Success Diaries

Success isn't a straight line. Even the most accomplished business leaders have had to face the anvils of crisis at pivotal points. There are immense learnings to gain from moments of such successes and failures

At Kalaari, we draw our energy from helping founders succeed. Through Success Diaries, we bring to you case studies that draw analysis and insights from the journeys of extraordinary companies. We hope this helps you as you build an enduring enterprise of tomorrow

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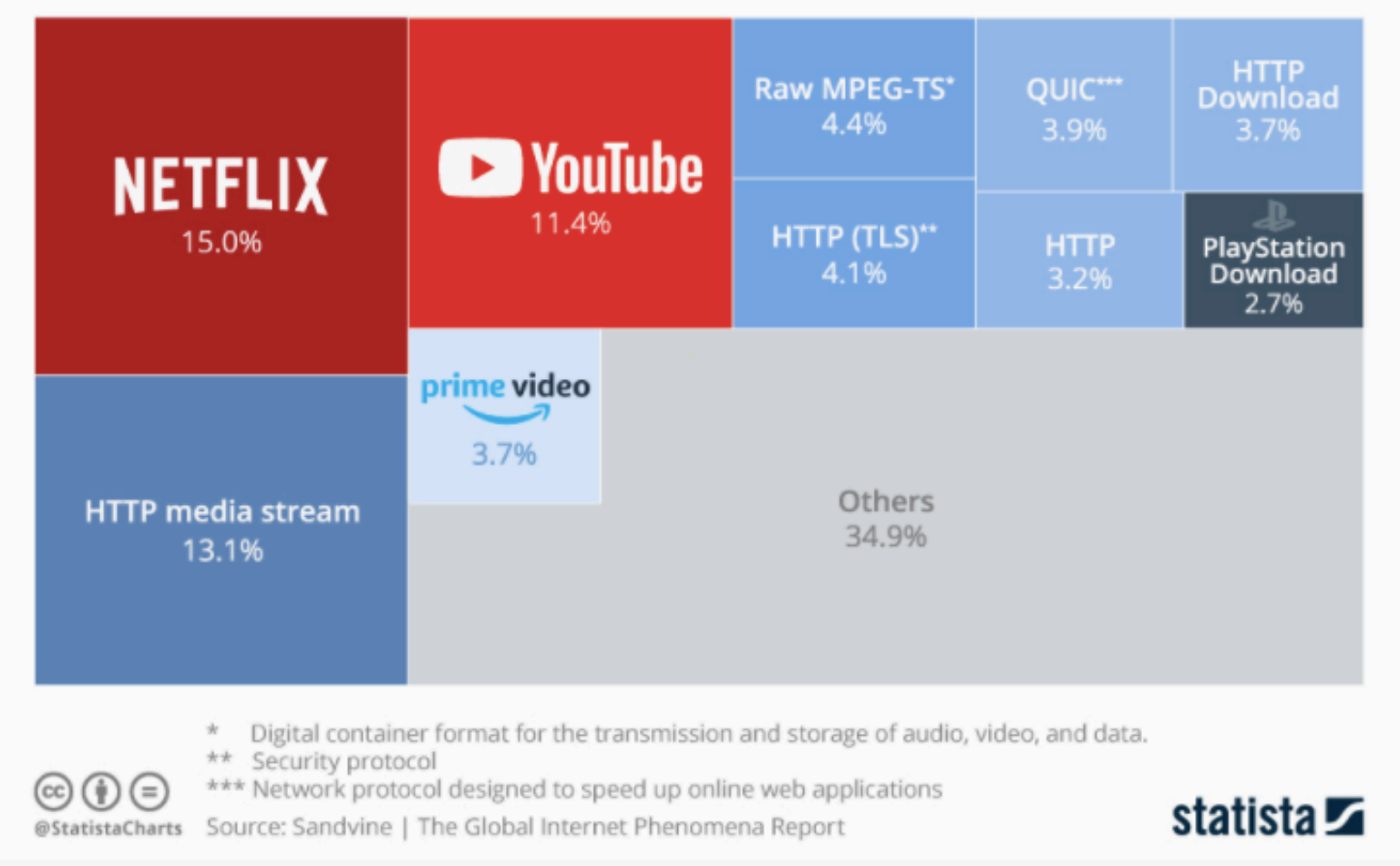
NETFLIX

The media revolution that was streamed not televised

By Harshith Mallya

Netflix accounts for 15 percent of global internet traffic!

Distribution of worldwide downstream traffic by application



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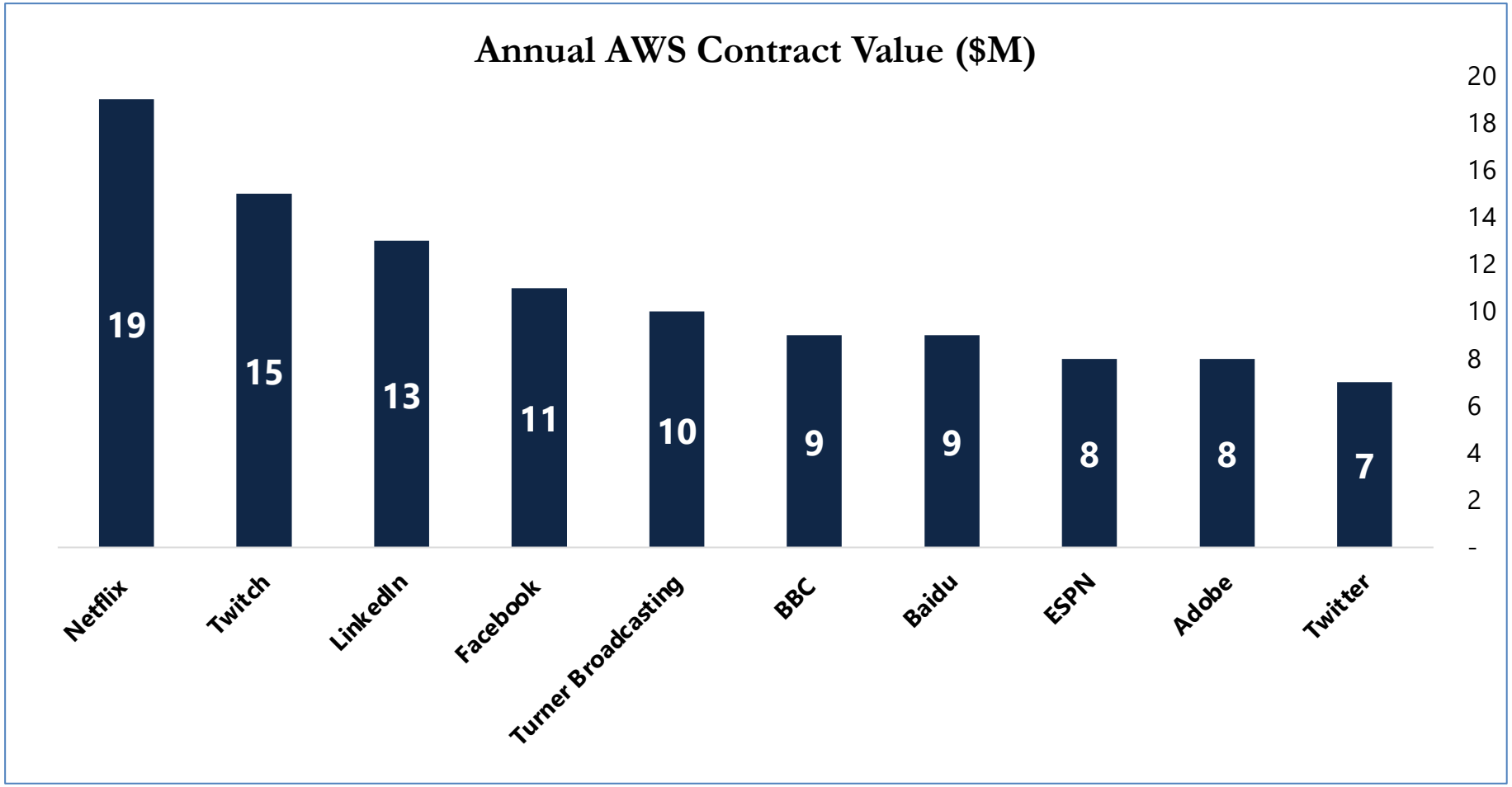
Netflix is also the largest AWS customer globally



Source: Contino

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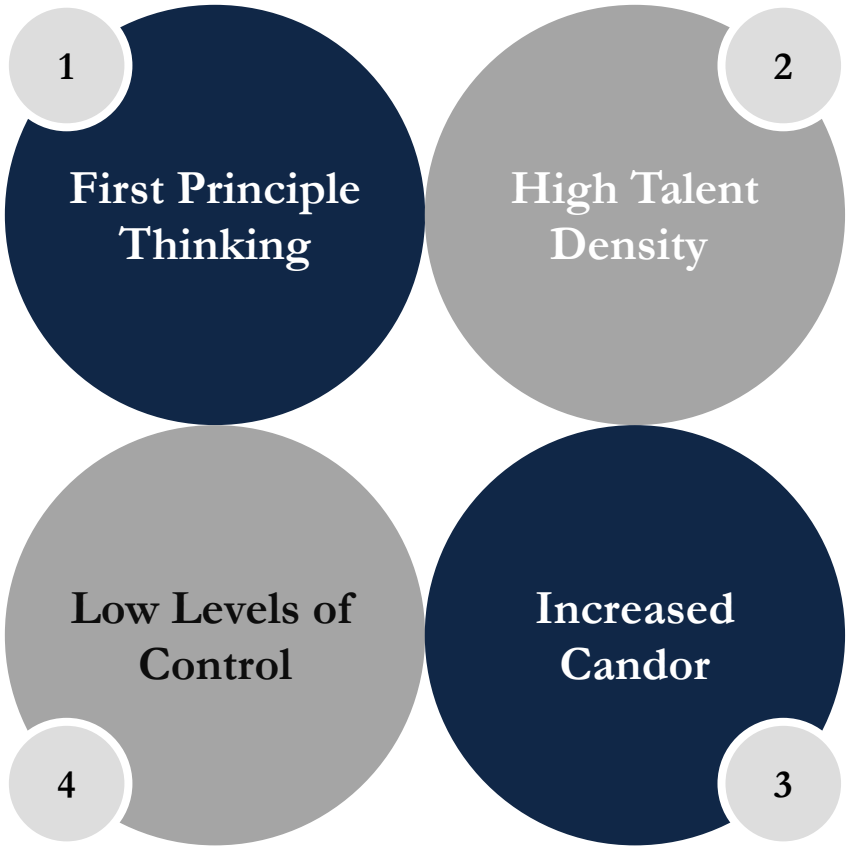
Netflix success derives itself from four key tenets



First Principle Thinking

Netflix credits first principle thinking for its ability to jump from DVD rentals to content aggregation and then to original content production

High Talent Density

Netflix believes that if an organization is made of only high performers, you can have a leaner team with high ownership and high outputs

Increased Candor

When you disagree with an idea or decision but do not express that disagreement, Netflix believes that the employee is disloyal to the company

Low levels of Control

At its core, Netflix's ethos is "People over Process". It gives employees freedom to make decisions but also expects constant peak performance

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Early days of Netflix

💡 **Fun Fact:**

Netflix was initially called Kibble. Co-founder, Marc Randolph, believes a company's beta name must be really bad so as to force the team to come up with a better name & brand identity before launch. The founders considered names such as 'Webflix', 'TakeOne', 'NetPix' before settling on Netflix – even though they didn't like it. Marc Randolph still owns Kibble.com. It redirects to his personal website

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After $700M exit, Reed Hastings was bitten by entrepreneurial bug again

Reed Hastings

- Degree in Mathematics from Bowdoin College and Master's in CS from Stanford
- Hastings' first job was at Adaptive Technology which he left in 1991 to start Pure Software
- Pure Software went public in 1995 under his leadership

Marc Randolph

- Degree in Geology from Hamilton College
- Worked on D2C marketing operations at Borland International & short stints at Silicon Valley startups before joining Pure
- VP of Corporate Marketing at Pure-Atria

In 1997, Hastings sold Pure-Atria to Rational Software Corporation for $700M

Hastings and Randolph came up with the idea for Netflix while commuting between their homes in Santa Cruz and Pure Atria's headquarters while waiting for the merger to close

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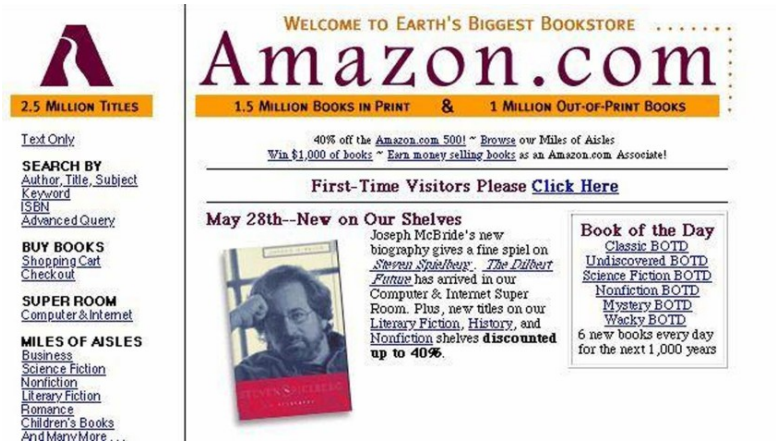
What Amazon did with books, Netflix aimed to do with DVDs



- Amazon started out by selling books over the internet as books were easy to pack & ship
- Hastings and Randolph tried to find a large category of portable items to sell over the Internet
- VHS tapes were too expensive to stock and too delicate to ship; DVDs on the other hand were compact & easy to ship

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Netflix launched as the world's first online DVD rental store

Netflix

- Founding year: 1997
- First online DVD rental store with over 900 DVDs
- Netflix introduced monthly subscriptions in September 1999 and partnered with US Postal service for shipping
- Netflix had a 300K customers base & offered subscriptions, which eliminated late fees

Blockbuster Video

- Founding year: 1985
- Offered DVD rentals at offline brick and mortar retail stores
- Blockbuster operated with 1000+ offline stores and let consumers rent DVDs
- Late fees alone accounted for roughly 16% of revenue. Blockbuster began losing customers after Netflix launched

But with both companies facing challenges, Netflix approached Blockbuster for a merger

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Blockbuster passed on the opportunity to buy Netflix for $50M

- In 2000, Netflix was on track to lose $50M by the end of the year
- Blockbuster, by contrast, was at the height of its power, with thousands of stores across the country, and tens of thousands of employees
- Reed Hastings, proposed a $50M partnership to Blockbuster CEO John Antioco - Netflix would be renamed as Blockbuster.com and would handle the online business. Blockbuster would take care over their DVD rental business
- Blockbuster declined. The prevailing thought at the time in the wake of the Dot Com crash, was that Netflix's internet-based business was on much shakier footing compared to Blockbuster's offline movie rental empire

September 2000

Blockbuster Could Have Bought Netflix for $50 Million, but the CEO Thought It Was a Joke

John Antioco's arrogance in September 2000 cost Blockbuster its future.

September 2010

Blockbuster files for bankruptcy in US

23 September 2010 Share

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Netflix built its own set-top box but embraced streaming after YouTube's success

- In the mid-2000s, internet speeds had improved sufficiently to allow customers the ability to download movies online
- In December 2007, Netflix was almost ready to release Project Griffin, a Netflix-built set-top box that could download movies overnight and be ready to watch the next day. By 2005, Netflix had acquired movie rights and designed the box and were ready to release it
- But after discovering YouTube, and witnessing how popular streaming services were despite the lack of high-definition content, the concept of using a hardware device was scrapped and replaced with a streaming concept instead

"Much of the time, the right strategy is to improve what you've got, and then some of the time, everything changes – and correctly recognizing the differences there is really important."
– Reed Hastings, CEO, Netflix

How Netflix built its own set-top box, and why Reed Hastings wouldn't release it

By Adi Robertson | @thedextriarchy | Jan 23, 2013, 9:42am EST

Source Fast Company

via www.fastcompany.com

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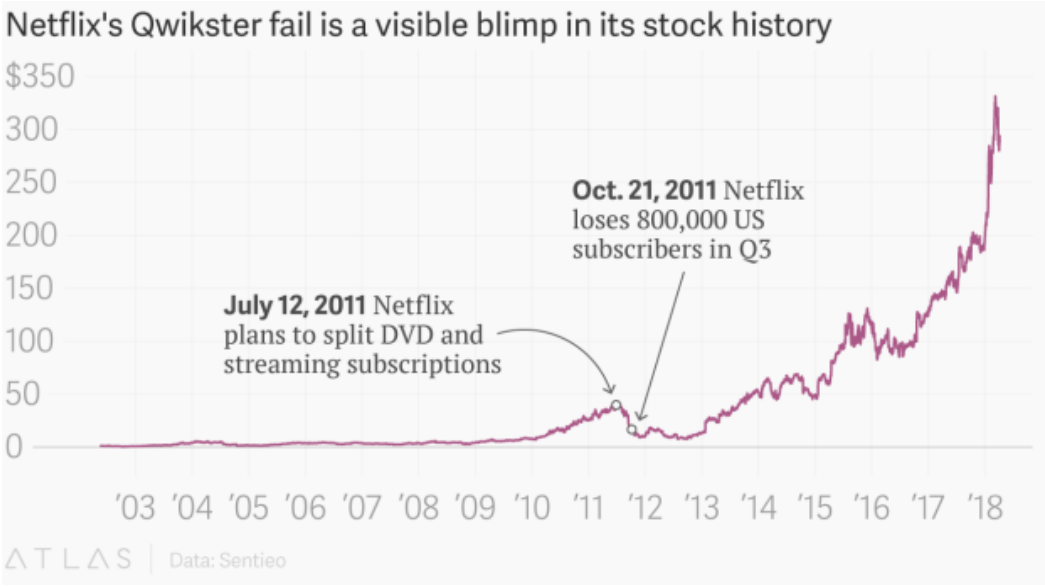
Hastings was asked to resign for trying to split DVD rentals & streaming business

- In July 2011, Netflix decided to split its streaming business and its DVD rental business into two distinct subscription packages: Netflix for streaming, and Qwikster for rentals
- At first, the stock rose to an all-time closing high of $42.68, with investors drawn to the additional revenue per subscriber the move might produce
- But the dual plans effectively amounted to a 60% price hike. Subscribers expressed displeasure and started opting out
- Hastings was asked to resign but he refused on the grounds that it was his first blunder in 12 years

Key learning – Loyal customers tend to have emotional bonds with products and making drastic changes overnight along with price increases needs to be thought through well



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Foray into Original Content

💡 **Fun Fact:**

Netflix had ~11,000 movies and TV titles on its streaming platform in 2012. It has half of that number in 2020. But, powered by its recommendation engine & original series, time spent on Netflix has only increased. An average user spends 71 minutes each day on Netflix

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Netflix leveraged original content to change the game

- Netflix initially licenced content from networks and enabled viewers to binge watch entire TV series without ads. Hastings realised that all networks would launch their own streaming platforms in due course

- Onboarded talent to launch Netflix Original shows and released entire season of House of Cards in one shot in 2013

- Within 30 days of the release of the third season, 6.5 percent of all Netflix accounts accessed the show, many of which were new subscriptions

"Pay television didn't have a distribution problem — it had a packaging problem and a content problem."
– Ted Sarandos, Co-CEO, Netflix

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08 SEP 2016 COLD CALL PODCAST

How Netflix Built its House of Cards (and Changed TV Forever)

Before "House of Cards" was a hit TV series, it was a total shot in the dark. Luckily for the small production company behind it, Netflix saw it as a shot worth taking.

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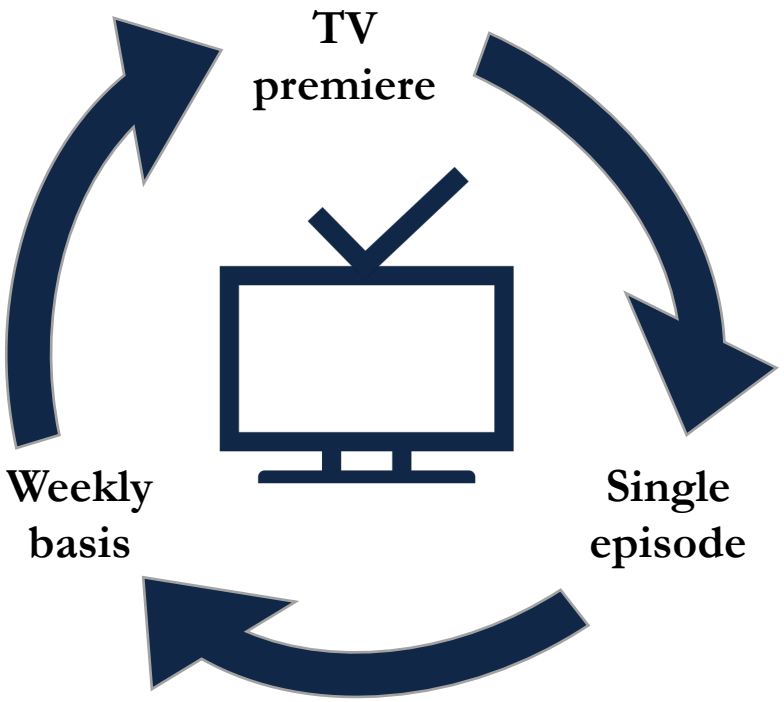
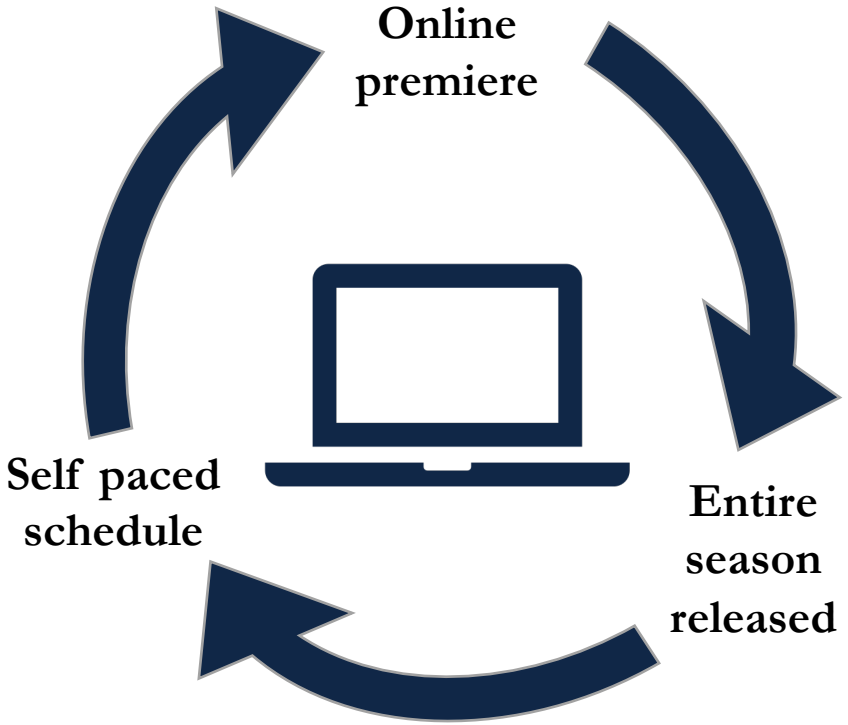
Netflix leveraged its business model to popularise binge-watching

Old model (Ad supported)



New model (Subscription based)



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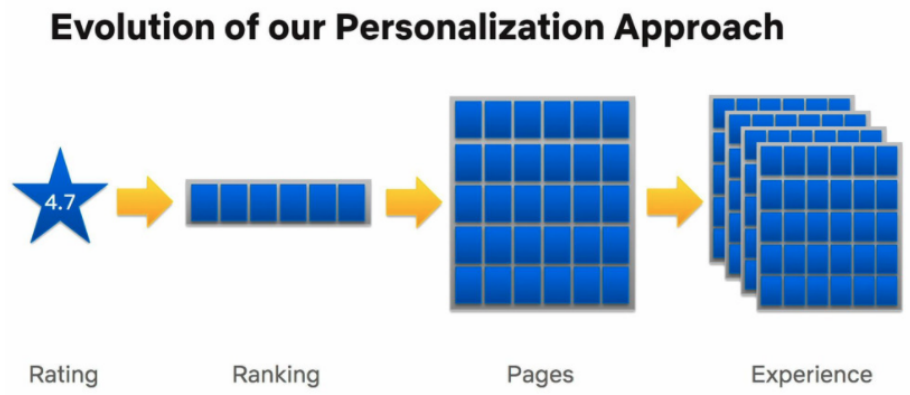
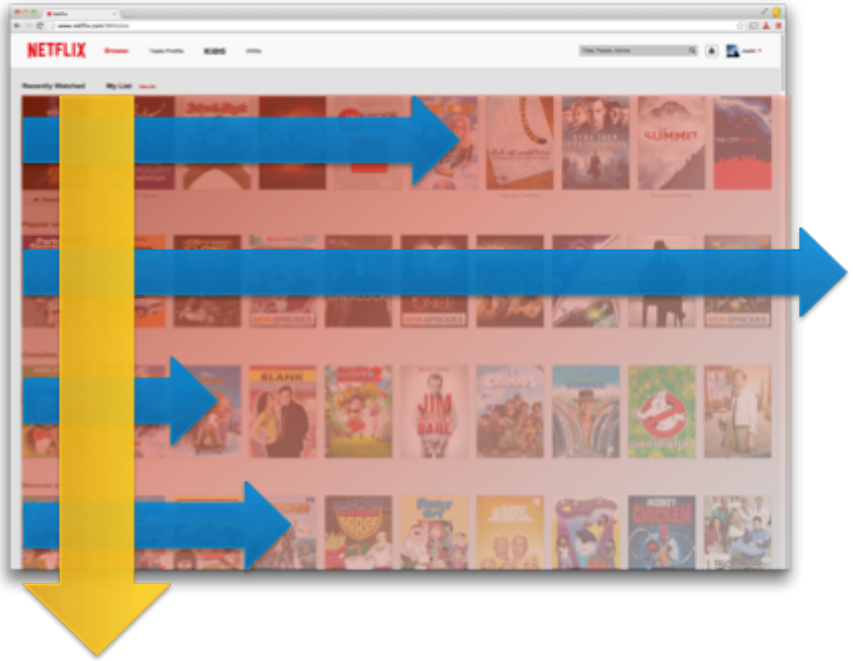
Netflix analyses over 76,000 data points to personalize your viewing experience





- The original Netflix recommendation engine collected only four data points to personalise the experience
- But over time the recommendation engine has become more robust and more than 80 percent of the TV shows and movies people watch on Netflix are discovered through the platform's recommendation system
- Every time a user presses play and spends some time watching a TV show or a movie, Netflix gathers surface level data like genre of movie, and also, the sections at which a movie is paused to feed its algorithm
- In 2014, Netflix had 76,897 "altgenres" or data points to describe types of movies and shows. Netflix uses the tagging to personalize each customer's homepage with content that it believes the customer will like based on characteristics of what the customer has watched previously

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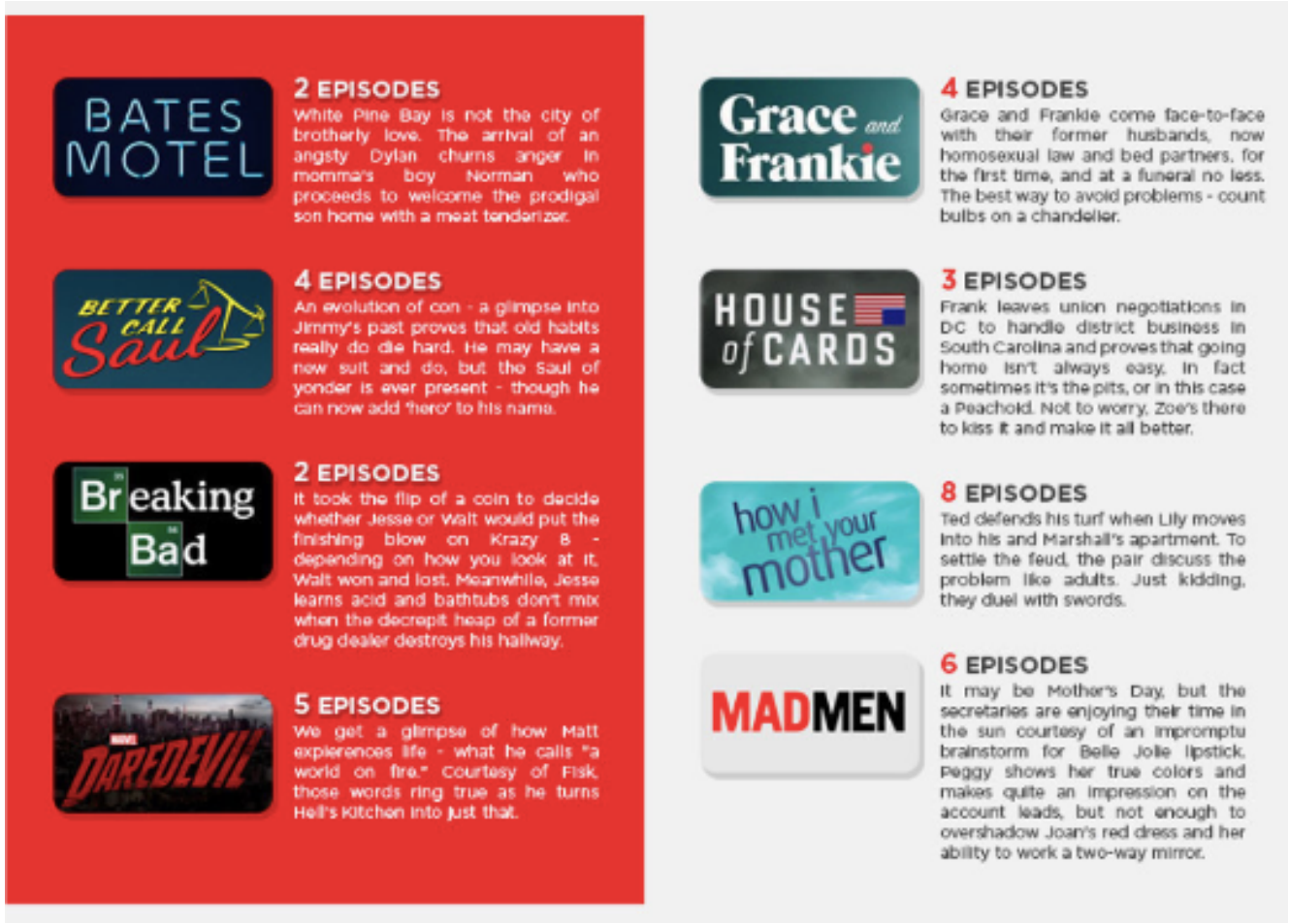
Netflix can predict the exact episode that gets you to binge-watch an entire series

- Netflix analyses streaming habits to figure out exactly how we all get obsessed with certain series
- The benchmark Netflix uses to measure "hooked" is the episode from which 70 percent of people on board for the rest of the season
- For some shows, it happens as early as the second episode. For others, it takes as many as eight episodes
- The thought behind releasing an entire season at once:

> "We found that no one was ever hooked on the pilot episode. This gives us confidence that giving our members all episodes at once is more aligned with how fans are made."
> **– Ted Sarandos, Co-CEO, Netflix**

Episode that got subscribers hooked



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Netflix has 193M+ paying subscribers globally

As of Oct 2020

Total revenue in 2019

In 2019

In 190 countries

Global Employee Count

Projected revenue from India (2020)

For Producing & licensing content

Indian Subscribers by end of 2020

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Foundation Capital made more from Netflix than all other investments combined

- Netflix raised five rounds of funding before going public. Reed Hastings invested $2.5M during the Series A round in 1997 and Foundation Capital invested in Netflix in 1999

- The firm has invested in about 200 companies including Uber and Oracle over the course of the firm's history. Netflix is on the way to actually equalling or exceeding the value of all the other 199 companies they invested into in that time period

Date	Capital Raised	Investors	Valuation
10/01/1997	$2.5M	Reed Hastings	$7M
06/18/1998	$6.1M	Institutional Venture Partners	$12.6M
06/04/1999	$15.2M	Foundation Capital; Institutional Venture Partners; Technology Crossover Ventures	$88M
10/25/1999	$29M	Foundation Capital; Technology Crossover Ventures	$206M
04/07/2000	$50M	Europ@web; Foundation Capital; Institutional Venture Partners; Technology Crossover Ventures	$347M
05/23/2002	$82.5M	Public	$310M

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Learnings from Netflix

💡 **Fun Fact:**

While having a 'To Do List' and sticking to it is a recipe for success, Reed Hastings believes that leaders should also have a 'To Don't List' a list of things to not do at all

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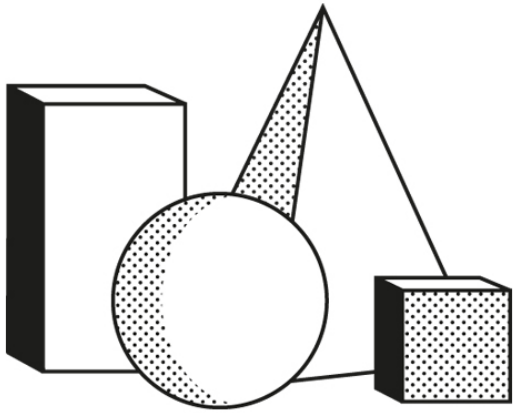
Leverage first principle thinking to constantly innovate



- First-principle thinking is one of the best ways to reverse-engineer complicated problems and unleash creative possibility. The idea is to break down complicated problems into basic elements and then re-assemble them from the ground up
- Instead of blindly following directions, or sticking to a process, Netflix employees are encouraged to a constantly ask, "What's best for the company? And couldn't we do this other way instead?"
- Team members are encouraged to not only to make decisions but to do so "based on the long term, not near term"
- Ted Sarandos, Co-CEO of Netflix, informed the team about the House of Cards deal after it was signed. Based on first principle thinking, getting into original content was the obvious next step and his move was supported by the leadership team

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Build up talent density at all levels to achieve peak performance

We're a *team*, not a family

We're like a **pro sports team**,
not a kid's recreational team

Netflix leaders
hire, develop and cut **smartly**,
so we have stars in every position

NETFLIX

24

The Key: Increase Talent Density faster than Complexity Grows

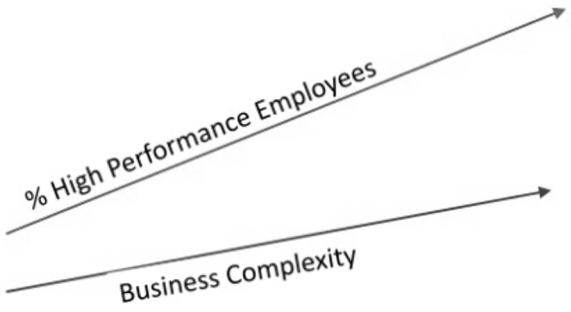

Image Credits: Netflix Culture Doc

- Hastings believes that a team with one or two merely adequate performers brings down the performance of everyone on the team. The Netflix philosophy is that employees are a pro-sports team, not a family

- Hence, it is up to the team lead to ensure that employees are amazing at their positions and play effectively with others. Netflix believes that a smaller team of 'A' performers can outperform a larger team of 'A' and 'B' performers

- All managers have to conduct regular checks to ensure they've got the best person in every spot with the **Keeper's Test -** "If a person on your team were to quit tomorrow, would you try to change their mind? Or would you accept their resignation, perhaps with a little relief? If the latter, you should give them a severance package"

- Netflix doesn't tolerate brilliant jerks and also, lets non-performers go with a severance check

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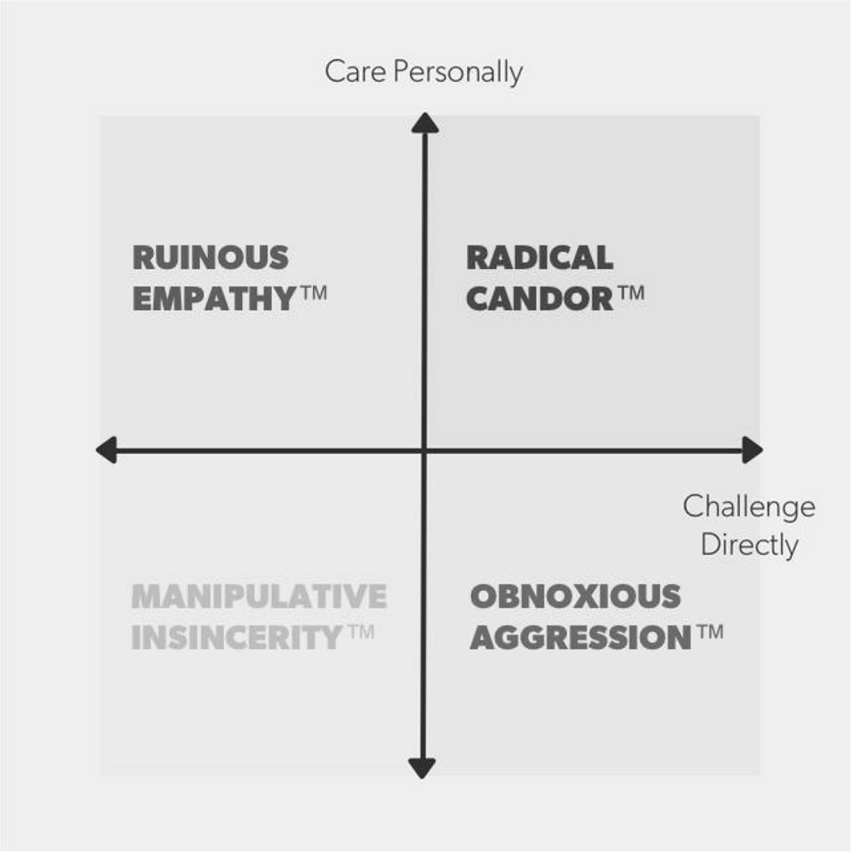
Pursue radical candor by openly sharing and receiving feedback



Courtesy of CANDOR

- "Part of being an adult is being able to hear the truth. And the corollary is that you owe the adults you hire the truth. That is actually what they want most from you." – Patty McCord, former Chief Talent Officer, Netflix
- Netflix promotes not just candid feedback but also frequent feedback, which, increases the chances that employees will hear something hurtful
- But openly sharing and receiving criticism isn't easy. As the leader, solicit feedback frequently and respond with an open mind when you receive it. Exhibit the courage you want people to have, the courage to say, "I honestly don't think that's a good idea at all, and here's why"
- With candor, high performers become outstanding performers. Frequent candid feedback exponentially magnifies the speed and effectiveness of your team or workforce

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Build an organization with democratized decision making

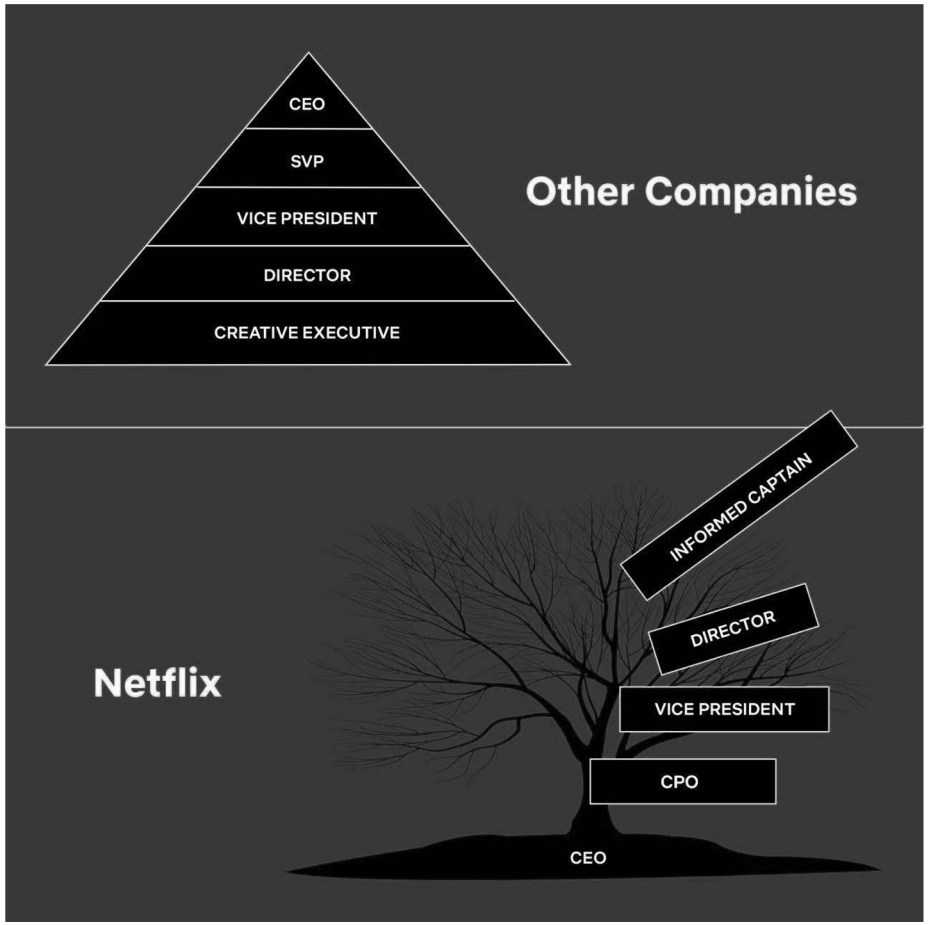

Image Credits: No Rules Rules by Reed Hastings & Erin Meyer

- The pyramid decision-making structure is recognizable in the majority of organizations
- Either the boss makes the decision and pushes it down the pyramid for implementation, or those at lower levels make the smaller decisions but refer the bigger issues to the higher-ups
- Netflix is more like a tree, with the CEO sitting all the way down at the roots and the informed captain up at the top branches making decisions
- "I pride myself on making as few decisions as possible in a quarter, sometimes I can go a whole quarter without making any decisions." – Reed Hastings

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Learnings for Startups

Hire **first principle thinkers and build talent density.** Innovation generally happens slowly. But sometimes it happens fast, and business models and processes may need to be changed overnight

Inculcate a sense of **freedom and responsibility.** Create a system of **candor and eliminate controls.** Empower people by dispersing even big-ticket decisions across the workforce at all levels

Innovate for the long term. Even while DVD rentals was a core part of their business, Netflix began exploring online streaming

Build **personalization at the core of your product** to improve retention. Leverage data to your advantage and build effective feedback loops to truly understand what your customer wants

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