

# Netflix: Building Both Sides of the Ad-Supported Plan

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*A strategy case for MBA students and working professionals*

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**Case status:** Constructed teaching case. Netflix did not disclose the specific resource decision posed here.

## The next increment

At 1:05 p.m. Pacific Time on January 23, 2024, Netflix's Q4 shareholder letter had been available for only a few minutes. It showed that the company's advertising-supported plan was gaining members quickly. It also showed the limits of what outsiders could tell: Netflix did not disclose advertising revenue, advertiser pricing, retention by plan, or the cost of building the business.

For a hypothetical 2024 planning discussion, Netflix's leaders must decide where to put the next increment of advertising effort. Should they focus on growing the audience for the lower-priced ad plan through plan features, distribution and bundles? Or should they strengthen advertiser-side sales, targeting and measurement so that the audience already on the plan is more useful to buyers? Either route must preserve the member experience. The public record identifies no specific budget request or internal proposal; the choice in this case is constructed for discussion.

The paths are connected. A larger audience may make Netflix more valuable to advertisers, while better advertiser capabilities may support demand and spending. Yet advertising can also reduce the value viewers place on the service. The company must choose a sequence without public evidence about which side is currently the tighter constraint, or what return either path would produce.

## A new plan inside a subscription business

Netflix introduced its ad-supported plan in November 2022. Its established business depended on paid memberships and a large content offering. Advertising added a second paying group to the platform: advertisers seeking access to audiences, alongside viewers choosing among plans and services.

Netflix had already named work on both sides. In its Q3 2023 letter, the company described building ad membership as an immediate priority, alongside bundles and product improvements. It said it was developing its own ad sales team and technical infrastructure to complement Microsoft's capabilities. By Q4, Netflix also pointed to continued work on advertiser

targeting and measurement.

These efforts competed for management attention and specialized talent. The company expected high-single-digit growth in content amortization in 2024 and cash content spend of up to \$17 billion. Those company-wide forecasts indicate an execution-heavy year, but Netflix did not identify content spending as a direct alternative to an advertising allocation.

## **Adoption signals, with important limits**

Netflix reported that ad-plan membership grew nearly 70% quarter over quarter for a second consecutive quarter. It also said the ads plan represented 40% of sign-ups in the countries where advertising was available. The 40% figure is a share of sign-ups in those markets, not a share of all Netflix memberships or net additions.

The letter said that improved offerings, including downloads, and the phase-out of the Basic plan were contributing to sequential membership growth. Netflix planned to phase out Basic for new and returning members in Canada and the United Kingdom in Q2 2024, and said it would consider other markets. The company did not quantify how much of ad-plan adoption came from new customers, migration from Basic, or specific product changes. Rapid growth and sign-up share therefore do not establish incremental adoption, continued viewing, retention, or contribution.

Earlier, Netflix's advertising president had reported 15 million monthly active users for the ad-supported plan worldwide as of November 1, 2023. Monthly active users are not the same as paid memberships, unique households, viewing hours, ad impressions, or revenue. The public disclosures did not connect that audience measure to advertising yield.

The Q4 letter forecast strong advertising growth in 2024 from a small base, while saying advertising would not yet be a primary driver of overall revenue growth. Company-wide Q4 revenue grew 12% year over year, and management cited paid sharing, price changes and the content slate as contributors. Those results do not isolate an advertising effect.

## **Advertisers and competitors**

Netflix's Q3 letter described its own sales and technology investment as complementary to Microsoft's capabilities. The Q4 letter said targeting and measurement remained active improvement areas. Yet the public materials supplied no advertiser renewal rate, campaign outcome, fill rate, effective price, ad revenue, or sales and technology cost. Leaders could not know from the disclosed data whether audience scale, sales coverage, measurement credibility, or another factor most constrained the business.

The competitive environment was changing. Disney had launched a U.S. ad-supported Disney+ plan in December 2022 and reported more than 100 advertisers at launch. Amazon announced in September 2023 that Prime Video would introduce limited advertising in early 2024 in several markets, with a U.S. option to pay extra for an ad-free service. These announcements signaled competition for viewers and advertisers, but Disney's portfolio and ad operation differed from Netflix's, and Prime Video was part of a broader bundle. Their economics could not be transferred directly.

## **A two-sided platform, and a member constraint**

Economist Mark Armstrong's model of two-sided markets offers one way to frame the choice. In the model, participation on each side depends in part on the value created by participation on the other side. For a streaming service, audience scale could make advertising inventory more attractive; improved sales and measurement could make campaigns more valuable to advertisers. Advertisers may also use multiple platforms. At the same time, viewers may dislike commercial interruption, so more advertising or poorly matched ads could reduce viewer value.

The framework identifies possible links, not which investment should come first at Netflix. It does not estimate Netflix's demand, costs or returns, and supplies no optimal sequence for this decision. The company had no public plan-level measures of retention or viewing with which to assess the member side of the trade-off.

An experiment by Freeman and coauthors provides a limited clue about what to measure. In a randomized study of 327 undergraduate students, participants watched a short YouTube video with a 15-second pre-roll or mid-roll ad. Mid-roll placement raised reported anger and intrusiveness in that setting. The study measured immediate responses to one short video and ad, not Netflix subscription choices or behavior over time. It does not show that a particular Netflix ad plan or placement changes sign-up, viewing, churn or contribution.

## **What should the team prioritize?**

The audience-building route might expand the pool of viewers available to advertisers and make the plan more relevant in additional markets. It also depends on whether sign-ups represent incremental demand and whether those members stay and watch. Basic-plan phase-out, features, bundles, content, prices and country mix could all affect reported adoption.

The advertiser-capability route might improve campaign usefulness, sales productivity, pricing or renewals without first expanding the audience as broadly. But Netflix reported no results showing that targeting or measurement had improved advertiser outcomes, and capability investments could take time to build. If the audience is too small or advertiser demand is weak, stronger tools may not produce value.

A staged approach could support learning on both sides, but it still requires deciding what to do first, where to test, what measures matter and what evidence should shift resources. Whatever the sequence, member experience remains a constraint. A high sign-up share cannot answer whether members watch, renew or generate incremental value; a campaign metric cannot establish that the ad plan is profitable.

The task for the planning team is to recommend where Netflix should place the next increment of effort, explain its assumptions, and specify what evidence would cause it to change course.

## Discussion questions

1. What decision does Netflix face at the cutoff? Which parts are known company priorities, and which parts of the proposed resource choice are hypothetical?
2. How should the team compare audience and distribution work with advertiser sales, targeting and measurement? What does each path depend on?
3. What do the reported sequential membership growth and 40% sign-up share establish? What do they leave unresolved?
4. How should member experience shape the choice? What can Freeman et al. inform, and what cannot be inferred from that study?
5. Recommend a 2024 sequence. Identify the market- and member-level, advertiser-level and economic evidence that should trigger expansion, revision or pause.

## Sources and cutoff

The cutoff is January 23, 2024, at 1:05 p.m. PT. It includes Netflix's written Q4 2023 shareholder letter, furnished as Exhibit 99.1 to an 8-K accepted by the SEC at 1:02:17 p.m. PT. Netflix had scheduled its live interview for 1:45 p.m.; the interview and transcript are excluded, as is the 2023 Form 10-K filed January 26, 2024. Primary company sources include Netflix's Q4 and Q3 2023 shareholder letters, its November 2023 advertising update, its 2022 Form 10-K, and the dated Disney and Amazon announcements described above. Academic sources include Armstrong (2006) and Freeman, Wei, Yang and Shen (2022; first published online 2021). Detailed citations, locators, access depth, competing explanations and limitations appear in the source register, literature review and evidence extraction.

*The planning discussion and alternatives are constructed for teaching. No later outcomes are included.*