



HARVARD BUSINESS SCHOOL  
CASES

MBA核心课案例教学推荐教材

Corporate Financial  
Management  
(Reprint)

公司财务管理  
(英文版)



# 出版说明

随着 MBA 教育逐渐走向成熟，人们对于案例教学已不再陌生，很多院校，特别是首批 MBA 试点院校已经比较普遍地采用案例教学这种模式。案例教学、案例编写也成为全国 MBA 教学指导委员会十分重视并大力推广的重要工作。为满足教学需要，中国人民大学出版社与哈佛商学院出版公司达成了引进出版哈佛商学院案例的协议，围绕 MBA 教学选择了十门课程，包括：战略管理，人力资源管理，营销管理，公司财务管理，领导学，组织行为学，供应链管理，技术与运营管理，财务报告与控制，企业、政府与国际经济，中文版和英文版同时推出。先由哈佛大学教授从其数千个案例中进行选择、推荐，再由中国教授从推荐的案例目录中遴选，在翻译的过程中又作了进一步的调整，最终确定了目前的案例。

多年来，中国人民大学出版社一直在不懈地打造经管类图书的品牌，特别是，作为高等教育教材出版的市场领先者，我们一直希望能为中国的管理教学和实践提供更多、更好的产品。随着中国 MBA 市场规模的扩大，学生人数的增加、素质的提高，教师队伍的成熟，我们发现，案例教学教材的数量不足及质量不高成了一个比较大的问题，基于大量的市场调研，哈佛商学院的案例便成了我们针对 MBA 教学引进案例的首选。毕竟，哈佛大学是最早开始 MBA 教育的，其 MBA 学位计划有近一百年的历史。哈佛案例每年能销 600 万份，其案例教学法也在逐渐为世界上各大学校所熟悉和借鉴。作为一家以为高等教育服务为己任的大学出版社，我们深感哈佛案例的引进对于我国工商管理教育理论和实践的提升具有十分重要的意义，事实上，我们在 2002 年曾引进出版了一套哈佛商学案例，分商务基础系列和实务系列，共 21 种，在当时引起了很大的反响，只是囿于条件，案例没能根据课程设置选取，不便于教师在教学中使用，基于此，便有了我们这套针对 MBA 核心课程的案例。

在运作这套案例的过程中，我们广泛听取了老师们的意见和建议，我们发现，单是引进一些案例并出版不能满足教学的实际需要，对于很多老师来说，如何讲授哈佛案例才是一个难点。同时，我们在前期调研和筹备工作中也深感案例的推广不再局限于传统意义上的图书推广工作，它已超出了传统单纯出版图书的概念，变成了一种教学理念和教学方法的推广，它需要我们提供更多、更长期的后续服务，并改变传统的出版模式。

就在我们策划出版这套案例书之际，哈佛商学院酝酿已久的 PCMPCL (Program on

Case Method and Participant-Centered Learning) 培训计划正式启动。为配合 PCMPCL 项目, 哈佛商学院出版公司邀请包括中国大陆、香港、台湾等地区和新加坡在内的 16 所大学的商学院选派一些教授到哈佛商学院参加哈佛案例教学的培训。首次培训定于 2005 年 8 月, 同年 12 月还将在中国举办第二期有关案例教学与写作的培训。

同时, 为帮助广大教师更好地使用哈佛案例, 中国人民大学出版社还将配套引进案例的教师用书、教学录像等辅助资料(出于授权限制, 仅向使用本案例教学的教师提供)。在案例出版后, 我们还将提供教学支持, 帮助中国教师更好、更便利地使用案例。

运作案例出版的过程是艰苦的, 但结果是美好的、令人难忘的。在和哈佛商学院出版公司的合作中, 我们一次又一次地听到他们虔诚地谈及他们的使命: 改善管理实践。在案例出版的过程中, 很多人做了辛苦的工作, 我们感谢哈佛商学院高级副院长、贝克基金教授史蒂文·C·惠尔赖特(Steve C. Wheelwright)先生, 他为我们的案例出版写了序, 他在这套案例书 10 门课的选择中起了决定性的作用, 没有他的努力, 这套书的出版是不可能的。感谢 John Quelch、Michael Tushman、Debra Spar、Pankaj Ghemawat、David Hawkins 以及 David Upton 等教授, 他们在我们初选案例的过程中给予了建议和指导; 感谢哈佛商学院和哈佛商学院出版公司的下列人员, 他们为案例的挑选做了许多工作: Paul Andrews、Tim Cannon、Tad Dearden、Mike Derocco、Pat Hathaway、Amy Iakovou 和 Carol Sweet; 感谢哈佛商学院出版公司国际部总经理陈欣章先生, 他促成了案例最终出版协议的签订和执行, 并完成了整个过程中的协调工作。最后, 也要感谢所有参加案例中文版翻译的教授, 他们都有自己繁重的教学任务, 在出版时间紧迫的情况下, 各位教授都保质、按时地完成了翻译工作。

我们希望这套案例书的出版以及后续的培训能影响几百、几千乃至上万个 MBA; 我们希望他们能用一种新的视角, 适应国际化的大趋势, 理解现代企业的管理方法, 理性地接受信用经商的理念, 推动中国经济的更大发展; 我们希望能通过我们的出版物来引导中国的管理实践。如能做到此, 那么其间的各种辛苦努力也就值得了。

感谢您选用或关注我们的这套案例书, 对您的任何反馈我们都十分珍视。我们的联系方式: 010-62510566 转 551 或 541; E-mail: rdcbsjg@crup.com.cn 或登录: <http://www.rdjg.com.cn>。

中国人民大学出版社

2005 年 7 月



# 序

“培养世界上有影响力的领导人”是哈佛商学院的使命。1908年，哈佛商学院正式成立。为实现这一使命，哈佛商学院通过实施各种项目，影响众多不同的人。哈佛商学院最出名的可能是其MBA项目，但同时我们也通过开展高级管理人员培训项目(Executive Education Program) (包括AMP项目以及其他逾100个为职业经理人开设的各种培训项目)和通过哈佛商学院出版公司的出版物追求我们的使命。我们的出版物包括《哈佛商业评论》、哈佛商学院图书、网络课程，以及哈佛商学院案例研究。

为杰出院校提供建议也是我们使命的一个重要方面。在过去的60年里，哈佛商学院为世界上许多院校不仅提供了教学案例，还通过各种项目帮助他们及其教师提升了自己的案例教学能力。包括：国际教师项目(ITP)、以参与者为中心的教学法培训项目(CPCL)、案例教学与以参与者为中心的教学法培训项目(PCMPCL)。其中，PCMPCL项目发起于2005年8月，其目的在于帮助中国大陆、香港、台湾等地区和新加坡的主要商学院提升其在MBA项目、高级管理人员培训项目以及以管理实践为导向的研究中，熟练运用案例教学和启发式教学的能力。

通过多年的实践，哈佛商学院发现案例教学的应用通常需要经历三个阶段。第一阶段，案例在管理学课堂上是作为概念或原理的例子、说明来使用的。第二阶段，将案例研究作为主要的学习方法，依靠案例讨论。第三阶段，教授开始把他们在案例研究和课程发展上取得的成果大量应用于教学，以便更好地理解 and 传授如何做决定。

为实践我们的使命，哈佛商学院和哈佛商学院出版公司很高兴与中国人民大学出版社携手帮助中国商学院及其教授实现从第二阶段向第三阶段的跨越。我们的努力包括：为来自中国大陆、香港、台湾等地区和新加坡的教授提供为期10天的PCMPCL培训；出版一套根据MBA核心课编辑的案例书(分中文版和英文版)；组织一系列后续服务的案例教学和案例写作的培训班；建立一个服务于中国教师的案例服务中心。

我们这样做的目的有两个，并且这两个方面都与哈佛商学院的使命紧密相连。一

个目的是通过帮助全球教育机构——正如我们在中国发现的那些机构一样——发展他们自身的、着眼于管理实践的案例教学能力，从而促进全球管理教育水平的提高。另一个目的是帮助这些机构培养一些能够在他们的学校中起到带头作用的教师，使他们能够写出新的、能够与世界分享的案例研究和教学资料。这种既符合国际标准，又与中国具体管理实践相关的案例研究正是中国管理教育机构所急需的。

我们很高兴中国人民大学出版社和中国许多优秀的商学院加入我们的队伍。我们希望哈佛案例书在中国的出版能对中国的教育机构、教师及其培养的未来职业经理人有所帮助，帮助他们实现在全球经济中扮演重要角色的梦想。

**史蒂文·C·惠尔赖特 (Steven C. Wheelwright)**

**哈佛商学院高级副院长，贝克基金教授**

**2005年6月**



# PREFACE

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The mission of the Harvard Business School (HBS) is “to educate leaders who will make a difference in the world.” Founded in 1908, when Harvard University was already more than 250 years old, HBS achieves this mission by reaching a wide range of audiences through a variety of programs. While HBS is perhaps best known for its MBA Program, it also pursues this mission through its Executive Education Programs (including the Advanced Management Program as well as over 100 additional programs for practicing managers) and through the publishing activities of Harvard Business School Publishing (HBSP) which include Harvard Business Review, HBS Press (books), E-Learning products, and HBS Case Studies.

Providing guidance for leading academic institutions continues to be an important aspect of the HBS Mission. Over the past 60 years, HBS has not only made its case studies available throughout the world, but has assisted other Universities and their faculties in developing their ability to teach by the case method. This has included the offering of such courses as The International Teachers Program (ITP), Colloquium on Participant Centered Learning (CPCL) and the Program on Case Method and Participant Centered Learning (PCMPCL). The PCMPCL Program initiated in August of 2005 is aimed at helping leading Business Schools in Greater China and Singapore to develop excellence in the use of the case method and participant centered learning in both MBA and Executive Programs, as well as in practitioner-oriented research.

HBS has discovered over the years that adoption of the case method often proceeds through three stages. The first stage is where cases are used as examples and illustrations of principles and concepts being taught in a Management Course. The second stage is where cases become a primary means of learning, with a majority of the class sessions in a program relying on field-based cases. The third stage is then where the faculty begin doing significant amounts of their case-based research and curriculum development to better understand and teach about decision making.

Consistent with our mission, we at HBS and at HBS Publishing are pleased to offer—in conjunction with our partner, China Renmin University Press—a comprehensive approach to Chinese Business Schools and their faculty, that is focused on helping them progress through

the second stage of participant-centered learning and into that third stage. This overall effort consists of offering the 10-day PCMPCL Course to teams of business school faculty from Greater China and Singapore, providing a series of case books (through China Renmin University Press) tailored to the Ministry of Education's MBA curriculum recommendations, offering a set of follow-up case teaching and case writing seminars in China, and establishing an academic support center to assist faculty with their unique course and case requirements.

Our purposes in doing this are two-fold, but both are directly tied to the HBS Mission. One purpose is to facilitate better management education throughout the global economy by assisting leading educational institutions—such as those found in China—in developing their capabilities in practitioner focused, case based teaching. The other purpose is to help the leadership at such institutions to develop a critical mass of faculty who can lead the efforts of their own institutions in creating additional case-based teaching and research materials that can be shared with other parts of the world. Such China-specific management materials of a world class caliber are anxiously needed by academics elsewhere in the world.

We are pleased that China Renmin University Press and so many leading Chinese Management Schools would join with us in pursuit of these purposes. We anticipate that this series of case books will be a significant contributor to the pursuit of the important role that Chinese Educational Institutions, their faculty, and the practitioners they serve will have in the global economy.

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E. SCOTT MAYFIELD

## NetFlix.com, Inc.

In July 2000, Reed Hastings, chairman and CEO of NetFlix.com, Inc., faced a critical decision. Three months earlier, following one of the worst episodes on record for the NASDAQ market, NetFlix had submitted its S-1 filing for its initial public offering (IPO).<sup>1</sup> As a result of the market downturn, many Internet companies had been forced to withdraw their IPOs. Investment bankers indicated to Hastings that NetFlix would need to show positive cash flows within a twelve-month horizon in order to have a successful offering. Hastings knew that NetFlix was at a crucial stage. With revenues doubling every six months, NetFlix was enjoying tremendous success. But continued success depended on the company's ability to sustain triple-digit growth for the foreseeable future. Soon, Hastings would have to decide whether or not to proceed with the company's anticipated IPO.

Hastings asked Barry McCarthy, the chief financial officer, to re-evaluate the cash flow requirements of the company's current business plan, to suggest modifications that would improve the company's projected cash flows, and to make a recommendation on whether the company should go forward with its planned offering. As McCarthy reviewed the existing NetFlix business model, he considered possible changes that might allow the company to proceed with its planned IPO and yet sustain the type of future growth that would be necessary for the company to achieve its long-run objectives. McCarthy was acutely aware of the company's current financing need, but he worried about the effect that changes to the business plan might have on the company's current operations.

### *The Company*

NetFlix.com, Inc. was founded in 1997 by Reed Hastings and Marc Randolph. NetFlix operated an Internet-based unlimited rental subscription service for digital video disc (DVD) formatted movies. The DVD provided a new technology for storing and playing movies with image and sound quality exceeding that of traditional videocassettes. A DVD was similar in size to an audio compact disc and was capable of holding an entire feature-length film, as well as additional information such as subtitles in different languages, additional shorter videos about the making of the film or other related subject matter, and information about the actors, director, and producers. With its high quality and additional features, the new DVD technology provided an attractive alternative to traditional videocassettes for the home video market. By combining the superiority of the new DVD

<sup>1</sup> After reaching a historical high of 5,048 on March 10, 2000, the NASDAQ Composite Index had fallen 25% to 3,794 by April 18, 2000, the day of the NetFlix S-1 filing.

Professor E. Scott Mayfield prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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technology with the convenience of the Internet, NetFlix provided a new way to select and to rent home movies.

Randolph managed production of the NetFlix web site, including the features, functionality, and content on the site. Randolph believed that consumers were often frustrated in their efforts to select and view movies at traditional video stores because of limited selections and a focus on new release movies. With its unlimited "virtual" shelf space for stocking videos, the NetFlix web site focused on improving the experience of selecting a movie to watch by providing an intelligent interface for browsing, searching, and evaluating potential movies. The NetFlix web site also integrated movies currently showing in theaters by providing the ability to check local listings and show times, as well as the ability to view movie trailers on its web site. In addition, the NetFlix web site kept track of each subscriber's preference for various types of movies and provided an individualized predicted rating for all of the movies on the web site.

Since launching its web site in April 1998, NetFlix had experienced rapid growth. Revenues had grown from \$1.4 million in 1998 to \$5.0 million in 1999. The number of full-time employees increased from 46 in December 1998 to 270 in December 1999. By March 31, 2000, NetFlix had over 120,000 paying subscribers. Typical of most Internet startups, however, NetFlix had not yet earned a profit, reporting net losses of \$11.1 and \$29.8 million in 1998 and 1999, respectively. Exhibit 1 and Exhibit 2 provide annual financial statements for 1998 and 1999. Exhibit 3 provides quarterly operating results for 1999.

The NetFlix business model focused exclusively on the new DVD format technology. Management had four main reasons for focusing on this specific segment of the home video market.

- DVD players were the fastest growing segment of the video player market. Because of the rapid adoption of the new DVD technology, sales were forecast to grow at a 49% compound annual rate over the next five years.<sup>2</sup> Exhibit 4 provides a comparison of DVD player and videocassette recorder sales during the first five years after their respective introductions.
- Because of their small size, light weight, and durability, DVDs could be distributed to subscribers on a cost effective basis via regular U.S. mail. Including the costs associated with processing the order, McCarthy estimated the round-trip cost of shipping a DVD to a subscriber and back to NetFlix to be about \$1.00.
- In order to promote sales of DVD players, manufacturers were willing to include NetFlix promotional offers with their packaging materials at essentially no cost, which allowed customer acquisition costs to be kept to a minimum. Management had negotiated agreements with most of the leading DVD manufacturers, including Sony, Toshiba, Panasonic, and RCA. These manufacturers accounted for over 90% of the DVD players sold in the United States in 1999.
- Management believed that early adopters of DVD technology were likely to have a computer with an already existing internet connection and were likely to be willing to conduct commerce over the internet.

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<sup>2</sup> Paul Kagan Associates, Inc., as cited in NetFlix S-1 filing.

Hastings viewed NetFlix as a combination of a traditional video store, such as Blockbuster or Hollywood Video, and a subscription cable TV service, such as HBO, Cinemax, or Showtime. By paying a single monthly subscription fee ranging from \$15.95 to \$19.95, a NetFlix subscriber could rent an unlimited number of DVDs each month and could keep a DVD as long as desired.<sup>3</sup> Because NetFlix did not impose a specific date on which a DVD was to be returned, subscribers did not have to worry about paying additional fees for videos that were returned late. In order to attract new subscribers to the NetFlix web site, NetFlix distributed coupons for a free month of service with new DVD players. The costs associated with these free months of service to new subscribers made up the majority of sales and marketing expenses. In 1999 alone, NetFlix recorded over \$16.4 million in sales and marketing expense.

Once a subscriber had signed up for the free month of service, the objective was to get the subscriber to convert from free- to paid-status and then to retain that subscriber for as long as possible. In order to study the effect of the subscription fee on conversion and retention rates, management had tested a variety of different price points. Based on analyses of data from these market tests, McCarthy believed that his company's ability to retain subscribers was comparable to that of successful subscription cable services. McCarthy estimated that approximately 70% of new subscribers converted to paid-status and that 40% of subscribers that converted to paid-status continued to subscribe after six months. McCarthy expected retention rates for subscribers that subscribed more than six months to be quite high.

Because the NetFlix business model focused on the acquisition and retention of individual subscribers, McCarthy projected future NetFlix financing requirements using a subscriber model. First, McCarthy modeled the expected cash flows from a newly acquired subscriber, including the subscription fees paid, the expected number of discs rented, the costs associated with shipping and disc acquisition, and any other cash flows that varied directly with the acquisition or loss of an individual subscriber. Second, McCarthy modeled the likelihood that any given subscriber would be retained over the forecast horizon. And last, McCarthy used the projected number of future new subscribers together with the number of existing subscribers to forecast the company's expected aggregate cash flows.

### *The Marquee Queue*

A key aspect of the NetFlix business model was the "Marquee Queue" concept. The "Marquee Queue" allowed a subscriber to have several movies on hand for viewing at all times. A subscriber's queue was simply a list of all the movies that the subscriber had selected, but which had not yet been sent to the subscriber. After logging on to the NetFlix Web site, a new subscriber would browse the virtual aisles and select movies that he or she wanted to watch. These movies would be used to build the subscriber's queue. The NetFlix web site made it easy for the subscriber to edit the queue, such that the list could be arranged in the desired order. NetFlix would then ship the DVDs at the top of the queue to the subscriber.

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<sup>3</sup> Since launching its Web site, management had tested a variety of different pricing plans. From February 1999 through October 1999, NetFlix generated most of its revenues from individual DVD rentals and associated shipping charges. In September 1999, NetFlix launched its subscription rental service for a fixed monthly fee of \$15.95. Under this plan, subscribers could rent up to four DVDs per month. In February 2000, NetFlix modified its subscription rental service to provide unlimited rentals for a fixed monthly fee of \$19.95. At that time, existing subscribers were migrated to the unlimited rental service at their original fee of \$15.95.

NetFlix allowed a subscriber to have up to four DVDs in his or her possession at one time. Once a subscriber had viewed a movie and returned the DVD to NetFlix, the next DVD in the queue was automatically sent to the subscriber. In this way, a subscriber could always have movies in his or her possession for immediate viewing.

In order to fulfill subscriber requests, NetFlix maintained an extensive DVD library. As of December 1999, the NetFlix DVD library contained approximately 5,800 titles and over 620,000 individual discs. In order to process subscriber orders, NetFlix leased a 58,000 square foot distribution facility capable of processing and shipping over 6 million DVDs per month. During the month of March 2000, NetFlix shipped over 800,000 DVDs to about 155,000 total subscribers.

NetFlix purchased its DVDs on a wholesale basis from distributors. Approximately 20% of the DVDs in the library were allocated to new release titles and the remainder to back catalogue (non-new release) titles. New release titles were generally defined as movies that had been made available to the home video market within the past two months. As of the end of 1999, the net book value of the DVD library was about \$8.7 million. **Exhibit 5** provides information on the accounting treatment of the DVD library. For financial reporting purposes, NetFlix depreciated its DVD library over three years. However, because of their digital technology, McCarthy expected the actual DVD library to last an indefinite length of time without any deterioration in quality except for damage resulting from shipping or misuse. For this reason, NetFlix did not sell its older DVDs. Instead, discs naturally migrated into the back catalogue as they aged.

### *The Personal Movie Finder Service*

In addition to providing a "storefront" for renting movies, NetFlix offered individualized movie recommendations as part of its Personal Movie Finder Service. NetFlix asked its subscribers to evaluate the movies they rented using a simple point-and-click scoring system. Using this information, NetFlix constructed a preference profile for each subscriber. These profiles were used to supply a predicted rating for every movie on the NetFlix web site that was unique to each NetFlix subscriber. As more subscribers were added to the database and as existing subscribers rated more movies, NetFlix expected the quality of its movie recommendations to improve.

By providing reliable recommendations for selecting movies, NetFlix sought to develop sufficient brand loyalty to compete effectively against potential future entrants as well as existing video rental retailers. In addition, NetFlix anticipated that the information collected from its subscribers would also be useful to movie studios for promoting movies showing in theaters. According to the Motion Picture Association of America, the industry spent an average of \$21.4 million per movie to market and promote the theatrical release of new feature films. Management believed that their rapidly growing subscriber base and Movie Finder database could provide the industry with an effective means to market movies to a targeted audience on a personalized basis. Finally, as Internet technology developed, NetFlix was hopeful that its technology could be used as a programming guide to Internet delivered video. Through the development of its Personal Movie Finder service and the growth of its subscriber base, NetFlix hoped to become the definitive online intermediary for choosing movies and other video entertainment.

### *Consolidation and Innovation in the Home Video Market*

Analysts estimated that U.S. consumers spent about \$25.6 billion on movie theater tickets and home videos, with home video rentals accounting for about 32% or \$8.3 billion.<sup>4</sup> Although success at the box office was important to movie studios, profitability often depended on revenues from alternative markets, such as home video, pay-per-view, and television. In 1999, revenues from the home video market were estimated to account for almost 50% of domestic movie studio revenues.<sup>5</sup>

The home video industry was highly fragmented. However, with a 14% decrease in the number of video stores operating in the United States since 1997, the industry was consolidating rapidly.<sup>6</sup> In 1999, Blockbuster, Inc. was the world's largest video retailer with a 30% revenue share of the home video rental market.<sup>7</sup> Having almost three times as many domestic stores as its nearest competitor, Blockbuster estimated that roughly 60% of the U.S. population lived within three miles of a Blockbuster store. The typical Blockbuster store carried 4,500 different movie titles, 500 of which were new release titles. In 1999, approximately 78% of Blockbuster domestic rental revenue was from new release movies. Blockbuster also had begun to rent movies in DVD format. In 1999, most Blockbuster stores stocked between 200 and 300 different DVD titles.<sup>8</sup>

Traditionally, movies were made available for distribution in the home video market about two months after the end of their theatrical release. Video rental retailers typically purchased copies of videos from distributors and then rented them to their customers, keeping the revenue generated from the rental and/or sale of the tapes. However, two major innovations were anticipated to have a permanent impact on the way in which the industry distributed movies. They were: (1) revenue sharing and (2) video-on-demand.

**Revenue sharing** With the consolidation of the home video market and the increased importance of the home video to movie studios, revenue sharing agreements between movie studios and major retailers were becoming more common. Under a revenue sharing agreement, a retailer paid a lower price for each videocassette in exchange for sharing a portion of the rental revenue with the movie studio.<sup>9</sup> Because revenue sharing reduced a retailer's required inventory investment, retailers were willing to stock more copies of each new release title and customers were more likely to find a copy of the movie they wanted to rent. Since implementing revenue sharing in 1997, the typical Blockbuster store carried 60% more movie titles and stocked nearly four times the number of videocassettes.

**Video-on-demand** With the widespread adoption of the internet, analysts believed that home video would eventually be delivered directly to consumers over high-speed internet connections. The eventual advent of video-on-demand meant that video retailers had a limited time frame in which to position themselves for this new environment. Although it was generally agreed that such a change would take place, there was less agreement on the length of time it would take for the

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<sup>4</sup> Paul Kagan Associates, Inc., as cited in NetFlix S-1 filing.

<sup>5</sup> Paul Kagan Associates, Inc., as cited in Blockbuster 1999 Annual Report

<sup>6</sup> Blockbuster 1999 Annual Report.

<sup>7</sup> Casewriter estimate.

<sup>8</sup> Blockbuster 1999 Annual Report.

<sup>9</sup> In a typical revenue-sharing agreement, a retailer might purchase a new release videocassette for less than \$10 in exchange for returning 40% of the rental revenue generated during the first six months to the movie studio.

necessary infrastructure to be put in place or on who would eventually become the conduit for providing home video entertainment.

### *Conclusion*

Knowing that NetFlix had a limited time frame in which to assemble a "critical mass" of subscribers, McCarthy considered the effect that entering into revenue-sharing agreements with movie studios might have on projected NetFlix cash flows. He also wondered whether the major movie studios that had already signed agreements with Blockbuster would be willing to sign similar agreements with a relatively new Internet startup such as NetFlix. Considering the enormous growth requirements facing NetFlix, McCarthy was concerned that revenue-sharing agreements alone might not free up enough working capital to allow for a successful offering later in the year. McCarthy also considered whether NetFlix could afford to continue offering a free month of service in order to attract potential new subscribers. At the same time, he wondered whether the company could afford not to do so.

**Exhibit 1** Income Statements for NetFlix.com, Inc. (thousands of dollars)

	Year Ended December 13,	
	1998	1999
Revenues	1,339	5,006
Cost of revenue	<u>1,311</u>	<u>4,373</u>
Gross profit	28	633
Operating expenses:		
Product development	3,857	7,413
Sales and marketing	4,815	16,424
General and administrative	1,358	2,085
Stock-based compensation	<u>1,151</u>	<u>4,742</u>
Total operating expenses	<u>11,181</u>	<u>30,664</u>
Operating loss	<u>(11,153)</u>	<u>(30,031)</u>
Other income (expense)		
Interest and other income, net	114	924
Interest expense, net	<u>(42)</u>	<u>(738)</u>
Net loss	<u>(11,081)</u>	<u>(29,845)</u>

Source: Company reports.



Exhibit 2 Balance Sheets for NetFlix.com, Inc. (thousands of dollars)

	As of December 31,	
	1998	1999
<b>Assets</b>		
Current assets		
Cash and cash equivalents	1,061	14,198
Short-term investments	—	6,322
Prepays and other current assets	635	720
Total current assets	1,696	21,240
Rental library, net	2,011	8,695
Property and equipment, net	1,062	4,499
Deposits and other assets	80	339
Total assets	<u>4,849</u>	<u>34,773</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Notes payable	1,000	625
Current portion of capital lease obligations	579	571
Accounts payable	3,063	5,334
Accrued liabilities	1,640	3,211
Deferred revenue	118	471
Total current liabilities	6,400	10,212
Capital lease obligations	172	811
Note payable	—	3,959
Total liabilities	6,572	14,982
Mandatorily redeemable conv. pref stock	6,321	51,819
Shareholders equity (deficit):		
Convertible preferred stock	4	4
Common stock	3	7
Additional paid-in capital	8,100	16,087
Deferred stock-based compensation	(4,711)	(6,841)
Accumulated deficit	(11,440)	(41,285)
Total shareholders' equity (deficit)	<u>(8,044)</u>	<u>(32,028)</u>
Total liabilities and shareholders' equity (deficit)	<u>4,849</u>	<u>34,773</u>

Source: Company reports.