UNIVERSITY OF ESWATINI

DEPARTMENT OF BUSINESS ADMINISTRATION

MAIN EXAMINATION PAPER

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TITLE OF PAPER : ELECTRONIC COMMERCE

COURSE CODE : BUS 634 MBA

TIME ALLOWED : THREE (3) HOURS

INSTRUCTIONS:

1. THE NUMBER OF QUESTIONS IN THIS PAPER = SIX (6)
2. SECTION A IS COMPULSORY.
3. ANSWER ANY THREE (3) QUESTIONS IN SECTION B
4. THE MARKS TO BE AWARDED FOR EACH QUESTION ARE INDICATED ALONGSIDE THE QUESTION.

NOTE: MARKS WILL BE AWARDED FOR GOOD COMMUNICATION IN ENGLISH, AS WELL AS FOR ORDERLY AND NEAT PRESENTATION OF WORK. FURTHER MARKS WILL BE AWARDED FOR USE OF RELEVANT EXAMPLE.

SPECIAL REQUIREMENTS: NONE

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

SECTION A

How Does This Movie End?

In the Netflix online television comedy-drama series, *Orange is the New Black*, the lead character is Piper Chapman (Taylor Schilling), a recently engaged blond New Yorker sent to a federal prison for a crime committed years before. Critically acclaimed, and widely followed, *Orange* follows in the footsteps of Netflix's earlier successful online TV series *House of Cards*, a political insider's tale of Washington politics starring Kevin Spacey. *House of Cards* was the first-ever online television series to win an Emmy award (for best director). *Orange* won three Emmy creative awards in 2014. In 2014, Netflix racked up 31 nominations, and in 2015, 34 nominations. In 2016, the number soared to 56 nominations, making Netflix the third leading platform/network behind HBO (96) and FX Networks (38). Besides returning series like *Orange is the New Black*, its new series *making a Murderer* and the documentary *What Happened, Miss Simone?* each scored six nominations. Netflix is quickly becoming the non-cable alternative to cable TV. By producing its own content, Netflix is able to differentiate itself from cable TV shows and attract new subscribers looking for new shows, not retreads from the cable networks. However, original productions are much more expensive to produce than licensing existing content.

While Netflix does not release the number of viewers for any of its original TV shows, executives credit these shows with driving the streaming service to a record 83 million worldwide subscribers by the second quarter of 2016 (45 million in the United States where 60% of its subscribers come from). In 2016, Netflix announced its presence in all foreign markets except China, and that it had gained 3.5 million new subscribers outside the United States. Its goal is to hit 100 million subscribers by 2017. Its subscriber growth rate in the United States has slowed considerably in the last few years because its market penetration is so high. Netflix shares have increased by over 8,000% since it first went public in 2002, but it has hit a rough spot in 2016, with the stock market punishing the company for failing to achieve expected subscriber growth targets in the United States, amid concerns about growing competition in the streaming marketplace. Many subscribers dropped the service in 2016 because Netflix raised its prices and Amazon grew its own video streaming service. It is currently selling at over 300 times its projected earnings, much more expensive than Google, Facebook, or other tech companies because it is still perceived as a growth company. Revenues in 2015 were $6.7 billion, up 22% from 2014, but profits were a paltry $122 million, less than half the previous year. Netflix's profit margin is less than 2%, far less than a retailer like Walmart (4% margin).

Netflix got its start as a mail order company renting DVDs of older Hollywood movies using the postal system. Founded by two Silicon Valley entrepreneurs, Marc Randolph and Reed Hastings, in 1997, the company started by renting individual copies of 900 DVD movie titles and delivering them to customers by postal mail. In 2000, it switched to a subscription model where customers could receive DVDs on a regular basis for a monthly fee. By 2006, it had delivered its billionth DVD and became the largest subscription provider of DVDs. In 2007, Netflix began a video-on-demand streaming service of movies although it still retains a DVD subscription business. In 2016, Netflix is the largest player in the movie and TV series streaming market, and consumes over 35% of the U.S. Internet bandwidth to serve its customers.

Netflix is one of those Silicon Valley stories that might make a good movie, or even a television series, because of its potential for disrupting the American television and movie landscape (or what's called premium video). It's a dream-come-true story of accomplishment, pluck, innovation, and Internet technology. In a few short years Netflix created the largest DVD rental business in the country, and then created the largest streaming video service. Today Netflix accounts for over 90% of digital movie streaming, while its chief streaming competitors, Amazon and Hulu, make up the remaining market. Netflix has created the largest database on consumer video preferences and built a recommendation system that encourages consumers to see more movies. Netflix is as much a technology company as a content company: it has developed its own proprietary video encoding system and distributes its video using over 1,000 servers in the United States located close to its customers to ensure high speed and quality delivery. Netflix discovered that older TV series had strong niche followings and built a new model of "binge watching" where consumers could watch all the episodes of a series in several sittings. Netflix has entered the content creation business by developing original TV series. For this reason, Netflix is an example of convergence in the media industry where an Internet company becomes a media content producer.

In the movie and TV business there are only two ways to make money: either own the content or own the pipes that deliver the content. All the better if you can do both. Netflix has become recognized as an important pipeline to a very large audience. For instance, Netflix has a deal with the Weinstein Company, a major American film studio and producer of ten Academy Award films, to become the exclusive subscription TV home for the film studio's content, beginning in 2016. This move puts Netflix into the same league of premium channel distributors and in direct competition with other cable networks like HBO, Starz, Showtime, and A&E for the rights to show movies about eight months after their theater run is complete. Netflix also has a deal with Warner Brothers to be the exclusive Internet distributor of the Batman prequel *Gotham*, and with Twenty-First Century Fox in 2016 for the FX series *American Crime Story*.

In one possible ending scenario for the Netflix movie, the company challenges the much larger cable television industry, which is based on an entirely different technology and business model, namely, selling expensive bundles of hundreds of TV channels that few people watch, then raising monthly fees faster than the rate of inflation. Given Netflix's large national audience of streamers, the company makes new friends in Hollywood and New York that are looking for ways to distribute their shows to a new online, mobile, and social world; Hollywood stretches the distribution window so that Internet distributors like Netflix get the same treatment as cable systems by allowing them to show the latest movies and shows at about the same time as cable systems. And the cable television industry is forced to retreat from its bundling practices and offer customers the ability to select just those channels they actually watch. Cable industry revenues plunge as a result. In this dream scenario, Netflix goes on to challenge the cable networks by producing its own original TV dramas, and adds comedy and documentaries to the mix. A story with a happy ending for Netflix! But happy endings happen mostly in Hollywood.

The outcome of this movie depends on how well Netflix can deal with some considerable challenges. For instance, one source of Netflix's poor profitability is that the costs of content are very high, both purchased older series as well as new content, which is far more risky. The owners of older cable TV series and Hollywood movies charge Netflix for the privilege of distributing their content as much as they do established cable TV networks. In 2016 Netflix reported streaming content obligations to content producers of $12 billion! With $6.7 billion in gross revenue, it paid out $5.7 billion in payments to content owners (mostly cable networks) and production studios for original content. Netflix barely makes any profit. Netflix is, after all, mostly a database and delivery platform, and the company is in a constant bidding war with both cable and Internet giants all looking for the same thing—popular TV series with a built-in or potential audience. But content owners have wised up to the value of their backlist TV series and have raised their prices accordingly. Series just a year old are very expensive or non-existent. Netflix is paying hundreds of millions to Disney, Paramount, Lionsgate, and MGM to license hit shows and movies. As a result of content owners charging more for older cable shows, Netflix has taken the more risky option of developing its own original series. But this is very expensive as well. The critically acclaimed *House of Cards* cost Netflix $100 million for 26 episodes, $4 million an episode. Newer shows like *Between*, *Narcos*, and *Bloodline* are running around $20 million a season. It's possible that Netflix does not scale, and that the more subscribers it has and the more it attracts them with original expensive content, the less profit it makes because the cost of doing business rises faster than revenue.

A second challenge Netflix faces is the risk of creating new content. It's not as if wealthy Silicon Valley entrepreneurs can fly to Hollywood or New York with lots of cash and simply purchase new content. As one pundit noted, this might lead to a mugging, but not a successful TV series or movie. Silicon Valley is generally not the place to go if you're looking for story tellers, writers, producers, directors, talent agents, and cinematographers. Algorithms don't come up with new ideas for novels, plays, movies, or TV series, and they have not proven to be good at guessing what series will succeed in the future. Older series are proven series, and Netflix can identify which of its customers watched the series in previous years, and estimate the audience size, and whether new subscribers will be attracted by the re-plays. But when it comes to new TV series, Netflix has tried to use its algorithms to predict what new series its customers might be interested in with mixed results. Netflix has produced some real winners according to critics, but it has also produced some losers that did not get critical acclaim like *Lillyhammer*, *Hemlock Grove*, *Bad Samaritans*, *Richie Rich*, and *Mitt*. There has been only one tech company in history that was successful with content production for movies or television, and that is Pixar, which pioneered computer-generated animated feature-length movies. It is impossible to know how well Netflix's original content is performing because the company refuses to release this data. Nielsen has begun a rating service for Netflix shows. This service is paid for by the content producers who will base their charges in part on how many Netflix subscribers stream their shows.

While Netflix stands out as a powerful Internet brand today, Netflix has many powerful competitors. Netflix does not have unique technology. In fact, streaming technology is widespread and well understood. The success of Netflix's streaming model has attracted Amazon, Apple, Yahoo, Google, and content producers like Hulu and HBO to the fray. In 2015, Verizon announced a free, ad-supported mobile streaming service call go90, aimed at Millennials who routinely watch video on their smartphones. Some of these firms are tech firms with very large Internet audiences, strong brand names, and a good understanding of what their millions of online customers want.

Apple is the leader in downloaded movies where customers own or rent movies, and of course, it owns iTunes, the world's largest online media store for the purchase of music, videos, and TV series. HBO, founded in 1972, is the oldest and most successful pay television service in the United States with over 140 million cable TV subscribers worldwide, and the originator of a long list of highly successful original TV series and movies such as *Sex and the City*, *The Sopranos*, *The Wire*, *Game of Thrones*, and *True Blood*. If Netflix has a direct competitor on the creative front, it is HBO, a more traditional programmer that does not use computer algorithms to design its content, but instead relies on the hunches and gifts of editors, producers, and directors to produce its content.

Netflix's competitors have very deep pockets. This means Netflix also has competitors for talent and the production of new content, and perhaps price pressure as well. Along with Hulu, Amazon has emerged as the biggest competitor to Netflix streaming. For instance, Amazon offers free streaming to its 60 million Amazon Prime customers, and has taken on HBO TV series to stream to Prime customers without additional fees. Amazon has also moved into original series production with *The Man in the High Castle, Transparent, Mozart in the Jungle,* and others, winning 16 Emmy awards in 2016. Apple iTunes and Amazon have far larger databases of subscribers and their preferences. Google is actively pursuing long-form content creators for its video channel program. There is no cost to Google users because the service is ad supported.

So another possible ending for the Netflix movie is that ultimately it can't compete with Apple, Google, Yahoo, Hulu, and Amazon, or the content producers like CBS and HBO Now, which have started their own streaming services. Generating a negative cash flow of $1 billion a year, Netflix may run out of investors who make up the difference.

Netflix can be imitated by its competitors, and its profitability reduced to less than shareholders can tolerate. Apple's 2015 revenue was a staggering $234 billion, 30 times larger than Netflix, and it has a cash reserve of $234 billion. It is entirely within Apple's capabilities, or Amazon's or Google's, and others to develop a competing streaming video service. Equally worrisome, major cable networks like CBS and NBC have started their own streaming networks for their original content. In July 2016, Wall Street finally got the message that Netflix was facing a slew of streaming competitors, and its stock fell over 30%. Netflix may have created a new world of streaming, bingeing, and content production, but it may not be able to survive the world it created. This show is not over until the last episode is finished. Stay tuned.

Questions

1. What are the key elements of Netflix's strategy today? 20 marks

2. Why is Netflix in competition with Apple, Amazon, and Google, and what strengths does Netflix bring to the market? 20 marks

SECTION B

Question 1

Identify the major trends in supply chain management and collaborative commerce. 20 MARKS

Question 2

A) What do social networks auctions and portals have in common? 10 MARKS
B) Discuss the trends taking place in an online financial service industry. 10 MARKS

QUESTION 3

You are working for International Delicacies, which has become successful selling unusual food and gift items through its mail order catalog. Most customers call the toll-free telephone number on the catalog, but some still send in orders by mail. Your manager, Jagdish Singh, wants to add an online store that will complement the company's existing mail order and telephone sales channels. He wants you to lead the internal team for the project. Write a memo to Jagdish in which you outline the steps you will take to staff the internal team, make decisions about internal development vs. outsourcing, be sure to include an evaluation of whether an incubator or a fast venturing strategy might make sense for this project. 20 MARKS

QUESTION 4

Many people have strong negative reactions to pop-up, pop-behind, interstitial, and rich media ads. Assume you are the director of an advertising agency that specializes in creating and placing these ads. You see an opinion article in your local online newspaper that harshly criticizes these ads as intrusive and unnecessary. Write to post in the comments section of this article in which you explain, from the advertiser's viewpoint, why these ads can be more effective advertising media than text ads. 20 MARKS

QUESTION 5

Bonnie Carson has owned and managed her gift and card shop in the Central Shopping Mall for three years. Business has been good, but Bonnie wanted to expand her business. A year ago, she hired a Web designer and built a Web site hosted by a national Internet service provider. Part of the monthly ISP fee for her merchant site includes the software needed to process credit card purchases. She has obtained a merchant account with a national credit card processing company. Bonnie's Web-based business is beginning to pick up. She wants to provide more payment options to her customers and is considering a payment processing service such as PayPal as an additional option. Write a report in which you advise Bonnie on this. Identify at least three reasons that Bonnie should use such a service and at least three reasons why she should not. 20 MARKS