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Two Decades and More: Evolution of Netflix's Business Models and Outlook of Future

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ABSTRACT: This paper aims to study the growth of Netflix as one of the most successful multinational corporations in the entertainment industry. SWOT analysis is used as the theoretic frame to analyze the different combinations of strategies that Netflix has taken under various circumstances. Based on the focus shift, this paper divides Netflix's history into three periods: freshly established as a movie rental business, domestic (United States) streaming services provider, and international streaming content creator and service provider. SWOT analysis is then used to examine the strength and weaknesses of Netflix and the opportunities and threats it faces in different periods, providing an overview of its circumstances. Comparing the different combinations of strategies that Netflix has taken at different growing stages, this paper has found out that Netflix has always emphasized its strength such that its strategies are mostly strength-radiated. Even though its strength is constantly changing from time to time due to the intense competition present in the markets, the strength-based approach has allowed it to explore opportunities or overcome threats. During the global expansion period, Netflix has also raised its attention on improving its weakness, potentially due to the stronger competitors in the international streaming market. Nowadays, Netflix has become the leading company in the global streaming industry, evident by its continuously greatest market share in recent years. However, as the whole ecosystem grows, Netflix must make sure it can grab the potential opportunities of faster broadband speed and upgraded accessories, especially in this era, where the boundary of different types of entertainment remains unclear, giving rise to even more powerful potential competitors, such as Tiktok, for people's limited leisure time.

1. INTRODUCTION

With the trend of its original series Squid Game, many started to view Netflix as one of the most successful companies in the global entertainment industry. Unlike traditional entertainment providers like theatres and cinemas, Netflix operates as an online portal that offers its consumers a wide variety of drama series, TV shows, and movies that can be newly released in the cinemas[1].

With the ongoing pandemic, the streaming services provided by Netflix and its competitors inevitably become one essential part of people's entertainment patterns worldwide, thanks to the high-speed internet connection presented in most parts of the world. Netflix has hence seen a steady increase in its revenue over the years, even during the pandemics [2] while firms in other sectors were suffering scaling back of their production due to closures of national boundaries and lockdown measures.

Nevertheless, many may not be aware that founded in 1997, Netflix started its business with DVD rentals which are still under their business now [3]. There has been a shift of focus in Netflix from the DVD rental industry to the streaming industry, allowing it to stand still in the entertainment market.

Over the years, researchers have been conducting studies about how Netflix's unique business model has allowed it to become one of the most significant companies in the worldwide streaming or even the whole entertainment industry. Business models provide insights into how a firm or an organisation plans to earn profits. The models often capture a few critical components of the firm's operation, ranging from the key resources, key partners, to the key cost structures. Consequently, the models are often used to perform analysis of the firms' performances [4]. In the case of Netflix, the on-demand subscription-based business model, which essentially requires each customer to pay a specific price every month to access Netflix's unlimited library of steaming services, has brought great success to Netflix by ensuring its leading position in the streaming service industry. Despite being in a highly competitive industry, Netflix has developed a range of strategies, from pricing to marketing, to help itself maintain its leadership as far as possible. These strategies include pricing strategies such as different services provided at different prices and marketing strategies such as a gradual expansion of production in a global range.

Research has also shown how Netflix managed to defeat its initial competitors such as Blockbuster in the movie rental industry in the 1990s by introducing a

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disruptive new business model with the integration of newly discovered technologies at that time, and hence accumulate considerable profits, which allowed it to take a brave step into the streaming industry in the later years. The unique organisational ambidexterity, one of the critical factors that allow Netflix to stand out from its competitors and perform a smooth transition into a new industry, has also been covered [4].

Although research has provided us with a general understanding of the various strategies and unique business models that Netflix has taken over the years, there lacks a detailed study and discussion on the different circumstances faced by Netflix at different periods, which can therefore be used to explain the factors that impelled Netflix to come up with all these innovative ideas.

This paper, therefore, aims to assess the different situations that Netflix faces by looking at both internal and external factors in a more detailed and systematic manner. Moreover, the evolution of Netflix's business models will also be included to provide a deeper understanding of each move taken by Netflix, giving a clearer view of Netflix's massive success as a streaming service company and providing a smoother transition process of Netflix from the movie rental industry to the streaming service industry. By examining the current circumstances that Netflix is in, integrating different factors such as impacts of the global pandemic COVID-19 and edge-cutting technologies, this paper will give a brief overview of the future of Netflix and justify why Netflix can sustain its success and even turn into the dominant firm in the entertainment industry.

2. Theoretical frame

By using a comparative approach, this article aims to research on how Netflix has been making adjustments to its business model throughout the years to help itself gain and maintain the greatest market share in both the movie rental and streaming industries by adopting rising technologies such as DVD and the Internet. In order to assess the internal and external factors that lead to the various adjustment, strength, weakness, opportunities, and threats (SWOT) analysis is a useful framework as it helps reveal the competitive situation which the firm is in [5]. A theoretical framework of SWOT analysis is used to illustrate the strength and weakness as well as various opportunities and threats faced by the company at different time periods. By looking at the interconnection of the four dimensions, this paper article hopes to see what kind of combination of strategies that Netflix would choose during different time periods or under various circumstances.

3. Transformation of Netflix

3.1. 1997- 2007 when just founded in the movie rental industry

Back in 1997, when Netflix was just founded, its main focus was in the movie rental industry, which was dominated by 2 big firms, namely Blockbuster Video and Movie Gallery, with a number of small mom-and-pop movie rental shops.

Movie industry has a few windows for revenue besides the big screen in the cinemas and theatres. Movie rental hence, being part of it, allows the consumers to enjoy a pay-per-view service.

Prior to the entrance of Netflix, Blockbuster was able to enjoy the greatest market share in the movie rental industry, which was mainly based on the in-store model at that time. Founded in 1985, Blockbuster broke into the industry with an inventory that was much bigger than the existing family operations. With the centralized computer system which helped monitor the inventories, Blockbuster managed to differentiate itself from its nearest competitors, laying down the foundation for success. The company started an extensive expansion, from 1987 to 1993, to more cities and even overseas, hoping to reap more profits from the demanding market. With its great bargaining power due to high market share, Blockbuster managed to have business agreements with the movie studios which allowed Blockbuster to obtain video tapes with a much lower cost. [6]

However, this trend of success was terminated by the appearance of Netflix in the late 1990s and its disruptive new business model. Not continuing with the traditional form of rental as tapes, Netflix grabbed the opportunity of rising DVDs and brought this new technology into the industry. Less costly and less fragile, DVDs reduced the cost incurred by Netflix [6] and hence, rendered the competitiveness of tapes. Blockbuster, on the other hand, failed to correctly weigh the significance of the edge-cutting technology and did not pay much attention to the rise of its future biggest competitor—- Netflix.

Netflix abandoned the in-store business model adopted by the mom-and-pop shops and Blockbuster. Instead, it started with the new business model, which allowed consumers to register and make rental decisions online. The selected DVD would be mailed to the address within a few days. Moreover, unlike what Blockbuster was doing, in Netflix's business model it removed the late fees which were largely unappreciated by the consumers. After experiencing both pay-per-view mode, which essentially requires consumers to pay every time when they rent a movie, and subscription mode, Netflix decided to turn to subscription-based operations in 1999.

The four quadrants of SWOT analysis are shown below.

Strength
• Disruptive business model which provided consumers with great convenience and hence, increased the demand for Netflix • Only needed to prepare and maintain • warehouses but not stores • Adoption of new DVD technology which allowed Netflix to reduce their cost of production and transportation • Greater variety of titles than its rivals— both mom-and-pop retailers and Blockbuster • Monthly-subscription model, which was

offered at a much lower price, led to more demand. Consumers might also develop habit of subscribing to Netflix due to the preference of status quo

Weakness
● A newly established company, which might not have accumulated consumer base, led to relative unstable demand ● Might incur high cost when it was trying to break into the industry due to the capital-intensive nature of the industry

Opportunity
● Trending of the Internet where more and more families start to own their own computers ● Progressing DVD technology

Threat
● Various competitors ○ Blockbuster: owned great market share and hence was able to perform strategies like predatory pricing to force Netflix out of the market ○ Mom-and-pop shops: consumers might have form habits of borrowing from such shops which required time for this consumption pattern to change ○ Redbox: offering vending machines to conduct movie rental at a very low price ○ Magic Disc; DVD Express and Reel.com, which also provided DVD rental by mail services ○ New form of windows: online streaming ○

Netflix was successful in grabbing the opportunities. Paying close attention to the fast-developing DVD technology, Netflix established cooperation with the DVD player suppliers to secure the indispensable complementary goods. In order to tackle the potential threats that arose from the fierce competition, Netflix had also been spending extensively on its marketing strategies to secure their consumer base as far as possible. At this initial stage where Netflix just started off with its business, its strategies were mainly designed in a way that radiated from its strengths. By considering how its strength can lead to greater exploitation of the opportunities as well as help to tackle the potential threats, Netflix had adopted strategies based on the combination of strength plus opportunity (S-O), and strength plus threats (S-T).

3.2. Movement into the streaming industry, 2007 to 2010

Netflix gradually expands its business over the years. Initially, Blockbuster did not realise how Netflix, as a competitor, could cause an extremely severe impact on its sales and revenue. However, as the competition continued, Blockbuster had adopted hybrid strategies in order to keep its market share. Blockbuster had also moved part of their service online, constituting Blockbuster Online to complement their previous services provided.

Blockbuster Online had created pressure on Netflix to some extent. In order to differentiate itself from the various competitors and help its consumers to select which movie they want to entertain themselves from the seemingly infinite pool of substitutes, Netflix has been devoting its research and development budget into a recommendation system, which was a algorithm that makes predictions about consumer's preference for movies based on his recent rentals.

Just as how people's preference of watching movies has been shifted from theatre movies to DVD rentals as it provided them the comfort of watching the movies at home, there were also more and more consumers, due to the proliferation of personal computers and advancing technologies of the Internet, started to favour the streaming services which allows them to avoid all the transportation and time cost when travelling back and forth to borrow or return the DVDs.

Netflix, willing and able to catch up with the newest trend, then announced that it was going to have half of its company entering the new streaming industry while the other half will remain in the DVD rental industry as Netflix was still enjoying great profits as it had rented a billion films by the early 2000s. Having great organisational ambidexterity, Netflix allowed half of its company which stayed in the movie rental industry to turn to exploitation where the focus is on how to scale and maximise the profits; while the other half turns into exploration [4] where the focus is more on innovation and discovery of the various possibilities of successes.

With the capability to deliver large amounts of data at relatively low cost, Netflix was able to deliver the whole content of the entire program through the Internet, forming a video-on-demand model. Similar to what it has adopted for its movie rental services, Netflix also used a subscription-based business model in the streaming industry, where consumers are required to pay monthly to access any movies or programs in Netflix's library whenever they want on their computers. Meanwhile, Netflix also brought forward its predictictive recommendation algorithm from the movie rental industry to its streaming services. Instead of dividing its users into different demographic categories like what happened in the TV era previously, Netflix grouped them with various taste preferences. Such cauterization helped Netflix label its programs with complex tags to aid its algorithm.

The four quadrants of SWOT analysis are shown below.

Strength
● Accumulated profits from the movie rental industry ● Popularity of the brand established through previous operation of movie rental industry ● Consumer base which can be easily transferred to the streaming industry as well ● Recommendation algorithm which largely improved the customer experience and can be integrated into the streaming model as well ● Monthly subscription-based service which nudging the consumers to form a consumer pattern which is unlikely to change due to status quo bias mindset

Weakness
● New to the industry, which may leave it at a disadvantaged stage: faced relatively high barriers to entry due to the presence of advancing technology as well as heavy capital assets required

Opportunity
● Trending of mobile devices like smartphones and tablets ● Potential markets outside USA

Threat
● Rivals in online streaming: ○ Youtube who was the first one to start provide streaming services ○ Hulu - a year experience in the industry ○ Amazon ● Rivals in other forms of entertainment ○ cable TV ● movie theatres

Similar to the previous combination, Netflix still chooses to explore every potential of its strength to help itself grab the upcoming opportunities and overcome the threats posed by its rivals from both the online streaming industry and other forms of entertainment. With its large base of consumers and the "addictive" way of subscription mode, Netflix came up with strategies to cultivate the binge-watching of its consumers, given the convenience of enjoying its service whenever and wherever they wish on their mobile devices. In order to address the fierce competition, Netflix has been keeping its monthly fee low while still giving its consumers unlimited access to its library. With stable revenue from its exploitation in the movie rental industry, Netflix was able to start planning ahead for its expansion in terms of geographic location and production of original content.

3.3. 2010 to now, Internationally expansion and production of original content

In 2010, as the online streaming market in the USA was getting more mature and saturated, Netflix announced its plan of expansion to other regions in the world, step by step. The surrounding regions like Canada and Latin America became the first few targets of Netflix to grow its business, followed by areas geographically further away like Europe and India, where broadband penetration and usage of mobile devices are high. This great move of moving internationally writes the new chapter for Netflix as a business.

With the emergence of rivals who shared the same library of titles with Netflix, Netflix realised how important it could be to differentiate its library from its rivals to keep its consumer to a large extent. In 2011, Netflix started its business of creating original content. Netflix owns and operates three content production companies, Netflix Studios, located in the US, Germany, and Singapore. These companies produce or co-produce their content, enabling Netflix to have part of the library exclusive to further compete with its rivals like HBO who has been constantly injecting great original series like Game of Thrones into the market. Hence, its exclusive and original content allows the company to attract and retain subscribers. Throughout the years, the original content created by Netflix has obtained great success on a global scale, winning awards from time to time.

Netflix is also active in seeking partners. By cooperating with various high-tech companies like Amazon Web Service in 2010, Netflix improved the consumers' experience by increasing the general speed of streaming. With the collaboration with DreamWorks Animation and Warner Bros, Netflix can produce content with a greater possibility to attain the market's good ratings.

Throughout the years, Netflix gradually secures its position as the leader in the online streaming market with the greatest market share. However, taking the lead in one form of modern entertainment also suggests that the threats faced by Netflix are no longer restricted to the streaming or movie rental market anymore. Assuming that the proportion of time that one person spends on entertainment is roughly constant, different forms of entertainment, be it watching movies or playing games, now become substitutes for one another. Hence, Netflix has also been paying attention to these potential rivals in areas that can be drastically different from online streaming. In 2014, Netflix had also incorporated its business into the eSports market, forming a means to perform risk diversification.

The four quadrants of SWOT analysis are shown below.

Strength
● Greatest market share in the streaming industry, come along with large audience base across the world; running with zero debts; exclusive contracts with filmmakers building high barriers to entry ● Broad library of content with part of it being original ● Consistent internal expansion to reach worldwide audiences ● Diversification of operations such as eSports outside the current online streaming business

Weakness
● Library focuses on the breath but not exclusivity, causing overlaps in the content provided with its competitors. ● Limited power of original content since its competitors can also produce their own content and restricting Netflix from getting those copyrights ● Problem of code sharing reduces the profitability ● The service is highly based on the Internet, rendering the growth of the consumer base

Opportunity
● Due to the pandemic, people are turning their activities online ● Improvements in the overall ecosystem due to the development of technologies such as 5G ● Upgrading of their consumers' experience by integrating more functions, such as bullet screen
Threat
● Slowing down of the rate of releasing its originally produced series due to the pandemic ● Presence of close substitutes (Disney +, Hulu, Amazon Prime Video) and less direct competitors like TikTok, YouTube in the market, which are backed up by a conglomerate ● Strict regulation from certain governments

At this stage, Netflix has already established its leadership in the streaming market, enjoying the greatest market share, stable consumer base, and great revenue. Its strategies were more comprehensive, enlarging its strengths while at the same time focused on overcoming its weaknesses.

3.4. Future outlook in view of Covid-19 and advancing technologies

Although the lockdown measures are easing in most countries, the habits developed during the pandemic are unlikely to change in a short time. When people were staying in their homes as long as possible, the primary source of entertainment became their mobile devices and personal computers, providing great opportunities for Netflix and its potential competitors such as TikTok. On one side, the lockdown measures created a suitable environment for Netflix to cultivate the binge-watching habit of its consumers. Consumers found themselves having more time to indulge in such viewing behaviour. Netflix was enjoying growth while other industries were suffering from mandatory shut down due to the pandemic. However, such binge-watching behaviour works the same way for other forms of entertainment as well, evident by the trending of Tiktok.

With the growing technology of 5G, broadband speed has improved, allowing more consumers to access the internet faster. Hence, Netflix can expect to see an increase in its consumer base. Moreover, with the trend of Augmented Reality (AR) and Virtual Reality (VR), the media that Netflix can use is no longer restricted to screens of mobile devices. Especially during the lockdown period, where VR can provide people with the feeling of being physically transferred to another world, allowing them to escape from the confines of reality. Such innovation can revolutionise the entertainment industry by changing the fundamental way of consuming entertainment, hence, serving as an opportunity for Netflix.

3.5. Possible strategies of which Netflix can adopt

Looking at the possible future trend, a range of strategies based on different approaches Netflix can take to help itself sustain its current glory. Considering its greatest market share and huge consumer base around the globe, Netflix can utilize this strength by improving the quality of its product in several aspects. Firstly, improve the quantity and quality of the movies or shows available on their websites. Secondly, develop different functions such as bullet screens that will help upgrade the consumer experience. Thirdly, Netflix should continue its expansion with the aid of technologies such as 5G or VR. Besides, the leading position in the market can potentially give Netflix greater bargaining power when cooperating with different filmmakers such that Netflix can have more exclusive rights to its library. Netflix can also consider utilising its opportunities to help tackle its weakness by signing exclusive contracts with technological accessory providers like Amazon Web Services or VR equipment manufacturers to gain competitive advantages over its rivals.

4. Conclusions

For more than twenty years, ever since its foundation in 1997, Netflix has demonstrated how to grab opportunities and utilise its strength to overcome potential threats and weaknesses. In the early establishment stage, Netflix did not enjoy advantages such as a large consumer base and capital flow and hence focused on exploiting its strength of unique business model to help itself stay in the market. Thus, its primary approach used a mix of S-O and S-T strategies to help itself grow under the pressure of dominant firms like Blockbuster. Such a combination of strategies has allowed Netflix to grow and flourish in 10 years and take the lead in the movie rental industry, one of the greatest sources of entertainment at that time. Constantly scrutinising every potential opportunity closed to the industry, Netflix took the extraordinary move into the movie streaming industry. Facing a new industry this time, Netflix smoothly established its business with the help of the accumulated capital and consumer base from the movie rental industry. Like its previous choice, Netflix still emphasised its strength radiated approach. As the company grew, Netflix no longer limited itself to the United States and started international expansion. At this stage, facing more fierce competition from stronger competitors, Netflix started to pay more attention to its weaknesses and adjust its combination of strategies to help tackle them. With the rapidly changing technologies nowadays, Netflix should therefore preserve its close attention to all sorts of opportunities to find the potential place to exaggerate its strength or solution to its weaknesses.

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