

# [Can netflix recover from its strategic mistakes?](https://assignbuster.com/can-netflix-recover-from-its-strategic-mistakes/)

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Introduction and company overview

Netflix is the world’s leading provider of online streaming media and movie rentals with more than 50 million of online subscribers.[1] It is the most prominent provider of online streaming media in the world with operations in the US, Canada and in 42 countries in Latin America and the Caribbean. In fact, Netflix is the single largest source of internet traffic in the US, consuming 29. 7% of the peak downstream traffic.[2] Since its inception, this giant provider of online streaming media has gained increasing popularity. The company was first founded by Reed Hastings in 1997.[3] Netflix began its operations with the selling of DVDs and offering of rental services by mail. The demand for DVD by rental services quickly outweighed the demand for buying DVDs which led to the company focusing their business model on dvd rentals.[4] Over the years, the company’s growth quickly gained momentum to the point that it passed its 500, 000 subscriber mark.[5] The company continued to experience a rapid growth and by 2003, the subscriber base had already tripled to 1. 5 million.[6] In 2007, Netflix launched the online-streaming services and positioned itself for the imminent transition to digital media by partnering with companies such as Microsoft, LG Electronics, Samsung and Roku and negotiating agreements with the biggest entertainment companies such as CBS, Starz Entertainment, and Disney for streaming of media content.[7]

Throughout 2010 and the first half of 2011, the company experienced an unprecedented growth. The number of online subscriptions in the US alone doubled from 12. 3 million to 24. 6 million.[8] The quarterly revenue rapidly increased from $445 million to $770 million and the stock price increased reach an all-time high of $304. 79.[9] However, a series of strategy changes implemented in mid July 2011 tarnished the company’s image and led to a steep decline in profitability and stock price. In mid-July 2011, Netflix implemented a new pricing plan which raised the monthly subscription by 60%. Customers reacted negatively to these price changes with more than 600, 000 Netflix subscribers cancelling their subscription.[10] Towards the end of 2011, the company implemented another strategic change by creating Qwister and splitting the DVDs-by-mail business from internet streaming business. This sparked a second furore leading to a further decline in its stock prices. Netflix’s decline in the industry can be attributed to such kind of strategic mistakes. With these in mind, can Netflix can recover from its strategic mistakes?

External analysis

Netflix’s performance in the industry is affected by a number of external factors. An external audit of the industry reveals some of these political, economic, social and technological factors.

## PESTLE ANALYSIS

### Political and Legal factors

Among the various factors affecting the performance of Netflix in the industry are the political and legal factors, particularly legal battles, trademark, copyright and patent issues. Netflix faces ongoing legal battles with several companies including Comcast and Time Warner Cable.[11] This began with complaints from Comcast customers that the connection speed for Netflix streams had dropped significantly. Netflix’s own data showed a massive decline in connection speed as shown in the figure below.

Fig. 1 Netflix’s own data showing a massive decline in Comcast’s connection speed.[12]

More recently, Netflix filed a petition with the US Federal Communications Commission challenging the proposed merger between Comcast and Time Warner Cable.[13] Netflix argues that the merger should not be allowed under the FCC’s public interest standard as it would stifle the competitive internet market and could potentially cause public harm by making the already expensive high definition (HD) even more expensive for video companies and consumers.[14] However, the petition to deny the proposed merger may not succeed as the commission has already determined that Comcast has the right to discriminate against online video distributors. The commission also determined that the public harm claim that Netflix raised was merely speculative and highly unlikely. The approval of the proposed merger points to the difficulty that Netflix may face in future. Comcast has already shown its willingness to discriminate against online video distributors by manipulating internet traffic at interconnection points with the aim of harming Netflix.[15]

### Social factors

From the social perspective, Netflix relies on the popularity of its media content among consumers. Even though Netflix has raced to become ubiquitous having pioneered online streaming, its main weakness has been the inability to feature the latest releases. It should be remembered that consumers want the most recent content. This is a particular area where Netflix has always been lagging behind. According to a recent consumer report, 81% of the respondents were found to stream media from Netflix, making it the most popular.[16] However, these respondents expressed their dissatisfaction with the service citing Netflix’s movie line up as the biggest issue of concern. Respondents were displeased with the limited selection of movies especially the latest releases.[17]

### Economic

In terms of economic factors, Netflix operates in an industry characterized by large entry costs, low prices and a very competitiveenvironment. To maintain an edge in the market, firms have to price competitively against rivals. The industry is still at its infancy and many companies appear to be experimenting their business models. For example, YouTube recently reached an agreement with Lions Gate Entertainment which secured it rights to mainstream movies from the entertainment company.[18] Apple recently unveiled its plans to develop an upgraded Apple TV that allow consumers to stream video from TV Sets. Hulu recently begun a new subscription plan that allows customers to watch some TV shows that are not available for free at the cost of $10 per month.[19] With streaming becoming more competitive, Netflix will have to improvise in order to continue to thrive in the industry.

### Technological

Technologyis rapidly changing and for Netflix to continue to thrive, it must contend with the constantly evolving and competing technology. Even though Netflix gained its initial competitive advantage from its business model which capitalized on the weakness of the tradition brick and mortar businesses, it continues to face the challenge of adjusting to new technological pressures.[20] Already some of Netflix’s competitors are offering additional innovative services to its customers. For example, Amazon Prime provides users with services such as free two-day shipping and free kindle book in addition to instant video streaming. HBO has made its online content available for purchase without the need of cable subscription. Vudu is releasing many titles the same day they out on DVD compared to Netflix which releases them 28 days later.[21]

## Five forces framework

### Rivalry among firms

There is no doubt that competition is becoming more intense in the industry. Netflix faces many rival competitors in the industry from Blockbuster to Hulu Plus, Amazon Prime, Vudu, Comcast, GoogleTV, Apple TV and many others (Indiviglio, 2010). The intense rivalry is due to the large consumer market in the movie rental industry. The rivalry is also increased by the different methods that consumers can obtain a movie from in-store rental to mail delivery to online streaming and video on demand. The switching costs remain relatively low which perhaps contribute to the fierce rivalry in the industry. A large number ofthe rivalcompetitors have large levels of capital and greater economies of scale which makes competition in the industry very fierce.

### Threat of new entrants

While Netflix faces intense rivalry from competitor firms, the threat of potential new entrants is relatively low due to the large entry costs in the market. Most of the existing firms have already established a well-known brand such as Hulu plus, Red box and Amazon instant video.[22] This makes it increasingly difficult for new players to thrive in the market. A potential new entrant would have to incur a lot costs in marketing and advertising to establish its brand and become competitive.

Threat of substitution

Similarly, the threat of substation is relatively low as many consumers prefer online streaming to physical DVD rentals. While there is no much of a threat to Netflix online streaming model, there is an existing threat from illegal pirating. Some websites provide customers with free access to most media content. However, most of these websites are illegal. Further, these websites are somewhat complicated and are not nearly intuitive as Netflix’s service.[23] While it remains government’sresponsibilityto enforce anti-pirating laws, it may be in Netflix’s best interest to lobby for tighter enforcements of these laws.[24]

### Bargaining power of consumers

In terms of the bargaining power, consumers seem to have a higher ground. Consumers have a higher bargaining power since there are many options in the industry with little or no switching costs. Netflix currently charges its customers an affordable monthly fee of $7. 99 but since customers are not locked into contracts, they can easily switch from one online streaming company to another with minimal or low switching costs.[25] High consumer bargaining power implies that the company must be very careful in implementing its strategies. This can be seen with the price changes that Netflix imposed on its subscribers in 2011. A new pricing plan announced by the company in mid-July 2011 which increased the subscription price by 60% sent the company’s stock price in a tailspin.[26]

### Bargaining power of suppliers

Content remains a key input in Netflix’s business strategy. Since there are very few media content providers that offer high quality content, the bargaining power of suppliers remain relatively high. Suppliers can impose a price increase or offer low quality content and this could have an adverse impact on the company’s profitability.[27] Recognizing the relatively high supplier’s bargaining power, Netflix recently begun developing its own content, some of which have received acclaim in the industry such as the “ House of cards” and “ Hemlock Grove”.[28] However, despite these efforts, Netflix’s survival is largely dependent upon the variety of its content. Netflix still has to rely on its content providers to meet the needs of its large consumer base.

II Internal analysis

An analysis of the internal environment of Netflix is also important as it identifies the competencies that currently exist for the company to compete effectively. The VRIO framework and value chain model is going to be very useful in the analysis of the internal environment.

## Distinctive competencies: the VRIO framework

### Question of value: are the company’s resources and capabilities enabling it to capitalize on opportunities and neutralize external threats?

In terms of distribution, Netflix has a sustainable advantage. It has several distribution channels from the physical distribution of titles through physical stores to distribution by mail.[29] However, this is a temporary advantage as blockbuster is posing a huge threat to the physical distribution of titles. Perhaps the biggest sustainable advantage lies with their online streaming capabilities. Being the first company with the capability to offer online video streaming service, it undoubtedly ranks at the top of video companies with the most widely streamed content. However, Apple is posing a huge threat having established presence in online streaming through iTunes.[30]

### Question of rarityAre there only a few numbers of firms with these capabilities?

In some certain capabilities, Netflix have a sustainable advantage over competitor firms whereas in other capabilities, the company has only a temporary advantage. For example, in DVD rental and Blue Ray rental; Netflix only has a temporary advantage since many firms have the capabilities to produce these items.[31] However, with regard to online streaming, title variety, and convenience to consumers; Netflix has a sustainable advantage. This is because many other firms in the industry do not have the internal capabilities to innovate in these particular areas.

### Question of inimitability?

The industry is characterized by large entry costs. Many firms lack the necessary resources and internal capabilities to offer similar content. It is quite expensive and extremely difficult to form agreements with content providers. Netflix has a temporary and sustainable advantage in this particular area having engineered the online streaming business model and formed agreements with several content providers including warner Bros and CBS among many others. Netflix’s possess key resources and capabilities that provide it with advantages that are not easy to imitate.[32]

### Question of organization?

An important part of the internal analysis is examining how the policies and procedures are organized and whether this organization supports the company’s use of its valuable resources. Netflix has a functional centralized organizational structure in which the CEO has direct control over its six departments.[33] Netflix’s embraces acultureof freedom and innovation. Employees have the freedom to remain innovative and productive. This shows how the company’s organization policies are organized to support its valuable resources.

Part III: Issues and challenges

However, even with these resources and competencies, Netflix faces some challenges/impediments in its drive to remain competitive. One major challenge is its reliance on content providers. The company still has to depend on other content providers such as CBS and Time warner in order to continue to maintain the breadth and variety of their products. Such form of dependence can have dire consequences on the company especially where there are disagreements. For example, in mid July 2011, Netflix was forced to implement a new pricing plan that raised the monthly subscription by 60% after Starz, one of its content providers, demanded $300 million for renewal of its license with Netflix.[34] Initially, Netflix had been paying this premium movie channel $30 million annually. This was a huge step back and led to a steep decline in its stock price. Recently, Netflix was forced to remove some of its content after losing its contract with Viacom International, a leading provider of children shows.[35]

While the huge subscriber base may give Netflix some sought of leverage in negotiating terms, much of its survival is still at the mercy of its content providers. Another challenge facing Netflix lies with the stiff competition in the movie industry. Even though the threat for potential new entrants is relatively low, there is an intense rivalry in the industry among key players such as Blockbuster, Hulu Plus, Amazon Prime, Vudu, Comcast, Google TV, and Apple TV.[36] With the battlefront shifting online, Netflix is going to be in direct competition with some of the well-financed and innovative companies such as Apple, Google and Amazon.[37] Netflix will have to be savvier than ever by negotiating better agreements for online streaming in order to take on these giant companies.[38]

Part IV: Generation of strategic growth option

Netflix’s overall situation is fairly attractive and somewhat sustainable. However, there are a number of Strategic Options that the company could pursue in its efforts to continue to grow and develop. The Ansoff matrix tool below will be used to describe these options.

Ansoff matrix tool[39]

## Ansoff Matrix

### Market development

International expansion is one of the strategic growth option. Netflix has already entered into regional license agreements to stream media content from 42 countries in Central America, South America and the Caribbean.[40] However, this international expansion need to be implemented very cautiously. While this has allowed Netflix to expand its subscriber base, the company is spending so much that it doesn’t actually profit from this international expansion. For example, in the last quarter of 2012, international losses hit $105 million despite the gain of 6 million new subscribers.[41]

### Product development

The company could also benefit from developing its own original content and focusing on the online streaming business. Developing its own original content will reduce their dependence on content providers. There is also an imperative need to phase out the “ DVD mailing option” from Netflix’s business model. The movie industry is quickly shifting online, yet Netflix continues to develop millions of DVDs which have high operating costs. Despite its huge revenue, Netflix’s margins are eaten up by its huge production costs.[42] With the movie industry shifting online, Netflix may lose out on major profits if they take too long to phase out the DVD mailing option.

### Market penetration

In terms of market penetration, Netflix need to increase its domestic market. Growth in online streaming has resulted due to the increasing broadband penetration, growth in connected devices, faster download speed and the broader trends of media consumption.[43] A large part of the purchasing and usage of Netflix’s content come from existing customers in the US. However, there is still a larger market in the US that Netflix can benefit from. Netflix can leverage its first mover advantage to expand more rapidly in the US.

### Diversification

Netflix is currently in competition with rivals in the market in two main product lines: dvd rentals and online streaming. With virtual rivals such as Amazon, Hulu and cable TV companies among many others, competition in online streaming is going to be intense. In the product line of DVD rental, competitors such as Blockbuster and Red-box pose a huge threat.[44] To maintain an edge in the market, Netflix need to diversify its product line to include video and computer games.

Part V Evaluation of strategic growth options

With these strategic options identified, it is important to evaluate each option in terms of suitability, accessibility and feasibility. SAF framework will be very useful in this evaluation.

## SAFe framework

### Suitability criteria

Suitability criteria will evaluate whether these strategic options support Netflix’s mission and values, whether they are suitable for industry life cycle stage and whether they strengthen Netflix’s competitive position. Netflix’s mission statement is to grow the streaming subscription business both domestically and globally and to improve customer experience while staying within the parameter of their consolidated income and operating profit.[45]

Strategy optionsSupports Netflix’s mission and valuesSuitable for industry life cycle stageStrengthens Netflix’s competitive position   
Expanding subscriber base internationally – market developmentyesYes – it is important to expand internationally currently in the industry. Yes. In the long term, this will consolidate their position in the industry   
Expanding rapidly in domestic market – market penetrationYesYes – market penetration is also important. Yes, in the long run.   
Focusing squarely on online streaming business and producing some its content – product developmentYesYes – the shifting market environment makes this strategy very effective. Yes – the industry is moving online and this strategy will significantly improve Netflix’s competitive position   
Diversifying product line to include video and computer games. yesYes – suitable for industry life cycle stageYes – this strategy will distinguish Netflix from competitors

### Accessibility criteria

The accessibility criteria is assessed based on customer reactions, risks of losses and returns on investments.

Strategy optionsReaction of customersRisk of lossesReturns on investments   
Expanding subscriber base internationally – market developmentNo effect on customer reactionHigh – margins from international segment so far remain very low compared to domestic levels. Already the company has incurred huge losses from this expansion. Low – Broadband infrastructure is very poor in many international countries and pricing strategy may be seen as high in developing economies.   
Expanding rapidly in domestic market – market penetrationNo discernible effectLow – margins from domestic segments are very highHigh – the current low pricing policy is very attractive for new customers and entertainment consumption remains high   
Focusing squarely on online streaming business and producing some its content – product developmentPositive impact – provides customers with the convenience they need. Low – the industry is shifting online and customer subscription for online streaming is increasing. Very high – market shifting online and broadband infrastructure allows for streaming of high quality hence improving customer experience.

Producing its content will reduce its dependence on content providers.   
Diversifying product line to include video and computer games. Positive – it will enhance customer experienceRelatively low due to lack of differentiation between competitorsHigh – the added feature will increase customer experience among consumers who like video games.

### Feasibility criteria

Feasibility criteria involves examining whether Netflix has the internal capabilities and resources to support implementation of these strategic options

Strategy optionsDo existing technological assets support this strategy? Does Netflix have enough financial resources to support implementation of this strategy? Is there enough information available for implementation of this strategy?   
Expanding subscriber base internationally – market developmentTechnically, Netflix’s content delivery network is able to support this strategy. Netflix still has enough financial resources to expand internationally, however, huge losses have been incurred in implementation of this strategyYes, there is enough information to implement this strategy, however, the losses incurred so far raises the question of whether it is a feasible option?   
Expanding rapidly in domestic market – market penetrationYes, Netflix’s content delivery network is able to support this strategyYes, the company still has enough funds for market penetration. Yes, Netflix has enough information to ensure success of this strategy.   
Focusing squarely on online streaming business and producing some its content – product developmentYes, Netflix has exceptional tools with intelligent analysis that enable it to detect faults in systems, improve on customer experience and handle increasing data traffic. There are enough financial resources to implement this strategy. Yes, Netflix has enough information. For example, when it created its original TV series “ House of Cards”, Netflix knew that it would be a hit based on examining consumers viewing habits.   
Diversifying product line to include video and computer games. No, Netflix may not have the technical capabilities to produce computer games. However, there are enough financial resources to implement this strategy. Also, there might not be enough information to implement this strategy. Netflix may not have enough history data to base on since most consumers subscribed to watch movies and not play computer games.

PART VI Description of Selected Strategy

Netflix need to focus squarely on the streaming business and phase out the DVD mailing option from its product portfolio. It should be noted that movie industry is quickly moving online and the DVD business is bound to declines. This can be seen with the decline in Netflix’s domestic subscribers.

Declining number of DVD subscribers while domestic streaming subscribers increase.[46]

This is also very much consistent with Netflix’s generic business strategy of differentiation, costleadershipand providing customers with convenience. While the DVD business has in the past been very profitable compared to the online streaming business; there is a slow but inevitable decline in the DVD business as the industry moves towards online streaming.[47] The huge costs associated with production of physical discs, packaging costs and the high costs of running the DVD distribution centers will adversely affect the DVD business.

Netflix contributing profit, DVD vs domestic streaming.[48]

Focusing exclusively on online streaming will without doubt enhance these generic strategies by differentiating Netflix from brick and mortar stores such as Blockbuster and Redbox, and providing customers with the convenience that they need. Netflix has the internal capabilities and resources to carry out this strategy successful. For the company to successfully carry out this strategy, it has to be vigilant in supporting millions of connected devices used by consumers in online streaming.[49] From the operational perspective, Netflix has large, complex and highly distributed systems environments. The company has exceptional tools with intelligent analysis that enable it to detect faults in systems and improve on customer experience and handle increasing data traffic.[50]

Also, Netflix need to pay more attention on creating its own original content. This will decrease its dependence on content providers. Netflix is guaranteed success in content creation since they have enough information about the content that customers are desperately in need of. This can be seen with its original TV series the “ House of cards” and “ Hemlock Grove”, both of which have received acclaim in the industry.[51] Netflix is able to determine if a particular TV series or movie is going to be a hit based on consumers viewing habits. This provides them with a huge advantage in content creation. However, this does not mean that Netflix should abandon its providers as its survival is largely dependent upon the variety of its content. Netflix still has to rely on its content providers to meet the needs of its large consumer base.

Conclusion

In conclusion, while Netflix is the most prominent provider of online streaming with operations in the US, Canada and in 42 countries in Latin America and Caribbean, it faces a number of political, economic, social and technological factors in the industry. From legal battles emerging form trademark, copyright and patent issues to social and economic factors such as the inability to feature the latest releases and stiff competition in the industry. The main issues and challenges that Netflix faces are the high bargaining power of suppliers and stiff competition from well-financed and innovative companies such as Apple, Google and Amazon. However, the company could pursue various strategic growth options to further consolidate its position in the industry such international expansion, domestic market penetration, product development and diversification. Based on the SAF framework, Netflix is better positioned to focus exclusively on online streaming business and developing its own original content. This will provide the company with the sustainable advantage that it needs in terms of reducing the suppliers bargaining power, consolidating its competitive position in the industry and increasing customer experience.

Netflix’s overall situation is fairly attractive and somewhat sustainable. It remains the single largest source of internet traffic in the US, consuming 29. 7% of peak downstream traffic. However, given the inevitable decline of the DVD business, the company should consider focusing their business model on online streaming and creation of original content. With the growing capabilities of broadbandcommunication, which allow for faster downloads and streaming of content, the industry is quickly moving online. This does not mean abandoning its content providers. It should be remembered that Netflix’s survival is dependent on the variety of its content. Netflix should be savvier than ever by negotiating better agreements for online streaming, increasing the selection of titles and making it possible to stream more content including the latest releases.

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