

Netflix and Microsoft on Ad Tiers: Is this cooperation good or bad?

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Abstract. This article will be analyzing the deal on adding ad tiers between Netflix and Microsoft in 2022. It is worth to discuss whether this partnership with Microsoft is necessary for Netflix based on Netflix's current ability and resources. It will be introducing the process of preparing strategies before the deal, negotiating maximum benefits from the deal, and predicting the results after the deal. It will base on Netflix and Microsoft's strengths, weaknesses, opportunities, and threats to further explain how each party would gain their relative bargaining power and be in a better position during the deal. Defining the objectives and listing out the strategic planning will help each company to gain a clear vision and better understanding of the needs of buyers and suppliers. This article will also discuss some major concerns and economic issues that each party might face. To conclude, the partnership between Microsoft and Netflix is efficient, and it should bring a positive outcome after it is released.

Keywords: Netflix, Microsoft, deal making.

1. Introduction

Most companies in the entertainment industry require diverse needs and technology before delivering a product to the audience. Especially the online platforms, they are demanding more diverse workers, not only directors and actors, to build a nearly perfect website for customers to watch. After estimating the overall cost, most companies choose to work together with other companies to achieve the lowest cost. Having the best deal with other companies who are already experienced at it, especially in technology areas that are riskier and require more knowledge, by negotiating costs lower than developing a new department in their own company. Due to covid-19, companies are urged to have wise strategic planning to survive in the market. Therefore, acquisitions and deal-making happened to be more frequent than before as companies require more maintenance fees, and at the same time, they need to be beneficial even though customers' wallets are no longer flat. In an effort to fulfill their needs, companies consider many factors and find their partner carefully before making a deal.

Netflix, as an entertainment giant back through its history, had lost nearly one million subscribers due to the increase in subscription fees at the beginning of 2022 and planned to not any further lose its subscribers. Therefore, in July 2022, Netflix announced that it had chosen Microsoft as its partner to work further on an advertising platform in which sooner than later, the customers will expect to see some ads being popped up if they wish to pay at a lower price. After releasing this news, the public was surprised that Netflix took action that broke its ads-free tradition due to the pressure of covid-19. Microsoft, as is always the technology giant in the industry, promised that it will work better on customer privacy and to better match correct shows to the correct customer. As the result was shown after the releasing news, both companies' stock prices are climbing up a bit, still, Netflix has been at its worst through the years as it needs some time to back to its peak.

In this deal, Netflix, as the buyer, wanted the product, then it came to Microsoft, as the seller, to negotiate. It seemed simple but in-depth, it is a long process before deciding the deal. Before any deal, companies will first list out their SWOT (strength, weakness, opportunities, threats) and their objectives as these will help companies to have a clearer vision. Then, they will start to negotiate with different partners: the buyer is willing to buy the product at its lowest cost while the seller wants to sell it at the highest price. Only when the buyer's price is higher than the seller's price, a deal will become possible. Within this zone of possible agreements, buyers and sellers will discuss their needs and wants, and to a certain price, when all parties agree, the deal will be made. Just as in tag of war,

each party wishes to pull their rope towards their sides. Companies are listing their relative bargaining power and some leverage points to help them win a better standing. They will also have concise strategic planning and concerns. This article will analyze the deal between Netflix and Microsoft, and also, the outcome that this collaboration might bring.

2. Data and Method

Netflix Incorporated is founded in the United States mainly serves over-the-top media. Before it served on the Internet in 1997, it was mainly sold and rented by mail using DVDs. After releasing the subscription model in 1999, Netflix started to gain more users and grow faster as its attracted offerings and no late fees. [1] In 2007, different from traditional TV channels, Netflix's streaming services began to use through connected TVs and all other devices that support the Internet. In 2012, Netflix started to produce a exclusive content called *Netflix Originals*. After years of having combined exclusive and non-exclusive shows with completely ads-free, Netflix had gained success as its stock price climbed up to nearly 700 US dollars in 2021. [2] One of the well-knowns of *Netflix Original Series* is called *The Stranger Things*, an American science fiction drama television series who had been continued for four seasons until 2022 and would still be continued due to the impressive results from the audience. Reports showed that due to the coming back of *The Stranger Things* season four, Netflix was able to gain back some of its losses due to the decrease of subscribers while other economists argued that the increasing in viewing is insufficient to prove. [3] The subscription fees today are divided into three tiers in which the resolution will be different. Under each subscription, the user can have multiple usernames and passwords that they can share with their friends or family members. Under different subscription plans, the user will also be able to log into different devices at once.

Microsoft Corporation, the well-known technology corporation that produces electronics and computer software, is the flagship since 1975 when it was first founded in the United States. It is ranked 14th in the 2022 Fortune 500. [4] Back to 1970s and 1980s, Bill Gates and Paul Allen first introduced their software and then had their own version of Unix. As the progression went on, Microsoft invented Windows and Office, which are still being used today, and were followed by more innovations in computer science till now. Some of Microsoft's creative entertainment products, such as Xbox, had dominated the market and earned billions of dollars. Recently, Microsoft started to make acquisitions frequently than usual, for instance, LinkedIn and Activision Blizzard, [5] which drove Microsoft to another height of success. Microsoft is also impressed globally due to the widespread of its products and technology. During each deal, both parties will first negotiate with each other until reaching the desired price. For Netflix, as the buyer of the ad-supported tier, it wants to spend less but also receive good quality. On the other hand, Microsoft, as the seller, wants to sell this built online platform to be as highest as possible. Before each negotiation, each corporation will list out its strengths, weaknesses, opportunities, and threats to be better prepared.

3. Analysis

3.1 Netflix's SWOT Analysis

Netflix's strengths can be listed as the following. First of all, Netflix has combined exclusive and non-exclusive content. Netflix could be profiting from its existing exclusive content and also from present content, which will support its investment financially. Moreover, because of their good quality of content, even though they lost many subscribers in 2022, they still have a considerable amount of users around 220 million, which represents a large market share. Having a large active user base will help Netflix has a better view of the market and customers' habits and also attracts more producers to join. In addition, to enhance its customers' experience, Netflix has better adaptability. [6] Netflix adjusts its service frequently to meet the needs of the market and the user. For example,

for years, Netflix had been investing in Korean content, and after the release of Squid Game, the public's response was without precedent, and Netflix was able to earn a big boost. [7]

For weaknesses, Netflix doesn't have any investments other than media; therefore, it might slow the growth compared to its competitors. For instance, Disney+ has its theme parks and merchandise for movies. Another weakness is that Netflix has some limitations to stop them from expanding. Netflix's user is mainly in North America and could only be accessed in a couple of countries will foreign shows. Moreover, Netflix is also in heavy debt. One of its previous concerns was the content was that the American movies distributed in some Latin American countries were dubbed, prompting a number of movie buffs to request the option to view films in their original English format with subtitles in the local language of their country.[8] Tryon also stated in his article that although the Netflix expansion seemed to promise the potential of more flexibility and mobility, the reality was somewhat more complicated, leaving consumers with limited choices in terms of the amount of content they could watch, as well as a limited catalog to choose from. Moreover, Netflix is also in heavy debt. Based on the analysis report, Netflix's debt ratio is 42.07%. The higher the ratio, the greater risk will be associated with Netflix's operation. [9] In its reports, Macro axis continued to propose that a high debt-to-assets ratio may indicate a low borrowing capacity of Netflix, which in turn will lower the firm's financial flexibility. Conversely, this heavily long-term debt might also push Netflix to think faster of any possible ways to increase profit.

Talking about opportunities, Netflix could expand its market to the gaming industry. For instance, they could film an interactive game using the same techniques as the movies with more detailed feelings and plots than normal games. Also, they could implant their original contents into the metaverse that might lead to an industry in which its competitors haven't stepped in yet. Nowadays, a new type of game called Script Killing has dominated the market better than escape rooms in China in which many young people and adults would spend hours playing them. Netflix can catch the opportunity to introduce this new type of reality show in which some influencers will be invited to the game and to find the murderer like China, or they can innovate some new ways other than traditional TV shows, for instance, they can give the audience some scripts combined with murder mystery shows.

When mentioning threats, Netflix has its competitor not only within the industry, for example, when it sees Disney merged with Hulu, but also in the new arising short videos industry, such as TikTok, which will take away many of its subscribers. The other potential threat is the pandemic. Because pandemics could be spread so quickly, it will suspend some crews from filming, and it will a huge loss for having a longer filming time and later release date. One last threat might be regulations. For example, if Netflix wants to acquire Roku, it might touch on the antitrust policy that will stop Netflix from growing. However, an antitrust policy is good for a country to create a free and competitive market that allows consumers to buy things at a lower price.

3.2 Microsoft Analysis

For strengths, Microsoft has founded the company for so many years and is experienced in many technology products such as on ad-supported tiers. Back in 2007, Microsoft was investing \$240 million for a minority 1.6 percent stake in Facebook. [10] Under the agreement, Microsoft became the exclusive advertising platform with Facebook. [10] Past experiences helped Microsoft to become a better partner compared with others. Like Netflix, Microsoft also has a large share in the market, which means Microsoft has a large user base data as well. This proved that Microsoft has the ability to serve better with needs like Netflix. Also, nowadays, Microsoft is more diverse and invested in lots of different companies in the technology industry, for example, Xbox and games. This diversity will drive more possibilities with its partners so that it might have a chance to work further. For example, if Netflix wants to produce games for its movie fans, if the previous deal with Microsoft is excellent, it will likely work with Microsoft again because it trusts its partner and is familiar with Microsoft's work style and system already. As a fact, Microsoft runs the Game Pass, which is frequently called the "Netflix of gaming," with a la carte presentation and a similar subscription model as Netflix. And

Netflix has recently moved into games publishing and has made more than 20 mobile games available for free to paid subscribers. [11] Besides the recent deal in 2022, in 2008, Microsoft and Netflix were cooperating on Xbox that Netflix will allow Xbox users to stream movies from Netflix to their TV through the gaming console. [12] Therefore, it might be a chance for Netflix to choose Microsoft to have a partnership again.

Talking about weaknesses, these days, Microsoft acquired a lot of companies but lacks innovation. Although these investments are expanding the power of dominating the market, Microsoft still needs to improve its own produced products otherwise it may not that powerful to compete with its competitor, for example, apple. In addition, Microsoft's investments are not diverse. To better explore their market and decrease the risk of investment, it is better to hold diverse investments in all industries. Therefore, dealing with Netflix opens the opportunity for the entertainment industry. Another opportunity that Microsoft can be developed is to invent an app that is just accessible as apps like WhatsApp but to use in the office. Although emails are mainly used in workspaces, the traditional way of contacting needs a revolution. There can be easier ways to contact and in a more secure way.

One of the threats that Microsoft faced is an economic issue. For example, the pandemic slows down some of the producers' efficiency in producing CPUs; therefore, some new releases might be pushed into longer waiting times. Another threat might be a trade war. Trade war will push Microsoft to change its production to other countries and bring a loss. [13]

3.3 Deal Analysis

Before making any further negotiations, each company needs to be clear on its goal. With the decrease in subscribers, Netflix is finding the goal to solve the decrease in profits instead of a plan that only suits the pandemic. Based on economies of scope, Netflix is now trying to lower its average cost by having financial benefits with an ad-supported tier. They want to find a seller who is proficient on the advertising platform, so the product could release as soon as possible, and they will receive the user back. On Microsoft's side, they want to gain more reputation in the industry and step into the CTV space. The mutual goal is to boost earnings and gain more customers. More, there are a few concerns that each party needs to be aware of the opposite party. Each party should make sure that their partner is in good standing. For years, people are concerned about women's rights or racial rights; therefore, in the opposite company, there shouldn't be any forced or child labor, and they shouldn't have any unsolved disputes. The other concern that Netflix needs to agree with Microsoft is that Microsoft should not leak any of its user's private information or that the users' habits shouldn't be spied on by other online platforms. For example, after watching Netflix, the user shouldn't be showing the TV show's advertisements that they just watched in their search engine.

During negotiations, strengths are used as the relative bargaining power in negotiation. With all the positive outcomes that Netflix will bring, for example, working with a large user database will help Microsoft improve its technology and innovation, and Netflix will drive the ideal price more to its side. On the other hand, empirical cases make Microsoft pull the price more ideal to its budget. To better pull the price to its side, each company will have its key leverage points. In the deal between Netflix and Microsoft, Netflix is the less leveraged side. It is because Netflix is urging to have its ad-supported tier be released as soon as possible, but it lacks the technology. In an effort to get a better deal in negotiation, Netflix will have its best alternative to a negotiated agreement, which is Google. Google is also a technology giant that is empirical in advertisements that can provide the same service as Microsoft. However, Microsoft has more leverage in these ways. First, Microsoft is platform neutrality. Unlike Google which has YouTube or Roku which has a Roku channel, Microsoft has not yet entered the media industry. [14] There is less concern for Netflix about having its competitor as its supplier. Although Microsoft was labeled the underdog compared to other companies during the negotiation, it turns out to be an advantage. The company wouldn't be stressed that Microsoft will not be competing in the streaming and could be focusing on supporting Netflix and creating its own ad business.[15] Moreover, Microsoft has stronger privacy protection. After the acquisition of Xandr, an online platform that sells and serves advertisements on a global basis, Microsoft claims that it

could match advertisements better with less leaking of privacy information. Nowadays, secured information has been inspected by many sides, especially data statistics, to avoid any scandals, Netflix should decide cautiously when choosing partners. In addition, if Netflix wants to expand its market globally, it is better to work with a global advertising platform from the beginning than later.

However, the deal might bring some negative effects to Netflix. When Netflix was dealing with the existing directors or casts, one of the agreements was ad-free. Having advertisements before movies might make some directors unpleasant, or these existing partners might become indifferent to putting their contents in any other channels, which will lose cooperation and some great original products.

For negotiation strategies, instead of BATNA, each party should also prepare their reservation price, the price that they will be indifferent to achieve a negotiated agreement or walk away. For Netflix, the reservation price should be BATNA plus the switching costs since they need to adapt their system to Microsoft's. For Microsoft, they need to include the opportunity cost that they might earn by having other programs. When defining each party's aspiration level, Netflix and Microsoft seemed equal in that both parties are excited to work with each other, and based on their leverage points, they are complementary to fulfill each other's needs.

4. Conclusion

After negotiating, Netflix and Microsoft finally made a deal as both parties are satisfied with the price. In July 2022, Netflix COO Greg Peter announced: "Microsoft has the proven ability to support all our advertising needs as we together build a new ad-supported offering. More importantly, Microsoft offered the flexibility to innovate over time on both the technology and sales side, as well as strong privacy protections for our members." After the release of the news, based on the stock price, both companies had grown to a certain percentage. Netflix seemed to grow higher than Microsoft, this is probably because the public is also looking forward to seeing Netflix back to its peak since the deal is vital to the future development of Netflix, and Netflix will likely gain back the customers that they have lost. As shown in figure 1 [14], economists predict that with the improvement of adding ad tiers, entertainment companies such as Disney+ and Netflix will be boosting the total amount of subscribers in the next three years.

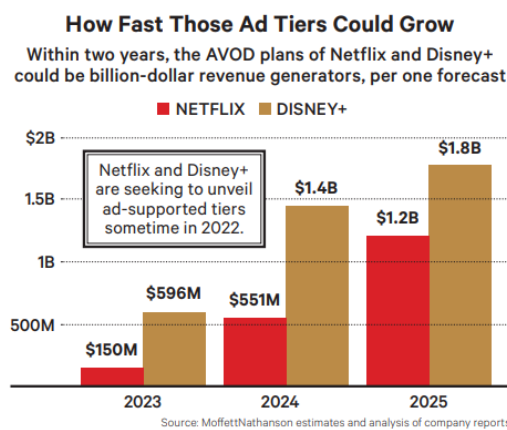


Fig. 1 Predictions on ad tiers

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