

Adaptive Cycle of Resilience: Netflix Case Study

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INTRODUCTION

For the past decade, the entertainment industry has undergone a full reconceptualization. Specifically, the movie and TV programmes sphere has been severely influenced by the rise of Internet and related services, such as Youtube. This case study focuses on the organizational change in the company Netflix, which has been marked by innovation, user empathy, but also by severe market failures that needed correction. The case study researches two questions:

1. How did the Internet affect the movie industry?
2. What strategic decisions enabled Netflix to maintain a strong market position, while its main competitors have gone bankrupt?

In order to answer these questions, the case study will analyze Netflix's timeline, i.e. main activities and decisions, juxtaposed with major changes in the external environment. The analysis is performed with a reference to the adaptive cycle of resilience [7].

ABOUT NETFLIX

Netflix is currently the international market leader in online streaming of movies and TV programmes. It operates in North and South America, the UK, Ireland, Netherlands, Sweden, Denmark, Norway and Finland [1]. The company has more than 40 million members worldwide, and has ambitious plans to maintain a stable growth of the market share. It is headquartered in Los Gatos, California, and is listed on the Nasdaq stock exchange under the symbol NFLX.

BRIEF HISTORY

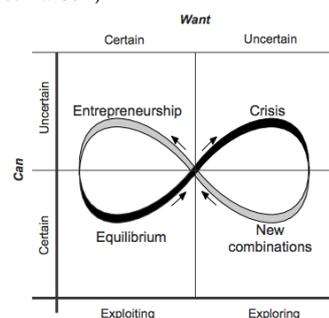
Netflix was founded in 1997 by Reed Hastings and Marc Randolph. In 1999 it launched the subscription service that allowed members to rent an unlimited number of DVDs. One year later, it introduced the personalized movie recommendation system, aimed at making relevant suggestions to users based on their preferences. In 2007, Netflix launched online streaming, allowing its users to view media content of their choice directly from their computers. In 2010-2012, the market base was extended to Canada, Latin America, the Caribbean, Nordic countries, UK, Ireland, and Netherlands [2].

COMPANY LAUNCH

When Netflix started its service of renting DVDs and distributing them through the postal service in 1997, its chances of success seemed rather low. The competition was fierce, with companies like Blockbuster, Amazon and Wal-Mart dominating the market. It seemed so unlikely that a new entrant would succeed, that a Wall Street analyst referred to Netflix as ““a worthless piece of crap” [3]. Yet the launch of the subscription service in 1999, offering unlimited rentals for a low monthly fee, revolutionized the market and proved to be an enormous success. As a result of a carefully designed strategy and accurate implementation, the company had gained 23 million subscribers and above 60% of market share by 2010. At the same time, its biggest competitor, Blockbuster, filed for bankruptcy in 2010[3].

Despite fierce competition, Netflix managed to position itself on the movie rental market through an innovative strategy. While Blockbuster, for example, was offering DVD rentals from a bricks-and-mortar location, Netflix decided to make use of new technology. The DVD-by-mail service did not only save time for customers, but also made the entire experience effortless and more entertaining. By waiving the late fee (fee for returning a DVD too late) and introducing the subscription service, the company changed not only itself, but also the entire industry. By adjusting to customer needs and utilizing new technology, Netflix managed to reach equilibrium, as illustrated in the Adaptive Cycle of Resilience (Figure 1).

Figure 1. Adaptive Cycle of Resilience (Abcouwer & Parson)



CRISIS

The crisis period for Netflix started around 2005, when Youtube and other video streaming websites were introduced and started to become popular. This, in combination with the significant growth in Internet speed, created a strong shift in consumer preferences. Users' interest in DVD rental plunged, thus affecting the entire business strategy of Netflix. The company's management was rather quick in detecting the new trend and deciding to change the strategy accordingly. In 2011, a controversial change in policy was announced – a 60% price increase. The new offer was a \$16 monthly fee, for the service of online streaming and one DVD rental at a time [4]. The increase in price generated anger among users, followed by a large cancellation of subscriptions and negative messages posted on social media. Soon after, Netflix announced its plans to focus on online streaming and move its DVD-by-mail service to a separate website called Qwikster. This plan, however, was severely criticized by both media and users. Less than one month after the announcement, the company's co-founder Reed Hastings declared that the separation plan would be abandoned [6]. The external circumstances of rising Internet streaming, combined with the two controversial company decisions, lead Netflix into the phase of deep crisis, as illustrated in the Adaptive Cycle of Resilience (Figure 1).

COMPANY REBRANDING

Following the period of crisis, Netflix understood the need to reinvent the company. The new market of online streaming, however, was not easy to adjust to. The company struggled with its content strategy - large media companies would not agree to license their popular movies and TV programmes on attractive terms. This led to a poor content on the Netflix website:

“Three years ago, Netflix's streaming content was nothing but a hodgepodge of various old movies and television shows from a variety of networks and studios - really, anything Netflix could get its hands on at a reasonable price.”[5]

Considering the problems encountered with obtaining licenses for highly demanded content, Netflix decided to adopt the backward integration strategy. In other words, the company started creating its own content (e.g. The House of Cards, Orange Is The New Black, etc). The chief content officer recently stated “the goal is to become HBO faster than HBO can become us.”[4]

The new strategy of Netflix is still being rolled out, however the initial results are promising: the stock price is growing, as is the customer base. In the first quarter of 2013, Netflix attracted two million new US subscribers [4].

It seems that innovation, consistency and new combinations lead the company back to the entrepreneurship phase (Figure 1). Data also suggests the slow but steady move towards a new level of equilibrium, as represented in the Adaptive Cycle of Resilience (Figure 1).

CONCLUSIONS

As described in this case study, Netflix is a representative example for the adaptive cycle of resilience, as introduced by Abcouwer & Parson [7]. The first question posed in the introduction was: How did the Internet affect the movie industry? This case study showed that the rise of Internet, and specifically the introduction of video streaming services, such as Youtube, have created a shift in user expectations and in the consumer demand as a whole. As a consequence, companies that were not fast enough to adapt their business model (e.g. Blockbuster) were forced to declare bankruptcy. The second question posed in the introduction was: What enabled Netflix to keep its strong position on the market? Through innovation and strategic thinking, the company entered a highly competitive market in 1997. This step represented the entrepreneurship phase of the adaptive cycle. In 2005, Netflix entered the phase of crisis, which posed a threat for the very existence of the company. Through trial-and-error, but also through empathy, transparency and determinacy, the company managed to overcome the crisis and reach the entrepreneurship phase for a second time, steadily moving towards a new equilibrium.

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