Communication, Society and Media
ISSN 2576-5388 (Print) ISSN 2576-5396 (Online)
Vol. 7, No. 2, 2024
www.scholink.org/ojs/index.php/csm

Original Paper

Netflix Overseas Strategy: Why Is China the Most Unnecessary Market for Netflix?

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Received: July 30, 2024 Accepted: August 13, 2024 Online Published: August 24, 2024
doi:10.22158/csm.v7n2p127 URL: http://dx.doi.org/10.22158/csm.v7n2p127

Abstract

Netflix, Inc. has grown into the world's leading internet television network, offering on-demand streaming ser-vices globally. Its core business strategy focuses on expanding its streaming membership while maintaining profitability. Over recent years, Netflix has shifted its attention towards international markets, which now generate more revenue than its domestic market. However, despite substantial investments, challenges remain, including intense competition, high costs, and differing user habits. Netflix's attempts to enter China, a significant market, have been met with regulatory challenges and stiff competition from local players. The complex landscape suggests that large-scale investment in China may not yield favorable returns for Netflix.

Keywords

global expansion, streaming services, international markets, competitive landscape, China market challenges

1. Introduction

Netflix, Inc. is the world's leading internet television network, provide on-demand video, streaming movies, original series and documentaries in over 190 countries. Netflix's users can watch contents anytime, anywhere, on nearly any Internet-connected screen. Additionally, Netflix also provides DVD services in the United States till September 29, 2023.

Netflix's core business strategy is "to grow our streaming membership business globally within the parameters of our profit margin targets" (Netflix 2023 Annual Report, 2023). By the end of the fiscal year 2018, there are three main business segments for Netflix: domestic streaming, international streaming and domestic DVD. Starting from the fiscal year 2019, Netflix combined the domestic streaming and international streaming segments, and reported the streaming financials based on four regions: United States and Canada (UCAN), Europe, Middle East, and Africa (EMEA), Latin America (LATAM), and Asia-Pacific (APAC) (Netflix 2019 Annual Report, 2019).

Let's take a look at the Netflix 2016-23 annual report. From 2016 to 2018 annual reports where the domestic DVD segment's data is separately listed, we can see that the domestic DVD segment is the only part that losing customers even it's still profitable and had the highest contribution margin and maintained a slight but steady growth each year.

Table 1. Domestic DVD Segment, Netflix 2016 Annual Report

Domestic DVD Segment

	As of/ Year Ended December 31,			Change			
	2016	2015	2014	2016 vs. 2015		2015 vs. 2014	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Net losses	(790)	(863)	(1,163)	(73)	(8)%	(300)	(26)%
Memberships at end of period	4,114	4,904	5,767	(790)	(16)%	(863)	(15)%
Paid memberships at end of period	4,029	4,787	5,668	(758)	(16)%	(881)	(16)%
Average monthly revenue per paying membership	$ 10.22	$ 10.30	$ 10.29	$ (0.08)	(1)%	$ 0.01	— %
Contribution profit:							
Revenues	$542,267	$645,737	$765,161	$(103,470)	(16)%	$(119,424)	(16)%
Cost of revenues	262,742	323,908	396,882	(61,166)	(19)%	(72,974)	(18)%
Contribution profit	279,525	321,829	368,279	(42,304)	(13)%	(46,450)	(13)%
Contribution margin	52%	50%	48%				

Table 2. Domestic DVD Segment, Netflix 2018 Annual Report

Domestic DVD Segment

	As of/ Year Ended December 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Paid memberships at end of period	2,706	3,330	4,029	(624)	(19)%	(699)	(17)%
Average monthly revenue per paying membership	$10.19	$10.17	$10.22	$0.02	— %	$(0.05)	— %
Free trials at end of period	25	53	85	(28)	(53)%	(32)	(38)%
Contribution profit:							
Revenues	$ 365,589	$ 450,497	$ 542,267	$ (84,908)	(19)%	$ (91,770)	(17)%
Cost of revenues	153,097	202,525	262,742	(49,428)	(24)%	(60,217)	(23)%
Contribution profit	212,492	247,972	279,525	(35,480)	(14)%	(31,553)	(11)%
Contribution margin	58%	55%	52%				

Although the total revenue of the domestic DVD segment continuously declined from 2016 to 2023, its low costs allowed this part of business to positively contribute to Netflix's financial health until the segment was discontinued in September 2023.

Table 3. Netflix 2023 Annual Report

	As of/Year Ended December 31,			Change
	2023	2022	2021	2023 vs. 2022
	(in thousands, except revenue per membership and percentages)			
Financial Results:				
Streaming revenues	$ 33,640,458	$ 31,469,852	$ 29,515,496	7 %
DVD revenues (1)	82,839	145,698	182,348	(43)%
Total revenues	**$ 33,723,297**	**$ 31,615,550**	**$ 29,697,844**	7 %
Operating income	$ 6,954,003	$ 5,632,831	$ 6,194,509	23 %
Operating margin	21 %	18 %	21 %	
Global Streaming Memberships:				
Paid net membership additions	29,529	8,903	18,181	232 %
Paid memberships at end of period	260,276	230,747	221,844	13 %
Average paying memberships	240,889	222,924	210,784	8 %
Average monthly revenue per paying membership	$ 11.64	$ 11.76	$ 11.67	(1)%

For the streaming services part, the classification method from Netflix's 2016-2018 fiscal years will be temporarily adopted, dividing the market into domestic streaming and international streaming segments. Netflix has developed its domestic streaming market over several years, resulting in a mature and highly competitive landscape. Membership growth steady each year, By the end of the second quarter of 2023, the number of sub-scribers in the U.S. and Canada amassing over 75 million, and one in three U.S. users said they would not drop the streaming service.

Table 4. Domestic Streaming Segment, Netflix 2018 Annual Report

Domestic Streaming Segment

	As of/ Year Ended December 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Paid memberships at end of period	58,486	52,810	47,905	5,676	11%	4,905	10%
Paid net membership additions	5,676	4,905	4,504	771	16%	401	9%
Average monthly revenue per paying membership	$ 11.40	$ 10.18	$ 9.21	$ 1.22	12%	$ 0.97	11%
Free trials at end of period	2,065	1,940	1,526	125	6%	414	27%
Contribution profit:							
Revenues	$7,646,647	$ 6,153,025	$5,077,307	$ 1,493,622	24%	$1,075,718	21%
Cost of revenues	4,038,394	3,470,859	2,951,973	567,535	16%	518,886	18%
Marketing	1,025,351	603,746	412,928	421,605	70%	190,818	46%
Contribution profit	2,582,902	2,078,420	1,712,406	504,482	24%	366,014	21%
Contribution margin	34%	34%	34%				

Year ended December 31, 2018 as compared to the year ended December 31, 2017

To achieve more profit, Netflix has been vigorously pursuing international expansion. From 2014-2018, The membership of international streaming segment grows very fast every year, mainly generated by its continuing increased investment. The highest increase in the cost of revenue occurred in 2016, with a 64% rise compared to 2015; the lowest increase, in 2018, was still substantial at 32%. At the end of 2018 fiscal year, the cost of revenue for the international streaming segment reached an astounding 5.7 billion, brings back 7.7 bil-lion revenues, in the meantime, the domestic streaming segment has a cost of revenue of 4 billion, at a significantly lower cost, brings 7.6 billion of revenue in return. It's noteworthy that despite cost considerations, the fiscal year 2018 saw overseas streaming segment profits surpass those from the domestic U.S. market for the first time.

Table 5. International Streaming Segment, Netflix 2016 Annual Report

International Streaming Segment

	As of Year Ended December 31,			Change			
	2016	2015	2014	2016 vs. 2015		2015 vs. 2014	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Net additions	14,341	11,747	7,347	2,594	22%	4,400	60%
Memberships at end of period	44,365	30,024	18,277	14,341	48%	11,747	64%
Paid memberships at end of period	41,185	27,438	16,778	13,747	50%	10,660	64%
Average monthly revenue per paying membership	$ 7.81	$ 7.48	$ 8.34	$ 0.33	4%	$ (0.86)	(10)%
Contribution loss:							
Revenues	$3,211,095	$1,953,435	$1,308,061	$1,257,660	64%	$645,374	49%
Cost of revenues	2,911,370	1,780,375	1,154,117	1,130,995	64%	626,258	54%
Marketing	608,246	506,446	313,733	101,800	20%	192,713	61%
Contribution loss	(308,521)	(333,386)	(159,789)	(24,865)	(7)%	173,597	109%
Contribution margin	(10)%	(17)%	(12)%				

Regardless of the significant revenue gap before 2018, the international streaming segment allocated a much larger portion of its budget to marketing expenses compared to the domestic streaming segment. However, despite these investments, the overseas Contribution profit remained in a deficit state for years. From the perspective of Netflix's investment and marketing, we can infer that the overseas part is at the center of its cur-rent business strategy.

Table 6. International Streaming Segment, Netflix 2018 Annual Report

International Streaming Segment

	As of /Year Ended December 31,			Change			
	2018	2017	2016	2018 vs. 2017		2017 vs. 2016	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Paid memberships at end of period	80,773	57,834	41,185	22,939	40%	16,649	40%
Paid net membership additions	22,939	16,649	13,747	6,290	38%	2,902	21%
Average monthly revenue per paying membership	$ 9.43	$ 8.66	$ 7.81	$ 0.77	9%	$ 0.85	11%
Free trials at end of period	7,131	4,998	3,180	2,133	43%	1,818	57%
Contribution profit (loss):							
Revenues	$ 7,782,105	$ 5,089,191	$3,211,095	$2,692,914	53%	$1,878,096	58%
Cost of revenues	5,776,047	4,359,616	3,042,747	1,416,431	32%	1,316,869	43%
Marketing	1,344,118	832,535	684,591	511,583	61%	147,944	22%
Contribution profit (loss)	661,940	(102,960)	(516,243)	764,900	743%	413,283	80%
Contribution margin	9%	(2)%	(16)%				

The continuously increasing cost of revenue and marketing expenditures eventually yielded substantial returns. In 2017, Netflix nearly broke even in the international streaming segment. By 2018, the contribution margin for the international streaming segment finally turned profitable. This turnaround, coupled with the continuously expanding and deepening overseas market, resulted in the international streaming segment's revenue surpassing that of the domestic segment. These factors likely explain why, starting in 2019, the international streaming segment was no longer reported as a separate category. Instead, revenue began to be reported by region, with cost of revenue and marketing expenses unified across segments.

In 2017, Netflix passed a major milestone in terms of its subscriber base, surpassing 100 million sub-scribers globally. It was also in this year that the number of international subscribers exceeded the number of U.S. domestic subscribers for the first time (Netflix 2017 Annual Report, 2017). By the end of the 2023 fiscal year, the total number of subscribers worldwide had surpassed 260 million. Of these, approximately 31% were from the United States and Canada (UCAN), 34% from Europe, the Middle East, and Africa (EMEA), 18% from Latin America (LATAM), and 17% from the Asia-Pacific (APAC) region (Netflix 2023 Annual Report, 2023). This indicates that the broader international market (outside North America) has become the primary revenue source for Netflix.

Table 7. International Streaming Segment, Netflix 2017 Annual Report

International Streaming Segment

	As of /Year Ended December 31,			Change			
	2017	2016	2015	2017 vs. 2016		2016 vs. 2015	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Net additions	18,467	14,341	11,747	4,126	29%	2,594	22%
Memberships at end of period	62,832	44,365	30,024	18,467	42%	14,341	48%
Paid memberships at end of period	57,834	41,185	27,438	16,649	40%	13,747	50%
Average monthly revenue per paying membership	$ 8.66	$ 7.81	$ 7.48	$ 0.85	11%	$ 0.33	4%
Contribution profit (loss):							
Revenues	$ 5,089,191	$ 3,211,095	$ 1,953,435	$ 1,878,096	58%	$ 1,257,660	64%
Cost of revenues	4,137,911	2,911,370	1,780,375	1,226,541	42%	1,130,995	64%
Marketing	724,691	608,246	506,446	116,445	19%	101,800	20%
Contribution profit (loss)	226,589	(308,521)	(333,386)	535,110	173%	24,865	7%
Contribution margin	4%	(10)%	(17)%				

Table 8. Domestic Streaming Segment, Netflix 2017 Annual Report

Domestic Streaming Segment

	As of/ Year Ended December 31,			Change			
	2017	2016	2015	2017 vs. 2016		2016 vs. 2015	
	(in thousands, except revenue per membership and percentages)						
Memberships:							
Net additions	5,319	4,693	5,624	626	13%	(931)	(17)%
Memberships at end of period	54,750	49,431	44,738	5,319	11%	4,693	10 %
Paid memberships at end of period	52,810	47,905	43,401	4,905	10%	4,504	10 %
Average monthly revenue per paying membership	$ 10.18	$ 9.21	$ 8.50	$ 0.97	11%	$ 0.71	8 %
Contribution profit:							
Revenues	$ 6,153,025	$ 5,077,307	$ 4,180,339	$ 1,075,718	21%	$ 896,968	21 %
Cost of revenues	3,319,230	2,855,789	2,487,193	463,441	16%	368,596	15 %
Marketing	553,331	382,832	317,646	170,499	45%	65,186	21 %
Contribution profit	2,280,464	1,838,686	1,375,500	441,778	24%	463,186	34 %
Contribution margin	37%	36%	33%				

Table 9. UCAN, EMEA, LATAM, APAC Revenues, Netflix 2023 Annual Report

United States and Canada (UCAN)

	As of/Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except revenue per membership and percentages)				
Revenues	$ 14,873,783	$ 14,084,643	$ 12,972,100	$ 789,140	6 %
Paid net membership additions (losses)	5,832	(919)	1,279	6,751	735 %
Paid memberships at end of period (1)	80,128	74,296	75,215	5,832	8 %
Average paying memberships	76,126	74,001	74,234	2,125	3 %
Average monthly revenue per paying membership	$ 16.28	$ 15.86	$ 14.56	$ 0.42	3 %
Constant currency change (2)					3 %

Europe, Middle East, and Africa (EMEA)

	As of/Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except revenue per membership and percentages)				
Revenues	$ 10,556,487	$ 9,745,015	$ 9,699,819	$ 811,472	8 %
Paid net membership additions	12,084	2,693	7,338	9,391	349 %
Paid memberships at end of period (1)	88,813	76,729	74,036	12,084	16 %
Average paying memberships	80,928	73,904	69,518	7,024	10 %
Average monthly revenue per paying membership	$ 10.87	$ 10.99	$ 11.63	$ (0.12)	(1)%
Constant currency change (2)					(1)%

Latin America (LATAM)

	As of/Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except revenue per membership and percentages)				
Revenues	$ 4,446,461	$ 4,069,973	$ 3,576,976	$ 376,488	9 %
Paid net membership additions	4,298	1,738	2,424	2,560	147 %
Paid memberships at end of period (1)	45,997	41,699	39,961	4,298	10 %
Average paying memberships	42,802	40,000	38,573	2,802	7 %
Average monthly revenue per paying membership	$ 8.66	$ 8.48	$ 7.73	$ 0.18	2 %
Constant currency change (2)					10 %

Asia-Pacific (APAC)

	As of/Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except revenue per membership and percentages)				
Revenues	$ 3,763,727	$ 3,570,221	$ 3,266,601	$ 193,506	5 %
Paid net membership additions	7,315	5,391	7,140	1,924	36 %
Paid memberships at end of period (1)	45,338	38,023	32,632	7,315	19 %
Average paying memberships	41,033	35,019	28,461	6,014	17 %
Average monthly revenue per paying membership	$ 7.64	$ 8.50	$ 9.56	$ (0.86)	(10)%
Constant currency change (2)					(6)%

2. Method

2.1 Current Stage of Netflix Overseas Strategy

As previously discussed, the international segment is the main direction of development for Netflix. From the 10-K report, it is evident that despite rapid membership growth and the expansion into more countries, these achievements come at a significant cost. Whether in 2016 or 2023, the expenses are substantial and certainly not cheap.

Table 10. Cost of Revenues & Marketing, Netflix 2023 Annual Report

	Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except percentages)				
Cost of revenues	$ 19,715,368	$ 19,168,285	$ 17,332,683	$ 547,083	3 %
As a percentage of revenues	58 %	61 %	58 %		

	Year Ended December 31,			Change	
	2023	2022	2021	2023 vs. 2022	
	(in thousands, except percentages)				
Marketing	$ 2,657,883	$ 2,530,502	$ 2,545,146	$ 127,381	5 %
As a percentage of revenues	8 %	8 %	9 %		

According to calculations by the Statista Digital Market Outlook analyst team, Netflix incurred a monthly loss of $0.60 per international subscriber in the second quarter of 2016, while U.S. subscribers generated an operating profit of $2.90 per month. The international segment continued to lose money until the first quarter of 2017. Meanwhile, annual reports consistently show that the contribution margin of the international segment has been persistently lower than that of the domestic segment. The long-term losses and lower contribution margin in the international segment are due to several factors adversely affecting international results:

1) The average revenue per international user is lower than it is in the United States because prices differ across different regions, in some newer market Netflix offers customer one-month free trial, and in some market, the subscription fee is different (lower) from the domestic market;

2) Secondly, the cost of revenue, consisting mainly of costs related to the acquisition, production and licensing of content, is significantly higher on a per user basis than it is in the United States (Statista Felix Richter, 2016). Netflix made $990.3 increase in 2017 and $976 million increase in 2018 in content expenses for international spending;

3) Thirdly, entering new markets requires significant marketing expenses. Rising brand awareness in a new market is challenging, a company needs to consistently invest heavily in promotion, and it will take a long time to see a return. In 2018, $327 million increase in expense was due to the streaming delivery expenses, costs associated with customer service call centers and payment processing fees, all driven by its growing member base (Netflix 2018 Annual Report, 2018). Since 2018, marketing expenses for the international streaming segment have surpassed $1 billion. In 2023, Netflix's total marketing expenses reached $2.6 billion, with the majority allocated to international markets, accounting for 8% of that year's total revenues.

Through years of sustained investment, Netflix's global expansion has yielded substantial returns. As of March 2022, Netflix is available in over 190 countries, with more than 260 million paid subscribers, over 73 million of whom are located in the United States (Netflix, 2024). Globally, Netflix is unavailable only in main-land China, North Korea, Russia, and Syria (Netflix, 2024). The absence of Netflix in North Korea, Russia, and Syria is due to political or wartime reasons. However, why has China, a major market, not become one of Net-flix's territories?

2.2 Netflix's Attempt to Enter China during the Years

China has 1.09 billion Internet users as of 2023, representing 77.3% of the Chinese population who can access the Internet at home via any device type and connection. This also means that one-fifth of the world's Internet users are in the Chinese market (CNNIC, 2024).

Signs of Netflix's interest in China first surfaced in May 2015, when the company was reported in talks to form a partnership with Wasu Media, a Chinese holding company backed by Alibaba's Jack Ma (Net-flix's Pricing Power, 2015).

Disney took the initiative to enter the Chinese market. At the end of 2015, Disney and Alibaba launched DisneyLife in China; only after five months, this streaming video service has been shut down. Con-firmation of the closure follows the shutdown of Apple's iTunes Movies and iBooks services in China in April 2016 (Frater, 2016). Not only Disney and, in June, UK-based video streamer Mubi also terminated plans to form a $50 million venture with Chinese film distributor Huanxi (Jon Russell, 2016).

Under such a circumstance, on Oct 7, 2016, Netflix's Chief Executive Reed Hastings said at the New Yorker TechFest that "Disney, who is very good in China, had their movie service shut down. Apple, who is very good in China, had their movie service closed down. It doesn't look good" (BNN Bloomberg, 2016).

In 2017, Netflix has given up its intention to launch its own streaming services in China but choose to license their content to a local streaming website called "iQiyi" (Frater, 2016). In the Netflix's 2016 Final Q3 Letter, it includes a particular section to talk about China market: "The regulatory environment for foreign digi-tal content services in China has become challenging. We now plan to license content to exist online service providers in China rather than operate our own service in China in the near term" (Final Q3 Letter, 2016). On 27 April 2017, iQiyi and Netflix have signed a content licensing agreement for Netflix original series. The de-tail of this agreement hasn't been revealed.

In 2020, when Netflix's co-CEO Reed Hastings was once again asked about the Chinese mainland market, he stated, "We got turned down by the Chinese government several years ago. And we have not been spending any time on China in the last couple years", Instead of pursuing the Chinese market, Netflix has di-rected its focus towards other regions such as India, Europe, and Latin America. The company has also been making efforts to appeal to Mandarin-speaking audiences worldwide (Kevin, 2020).

3. Result

Although there are many cultural and political factors, this study will mainly focus on the financial performance segment as much as possible. This research will discuss whether the Chinese market is worth Net-flix's large-scale investment or not from the perspective of economic cost and ROI, based on Netflix and some Chinese local video providers' financial reports as well as other financial-related materials.

(1) Fierce competition

Due to the enormous potential of the Chinese market and a series of policies aimed at protecting local enterprises, China is home to numerous large-scale and highly competitive internet companies. As of August 2023, Alibaba and Tencent rank among the top five capitalization internet companies in the world, while Baidu ranked 18th on that list (CompaniesMarketCap.com., 2023). Interestingly, these leading internet companies all have their own streaming services platforms. Baidu owns iQiyi, while Alibaba owns Youku. Tencent, a Chi-nese conglomerate offering streaming services, entertainment, gaming, payment systems, music, etc., generated a revenue of 77.99 billion in the 2022 fiscal year. WeTV, along with iQiyi and Youku, form the Big Three of the Chinese streaming market. Additionally, there are formidable competitors such as ByteDance, which owns Douyin and Xigua Video. Douyin has registered users reaching 1.06 billion and daily active users of 770 mil-lion. Xigua Video has not only reached content cooperation agreements with BBC Studios but also has accu-mulated over 350 million users, with a daily playback volume exceeding 4 billion (Jiangxi Network Radio and Television Station, 2020). Other competitors like AcFun, Bilibili, Mango TV etc., each have a considerable market share, leaving Netflix with limited room for market development.

(2) Hash operating costs

Except for the saturated market, Netflix also doesn't have a financial advantage. The Fierce of competi-tion in the Chinese market is reflected in almost all of the Streaming services mentioned before are losing mon-ey year after year to seize the market and compete with each other. Take iQiyi as an example,

Table 11. Revenues, iQiyi 2018 Annual Report

	For the year ended December 31,						
	2016(1)		2017(1)		2018		
	RMB	%	RMB	%	RMB	US$	%
	(in thousands, except for percentages)						
Revenues:							
Membership services	3,762,183	33.5	6,536,028	37.6	10,622,769	1,545,018	42.5
Online advertising services	5,650,366	50.3	8,158,924	46.9	9,328,061	1,356,710	37.3
Content distribution	500,952	4.4	1,191,816	6.9	2,162,643	314,543	8.7
Others	1,323,906	11.8	1,491,582	8.6	2,875,643	418,245	11.5
Total revenues	**11,237,407**	**100.0**	**17,378,350**	**100.0**	**24,989,116**	**3,634,516**	**100.0**
Operating costs and expenses:							
Cost of revenues(2)	(11,436,595)	(101.8)	(17,386,563)	(100.0)	(27,132,811)	(3,946,304)	(108.6)
Selling, general and administrative(2)	(1,765,824)	(15.7)	(2,674,990)	(15.4)	(4,167,889)	(606,194)	(16.7)
Research and development(2)	(824,482)	(7.3)	(1,269,806)	(7.3)	(1,994,652)	(290,110)	(8.0)
Total operating costs and expenses	(14,026,901)	(124.8)	(21,331,359)	(122.7)	(33,295,352)	(4,842,608)	(133.3)
Operating loss	**(2,789,494)**	**(24.8)**	**(3,953,009)**	**(22.7)**	**(8,306,236)**	**(1,208,092)**	**(33.3)**
Total other (expenses)/income, net	(271,440)	(2.4)	208,512	1.2	(676,194)	(98,347)	(2.7)
Loss before income taxes	**(3,060,934)**	**(27.2)**	**(3,744,497)**	**(21.5)**	**(8,982,430)**	**(1,306,439)**	**(36.0)**
Income tax (expense)/benefit	(13,088)	(0.1)	7,565	0.0	(78,801)	(11,461)	(0.3)
Net loss	**(3,074,022)**	**(27.4)**	**(3,736,932)**	**(21.5)**	**(9,061,231)**	**(1,317,900)**	**(36.3)**

Table 12. Revenues, iQiyi 2021 Annual Report

	2019		2020		2021		
	RMB	%	RMB	%	RMB	US$	%
	(in thousands, except for percentages)						
Revenues:							
Membership services	14,435,611	49.8	16,491,030	55.5	16,713,664	2,622,739	54.7
Online advertising services	8,270,600	28.5	6,822,115	23.0	7,066,751	1,108,927	23.1
Content distribution	2,544,221	8.8	2,660,074	9.0	2,855,602	448,106	9.3
Others	3,743,226	12.9	3,733,996	12.5	3,918,342	614,873	12.9
Total revenues	**28,993,658**	**100.0**	**29,707,215**	**100.0**	**30,554,359**	**4,794,645**	**100.0**
Operating costs and expenses:							
Cost of revenues(1)	(30,348,342)	(104.7)	(27,884,395)	(93.9)	(27,513,497)	(4,317,468)	(90.0)
Selling, general and administrative(1)	(5,236,007)	(18.1)	(5,187,835)	(17.5)	(4,725,142)	(741,478)	(15.5)
Research and development(1)	(2,667,146)	(9.2)	(2,675,494)	(9.0)	(2,794,927)	(438,585)	(9.1)
Total operating costs and expenses	(38,251,495)	(131.9)	(35,747,724)	(120.4)	(35,033,566)	(5,497,531)	(114.6)
Operating loss	**(9,257,837)**	**(31.9)**	**(6,040,509)**	**(20.4)**	**(4,479,207)**	**(702,886)**	**(14.6)**
Total other expenses, net	(967,050)	(3.3)	(943,368)	(3.2)	(1,532,781)	(240,527)	(5.0)
Loss before income taxes	**(10,224,887)**	**(35.2)**	**(6,983,877)**	**(23.6)**	**(6,011,988)**	**(943,413)**	**(19.6)**
Income tax expenses	(51,852)	(0.2)	(23,276)	(0.1)	(96,545)	(15,150)	(0.3)
Net loss	**(10,276,739)**	**(35.4)**	**(7,007,153)**	**(23.7)**	**(6,108,533)**	**(958,563)**	**(19.9)**

Table 13. Revenues, iQiyi 2023 Annual Report

	For the year ended December 31,						
	2021		2022		2023		
	RMB	%	RMB	%	RMB	US$	%
	(in thousands, except for percentages)						
Revenues:							
Membership services	16,713,664	54.7	17,710,830	61.1	20,314,216	2,861,197	63.7
Online advertising services	7,066,751	23.1	5,331,697	18.4	6,223,903	876,618	19.5
Content distribution	3,007,828	9.8	2,562,412	8.8	2,458,610	346,288	7.7
Others	3,766,116	12.4	3,392,609	11.7	2,875,922	405,066	9.1
Total revenues	**30,554,359**	**100.0**	**28,997,548**	**100.0**	**31,872,651**	**4,489,169**	**100.0**
Operating costs and expenses:							
Cost of revenues[1]	(27,513,497)	(90.0)	(22,319,315)	(77.0)	(23,102,492)	(3,253,918)	(72.5)
Selling, general and administrative[1]	(4,725,142)	(15.5)	(3,466,579)	(12.0)	(4,014,070)	(565,370)	(12.6)
Research and development[1]	(2,794,927)	(9.1)	(1,899,233)	(6.5)	(1,766,610)	(248,822)	(5.5)
Total operating costs and expenses	(35,033,566)	(114.6)	(27,685,127)	(95.5)	(28,883,172)	(4,068,110)	(90.6)
Operating (loss)/income	**(4,479,207)**	**(14.6)**	**1,312,421**	**4.5**	**2,989,479**	**421,059**	**9.4**
Total other expenses, net	(1,532,781)	(5.0)	(1,346,197)	(4.6)	(956,878)	(134,773)	(3.0)
(Loss)/income before income taxes	**(6,011,988)**	**(19.6)**	**(33,776)**	**(0.1)**	**2,032,601**	**286,286**	**6.4**
Income tax expenses	(96,545)	(0.3)	(84,000)	(0.3)	(80,047)	(11,274)	(0.3)
Net (loss)/income	**(6,108,533)**	**(19.9)**	**(117,776)**	**(0.4)**	**1,952,554**	**275,012**	**6.1**

From iQiyi's financial reports from 2018 to 2023, it is evident that the operating costs and expenses were above $4.1 billion (30 billion RMB) each year from 2018 to 2022. It wasn't until the end of the 2023 fiscal year that iQiyi achieved profitability for the first time. Prior to 2023, iQiyi's annual losses were partly covered by inves-tors and partly by Baidu. The primary reason Baidu continues to support this part of the business is to compete with other streaming services, relying on income from its other business segments (search engine, financial ser-vice, delivery service etc.) to offset the losses of this plate. The first profitable year for iQiyi came 13 years after its establishment.

Why did iQiyi finally turn profitable in 2023? Was it due to increased revenue? Between 2016 and 2018, iQiyi's revenue maintained a high growth rate of over 40%. Revenue increased by 16% from 2018 to 2019, but from 2019 to 2023, revenue remained stagnant at around $4 billion (30 billion RMB) with no signif-icant increase. Thus, the answer to iQiyi's profitability lies in cost reduction. The method of reducing costs was simple yet harsh: layoffs. Starting at the end of 2021, iQiyi implemented multiple rounds of large-scale layoffs. Except for the core departments (such as procurement and production department of series and variety show), non-core departments such as iQiyi Research Institute, iQiyi Game Center, and the short video product "Sui Ke (similar to YouTube)" all faced layoffs. Some departments were merged. In fact, during the analyst conference call for iQiyi's Q3 2021 report, iQiyi's founder, chairman, and CEO Gong Yu hinted that non-core business departments might be layoff. "For iQiyi, the focus is on increasing revenue and cutting costs, mainly by cutting inefficient businesses and projects, and increasing and trying new monetization opportunities", said Gong Yu (2021).

In 2023, iQiyi delivered its best financial report in history, but Wall Street seemed unimpressed. Imme-diately after the release of the report, the company's stock price briefly rose before falling again. The capital market is always right; turning a profit does not necessarily mean iQiyi has fully turned the corner (Sina Fi-nance, 2024).

The terrible news for Netflix is that losses are the norm for all Chinese domestic streaming services—it relates to consumer habits, which will be discussed later—but not a single company has any intention of leav-ing the market. Some of them have strong parent companies (iQiyi, WeTV, Youku, Mango TV), which Netflix does not; some have government support (Migu TV), which Netflix does not; and some are niche services (Bilibili), targeting a specific otaku community and becoming an integral part of its culture, something Netflix clearly cannot replicate or compete with.

From Netflix's annual report, Netflix has spent a significant amount of money on expanding into over-seas markets. If they attempt to enter the Chinese market, it would feel like falling into a bottomless pit, with a hard-to-achieve return on investment.

Consider the example of Uber when it entered China and faced competition from Didi and Kuaidi. For several months, people in China who wanted to take a taxi not only did not need to pay but also received cou-pons for their next ride using these taxi apps. As Didi and Kuaidi completed their merger, the final battle be-tween the local company and Uber began. Uber, which did not adopt a subsidy strategy in other parts of the world, allocated $1 billion for subsidies in China. "Didi and Uber raised a combined total of about $20 billion, while the first Gulf War cost approximately $60 billion" (Lu, 2016).

As the money-burning war intensified, investors' patience wore thin. Additionally, losses in the Chi-nese market somewhat hindered Uber's global IPO plans. For Uber's investors, cutting losses in China, preserv-ing the global market, and going public as soon as possible were more important than capturing the Chinese market (Brad et al., 2016). Uber poured all its earnings from the U.S. into China, but it was still not enough. The result was Didi acquiring all of Uber's business in China. Netflix would not want a repeat of this scenario.

(3) Different user habits

So why are almost all streaming services in China losing money? Lowering prices to increase competi-tiveness and investing heavily in promotions are some of the reasons. The biggest issue is the video consump-tion habits of Chinese audiences. Only in recent years has the "subscription" awareness started to develop; for decades, everyone watched videos and online content for free. According to statistic, in 2022, China accounted for about one-fifth of the 5.4 billion (1.08 billion) internet users worldwide. However, compared to its total population, China's internet penetration rate is lower than in other Asian countries (https://www.statista.com/statistics/265140/number-of-internet-users-in-china/).

In China, iQiyi's membership fees are considered relatively high. Its basic plan costs $4 per month and $25 per year, offering 4K MAX+HDR+surround sound on mobile devices. Youku's annual membership can be as low as $18. These membership price levels were reached after a series of significant price hikes led by iQiyi from 2020 to 2022, which sparked considerable public dissatisfaction and led to a wave of membership cancellations across various streaming platforms. Currently, Netflix's basic plan (which only supports 1080p and includes a few ad breaks) costs $6.99 per month, making it difficult for Netflix to compete with Chinese streaming providers on price.

Facing high video membership fees, according to Statista, 52 percent of respondents from China stated that they had watched pirated content on a mobile device (Irdeto; YouGov, 2017). If Netflix can't come up with new revenue growth channels, relying solely on subscriptions won't give it a fighting chance in the Chinese market.

User habits also encompass audience tastes, which are notoriously difficult to predict. Take Netflix's original drama "Marco Polo" as an example. This show, set against the backdrop of Chinese history and pro-duced with a Chinese audience in mind, cost Netflix approximately $90 million for its first season's 10 epi-sodes, making it the second most expensive TV show in the world after "Game of Thrones". Netflix is hoping the series will help their international expanding, however only after two seasons Marco Polo has been canceled. The series' two seasons resulted in a $200 million loss for Netflix (Goldberg, 2016). That is a typical case of failure to grasp the user's preferences.

These differences in user habits can cost Netflix a fortune, Netflix needs to find ways to lower sub-scription fees while enhancing service content. Additionally, they must conduct in-depth studies on the tastes of the Chinese market, providing more original series and acquiring more existing local content if necessary. How-ever, this approach may also lead to further complications.

(4) High original program production costs in China

The different market has different production structures. Netflix's original programming is the key ele-ment to differentiate their service from other offerings, enhance Netflix's brand and otherwise attract and retain members. But produce original series not that easy in China. Despite the censorship and regulation difficulties, the production cost is also a big problem. In this stage of Chinese motion picture business, actors and actresses are much more important than the program itself. Lu Han, a former member of the South Korean Chinese boy group EXO, now one of the most popular idols in China, earned $17 million (120 million RMB) by shooting his very first a TV drama called "choose heaven". The total cost of this show is $60 million (400 million RMB), with one-third of the budget goes to one single actor, other actors and actresses are not cheap either. $1.4 million on promotion, $5 million on special effects, and only $2 million on clothing (NetEase Entertain-ment, 2017). The allocation of resources reflects the show's high production costs.

On December 24, 2018, the Beijing Radio and Television Bureau issued the "Implementation Rules for Further Strengthening the Management of Radio, Television, and Online Audiovisual Programs", which stipulates that the total remuneration of all guests for each program must not exceed 40% of the total program cost, and the main guests' remuneration must not exceed 70% of the total guest remuneration (Beijing Munici-pal People's Government, 2018). However, according to China News Weekly (2024), the top-tier actors' remu-neration for a single project still reaches around $ 3 million (20-25 million RMB). These actors do not demon-strate outstanding performance skills, and the anticipated online traffic they are expected to generate often re-mains unrealized. Their value predominantly lies in attracting investment during the pre-production stage of film and television projects.

4. Discussion

Fierce competition, high operating costs, different user habits, and high original program production costs in China, these difficulties and other political constraints make the Chinese market a place that is not suitable for Netflix's expansion. If Netflix forced into the Chinese market, it is likely to fail quickly like DisneyLife and Apple's iTunes movie; Even if it can stay for a long time, it can hardly make differences from what's happening to Uber—caught into the big fight with China's local companies, invested heavily but hopeless to see any payback.

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