Analysis

Netflix keeps adding members, but rising costs and risks bring new challenges

Company has 100 million members, but spends more each year to feed its insatiable need for content

By Pete Evans, [CBC News](#) Posted: Aug 12, 2017 5:00 AM ET Last Updated: Aug 12, 2017 5:55 PM ET

It's lonely at the top of the streaming world — especially if you peer over the cliff and see the hordes of rivals clambering up to take your spot.

That's where Netflix finds itself at the moment, as the company that turned itself from a DVD-by-mail business 20 years ago to a $75 billion media colossus with more than 100 million customers around the world faces problems it hasn't had to deal with thus far in its meteoric rise.

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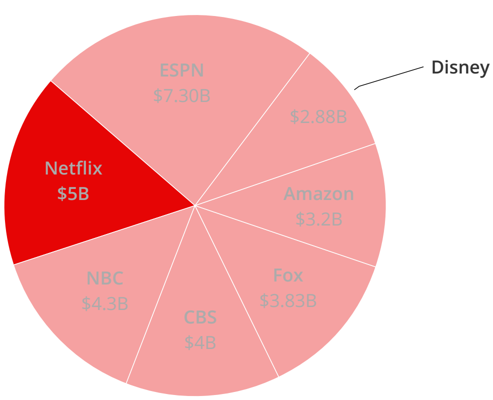
The company has grown quickly thanks to its solid value proposition: unlimited online streaming of thousands of movies and entire seasons' worth of TV shows, for roughly $10 a month. Contrast that with cable television services that can cost five to 10 times that much.

Netflix has not so much made inroads into the traditional TV model as it has built an eight-lane superhighway right through it.

The company's scale is enormous. In addition to its back catalogue of old movies and shows, the company will release 30 of its own movies this year, spending up to $500 million in the process. That's about 10 per cent of its total costs, which are themselves ballooning to more than $6 billion this year — more than any TV network save ESPN will spend on content this year.

Netflix's costs are ballooning

Streaming giant Netflix spent more than $5 billion on content last year — a number that has grown exponentially and is expected to continue to do so for years to come.



Source: Boston Consulting Group

So far, higher costs have been justified because the company has been growing quickly too, with customer numbers up 25 per cent in the past year and almost quintupling since 2012.

But critics are starting to wonder if that can go on forever. Since 2010, Netflix has grown its revenue by about 24 per cent a year, compounded annually. But the amount it spends on new content has gone up by even more — 42 per cent, according to a recent report from investment research firm New Constructs.

- **ANALYSIS: Cable price hikes could inspire more cord cutting**

"The realities of Netflix's costly business model are finally catching up to the firm," analysts David Trainer and Kyle Guske said in a recent note. "Netflix is beginning to acknowledge the challenging economics of producing original content."

Not all of Netflix's threats come from within, either.

Amazon Prime launched its video service in Canada last year, and they, too, are aggressively investing in new content to gain market share at the expense of Netflix and traditional broadcasters.

In July, U.K.-based streaming service DAZN (pronounced Da Zone) made a big splash in Canada by securing the exclusive rights to broadcast all NFL games for the upcoming season in Canada — a major first step for a startup looking to fulfil its self-professed vision to become "the Netflix of sports."

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And the past week alone has seen three big developments in the streaming industry, starting with CBS's decision to take its own streaming service known as All Access around the world, including Canada, starting next year.

Launched in 2014, CBS offers the entire back catalogue of hit CBS comedies and procedural dramas — along with premium Showtime content plus a 24/7 news channel — for $5.99 US a month, or $9.99 for a version with no commercials. The service has grown quickly, now boasting more than 4 million customers in the U.S. and on track to double that by 2020, CBS said in announcing the move.

- **Netflix is piling up viewers — but big bills, too**

While CBS has grand plans for the service in Canada, in reality it's likely to be quite stripped down at launch — thanks in part to content sharing deals already in place that have CBS content such as *How I Met Your Mother* on Netflix and *The Big Bang Theory* on CraveTV.

A day after CBS struck out on its own, Disney announced it, too would be severing ties with Netflix and launching its own streaming service starting in 2019. (Technically, Disney content will remain on Netflix Canada due to pre-existing agreements for a little while yet, but that is unlikely to hold true forever if Disney's own service gains traction.)

Netflix's own hit shows and its vast catalogue of reruns make it big enough to withstand many hits, but over the long term losing Disney could hurt because it's such a behemoth — especially in kids programming — says Ophir Gottlieb, CEO of Capital Market Laboratories.

"It is a content juggernaut," Gottlieb said in an interview.

Losing Disney "makes it more difficult for Netflix to add subscribers and that throws a monkey wrench into the growth prospects."

That's because while Netflix has focused on original programming, licensing deals with other content makers like Disney are still a huge part of their catalog.

Even critically acclaimed Netflix movies like the Oscar-nominated *Beasts of No Nation* only drew about three million viewers, Bloomberg analyst Geetha Ranganathan said in a recent report. That's about half of what some of the service's more popular shows can draw for a single episode.

"Culling these older movies," from Disney and others, Ranganatham said, "risks turning off more users."

If that happens, Gottlieb says, it may create a vicious circle. If people start watching less often or for fewer hours, "we could all of a sudden have a cancellation narrative," he said.

- **Cutting the TV cord? Call the anti-cable guy**

If new customers stop signing up and existing ones cut their streaming cord because of dwindling offerings, "that would be the sort of catastrophic view of the world for Netflix," Gottlieb said.

Facing higher costs and surging competition is tricky, which might be why Netflix has just announced a price hike for Canadians. The basic plan with no high-definition viewing and one screen goes up $1 to $8.99 a month starting now for new members. HD viewing on two screens will now cost $10.99 a month and the deluxe edition with four simultaneous streams in ultra-high definition goes up to $13.99.

Existing members can expect to see their locked-in prices inch up to match that in the coming weeks, which means the company has its work cut out for it to convince consumers it is still worth a premium price as alternatives spring up almost daily.

- **1 in 4 Canadians think about cutting the TV cord**

If there's one thing in Netflix's favour, Gottlieb says, it's that research suggests that as consumers are offered more streaming options, their desire for a bundled package to aggregate it all actually goes up.

"The future is going to be a la carte [and] for all of us TV watchers we're going to probably have this uncomfortable middle period where we don't really know what to subscribe to," he said.

Faced with the prospect of a half-dozen streaming services, Netflix may well find its salvation in aping the thing it set out to destroy in the first place.

"Netflix," Gottlieb said, "is becoming the new version of cable."

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