In this article, the author explores recent pricing and product delivery changes by Netflix and examines the lessons learned from the company's previous failed attempts at changes in these areas. Author Tim J. Smith is the managing principal at Wiglaf Pricing, adjunct professor at DePaul University, a frequent PPS speaker, instructor and presenter, and the Academic Advisor for the Certified Pricing Professional designation. His most recent book is Pricing Strategy: Setting Price Levels, Managing Price Discounts, & Establishing Price Structures (South-Western Cengage Learning, 2012). He can be reached at tsmith@wiglafpricing.com.

Netflix Goes to the Pricing and Branding Trough Once Again

In 2011, Netflix's pricing and branding shuffle enraged customers. After taking a few back steps, Netflix is at it again for 2014. What makes Reed Hastings, CEO of Netflix, Inc. (NFLX) think he will succeed this time, given that customers and shareholders alike ranted hyperbolic disapproval at his earlier moves?

Strategic Error in 2011

As of 2010, Netflix subscribers could enjoy a mix of online streaming and DVD-by-mail movies from Netflix. Subscription prices varied according to the number of DVDs a customer could borrow at a time.

But Mr. Hastings perceived a shift coming to the movie rental industry. His vision for the future of DVDs rentals was bleak, but that for streaming video was bright. Mr. Hastings’ desire to keep Netflix at the forefront of the shifting movie consumption patterns required decisions and actions, and so he took them—like any good CEO would do.

Around July 2011, Netflix began to quietly separate its streaming line of business from its DVD-by-mail line of business with plans to charge $7.99 for each service with no bundled discount. This relatively minor change in pricing alone created some customer complaints, but most customers accepted the change.

However, Hastings wanted to make the separation between the lines of business more obvious to customers, and perhaps set up Netflix, Inc. for restructuring.

In September 2011, two month after the pricing change, Netflix launched Qwikster. Qwikster was the new portal through which DVD-by-mail subscribers were to order future DVD rentals, while Netflix was to remain the streaming video subscription service.

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Customers howled at this change. They neither liked having to use two websites nor the change in pricing. 16,000 subscribers logged their complaints on the Netflix blog.

By October 2011, just one month after the launch of Qwikster, Netflix retreated. They killed Qwikster, returned these customers to the Netflix brand, yet kept the price structure changes in place.

By 2011 year end, subscription numbers had returned to an upward path. 610,000 new subscribers had joined the Netflix services in the fourth quarter of 2011. The total number of subscribers hit 24.4 million at 2011 year end, leaving only a small dent in the upward trajectory from the prior June 2011 subscriber base of 24.6 million related to the third-quarter pricing and branding changes.

It appeared as though the customer complaints were arising more from a branding challenge than a pricing challenge. Customers really didn’t like the new Qwikster brand, Qwikster website, nor Qwikster login-process, but they were willing to accept the new pricing structure.

That is, the strategic error was in branding, not pricing. And the error was not insurmountable. Following a quick branding correction by Hastings, Netflix was back in the game.

And Strategic Changes in 2014?

Through 2012 and 2013, subscriber numbers continued to grow at Netflix to 38.5 million, through rapid growth to 31.7 million streaming customers and slow declines to 6.8 million DVD-by-mail subscribers. These changing subscription patterns showed Hastings pre-science, yet it also raised new questions: How will Netflix define the future of the movie-streaming business?

In January 2014, Hastings announced he has been exploring his possibilities in both pricing and branding once again.

First, in terms of branding, he has quietly moved the DVD-by-mail business to dvd.netflix.com and has determined to brand future envelopes with the dvd.netflix.com logo. This small change in branding seems to have gone over with customers without a hiccup.

Second, in terms of pricing, Netflix has added two tiers. At the lower end, Netflix is testing a $6.99 offer for single-streaming. At the upper end, Netflix is testing an $11.99 offer for four concurrent streams on top of its 3-stream standard at $7.99. Netflix is also testing price differentials for standard definition versus high-definition streaming. Hastings has indicated an intention to define three different standard options for customers to select between.

Will the 2014 Branding Changes Stick?

Unlike the 2011 move, the 2014 branding shift is unlikely to cause major challenges for Netflix.

The change from netflix.com to dvd.netflix.com is subtle. It is along the order of magnitude of British Petroleum using the BP name and 20th Century Fox shifting to 21st Century Fox, or the development of a single logo for the collection of businesses run by Emerson. And, as people are becoming comfortable with subdomains as internet addresses proliferate, they aren’t likely to see the shift as a significant change.

But most importantly, the shift is unlikely to be perceived as a message from Netflix to its DVD-by-mail customers that Netflix no longer desires their business, unlike the prior removal of the Netflix brand name from that subscriber base and the unceremonious shift to the Qwikster moniker.

As Regis McKenna has espoused, a brand is a history of experiences through which customers learn what to expect from the relationship. As such, unilaterally killing that relationship by throwing customers into a new brand is a dangerous move for a business to take in one step. Case studies have demonstrated that slow adjustments over time can enable the shift, but dramatic moves in brand names disrupt business.

Hastings’ small shift in branding the DVD-by-mail business is likely to be part of a long-term move to prepare Netflix for a streaming-focused business. But for now, Netflix is able to both state it values its DVD-by-mail customers and is building its streaming subscriber base. “Ands” work better than “buts,” and maintaining relationships works better than distancing customers.

And the 2014 Pricing?

Like the 2011 move, the 2014 pricing shift is likely to improve Netflix’s future.

As product categories escape the introduction phase and transition through the growth phase en route to maturity, customers disaggregate from a monolithic market into distinct segments.
Different customers, and therefore different segments, will desire different things from the market category. Astute marketers therefore engage these segments by offering product packages which meet the various segments’ demands at prices they are willing to pay and which overall improve the firm’s overall profitability.

Mr. Hastings is well aware of this. In response to pricing questions during the 22 January Netflix Earning Call, he stated in the “It’s not clear that one price fits all” after stating “We’re willing to take on a slightly richer offering and realizing that that might be better for consumers and us.” Existing customers will find their current plans grandfathered into the near future. New customers will find their options expanded and be able to select offers which better align with their needs and pocketbooks.

In other words, Mr. Hastings realizes the streaming video market is in the growth phase and that if Netflix is to win market dominance at the maturity phase, it needs to broaden choices for customers now.

Mr. Hastings went on to indicate that the current experiments in pricing and packaging is not over. More changes may come. This too is good.

The three streaming packages in their current form are unlikely to exhaust the future needs of the market or cost structures. Variations in internet download speeds, the greater value delivered in high-density video over standard-density video, and the potential impact of the end of net neutrality all create the need for flexibility in pricing—not to mention potential competitive moves and content supplier opportunities.

**Swill the Trough**

This time around Reed Hastings’ branding and pricing moves are aligned with the market needs. The hyperbole surrounding his 2011 error is unlikely to be resuscitated in 2014. Instead, Netflix should swill down the trough and continue its explorations.

Mr. Hastings realizes the streaming video market is in the growth phase and that if Netflix is to win market dominance at the maturity phase, it needs to broaden choices for customers now.

**Note of Interest and Holdings:** At the time of writing, the author is not currently a direct consultant to nor investor in any of the firms listed in this article.

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