Netflixed: The Epic Battle for America's Eyeballs

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Summary

1. A good story about the DVD rental war between Netflix and Blockbuster.

Key Takeaways

1. The complete history of Netflix comprises a long and untidy striving for greatness with multiple disasters, lucky breaks, betrayal, and heartbreak.
2. Marc Randolph (Original Head of Marketing for Netflix) was always fascinated by direct mail and thought you could use the internet to monitor people's reactions and behaviors to it. He called it "Direct Mail on Steroids".
3. Randolph needed to find a large category of products that people would prefer to do online either because of convenience or better selection.
    a. Thought it would be difficult to take Blockbuster's model and just do it via the mail but found inspiration from Amazon and its wide selection could be a differentiator ("The Long Tail").
4. Original Netflix head of operations spent three months at the post office learning how it worked and how to deliver product promptly, economically and in one piece. They needed to master the post office.
    a. <u>Note:</u> Sometimes you just need to do the work!
5. Blockbuster and Hollywood video initially refused to stock DVDs because it represented a risk to the existing VHS rentals.
    a. A factor that broke Netflix's way.
6. Studios were unwilling to drop the $15 wholesale price on DVDs so Netflix was careful with how they drove interest to certain movies on its site and didn't emphasize new releases.
7. DVD Player manufacturers used Netflix as a way to popularize the format because it was holding down their sales.
8. Netflix had meetings with Amazon early on about potentially combining but it didn't go anywhere and now they compete today!
    a. Bezos made a $12 million offer.
9. They noticed a lot of growth came from overnight delivery zones and people recommending their friends so they needed to focus its marketing and distribution spend on these zones.
10. Netflix eventually had to do revenue sharing agreements with the studios as customers kept discs as long as they wanted and it caused massive inventory management problems and they needed studios to lower the wholesale price of DVDs.
11. Netflix and Blockbuster had preliminary discussions of combining but it never went anywhere.
12. Antioco believed that Blockbuster had a fatal flaw in that its business model was built around "Managed Dissatisfaction".
    a. Consumer resentment over late fees, poor selection and customer service.
    b. Today this reminds me of cable and these business need to watch out; this business model is harder to manage today than ever before.
13. Under Antioco, Blockbuster also began investing in producing and distributing movies through a wholly owned subsidiary called DEJ Productions, after deciding that the digital future may call for exclusive content like that offered by the premium cable movie channel Home Box Office.

    a. Good idea but too early.

14. Netflix passed on the kiosk model of distribution as it eliminated its convenience proposition and the inventory costs of new releases would be prohibitive and online distribution was on the doorstep.
15. Blockbuster was slow to replicate the Netflix model as it had a big culture tax across its existing business model.
    a. They copied the Netflix website but they didn't have the matching algorithms underlying it.
16. Antioco's turnaround plan consisted of building no more video stores, video game trading and ending late fees.
    a. Late fees must have been incredibly high margin.
17. Unintended consequence of late fees: originally a tool to pressure customers to return videos for more inventory turns and to curtail inventory shortages but eventually became a dependable, high margin revenue source.
    a. The Blockbuster franchisees liked it and wouldn't give it up without a fight.
18. **Mental model for Netflix:** On the surface, Netflix is a massive video store; taking in cash for monthly renting rights and loaning out DVDs to the consumer. Beneath the surface, Netflix is akin to a think-tank, creating algorithms to maximize the *longterm* value of each customer that it enlists, orchestrating a complex distribution system and finding ways to reduce its costs of service.
19. Although the online business seemed a natural extension of Blockbuster's core competency, "it is quite rare for a mature company to enthusiastically go after a new business that promises to cannibalize, in part, a corporate cash cow," Cibelli wrote.
    a. Refer to this as a culture tax!
20. History is repeating itself with streaming:
    a. Hastings maintained a steadfast answer to the criticism and takeover rumors circulating that spring. Netflix would run at break-even (Note: today is actually at a loss) —sacrificing profits and plowing all of its cash into growing its subscriber base as fast as it could to raise an impenetrable barrier to entry by Amazon and other challengers. A subscriber-based business would lose a lot of money until it got large enough to defray fixed overhead costs. In early 2005, Hastings and McCarthy pegged the cost for a new competitor to enter the market at $350 million to $500 million.
        i. What is the cost today?
21. The Max Planck/Chauffeur Test
    a. Blockbuster Online had copied Netflix's fulfillment system without really understanding how it worked. Netflix achieved overnight delivery quickly by letting its subscriber base dictate where the hubs would go, rather than just plunking them down in large population centers, as Craft and Ellis had done.
22. Bob Iger embraced streaming deals early on (with Apple) after acquiring Pixar because he knew eventually consumers would watch what they wanted, when and where they wanted, and there was nothing the content owners could do about it.
    a. Embracing that today to with Disney + DTC initiative.
23. Netflix's recommendation engine was used as a tool to smooth demand and mange inventory as it steered subscribers to older films with better rental economics and helped the Company in its war with Blockbuster.
24. After Ichan got involved he hired a retail guy who wanted to focus on the store strategy and this proved costly.

    a. He assumed consumers would want to load a movie onto a disk or flash drive (too much friction).
25. The Blockbuster brand stood for one thing only: a place to rent the latest DVD releases. Blockbuster had to close nonperforming stores and use the remaining stores to support the move to online rental and digital distribution.
26. Blockbuster Total Access was something Netflix could not match although it was not profitable and the decision to abandon it helped Netflix win.
    a. Hasting told him "You had us in checkmate".
27. Hasting told investors that online delivery would evolve into three parts: subscription streaming, file download and free streaming.
    a. Netflix wanted to own the first part.
28. So many small things could have allowed Blockbuster to prevail over Netflix but none of them did.
    a. Viacom letting Blockbuster spend money earlier to take Netflix on.
    b. $1 billion dividend taken by Viacom ("goodbye kiss").
29. The ultimate value of online video was questioned for a while as Starz allowed Netflix to stream its movies for 2 years and $25 million.
    a. This really kickstarted Netflix in online distribution.
30. This then led to the EPIX deal for 5 years and $800 million.
    a. In 2010, the studios and cable operators realized they let Netflix, the Trojan horse into its industry.
31. Business that fail to evolve with technology tend to die.
    a. Netflix embraced this and also called the burn the lifeboats strategy.
32. Netflix had almost 15 years of data and really helped its business: helped identify consumer tastes.
33. To Hastings, this fulfilled a "virtuous circle" for Netflix: better content meant more subscribers; more subscribers meant more money for better content.
    a. Note: Positive Feedback Loop.

What I got out of it

1. Netflix struggled a lot along the way but eventually won the war; also a few small events could have changed the trajectory of this whole industry.

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