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Netflix Strategic Business Analysis

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Company Strategic Overview

Netflix, Inc. was founded in Scotts Valley, CA in 1997 by Reed Hastings and Marc Randolph.[1] The two men were heavily involved, with Hastings being the first chief executive officer (CEO).[2] Netflix sold and rented DVDs by mail. With the launch of Netflix.com in 1998, the decision was made to eliminate the sale of DVDs with the subscription service forming in 1999.[3] The service offered members unlimited DVD rentals with no late fees, due dates, or rental limits. Netflix was operating at a loss during the time, revenue was $5,006,000 while profit was ($29,845,000).[4] In September 2000, during the dot-com bubble, Hastings and Randolph offered to sell the company to Blockbuster LLC; John Antioco, CEO at the time, declined.[5]

To generate additional capital, the company went public in May 2002, selling shares at $15 under the National Association of Securities Dealers Automated Quotations (NASDAQ) ticker NFLX.[6] By the end, 6,000,000 shares were sold, raising $83,000,000.[7] In the year 2002 Netflix was reporting $150,818,000 in revenue generation.[8] Not till 2003 was Netflix in the black, reporting a profit of $6,512,000 with total revenues of $272,243,000.[9] After making its initial public offering (IPO) Netflix steadily grew, hitting 5 million memberships in 2006.[10] Streaming was introduced in 2007.[11]

In the comfort of one's home, favorite series, and films were now available with the click of a button. Collaboration with electronic companies made way for streaming on smart TVs and game consoles.[12] Manufacturers were encouraged to include integrated Netflix support. In 2010, Netflix began to launch internationally. Canada was their first introduction to a foreign market.[13] The addition of a dedicated kid's experiences debuted shortly after.[14] A strategic investment to win new members was introduced in 2013: Netflix original programming.[15] Netflix hit an all-time high in subscriptions at 35,600,000 subscribers.[16] Netflix won its first academy award in 2017 with 'The White Helmets'.[17] CO-CEOs were announced in 2020 as Hastings & Ted Sarandos.[18] The acquisition of content such as StoryBots, The Roald Dahl Story Company, and Scanline VFX, an experienced studio, grew the core of Netflix, providing outstanding entertainment.[19]

Netflix continues to produce groundbreaking entertainment; August marked their 25th anniversary. Revenue at 2021's calendar year end was recorded as $29,697,844,000, with streaming the primary source, growing from its IPO by 19,335% respectively.[20,21] Subscriber growth reached 27,500% roughly since the IPO.[22,23] As of close day 9/27/2022, NFLX was trading at $224.36/share; Netflix's stock price has grown by approximately 1,396%.[24,25]

Global Industrial Classification Standard

The Global Industrial Classification Standard (GICS) is a model developed by Standard & Poor's and Morgan Stanley Capital International to meet the needs of the world financial community, by classifying all company activity according to primary revenue-generating business activity.[26] Universally respected, the GICS framework is accurate, and evolves to meet modern times. The GICS framework breaks down publicly traded companies by sectors, industry groups, industries, and sub-industries, dividing the competitive space.[27] As shown in Figure 1, Netflix competes in the Communication Services sector, the Media and Entertainment sector, the Entertainment sector, and the Movies and Entertainment sector.[28] Netflix's direct competitors include Walt Disney, Bolloré and Vivendi.[29]

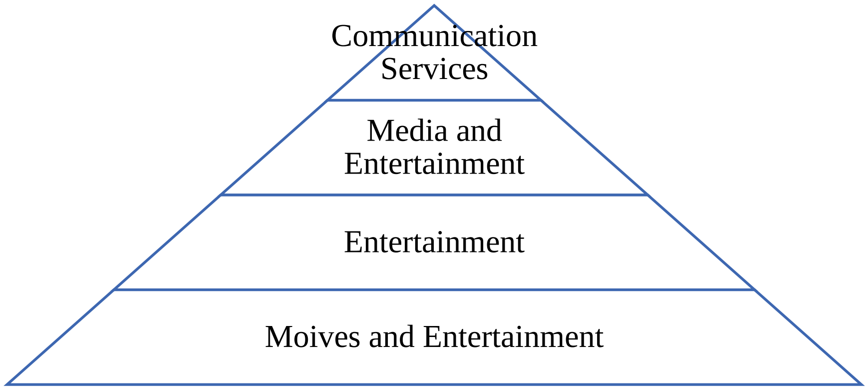

Figure 1: GICS - Netflix

Business Model

A business model is how strategies work together to enable the company to achieve competitive advantage meaning superior profitability and profit growth.[30] Netflix has a subscription-based business model, generating all revenue from paying subscribers.[31] Depicted in Figure 2, Netflix has one revenue stream within the sub-industry, Movies and Entertainment, subscriptions. As of year-end 2021, Netflix reported $30,000,000,000 in revenue, 100% of which was made up of 220,000,000 subscribers.[32]

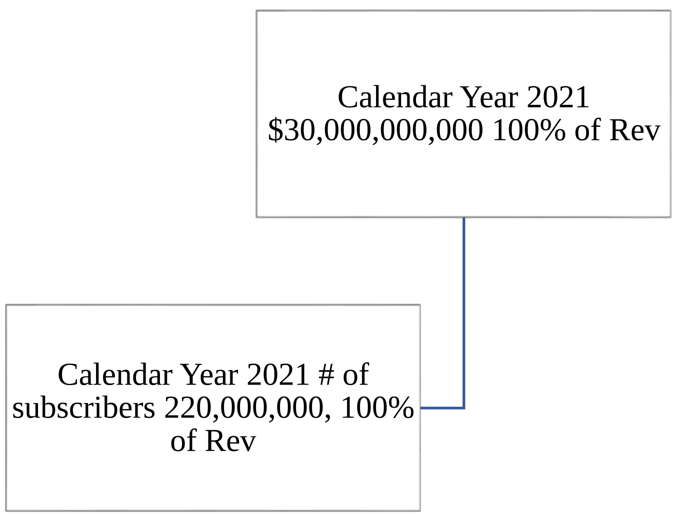

Figure 2: Business Model – Netflix

External Analysis:

Within the strategic management process, an external analysis examines an organization's external operating environment. The operating environment shapes competition for the company's sub-industry: competition from actual/potential competitors, competition when an industry evolves, and competition affected by macro-environmental forces.[33] These results reveal strategic opportunities and threats to companies' profitability.[34] An external analysis typically includes analysis of macro-environmental, industry life cycle, and Porter's Five Forces.[35] For the purposes of this assignment, an industry life cycle of the movies and entertainment sub-industry will be studied. This is in addition to studying three of the five forces in Porter's Five Forces –

Risk of Entry by Potential Competitors, Intensity of Rivalry Among Existing Competitors, and Bargaining Power of Buyers.

Macro-Environmental Analysis:

A macro-environmental analysis considers the general health and well-being of a nation and the organizations occupying it, which in turn affects their ability to earn an adequate rate of return.[36] The results of these forces will be applied to the sub-industry in which the company operates.[37] The macroenvironment has a direct impact on any or all of Porter's Five Forces as well as altering the industry life cycle.[38] Typical included within a macro-environmental analysis is six forces: economic (U.S. GDP, U.S. CPI, U.S. interest rates, and U.S. foreign exchange rates), technologic, social, demographic, political/legal, and global.[39] Forces are evaluated for strength; weak forces limit a company's ability to increase prices to grow revue/profit whereas strong forces allow for companies to increase prices to grow revenue/profit.[40] In this report global forces will be studied.

Global Forces

Global Forces refers to trends in the global environment.[41] Like all other sectors/markets, the movies and entertainment sub-industry is faced with growing concerns about Covid-19 and climate change.

In 2020 the Covid-19 pandemic was declared, and a lockdown commenced.[42] The temporary closure of movie theaters, the shutdown of TV/film production, as well as the mass cancellations of live sports and entertainment events caused revenue growth to be (11.9%) in 2020.[43] However, the Covid-19 pandemic sparked a boom for streaming and cable broadband subscriptions, a shift to in-home entertainment.[44] In the foreseeable future, the pandemic accelerated the decline of linear television and traditional pay-TV packages; the movies and entertainment sub-industry was propelled forward along the life cycle curve.[45] After the pandemic-related disruption, movies and entertainment rebounded, recorded higher consumer engagement and strong revenue growth from streaming platforms, 9.7% in 2021.[46]

Climate change can be defined as long-term shifts in temperature and weather patterns.[47] Human activities, such as releasing large amounts of carbon dioxide and other greenhouse gases into the atmosphere, change earth's climate.[48] A survey done by Pew Research Center indicated 72% of people across the world are concerned that climate change will harm them personally at some point in their lifetime.[49] A March 2021 report by the Sustainable Production Alliance said "Climate change is the most pressing global issue facing us today,".[50] As customers (subscribers) are becoming vigilant, companies must too.[51] Strategic management strategies to address carbon emissions must be considered by the movies and entertainment sub-industry.[52] Scripts, productions design, transportation, accommodations, energy management, and materials used have now become relevant in a new way.[53] A consortium including some of the world's biggest film, television and streaming companies reported an average carbon footprint of 3,400 metric tons, approximately half of which came from air travel and utilities.[54] Leaders in the sub-industry: Walt Disney, Spotify, and Netflix all conduct sustainability reports.[55,56,57]

Within the macro-environmental analysis, the global force of Covid-19 makes for an opportunity while climate change is a threat. Profitability can be affected in both directions, increases and decreases. The unforeseen growth experienced from the Covid-19 pandemic, the movies and entertainment sub-industry thrived. Companies must alter operations to adjust with society's view on climate change. The sub-industries is now being held accounting for what they emit.

Industry Life Cycle Analysis:

The industry life cycle model tracks important changes in an industry to determine the strength of competition.[58] Over five different stages: embryonic, growth, shakeout, mature, and decline, companies are presented with new opportunities and or threats to profitability.[59] This analysis will be focused on identifying the current industry life cycle stage for the movies and entertainment sub-industry, within which Netflix competes.

The movies and entertainment sub-industry is in the shakeout stage, referring to a sorting-out of competition.[60] To support the statement, research was gathered on revenue growth for the sub-industry, sub-industry competitive structure, and barriers to sub-industry entry.

Revenue growth can be quantified. Past data shows in 2021 movies and entertainment reached 9.7%, presently the sub-industry hit 13.4%, and predicted for 2023 a slow down to 11.4%.[61] Indicative of a sub-industry in the shakeout stage, explosive growth cannot be maintained. Sooner or later the rate of growth slows.[62] Capacity exceeds demand.

Based on qualitative data, competitive structure refers to the number and size distribution of companies inside the sub-industry.[63] The nature of competition is found by characterizing the industry as fragmented, consolidating, or consolidated. Within movies and entertainment, the number of competitors has started to decrease, resulting from the consolidation process of mergers and acquisitions.[64] The sub-industry is moving towards becoming a few powerful companies. By uniting and building, organizations are combining assets to become more competitive.[65,66] April 8 marked the merging between Discovery and AT&T's WarnerMedia. Additionally, a merger between Amazon/Metro-Goldwyn-Mayer Studios closed on March 17.[67] Competition in the shake out stage is greater than growth, due to larger firms emerging.[68]

Barriers to entry are the costs a company, not competing in the sub-industry, faces to enter and become a competitor.[69] Barriers prevents and or discourages newcomers, limiting competition. Currently facing the movies and entertainment sub-industry are barriers of government regulations, switching costs, and capital investment costs.[70] For example, varying European governments impose restrictions on foreign ownership of media.[71] The sub-industry is dominated by established companies. Customers are becoming brand loyal, preventing new entrants of firms.[72] Expensive capital is needed for content production.[73]

From the industry life cycle analysis and corresponding shakeout stage the movies and entertainment sub-industry presents a threat to companies' ability to increase profitability. Conditions in the external environment endanger revenue and threaten to raise expenses.[74] Despite high entry barriers, the industry revenue has started to level off and the industry's competitive structure is consolidating, making competition more intense.[75] Accordingly, these conditions will make it difficult for companies to increase profit and revenue.

Porter's Five Forces Analysis:

Michael E. Porter developed a framework in 1979 to help managers identify opportunities and threats by analyzing five forces that shape competition facing an industry.[76] The goal being to measure attractiveness and prospective profitability.[77] Porter's original model includes five forces: Risk of Entry by Potential Competitors, Intensity of Rivalry Among Existing Competitors, Bargaining Power of Buyers, Bargaining Power of Suppliers, and Availability of Close Substitutes.[78] For this paper, three forces will be addressed: Risk of Entry by Potential Competitors, Intensity of Rivalry Among Existing Competitors, and Bargaining Power of Buyers.

Risk of Entry by Potential Competitors

The force associated with Risk of Entry refers to the degree, an opportunity or threat, of potential competitors, companies not currently competing, entering the market because they have the capability to do so.[79] The risk of entry is a function of entry barriers.[80] As discussed in the life cycle analysis, the relevant entry barriers to the sub-industry in question are government regulations, switching costs, and capital investment costs. The movies and entertainment sub-industry has high entry barriers making setting foot in the market challenging. Consequently, this equates to a weak force, presenting an opportunity for the sub-industry's ability to increase profitability.

Government regulation can present a major entry barrier for many industries.[81] Across Europe, governments impose restrictions on media ownership by foreigners, on the amount of media any one owner can control, and how information flows within a country.[82] These regulatory hurdles significantly raise the height of entry barriers.[83] The government regulations will result in significantly fewer entries, increasing profit rates for those already established companies.

Switching costs arise when a customer invests time, energy and money switching from one product to another.[84] Unwilling customers wanting to switch, act to increase entry barriers for movies and entertainment.[85] As the sub-industry is dominated by established companies with a significant presence in filmmaking, a company attempting to enter would face challenges of consumer preferences, busy subscribers not having time, and financial constraints.[86] When switching costs are high, customers can be locked into the product even if new entrants offer better products.[87]

Capital investment is the cost associated with the acquisition of the physical assets needed to conduct business goals and objectives.[88] The high financial outlay required for content production prevents poorly funded new entries from entering the industry.[89] Financing for technology development, licensing, and original content creation directly raise the cost.[90]

Intensity of Rivalry Among Existing Competitors

The Intensity of Rivalry Among Existing Competitors evaluates the degree to which companies in the sub-industry can steal market share.[91] Rivalry is a function of industry demand, industry competitive structure and cost conditions.[92] Competitive rivalry among top firms is intense; elevated rivalry is a threat to the sub-industry, making intensity of rivalry among existing competitors a strong force.[93]

Industry demand is the total aggregate demand for products in an industry.[94,95] As for the movies and entertainment sub-industry, supported by predicted decline in revenue growth, supply is outpacing demand.[96] Demand stagnates or declines when the market approaches saturation, which constitutes a threat. Streaming has become an "arms race," more and more companies are creating or merging content to rival one another.[97] A company can only grow by taking market share away from competitors. Walt Disney controls the majority of revenue share while Netflix dominates percent earnings before interest and taxes.[98]

Industry competitive structure refers to the number and size of companies distributed inside the sub-industry.[99] Research gathered in the life cycle analysis depicts movies and entertainment in the shakeout stage, consolidating the sub-industry. Mergers and acquisitions make for a few powerful companies with great resources.

Cost conditions are expenses necessary for the function of an efficient business.[100] Integrating what is known about capital investment, the sub-industry for movies and entertainment requires large financial backing.[101] Technology development, licensing, and original content creation are unavoidable fixed costs.[102] When the cost of production is lofty, firms cannot cover their fixed cost if sales volume is low. To be profitable, strategies to drive up sales volume are needed. In movies and entertainment, demand has leveled off. This means companies are simultaneously engaged in the same practices, resulting in intense rivalry and lower profits.[103]

Industry demand is on the decline, industry competitive structure has made for powerful competitors and industry cost conditions are steep, leaving movies and entertainment little room for growth. These data present a strong force to the Movies and Entertainment sub-industry. Strong forces are threats, hindering companies' ability to increase profitability.

Bargaining Power of Buyers

Bargaining Power of Buyers refers to the ability of a given buyer group to bargain down the prices charged to them by the sub-industry.[104] Powerful buyers can also demand better quality products and services, raising costs for companies in the industry. Two relevant buyer groups to the movies and entertainment sub-industry are: subscribers and advertisers.

Subscribers are the customers making regularly scheduled payments to receive a good or service.[105] Within movies and entertainment subscribers are a strong force, having high bargaining power which makes them a threat, decreasing profitability. Consumers can easily choose from an extensive selection of programming and streaming services.[106] The broad availability of substitutes increases consumers' bargaining power.[107] Other forms of entertainment like video games, books, exercise, instruments, and social media give subscribers immense power to get what they want. Digital technology has allowed piracy – the illegal reproduction, acquisition and downloading, sale, purchase, or distribution of copyrighted products.[108] When non-subscribers can threaten to enter the industry by obtaining ownership of content without paying, thus supplying their own need, the divide of power widens.[109]

Advertisers can be a person or company promoting a product, service, or event.[110] Like subscribers, advertisers present a strong force to movies and entertainment. Sponsors can narrow profits, making them a threat to the sub-industry. By having choices like cable, billboard, publications, endorsements, etc…, which are just as if not more effective as promoting in movies and entertainment, advertisers too have power over companies.[111] If demands are not met by one programming or streaming service, there are plenty to choose from, taking their business elsewhere. Major advertising firms have the benefit of other revenue streams.[112] There is a high degree of likelihood of further cuts in advertising spending for movies and entertainment.[113] Following a 12.6% revenue decline in 2020 advertising, revenue rebounded to 4.8% annual growth in 2021.[114] In 2022, advertisers and marketers are cutting back on spending leading to a

(1.1%) revenue decline.[115] What these data reveal is anticipated slowing of the economy or potential recession. When the sub-industry is dependent upon advertisers for a large quantity and or large percentage of total revenue, marketers can leverage this to bargain for price reductions.[116]

Subscribers and advertisers have options to choose from; both groups are strong forces, being able to leverage their positions to get what they need. Bargaining Power of Buyers presents a threat to the movies and entertainment ability to increase profitability.

Summary of Opportunities and Threats:

The external analysis has identified opportunities and threats the movies and entertainment sub-industry faces when strategizing operations to increase profitability. Porter's analyses, Risk of Entry by Potential Competitors, reveals high entry barriers which makes for a weak force, presenting an opportunity to increase profitability.[117] The weak global force of Covid-19 and strong climate change force present a threat and opportunity to companies' ability to increase profitability. From the life cycle analysis, the movies and entertainment sub-industry is in the shakeout stage. Revenue growth is projected to decline in the coming year, demand is approaching saturation and large conglomerates are forming, for these reasons the shakeout stage is a strong force, threatening companies' ability to increase profitability. Intensity of Rivalry Among Existing Competitors is intense.[118] Industry demand, industry competitive structure and cost conditions make for a strong force which threatens the sub-industry's ability to increase profitability. Subscribers and advertisers are strong forces, falling under threats to increased profitability. This is due to the ease of choosing from an extensive selection of programming and streaming services.[119] Below, Figure 3, integrates the collective results this report reveals to Netflix. Across the analyses Netflix faces rising expenses, falling revenue, and shrinking profit.

Opportunities	**Threats**

• Risk of Entry by Potential Competitors
• Macro-economic forces
	• Macro-economic forces
	• Shakeout Stage Industry Life Cycle
	• Intensity of Rivalry Among Existing Competitors
	• Bargaining Power of Buyers
	    ○ Subscribers
	    ○ Advertisers

Figure 3: Summary of Opportunities & Threats – Netflix

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