content put Netflix in position to compete head-to-head with the growing numbers of VOD providers. Second, providing streamed content to subscribers had the attraction of being cheaper than (1) paying the postage on DVD orders and returns, (2) having to obtain and manage an ever-larger inventory of DVDs, and (3) covering the labor costs of additional distribution center personnel to fill a growing volume of DVD orders and handle increased numbers of returned DVDs. But streaming content to subscribers was not cost-free; it required server capacity, software to authenticate orders from subscribers, and a system of computers containing copies of the content files placed at various points in a network so as to maximize bandwidth and allow subscribers to access a copy of the file on a server near the subscriber. Having subscribers accessing a central server ran the risk of an Internet transmission bottleneck. Netflix also used third-party content delivery networks to help it efficiently stream movies and TV episodes in high volume to Netflix subscribers over the Internet.

By combining streaming and DVDs-by-mail as part of the Netflix subscription, Netflix was able to offer members a uniquely compelling selection of movies for one low monthly price. Netflix executives believed this created a competitive advantage as compared to a postal-delivery-only or Internet-delivery-only subscription service. Furthermore, management believed that Netflix's combination postal-streaming subscription service delivered compelling customer value and customer satisfaction by eliminating the hassle involved in making trips to local movie rental stores to choose and return rented DVDs.

Marketing and Advertising Netflix used multiple marketing channels to attract subscribers, including online advertising (paid search listings, banner ads, text on popular sites such as AOL and Yahoo, and permission-based e-mails), radio stations, regional and national television, direct mail, and print ads. It also participated in a variety of cooperative advertising programs with studios through which Netflix received cash consideration in return for featuring a studio's movies in its advertising. Most recently, Netflix had begun working closely with the makers of Netflix-ready electronics devices to help generate new subscribers for its service.

Advertising campaigns of one type or another were under way more or less continuously, with the lure of one-month free trials usually being the prominent ad feature. Advertising expenses totaled approximately $205.9 million in 2009, $181.4 million in 2008, and $207.9 million in 2007. Netflix management believed that its paid advertising efforts were significantly enhanced by the benefits of word-of-mouth advertising, the referrals of satisfied subscribers, and its active public relations programs.

Management had boosted marketing expenditures of all kinds (including paid advertising) from $25.7 million in 2000 (16.8 percent of revenues) to $142.0 million in 2005 (20.8 percent of revenues) to $218.2 million in 2007 (18.1 percent of revenues). When the recession hit in late 2007 and 2008, management trimmed 2008 marketing expenditures to $199.7 million (14.6 percent of revenues) as a cost-containment measure, but in 2009 marketing expenditures resumed their upward trend, climbing to $237.7 million (14.2 percent of revenues).

Transitioning to Internet Delivery of Content In early 2010, Netflix had two primary strategic objectives: (1) to continue to grow a large subscription business and (2) to gradually migrate subscribers from postal delivery of DVDs to Internet-based delivery of content as the popularity of Internet-delivery grew. Top executives at Netflix expected that Internet delivery of media content would surpass postal delivery within three to seven years and that eventually postal delivery would account for a relatively small fraction of Netflix's business.

NETFLIX'S PERFORMANCE AND PROSPECTS

Recent financial statement data for Netflix are shown in Exhibits 3 and 4. Management's latest forecast called for having between 15.5 million and 16.3 million subscribers by year-end 2010, full-year 2010 revenues of $2.11 billion to $2.16 billion, and diluted earnings per share of $2.41 to $2.63. The company announced a $100 million program to repurchase shares of its common