The Online Battle for the Movie Rental Market

It had to come to this, someday! U.S.-based Netflix, Inc., the online movie and TV-program rental distributor, announced in the Summer of 2010 that it was going to enter the Canadian market (see netflix.ca) in the coming fall (Flavelle, 2010, p. B1). Company plans held true. Canada is the first foray of Netflix outside the U.S. (Flavelle, 2010, p. B1). The Netflix brand is known to Canadians (i.e., brand recognition) because of travel to the U.S. and because of the advertising by the company in U.S. media to which Canadians have access, such as magazines, newspapers, online, and the various U.S. television networks carried by Canadian cable and satellite companies.

Netflix, based in Los Gatos, California, began operations in 1997 (Krashinsky, 2010, p. B1). By early Summer, 2010, the company had between 13 and 14 million subscribers (cf. Krashinsky, 2010, p. B6; McLean, 2010, p. B3); into the fall and by the end of the year, that number, in the U.S. and Canada combined, had almost reached the 17 million mark (see Krashinsky, 2011, p. B7; netflix.com). The successful initial market entry of the company relied on low prices, relative to the traditional video stores of the time (e.g., Blockbuster, Inc.), DVD rental by mail, and further distribution and market penetration via automated movie-rental boxes (or kiosks) strategically placed throughout the market (e.g., outside a Walgreen's drugmart). The red movie-rental boxes, known as *Redboxes*, are operated by a firm carrying on business as Coinstar (Krashinsky, 2010, p. B1; also see coinstar.com). The fastest growing channel of distribution for the company is the online streaming of videos. The online distribution channel was the initial focus of the company in 1997, hence, the name *Netflix*, but a lack of distribution rights and the limitations of technology at the time delayed development of this channel.

While Netflix allows consumers in the U.S. to download movies (via streaming) off the Internet for home viewing, to pick-up and return a DVD at one of the Netflix "Redboxes" (i.e., kiosks), or to receive and return DVD rentals by mail; only the download (streaming) option is available in the Canadian market. As with the U.S. operation, for the Canadian market, there is only a single online subscription rate, set at $7.99 per month (same rate as in the U.S.), with unlimited viewing privileges. The option of a one-month free trial with unlimited viewing privileges is also available for new subscribers. One factor that might slow the market penetration of Netflix in Canada is the depth of program and movie choice that will be available through the Canadian operation: The U.S. Netflix operation offers nine times more movies and 11 times more TV shows than are available through the U.S. operation of the company (Krashinsky, 2011, p. B7).

Netflix is also pursuing market expansion with the latest technology. The company introduced an application for the iPad the day the latter product was introduced to the market, plans on linking to the iPhone, plans on developing products for the Android mobile platform (Krashinsky, 2010, p. B6), and has been working with manufacturers of Blu-Ray disk players to enable consumers to connect the online products of Netflix to their televisions at home (Krashinsky, 2010, p. B6). Netflix is clearly in an offensive strategy mode. It is not known if Zip.ca is pursuing any of these areas; if not, the company may eventually have to take a defensive posture, if Netflix is successful in expanding market coverage through multiple channels that rely on the latest technology. Many of the traditional ways used for movie-rental distribution may follow in the footsteps, and demise, of the buggy whip. However, until the newer technology is developed, the viewing of downloaded material is limited to computer, television, and iPad use.

In the Canadian market, the direct competitors of Netflix include the various cable and satellite companies in Canada and other firms that make similar media available (Flavelle, 2010, p. B1), as well as the traditional movie rental firms, such as Blockbuster Canada (cf. Krashinsky, 2010, p. B1). Canadian cable companies are in the early stages of offering similar online services for this developing market (Flavelle, 2010, p. B1). In the U.S., Netflix (online) subscribers can access the traditional mail-order DVD rental market for an additional $2.00 per month (see netflix.com), plus, of course, the regular $7.99 per month subscription rate. In the early summer of 2010, Flavelle (2010, p. B3) reported that the online fee was $8.99 per month.

One reason Netflix is not offering th email-order option as it enters the Canadian market is because the technology in the industry is in a state of flux (i.e., moving from mail-order to the streaming of online content) (cf. Flavelle, 2010, p. B3). Remember, it was not that long ago that VHS dominated the store-front and mail-order movie-rental industry. Consumers who own a game console, such as Xbox 360® or PlayStation 3®, also have the capability of downloading any program available on the Internet (Flavelle, 2010, p. B3) and viewing it on their televisions. Given the wide variety of ways that consumers can access and view online TV and movie content (i.e., to occupy their time), it is not difficult to understand how demand for traditional cable and satellite television could be negatively affected (cf. Flavelle, 2010, p. B3).

Operations similar to Netflix and the ensuing price wars that resulted after the firm entered an already established movie rental market have reduced the market share for in-store rentals to less than half of the movie rental market in the U.S. (Krashinsky, 2010, p. B1). The competitiveness of the market forced the U.S. arm of Dallas-based Blockbuster to seek bankruptcy protection in September, 2010 (Spector and Lublin, 2011, p. B14). During the past two years, the company has had to close around 1,000 stores (Spector and Lublin, 2011, p. B14). If the company is unsuccessful in obtaining the required influx of cash from creditors as it readies to leave bankruptcy protection, it expects to have to close hundreds, if not up to a 1,000, of the remaining 5,000 stores (Spector and Lublin, 2011, p. B14). Not only is Blockbuster being forced to close stores, but the earnings picture for the company continues to worsen. In 2010, the company had earnings of less than $100 million (BITDA), down from a value of more than $150 million in 2009 (Spector and Lublin, 2011, p. B14).

The picture for the traditional movie rental store in Canada is not as bleak as it is in the U.S. In Canada, the traditional movie rental stores still dominate the market and, overall, remain profitable (cf. Krashinsky, 2010, p. B1), with Blockbuster Canada being the market leader (Krashinsky, 2010, p. B6). However, the online movie rental market only represents 0.6% of the movie rental market and kiosks only draw another 1.4% of the $1.3 billion market in Canada (Krashinsky, 2010, p. B1).

The competitiveness of the movie rental market in Canada is expected to increase, since other competitors are expected to follow the lead of Netflix (cf. Krashinsky, 2010, p. B1). One of the current competitors in the Canadian market with whom Netflix will have to contend is Zip.ca, a Canadian firm that started operations in 2004. In 2009, the customer base for Zip.ca was estimated to be around 50,000, reflecting, for whatever reason, a growth rate that is much lower than that achieved by Netflix in the U.S. (Krashinsky, 2010, p. B6). One reason offered for the difference in the growth rates is that there is greater perceived value to the consumer in what is offered by Netflix in the U.S., due to the lower cost and the much larger choice of movies to view in that market (Krashinsky, 2010, p. B6). To gain successful market entry in the U.S., from a price-point perspective, Netflix was able to undercut the overall prices set by the traditional store-front movie-rental operations (Krashinsky, 2010, p. B6).

Currently, Zip.ca follows the Netflix postal model by delivering customer DVD requests by snail mail. There are seven price lines, with monthly subscription rates ranging from $5.95 to $49.95, depending on the number of titles the customer has out on loan at a time and out during the month (see Table 1). The cost of postage is included in the rental price, including the cost of a prepaid return-envelope for sending the DVD back to the company (Krashinsky, 2010, p. B6).

Table 1: Zip.ca monthly rental plans for postal delivery of DVDs

Number of DVDs out at a time	Monthly subscription	Conditions
1	$5.95	maximum of 2 out per month
1	$10.95	unlimited out per month
2	$18.95	unlimited out per month
3	$24.95	unlimited out per month
4	$24.95	maximum of 11 out per month
6	$36.95	maximum of 16 out per month
8	$49.85	maximum of 22 out per month

Source: zip.ca website, January 19, 2011.

Similar to the market offering of Netflix, Zip.ca offers a one-month free trial promotional offer is available from the company for new subscribers. The conditions for the free trial period offer are the same as the 3 DVD membership plan that the company offers (i.e., 3 out at a time and unlimited rentals during the month). If a customer fails to cancel the subscription prior to the end of the trial period, during the following month, the customer will be charged automatically at the same subscription rate, unless one of the other subscription plans was selected by the customer and registered with the company prior to the end of the trial period (see terms of use on the zip.ca website).

To fight head-to-head with Netflix, Zip.ca plans to distribute movies online and from rental kiosks in the near future. The website for Zip.ca has tabs for mail, kiosk, and streaming options. As of the beginning of 2011, however, only the mail option is fully operational. The streaming and kiosk options still appear to be under development. Nonetheless, the website does indicate that 82,000+ movie and television programs are available, and in the "terms of use" legal information on the website, it indicates that zip.ca also may also sell new or used DVDs; thus, the company appears to want to keep all channels of distribution open. The one interesting feature of the website is that the company shows a "red" DVD kiosk, the same colour used by Netflix in the U.S.

The plan of Zip.ca was to enter the online rental market sometime in the fall (Krashinsky, 2010, p. B6), but this option has yet to become a total reality. By Fall 2010, the company expected to complete a pilot project to test $1-a-day movie rental kiosks in selected Metro supermarkets in Montreal and Ottawa (Krashinsky, 2010, p. B6). A successful pilot project indicate that the company would then begin placing the rental machines in 800 Metro stores across the country under a shared-revenue agreement with the stores (Krashinsky, 2010, p. B6).

As of the end of 2009, competitors in Canada were operating about 400 DVD dispensing machines in the market (Krashinsky, 2010, p. B6). In the U.S., there are about 27,000 such machines (Krashinsky, 2010, p. B6). As of January 2011, the status of Zip.ca in the kiosk market is uncertain, since only six Metro store locations are listed on the zip.ca website as providing this service (4 in eastern Ontario and 2 in the Montreal, Quebec, area). However, on the company website, there is a sign-up link for customers to receive notification when locations are open within the respective shopping areas.

Other major competitors in the Canadian movie rental business include Cineplex; Rogers Communications, Inc. and other Internet providers (e.g., Shaw Communications: Video On Demand, Bell Canada: Pay Per View); Blockbuster Canada; dedicated movie channels with video on demand options (e.g., Movie Central); and, possibly in the near future, Amazon.ca. Cineplex, is a major movie theatre operation in Canada, with 129 theatres. Cineplex plans to expand the online DVD store it operates, allowing consumers to purchase or to rent downloaded movies ("Cineplex to offer," 2010; Krashinsky, 2010, p. B6). For a rental price of $2.99, $3.99, or $4.99, depending on the movie, consumers can digitally download a movie, have access to the movie for 30 days, and view the movie as many times as desired over any 48-hour time period within the 30-day period (see Cineplex "Find in Store" link at cineplex.com). To be able to rent movies, Cineplex must receive permission to do so by the studios that own the rights to the movies, as has so far been granted by Sony, Universal, and Warner Bros ("Cineplex to offer," 2010). All movie and television program rental operations must receive the same authorization.

Rogers Communications, Inc., a major cable/cellphone/internet operator in Canada, rents movies through the traditional company retail stores and operates Rogers On Demand Online (Krashinsky, 2010, p. B6). The latter online operation allows subscribers to watch what is showing on television online, as well (Krashinsky, 2010, p. B6). Rogers also operates a video-on-demand service, which allows customers to rent movies for viewing via television (Krashinsky, 2010, p. B6). Overall, the corporate structure of Rogers allows customers to satisfy their entertainment needs via television, computers, and mobile phones, including the video-on-demand online service (Flavelle, 2010, p. B3). Such a structure is consistent with the belief by the company that consumers prefer to single source all of their entertainment needs (Flavelle, 2010, p. B3), which may be why the company is investigating the online movie rental option (cf. Krashinsky, 2010, p. B6). The investigation of the latter market may position company to be ready to take a defensive move, if the online competitors damage the current movie rental business of the company.

Another competitor in the market is Blockbuster Canada. Blockbuster Canada feels the traditional movie rental market for movies is secure, even though it is looking into the online rental market (Krashinsky, 2010, p. B6). The company believes that it has to market the company product in the way which consumers desire (Krashinsky, 2010, p. B6). One way in which the company tries to meet consumer needs/wants and to better respond to the changing competitive market is by offering a "Favourites Movie Pass." This rental option allows customers to rent an unlimited number of selected movies for $9.99 a month, with the condition that only one movie can be out at a time (see blockbuster.ca website).

As indicated, a possible "bull in the china shop" in the movie rental business in the near future is Amazon.ca. Even though Amazon.com in the U.S. has only queried studios about setting up a movie rental subscription service in the U.S. similar to what Netflix offers, the recent purchase of full control (up from 42% ownership) of Lovefilm, a European DVD rental and movie-streaming service which operates in the U.K., Scandinavia, and Germany (Peers, 2011) suggests that Amazon, which currently only sells movies, might become a serious contender in the online movie rental business in the near future. Since Amazon operates Amazon.ca in Canada, it would be a simple process to enter the Canadian market in the same way. The fact that this company had a significant investment in Lovefilm prior to the complete takeover of the firm indicates that the thinking process pertaining to the rental business was already in motion.

If it were not enough to have to worry about the competitive nature of the market, another issue that Netflix has to deal with respect to the Canadian operation is the impact restrictions on download data-limits set by Canadian Internet operators will have on consumer downloading behaviour over the Internet. Within a week after Netflix announced plans to enter the Canadian market, Rogers Communications Inc., a major Canadian cable and Internet access provider, as previously indicated, restructured the rates and data limits for Internet access (McLean, 2010, p. B3). As of July 21, 2010 (i.e., after the Netflix announcement), new customers of the Lite Internet service provided by Rogers were only allowed 15 gigabytes of downloaded data per month, down from the previous limit of 25 GB for those who subscribed to the Internet service prior to July 21, 2010 (McLean, 2010, p. B3; Krashinsky, 2011, p. B7). The overage surcharge per gigabyte (i.e., for additional data-downloading access beyond the allowed limit) also went from $2.50 per GB to $4 per GB, up to a limit of $50 for the overage (McLean, 2010, p. B3). The download data-limit for those who subscribe to the Extreme service saw their monthly data-limit go from the original 90 GB limit to 80GB (McLean, 2010, p. B3). The data-limit and rate changes did not apply to existing customers (McLean, 2010, p. B3).

While data limits are usually not a major concern when it comes to ordinary Internet usage, downloading movies and television programs poses quite a different situation. The typical two-hour movie downloaded on Netflix involves about 2 GB of data transfer; a HD movie uses up about 3 GB of data-transfer capacity (McLean, 2010, p. B3). Under the Lite subscription offered by Rogers, this means that a customer could view 5 HD movies or 7-8 regular movies per month (i.e., 15 hours of viewing) without facing an overage charge (cf. McLean, 2010, p. B3). Use of the subscription plan set by Netflix (i.e., $7.99 per month and unlimited) beyond the limits set by Rogers would lead to higher and additional costs to the consumer, costs of which the consumer may not be aware. To take full advantage of the Netflix market offering, old and new customers may have to consider upgrading to a higher data-capacity Internet plan or switching to non-Internet movie-rental options (e.g., Zip.ca and the traditional store-front movie rental retailers).

In the U.S., not only do consumers have a greater choice of television programs and movies to view, but they also have much higher data-download limits. One of the lower limits offered in the U.S. is by Comcast, which is set at 250 GB, enough to allow for around 8 hours of viewing per day (Krashinsky, 2011, p. B7). Since, in both Canada and the U.S., movie Web services are also provided by cable and satellite services (cf. Krashinsky, 2011, B7), independent movie rental services, such as Netflix and Zip.ca, pose a threat to the current infra-structure (cf. Krashinsky, 2011, p. B7). One way to discourage customer use of such services is to change the data limit and rate structure. Bell Canada states that the data caps set for online Internet use are above what the average user requires and that heavy users should pay for what they use (Krashinsky, 2011, p. B7); the latter situation being no different from the situations in many industries (e.g., home consumption of city water and electricity).

The smaller Internet companies in Canada rent space for the major networks, often offering unlimited access to customers as a means by which to compete (Krashinsky, 2011, p. B7). Unfortunately for the smaller companies, the regulatory agency in Canada - Canadian Radio-television Telecommunications Commission (CRTC) - gave the networks permission to set the charges to the smaller companies based on usage, a decision that has resulted in increased costs to these firms (Krashinsky, 2011, p. B7), with corresponding cost increases being passed on to final consumers (Krashinsky, 2011. P. B7). As a result, promoting the benefits of the "unlimited usage" option may not be as sound a strategy as it once was for the smaller firms.

As was stated at the beginning of the case, "It had to come to this, someday!" Only time will tell how things evolve. Remember, it was in 1969 that the first step was taken to initiate a national computer network in the U.S. The thought of using such a system for movie distribution was probably the farthest from the minds of the scientists and engineers of the day.

Focus: The concepts that are relevant to this case are categorized by general topic area, as set out below: [Note: Not all of the concepts listed are directly used in the article; some of the concepts relate to the general area of discussion pertaining to the questions posed at the end of the case.]

General marketing concepts: country of origin; competitive advantage; sustainable competitive advantage; survival (business goal); market penetration (in general); B2C market (Business-2-Consumer); market development (see Ansoff, 1958).

Consumer concepts: ethnocentricity; generic demand vs. selective demand; adoption process (concept and stages), stimulus generalization.

Product/service concepts: brand awareness; brand recognition; brand preference; depth and width of product offering; conceptual content of new product and rate of diffusion: compatibility, relative advantage (economic, technical, social), divisibility (trialability), communicability (observability), complexity; degrees of innovation: continuous, dynamically continuous, discontinuous (in terms of degree of relatedness to currently existing products and impact on behaviour of consumers); product vs. service; product/service attributes (durable, semi-durable, nondurable, digital); evaluative criteria; types of new products: new concept, new process, new to the company, new model; product life cycle (concept and stages).

Place (distribution) concepts: channel flows: product/service [forward and reverse], financial, information; sales promotion; horizontal (intra-type vs. inter type) conflict (competition); vertical channel; reverse channel; vertical conflict; channel facilitator; intensity of distribution; single-, dual-, and multi-channel distribution; direct channel; indirect channel; geometric principle of place convenience; geographic pricing: uniform delivered prepaid pricing; retailer; pure play retailer; bricks and mortar retailer; clicks and bricks retailer, scrambled merchandising.

Promotion concepts: promotion (advertising, sales promotion, personal selling, publicity); negative-option selling.

Price concepts: price level policy; odd-even pricing; price points (price lines).
Other concepts: streaming; BITDA (accounting concept); monopolistic competition; external environment (CERTS): competition, economic, regulatory, technology, social (e.g., political system, culture), broadband, bandwidth, data limit.

Questions:

1. Define each of the concepts listed in the Focus section.

2. Explain how each of the concepts listed in the Focus section apply to the case. Use specific information (i.e.., quote from the case) to support your answer.

3. Based on the information presented in the case, draw and fully label the structure of the entire channels of distribution for Netflix (Canadian and U.S.), Zip.ca, Cineplex, Blockbuster, and Rogers. Compare the nature of the channels of distribution across the different businesses.

4. If vertical integration were to happen in the movie rental business, what would be the nature of such integration? Explain. What are the economics of such integration to the businesses involved?

5. What is the nature of the channel flows that occur within the movie rental business? Explain.

6. Why did the online movie rental business not exist before the invention of the Internet, cable television, satellite television, and the related technology? How can such a business exist today? How could the movie rental business exist if the Internet and the associated capability did not exist? When did the Internet come into existence?

7. Discuss, in the context of the types of new products (i.e., new concept, new process, new to the company, and new model), why the online/broadcast movie-rental business has been successful, at the expense of the traditional store-front movie-rental business? Include in your discussion reference to the VHS, DVD, and streaming formats. [As a side question, what format was used for movies prior to the VHS format?]

8. Discuss, in the context of the conceptual content of new products/services (i.e., compatibility, relative advantage, divisibility, communicability [observability], and complexity), why the online/broadcast movie-rental business has been successful, at the expense of the traditional store-front movie-rental business?

9. Explain how the history of the buggy whip is an appropriate analogy for what is happening in the B2C (Business-to-Consumer) movie distribution business.

10. Based on the contents of the case, explain the nature of any vertical conflict that has arisen in the distribution channel for online/broadcast movie rentals.

11. Both Netflix and Zip.ca offer new subscribers a one-month free trial period with unlimited viewing. The conditions for the free trial period with Zip.ca are the same as the 3 DVD membership plan that the company offers (i.e., 3 out at a time and unlimited rentals during the month). The Netflix one-month free trial period is unlimited online viewing within the stated time period. What consumer behaviour concept underlies the reason for offering a free trial period? Explain how such a strategy relates to the concept. Under which category of the promotional component of the marketing mix does such a market offering apply? Explain.

12. When a customer signs up for the free one-month trial period with Zip.ca, unless the customer cancels the subscription prior to the end of the trial period or makes other arrangements with the company, the customer will be billed at the 3 DVD "out" subscription rate automatically during the following month (i.e., $24.95). As it states in the 'Terms of Use' on the website of the company, at the time of signing-up for the trial period, the company received a $30 pre-authorized amount from the customer's credit card. What term is used to describe the cancellation condition set by the company? What is the legal status of such a condition in Canada? in the U.S.?

13. Explain how the *geometric principle of place convenience* applies to customers who rent movies directly from store-front operations, from kiosks, received through the mail, and downloaded online (i.e.., via streaming). What are the advantages and disadvantages to the customer and to the company with each rental option?

14. Given that Netflix, Blockbuster, and Amazon.com are U.S.-based firms, each with a separate Canadian operation, to what extent do you think that, Zip.ca, a Canadian-based firm, would (and should) be able to successfully compete against these other firms based on a country-of-origin foundation (i.e., rely on the ethnocentric attitudes of Canadians - similar to U.S. firms relying on a nationalism foundation when competing in the U.S.)?

15. What comes first, brand awareness or brand recognition? Explain.

16. Based on the contents of the case, what do you think the future holds for the industry (i.e., movie/TV-program rental)? Explain.

17. Create a multi-column/multi-row table listing the concepts in the first column, the definition of the concepts in the second column, and a quote from the case that supports/reflects the concept in the third column - include a title for each column. Since this case can be discussed either near the end of the course or throughout the course, it is best that you work on this table as the relevant topic areas are covered in the course.

18. Explain how the concept of stimulus generalization applies to this case. Why do marketers make use of this concept? In the current context, is it a wise move for either Netflix or Zip.ca to rely on this concept, whether it is used intentionally or by accident?

Sources: [1] Flavelle, Dana. (2010, July 20). Netflix to stream over border. *The Toronto Star*, pp. B1, B3); [2] Krashinsky, Susan. (2010, July 20). Netflix set to shake up file rental business with online streaming. *The Globe and Mail*, pp. B1, B6. [3] Krashinsky, Susan. (2011, January 12, p. B7). Netflix confronting Canadian challenges. *The Globe and Mail*, p. B3. [4] McLean, Jesse. (2010, July 24). Rogers shrinks user download limits. *The Toronto Star*, p. B3. [5] Peers, Martin. (2010, January 21). Amazon streams Europe. *The Wall Street Journal*. Retrieved from http://online.wsj.com/article/S B10001424052748704881304576094240849211816.html?mod= WSJ_Markets_section_Heard [6] Spector, Mike, & Lublin, Joann S. (2011, January 18), *The Globe and Mail (The Wall Street Journal section)*, p. B14. [7] Cineplex to offer online movie rentals. (2010, November 19). *Money*. Retprieved from http://money.canoe.ca/money/business/canada/archives/2010/11/ 20101119-130824.html [8] Netflix websites: http://www.netflix.com, http:www.netflix.ca (click on the link at bottom of the Netflix website that opens to access the U.S. or Canadian website). [9] Zip.ca website: http://www.zip.ca. [10] Cineplex website: http://www.cineplex.com.

Bibliography: [1] Ansoff, H. I. (1958). A model for diversification. *Management Science*, *4*(4), 392-414.