled their subscriptions (Jacques, 2011). Netflix offered no apology for the price increase during the first two months of the debacle, even while watching their stock prices drop more than 50 percent (Jacques, Netflix Customers Are Seeing Red, 2011). Then cable channel Starz broke off talks to renew a deal that would supply movies and TV shows to the online streaming selection (Grover, Edwards, & Fixmer, 2011). Finally, Hastings apologized for the unclear announcement in his September 18 blog post only to further explain that the DVD-by-mail service would be called Qwikster and would be treated as a separate company (Hastings, An Explanation and Some Reflections, 2011).

This did nothing to calm the rage of consumers and in fact added fuel to the fire as angry subscribers took to social media to express their outrage. The hashtag, #DearNetflix was the fifth highest trending topic on Twitter following the initial July announcement (Tsukayama, 2011). The Netflix Facebook page received more than 20,000 comments – mostly negative – about the price hike within the first few days (Tsukayama, 2011). In fact, they received more than 9,000 Facebook comments within the first six hours and 41,000 comments within 26 hours (Mack, 2011). Users had to "like" the Netflix Facebook page in order to leave comments so the popularity of the page suddenly soared as people rushed to vent their frustrations (Mack, 2011). To their credit Netflix did not remove the negative remarks, but there were no apparent responses or comments from Netflix either via Facebook or Twitter and they failed to directly comment on the outrage. The silence from the company seemed to further infuriate customers, especially since Netflix had built a solid reputation for service and in understanding consumers.

Over the next few months, Netflix maintained social media silence amidst the onslaught of complaints and plummeting stock prices. Eventually on October 10, 2011, Reed Hastings finally posted a brief blog to the Netflix website announcing that the plans for Qwikster would be abandoned. Hastings never apologized for the debacle and simply reiterated that although "the July price change was necessary, we are now done with price changes." Netflix has since become a classic case study of how a successful company with a stellar reputation for customer service can destroy their brand in a short time by ignoring the needs of the consumers and failing to acknowledge their frustrations.

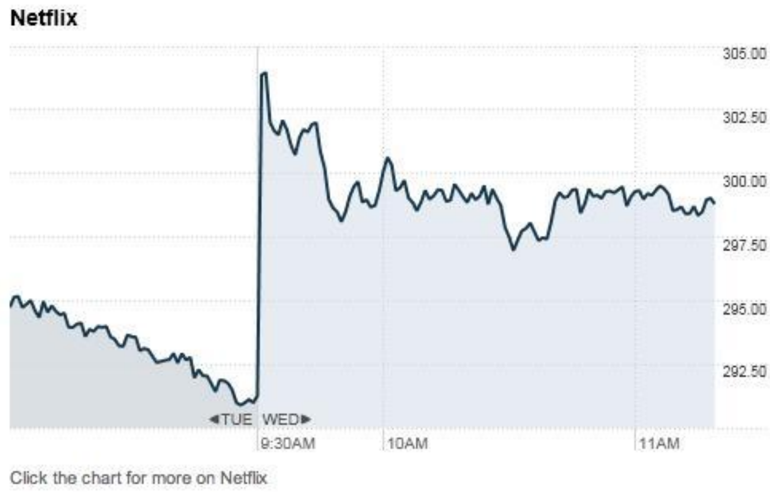
TIMELINE OF KEY EVENTS

July 13, 2011:	Netflix stocks reach an all-time high of $300 per share.
Sept. 1, 2011:	Netflix cancels its $9.99 DVD and streaming package and separates it into two services costing $7.99 each.
Sept. 5, 2011:	Netflix begins to offer service in Latin America as a streaming-only service with no DVD option, same as the Canadian service.
Sept. 18, 2011:	CEO Reed Hastings “apologizes” but keeps price hike in effect.
Sept. 19, 2011:	Stock prices drop 50% from July; Netflix CEO Reed Hastings introduces Qwikster, the new company that will take over the DVD service.
Oct. 10, 2011:	CEO Reed Hastings acknowledges that the new Qwikster service will “make things more difficult” for customers and decides to forego the new branding.
Oct. 24, 2011:	More than 805,000 Netflix customers cancel subscriptions over the price hike; Stock prices plummet an additional 27% down to $85 per share.
Oct. 25, 2011:	Stock prices fall another 10% before opening.
Nov. 21, 2011:	Netflix announces plans to raise $400 million by issuing debt and selling its stock. This raises new fears about their financial strength and marks their first annual loss in a decade.
Dec. 6, 2011:	Hastings appears before an investors’ conference in New York where he discusses the recent mistakes and predicts that all will be forgiven soon.
Dec. 22, 2011:	Netflix cuts Hastings stock option rewards by 50% to $1.5 million in 2012 but keeps his base salary unchanged at $500,000.

III. APPENDICES

Appendix 1

Netflix Stock Hits All-Time High



Writer, S. (2011, July 13). *Chronicling Netflix's Collapse*. Retrieved December 7, 2012, from http://mashable.com/2011/09/19/netflix-reed-hastings-video/

Appendix 2

Netflix Loses Half Its Value in Two Months

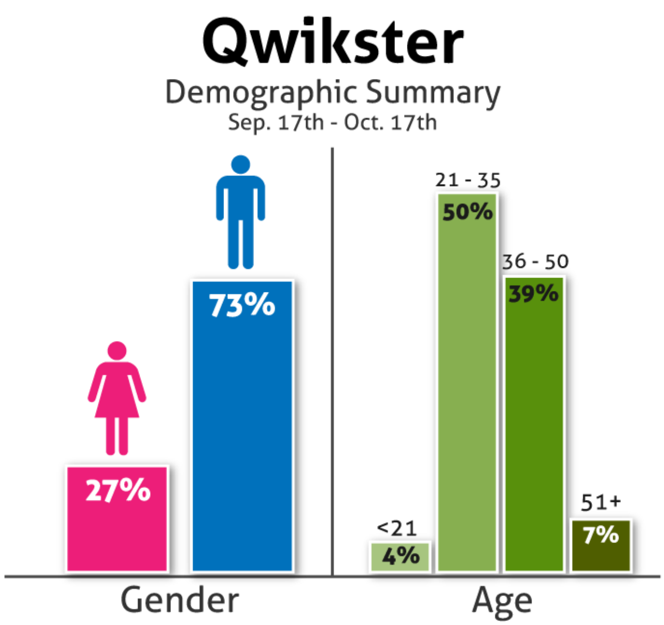
Writer, S. (2011, September 19). *Chronicling Netflix's Collapse*. Retrieved December 7, 2012, from http://mashable.com/2011/09/19/netflix-reed-hastings-video/

Appendix 3

Netflix Stocks Plummet 27% Following Earnings Report

Writer, S. (2011, October 24). *Chronicling Netflix's Collapse*. Retrieved December 7, 2012, from http://mashable.com/2011/09/19/netflix-reed-hastings-video/

Appendix 4



Analyzing the Buzz: Netflix & Qwikster. (2011, October 20). Retrieved from Banyan Branch: http://banyanbranch.com/social-blog/analyzing-the-buzz-netflix-qwikster/

Appendix 5

NETFLIX US

Sunday, September 18, 2011

An Explanation and Some Reflections

I messed up. I owe everyone an explanation.

It is clear from the feedback over the past two months that many members felt we lacked respect and humility in the way we announced the separation of DVD and streaming, and the price changes. That was certainly not our intent, and I offer my sincere apology. I'll try to explain how this happened.

For the past five years, my greatest fear at Netflix has been that we wouldn't make the leap from success in DVDs to success in streaming. Most companies that are great at something – like AOL dialup or Borders bookstores – do not become great at new things people want (streaming for us) because they are afraid to hurt their initial business. Eventually these companies realize their error of not focusing enough on the new thing, and then the company fights desperately and hopelessly to recover. Companies rarely die from moving too fast, and they frequently die from moving too slowly.

When Netflix is evolving rapidly, however, I need to be extra-communicative. This is the key thing I got wrong.

In hindsight, I slid into arrogance based upon past success. We have done very well for a long time by steadily improving our service, without doing much CEO communication. Inside Netflix I say, "Actions speak louder than words," and we should just keep improving our service.

But now I see that given the huge changes we have been recently making, I should have personally given a full justification to our members of why we are separating DVD and streaming, and charging for both. It wouldn't have changed the price increase, but it would have been the right thing to do.

So here is what we are doing and why:

Many members love our DVD service, as I do, because nearly every movie ever made is published on DVD, plus lots of TV series. We want to advertise the breadth of our incredible DVD offering so that as many people as possible know it still exists, and it is a great option for those who want the huge and comprehensive selection on DVD. DVD by mail may not last forever, but we want it to last as long as possible.

I also love our streaming service because it is integrated into my TV, and I can watch anytime I want. The benefits of our streaming service are really quite different from the benefits of DVD by mail. We feel we need to focus on rapid improvement as streaming technology and the market evolve, without having to maintain compatibility with our DVD by mail service.

So we realized that streaming and DVD by mail are becoming two quite different businesses, with very different cost structures, different benefits that need to be marketed differently, and we need to let each grow and operate independently. It's hard for me to write this after over 10 years of mailing DVDs with pride, but we think it is necessary and best: In a few weeks, we will rename our DVD by mail service to "Qwikster".

We chose the name Qwikster because it refers to quick delivery. We will keep the name "Netflix" for streaming.

Qwikster will be the same website and DVD service that everyone is used to. It is just a new name, and DVD members will go to qwikster.com to access their DVD queues and choose movies. One improvement we will make at launch is to add a video games upgrade option, similar to our upgrade option for Blu-ray, for those who want to rent Wii, PS3 and Xbox 360 games. Members have been asking for video games for many years, and now that DVD by mail has its own team, we are finally getting it done. Other improvements will follow. Another advantage of separate websites is simplicity for our members. Each website will be focused on just one thing (DVDs or streaming) and will be even easier to use. A negative of the renaming and separation is that the Qwikster.com and Netflix.com websites will not be integrated. So if you subscribe to both services, and if you need to change your credit card or email address, you would need to do it in two places. Similarly, if you rate or review a movie on Qwikster, it doesn't show up on Netflix, and vice-versa.

There are no pricing changes (we're done with that!). Members who subscribe to both services will have two entries on their credit card statements, one for Qwikster and one for Netflix. The total will be the same as the current charges.

Andy Rendich, who has been working on our DVD service for 12 years, and leading it for the last 4 years, will be the CEO of Qwikster. Andy and I made a short welcome video. (You'll probably say we should avoid going into movie making after watching it.) We will let you know in a few weeks when the Qwikster.com website is up and ready. It is merely a renamed version of the Netflix DVD website, but with the addition of video games. You won't have to do anything special if you subscribe to our DVD by mail service.

For me the Netflix red envelope has always been a source of joy. The new envelope is still that distinctive red, but now it will have a Qwikster logo. I know that logo will grow on me over time, but still, it is hard. I imagine it will be the same for many of you. We'll also return to marketing our DVD by mail service, with its amazing selection, now with the Qwikster brand.

Some members will likely feel that we shouldn't split the businesses, and that we shouldn't rename our DVD by mail service. Our view is with this split of the businesses, we will be better at streaming, and we will be better at DVD by mail. It is possible we are moving too fast – it is hard to say. But going forward, Qwikster will continue to run the best DVD by mail service ever, throughout the United States. Netflix will offer the best streaming service for TV shows and movies, hopefully on a global basis. The additional streaming content we have coming in the next few months is substantial, and we are always working to improve our service further.

I want to acknowledge and thank our many members that stuck with us, and to apologize again to those members, both current and former, who felt we treated them thoughtlessly.

Both the Qwikster and Netflix teams will work hard to regain your trust. We know it will not be overnight. Actions speak louder than words. But words help people to understand actions.

Respectfully yours, -Reed Hastings, Co-Founder and CEO, Netflix

Posted by Reed Hastings at 8:59 PM

+1 +607 Recommend this on Google

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Appendix 6

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