

This article effectively presents a powerful example of the major impact of business communications on a firm's profits, competitive success, and even survival.

## Can Netflix Regain Lost Ground?

CEO Reed Hastings' poorly explained pricing and service changes have alienated customers and handed rivals an opening

By [Cliff Edwards](#) and [Ronald Grover](#)

At Netflix ([NFLX](#)), new hires are drilled in Chief Executive Officer Reed Hastings' guiding principles. Avoid "barnacles" that can slow down a fast-growing business, Hastings advises newcomers. Make tough decisions without agonizing and focus on great results rather than process, go his dictums, which are posted on the video service's corporate site.

Now Hastings, who founded Netflix in 1997, is learning the limits of his shoot-first credo. His attempt to navigate away from DVDs-by-mail and toward online movies and television shows resulted in a series of poorly explained pricing and service changes, announced by Hastings on the Netflix blog, that alienated customers and Wall Street.

Besides becoming the butt of late-night TV hosts' jokes, the company may have lost as many as 600,000 of its 24.6 million U.S. customers since July, estimates Darren Aftahi, an analyst with Northland Capital Markets. The extent of the damage should be revealed on Oct. 24, when the company announces earnings and subscriber numbers that will show how many customers have fled. "Moving forward step by step, despite the foot with the bullet hole," Hastings wrote on his Facebook page in late September after striking a deal to add streaming titles from DreamWorks Animation ([DWA](#)), maker of the *Shrek* movies. He declined to comment.

Hastings might have dodged the bullets had he paid more attention to process and reacted more speedily to his customers' frustrations, expressed in the thousands of negative comments on the Netflix blog. The miscalculations began in April, when Hastings moved to end a debate within the company over how much of Netflix's resources should be devoted to the DVD business, as opposed to streaming movies over the Web. Netflix executives expect the DVD business to decline over the next five years. Hastings' plan, announced at an April staff meeting, was to separate and rename the DVD business Qwikster, according to a former employee. Customers were told in July that they would be charged \$7.99 for each, instead of \$9.99 for both.

For years Netflix had carefully tested its products in focus groups assembled in the Lord of the Rings conference room in Building A at its Los Gatos (Calif.) headquarters campus or at rented space around the country. Focus groups have been asked about everything from the red color of DVD envelopes to the quality of video streams. This time Hastings skipped the focus group step, missing an opportunity to gauge customers'

potential reactions to separate websites and billing, according to the former employee. (Netflix spokesman Steve Swasey declined comment.) Instead, Hastings and his team relied on data showing that 75 percent of new signups before the price hike preferred streaming.

After the April discussions, there was hardly any internal talk about the plans to split the businesses. At a July meeting, the company's chief marketing officer said that she was monitoring reaction to the price hike announced in a blog posting on July 12, but made no mention of how the plan to spin off the DVD business into Qwikster would be communicated to subscribers, according to someone in attendance. Soon after, Netflix began moving workers at the DVD business into office space in San Jose and hiring Qwikster staffers, including a chief marketing officer.

Netflix executives expected a spike in cancellations after the price increase, but thought it would be short-lived, Chief Financial Officer David Wells said at a conference on Sept. 21. Some of the company's analysis proved correct: Even amid the backlash, the majority of new customers are opting for the \$7.99-a-month streaming-only plan, skipping the add-on for DVDs, says Swasey. He points out that for the millions of customers who took the streaming-only plans, the price change was a "non-event."

The problem was with older users long accustomed to receiving the red DVD envelopes in the mail. Netflix had been working to wean them off of the three-at-a-time DVD habit to reduce costs, and Hastings wanted to move them more quickly to streaming only, Swasey says. But it turned out that those customers viewed the online service as a free add-on to DVDs, not the other way around, says James McQuivey, an analyst with Forrester Research. On Sept. 15, Netflix said it may have a net loss of 600,000 customers in the third quarter, reversing a trend of large subscriber gains. The defections may continue, with as many as 1.95 million subscribers dropping service in the fourth quarter, estimates Northland Capital's Aftahi.

Hastings believed that announcing new content deals for streamable content soon after the price increase would help calm subscribers and investors. Yet things worsened the day of the price hike when word spread that Netflix's negotiations with Liberty Media's ([LSTZA](#)) Starz cable network had failed, and that Netflix would lose access to newer films from Walt Disney ([DIS](#)) and Sony ([SNE](#)). That left the impression Netflix was losing content as it raised prices.

Swasey says that the price increase only really mattered to half of Netflix's members, and that the company could have done a better job explaining the economics of the move. "We should have said \$2 a month for unlimited DVDs just wasn't covering it," he says. The company also should have explained to customers that the Starz deal was not so significant, since the content involved a small share of viewing and that the higher payment Starz demanded could be better spent on other fare. "That was another issue where we did not get out in front of it as well as we could have," Swasey says.

Hastings' final miscue was his Sept. 18 blog post which purported to apologize to angry Netflix users. It came off badly when he took the opportunity to announce that the DVD operation would move to the new Qwikster service, says Dave Gray, senior vice-president at social-networking consultancy Dachis Group. "It was definitely a half-

hearted, 'We're sorry you feel the way you do' apology," he says.

Now that Netflix has backtracked on Qwikster, will all be forgiven or have some subscribers stopped listening? One warning sign: While Hastings' apology and Qwikster

announcement drew 27,842 spirited comments on Netflix's blog, the company's retraction of the breakup plan drew only 843.

***The bottom line:*** *Netflix's decision to raise prices and split its movie-delivery service may cost the company 600,000 subscribers.*

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