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Netflix tries for damage control in a 'New Coke' turnaround

Reuters

Will CEO Reed Hastings be able to restore confidence in his company?

By Martha C. White

Netflix has sent its most recent venture — a plan to split its streaming and DVD-by-mail offerings into two separate businesses — to the cutting room floor.

CEO Reed Hastings said on the company's blog that the planned split was dead, but the bad reviews the move earned can't be erased so easily. Netflix first antagonized customers in July when it announced a 60 percent price increase to its hybrid DVD-and-streaming subscription. The planned split, which would entail renaming the DVD business Qwikster and require hybrid-plan users to keep two separate accounts, immediately got two thumbs down from customers when it was announced just a few weeks ago.

Netflix stock, which was in the $300 range in July, dropped by nearly $200.

In the annals of corporate blunders, it's not quite New Coke, but Netflix picked a bad time to stumble. Competition from rivals as diverse as Dish Networks and Amazon is growing, and every disenchanted customer is a potential defector.

The banking sector offers a particularly chilling cautionary tale for Netflix: It's a lot more of a headache to move a checking account than it is to cancel a movie subscription, yet consumers are willing to dismantle the foundation of their personal finances in response to unpopular fees.

The company's about-face may be rewarded by investors — Netflix stock advanced about 3 percent when the announcement was made, but it has since fallen — but it also forces executives to prove themselves in a field they once dominated.

"It's no doubt reassuring that people can change their minds and get back on track," says Will Richmond, president and founder of market research firm Broadband Directions LLC. "At the same time ... it takes a little bit of the shine off the Netflix invincibility," he says.

What about customers? Most of them will come back, says David Miller, managing director with investment firm Caris & Company. "I'd be wiling to bet churn went to 7 to 8 percent. They've got a lot of work to do to get those people to come back," he says.

But wooing back its subscriber base will take time. "It could be three to six months, and in the meantime there's a lot more competition," Miller says. "You can't fix that in one quarter."

Despite the griping from customers about the price changes over the summer, that alone wouldn't have led to mass cancellations, says Robert Passikoff, founder and CEO of branding and research company Brand Keys. Prior to the price change, Netflix had a 99 percent satisfaction rating in Brand Keys surveys that measured the company met customer expectations. Following the price increase, that dipped slightly to 96 percent, but it dropped down to 87 percent after the company rolled out Qwikster and its split lineup.

"When they split the company, they did it in such a way that nobody understood precisely how it was going to work, and that confusion led to a degradation in terms of the brand," Passikoff says.

Netflix had loyal customers who were willing to swallow the price increase because they had a well-liked service that offered value even at a markup, but shaking up the foundation of that service torpedoed the value customers perceived.

By way of comparison, Passikoff points to Starbucks' much-maligned push for efficiency in the mid 2000s: The coffee chain phased out time-consuming elements of its operations like complicated espresso machines and fresh-ground beans. Customers hated it, a fact acknowledged by company head Howard Schultz in a leaked 2007 memo.

Despite this admission, investors continued to hammer the stock for another couple of years, and Starbucks learned the hard way — as Netflix is likely to — that restoring customer confidence in your brand during an economic slump is an uphill endeavor.

In spite of the economic and competitive challenges facing Netflix, Caris & Company's Miller is bullish about its long-term ability to attract and retain subscribers.

"At the end of the day, though, the selection is still the best on Netflix," he says. Most streaming subscribers are there for the TV shows, and thanks to its partnerships with networks like Fox, this is an area where Netflix excels. "There's no one that matches this kind of selection," he says.

Bowing to an outcry from its customers, Netflix is dropping a plan to spin off its DVD service into a new company called Qwikster. NBC's Brian Williams reports.

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