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The Escalating Competition Faced by Netflix

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Abstract

Netflix is the biggest over-the-top media service company in the world. It provides video on demand to its paid subscribers. As of December 2021, the company has 222 million paid subscribers in more than 190 countries. The ongoing global pandemic has boosted Netflix's revenues and profits as people have spent more time indoors. However, the growing popularity of video-on-demand services has encouraged significant competition from other providers. This paper describes how escalating competition may affect Netflix's business model. The escalating competition appears to have required Netflix to develop a strategy to deal with emerging competitors, defend its market share, and create sustainable firm values for its shareholders. This case study is intended for M.B.A. students or undergraduate senior students. By reading this case study, students are supposed to analyze the strengths and weaknesses of each company, discuss how Netflix can defend its market share, and suggest how Amazon or Disney could challenge the market share held by Netflix.

Keywords: Netflix, Amazon, Disney, video-on-demand, market competition, case study.

I. INTRODUCTION

1.1. Background Information

Netflix Inc., headquartered in Los Gatos, California, is one of the world's leading entertainment companies. Its primary business is a subscription-based streaming service that provides movies, TV shows, and documentaries to internet-connected devices (Netflix.com, n.d.). In addition, Netflix delivers DVDs of movies and TV shows vis US mail, with free shipping and no late fees for customers who pay a monthly subscription ("How DVD Netflix works," n.d.). As of December 2021, the company has over 222 million subscribers in more than 190 countries (Sperling, 2022).

The period of 2020–2021 was a turning point for video streaming service companies. After the COVID-19 outbreak in 2020, people began watching more videos at home through Netflix, which led to a surge in its stock prices in the years 2020 and 2021. The higher demand may attract new competitors to the industry (Karuna, 2007).

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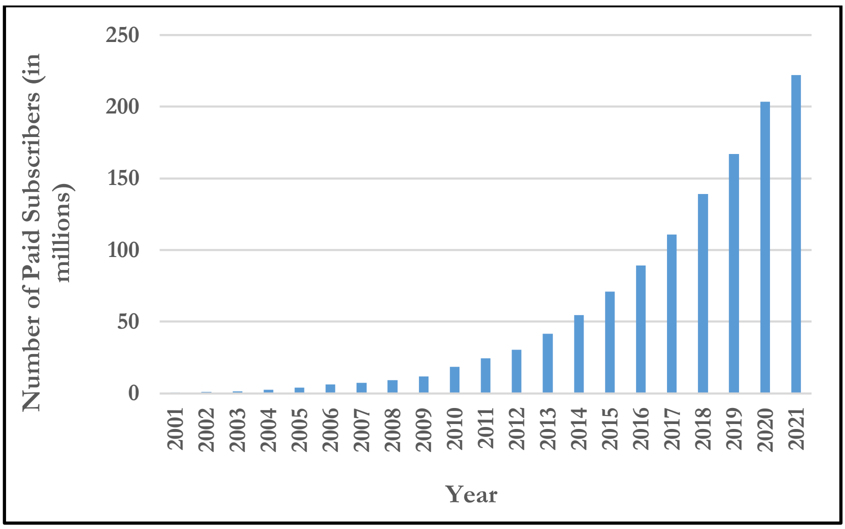
Netflix has faced significant competition from other providers such as Hulu, Amazon prime video, Apple TV, Disney plus, Peacock, HBO max, and Paramount+.

II. LITERATURE REVIEW

Market competition has emerged as a new paradigm for business studies. Generally, twenty-first century firms confront more intense market competition (Zimmerman, 2015). Karuna (2007) described the multidimensional characteristics of market competition: product substitutability, market size, and entry costs. Greater product substitutability, higher demand created by higher market size, and lower entry costs may attract new competitors to the industry. A variety of firm-level mechanisms are related to corporate strategy. For example, integrated performance measurement tools such as a balance score card and risk management can provide a "bird-eye" view of corporate strategies (Seetharaman et al., 2016). Uncertainly plays a useful role in financial reporting (Barker et al., 2020), and thus potentially affects the decision-making of external users. Over-the-top (OTT) platforms have recently become the preferred way to watch television shows and movies, especially among young audiences (Sadana & Sharma, 2021; Varghese & Chinnaiah, 2021). Among many other OTT platforms, Netflix is uniquely successful. Netflix has gained a large market share from traditional television networks (Park, 2017).

Figure 1
Number of Paid Subscribers of Netflix



Sources: https://backlinko.com/netflix-users; and https://www.nytimes.com/2022/01/20/business/netflix-quarterly-earnings.html.

III. RESEARCH METHODOLOGY

To investigate how escalating competition may affect Netflix's business model, we employ a case-study method. According to Yin (1984; 2009), the case study methodology is preferred "when the focus is on a contemporary phenomenon within a real-life context." Individual, organizational, social, and political phenomena are better acknowledged in a case study (Yin, 1984; 2009). By utilizing the case study method, investigators can take into account the holistic and meaningful characteristics of real-life (Yin, 1984; 2009; Burns, 1994; Patton & Appelbaum, 2003). In our study, we examine the competitors' strategies (Amazon prime video and Disney plus) to gain further insight into Netflix's business model and its future as a company. Feagin et al. (2016) argued that case studies "generally picture a world of complexity." Details of the competitors' business strategies are obtained from primary and secondary sources such as the firm's annual report, data published by the firm itself, newspapers, and the Nasdaq stock market.

3.1. History of Netflix

Netflix was founded by Reed Hastings and Marc Randolph on August 29, 1997. They launched the Netflix website – the world's first online DVD-rental company – with 30 employees and 925 titles for rent on April 14, 1998. In late 1999, Netflix introduced a monthly subscription model that offered unlimited DVD rentals for a flat fee and no late fees. With the rapid spread of DVD players, the company's published subscribers reached one million in early 2000. In February 2000, it introduced a personalized recommendation algorithm system, CineMatch, which analyzes customers' rental patterns and recommends their preferred contents to customers whose profiles are similar (Fundinguniverse, n.d.). CineMatch became a contributing factor to the company's success as a streaming service.

Since 2007, Netflix has moved away from its online DVD rental service and focused on video-on-demand (VOD) streaming. In 2011, the company reached 23 million paid subscribers in the US as its streaming business expanded rapidly. That year, the company began providing a standalone streaming service separate from its DVD home-rental service. In February of 2013, Netflix introduced its own TV shows to lessen its dependence on existing content providers. The company has produced in-house video content, or obtained exclusive rights to, streaming content such as Stranger Things, The Crown, BoJack Horseman, and Orange Is the New Black. This content is called "Netflix Original" Fundinguniverse, n.d.).

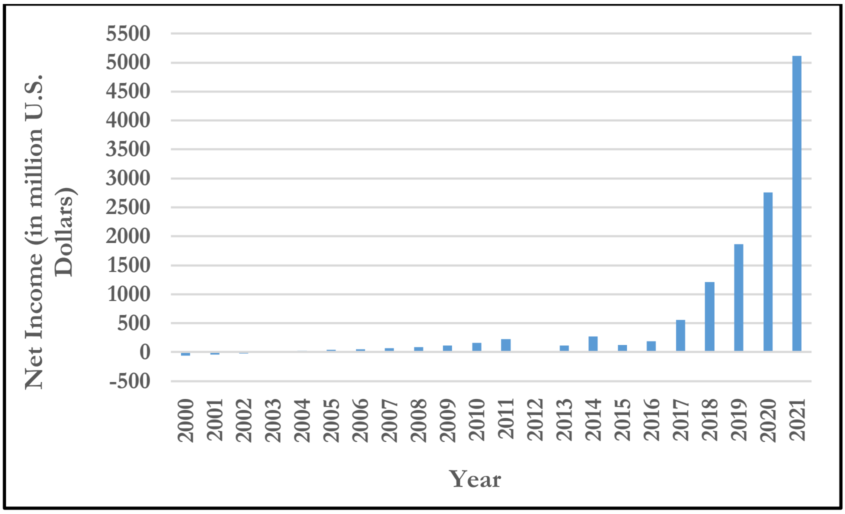
After the huge success of its VOD subscription model, Netflix went public in May 2002, selling 5.5 million shares of common stock at $15. Since the company went public, its stock has split twice: on a 2-for-1 basis in 2004 and on a 7-for-1 basis in 2015. In August 2021, Netflix's stock value surpassed $500, and the company's market capitalization reached $230 billion (Nasdaq, 2021). The company's revenues are mainly earned from monthly membership fees for its streaming services. Approximately 65% of Netflix subscribers are based outside of the US & Canada (Netflix, 2021). In 2021, the company's annual revenues reached $29.7 billion and it made more than $5.1 billion in profit. In addition, the company employs nearly 9,400 full-time employees across 59 countries.

3.2. Covid-19 Pandemic

The COVID-19 virus was first identified in China in December 2019 and, in the months that followed, spread around the globe, with the World Health Organization (WHO) declaring a pandemic on 11 March 2020. Since then, many governments worldwide have encouraged or required their citizens to stay at home, with people being asked to work remotely and students attending online classes. As a result, people have spent more time watching Netflix and many new customers have subscribed to the service.

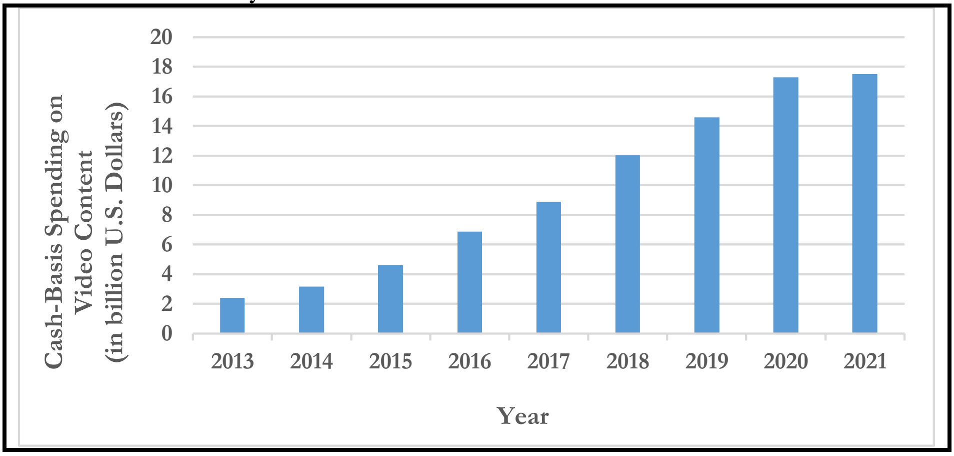
The consequences of the worldwide lockdown have been devastating for many industries including the airline industry, hotel industry, and movie industry. Netflix, however, experienced a considerable increase in its number of paid subscribers, revenue, and profit. The number of subscribers increased from 167 million in 2019 to 203 million in 2020 (Dean, 2021). Consequently, its revenue increased from $20 billion to $25 billion, while its net income increased from $1.9 billion to $2.8 billion (Netflix, 2021). Fast growth in monthly subscriptions made it possible for Netflix to invest more than $15 billion in producing a variety of video content in 2020 alone.

Figure 2
Net Income of Netflix from 2000 to 2021



Source: https://ir.netflix.net/financials/annual-reports-and-proxies/default.aspx.

Figure 3
Content Investment by Netflix



Sources: https://backlinko.com/netflix-users; and https://www.thestreet.com/investing/netflix-fourth-quarter-earnings-live-blog.

The pandemic brought not only opportunities, however, but also new rivalries to Netflix. Since Netflix proved that enough customers are willing to pay for on-demand video subscriptions, several companies from both the entertainment industry and the technology industry have entered the market. As of October 2021, Hulu, Prime Video, Showtime, Starz, Apple TV, Disney plus, Peacock, HBO Max, Discovery+, and Paramount+ provide on-demand video subscription services. Companies like Amazon and Apple have substantial capital to invest, while others, such as Disney and HBO, have access to high-quality popular content. Though none of these firms are as big as Netflix yet, the company needs to develop a strategy for dealing with emerging competitors. Among these rivals, two companies currently have more than 100 million customers: Prime Video has approximately 200 million subscribers (Amazon, 2021) while Disney plus has around 118 million subscribers (The Walt Disney Company, 2021).

IV. RESULTS AND DISCUSSIONS

4.1. Competitors

4.1.1. Amazon prime video

The recent heavy investment in Prime Video by Amazon.com, Inc. (Amazon, hereafter) has surprised other video streaming service companies. In May 2021, a few months after Amazon made a 10-year deal for the exclusive rights to "Thursday Night Football" (beginning in 2023 and costing $1.32 billion per year (Spangler, 2021)), Amazon paid $8.5 billion to acquire Metro-Goldwyn-Mayer (MGM). Ownership of MGM gives Amazon access to 4,000 films and 17,000 TV shows including the James Bond movies, Rocky, and Legally Blonde, even though it may take years to bring those titles to Prime Video (Faughnder, 2021).

Amazon was founded in Washington by former Wall Street hedge fund executive Jeff Bezos on July 5, 1994. The company began trading by selling books online. Books are small but relatively expensive items that offer a wide variety of titles, making them an ideal product for an online retail business. Over time, Amazon expanded its product lines, and by 1999 it sold almost every type of product imaginable. Since 2002, Amazon has offered Amazon Web Services (AWS), which rents out computer processing power and data storage to other firms. By using AWS, Netflix can provide streaming services to customers without owning servers.

Amazon Prime is a paid subscription program that offers one- or two-day delivery of goods, streaming video and music, and free e-books. By 2021, Amazon had attracted 200 million Prime members (Spangler, 2021). Although Prime Video started as one of several services offered to Prime members, Amazon has increased its investment in video content significantly over the last few years, spending more than $10 billion on the service in 2020 alone. While online shopping will remain Amazon's primary business, with Prime Video being a free add-on service for Prime members, the company's rapid growth has made it one of the most formidable competitors in the video streaming industry. As the biggest online shopping mall in the world, Amazon can spend a sizeable amount of money on video content without needing to make a direct profit from it. In addition, the company can provide Prime members with other complementary services such as free e-books and cloud gaming.

Table 1
Total Digital Video and Music Expenses

Year	2014	2015	2016	2017	2018	2019	2020
Revenue	89	107	136	178	233	281	386
Content Budget	1.3	N/A	N/A	4.5	6.7	7.8	11

Source: https://ir.aboutamazon.com/annual-reports-proxies-and-shareholder-letters/default.aspx.

4.1.2. Disney plus (with Hulu and ESPN+)

The Walt Disney Company (Disney, hereafter) is an American mass media and entertainment conglomerate. It has a strong reputation globally, based largely on its theme parks and movies. It has six substantial theme parks located in California, Florida, Paris, Hong Kong, Shanghai, and Tokyo. It has also made several recent international hit movies, including *The Avengers* and *Frozen*. Disney was founded as Disney Brothers Cartoon Studio by Walt and Roy O. Disney in 1923 and renamed The Walt Disney Company in 1986. In the early days, Disney built a reputation primarily as a leading animation company. Over time, however, it expanded its business into the film and television industries. Its current film studio division includes Walt Disney Pictures, Walt Disney Animation Studios, Pixar, Marvel Studios, Lucasfilm, 20th Century Studios, 20th

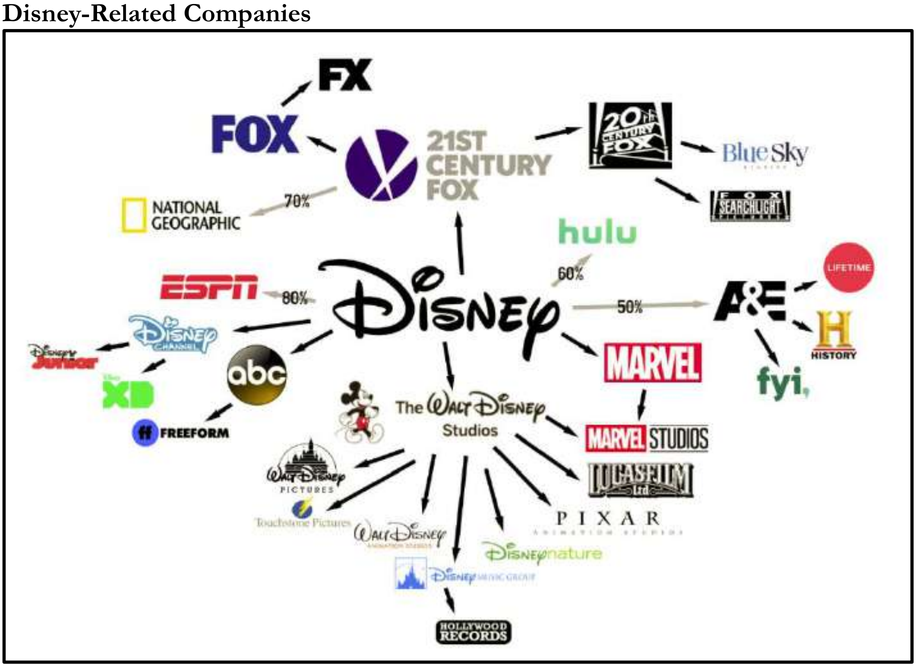
Century Animation, and Searchlight Pictures. It also has several television channels like ABC, Disney Channel, ESPN, Freeform, FX, and National Geographic.

On November 12, 2019, the Walt Disney Company launched Disney plus in the United States and four other countries. Although Disney plus entered the online streaming industry later than its competitors, it had already attracted 118 million subscribers globally as of October 2021 (The Walt Disney Company, 2021). Disney also offers a bundle comprised of Disney plus, Hulu, and ESPN plus at a discount. This discount policy has increased subscribers not only to Disney plus but also to Hulu and ESPN plus. As of October 2021, Hulu had attracted 43 million paying customers while ESPN plus had 17 million subscribers. A year and a half earlier, Hulu and ESPN plus had 32 million and 8 million subscribers, respectively (Keys, 2021).

The launch of Disney plus has increased Disney's revenue from video streaming services considerably, raising it from $3.3 billion in 2019 to $10.4 billion in 2020, while its content production costs almost doubled from $6.9 billion in 2019 to $12.3 billion in 2020. Heavy investment in online video content has, however, led to significant operating losses in relation to Disney's streaming services, resulting in a $1.8 billion loss in 2019 and a $3.3 billion loss in 2020. However, these losses will not discourage Disney from producing more original movies and dramas for Disney plus, and Disney remains one of the world's largest entertainment companies, with $200 billion in assets.

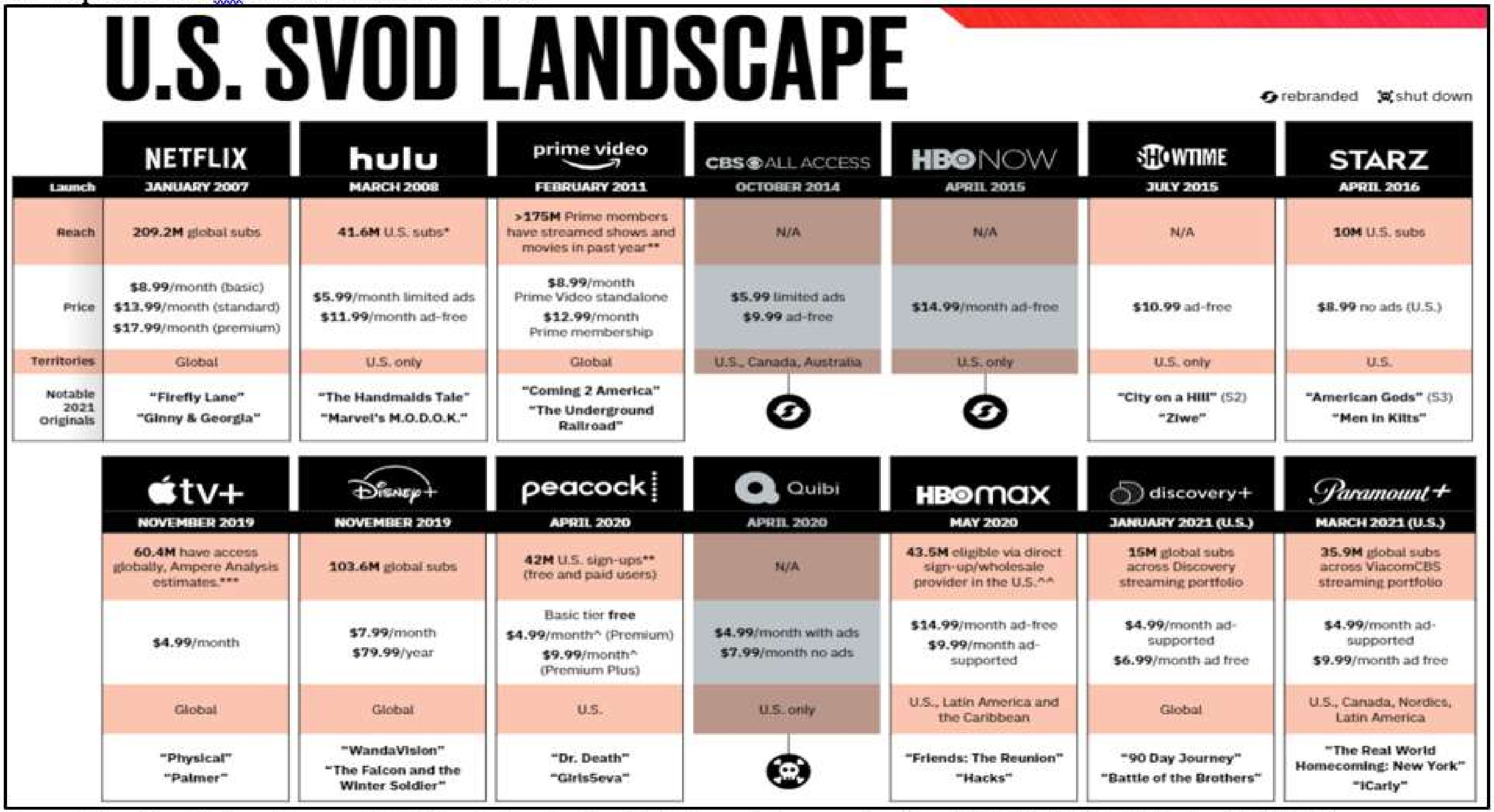
Unlike Netflix, which provides an all-in-one streaming service to its subscribers, Disney offers three separate steaming services for different customer groups. Disney plus is child-focused, while Hulu is more adult-focused and ESPN plus specializes in sports.

Figure 4
Disney-Related Companies



Source: https://i.redd.it/5wznavxh6yd11.png.

Figure 5
Subscription Video-on-Demand in the U.S. Market



U.S. SVOD LANDSCAPE

rebranded   shut down

	NETFLIX	hulu	prime video	CBS ALL ACCESS	HBO NOW	SHOWTIME	STARZ
Launch	JANUARY 2007	MARCH 2008	FEBRUARY 2011	OCTOBER 2014	APRIL 2015	JULY 2015	APRIL 2016
Reach	**209.2M** global subs	**41.6M** U.S. subs*	**>175M** Prime members have streamed shows and movies in past year**	N/A	N/A	N/A	**10M** U.S. subs
Price	**$8.99**/month (basic) **$13.99**/month (standard) **$17.99**/month (premium)	**$5.99**/month limited ads **$11.99**/month ad-free	**$8.99**/month Prime Video standalone **$12.99**/month Prime membership	**$5.99** limited ads **$9.99** ad-free	**$14.99**/month ad-free	**$10.99** ad-free	**$8.99** no ads (U.S.)
Territories	Global	U.S. only	Global	U.S., Canada, Australia	U.S. only	U.S. only	U.S.
Notable 2021 Originals	"Firefly Lane" "Ginny & Georgia"	"The Handmaids Tale" "Marvel's M.O.D.O.K."	"Coming 2 America" "The Underground Railroad"			"City on a Hill" (S2) "Ziwe"	"American Gods" (S3) "Men in Kilts"

	tv+	Disney+	peacock	Quibi	HBO max	discovery+	Paramount+
Launch	NOVEMBER 2019	NOVEMBER 2019	APRIL 2020	APRIL 2020	MAY 2020	JANUARY 2021 (U.S.)	MARCH 2021 (U.S.)
Reach	**60.4M** have access globally, Ampere Analysis estimates***	**103.6M** global subs	**42M** U.S. sign-ups** (free and paid users)	N/A	**43.5M** eligible via direct sign-up/wholesale provider in the U.S.^^	**15M** global subs across Discovery streaming portfolio	**35.9M** global subs across ViacomCBS streaming portfolio
Price	**$4.99**/month	**$7.99**/month **$79.99**/year	Basic tier **free** **$4.99**/month^ (Premium) **$9.99**/month^ (Premium Plus)	**$4.99**/month with ads **$7.99**/month no ads	**$14.99**/month ad-free **$9.99**/month ad-supported	**$4.99**/month ad-supported **$6.99**/month ad free	**$4.99**/month ad-supported **$9.99**/month ad free
Territories	Global	Global	U.S.	U.S. only	U.S., Latin America and the Caribbean	Global	U.S., Canada, Nordics, Latin America
Notable 2021 Originals	"Physical" "Palmer"	"WandaVision" "The Falcon and the Winter Soldier"	"Dr. Death" "GirlsSeva"		"Friends: The Reunion" "Hacks"	"90 Day Journey" "Battle of the Brothers"	"The Real World Homecoming: New York" "iCarly"

Source: https://read-vip.variety.com/html5/reader/production/default.aspx?pubname=&edid =2e949e33-9379-4a0d-95cf-ccf7609337cf)

4.1.3. Netflix Stock Price

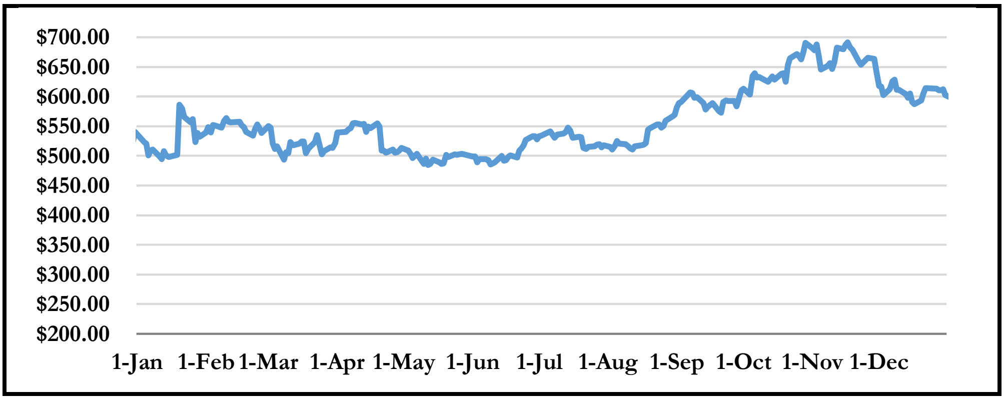
When the Covid-19 outbreak became a global pandemic in March 2020, the panic created by the crisis initially hurt Netflix's stock price. Soon after, however, the value began climbing again. Due to lockdown measures and public fear of the virus, many people turned to Netflix and other streaming platforms for entertainment that could be enjoyed at home. As a result, 2020 became a very successful year for Netflix. On December 31, 2020, the company closed the day on the stock market with a share price of $540.73, representing an impressive increase of 64% since the beginning of the year 2020.

Figure 6
Netflix Stock Price: Year 2020

Source: https://finance.yahoo.com/quote/NFLX/.

On September 17, 2021, Netflix released Squid Game worldwide. It became the most-watched series in the company's history. By the end of November 2021, Squid Game had attracted 2.17 billion hours of viewing (FlixPatrol, 2021). After the release of the series, Netflix's stock increased by nearly a hundred dollars in the space of two months: from $589.35 on September 17 to $691.69 on November 17. During the fourth quarter of 2021, Netflix gained an additional 8.3 million subscribers worldwide, raising its total number of subscribers to 222 million (Sperling, 2022).

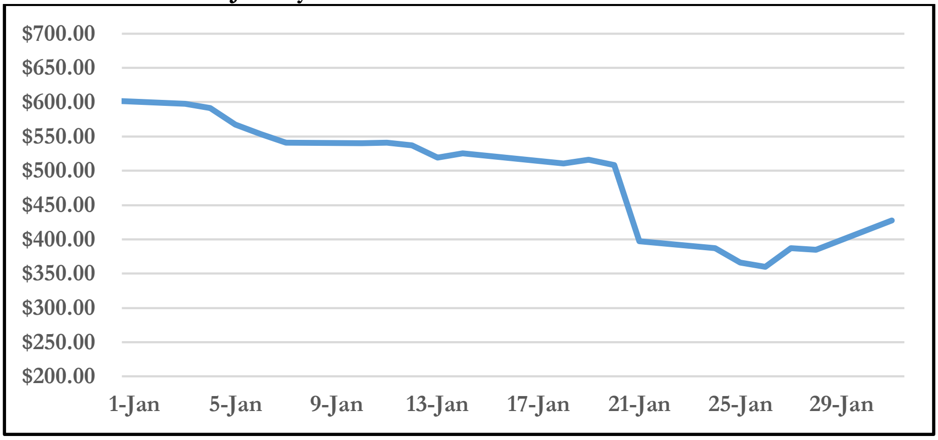
Figure 7
Netflix Stock Price: Year 2021



Source: https://finance.yahoo.com/quote/NFLX/.

At the start of 2022, Netflix experienced a massive stock loss: a 28.5% decrease during January. On January 21, 2022, the company's stock price was valued at $397.50, a huge drop of $110.75 in just one day. This was due to the expected slowdown in the growth of Netflix's subscription numbers. For the first quarter of 2022, the company had forecast just 2.5 million new subscribers. By contrast, the first quarter of 2021 saw it gain an additional 6.5 million subscribers (Sperling, 2022).

Figure 8
Netflix Stock Price: Januay 2022



Source: https://finance.yahoo.com/quote/NFLX/.

V. CONCLUSION

Overall, the escalating competition appears to have required Netflix to develop a strategy to deal with emerging competitors, defend its market share, and create sustainable firm values for its shareholders. Although its recent massive stock loss made Netflix's challenges and threats more visible to the public, this helped Netflix confront significant competition from other providers.

1. Analyze the strengths and weaknesses of each company (Netflix, Amazon, and Disney) by examining their 10-K filings on the EDGAR database.
2. Discuss how Netflix can defend its market share.
3. Discuss how Amazon or Disney could challenge the market share held by Netflix.
4. Is there any other video streaming company that could obtain a significant market share in the near future? Why is that?
5. Apple has a global outsourcing policy for its products. Is video content something that a company can outsource globally?
6. Show Netflix's stock price movements during a specific event period. What was the impact of the event on Netflix stock price?

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