

Redbox's golden opportunity: higher Netflix prices

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In this photo taken Aug. 26, 2011, Gary Cohen, senior vice president of marketing and customer experience at Redbox, poses at the company's offices in Oakbrook Terrace, Ill. Redbox is looking to pick up new customers with rival Netflix poised to raise its prices by as much as 60 percent for its existing subscribers beginning Sept. 1. (AP Photo/Brian Kersey)

(AP) -- Netflix is giving Redbox a golden opportunity to gain some ground.

Beginning Thursday, Netflix, the largest U.S. [video subscription service](#), will hit its nearly 25 million U.S subscribers with rate increases of as much as 60 percent. The sticker shock is expected to make [Redbox](#), which rents DVDs for \$1 per day through kiosks, even more enticing to movie lovers.

"We are very cognizant of the value of the dollar," said Gary Cohen, Redbox's senior vice president of marketing and consumer experience. "Redbox is all about simplicity, convenience and value."

[Netflix Inc.](#)'s higher prices will drive business to video rental chain Blockbuster and other home entertainment rivals too, but none are better positioned to take advantage of the disruption than Redbox, according to Wedbush Securities analyst Michael Pachter.

That's because millions of people are expected to keep paying for a Netflix service that streams video over high-speed Internet connections, but will look for other places to rent DVDs at a low price. Most people won't have to go far before coming across a Redbox kiosk; two-thirds of the U.S. population now lives within a five-minute drive of one of the company's red [vending machines](#), which are largely stationed in Wal-Marts, drug stores, supermarkets and [convenience stores](#).

Netflix, which is based in Los Gatos, has given its subscribers little reason to stray until now. Its service emerged as a household staple during the past few years while bundling rented DVDs through the mail with unlimited Internet video streaming for little as \$10 per month. Keeping both of those options will cost \$16 per month under Netflix's new pricing system. Netflix predicts about 10 million customers will avoid the higher prices by limiting their subscriptions to an \$8-per-month streaming plan that doesn't include the latest theatrical releases available on DVD and pay-per-view.

Pachter believes somewhere between 2 million to 3 million customers will simply close their Netflix accounts and abandon the service entirely to protest the higher prices.

Without providing specifics, a Netflix forecast issued in late July acknowledged its higher prices will result in an unusually high

cancellation rate. During the past year, Netflix averaged 2.8 million cancellations per quarter. That compared with an average of 5.2 million new subscribers every three months during the same period. Netflix isn't certain it will attract enough new customers to offset the cancellations in the three months ending in September.

If the projections pan out, a large audience of DVD renters will be up for grabs during the next few months.

The Netflix backlash is expected to be a boon for Redbox mainly because its in-store kiosks have become almost as ubiquitous as the red envelopes that Netflix uses to deliver DVDs.

In the past two years, Redbox owner Coinstar Inc. has more than doubled the number of DVD rental kiosks to 33,300. Compare that to Blockbuster, which is down to 1,500 stores in the U.S. after a bankruptcy filing last year led to its \$234 million sale to Dish Network Corp. earlier this year.

Redbox also offers something Netflix doesn't: video game rentals for \$2 per day. It also plans to begin selling an Internet streaming service before the end of the year, but hasn't provided many details about it yet.

Higher prices may be looming at Redbox too. In June, the company began testing DVD rentals at prices ranging from \$1.10 to \$1.20 in six markets: Kansas City, Mo.; Phoenix; Charlotte, N.C.; Portland, Ore.; Pittsburgh; and Austin, Texas. Redbox, which is based in Oakbrook, Ill., says it doesn't plan to raise its prices permanently.

Netflix CEO Reed Hastings viewed Redbox as his company's biggest competitive threat two years ago, but he no longer sees it that way. Hastings now says he is more worried about the Internet streaming options that supplement to pay-TV services, such as those offered by

Comcast Corp. and Time Warner Inc.'s HBO.

Neither of those rivals, though, will fill the DVD rental void if more households decide to stop getting their discs from Netflix. Hastings expects Netflix to be delivering DVDs to about 15 million subscribers at the end of September, including about 3 million customers who drop their Internet streaming plans and rent discs exclusively.

Fears of a mass customer defection have contributed to nearly 20 percent drop in Netflix's stock price since the company announced its higher prices in July. Curiously, Constair's shares have fallen by about 18 percent during the same period, even though analysts such as Pachter and Pacific Crest Securities analyst Andy Hargreaves are urging investors to buy the company's shares to take advantage of the anticipated influx of Netflix customers. (Coinstar got 85 percent, or \$726 million, of its revenue from Redbox during the first half of this year.) The sharp drop in Coinstar's market value is being driven by investors who believe DVD rentals are a dying business, Hargreaves said.

Redbox isn't predicting how many Netflix subscribers it might be able to attract.

Since Netflix announced its price increase, Redbox's promotional efforts have been limited to discounts offered through cell phones and free movie vouchers distributed through Facebook, where Redbox is more popular than Netflix these days. Redbox's Facebook page has nearly 3.6 million "likes" compared with 1.8 for Netflix's Facebook page, which has attracted more than 81,000 mostly outraged comments about the higher prices.

Unlike Netflix, Redbox isn't a big advertiser. Redbox's marketing expenses during the first half of this year totaled \$10 million compared with \$199 million at Netflix. Redbox "probably should be doing more

marketing than they have been," Hargreaves said.

Blockbuster has been more aggressive in its courtship of Netflix customers. Just two days after the higher prices, Blockbuster started offering Netflix free trials and discount offers.

Cohen is confident Redbox will prove irresistible to bargain hunters looking for a little home entertainment.

"Our business is easy to understand and it's easy to try, especially if customers are disgruntled with something else," he said.

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