

# Customer Relations

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At the beginning of 2011, Netflix was one of Silicon Valley's most successful and fastest growing consumer-service companies. By the end of October 2011, the company was stumbling from two customer relations disasters that had cost 800,000 members of its online DVD rental business. The reverse was shocking. Netflix's trajectory had been upward since its launch in 1999, when it offered a subscription service for unlimited rentals of DVDs for one low monthly subscription.

Netflix had from the beginning several advantages over DVD and video rental stores, such as Blockbuster, which faded under Netflix's assault and went bankrupt. One ordered DVDs from Netflix online, and they were delivered by mail in a distinctive red envelope that also became the return mailer. There was no need to go to a store. There was a larger catalog of movies to choose from on the Netflix site and not just multiple copies of the most recent releases. With Netflix there were no late fees for not getting a DVD back on time. In 2000, Netflix launched a personalized movie recommendation system.

By time Netflix went public on May 22, 2002 (NASDAQ: NFLX), it had 600,000 members. By the end of 2003, it had 1.4 million members. Its growth continued to rocket and by the end of 2010, Netflix boasted 20 million members, many of whom used its streaming service launched in 2007 that allows members to download and watch TV shows and movies instantly. Netflix expanded its services in 2008 to the Xbox 360 electronic game box, Blu-ray disc players, TV set-top boxes and the Apple Macintosh computer. In 2009-10, it went even wider to PS3 and Wii electronic game boxes, internet-connected TVs and the Apple iPad, iPhone and iPod Touch. Netflix also launched in Canada and announced entry into Latin America and the Caribbean for 2011. To keep up with rapid growth, Netflix solved numerous managerial issues such as receiving and processing tens of thousands of DVDs arriving and leaving from its facilities daily. Its population grew from two co-founders, Reed Hastings and Marc Randolph, to 2,180 full-time employees by Dec. 31, 2010 and 2,149 part-time and temporary employees.

Success bred competitors. Cable providers, direct broadcast TV services, telecommunications companies, such as Verizon and AT&T, internet movie and TV content providers, such as Amazon.com and Google's YouTube, and traditional players, such as Redbox, Best Buy and Wal-Mart are all distributing and/or streaming entertainment. Netflix was holding them at bay through rapid evolution in response to members. It had redefined its core strategy to focus on growth of its streaming subscription service in the US and internationally. It was expanding streaming content, improving user interfaces and reaching more

internet-connected devices. Netflix planned to continue rapid subscriber growth through:

- Obtaining more content.
- Expanding word-of-mouth promotion.
- Improving its service offering.

In April 2011, Hastings, the CEO, moved to end discussion in the company over the extent of resources to invest in the DVD business versus the streaming business. Netflix' senior leadership expected the DVD business to go into decline while the streaming business grew. Already 75 percent of new signups were for streaming rather than DVD rental. Hastings decided to separate the DVD and streaming business and to charge \$7.99 for each rather than a flat rate of \$9.99 for both. Hastings would also rename the DVD business to make the division complete. There would be two websites and two billing methods for those who wanted both DVDs and streaming. According to one report, Hastings did not test his decision with customer focus groups as he usually did.

Jessie Becker, the VP of Marketing, announced the change to two plans in a Netflix blog post on July 12, 2011. Plan 1 was unlimited streaming and no DVDs for \$7.99 a month. Plan 2 was for unlimited DVDs, one out at a time, and no streaming for \$7.99 a month. One could have both plans for \$15.98 a month. The blog post also announced a separate management team for DVDs by mail, but there was no announcement of the new name for the DVD service. Netflix expected some cancellations as a result of the change, but it noted that the majority of its new customers were signing up for the streaming-only plan even after the announcement.

The backlash was immediate and loud. One explanation for the anger was that older users accustomed to DVDs had viewed streaming as a free add-on to the red mailers rather than the opposite – DVDs an add-on to streaming. Exacerbating the protest was the news that Netflix had failed to conclude an agreement with the Starz cable network to distribute newer films from Disney and Sony.

There was speculation that Netflix may have lost 600,000 members in the third quarter, reversing the skyrocketing climb that had it at 24 million members by the end of June 2011. Financial analysts went negative on the stock. On Sept. 18, Hastings wrote a long apology on the Netflix blog. He explained the reason for the change, accepted blame for not communicating to members and announced that the name of the DVD service would be changed to Qwikster and that the new site and Netflix would not be integrated. The blog posting generated 27,860 comments, most of them negative. The media bashed Hastings in numerous articles.

On October 10, 2011, Hastings gave up. In a blog post on the Netflix site, he announced that the company was abandoning Qwikster but keeping the price change announced in July. There would be one Netflix site, one member account and one password.

However, the damage was done. In the company's Oct. 24 report on Third Quarter results, Hastings announced a loss of 800,000 members in a letter of apology to shareholders, employees and members of Netflix. Even though the company's revenue was up and net income was healthy due to the price increase, its stock plummeted, losing 35 percent in one day, and 75 percent of its value over the year. Media became naysayers asking if Netflix could recover, a far cry from adoring articles the company had for nine years. However, Hastings reaffirmed in the summary of the Third Quarter report that the company

“continue(s) to be well positioned to succeed in the large global market for streaming video. Consumer demand for unlimited, on-demand movies and TV shows streamed over the Internet keeps growing...”

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Questions for discussion:

1. What should Hastings have done to get customers ready for a price change?
2. What should Hastings have done to prepare consumers for the shift of focus to streaming video rather than DVDs?
3. Should Hastings have known that dividing the two services would be so unpopular?
4. If you were the communications officer at Netflix, what would you have advised Hastings while the change was underway?
5. What lessons for customer relations do you take from this disaster?