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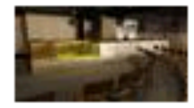

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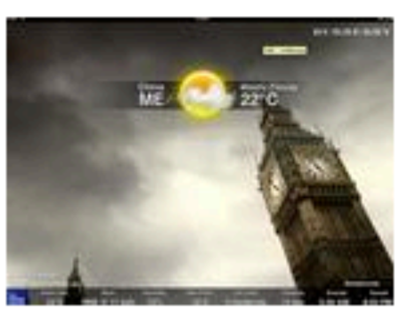

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Opinion: Netflix is expanding, but will its customers' wallets?

Thu, 30 Aug 2012

Gene Hoffman, CEO, Vindicia

After expanding into the UK early this year and then two quarters of losses, Netflix has posted a profit. However with aggressive expansion planned for Europe and the significant spend required, the online movie service needs to shore up its achievements, as it focuses on winning new customers and territories.

In the eight months since Netflix launched in the UK and Ireland, it has gained over 1m new subscribers for its TV and film services but new customers came with a large price tag. In Q2 alone, Netflix's acquisition costs in Europe were $89m.

With the recent announcement of further expansion into Western Europe, Netflix is staking out its territory. But it now needs its European success to mirror the profitability achieved in the US. It will want to ensure acquisition costs don't get out of control.

Part of Netflix's success in the UK derives from how it has staved off competition from Amazon's LoveFilm, largely through a high-profile advertising and marketing campaign. The campaign concentrated on a free trial month for customers, so key to its long-term success will be how trial customers are transformed into paying subscribers. We don't know Netflix's new customer churn rate yet but given that many will have moved on once their free trial has expired, it is likely to be high.

At my first company, eMusic, we faced similarly fierce competition from Napster, which gave away digital music for free. This prompted us to develop a tailored billing engine, which, alongside quality content, kept customers coming back. Now, at Vindicia, we see Netflix as a high profile example of the kind of challenges many of Europe's new digital media businesses face.

The 'freemium' or 'try before you buy' business model is a compelling way to boost customer numbers. But the management tools and practice needed to keep these customers for the long term are often ignored. Customer acquisition is, in many ways, easier than customer retention. For any fast-growth company, taking a moment to stop, take stock, secure and *then* move forward can be a very sensible step.

I do generally admire the Netflix business model. Last year in the US it experimented with customer billing and marketing data to figure out exactly which customers were their most loyal and spent the most. Then it could tailor its pricing packages accordingly. But now Netflix needs to apply this logic to retain its new customers across the pond. I am a little surprised by the speed of its planned expansion; focusing so intently on acquisition could be a risk.

The danger is that expanding further into Western Europe will distract from the challenges ahead, and Netflix will fail to claw back costs. The decisions to be taken around converting 'free trial' customers must be informed by good marketing and billing data. Good data analytics can show you exactly where your customers are, how they spend, and what is the best way to keep them. Netflix has done this in the US to great effect, where it now boasts a churn rate of 4% a month, and where the average stays tuned in for 25 months.

Netflix's strategic model of expanding, regaining profitability and then ploughing those profits into a further expansion is sound – and certainly seems to be paying dividends so far – as shown by its US success. However, the real key to long-term profitability will be ensuring the markets in which it currently has a presence maintain initial success, through a well-oiled customer retention machine.