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Will Netflix Become the Next Blockbuster?

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Image Credit | Cameron Venti

Can Netflix maintain its lead in streaming amid the surge of new competitors?

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Netflix has navigated the first two stages of growth: first, building a massive audience on the back of other companies' content libraries, then - following the success of House of Cards - becoming a major content producer in its own right. Since 2007, when Netflix began streaming movies and television shows, it has been operating in this space almost unchallenged, growing into a tech and content giant with a subscription base of over 200 million users worldwide and a market capitalization of $250 billion. While Netflix was blitzscaling and disrupting a key revenue stream of the incumbent media companies, these companies i.e. WarnerMedia, Disney, and NBCUniversal etc., mostly stayed on the sidelines by supplying content to Netflix. Unlike Netflix, for these media giants, getting into streaming would have meant cannibalizing highly profitable cable networks and putting their cash cow at risk. Developing the streaming infrastructure of the size required to compete with Netflix and Amazon would be incredibly expensive, and it would be a drag on these companies' balance sheets.

The bigger challenge for Netflix now is to maintain its lead, at a time when many more subscription video bundles are on offer. With increasing cord cutting - as per eMarketer, **35% of the US households are expected to cut the cord by 2024** - it had become clear to these media giants that it was no longer a matter of whether the new business model will make as much profit as the current one; instead, the question was, will they survive without shifting to the new business model, which led to a flood of subscription services in the market. Cable and satellite television subscribers continue to "cut the cord" at record rates, canceling expensive subscriptions in favor of less costly online alternatives. Due to this decline in traditional cable television viewership, advertising revenues have been affected, sparking a media sector consolidation - even as cable providers launch so-called "skinny bundles" of channels that make it less pricey than a traditional multichannel subscription. The growth of streaming has coincided with subscriber and viewership declines in traditional television.

Except for Apple, none of the other streaming services were started from scratch. For example, Disney+ had content from Disney, Pixar, Star Wars, and Marvel, including 7,500 television episodes and 500 film titles. HBO Max provides 10,000 hours of bundling all of WarnerMedia's content, including the entirety of "Friends'' and "South Park," hundreds of Warner Bros. movies, DC movies, the HBO library, and CNN documentaries etc. Peacock includes 15,000 hours of content, including complete seasons of "The Office" and "Frasier," Telemundo shows, Universal films, etc. And Paramount+ - a rebranding and expansion of an existing streaming service, CBS All Access - have access to content from Nickelodeon, CBS, Comedy Central, MTV, BET, and Smithsonian Channel, and movies from Paramount Pictures.

With so many new players adding on to the competition, customers will have to choose. **According to a survey conducted by The Wall Street Journal and the Harris Poll**, Americans are prepared to pay an average of $44 per month on video streaming services, so not everyone can emerge victorious.

The Streaming War

With a flood of new entrants, 2020 was supposed to be the year of streaming wars with an effort to grab subscribers. Instead, the coronavirus pandemic prompted governments worldwide to announce lockdowns that forced everyone to stay at home. With movie theatres and restaurants etc. shut down, and all the sports leagues halted, many people were left with a lot of time to consume videos from the comfort of their couch. This enabled both the incumbents like Netflix and Hulu and new entrants like Disney+ to grow at the same time.

Because of COVID-19 production shutdowns, the new streaming services were deprived of the majority of their original content. For example, WarnerMedia had planned to launch HBO Max with a special reunion of the main cast of the hit TV Show “Friends.” “The Flight Attendant,” a new drama starring Kaley Cuoco, was also halted, which later got released on November 26, 2020. Before the launch, John Stankey, the CEO of AT&T, admitted that HBO Max service would have to launch without some of the programmings it had hoped to release along with the launch and that further production would be delayed by several months. Peacock, owned by NBCUniversal, also premiered without some of the most awaited original programming, such as the drama “Dr. Death.” The production of the second season of Apple TV+’s most popular show, “The Morning Show,” starring Jennifer Aniston and Reese Witherspoon, was delayed in March 2020. Several other shows in development for Apple TV+, which debuted to much fanfare in November 2019, **experienced the same outcome**.

The coronavirus pandemic helped Netflix add a record 37 million subscribers in 2020, ending the year with over 200 million subscribers. Large incumbents like Netflix had an advantage during the pandemic, as they had already built up supplies of original content and were better prepared to weather this period. Netflix produces its content farther in advance than television networks, which put the company at an advantage to deliver fresh content. This put new entrants at a disadvantage as well, as most of their programs were in the pipeline before COVID hit. Netflix's overwhelming dominance during the pandemic **can be attributed to its vast library and consistent supply of original content**.

So Netflix and other incumbents will feel the heat once the pandemic subsides and the production of movies and shows get back to full swing.

Disney+

Before the launch of Disney+, the company **was projecting a subscriber base of between 60 and 90 million by 2024**. When Disney+ reached 86.8 million paying subscribers worldwide on Dec. 2, 2020, it almost surpassed the upper end of that guidance - just over a year after its launch. This strong performance led the company to revise its projection to 230 million and 260 million subscribers by 2024. Additionally, Disney has two other streaming services, Hulu, with 38.8 million subscribers, and ESPN+ with nearly 12 million. By 2024, the company **predicts the three platforms to have a combined customer base of 300 million to 350 million**. Most recently, Disney+ reached another milestone: in its first 16 months of service, the service had crossed 100 million subscribers.

Disney is becoming a real threat to the dominance of Netflix. In a rare admission of a competitor's strength, Reed Hastings stated that the arrival of Disney in streaming "takes away a little from us" after Netflix **announced its earnings numbers for the fourth quarter of 2019**. And in a **September 2020 interview with CNBC**, Hastings admitted that he had projected Disney+ to have just "20 million [subscribers] at best" in its first year.

Despite the might of Disney, success wasn't as straightforward as it may appear. In preparation for the launch of Disney+ the company made several acquisitions; including its biggest acquisition ever, 21st Century Fox - a $71.3 billion deal - to bulk up its content library and bolster its production capabilities. Disney acquired BAMTech for $2.6 billion to lay out the technology framework for streaming platforms. It canceled the output contract with Netflix, which set it back $150 million in annual revenue. And reshuffled its executive ranks to create a new direct-to-consumer division. While it was a risky bet for a company with $6.7 billion in quarterly sales from its legacy television operation, the then Disney CEO, Bob Iger, argued at the time that sitting back and doing nothing while customers “cut the cord” for streaming services **would have been a bigger risk**.

WarnerMedia and Discovery

It’s not just Disney. Even AT&T **revised its subscriber target** in March 2021, moving it from the 75 million to 90 million it had set in October 2019 to 120 million to 150 million by 2025. And this was before the merger announcement.

Now that WarnerMedia and Discovery have announced their merger, it will make them the second-largest media group by revenue after Disney, with $41 billion in revenue. The new company can leverage the profits from its cable business and pump them into its streaming business. And WarnerMedia and Discovery will complement their strengths in unscripted, i.e. Animal Planet, TLC, Discovery, etc., scripted like HBO and sports, i.e. Eurosport and Turner, etc., **and could become one of the few global streaming services**.

Brand and Deep Content Library of Competitors

Quibi was shut down a mere six months after launching its streaming service. Despite a series of strong indicators - being founded by former chairman of Walt Disney Studios, and co-founder and former CEO of DreamWorks Jeffrey Katzenberg, being led by former CEO of Hewlett Packard Enterprise Meg Whitman, and having raised $1.75 billion from investors, attracting some of the biggest names in Hollywood - Quibi missed its subscriber targets by a wide margin and failed to gain traction with viewers. Quibi was pitched as a revolutionary new entrant to the video-streaming war. The failure of Quibi **reinforces the point that streaming is a tough space to be in**. It also highlights the strength of these new entrants (excluding Quibi), who are able to hit the road running on the basis of their brand recognition and deep libraries of programming.

These media giants have a significant advantage over their technology competitors in terms of TV and digital empires with celebrity talent, intellectual property, and promotional ad inventory. **Using owned assets has become a common model for media conglomerates’ streaming services as they compete with Netflix**.

For example, Disney+ will use the assets it had created or acquired over the years to power its content and programming in the coming years. The company is recasting stars from past Star Wars films in shows that will grow the franchise's storytelling universe far beyond the Skywalker saga. **Marvel Studios is taking a similar path**, producing shows with storylines that tie into the Marvel Cinematic Universe and pick narratives from the movies released theatrically.

And this strategy is working for Disney+, when the Star Wars spinoff, The Mandalorian, **became the first non-Netflix show to top Nielsen's US streaming chart**. Even this year's release of Marvel's spinoffs "**WandaVision**" and "**The Falcon and the Winter Soldier**," have turned out to be a huge hit so far.

Removal of Content from Netflix

WarnerMedia, Disney, and NBCUniversal have been some of the largest content providers for Netflix for many years, licencing the content for a substantial fee. Now that these companies have started their own streaming services, they're taking their hit content back to feed their own platforms. Non-original "library programming" accounted for 72% of Netflix viewing minutes in October 2018, **according to Nielsen data**.

Even though original programming may drive up signups, it's not yet driving the viewership the way Netlfix would have hoped. According to Nielsen, the three shows that people spent the most time watching on the major streaming platforms in the United States in 2020, were "The Office," "Grey's Anatomy," and "Criminal Minds," and all these shows were launched on TV network over a decade and a half ago. And "The Office" is owned by NBCUniversal, "Grey's Anatomy" is owned by ABC/Disney, "Criminal Minds" belongs to ViacomCBS and rights to another hit show "Friends" **belongs to WarnerMedia**.

Furthermore, Netflix's film catalogue has shrunk by 40% since 2014, with over 2,600 fewer films now available for streaming. The US library of Netflix offered 6,494 movies for streaming in March 2014, but as of November 20, 2019, that number had come down to

3,849 titles. This was even before the launch of competing streaming services, so things will only get worse in the coming months as NBCUniversal, WarnerMedia, and Disney etc. **continue to pull content from Netflix to bolster their own streaming services**.

And as per Parrot Analytics, Netflix's share of total demand - a measure of its shows' popularity - is dropping, **from 65% in Q1 of 2019 to around 50% in Q1 of 2021**.

Exclusive Content

The streaming war has increased costs throughout Hollywood, as they vie for talent and property. For example, Amazon outbid other streaming services for a $250 million rights deal with the Tolkien estate for the **prequel spin-off series of The Lord of the Rings**, and more recently, Netflix had paid about $465 million in a bidding war to **acquire the rights to two sequels** to the surprise hit, "Knives Out" of 2019, a price tag **50% more expensive than the first film's gross receipts**.

And on the talent front, media giants like WarnerMedia and Disney have **secured lucrative multiyear deals with some of the biggest creators**, from "Star Wars" veteran J.J. Abrams to "Riverdale" producer Greg Berlanti.

Razor and Blade Business Model

Netflix's biggest challenge will be to protect its current business model. Competitors like Apple, Amazon, and AT&T etc., can exploit the synergy between complementary products by adopting the razor-blade strategy. These companies can use the razor (e.g. Prime) to hook the users by pricing the razor at cost (or even at a loss) to make money on the blades (e.g. e-commerce). It can become tough for a rival to compete with a firm whose strategy is based on complementary products.

Amazon
In 2016 Vox's Code Conference, Jeff Bezos **explained this strategy**:

> *"We get to monetize [our subscription video] in a very unusual way. When we win a Golden Globe, it helps us sell more shoes. And it does that in a very direct way. Because if you look at Prime members, they buy more on Amazon than non-Prime members, and one of the reasons they do that is once they pay their annual fee, they're looking around to see 'how can I get more value out of the program.' And so they look across more categories they shop more. A lot of their behaviors change in ways that are very attractive to us as a business. And the customers utilize more of our services."*

The recent MGM deal only further strengthens Amazon Prime Videos' value by way of back catalogue and future spin-offs, as MGM offers access to 4,000 films, the most notable being the James Bond franchise and 17,000 episodes of TV. At the least, **this could prevent existing Prime members from canceling their subscriptions**, even if it fails to attract new subscribers.

Apple

Apple had set its monthly prices for TV+, a video-streaming service, and Arcade, a video-game-streaming service at $4.99 - significantly lower than its competitors. Apple can afford that because it is still a hardware company, and the majority of its profits still come from hardware and the distribution advantage it has over its competitors, with over 1.4 billion devices in use worldwide. As a result, **any service that increases the stickiness of Apple's hardware and nudges users to upgrade will benefit Apple**.

Apple has created an all-consuming ecosystem, and adding more content, including TV+, will bring more people to Apple's platform, so it need not compete with other streaming players on price in the short- to medium-term, as fueling consumption on their platform and devices and **getting the users hooked to their platforms matters the most to them**. Apple's ultimate goal is to create an ecosystem of ongoing, subscription-based products that retain customers within the company's ecosystem and bundle all of its services to create a more unified customer base. When customers become reliant on Apple's apps, **investing in a new iPhone or MacBook makes even more sense**.

According to Matthew Ball, Managing Partner of Epyllion Industries, “An Apple Subscription allows the company to use its existing ecosystem, reach and brand to de-risk new business, out-compete in undifferentiated ones and create a rich, proprietary experience that its competitors will struggle to match (due to either their more modest cash reserves or scope of services).”

Disney
Disney’s streaming business may not be profitable until 2024 - but it has other ways to make franchises pay; via cruises, amusement park attractions, and merchandise, for example.

Microsoft vs. Slack

The impact of network effect and complementary products was clearly visible in the battle of Microsoft vs. Slack. When Microsoft launched Teams, Stewart Butterfield, the CEO of Slack, welcomed them openly and with a sarcastic, **full-page ad** in the November 2, 2016 edition of the New York Times.

But right from the outset, Slack didn’t stand much of a chance against Microsoft Teams as a standalone product. Microsoft Teams is positioned as an operating system that will act as a hub for the company’s more well-known products like Office. Through Teams, Microsoft software provides a hook to attract and retain customers for its broader portfolio of cloud-based services like Azure and Office 365. **Microsoft Teams is available for free to businesses that subscribe to Office 365**, and **over a million companies already use Office 365 worldwide**, including Fortune 500 companies like IKEA, Accenture, Dell, Volvo Group, Maersk, and Paypal. While Slack has a free version, upgrading to the paid version with the features that most companies need, like unlimited message history and app integration, starts at $6.67 per person per month. For example, L’Oréal SA, the cosmetics giant, **abandoned more standalone tools in favor of Teams**, owing in part to the bundled features.

On December 1, 2020 **Salesforce made an announcement that it will be acquiring Slack for $27.7 billion** in a cash-and-stock deal, making it the largest acquisition in the cloud software space.

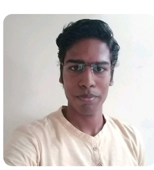
Conclusion

The failure of Quibi shows the strength of brands like Disney and HBO and the value of deep content libraries and intellectual property - which even Netflix relied on for its own success - that these major incumbents already possess.

Microsoft used network effects and complementary products with great effect to compete with Slack. Amazon, Apple, Disney, AT&T and Comcast are capable of using razor and blade business model and/or network effect and complementary products to upend the business model of Netflix.

According to McKinsey, ecosystem strategy has significant competitive implications. In a decade, 30% of global gross economic output will be contributed by companies operating a network of interconnected businesses.

Netflix might need to reinvent its business model again in this new competitive landscape, and initiatives like Netflix.shop and the sale of licensed products are moves in the right direction. But, the big question is, can these new channels become a significant driver of new revenue? If not, Netflix faces the risk of being acquired just like Slack, or worse - becoming the next Blockbuster.



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