Assignment Number 4-4

Governance and Stewardship

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For my corporate governance and stewardship analysis I've chosen to look at movie rental giant Netflix Inc. ("Netflix")

History

Netflix is the world's largest DVD and Blu-Ray mail delivery and video streaming rental service. They have 23 million subscribers in the U.S. and Canada who play movies over gaming consoles like the Xbox 360, Playstation 3 and Wii and other internet enabled devices as well as receive over 700 million DVD and Blu-Ray disks a year through the postal service (Epstein, 2010).

The deceptively simple idea is the brain child of CEO Reed Hastings. He thought of the business when he accumulated an exorbitant late fee from a traditional brick-and-mortar video rental store. Hasting said "I rented a VHS and I had misplaced it and it was six weeks late. So it was a $40 late fee…Now I'm thinking about lying to my wife about a late fee and the sanctity of my marriage for this thing!" (Schorn, 2009). During a trip to a workout session, Hastings had a brainstorm: Create a movie rental service based on the membership fee subscription model used by gym chains.

The model creates busy environments in each of their 40 warehouses across the country, the largest of which is in Silicon Valley. This warehouse receives the thousands of DVDs customers are finished watching in the early morning hours. Once they take the delivery, Netflix employees carefully check the quality of the disks individually and repackage any that are on another customer's want-list for immediate reshipment later that day. "Netflix moves more than 1.5 million DVDs a day, making Reed Hastings one of the post office's top ten customers for first-class mail." (Schorn, 2009)

Netflix has been on a rocketship of growth, and darling among Wall Street investors by "expanding among the best performers over the past two years, with its stock up 43% in 2011 and 132% from [2010]" trading at $280 (U.S.) a share as of July 20, 2011.

Board of Directors

The organizational structure of Netflix is "Highly Aligned, Loosely Coupled" (Intel, 2011) and based on performance not hours worked. Reminiscent of the free flowing outcome-based culture of W. L. Gore & Associates, Inc., Netflix hires great people and lets them do a great job. Netflix really trusts their employees who are not required to adhere to any vacation or budget policies. They're only asked to act in the company's best interest. This culture has been cultivated purposefully from the top down. The make-up of the Board of Directors reflects the organizational composition and its goals.

Structure and Members

Board Size

Netflix board is made up of seven members:

- Reed Hastings, Netflix, CEO

  Hastings founded Pure Software, which produced debugging software for different platforms, in 1991. He sold the company in 1997, just before the "dot com" bubble, for $750 million dollars. The sale gave him the startup money he needed for Netflix. Hasting is a true visionary, demonstrated by his quote in 2005: "We want to be ready when video-on-demand happens. That's why the company is Netflix, not DVD-by-mail." (Sauer, 2005) Recently, Hastings was added to the board of directors of Facebook.

- Richard Barton, Zillow Inc., CEO

  Barton is a former Microsoft executive who founded the travel booking website Expidia.com and the real estate estimation website Zillow.com.

- A. George “Skip” Battle, Investor

  “Battle served with Andersen Consulting in various roles, including worldwide managing partner, market development, until his retirement from Andersen Consulting. Battle served as a director of PeopleSoft until its acquisition by Oracle. He is also the former chief executive officer and executive chairman of Ask Jeeves.” (Linkedin, 2010)

- Charles H. Giancarlo, Silver Lake, Managing Director

  “Giancarlo had a variety of roles at Cisco Systems, Inc. His last position at Cisco was as executive vice president and chief development officer, a position he held starting in July 2005. In this position, he was responsible for all Cisco business units and divisions and more than 30,000 employees.” (Forbes)

- Timothy Haley, Redpoint Ventures, Managing Director

  “Haley is a Founding Partner of Redpoint Ventures. Prior to founding Redpoint, Tim was a general partner with IVP, a firm he began working with in 1987 and joined in 1998. Prior to joining IVP full-time in 1998, Tim was the principal of Haley Associates, one of the premier executive recruiting firms in the high technology industry. Tim was instrumental in the formation of numerous successful companies.” (Redpoint Ventures)

- Jay Hoag, Technology Crossover Ventures, General Partner

"Jay Hoag, a co-founder of TCV, has been a venture capitalist and technology investor for over 27 years. Prior to TCV, Jay was a Managing Director at Chancellor Capital Management where he spent over 12 years as a technology focused venture capitalist and fund manager. In addition to generating industry leading performance managing public technology portfolios, Jay led private investments in Ascend Communications, CompUSA, Intuit, Macromedia, NETCOM, PictureTel, Pure Software, Sybase and many others." (Technology Crossover Ventures)

- Ann Mather, MoneyGram International, Director

  "From 1999 to 2004, Ms. Mather served as executive vice president and chief financial officer of the computer animation production company Pixar, where she was responsible for finance, administration, business affairs, investor relations and human resources. She was Pixar's primary liaison with Disney on distribution matters related to the co-production agreement between the two companies. From 1992 to 1999, Ms. Mather held various executive positions at Disney, including senior vice president of finance and administration for its Buena Vista International theatrical division, with responsibility for Europe, Asia and Latin America." (Netflix, 2010)

The board has three committees: Audit, Compensation and Nominating & Governance.

Audit Committee

Members: Giancarlo, Haley, and Mather

Chair: Mather

Charter

"The purpose of the Audit Committee of the Board of Directors (the "Board") of Netflix, Inc., a Delaware corporation (the "Company") shall be:

- to provide oversight and monitoring of (i) the Company's financial reporting process (ii) the Company's systems of internal controls over financial reporting, (iii) the integrity of the Company's financial statements, and (iv) the independent auditors' qualifications, independence and performance;
- to provide the Board with the results of its monitoring and recommendations derived there from;
- to assist the Board in ensuring the Company's compliance with legal and regulatory requirements in connection with the Company's financial reporting process; and
- to provide to the Board such additional information and materials as it may deem necessary to make the Board aware of significant financial matters that require the attention of the Board." (Netflix)

Board Independence

Six of the members are designated as "Independent" as in they have no part in the day-to-day operation of the company. The "Dependent" member of the board is the CEO. The board totals seven members, the minimum amount to staff the committees with no one doing double duty. The chair person is also the CEO. Critics claim that this arrangement could possibly cause a conflict of interest. This view is not shared by the academic community:

> "In terms of splitting the roles, there is no academic evidence to suggest that [splitting the CEO and Chairperson jobs is] a good thing. What we do have evidence for is that it's important for the CEO to realize that he is reporting to the board and not controlling the board completely" (Metrick, 2004)

The rest of the board have no say in the everyday business of Netflix and are not related to anyone working for the company. They would be considered "outsider" members of the board.

With only so many hours in a day, the number of boards a member serves on is another way to evaluate board members. Hastings serves on three boards (Netflix, Microsoft and Facebook.) Any more than that could eat too much into the CEOs time. Barton is a member of eight boards including being chairman of Zillow Inc. and Glassdoor Inc. Giancarlo has five board memberships. Timothy Haley leads the pack with fifteen current board memberships. Hoag and Mather serve on ten boards each. Although being on many different boards can give a person lots of experience, there is the question of when do they have time to concentrate on Netflix's unique issues?

Finally, Netflix's Proxy Statement for 2011 stated "No related party transactions were identified in 2010." This means no relation of any board member received compensation for services to the company.

All things considered, Netflix seems to have an independent (although very busy) board of directors.

Interests of shareholders

The often quoted Nobel-laurite Milton Freedman wrote in his seminal article "[The social responsibility of corporations] is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom." (Friedman, 1970) The interest of Netflix's shareholders is much the same. They've been tolerant of Netflix's unorthodox business practices like not having a vacation time policy possibly because the company has been so incredibly profitable. Netflix has had several flare-ups with their investors including a dispute on how much is too much to pay for a popular show (Poggi, 2011), how many votes are needed to remove a board member (Pendola, 2011) and executive pay (Sandoval, 2011). For the most part, it looks like the board of Netflix has kept their shareholders interests in mind while making decisions.

Competing interests

Shareholders

As previously stated, shareholders are generally interested in maximizing profits. Modern shareholders are more savvy than to “kill the golden goose” by pushing their company into ruin with unreasonable expectations. Today’s investor understands that a good company has a mix of healthy profits, customer service and philanthropy. This doesn’t mean that shareholders’ interests are always in line with customers. Recently, Netflix changed their pricing structure much to the chagrin of customers. The price hike increased the basic subscription price 60% by separating the streaming and one DVD-by-mail options. Previously customers got both services for one low price. The move was designed to get Netflix “…quickly out of the money-losing DVD-by-mail business.” (Magee, 2011) Customers took to social networks like Facebook and Twitter to voice their complaints. Even though Netflix stock took a 30 point drop after the announcement ($280 a share to $250) the long-term outlook for the company is good as they save money on the processing of DVDs.

Management

Netflix unique corporate culture encourages management to take personal interest in the personal well-being of their employees. Unlike some less progressive companies, Netflix encourages freedom and personal accountability in every employee. In some cases, workers who are not flourishing are actually paid to find a different job. Management’s focus on the employee competes with shareholders drive for profits and customer’s desire for accurate customer service.

Over time the employee-focus has driven up the stock price and the happy workers pay-it-forward with great customer service.

Board of directors

“The primary responsibility of the board of directors is to protect the shareholders' assets and ensure they receive a decent return on their investment.” (Kennon) At Netflix, the board fills these responsibilities and more. Several internet and technology visionaries make up the board and they could skew towards the next shiny new tech at the sacrifice of stock prices.

Other stakeholders

Many customers like Netflix for its wide selection of movies and TV shows. Even so, a common criticism of the service is the lack of current TV episodes. In an attempt to update their library with one of cable’s most popular shows, Netflix went against stockholders short-term interests and paid $1 million per episode of the FX original “Mad Men.” As a result “Netflix shares fell $6.22, or 3 percent, to $233.75” (The Associated Press, 2011) Even though this action was not particularly popular with investors, Netflix decided to let customer interests prevail hoping to capture an even bigger segment of the market.

Conclusion

Netflix board of directors, by all measures, seems to be very independent and populated by visionaries who have the company’s interests at heart. Their committees are the minimum required and have charters befitting the direction the company is moving. Finally, Netflix stakeholders do have a number of competing interests that require deft navigation to remain successful.

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