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Netflix Has Room to Grow in Low-Income Homes But New Fees Unlikely

Companies: AAPL, AMZN, CMCSA, CVC, DIS, DISH, DTV, GOOG, LBTYA, LON:BSY/BSYBY, LON:BT.A/BT, NFLX, NLSN, OUTR, STRZA, T, TWX, VIA, VZ

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Research Question:

Can Netflix increase revenues through better demographic and mobile penetration and by charging extra for individual profiles?

Summary of Findings

- Sources expressed little support for individual profile fees as a smart or viable strategy for Netflix Inc. (NFLX). Their concerns include the potential backlash to a pricing model change and consumers' likely unwillingness to pay extra for individual profiles, even if they enjoy the feature.
- Netflix has an opportunity to expand into lower-income homes, especially as smart TVs become more common, tablets drop in price, and video technology allows for a better streaming in homes with slower broadband speeds. However, sources have not seen evidence of Netflix targeting such a demographic, nor do most sources consider it a fruitful path.
- Netflix's ability to increase mobile viewership is being held back mainly by factors outside of its control, such as cellular network connection speeds and device battery life. The viewing of shows and movies on tablets will grow, especially internationally, but consumers have little appetite for watching long-form content on their mobile phones.
- Eleven sources believe prices for digital content rights will continue to rise in the mid- to high single digits because of the industry battle for exclusive content deals. Three sources believe movie studios will start withholding more premium content from Netflix and other over-the-top (OTT) providers.
- Netflix's best paths to subscriber growth include continued investments in original shows and children's programming, more deals to get on cable set-top boxes, and international expansion.
- In a survey of 161 Netflix subscribers, we found that Netflix has continued to grow significantly and is not threatened by competition from cable and other streaming services. Netflix customers are increasing their usage, are highly unlikely to cancel their subscription in the next three months, and are decreasing their content viewing through other entertainment services, especially cable. One-third of subscribers are using Netflix to replace, rather than to supplement, other forms of entertainment. However, Netflix does not have room to raise prices and is slow to build its mobile penetration.

Silo Summaries

1) MOVIE STUDIO EXECUTIVES

Two of four sources said prices for digital content will continue to trend upward, while a third said they will level off as Netflix becomes more focused and savvy about what content to buy. Netflix cannot do much to target lower-income homes other than to keep its low subscription rate. Mobile use of Netflix will depend on factors outside of its control, such as global smartphone growth and the cost of data plans. Tablet viewing growth is expected in Latin America next year.

2) TV EXECUTIVES

Three of four sources think targeting lower-income households is neither a smart nor a likely strategy for Netflix. The remaining source disagreed and said Netflix should have success in that demographic. None of the four sources believes per-person subscription fees will work because of the cost-sensitivity of Netflix's customers and the lack of value in individual profiles. **Two sources said digital content prices are rising because of competition for exclusive content.**

3) CONTENT DELIVERY EXECUTIVES

Three of four sources said personalized services like Netflix's individual profiles are important and valuable in competing for subscribers, but all four sources agree that charging higher fees for such features through per-person subscriptions is an unlikely strategy for Netflix. None of the sources cited evidence of Netflix successfully penetrating lower-income homes, but three see opportunities to do so. Three sources believe prices for digital content rights will continue to rise for Netflix.

4) PAY TV PROVIDERS

These two sources believe Netflix will face difficulty in expanding into lower-income homes. **Consumers will not see enough value in Netflix's individual profiles to pay extra through per-person subscriptions. Mobile viewing remains difficult but should improve as 4G networks become more common in two to three years.** Programming costs for cable operators are rising almost 10% per year, while content-rights prices for digital distributors like Netflix also are trending up.

5) INDUSTRY SPECIALISTS

Four of five sources are skeptical that Netflix would try to add per-person subscription fees or could have success with it. **Three sources see at least some opportunity for Netflix to penetrate lower-income homes, with one suggesting a free, ad-supported model as the best route.** Digital content prices will continue to rise in the mid-single digits.

Netflix Inc.

	Potential for Individual Profile Fees	Potential for Success in Low-Income Homes	Digital Content Prices
Movie Studio Executives	↓	→	→
TV Executives	↓	↓	↑
Content Delivery Executives	↓	→	↑
Pay-TV providers	↓	↓	↑
Industry specialists	↓	→	→

Background

As cable cord cutting continues to gather momentum, Netflix has an increasing opportunity to expand its subscribership among lower-income demographics. A recent survey shows 30% of homes with an annual income of less than $30,000 rely solely on over-the-air TV—up from 22% in 2010.

Netflix has yet another subscriber growth opportunity among mobile device users as only 6% of Netflix subscribers access the service via smartphones. However, the delivery has significant room for improvement, as exemplified by frustrated user comments about the Windows Phone's Netflix app.

Netflix recently started rolling out individual profiles. Each subscription provides five different users within a household their own settings, recommendations, viewing history and queue. Reader comments have shown support for the new offering, especially among those who want to control their young children's TV viewing. This could be Netflix's first step in charging per-person subscriptions by adding an extra $1 to $2 fee for each profile within an account.

Blueshift's Dec. 14, 2012, report found that Netflix would not lose subscriptions despite the rise of new streaming services and TV Everywhere options from cable and satellite operators, and that the company was competing more with premium channels such as Time Warner Inc.'s (TWX) HBO and Showtime, which have had successful original shows. Netflix's recent deal to be an app on Virgin Media's (Liberty Global PLC/LBTYA) set-top TV in the United Kingdom only furthers its reach.

CURRENT RESEARCH

In this next study, Blueshift Research assessed whether Netflix was moving toward an individual-profile subscription model and whether it was successfully expanding its mobile device and demographic reach. We employed our pattern mining approach to establish seven independent silos, comprising 19 primary sources (including eight repeat sources) and seven relevant secondary sources focused on Netflix's new content, streaming quality and international expansion:

1) Movie studio executives (4)
2) TV executives (4)
3) Content delivery executives (4)
4) Pay-TV providers (2)
5) Industry specialists (5)
6) Consumer survey with SurveyMonkey (321 U.S. citizens, of whom 161 are current Netflix subscribers)
7) Secondary sources (7)

Next Steps

Several sources cited Netflix's deal with Virgin Media in the United Kingdom as a potential game-changer. Blueshift Research will look at Netflix's chances to replicate such an arrangement with U.S. cable and satellite operators and the threat that Netflix poses to pay-TV providers. We also will attempt to track Netflix's efforts internationally, where several sources cited significant room for growth for the company. Finally, we will further explore the bundling of content with other services and how such deals affect Netflix and other industry players, such as wireless network operators.

Silos

1) MOVIE STUDIO EXECUTIVES

Two of four sources said prices for digital content will continue to trend upward, while a third said they will level off as Netflix becomes more focused and savvy about what content to buy. A small studio owner said personalized features are key for any OTT provider, but a source representing a larger studio was adamant that Netflix will not try to roll out per-person subscription fees because of its prior bad experience with pricing changes. Netflix cannot do much to target lower-income homes other than to keep its low subscription rate, according to one source. Another cited an opportunity for Netflix to gain a foothold among the growing number of cost-sensitive consumers. One source said mobile use of Netflix will depend on factors outside of its control, such as global smartphone growth and the cost of data plans. Another source said movie and TV watching on phones is negligible in Latin America but that tablet viewing growth is expected in the region next year.

KEY SILO FINDINGS

Demographic Trends
- 1 of 4: No real path for Netflix to target lower-income homes.
- 1: More consumers becoming price-sensitive, which represents an opening for Netflix.

Individual Profiles
- 1: Netflix will not go this route after its Qwikster debacle.
- 1: Personalized features are key for OTT providers.

Mobile
- 1: Netflix watching on mobile devices depends on smartphone sales and data plans.
- 1: Tablet viewing to increase in Latin America.

Digital Content Rights
- 2: Prices headed upward.
- 1: Netflix is becoming pickier about what to buy.

1. Digital distribution executive for a major Hollywood studio

Extra fees for individual profiles are not going to happen; Netflix learned its lesson with the Qwikster debacle. Meanwhile, Netflix likely would face challenges in more aggressively targeting the lower-income demographic. Lower pricing or bundling content would risk severely damaging its relationships with content providers. Netflix is showing every sign of trying to keep TV and movie studios on its side. Prices for digital content are unlikely to keep rising.

Demographic Trends

- "In terms of going after a lower demographic, I think they are already doing that, but I'm not sure how they could do it more. Pricing lower than $8 [will make the studios furious] and will be difficult from a relationship perspective. What they can do is encourage people to cut the cord. However, again, they have a hard time doing that [overtly] because they'd [anger] all of the content providers, who own platforms or have major deals with platforms."
- "I don't think they're going to go after the lower-income demographic [any more aggressively than they already are]. I haven't seen it at all [within Netflix]. If anything, they're most interested in being on all set-top boxes."
- "Honestly, I don't think the lower-income demographic is attractive to Netflix. That demographic is unreliable. They will dip in and out when they can afford it. Netflix is a public company; they need subscribers that are in it for the long haul."
- "I think they're looking at the other end of the spectrum. I imagine they want to secure the young demographic—the ones who have been pirating content and have never, ever bought a thing in their life. ... That's where they need to spend their time because those are the people that will have money in five years."
- "As content providers, we can't set [Netflix's] pricing, but it's a huge concern for us. [Charging $7.99 a month] is as low as we'd want them to go."
- "Any perception that the content is being used as a throw-in, anything that cheapens the content is a concern. We also get worried when broadband providers have IPTV platforms and they do 'Get this and we'll give you the TV service for free' type deals. We can't put any floors on [Netflix's pricing]. We can only let them know we'll be extremely upset if they let it go too low."
- "Our contracts [with Netflix] do not allow for advertising. Absolutely not. If they did want to introduce an ad-based model, which we call AVOD, it wouldn't be close to the quality of content they offer now [with the ad-free model]."
- "We license SVOD—subscription VOD—which is not allowed to have advertising in it. Their only source of revenue is supposed to come from subscriptions and supposed to be a premium service. If they wanted to do advertiser-supported VOD, they'd have to come to us and it would be a completely different contract. We would negotiate a share in ad revenues using CPM data."
- "I guess Netflix could offer another package or do AVOD, but what Netflix is really worried about is confusing the customer."
- "They don't want to [anger] broadcasters. They're constantly saying to us, 'We can all play fair in the sandbox.' In the UK, they have the money and the power to go and bid on first-run shows. Both Netflix and [Amazon-owned] LOVEFiLM have considered bidding for new shows as if they were the broadcaster. Amazon is perhaps more interested in playing in that space, to compete head-to-head with the networks in the UK and Europe."

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Digital Distribution Executive
Major Hollywood Studio

Individual Profiles

- "It won't happen. Netflix learned a big lesson [from the Qwikster debacle]. I know that they've considered charging more for added features, but the idea of going out there and making things complicated, giving people too much choice and [angering] people again, I don't think they get another shot at that."

Mobile

- "The only place that we've had any luck [doing big mobile content deals] is in Japan. But in the U.S., we're not having much luck with [mobile-focused] deals."
- "Netflix could offer a lower price point for less devices. But keep in mind that the Netflix motto, their internal philosophy, is 'simple, simple, simple.' At one time they talked about offering more devices and more streams at a time. They thought about having transactional offerings, like Amazon's new-release stuff. But to date, they've resisted those options."

Digital Content Rights

- "We don't think fees will go down, but Netflix and its competitors are becoming pickier about what they want. They're also more interested in exclusivity, which is actually a good thing for us. I think that's a good thing for us because if services can differentiate, it means there is less likely to be a monopolistic situation."

- "The money keeps being substantial, but Netflix and its competitors are becoming more savvy in their deal making. Instead of taking everything that we say they need to take, they're being more selective and demanding. Before they were taking and paying whatever it took to get the model off the ground. We still have leverage because we have great content, but it's an evolving process."
- "Deals are going to get harder to negotiate, and I don't think [the studios] are going to be able to put as much volume through each deal, or have as much discretion about what we sell them."
- "Our biggest fear is no competition, that there will be a monopoly in any one territory. In the UK, we had a great situation where we had Amazon and Netflix bidding on some early window content. In that situation, we'll continue to see the really big fees. But the problem for our [home entertainment] business is that iTunes is by far the leader, and it's very tough to negotiate with a monopoly."
- "If the studios eventually decide to really fund Hulu and make it a serious competitor, that could be very interesting. It was up for sale, and at the last minute the studios decided not to sell it. Does this mean that now they'll step up and really go for it? I think that would be a smart move, because we need competition in this market."
- "Always remember too that the studios have talent to contend with [in terms of setting digital content prices]. They have the right to come in and look at any of our deals, and question the prices, because they're getting royalties."

The money keeps being substantial, but Netflix and its competitors are becoming more savvy in their deal making.

Digital Distribution Executive
Major Hollywood Studio

2. Hollywood studio executive overseeing Asia Pacific TV operations

Netflix will continue to see rising prices for digital content rights because of competition. Established providers like Netflix and Amazon will pay more for premium content, while new players will pay for initial access to shows and movies. Global smartphone growth is critical to Netflix's further penetration of mobile devices; the cost of data plans also is a key issue. Bundling of content with other services is the next frontier for Netflix and its competitors.

Demographic Trends
- N/A

Individual Profiles
- N/A

Mobile
- "Mobile usage [of Netflix] will vary by territory with usage plans being the big variable. Usage on mobile devices in Japan is enormous."
- "Smartphone uptake is a critical component [globally], but so is bundling by the operators. This will happen increasingly."
- "The big move is Netflix gaining carriage on Virgin in the UK."

Digital Content Rights
- "Digital content rights are trending upwards. It's all driven by competition in the market."
- "Incumbents [such as Netflix and Amazon] will pay more for holdbacks [premium content that studios hold onto for longer periods]. Disrupters [new bidders in various markets] will pay more for access [to content]."

3. Hollywood studio executive overseeing international digital distribution

Digital content rights prices are trending upwards except in regions where they were already quite high, such as Latin America. Viewing long-form content, such as Netflix's shows and movies, on mobile phones is virtually nonexistent in Latin America, but tablets are expected to lead to some good mobile penetration by the middle of 2014.

Demographic Trends
- "It's too early in the Latin American market [to parse out demographic trends]. Netflix hasn't had a strong impact on the market yet in Latin America. They had issues with quality and payment systems in the region."

- "[Netflix] hired Americans for jobs in the region, people who had no idea about the Latin American market. Now, after a year and a half, those problems are starting to be fixed, but it's still a struggle. They're not having a big impact on this region yet, but that will change."

Individual Profiles
- N/A

Mobile
- "There aren't enough serious players on tablets in Latin America to give us any significant numbers. We expect to see good numbers coming from tablets in six months or so, but there is no significant consumption [of long-form content] on mobile phones in these territories. It's not existent in that region."

Digital Content Rights
- "Digital content rights are going up where they were reasonable, but where they were really high—in Latin America—they are stable."
- "Prices were established at a very high level already a few years ago. Netflix may be renegotiating with some other studios. The other players entering the market may not have the same deep pockets as Netflix."
- "What surprises me at the moment, considering the size of Brazil and the health of the economy there, is there is a lot less competition happening there on SVOD than there is in Mexico. I'm wondering why nobody is taking the right steps to enter Brazil. There's a big gap there, but somebody is going to figure that out soon. It's not much discussed at the moment [within the industry], but it's a bit weird. Amazon will probably step in [to join Clarovideo] and I wouldn't be surprised if Comcast and Google were to launch their [SVOD] devices in that market."
- "Clarovideo is the big competitor to Netflix in Latin America, especially in Mexico. It's a service run by DLA and it's giving Netflix a run for its money in Mexico."
- "If you look at the SVOD market, Mexico is where the competition is heating up and the area where Netflix is going to get a lot of competition, some more serious than others. Clarovideo is making a lot of noise, and their numbers are stunning right now."

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Hollywood Studio Executive, Overseeing Intl. Digital Distribution

4. Owner of a small film studio specializing in documentaries and TV shows; repeat source

The opportunity exists for Netflix and others to penetrate lower-income homes, especially as more consumers become cost-sensitive. However, more important will be understanding appetites for certain programming. Netflix's individual profiles make a lot of sense and will help tie together viewing with buying.

Demographic Trends
- "With the personal interface coming, I think demographics are going to be less important than measuring of preferences. … The opportunity lies in the stories that present themselves more than any demographic."
- "We are pulling our 'haves' and 'have-nots' further and further apart. The have-nots are clearly going to be the larger market and the more cost-sensitive market. I would think there is an opportunity [for Netflix] to attract the cost-sensitive audience with quantity or value. However, it still needs to be high quality or high demand."

Individual Profiles
- "The idea [of Netflix's individual profiles] is smart. I think the future is in individual interactions, which are going to be much more important and powerful than demographics and even ratings."
- "Entertainment and consumption are going to be tied even closer soon. When will I be able to shop for suits and ties from Kevin Spacey's wardrobe while watching Netflix? On one screen? I think the answer is soon. I also think it is clear that consumers are fine with Big Brother as long as he is helpful."

Mobile
- "One of the most powerful trends is the viewers' acceptance of a non-linear channel interface. Whoever controls the interface will control content availability. It looks like [device] manufacturers are trying to take control of that, but I wonder if there is an opportunity for others to be multiscreen-dominant."

Digital Content Rights

- "I worry that the world of intellectual property is rushing toward a revenue crisis. It looks to me like the optimum price point for mass consumption of entertainment is going to be free. We were introduced to TV via the ad-supported model. Now technology is removing the advertising and the consumer is not understanding the consequences. The market has to find a way to make free work. Netflix has joined cable and others in the utility space of monthly billing."
- "Quality is going to be the driver. It is going to be a very competitive space where viewers can access low-demand content. High-quality, exclusive, branded content will always have buyers."

2) TV EXECUTIVES

Three of four sources think targeting lower-income households is neither a smart nor a likely strategy for Netflix. The remaining source disagreed and said Netflix should have success in that demographic as Internet-connected TVs, game consoles and less-expensive tablets become more common. None of the four sources believes per-person subscription fees will work because of the cost-sensitivity of Netflix's customers and the lack of value in individual profiles. One source said mobile viewing of shows and movies is challenging because of network connection speeds, while another said mobile growth will happen faster outside the United States. Two sources said digital content prices are rising because of competition for exclusive content.

KEY SILO FINDINGS

Demographic Trends

- 3 of 4: Lower-income homes are not a good target for Netflix.
- 1: Cheaper tablets and more smart TVs will help Netflix reach less wealthy consumers.

Individual Profiles

- 4: Per-person fees will not fly with subscribers.
- 1: Subscribers value content, not individual profiles.

Mobile

- 1: Slow cell network connection speeds are a barrier.
- 1: Mobile viewing will grow faster internationally.

Digital Content Rights

- Competition for exclusive content will keep prices rising.

1. VP of digital for a major UK content producer and broadcaster

Netflix should have success expanding into lower-income homes as smart TVs, game consoles and lower-end tablets become more common. Securing quality children's content also will be key to expanding into the lower-income demographic. Per-person subscriptions will be a tough sell because subscribers care about content, not features like individual profiles. Mobile use of Netflix is being held back by cellular network connection speeds. Digital content prices are trending upwards in the UK and Europe because competitors are looking to secure exclusive content and because subscriber numbers are increasing in these markets.

Demographic Trends

- "I don't think they've cracked [lower-income homes] now, but all the SVOD providers are looking to provide a mass-market service. The only way that OTT SVOD service works if it is mass market. At £5 [$8], with the type of license fees they've been paying in the UK, it has to be scalable. The best guesstimate at the moment is that Netflix has about 2.5 million subscribers in the UK [of 26.4 million households total], so it's still niche."
- "For Netflix to work, they have to become a tick box for [lower-income households], and that's when they quite easily quintuple their subscriber base in the UK. How is Netflix going to achieve this? It's when smart TVs become the norm in that lower demographic. I think once people see how easy and simple it is, it's a no-brainer."
- "Game consoles [are another important element], as is the massive proliferation of low-end tablet devices."

- "Although Netflix is probably not at it now, I can't see it being too problematic for them to surmount the problem of going after a lower-income and younger demographic."
- "The other thing that's going to definitely affect the lower demographic side of things is the kids' stuff. It's been really popular, and everybody can afford £5 to keep their children quiet for a few hours a day, regardless of income."
- "The reporting we get from Netflix [is quite opaque]. All it tells you is number of streams each month. We can potentially read into the types of audiences Netflix is appealing to because of the types of programs that are popular on the service. It's very mainstream still."
- "The Virgin deal [in the UK] is obviously a departure. It's really early days, but these kinds of triple-play plays look to bolster their own services and reduce churn. Virgin and BT are losing subscribers to Sky on that score. Virgin and the like don't want to be paying millions for better content so see Netflix being a quick content fix."

Individual Profiles

- "Content, not features [like individual profiles], is king and the only thing people want to pay for."
- "The overall Netflix service is generally perceived as working well [functionality-wise], and they seem to have stolen the march on other SVOD providers [on ease of use]. The UI [user interface] they have on multiple devices is a lot simpler. They've thought this through properly, and it all adds to the general overwhelming perception that this is best-of-breed service."
- "Look at iTunes and the amount of additional features and functionality they keep adding. Is that really keeping people on iTunes? No, it is synonymous now with music downloads for the mass market. It's not because they have a new added feature that people are going to go there in droves, but I think it does cement that relationship and give value-add."

Mobile

- "The problem with mobile is connectivity. We're just starting to roll out 4G in the UK, but that's confined to major city areas, and it's still early days."
- "From what we hear, Netflix viewing via game consoles is really high, but tablets is where the massive growth is. Two years ago 3% of households in the UK had tablets. That figure is now 22%."
- "[Household viewing] is coming back from bedrooms and going back into the one big screen in the living room. … That's a real opportunity because the Netflixes of the world are synonymous with the new smart TVs. Netflix is a sleeping giant that broadcasters around the world aren't that aware of at the moment."

> **Although Netflix is probably not at it now, I can't see it being too problematic for them to surmount the problem of going after a lower-income and younger demographic. … The problem with mobile is connectivity. We're just starting to roll out 4G in the UK, but that's confined to major city areas, and it's still early days.**
>
> *VP of Digital*
> *Major UK Content Producer & Broadcaster*

Digital Content Rights

- "We are nowhere near the American levels in the UK and Europe right now. We're currently in the early stages of year 3/year 4 renewal negotiations. We're definitely seeing an increase [in content prices]."
- "When Netflix first came to [content producers in the UK and Europe], they came with a rate card that many of us couldn't believe [was so high]. We were basically 250% over budget that year [2011–2012] because of Netflix."
- "Netflix came in with a rate card of between £2,000 [$3,200] and £5,000 [$8,000] per hour of programming, with the sliding scale of premium, standard, basic, etc. I then got my hands on [a very in-demand TV show], and the rate cards went out the window. We told Netflix and LOVEFiLM to come back with their best offers, and figure out what they would pay for [having the content] exclusively. That resulted in a five-fold increase in prices per episode. That is probably the rate card we're looking at again now for what we call our super-premium titles. You're probably looking at between £15,000 [$24,000] and £25,000 [$40,000] per episode in the UK."
- "The other difference in the UK is we do big volume. … You have to balance that really high rate card with volume. In other words, if you raise the rate card and price per episode, the volume goes down."
- "It's a three-horse race in the U.S., but in Europe, LOVEFiLM is no Amazon Prime. It's a problem we have in the UK at the moment. LOVEFiLM is a little on the back burner. It hasn't got the checkbook to be as aggressive [as Netflix] in the marketplace, but that will come in 12 to 18 months."
- "There's room for price increases for content in the UK and Europe because the subscriber base has got to grow. I don't know what Netflix's subscriber target is for the UK, but it's definitely higher than the 2.5 million that they're on now. Two years in, they know what has worked and, more importantly, what hasn't worked [content-wise]."
- "They're definitely looking for exclusive content and paying more of a premium. But the premium isn't really enough to buy out the market at this stage. I can sell an episode of in-demand TV to five competitors now at £10,000

[$16,000] each, but I'll be looking for more than £50,000 [$80,000] if one of them wants to have it exclusively. I don't think Netflix has got the subscriber numbers to warrant that sort of investment [in the UK] at the moment."

2. Digital media executive for a major U.S. broadcaster

Netflix's new personal profiles are a great feature. However, Netflix's subscribers are extremely cost-sensitive, so it will not raise its prices with per-person fees. Also, the company does not have much room to grow its subscriber base in the United States, but targeting lower-income households is an unlikely strategy. Netflix does not appear interested in targeting the growing market of Spanish-speaking consumers in the United States. PCs and gaming consoles are the most popular methods for watching Netflix; mobile devices account for about 20% of viewing. Outlets are in a race to negotiate exclusive content rights to maintain customers. Paying for individual shows and movies may become more popular than subscription-based services.

> **The only way for Netflix to see a return on their investment in Latin America and Brazil will be with local content, which they have been unsuccessful with. The possibility of broadcasting FIFA content could be an option, but they do not want to focus on sports.**
>
> *Digital Media Executive*
> *Major U.S. Broadcaster*

Demographic Trends

- "We are going through a large state of growth with expanding content types to target and reach more demographics."
- "Netflix is nearly capped out in the U.S. with just over 31 million subscribers. They are looking to expand their service aggressively to over 100 million subs by 2020 by expanding into new territories and slowing the decline of customers in Latin America and Brazil."
- "They are losing [out on the chance to reach] about 3 million [subscribers] per month in Latin America and Brazil due to a lack of local content. The three main players in Brazil do not want to offer their content to Netflix to keep them out of their territory."
- "The only way for Netflix to see a return on their investment in Latin America and Brazil will be with local content, which they have been unsuccessful with. The possibility of broadcasting FIFA content could be an option, but they do not want to focus on sports."
- "I can see the potential within the U.S. if Netflix were to focus on a purely Spanish-speaking demographic. I believe there are a lot of potential customers who do not have access to content as it is not in Spanish. … I know that Netflix is choosing to ignore this demographic as they do not see the return on their investment."
- "With over 90 million homes in the U.S., I can see a large potential of nearly 10 million Spanish-speaking subs, which could be targeted. Out of those 10 million, about 30% will have the access to devices and broadband which will connect them to Netflix, so I could safely say that there are 3 million [potential] subs which are not being targeted."
- "Their subscribers are [already] very price-sensitive, so targeting lower-income is not their mindset. Their goal in the U.S. is to keep the subscribers they have by growing their content library and not increasing the cost."

> **Consumers are very price-sensitive and have become accustomed to spending no more than $7.99 a month for unlimited content viewing. This is the magic number that could be pushed down only by the biggy of bigs, Amazon. I've heard they could be offering their prime services for $6.99 per month as another option to the $79 annually.**
>
> *Digital Media Executive*
> *Major U.S. Broadcaster*

Individual Profiles

- "Personal profiles will save many customers for Netflix. This allows their algorithm to take full effect, as the content viewing is not colluded with multiple viewers. This also allows families to create kid-friendly profiles."
- "Netflix had a major conundrum a few years ago when they increased pricing and split the DVD and [streaming] subscriptions. They lost nearly 50% of their subs."

Mobile

- "Mobile will be kept the same as all of their other offerings. They have no intention of changing one of the user interfaces without changing the other. Subscribers like to see consistency within all devices. One focus they could have will be utilizing [Google's] Chromecast and products like it where the mobile device will act as the remote control and you can flip content onto the TV. This will change the user interface as the remote control will have a different application. But for those who using Wi-Fi to connect to Netflix, the UI will remain the same."

- "Mobile viewing is close to 20% of viewers. The strongest device [for watching Netflix] is the PC, followed by [game consoles such as Sony Corp.'s/TYO:6758/SNE] PS3, then mobile."
- "Smartphones do play a major role in viewers, but this will change with the technology from Chromecast and other set-top boxes coming out. Mobile devices are not ideal for viewing. Laptops and [game consoles] offer a much stronger viewing experience."

Digital Content Rights

- "Everything is focused on exclusivity rights. It is a race to set up contracts to negotiate exclusivity rights to maintain customers."
- "Consumers are very price-sensitive and have become accustomed to spending no more than $7.99 a month for unlimited content viewing. This is the magic number that could be pushed down only by the biggy of bigs, Amazon. I've heard they could be offering their prime services for $6.99 per month as another option to the $79 annually."
- "There are only a few major players in the SVOD service: Amazon, Netflix, Hulu. These are the big guys with the deep pockets, which all content providers know. They butter their bread. I think this will change as we see [subscription-based streaming] changing to more transactional [pay-per-view] services."

3. Programming director for a family TV network; repeat source

This source is skeptical of Netflix's interest in targeting lower-income homes because of Internet access issues, but thinks Netflix is successfully expanding in the age spectrum. Adding incremental per-person charges on top of monthly subscriptions unnecessarily complicates the fee structure. Trends in prices for digital content rights vary depending on the content, with sports among the highest in demand.

Demographic Trends

- "Our demographic is skewed towards women and the younger generation, but we're trying to expand our demographics to extend to the male audience."
- "[Netflix is] definitely making a penetration across the age range."
- "I don't know if they can successfully go after the lower-income audience because that demographic comes with their own issues. For example, they may not have access to the Internet."
- "I don't think that's the right approach, skewing toward lower economics."

Individual Profiles

- "They already have a pretty neat feature with their recommendations based on current viewership. I don't think the new personal profiles will be adding much to their offerings."
- "Some people won't care [about incremental charges]. Other people will be dropping out and losing interest because of [per-person subscriptions], because they prefer to pay one household charge."

Mobile

- "We have an application for Android and iOS, but it's a free app. We don't have the base to even think about charging for our content yet."
- "It's just too early for mobile engagement. I'd say the breakdown is about 70/30 between TV and tablet [viewing]."
- "It'll still be a long while before the smartphone will reap the benefits from the content viewing market."

Digital Content Rights

- "[Digital content rights] are demand-driven. If you have something that people want, you can charge more for it."
- "Prices might be going up, but it's all market-driven."
- "Yes, maybe people are overestimating price inflation. But it all depends on the content provider."
- "Content like sports will always be constant and will always have an audience and will push prices upwards."

4. Executive producer for a TV production company

Targeting lower-income homes does not make much sense for Netflix. A more productive strategy is to develop content that can appeal to broader audiences. The source cited value in per-person profiles but said increased fees are a red flag. TV producers are not seeing higher revenue, even as they are asked to deliver more digital content along with their shows. Mobile viewership will rise faster internationally than in the United States.

Demographic Trends

- "What I'm seeing is the further shrinking of network bulls eye, particularly in cable. In cable, there is such a proliferation of channels with such diverse distributions, they are all doing their damnedest to distinguish themselves from competitors, even between networks under the same umbrella."
- "[Netflix] might be able to target the lower-income demographics for people who are in their 40s, 50s, 60s. If you are targeting people in their 30s, I don't know why you would want to migrate lower."
- "Why do you target a demo that is only making $30,000 a year? What's the purpose of targeting them?"
- "The new trend is 'co-viewing.' I've heard that word used more in the last year than in the last 10 years. It is where you produce a show [on a station] that predominantly [appeals to] males, but now it appeals to a husband and wife or even father and son."

> **The new trend is 'co-viewing.' … where you produce a show [on a station] that predominantly [appeals to] males, but now it appeals to a husband and wife or even father and son.**
>
> *Executive Producer*
> *TV Production Company*

Individual Profiles

- "It's about time they do [personal profiles]. It's based on empirical data, and we love it in our house. A lot of homes in Netflix have multiple users. Instead of me getting a bunch of SpongeBob shows on my list, it will go to my kid."
- "Netflix has had an interesting history related to their fees. The stock was flying high, and then they realized DVDs were a dying business. They now offer DVD, instant online and the combination of the two. When prices went up, everyone abandoned it, and now they slowly built themselves back up. A company like that should be very wise before they do anything with their price structure because … there is no contract with Netflix; people can cancel tomorrow."

Mobile

- "In the world of mobile, the younger you are, the more apt you are to watch content on a mobile devices. For most older folks, they tend not to watch content on mobile devices or even on the computer."
- "I firmly believe that you are going to see mobile penetration at a far greater penetration in foreign markets than in the U.S. We don't lack for space in America. In America, your TV size is a status symbol."

Digital Content Rights

- "It's the latest thing that content providers are arguing with cable and satellite companies and networks over."
- "Prices are, unfortunately, not going up. Now we're not only asked to deliver TV shows but also provide digital assets in all sorts of forms such as 'how-to' or photo galleries."
- "Netflix is responsible for driving prices of scripted goods up."

3) CONTENT DELIVERY EXECUTIVES

Three of four sources said personalized services like Netflix's individual profiles are important and valuable in competing for subscribers, but all four sources agree that charging higher fees for such features through per-person subscriptions is an unlikely strategy for Netflix. None of the sources cited evidence of Netflix successfully penetrating lower-income homes, but three see opportunities to do so based on Netflix's original programming, the improved video compression technology, and the growing use of mobile devices for watching shows and movies. Three sources believe prices for digital content rights will continue to rise for Netflix because of competition from Apple Inc. (AAPL), Amazon, Hulu and others.

KEY SILO FINDINGS

Demographic Trends

- 4 of 4: No sign of success yet for Netflix expanding into lower-income homes.
- 3: But it has the opportunity to reach these subscribers.

Individual Profiles

- 4: Unlikely strategy.

- 1: Some might be willing to pay extra for personal profiles, but Netflix may be gun-shy about adjusting pricing.

Mobile

- 1: The viewing of shows and movies on mobile devices may be growing in Asia.
- 2: Will grow in the U.S. as 4G spreads and device screens improve.

Digital Content Rights

- 3: Competition for content is high enough that prices will continue to rise.
- 1: Netflix is in a stronger bargaining position than ever.

1. Communications executive for an entertainment hardware developer; repeat source

Individual profiles within a household could have enough value for Netflix to charge an extra $1 to $2 per person, but such a change to its pricing model risks a repeat of its Qwikster disaster. Families are a good demographic target for Netflix because of its children's programming, as are younger adults with less disposable income who may be attracted to its original content and low price. Apple, Amazon and Hulu represent fierce competition for digital content, which will keep content prices rising, but Netflix is in a much stronger negotiating position for those rights than it used to be because of its subscriber base.

Demographic Trends

- "The original content piece for them could really grow their market considerably and could appeal to the cable-cutter, the hipster, the younger demographic that's looking for really good content but not willing to pay a lot for it. That same group that doesn't subscribe to cable but has their parents' HBO Go account and can watch all that great content on their tablet via the HBO Go app. That same demographic—20s to early 30s, single or no kids—is ripe for Netflix [to target] with original content."
- "On the original content side of things, they really are becoming more and more like an HBO. There's still a long ways to go in that direction, but they are clearly having some success with original programming. I don't know that it's drawing enough new subscribers at the current pace to offset the cost of that original programming, but there is content that's bringing new subscribers in because it can only be found on Netflix."
- "It was a huge, huge moment for them, maybe a stepping stone moment, with *House of Cards* getting recognized for an Emmy. You saw a huge slew of advertising in the week following that, where they were focusing on their original content. HBO is really in their sights in that regard from a content perspective."
- "For a long time, Netflix was known as the back-catalog service, the kids' service, the service that made the back catalog valuable. That's changed a lot. It's really perceived now as a service that has a combination of old and new but also premium content."

> **The original content piece for them could really grow their market considerably and could appeal to the cable-cutter, the hipster, the younger demographic that's looking for really good content but not willing to pay a lot for it.**
>
> *Communications Executive*
> *Entertainment Hardware Developer*

- "On the higher end, it's going to be tough from the family perspective because they don't have the new-release movies right away, but I do think that families with young children is an area that's ripe for them."
- "Families are a pretty good target. You look at a Netflix subscription for $8 a month, combined with a Roku [streaming player] at $50, combined with the children's catalog that's available. Kids never get tired of watching the same thing over and over again. That demographic could work pretty well for them."
- "The fact that they're getting all the catch-up TV stuff is also big for them. Netflix is becoming a hot spot for people who've heard about *Breaking Bad*, for example. They know it's the last season and Netflix has every single episode. … The whole idea of binge viewing has been such an interesting phenomenon."
- "From a technology perspective and being able to build the back end to support subscriber growth, I don't think they have any limitations there. I think they've figured out how to do that. They've gone from the tens of millions into the 20s of millions [subscribers] in the last year-and-a-half or so without a really serious glitch. They've been free of any failures on the back end."

Individual Profiles

- "Given some of the challenges they had when they last tried to adjust pricing, they're going to have really take their time and think about [additional fees]. They don't want the same kind of blowback, the same kind of dust-up, that they had when they tried to break off DVDs, raise prices and create Qwikster."
- "I would guess that the vast majority of their customers are in that $7.99 per month, streaming-only pricing plan, so they do need to generate other revenue. They need to generate revenue to pay for content licensing as well as content creating."
- "It wouldn't surprise me [if Netflix added an incremental per-person fee], but they have to be really careful about it. One of the challenges is, how do you release individual profiles at the current cost structure and then charge more for it after the fact? Maybe they could do it just for new customers."
- "If they can show value with these profiles, in terms of convenience as well as discovery and personalization and content engine recognition, then it might be worth an extra buck or two a month to separate accounts. There is value in separation if it's very, very easy to do."

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>
> *Communications Executive*
> *Entertainment Hardware Developer*

Mobile

- "I see improved broadband, 3G moving to 4G LTE, more ubiquitous Wi-Fi—faster speeds and in more public places—and also screen resolutions on smartphones and tablets as being really key factors in the expansion of video streaming in general."
- "Smartphones and tablets have paved the way for more OTT consumption because they are very personal devices. A computer is perceived as more of a business device and certainly isn't as portable. … Because 4G has become more ubiquitous and screens have become a lot better, it's very easy for people to enjoy content wherever they are."
- "One of the reasons video consumption on mobile devices has increased is that the cable, satellite and telcos are catching up on the technology side. Look at DISH [Network Corp./DISH] and the technology that's built into the Hopper—the ability to deliver content both streaming over Wi-Fi and cellular networks as well as delivering content from a DVR, transferring it to an iPad for watching it offline. That is very compelling to a consumer."
- "Having the large MSOs, telcos and satellite companies promoting over-the-top or Internet-delivered content is beneficial to the entire market because they have customer bases—14 million here, 20 to 25 million there. The OTT services are getting free marketing because the installed base [of pay-TV subscribers] is getting an education into what options are available."
- "One of the things Netflix is doing now that has a lot of promise, but also a lot of challenges, is striking a deal with Virgin to put the service onto a cable box. Until now, the only set-top box you saw Netflix on was TiVo [Inc./TIVO], and that's a retail product. This is a true, integrated MSO solution that gets sent out to all the customers. That is a pretty big development."
- "Can Netflix replicate that in the U.S. markets? Will there be willingness from Time Warner or Comcast [Corp./CMCSA] to put Netflix on their system? The upside is it could make the cable service more sticky, make customers happier by having a combination of linear and a really great over-the-top service."
- "The MSOs have to decide [if putting Netflix on their set-top boxes] is going to cannibalize Streampix or whatever I'm offering through VOD, and does that outweigh the upside of my customer maybe staying on for another two years. Each cable operator will have to make that decision."

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Digital Content Rights

- "There is [going to be competition for digital content rights]. Amazon did that exclusive deal with *Under the Dome*, where they had exclusive streaming rights to come out every Friday after the Monday airing on CBS [Corp./CBS]. That was a new twist on premium content that's also timely."
- "If you look back at the original Starz [STRZA] deal that Netflix struck, it was obviously a very good deal for Netflix—so good that Starz wanted nothing to do with Netflix when it was time to re-up. I think Starz felt like they could

basically develop their own over-the-top channel and monetize their content better. I would argue they have not been very successful in doing that."

- "In that same timeframe, Netflix went from 10 million to 28 million subscribers. Netflix is now as viable, if not more viable, as an outlet for that content from the major studios. They sit on the same level now as Time Warner Cable, Comcast, DirecTV [DTV], DISH, AT&T [Inc./T] and Verizon [Communications Inc./VZ] as important distribution channels for that content. Netflix is in a much, much better bargaining and leverage position than they were several years ago."
- "The thing that Netflix has over its competition is that they have the broadest number of paying subscribers. But Amazon, Apple and even Hulu clearly have deep pockets and have the ability to negotiate exclusive deals and, in Amazon's case, add value for consumers to something they're already paying for, the Prime membership."
- "There will be continued jockeying for exclusive content, whether that's [new-release] content or back catalog so the library is robust. Netflix doesn't really talk about their library of streaming content anymore. They don't put a number on it anymore. They don't feel they need to. They feel very secure in that regard."

2. Business development executive for an online distributor of movie and TV promos

Netflix is expanding into an older viewing demographic and also growing subscriptions via its children's content programming. Viewing through a tablet is definitely growing, but cell phone use for long-form content still is lagging. The source has seen no direct evidence of Netflix making a significant reach into lower-income homes, and said Netflix will not use its new individual profiles as a way to raise fees.

Demographic Trends

- "What everybody is seeing across the board is where [streamed content] used to skew heavily to a young demographic—18 to 24, maybe 18 to 34—we're seeing a much larger demo of say 18 to 54, and male and female pretty much evenly split. It still trends toward 18 to 34, but the growth has been in 34 to 54."
- "Everybody sees the need for children's programming. It's the parents who want easy access to children's programming. It's what drove Netflix to do the deal with [The Walt] Disney [Co./DIS] and Amazon to drive the deal with [Viacom Inc.'s/VIA] Nickelodeon. As a parent myself, buying 20 DVDs that the kids are going to watch 10 times, it just makes more sense to have this on instant and be able to call it up whenever. We're definitely seeing [our content provider] clients expanding their catalogs in that area."
- "The original content plays that all the [OTT players] are doing in the subscription models. This is what HBO did in the 1980s. It's what they're all now doing to differentiate themselves. Netflix won't release the viewership numbers for their original content, but they're clearly using [*House of Cards* and other shows] to bring more interest to their particular service, to make them noticeable over the networks."

> **Netflix has incredible data. We see exactly how many people are playing what trailer [for their content] at any given time, from what region down to the city level. [Netflix is] seeing all this [data] and they're not making movies, which is a big tell.**
>
> *Business Development Executive*
> *Online Movie & TV Promos Distributor*

Individual Profiles

- "I have set up separate profiles for my Netflix subscription for my children and my wife. It's a great feature and one which you're seeing on a lot of the recommendation engines—Digitalsmiths, Jinni, The Filter. … Are they able to monetize that? I think it's a stretch. If you make it like a Chinese menu, I don't think people are going to go for it."

Mobile

- "Mobile is not where people want to watch long-form content, at least with the smaller [cell phone] screens. It's just been growing and growing on tablets, and connected TVs are ultimately how people would like to view if it's convenient to them. … That's the real Netflix strategy: to be on everything, every device. It's worked for them very well, and we're seeing a lot of companies trying to play catch-up to that strategy."

Digital Content Rights

- "The main concern for content providers is to ensure healthy competition. The less competition, the worse it is for them. … Is there room for a lot more competition? I don't think so."

- "We're carving out the promotion of TV content, not only prior to air date but working with interactive program guides, in conjunction with companies like Rovi [Corp./ROVI]. But the networks seem to be shortsighted in this area, and the rights aren't altogether clear in the aftermarket."
- "We're watching the YouTube [Google Inc./GOOG] content from the TV networks for promoting an upcoming airing series go down the day after it aired. Where is the aftermarket [for TV]? Who controls it? It's something we're working on with the studios right now, and we're seeing a lot of different business models for it."
- "What we're evangelizing is the need for [movie and TV studios] to promote their TV series [beyond just promoting the episode that is about to air for the first time]. Look at *Downton Abbey*: On PBS, the ratings for season 1 and 2 weren't so great. Then it got dropped onto Netflix and season 3 took off. It was one of the highest-rated shows in PBS history. Same thing for *Breaking Bad*. The audience that grew out of the Netflix binge viewing meant that the audience went from 1 million on the pilot to 10 million for the finale, and it will go up again after the [latest Nielsen Holding N.V./NLSN numbers]. I think you're going to see more trends like this."
- "We wish the TV networks used their promos like the studios use trailers, to tune in and drive aftermarket, but they're all over the place right now."
- "Netflix has incredible data. We see exactly how many people are playing what trailer [for their content] at any given time, from what region down to the city level. [Netflix is] seeing all this [data] and they're not making movies, which is a big tell. A report released by Netflix said that over 50% of the content watched by Netflix customers is TV content. This is driving MSOs to have that catch-up TV available. Now Nielsen is tracking [ads being watched up to seven days after they originally air]."

3. SVP for a Asian VOD platform

Offering more personalized services will be a key for OTT providers and is an area where Netflix has an advantage over competitors. However, Netflix will have difficulty in charging per-person fees for those individualized features because any subscription rate over $8 per month will be challenging to sustain. Prices for digital content rights will continue to rise, and Netflix will need to step up for better content to stay on top of the competition. TV and movie watching on mobile devices is on the rise in Asia and should trickle into the United States, which eventually will help Netflix and other distributors target lower-income audiences.

Demographic Trends

- "There is the opportunity to grow subscribers every five years, for sure. I think they're going after the niche content plays that do draw in the extra subscribers."
- "They have amazing kid [content] options, and their kids' service is phenomenal."
- "They've done a fabulous job switching from the DVD by mail model to converting online. On their online platform, they're doing a great job dominating as far as content. The beautiful thing to someone that's worked for the cable industry for a long time in the U.S. is that more and more people are looking at Netflix to reduce their overall spend for entertainment in the home."
- "People are looking at reducing their costs by over 50% through cord cutting, and that cost savings is something that permeates all demographics. If I'm not a consumer of sports or live content, I can just go to Netflix. … Certain Netflix consumers that consume only over the Internet tell their friends and it spreads. They binge-watch on Netflix and save money every month. The pitch is that what used to cost $100 on TV is now only $20."
- "It's still not easy to hook up Netflix to your television. It's comparable to the difficulties that satellite systems had 20 years ago, to affix the satellite over their roof."
- "One interesting thing about Netflix is that in some homes it's viewed as a complementary service with current cable consumers, current satellite consumers and current groups that receive their content through AT&T and Verizon. Other people view it as a sole entertainment option."

Individual Profiles

- "It's going to be hard to raise prices above the $8 a month, but I think the future of entertainment consumption is how do you get to more personalized recommendations and understand who's watching and what they're watching. Netflix is catering more to more to their audience, and

> **The competition has figured out that exclusive content rights are huge. Netflix is going have to step up and pay exclusive money; otherwise, they will start losing out on content.**
>
> *SVP, Asian VOD Platform*

that's an inherent advantage they have."

Mobile

- "We're seeing more and more people start to consume content over their phones. There are some things taking place in China that will come to the U.S. and other parts of the world. You're seeing the larger-size mobile phones make a breakthrough right now. Just walking around China this year, there were phones that are larger than what you see in the U.S. that are half tablet and half phone. It lends itself to media consumption more easily with the slightly larger screen."
- "Two or three years ago, no one was watching any videos on their mobile phones. The challenge for mobile phones is that not a lot of people want to watch on such small screens and the content needs to be short. The beauty is that they now have these 20-minute comedies."
- "The breakdown of consumption [of OTT content] is about 60% is viewed on video game consoles or devices connected to a TV. The other 40% is on mobile devices [with the majority on tablets]."

Digital Content Rights

- "Netflix somewhat snuck up on the industry and was able to do some deals where all the studio partners thought the money from Netflix was just gravy; that perspective from Hollywood has changed."
- "[The industry] looked at Netflix in a whole new light where the rates that Netflix is going to have to pay are going to be competitive to what the market is going to pay. The content rights are going to be more and more expensive for Netflix, and they have to play a little bit smarter."
- "The competition has figured out that exclusive content rights are huge. Netflix is going have to step up and pay exclusive money; otherwise, they will start losing out on content."
- "Certainly rights are going to continue to increase. But the beauty behind Netflix is they have a huge installed base, so their ability to amortize their cost across a huge subscriber base helps in everything they do."

4. Marketing VP for a developer of video processing solutions; repeat source

Netflix's new individual profiles seem better suited for targeted advertising rather than per-person subscriptions. New compression technology will improve video quality, which could help Netflix move into lower-income homes with slower Internet connections. Netflix's best chance to increase its subscriber base is to add live programming.

Demographic Trends

- "Some of the deals Netflix is making with pay TV operators have the potential to bring them forward with an older demographic. The recent deal with Virgin, for instance."
- "An enabling video technology like HEVC [high efficiency video coding] has the potential to have them move down market into households with lower-speed Internet connections."
- "Adoption of HEVC will be one of the biggest factors over the next five years [in improving streaming video quality]. It allows for 50% reduction of bit rate at equivalent levels of quality. It will enable HD at 2.5 Mbps and 4K Ultra HD at under 15 Mbps."
- "There are two main drivers for HEVC at this point: One is the desire by satellite operators to differentiate with 4K, as they did with HD/H.264 almost a decade ago. The second is the desire by OTT and TV Everywhere operators to reduce delivery costs, which are most often charged by the bit."
- "Once a big satellite operator or a large OTT/TV Everywhere player adopts HEVC, the market will follow quite quickly. I see this starting mid-2014."
- "The only barrier that is very evident today is the availability of real-time encoding for 4K HEVC, but we're about to solve this. Many people say we're waiting for decoders, but software-based players are fine for the OTT/TV Everywhere market, and they don't burn through batteries as much as people believed. I think HEVC will be dominant in OTT/TV Everywhere within four years."
- "An evolution to live applications would be the best opportunity for expansion for Netflix as it will put them in a position to have a full offering."

> **An enabling video technology like HEVC [high efficiency video coding] has the potential to have them move down market into households with lower-speed Internet connections.**
>
> *Marketing VP*
> *Video Processing Solutions Developer*

Individual Profiles

- "I'm not sure [about per-person subscriptions]. I'm wondering if [Netflix's new individual profiles] might open the opportunity for an ad model vs. a subscription model as the advertising could be a lot more targeted and would allow Netflix to go for the most price-conscious."

Mobile

- N/A

Digital Content Rights

- "[Prices for digital content rights are headed] up because the future is on the digital side. And there are many more outlets for digital rights, especially when you look at all the mechanisms for slicing and dicing content in a digital world. The old world of four to five content windows was much more constrained than what is possible with digital."
- "[Netflix is being helped by] the rising cost of pay TV; the availability of apps on smart TVs, which is conditioning customers; higher bandwidths into the home; and natural generational shifts that evolve technology adoption."
- "Apps are really standard on smartphones and tablets, but on TVs it's still an outlier. Smart TVs are helping customers get used to an app environment on a larger screen. … Over time, as usability increases, the model will become more mainstream."

> **An evolution to live applications would be the best opportunity for expansion for Netflix as it will put them in a position to have a full offering.**
>
> *Marketing VP*
> *Video Processing Solutions Developer*

4) PAY-TV PROVIDERS

These two sources believe Netflix will face difficulty in expanding into lower-income homes, with one citing slow broadband connections as a barrier. The other source thinks premium content, such as recently released blockbuster films, would be needed for Netflix to penetrate such households. Also, consumers will not see enough value in Netflix's individual profiles to pay extra through per-person subscriptions, according to one source. Mobile viewing remains difficult but should improve as 4G networks become more common in two to three years. Programming costs for cable operators are rising almost 10% per year, while content-rights prices for digital distributors like Netflix also are trending up.

KEY SILO FINDINGS

Demographic Trends

- 1 of 2: Seeing subscriber growth across all demographic sectors.
- 1: Netflix must have blockbuster content to attract lower-income subscribers and cord-cutters.

Individual Profiles

- 1: Consumers will not be willing to pay extra for personal profiles.

Mobile

- 1: Mobile viewing will improve as 4G networks expand.

Digital Content Rights

- 1: Programming costs are rising in the high single digits.
- 1: Studios are going to withhold more content from Netflix and other digital distributors.

1. Business development executive for an Internet and cable TV provider in the United Kingdom

Netflix has the opportunity to expand into lower-income homes but not to charge additional fees for individual profiles. Lower-income subscribers will be more interested in premium, blockbuster-type content, than in additional features like individual profiles. Such customers also are less interested in having to search for content, preferring to watch shows and movies that are directed at them. Mobile penetration is constrained by issues with video quality, but that should change as 4G becomes more widespread in the next two to three years. Prices for content are rising, and studios are likely to start holding back more new-release content.

Demographic Trends

- “There is potential [to reach lower-income homes]. However, I think a lot of that potential lies in [offering lower-income consumers newer releases].”
- “Where Netflix has been particularly successful is making the service available on multiple devices, and that’s where you’d arguably reach the higher demographic, because they have access to tablets. However, if you’re going to appeal to a wider audience, it needs to be as simple as possible, and it shouldn’t have to be difficult to look for what you want. I think there’s a large demographic that just consume content because it’s directed at them. They don’t want to actually go and have to find it.”
- “It’s still slightly premature in terms of cord cutting, but I think that’s really the area where Netflix sees an opportunity to go after a lower-income demographic. There are two spheres here: One is where the cost of having a broad range of premium content is untenable, and customers are churning down. Netflix is appealing to a much wider demographic because they can afford it. Secondly, if there’s a very clear-cut cost of what the customer is getting, and they understand what they’re getting, then there’s an opportunity there. I think one of the biggest challenges is you have to have a wide enough range of first-pay content—or equivalent first-pay content—for customers to understand that they’re getting something and benefiting from it.”

Individual Profiles

- “[Individual profiles are] valuable to you as the provider—whether it’s as a provider of service or provider of content. But spinning that back the other way to the customer, they don’t see the value of it. If anything, they’re suspicious of it. The idea that they’re being profiled or tailored to often makes them feel as if they’re missing out on something. They would rather have the ability to not choose, or not consider things. It needs to be simplistic. And I think navigation is often the simplest way to gain that customer.”
- “There is potential [to expand into a lower-income demographic], but I don’t think it’s around the price point. Once you make the service available and it’s being consumed, there’s an element of ‘can’t be bothered to switch off my subscription’ if it’s at a low enough price point.”
- “There’s a certain demographic that likes the fact that they can go find movies because it’s by a specific actor or director, or comparable to things they have an interest in, or because it’s an independent film. But they are niche, and are not the majority of the consumers at this point in time. Right now the purchasing power is still with a slightly older demographic, particularly in light of recent economic conditions. While the demographic that can consume over multiple devices and looks at very specific content are able to do so, they don’t necessarily have the purchasing power to do so.”

> **The biggest change that we’re likely to see happen is that a lot of studios are going to start to hold back content. … [This] is a big reason behind the move by Netflix and others to make original content. It’s a relatively smart move from Netflix’s perspective, but it’s not cheap.**
>
> *Business Development Executive*
> *UK Internet & Cable TV Provider*

Mobile

- “One of the biggest challenges you have is what we call ‘TV quality standard.’ It means that while I’m watching something, it won’t keep buffering, that it’s a good viewing experience. It has a lot of bearing on the perception of the product and the experience.”
- “If you’re watching on mobile, you’ll often get buffering, freezing and other quality issues. All those things affect the ability to increase content availability on mobile.”
- “In Europe, tablets are considered the main form of mobile consumption, rather than a mobile phone, because the mobile platforms aren’t very robust. By contrast in Japan, they have very dedicated, robust spectrums that are solely there to provide content consumption.”

Digital Content Rights

- “Prices for content will push up.”
- “The biggest change that we’re likely to see happen is that a lot of studios are going to start to hold back content. Content providers, chiefly the studios, are starting to realize that if they are working with a Netflix or [Amazon.com Inc.’s/AMZN] LOVEFiLM, and that provider does independent deals with service providers such as Sky [British Sky Broadcasting Group PLC/LON:BSY/BSYBY] or British Telecom [BT Group PLC/LON:BT.A/BT], then the studio has lost several relationships in the marketplace. And [studios’ move to withhold content as well as to institute price increases] is a big reason behind the move by Netflix and others to make original content. It’s a relatively smart move from Netflix’s perspective, but it’s not cheap.”

2. Operations director for a small cable operator in the Southeast

Netflix will have trouble penetrating lower-income households, which may not have fast enough Internet connections. Pricing for both linear and streaming content continues to increase in the high single digits every year and will continue to do so until the industry shifts to an a la carte delivery model. This source's cable system is seeing subscriber growth in the high single digits year to year across all demographic sectors.

Demographic Trends

- "On broadband growth and Internet, we see growth in the high single digits year over year."
- "Netflix usage is pretty high across most demographic groups, but for the 60-and-over age group, they are least highly penetrated. That group is just more inclined to watch linear TV."
- "Targeting the lower-income demographics would be a challenge given the fact that those people may not have a broadband data connection that supports the platform. And as I understand it, Netflix is trying to get away from DVD deliveries in the future."
- "It would be hard to quantify the growth because there are risks and factors involved [with lower-income households]. Netflix relies on having customers that have adequate broadband connections in order to have effective delivery."

Individual Profiles

- N/A

Mobile

- N/A

Digital Content Rights

- "[Prices for] both linear and digital rights are going up every year in the high single digits."
- "I don't think [prices are] a bidder-driven issue. I believe it's a content-driven issue. Until the industry shifts to an a la carte online delivery system, it will continue to be a content holder-driven issue."
- "The cost of digital content far exceeds current inflation levels."

5) INDUSTRY SPECIALISTS

Four of five sources are skeptical that Netflix would try to add per-person subscription fees or could have success with it, based on its past difficulties with pricing changes and consumers' focus on content quality rather than features like individual profiles. Three sources see at least some opportunity for Netflix to penetrate lower-income homes, with one suggesting a free, ad-supported model as the best route. Both sources who commented on the cost of digital content agreed that prices will continue to rise in the mid-single digits. Two sources said original content is a key to Netflix's subscriber growth.

KEY SILO FINDINGS

Demographic Trends

- 3 of 5: Netflix can expand its reach into lower-income homes.
- 1: A free, ad-supported service might be attractive to cost-conscious subscribers.

Individual Profiles

- 4: Per-person fees are an unlikely tact for Netflix to pursue.
- 2: Content quality is more important than individual profiles.

Mobile

- 1: Mobile use is constrained by device battery life.

Digital Content Rights

- 2: Prices will rise 5%–8%.

1. President of a consulting firm to cable and Internet providers; repeat source

This source doubts Netflix will consider per-person subscriptions or additional fees. Rather, it will focus on making its service the most convenient and easiest to use to separate itself from the growing pack of competitors. Lower-income homes are not a great target for Netflix as those consumers are unlikely to be willing to give up live sports or hit programming. Netflix's route to subscriber expansion is in a superior recommendation engine, exclusive deals for attractive content like children's shows, and original programming.

Demographic Trends

- "They're not a good deal for lower-income homes. The lower-income family wants the sports like anyone else. Netflix is a very limited product. Netflix is old programs and old movies."
- "Content deals are being made that are exclusive. Netflix, I think, is very bright, very smart in going after children's programming. … A significant portion of their viewership is this long-form morning usage. That's parents plunking their kids down in front of the TV set."

Individual Profiles

- "You've got two tracks running. One is the library availability, which could just as easily be a cloud DVR. That's what Netflix is: a cloud DVR. It just has prerecorded a whole lot of library content. The other track is original programming. They're the same tracks everybody else is going to be using. There are a limited number of options here. … Who can do it best? How do you make it easy to use?"
- "Netflix came out of the gate with recommendation engines that were better than anybody else's. That's what Netflix was known for. That's why people liked them. At the time, Netflix spent a lot of time on categorizing [movies] and recommendation engines because all they had was DVDs that they were mailing."
- "If you look at Hulu, Vudu or Amazon, they all have the same delivery system and the same IP-based recommendation capabilities. At the same time, the cable guys … didn't have IP capability. But the new stuff the cable guys are putting in does."
- "Look at Comcast's X2; it puts Netflix to shame. They're not charging more for that. They're competing based on that. That's where the competition is going to go. We can make this easier for the consumer to use, you can use it on any device, you can choose the stuff you want to watch, when you want to watch it. You can set up a queue, you can block your kids. The issue there, I think, is all of them are going to be able to do that relatively quickly. The benefit that Netflix is that the cable guy has to deliver all of the hardware for people to do this. Netflix relies on people to buy an iPad for $700 and then you can watch on your iPad, which Netflix didn't pay for."
- "If [cable operators] can divert the cost of the navigation in part to the consumer, which is what Netflix did all along, then they can compete on that basis. Netflix is going to experience a lot more competition in the areas that it had achieved a great first-mover advantage. A great example was TiVo. They had a great system, but their problem was they had to build it into set-top boxes. What happens when the prime part of your audience already has the box?"
- "Netflix was successful in the DVD era because it took advantage of the technology and then got a deal with the Post Office, which allowed it to distribute more cheaply and more efficiently than others. It now can distribute more efficiently with broadband, especially since it's getting a deal. It doesn't pay for the infrastructure. How long that will last is a totally different question."
- "[Structural changes] will take the form of either a two-sided market, which is what the courts are looking at right now in the Verizon case, or it will take the form of usage-based pricing for broadband. Actually, it will probably be both. One way or another, people are going to have to pay for the cost of delivery. Right now, they're not. Netflix in particular is not. At some point, that's going to happen. I would say it probably will start becoming significant in two to three years, and ubiquitous in five years."
- "Netflix does not compete with broadband and it does not compete with cable. Netflix competes with HBO. Netflix is a program distributor. Their motto years ago was to do it faster than HBO did. Their biggest problem now is there are competitors entering the marketplace in the same distribution mode they are."

> **I'm not saying they're wrong in entering into the competitive market of exclusive video product; they're right. And I'm not saying they're wrong in creating their own video product; they're right. But it's a very expensive and very difficult road.**
>
> *President*
> *Cable & Internet Providers Consultancy*

- "They also created original programming, which is the HBO model. *House of Cards* was very successful. But I'm willing to bet you can't name any of the other 10 they have financed. I'm not saying they're wrong in entering into the competitive market of exclusive video product; they're right. And I'm not saying they're wrong in creating their own video product; they're right. But it's a very expensive and very difficult road."
- "[Netflix is] improving their service by improving their recommendation engines. They are offering a product that they know people want. That's why they're trying to get exclusive deals and focusing on children's programming. They're hoping they can have more hits like *House of Cards*. The rest of this stuff is just not that sticky."
- "The technology is in the process of change, and I think the program-producing companies are going to be able to sell directly. … They'll be able to control their own subscriber list and the technology is moving fast enough and the ISPs are improving. You'll be able to go from HBO, Showtime or wherever you want and pay directly without a transaction fee to the intermediary. Why do you need Netflix? Look at the Roku model: design the technology so people can go directly to the channels they want."

Mobile

- "There's a question of whether success will destroy Netflix. The more people that use over-the-top, the harder it will be for OTT to really work. The Internet is just not built for this. [Better video compression technologies] will help, but Netflix only has one-third of the subscribers of HBO and already represents 30-odd percent of broadband usage."

Digital Content Rights

- "The top [content producers] are going to be bid for. We've got HBO, Showtime and the usual suspects. … Then you have Netflix … and then add Hulu and Amazon Instant. … The net result is you have a model that inevitably means [prices are going] up."

2. President of a digital distribution consulting firm; repeat source

Netflix can grow its penetration into lower-income homes. Per-person subscriptions might be attractive in households that can afford the incremental charges because of the ease in personalization. Current mobile growth will by stymied by device battery life, but usage will grow for short-form content. Netflix is responsible for driving content prices up, but is starting to devote more money and resources toward original content. Digital content prices should grow in the mid-single digits over the next year.

Demographic Trends

- "There is definitely room for growth through targeting the lower-income demographic."

Individual Profiles

- "Having new personal profiles and per-person subscriptions would work great for higher-income households, but I don't think it would work for lower-income households."
- "For the higher-income families, it becomes easier because it doesn't increase your content selections at all and it just makes life easier. So in my case, I don't have to dig through my son's wish list to get to mine."

Mobile

- "[I think about] 60% to 70% [of viewers] watch content on their TV and about 10% on smartphones."
- "Battery life needs to be better for people to [watch video] on their smartphones. … A tablet is a different story because it has a bigger screen. But for short-form content, the phone will continue to see growth."

Digital Content Rights

- "The prices just keep going up."
- "Netflix is driving up the prices."
- "It's a seller's market for content, so the sellers are taking advantage of that, making the most money they can. That's not necessarily a bad thing, but that doesn't last forever. In fact, we're seeing changes in that because Netflix is buying less content and being more selective about the content that they are buying than in the past. They're putting more money and resources into their original content."
- "Cost of content for companies like Netflix or Amazon will continue to increase. Over the next 12 months, I see it growing in mid-single digits."

3. CEO for a provider of video analytics for marketing firms

Netflix charging more for features like individual profiles is unlikely because consumers only see value in content. If Netflix wants to go after lower-income homes, a more intelligent revenue stream would be to offer a free service supported by advertising. Netflix's original content will add some subscribers, but advertising offers bigger possibilities.

Demographic Trends

- "The first data point to consider is that the lower-income demographic is absolutely on the Internet in this country. That includes desktop and mobile and even tablet. Tablets are higher income, but a smartphone is not expensive anymore."
- "Netflix creating its own original content. So then how do you monetize that original content? You make it free to lower-income folks who don't want to pay for it and start to sell advertising—doing the opposite of what a lot of these companies did, the Pandoras of the world, which let people test the product to see if they like it with ads for free and then roll out the subscription fee. I think Netflix is backing into that same strategy, but in reverse. They started with pay subscription, and I believe they will eventually offer a free product where there's some kind of content limitation. I'm talking about a whole, new income stream rooted in advertising."
- "The people that pay for Netflix, at least in the U.S., represent a very saturated market. The exclusivity of the new original content is going to attract a small slither of new paying customers, but I think the organic path is to make Netflix available to people who can't afford Netflix."

> **I believe they will eventually offer a free product where there's some kind of content limitation. I'm talking about a whole, new income stream rooted in advertising.**
>
> *CEO, Video Analytics Provider for Marketing Firms*

- "At the Emmys this year, there were two things of note: the academy nominating *House of Cards*, meaning it now considers that TV. The second thing was the ad for Samsung TV; the definition of TV is changing to include content delivered via an IP address."
- "The future of TV is custom-tailored, a la carte offerings."
- "Look into what's happening in advanced or addressable TV. DISH and DirecTV are exposing advertising on traditional TV as programmatically purchasable. If Netflix doesn't eventually launch some kind of product that allows for a new revenue stream—[such as] advertising—they're shooting themselves in the foot. And they can completely segregate their [ad-free and ad-supported offerings]. I think Madison Avenue would be all over it."

Individual Profiles

- "Per-person subscriptions [for individual profiles] is not going to happen. I think that would be a huge mistake. Incremental enhancements to their software to make the product better is not worth money. The only thing that's worth money is the content."

Mobile

- "Marketingcharts.com recently sampled the demo of 18- to 24-year-olds and tracked trends of content consumption by type and device. There's a trend toward the younger demo using mobile devices, including longer-form streaming video content, and phasing out the broadcast/DVR consumption of that very same content."

Digital Content Rights

- N/A

4. President of a media consulting firm; repeat source

Personal profiles are a great feature as they allow for flexibility for multiple users within a household. However, Netflix will need to very carefully assess changes to its subscription structure, as it experienced backlash from past price jumps. The cost of digital content has been going up 5% to 8% year to year. Netflix is the main driver behind the increase.

Demographic Trends

- "From a broad macro-perspective, Netflix is trying to become an all-inclusive network. Although they are becoming more like a network, they are also a repository for a wide range of content."

Individual Profiles

- "Personalization is great because if you have a Netflix subscription and TVs in [several parts of the house], different members of the family can watch what they want."
- "[Netflix] needs to proceed with incremental charges carefully. They got pushed back on the DVDs a few years ago [when they increased rates]. I would think that would be OK up to a certain point. They probably aren't going to be pushing it unless people really become reliant on watching Netflix."

Mobile

- "My guess is that Netflix isn't doing so great on the mobile side. Given the length of their content and what they have, people aren't really watching it there."
- "About 70% of people watch on their TV screens, and the remaining 30% is split between tablets and smartphones."

Digital Content Rights

- "The studios are able to extract more income from [digital content rights] because there are more people watching those channels. My pure guess is that they are going up 5% to 8% year over year."
- "Netflix is the incremental bidder driving [prices] up, but they have definitely been coming up strong and have been a great source of revenue for everybody. They have been truly disruptive, and the studios are happy to make deals."

5. Technology writer and editor; repeat source

Cutting cable subscriptions and using services like Netflix are very attractive options for lower-income households, but taking these measures requires a certain amount of technical savvy. Original content will drive subscription growth, especially content that appeals to a wide demographic base. This source does not see value in individual profiles, partly because people have gotten used to sharing Netflix accounts and partly because Netflix's recommendation engines are spotty at best.

Demographics

- "There's an awareness of Netflix as a cord-cutting, cash-saving venture."
- "To be a full-on cord-cutter is a very economical solution for lower-income households. The major problem is you have to be very engaged with the cord-cutter community in order to do so."
- "What you need to watch Netflix is technology. You need a computer or a game console or a set-top box or a super smart TV."
- "I'd be interested to see a study that measures whether cord-cutting is happening in lower-income households versus higher-income households. I think a lot of higher-income households have the resources to figure out which device they need to get broadcast TV and which device they can use for Netflix and Hulu and all the services that are much cheaper than a cable subscription."
- "One of the things Netflix has done really well is create original content that has given the service value on a level that it hasn't had before and given it prestige on a level they haven't had before."
- "They actively resist giving out any numbers, but some of the numbers they have given show that their subscriber numbers go up every time they release a new original series and their viewership goes up every time they release a new original series. That points to the fact that people are finding [the original content]."

> **To be a full-on cord-cutter is a very economical solution for lower-income households. The major problem is you have to be very engaged with the cord-cutter community in order to do so.**
>
> *Technology Writer & Editor*

- "The more original stuff they have—the more stuff that people are aware is only available on Netflix—the more Netflix will become something that everyone wants to subscribe to."
- "Something they're doing really well is keeping a diverse [stable] of content available. That helps a lot. In terms of original content, they're leaning towards the HBO model of targeting white men, but there's definitely room for diversity in that model and Netflix is not opposed to it."
- "Netflix is not on the ground producing its own shows. They're all studio productions. *House of Cards*, for example, is owned by Media Rights Capital."
- "Eventually, they're probably going to have to own their own content."

Individual Profiles

- "Individual accounts are a great idea, but people have gotten used to the idea of sharing accounts."

- "I'd be interested [in a personal profile] if Netflix admitted that their recommendation algorithm model doesn't work."
- "I watch a lot of series on all my devices, and I don't share my password. No one else is using my account unless my roommate sometimes watches on my PS3 in the living room. But Netflix still has yet to predict something that I actually want to watch. [Netflix's recommendation engines] might be something that it abandons and just focuses on new releases and making it easier to find categories that you want to watch."
- "In order to embrace individual profiles, you have to embrace the notion that Netflix can accurately predict what an individual user will want to watch. Personally, I reject that idea."
- "The idea of adding $2 for a separate play list just doesn't make sense. The individual profiles are not worth paying for."

Mobile

- "The problem with Netflix on mobile is I'd love to run Netflix on my iPad, but I'm on a data plan that charges me for data. I'm not going to watch anything that costs me a lot of data."
- "There is definitely a market for short-form content on mobile. But I don't know if it's there for long-form because it's such a big commitment in terms of loading up the data or in terms of paying for the data."

> **The idea of adding $2 for a separate play list just doesn't make sense. The individual profiles are not worth paying for.**
>
> *Technology Writer & Editor*

Digital Content Rights

- "Netflix has done a really good job of distributing shows that have been created with other people's money, but those other people are trying to figure out how to distribute outside of Netflix."
- "I don't think costs are going to change dramatically."
- "They've done a nice job of [acquiring content] that is either really cheap or high-enough profile to warrant really going for."
- "A big factor with library content is just discovery. You can offer people as much content as you can, but you have to figure out how to get it in front of people. Discovery of that is a huge issue."

6) CONSUMER SURVEY

In a survey of 161 Netflix subscribers, we found that Netflix has continued to grow significantly and is not threatened by competition from cable and other streaming services. Netflix customers are increasing their usage, are highly unlikely to cancel their subscription in the next three months, and are decreasing their content viewing through other entertainment services, especially cable. One-third of subscribers are using Netflix to replace, rather than to supplement, other forms of entertainment. However, Netflix does not have room to raise prices and is slow to build its mobile penetration.

- **Netflix is a tremendously popular standalone service that continues to grow and is not threatened by any competitive services.**
  - Netflix usage has increased during the past three months. 36.03% of subscribers said they have increased their usage, compared with 16.16% who said their Netflix usage has fallen. (Q2)
  - 59.21% of Netflix subscribers are not at all likely to cancel their subscription during this time frame, and 26.32% are only slightly likely to cancel their subscription. (Q10)
  - Netflix provides a unique service that does not have a peer competitor to replace it. 39.47% of subscribers said they would not replace Netflix if they canceled their subscription. 30.82% of subscribers use Netflix significantly more than other entertainment services. (Q12) (Q5)

- **Cable is losing the battle to Netflix.**
  - Cable is suffering the most losses based on the continued rise of and loyalty to Netflix. Four of the top five forms of entertainment being cut back or canceled as a result of Netflix viewing are tied to the cable industry: cable (31.45%), premium cable (23.27%), Outerwall Inc.'s (OUTR) Redbox (19.50%), cable-on-demand (12.58%), and HBO (11.32%). (Q6)

- Netflix subscribers use Netflix more than their other entertainment options. Roughly three times the number of Netflix subscribers (62.9%) are using Netflix more than other forms of entertainment compared with the number of Netflix subscribers (18.87%) using it less than other forms of entertainment. (Q5)
- Nearly twice as many cable and premium cable subscribers (51.39%) are increasing their use of Netflix as those cable and premium cable subscribers (26.39%) who are decreasing their use of Netflix. (Q4 filtered, Q5)
- Cable and premium cable subscribers as a group are decreasing the amount of cable (19.44%) and premium cable (29.17%) they consume compared with other entertainment options. (Q4 filtered, Q6)
- Subscribers who use Netflix as a supplement to instead of a replacement for existing entertainment options are nonetheless decreasing/canceling more of the cable (49.06%) and premium cable (25.96%) they consume when compared with other entertainment services. (Q3 filtered, Q6)

➤ **Netflix is winning the battle for consumers who wish to replace/eliminate their other viewing options.**

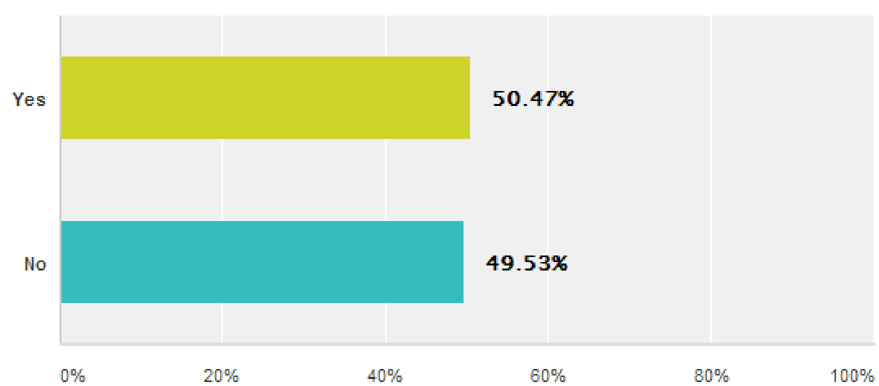
- Netflix is being used as a replacement for other entertainment options by more than one-third of Netflix subscribers (34.16%), setting a baseline for future Blueshift surveys into consumer behavior and usage patterns with Netflix. The remaining 65.84% of subscribers are using Netflix as a supplement.
- Netflix subscribers use an average of 3.33 additional entertainment services (such as cable, Redbox and Amazon Prime) in conjunction with their Netflix subscription. (Q4 analyzed)
- Subscribers who use Netflix as a replacement are utilizing one fewer entertainment option (2.58 services in addition to Netflix) than those who utilize Netflix as a supplement (3.72 services in addition to Netflix). (Q3 filtered, Q4)

➤ **Netflix will not be able to successfully pass on even a nominal price increase, nor is it making inroads among mobile users.**

- A $1 price increase would result in 19.08% of Netflix users dropping the service, while a $2 increase would decrease Netflix users by another 27.63%. (Q9)
- Of the Netflix respondents who gave even the slightest indication of canceling their subscription in the next three months, 40.32% said price would be the deciding factor. (Q11)
- Netflix is accessed through TV an average 64% of the time, desktop 26%, tablet 9%, and smartphones 4% of the time; use of these viewing options has not changed in the last three months. (Q7 and Q8)

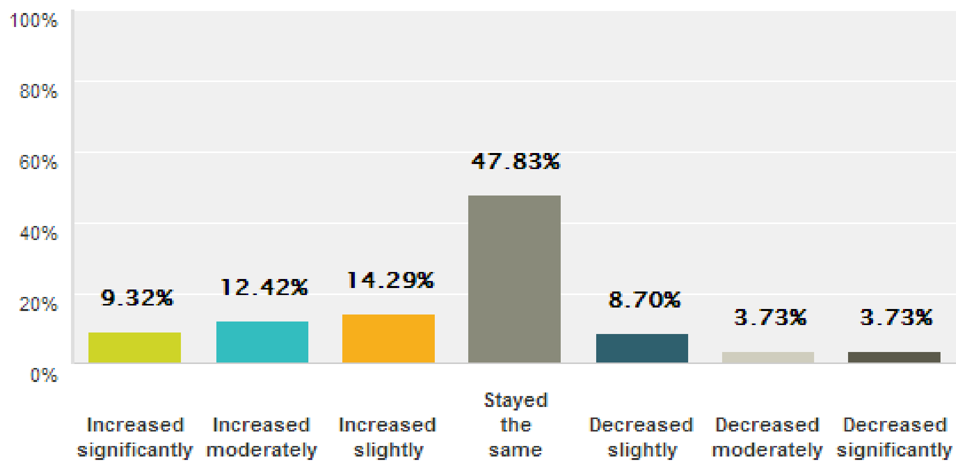
1. Are you a current Netflix subscriber?

321 total respondents



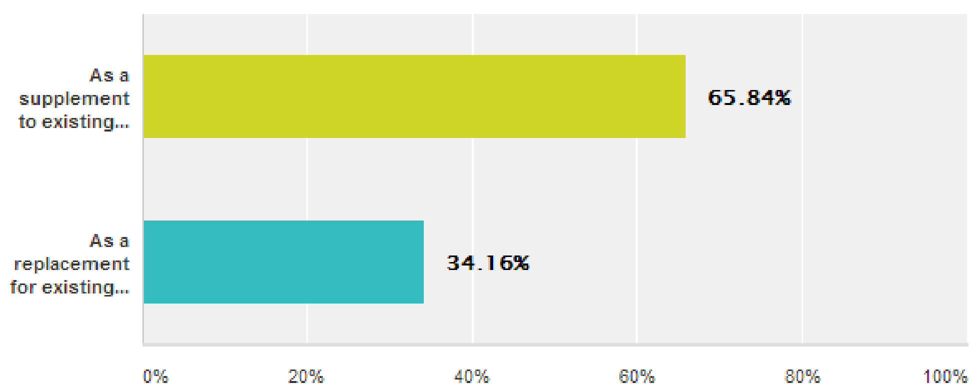
2. Over the past three months, has your usage of Netflix increased, decreased or stayed the same?

161 total respondents



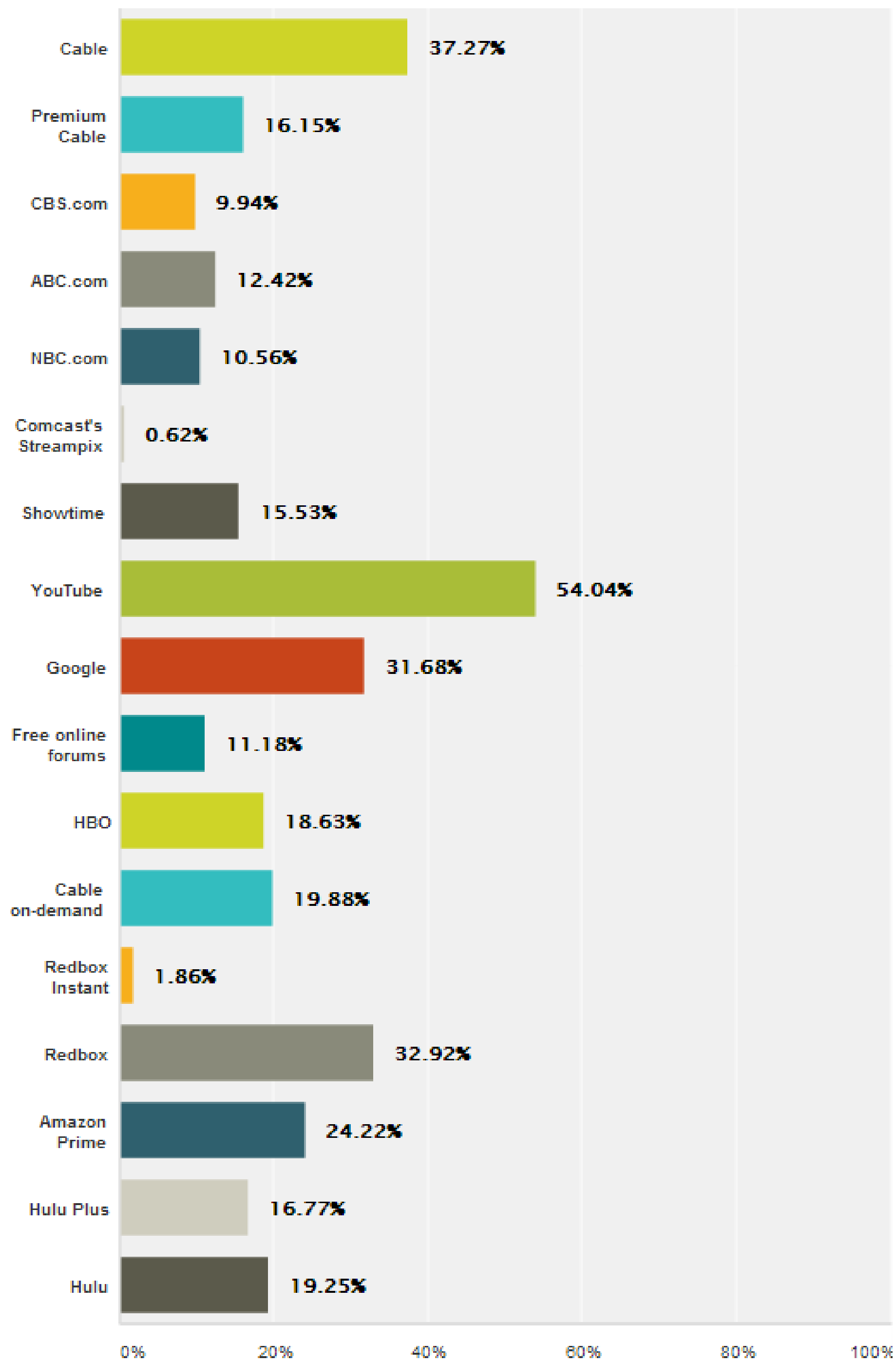
3. How are you using Netflix?

161 total respondents



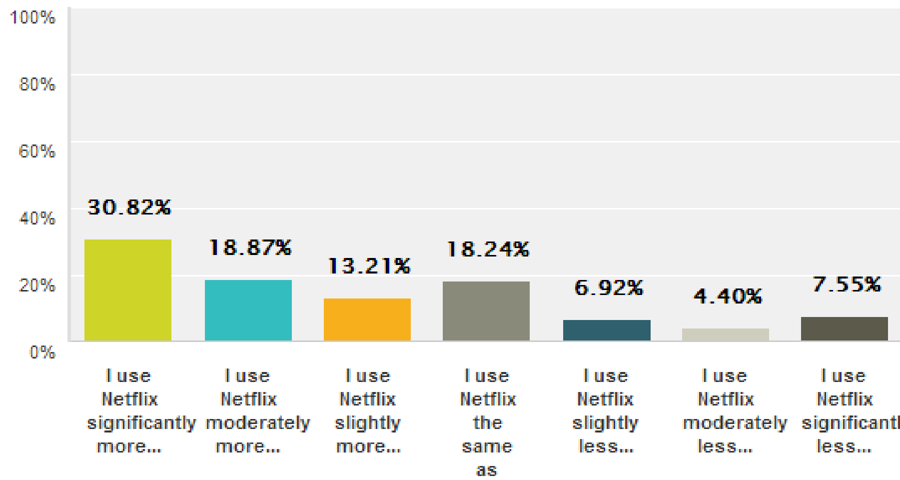
4. What other services do you use besides Netflix? (select all that apply)

161 total respondents



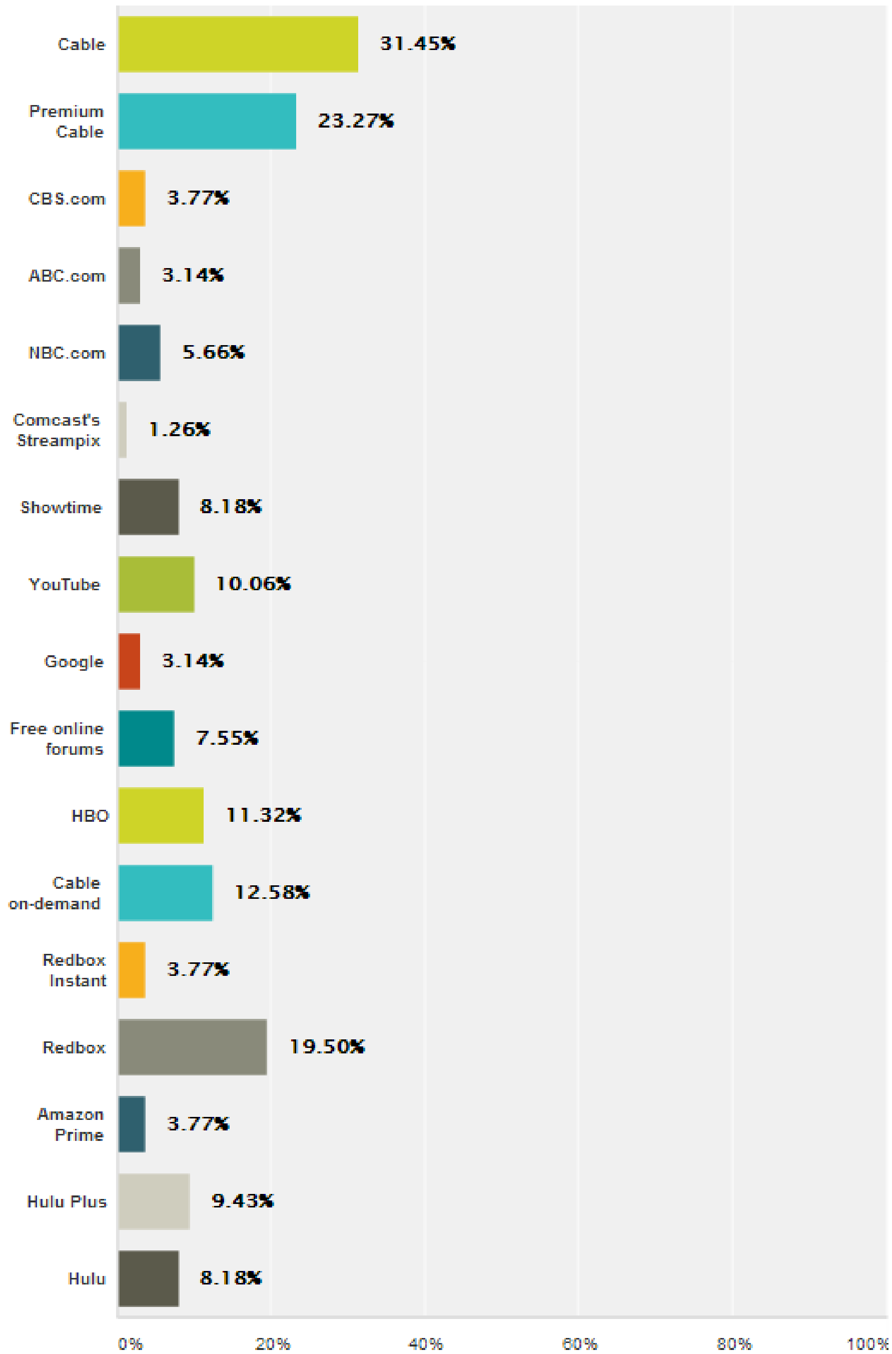
5. How does your Netflix usage compare to other services?

159 total respondents



6. Which other services have you cancelled or cut back on because of your Netflix subscription and usage? (select all that apply)

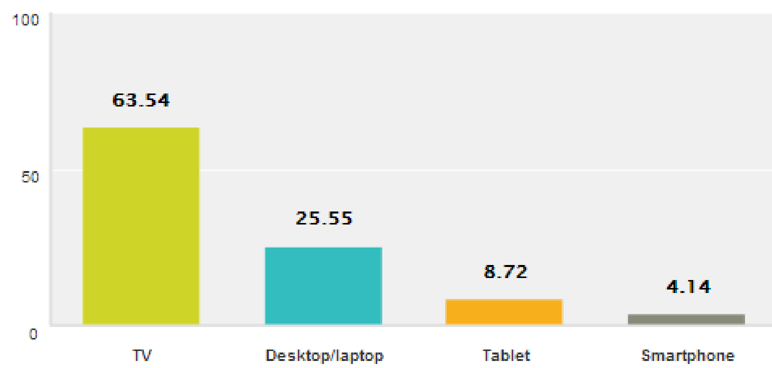
159 total respondents



7. How much of your total Netflix viewing do you do on the following devices?

(Give a percentage breakdown with whole numbers in each box from 0-100. Make sure your total adds up to 100.)

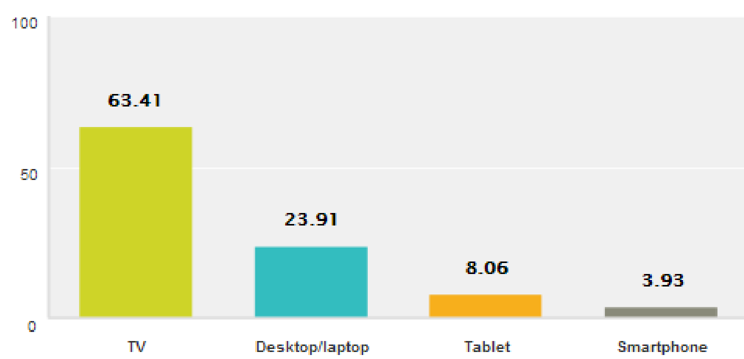
152 total respondents



8. How much of your total Netflix viewing did you do on the following devices 3 months ago?

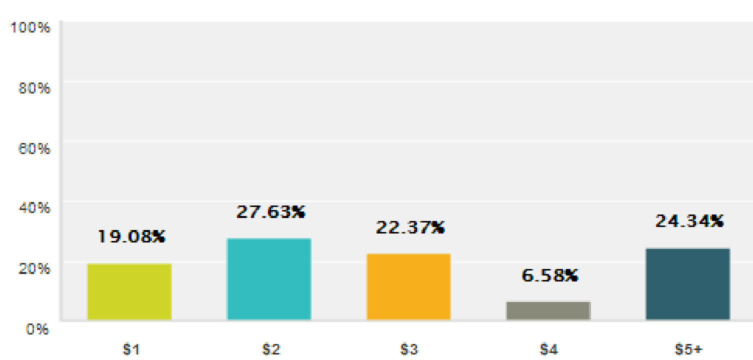
(Give a percentage breakdown with whole numbers in each box from 0-100. Make sure your total adds up to 100.)

152 total respondents



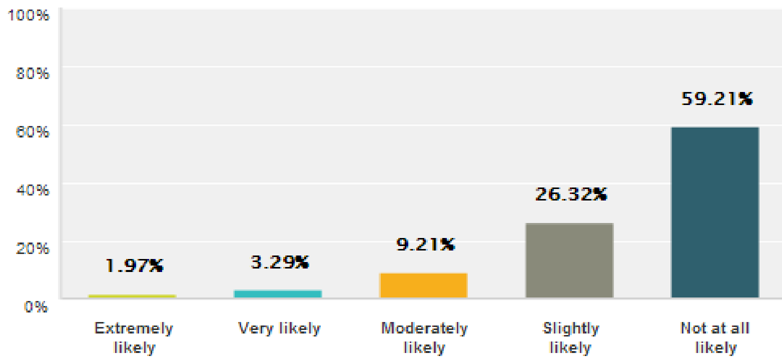
9. If Netflix were to increase its monthly subscription charge, which price increase would cause you to cancel?

152 total respondents



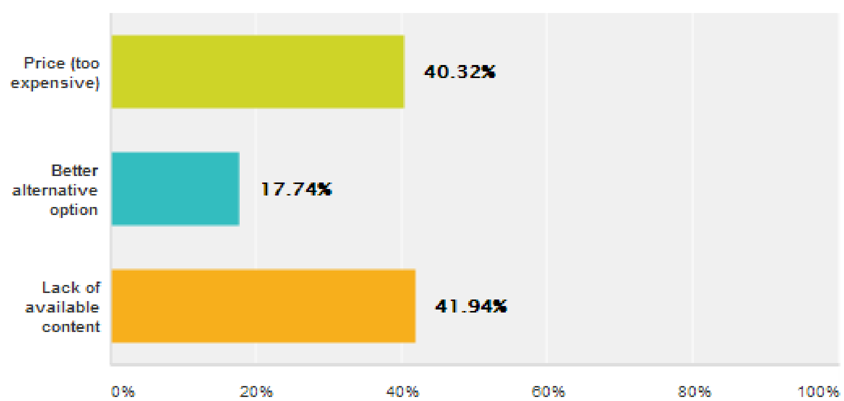
10. How likely are you to cancel your Netflix subscription in the next 3 months?

152 total respondents



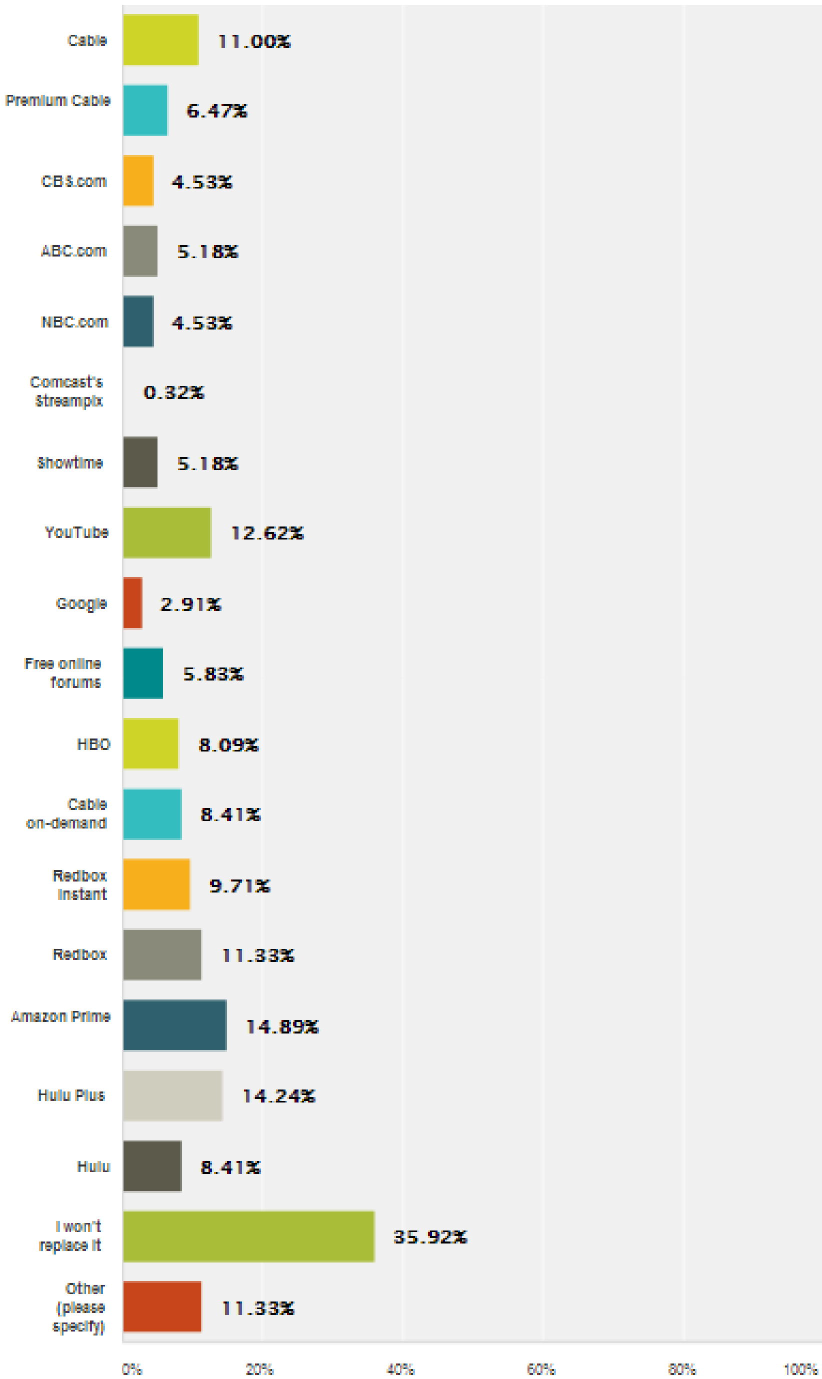
11. Why do you think you might cancel your Netflix subscription in the next 3 months?

62 total respondents – only those who responded to Q10 as “slightly likely” to “extremely likely” were asked to answer this question.



12. If you cancel Netflix, which service are you most likely to replace it with? (select all that apply)

309 total respondents



Secondary Sources

The following seven secondary sources discussed Netflix's content expansion, its efforts to improve the quality of streaming, a legal hiccup in the Netherlands, and expansion plans in Latin America.

NEW CONTENT

The following two articles highlighted Netflix's comedy specials and the possible acquisition of DHX as an expansion in children's content.

- **Oct. 7 Geekosystem article**
  Netflix is continuing to roll out comedy specials, to the approval of viewers.
  - "Netflix has been stepping up its original content efforts and recently announced it would focus on comedy specials. They kicked off with John Hodgman's wonderful *Ragnarok,* and today they're continuing it with Marc Maron's new special *Thinky Pain*. We like what you're doing here, Netflix."
  - "*Thinky Pain* is out today on Netflix in all English-speaking countries with Netflix according to Maron on his podcast *WTF* this morning. He also said that it will be available worldwide on Netflix as of October 21st."
  - "Of the special itself Maron said: 'I'm proud of this special. I went out of my way to do certain things on this special to honor who I am at this point in my career. We did it at a small venue. … You only see a couple rows of the audience. I did it in front of a small group of people, about 240 people.'"
  - "Besides Maron's new special comedy fans can also look forward to a new special from Aziz Ansari premiering November 1st."

- **Oct. 9 Bloomberg article**
  Netflix is one of the many competitors that could be eyeing DHX for an acquisition. DHX recently expanded its children's TV portfolio.
  - "Teletubbies, Inspector Gadget and Care Bears are making children's TV show producer DHX Media Ltd. ripe for a takeover."
  - "After adding these characters to its portfolio through two acquisitions in the last year, DHX now offers buyers a library of more than 9,000 half-hour TV show segments, including 'Yo Gabba Gabba!' and 'Madeline,' and associated merchandising rights. Sales at Canada's DHX are projected to rise 73 percent over the next three years, one of the fastest growth rates among similar-sized North American entertainment companies, according to data compiled by Bloomberg."
  - "The C$348 million ($336 million) producer may lure Netflix Inc. with programs that can add to the streaming service's push for more viewers, said Byron Capital Markets Ltd."
  - "'This is one of the largest independent portfolios of children's entertainment,' Sameet Kanade, a Toronto-based analyst at Jacob Securities, said in a phone interview. 'It's a no-brainer.'"
  - "DHX last month bought 'Teletubbies' producer Ragdoll Worldwide Ltd., building on its 2012 purchase of Cookie Jar Entertainment Inc., owner of the rights to 'Inspector Gadget' and 'Care Bears.'"
  - "The company's expanded portfolio of children's programming, which also includes Super Mario and Paddington Bear shows, bolsters its appeal as a takeover candidate, according to Kathy Schutz, an executive vice president and analyst at Bard Associates Inc."
  - "Kids' shows are attractive assets because they gain a new audience every few years, can be easily dubbed in different languages and generate lucrative ancillary revenue from licensing and merchandising, said Ralph Garcea, managing director and head of research at Global Maxfin."
  - "'Inspector Gadget' can just as easily air in French or German as English, and a Yo Gabba Gabba doll appeals to a child in South Africa as well as Canada, he said."
  - "DHX could attract interest from Netflix as the largest U.S. subscription-streaming service develops original content and competes for viewers with traditional media companies, said Dev Bhangui, a Toronto-based analyst at Byron Capital."
  - "Netflix is going to 'look for the guy who has the most formidable content,' Bhangui said in a phone interview. DHX stands out as the largest independent provider of children's TV programming, he said."

- “Multi-billion dollar companies ‘can swallow this without missing a heartbeat,’ Bhangui said. With DHX’s acquisitions bolstering its content library, ‘they will get taken out.’”

ENTERTAINMENT UPGRADES

The following three articles covered the initiation of Netflix’s individual profiles, the improved quality of its service with Super HD, and iPad users’ ability to stream with HD.

- Aug. 1 Engadget article
  Netflix has launched individual profiles, five profiles per subscription. Most subscribers view this as an advantage to avoid the cluster of children’s TV into their personal queues.
  - “Netflix is finally ready to deliver individual profiles for its streaming service, meant to satisfy households with shared accounts by providing everyone their own settings, viewing history and (where available) queue. Profiles are coming to all Netflix regions starting today, but may take a couple of weeks to appear on every account as they roll out gradually.”
  - “Device support will also take some time to hit everywhere even though most clients (the PS3 is shown above) are ready for profiles today. Two platforms not yet sorted are Android and the Nintendo Wii, where support will arrive ‘later in the fall’ and in mid-August, respectively. Once the new feature is available however, it should be easy for users to access and setup, as we learned from Chief Produce Officer Neil Hunt that focusing on ease of use was the company’s main priority. We’ve also had a chance to check it out ourselves, check after the break for a few more details and quick video preview.”
  - “In its use, that drive for ease of use affects how it works in a number of ways, enabling it is as easy as clicking a large plus sign and typing in each person’s name and selecting a persona logo. Each profile can link to a different Facebook account if you like, however be advised that it automatically pulls in your profile pic for the avatar. As far as setup, that’s it. It’s like having a brand new account otherwise, with the opportunity to seed preferred content and ratings just like any other new user.”
  - “From the master account settings and profiles page you can tailor each one for things like age, or even parental suggestions, although a true lockdown this isn’t. There are no passwords or other hurdles separating the leap from one profile to another, which the team compared to "locking all the doors in your house."
  - Aug. 1 comment: “‘Thank YOU!!! Now I won’t have to scroll through 10 pages of 6 year old shows to get to a movie that I want to watch.’”
  - Aug. 5 comment: “‘I know, I think I have A.D.D. because if I don’t see anything interesting in about three pages… I’m out. Will definitely be a kool feature.’”
  - Aug. 1 comment: “‘YES!! Finally I can hide all those naughty videos from my profile when I have company over! (by naughty, I of course mean like, with bad words).’”

- Aug. 27 Huffington Post article
  To improve its users’ viewing pleasure, Netflix is offering Super HD to those with the correct Internet service.
  - “Netflix is now offering Super HD, its highest-quality streaming video, to all of its customers, the company announced in a blog post on Thursday, expanded from a limited rollout in January. But some customers still might not be able to use Super HD all the time, because some Internet service providers haven’t joined a network Netflix designed to keep Internet congestion low.”
  - “When Super HD was introduced in January, it was available only to people whose Internet Service Providers were using Netflix’s Open Connect Network, a system of servers connected to local ISPs designed to help ease Internet congestion.”
  - “Netflix customers account for up to a third of Internet traffic at peak hours in the U.S., Netflix’s vice president of Content Delivery, Ken Florance, explains in a video (which you can also watch below). Open Connect is supposed to ease the burden on the Internet.”
  - “But not every ISP has joined Open Connect. Which means that not every Netflix customer will be able to use Super HD all of the time. Customers of Time Warner Cable, for example, might have to watch slightly grainier video, and they may experience sluggish Internet speeds when Netflix viewing is high, VentureBeat points out.”

- **Oct. 7 Cult of Mac article**
  Netflix 5 now allows iPads that are running iOS7 to stream HD video and allows AirPlay to switch between TV and the iPad.
  - “Netflix 5 brings HD video and AirPlay to iPads running iOS 7. You may have thought you had HD video streaming to your retina iPad, but you didn’t. 5 fixes that, and it also lets you throw your TV shows and movies up onto your big screen via Apple TV with native AirPlay streaming.”
  - “The new app’s biggest deal is probably HD streaming, which is not the same (as far as I can tell) as the new Super HD streaming. Super HD requires that your ISP be signed up to support it, and sends 1080p video over the wire.”
  - “Proper AirPlay is also a nice addition. Previously you could mirror the iPad’s screen to an Apple TV, but now you can do it properly, which has the added advantage of letting you sleep the iPad while it’s working. Why bother when your Apple TV already has a Netflix app? Why indeed? I guess it makes it easier to switch back and forth between screens if you’re walking around and , uh, trying to stay awake while you watch *Prometheus* to the end.”
  - “The app is available now, free.”

INTERNATIONAL EXPANSION

The following two articles discussed the controversy surrounding Netflix as it violated Dutch law, and the company’s plans to expand its audience in Latin America and more specifically Brazil.

- **Oct. 8 ZDNet article**
  Netflix is facing some challenges after not asking Dutch users permission to use personal data. The Dutch Data Protection Authority is in contact with Luxembourg, Netflix’s European base, to see if action can be taken.
  - “Video streaming service Netflix, which launched its services in the Netherlands last month, has found itself in violation of the Dutch Data Protection Act. However, as the company has chosen to headquarter itself in Luxembourg, the Dutch Data Protection Authority is unable to intervene on the matter.”
  - “The Netflix privacy violation is caused by a different interpretation of the definition of personal data. In its terms and conditions, the video streaming company states that it considers ‘personal data’ to be data that can be traced back directly to an individual. However, under Dutch legislation, data that can indirectly be traced back to an individual — for instance, by linking it to other data — is considered to be personal data as well.”
  - “According to Dutch law, companies need customers’ explicit consent to gather data that can indirectly be traced back to an individual, while Netflix only asks for consent for information that is directly linked to a user.”
  - “The Netherlands’ secretary of state for education, Sander Dekker, considers the discrepancy a significant threat to the privacy of Dutch customers. ‘Netflix gathers so much information of its customers that this can be considered extremely sensitive personal data, as referred to in article 16 of the Data Protection Act,’ he wrote on the Dutch government website.”
  - “‘There are strict regulations with regard to that, and customers must give their express consent for that, which, in case of Netflix, they have not. Under Dutch law, a user ID can also be considered personal data, whereas in the Netflix privacy statement, it is not considered as such.’”
  - “‘Moreover, Netflix gathers a lot of information about its viewers, in order to be able to offer them customised recommendations. If this information can be used to trace back religious or sexual preferences to the user, viewers must give their express consent for that information being gathered. There must be a specific button to confirm that, and Netflix doesn’t provide that button.’”
  - “As Netflix’s European operations are based in Luxembourg, they’re governed by Luxembourg’s laws, rather than Dutch law. As a result, even though it offers its services in the Netherlands, the Dutch Data Protection Authority can’t take action on any violations of the Dutch Data Protection Act by the company.”
  - “Had Netflix chosen to have its European base in the Netherlands, or indeed outside of Europe, the Dutch Data Authority could have intervened. However, businesses domiciled in Luxembourg constitute an exception, and their data processing methods can only be assessed under Luxembourg law.”
  - “Dutch MP Kees Verhoeven has called for Dekker to bring the matter to the attention of his Luxembourg counterpart, who could ask the country’s Data Protection Authority to take action. Whether this will happen, of course, remains to be seen.”

- Oct. 9 Variety article
  To gain further traction in Latin America and specifically Brazil, Netflix is launching *Apenas o fim*, an award-winning film from Brazil, and has commissioned its first production in Brazil, titled *A toca*.
  - "As part of Netflix's effort to expand in Latin America's largest market, the company announced Wednesday Oct. 9 Matheus Souza's 'Apenas o fim' was the winner of a local contest to select a Brazilian pic for distribution through Netflix worldwide."
  - "Brazil was the first country where Netflix deployed in Sept. 2011 outside the U.S. and Canada, and the country is company's number one market in Latin America, said the Netflix's chief content officer Ted Sarandos, who disclosed the contest winner during the Rio Film Fest. Currently in 41 countries worldwide, Netflix opened an office in Sao Paulo, Brazil, early this year."
  - "The Netflix deployment is shaking up the local market, prompting the big established local pay-TV operators, such as NET, to launch VOD services in a defense move to prevent the lost of subs."
  - "Although the company does not disclose local subs figures, it is known Netflix is rapidly expanding its subs base in Brazil."
  - "IHS Electronics & Media estimated Netflix's total Latin American paying [subscribers] at 1.6 million year-end 2012."
  - "The main challenge for the operation here comes from regulatory and fiscal issues. Brazil's National Film Agency Ancine) served notification in August to both Netflix and Apple's iTunes that the two international VOD distributors are required to pay the local tax contribution called Condecine. This is a fixed fee of$1,400 for every pic and US$340 for every series distributed in Brazil."
  - "Netflix has also commissioned its first exclusive production in Brazil. 'A toca' a three-seg half-hour series produced by web phenom comedians, the Parafernalia group. It is available just to local subs."
  - "Sarandos said the company has plans to produce locally original shows with robust budgets and worldwide distribution, but would not committee to a timetable: 'We will start producing original content in Brasil as soon as we have a large enough subscriber base.'"
  - "'Apenas o fim' will be offered to Netflix's worldwide platform as of the [beginning] of 2014, with subtitles in all native languages of the countries where the company operates."
  - "'Apenas o fim' won audience and special jury prize kudos in the 2008 Rio Fest, had a limited theatrical release in Brazil and will now open worldwide."

Additional research by Emily Carr and Debra Chen