Qwick retreat: Netflix kills plan to split in two (Update)

October 10 2011, By MICHELLE CONLIN AND CHIP CUTTER , AP Business Writers

In this Sept. 22, 2011 file photo, Netflix CEO Reed Hastings gestures during the Facebook f/8 conference in San Francisco. Hastings said Monday, Oct. 10, 2011, it's abandoning its widely panned decision to separate its DVD-by-mail and Internet streaming accounts. (AP Photo/Paul Sakuma, File)

(AP) -- To the ranks of New Coke and the Edsel, we can now add Qwikster.

Less than a month after announcing a plan to separate its DVD-by-mail and Internet streaming services, Netflix reversed course Monday and said it would keep the two services on a single website. Customers had complained loudly that the plan would have made it more difficult to watch movies. Investors hated it, too.

In the end, the company backed down. But Netflix's turbulent relationship with subscribers over the last three months raises questions about how it's being managed during the transition from delivering movies on disc to sending them over the Internet.

Until recently, CEO Reed Hastings had always seemed to possess an uncanny touch. He was the David who crushed goliath Blockbuster and a visionary who foresaw the death of the DVD. He was also a beloved leader who lavished his employees with above-market paychecks and unlimited time off.

When Netflix employees were asked to describe Hastings, they often pointed to the George Clooney character in Ocean's 11.

But that cool, smooth operator seems to have vanished. Six months ago, Hastings and Netflix could do no wrong. Today, he and the company are fodder for "Saturday Night Live" skits and targets of venom on social-networking sites.

Netflix's about-face initially pleased Wall Street. The stock rose as much as 10 percent in the first minutes of trading. But enthusiasm waned in the afternoon, and Netflix ended the day down 5 percent.

Analysts praised Hasting's attempt at a mea culpa, but the series of missteps has stirred doubts about his leadership at a time when the company faces wrenching industry change and ferocious competition.

"They're making decisions rashly and also potentially out of desperation," said Tony Wible, an analyst at Janney Capital Markets.

Netflix started to resemble a different company last summer. The stock had been on a tear, rising from $110 in July 2010 to more than $290 on July 12, 2011. But on that same day, Hasting's miscalculations began.

That's when he abruptly announced that Netflix was raising fees for its DVD business by as much as 60 percent.

For consumers, the timing could not have been worse. The economy remained stubbornly weak, and they had been given no warning.

They immediately took to Twitter and Facebook with their rants, bashing the company. Once the king of consumer loyalty indexes, Netflix sunk below competitors Blockbuster, Redbox and DirectTV.

On Sept. 1, before subscribers' heads had cooled, Netflix lobbed another grenade: It would no longer stream any content from its powerhouse provider, the premium cable channel Starz. Customers who subscribed to the DVD service complained they were paying more for less.

Then came the coup de grace: the dreaded Qwikster, the new name for the DVD-by-mail service.

It had all the earmarks of a marketing disaster. First, Netflix announced the split with no warning, which was unusual considering that Hasting and his executive team have a history as great communicators. Worse was the fact that the news came amid a consumer revolt.

As if all that were not enough, there was also the matter of the lame new name, which seemed eerily reminiscent of the dot-bomb Friendster. The moniker seems sure to go down in the annals of branding debacles.

Since the Qwikster affair, Netflix shares have slid 28 percent to $112, and consumers are bolting in big numbers.

Netflix had 24.6 million subscribers at the end of June, but it warned last month that it expected a net 600,000 to leave by the end of September because of the price increase. That would be by far the worst downturn in the company's history. Netflix reports final figures on Oct. 24 for the quarter that ended in September.

Analysts and diehard company fans are left struggling to understand Hasting's recent moves. Some are worried about the cost to morale inside the company and whether some of Hasting's A-team could begin to bolt.

Outside, the company faces another war for its reputation. If consumers perceive Netflix as a loser, it will be harder for Hastings to hang on to them. If Hollywood studios perceive Netflix as a has-been, it will be harder for Hastings to negotiate favorable content deals.

Where once Netflix stood alone, it now faces intense competition from Apple, Amazon, Wal-Mart and others.

It's not that analysts believe Hastings should have remained unchanged at a time when Netflix's business model was evolving. Netflix's DVD-by-mail business has a wildly different cost structure than the far cheaper Internet video streaming, which Hastings believes is the company's future.

Even in the midst of its stumbles, Netflix has plenty of supporters.

"In life we all make mistakes," said Michael Corty, an analyst at Morningstar. "You hope that your mistakes are small."

But those less sanguine fear the company could become the AOL of streaming.

"There are literally 10 to 20 things that can go wrong for this company in the next year," Wible said. "It's a fundamentally flawed business model. They don't own content. They don't own distribution, and they can't sustain the price point that they've established."

Hasting's business philosophy has long been rooted in the idea that companies rarely die from moving too fast. They die from moving too slowly.

On Monday, Hastings issued a mea culpa: "There is a difference between moving quickly - which Netflix has done very well for years - and moving too fast, which is what we did in this case."

Will Hastings now face pressure to step down? Analysts doubt it, saying he deserves credit for building Netflix up.

"He's entitled to have an occasional misstep," said Michael Pachter, an analyst at Wedbush Securities. "It's like firing Steve Jobs in 1985. It sounded like a good thing at the time, but it turned out to be a disaster. Reed is the visionary who got them there, and he's good."