Reference Guide on our
Freedom & Responsibility Culture

These slides are meant for reading,
rather than presenting

Freedom & Responsibility
Applies to our
Salaried Employees

Our hourly employees are important, but have more structured job roles

Culture: what gives Netflix
the best chance of
continuous success
for many generations
of technology and people?

Seven Aspects of our Culture

- Values are what we Value
- High Performance
- Freedom & Responsibility
- Context, not Control
- Highly Aligned, Loosely Coupled
- Pay Top of Market
- Promotions & Development

Lots of companies have
nice sounding
value statements

Enron Had A Nice-Sounding Value Statement with 4 Values

Enron headquarters

Their 4 values were chiseled in marble in the main lobby, but had little to do with the real values of the organization

- **Integrity**
- **Communication**
- **Respect**
- **Excellence**

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The *real* company values,
as opposed to the
nice-sounding values,
are shown by who gets
rewarded, promoted, or let go

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Real company values are the
behaviors and *skills*
that we particularly *value*
in fellow employees

We Particularly Value
in our Colleagues
these Nine Behaviors and Skills…

Judgment

You make wise decisions (people, technical, business, and creative) despite ambiguity

You identify root causes, and get beyond treating symptoms

You think strategically, and can articulate what you are, *and are not*, trying to do

You smartly separate what must be done well now, and what can be improved later

Communication

You listen well, instead of reacting fast, so you can better understand

You are concise and articulate in speech and writing

You treat people with respect independent of their status or disagreement with you

You maintain calm poise in stressful situations

Impact

You accomplish amazing amounts of important work

You demonstrate consistently strong performance so colleagues can rely upon you

You focus on great results rather than on process

You exhibit bias-to-action, and avoid analysis-paralysis

Curiosity

You learn rapidly and eagerly

You seek to understand our strategy, market, subscribers, and suppliers

You are broadly knowledgeable about business, technology and entertainment

You contribute effectively outside of your specialty

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Innovation

You re-conceptualize issues to discover practical solutions to hard problems

You challenge prevailing assumptions when warranted, and suggest better approaches

You create new ideas that prove useful

You keep us nimble by minimizing complexity and finding time to simplify

Courage

You say what you think even if it is controversial

You make tough decisions without excessive agonizing

You take smart risks

You question actions inconsistent with our values

Passion

You inspire others with your thirst for excellence

You care intensely about Netflix' success

You celebrate wins

You are tenacious

Honesty

You are known for candor and directness

You are non-political when you disagree with others

You only say things about fellow employees you will say to their face

You are quick to admit mistakes

Selflessness

You seek what is best for Netflix, rather than best for yourself or your group

You are ego-less when searching for the best ideas

You make time to help colleagues

You share information openly and proactively

Judgment

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NETFLIX **We Want to Work with People Who Embody These Nine Values** 19

"You question actions inconsistent with our values"

Part of the Courage value

Akin to the honor code pledge:
"I will not lie, nor cheat, nor steal, *nor tolerate those who do*"

All of us are responsible for value consistency

Values reinforced in hiring,
in 360 reviews, at comp review, in
exits, and in promotions

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Imagine if *every* person at Netflix
is someone you
respect and learn from…

Great Workplace is
Stunning Colleagues

Great workplace is *not* day-care, espresso, health
benefits, sushi lunches, nice offices,
or big compensation,
and we only do those that are efficient at
attracting stunning colleagues

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Like every company, we try to hire well

But, unlike many companies,
we practice "adequate performance
gets a generous severance package."

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We're a *team*, not a family

We're like a **pro sports team**,
not a kid's recreational team

Coaches' job at every level of Netflix
to hire, develop and cut **smartly**,
so we have stars in every position

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The **Keeper Test** Managers Use:

"Which of my people,
if they told me
they were leaving in two months
for a similar job at a peer company,
would I fight hard to keep at Netflix?

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The other people should get a generous severance now,
so we can open a slot to try to find a star for that role

The **Keeper Test** Managers Use:

"Which of my people,
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for a similar job at a peer company,
would I fight hard to keep at Netflix?

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Honesty Always

To avoid surprises, you should periodically ask your manager: "If I told you I were leaving, how hard would you work to change my mind to stay at Netflix?"

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Isn't Loyalty Good?
What About Hard Workers?
What about Brilliant Jerks?

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Loyalty is Good

- Loyalty is good as a stabilizer

- People who have been stars for us, and hit a bad patch, get a near term pass because we think they are likely to become stars for us again

- We want the same: if Netflix hits a *temporary* bad patch, we want people to stick with us

- But unlimited loyalty to a shrinking firm, or to an ineffective employee, is not what we are about

Hard Work – Not Directly Relevant

- It's about effectiveness – not effort – even though effectiveness is harder to assess than effort

- We don't measure people by how many evenings or weekends they are in their cube

- We do try to measure people by how much, how quickly and how well they get work done – especially under deadline

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Brilliant Jerks

- Some companies tolerate them
- For us, the cost to teamwork is too high
- Diverse styles are fine – as long as person embodies the 9 values

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Why are we so manic on high performance?

In procedural work, the best are **2x** better than the average.

In creative work, the best are **10x** better than the average, so huge premium on creating effective teams of the best

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The Rare Responsible Person

- Self motivating
- Self aware
- Self disciplined
- Self improving
- Acts like a leader
- Doesn't wait to be told what to do
- Never feels "that's not my job"
- Picks up the trash lying on the floor
- Behaves like an owner

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Responsible People
Thrive on Freedom,
and are **Worthy** of Freedom

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Our model is to *increase* employee freedom as we grow, rather than limit it, to continue to attract and nourish innovative people, so we have better chance of long-term continued success

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Most Companies
Curtail Freedom as they get Bigger

Bigger

Employee Freedom
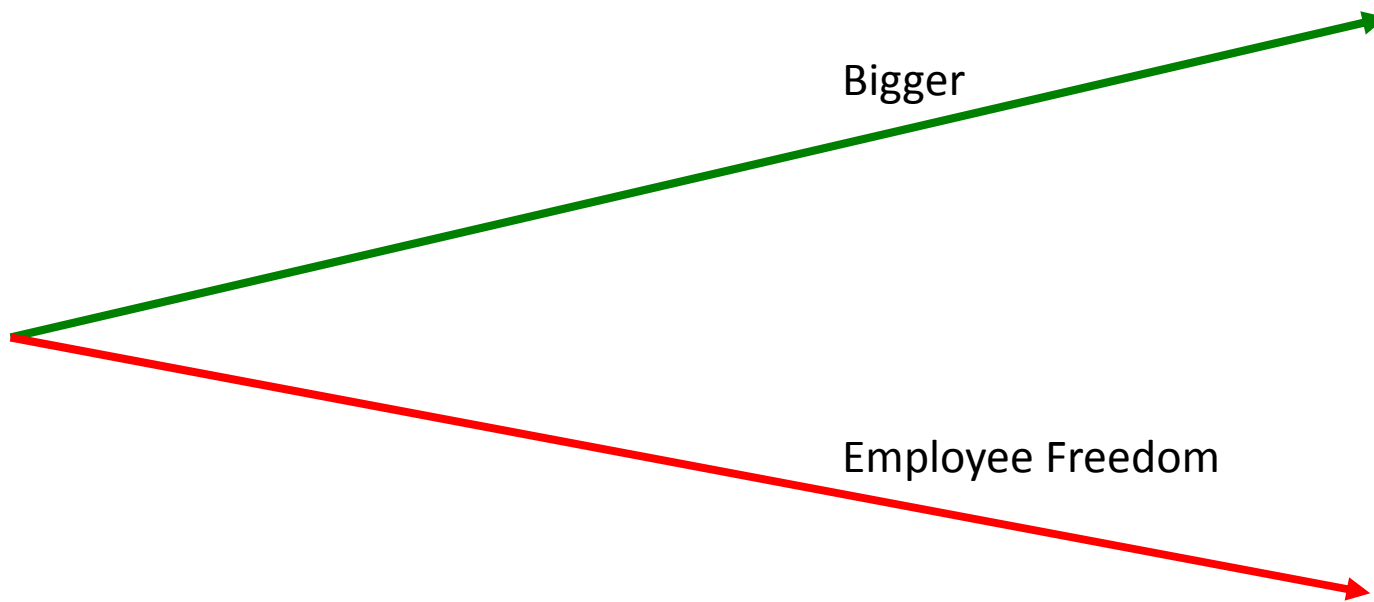
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Most Companies Curtail Freedom
As They Grow to Avoid Errors
(sounds pretty good to avoid errors)

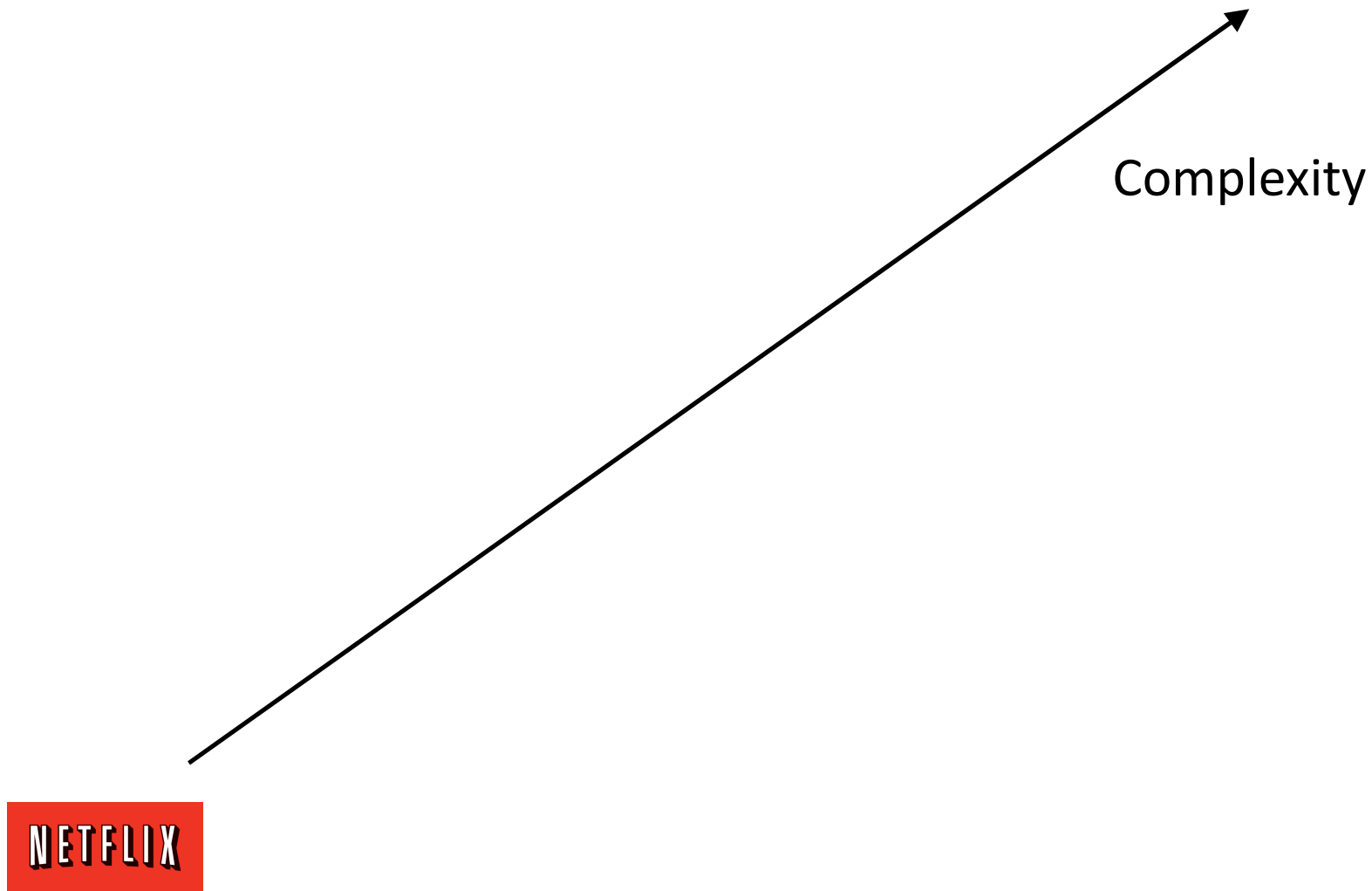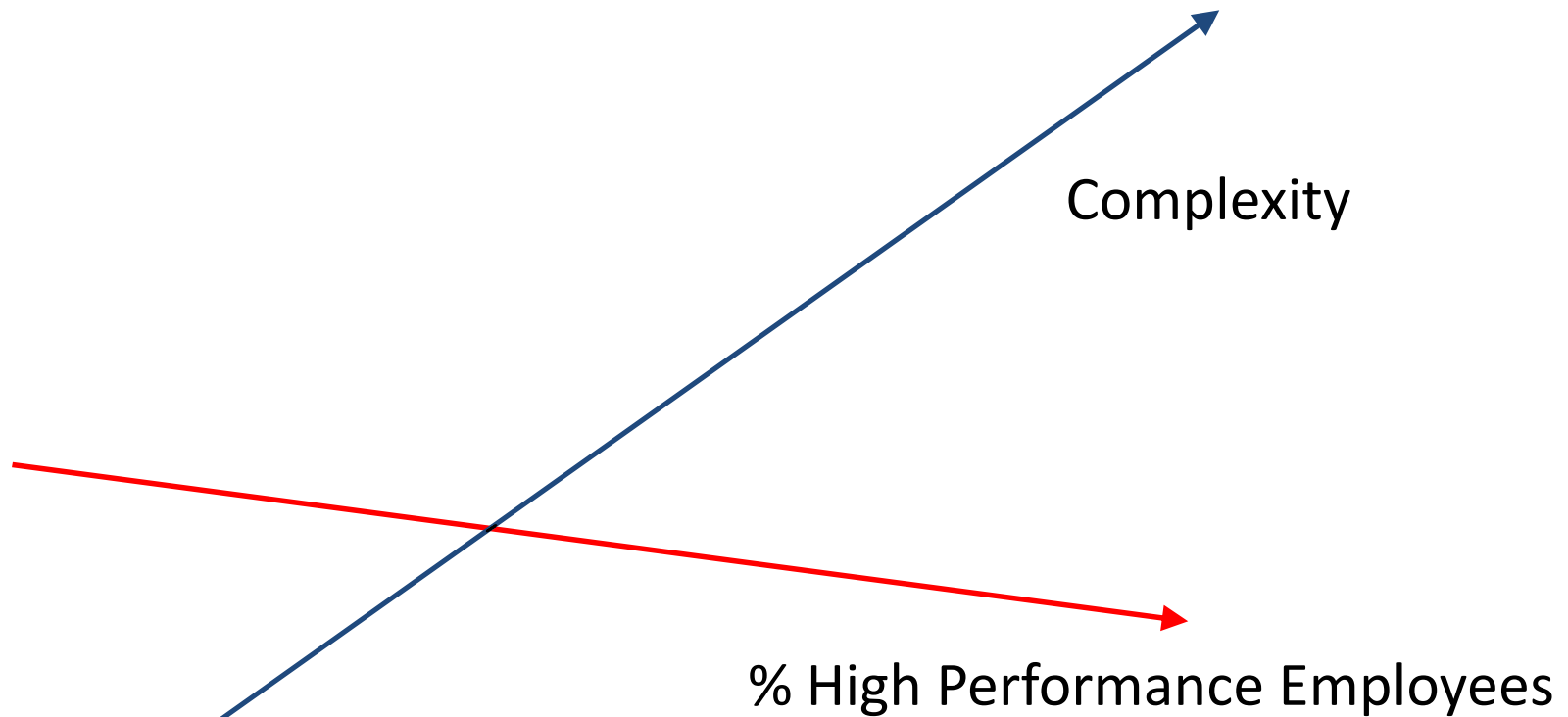# Desire for Bigger Positive Impact
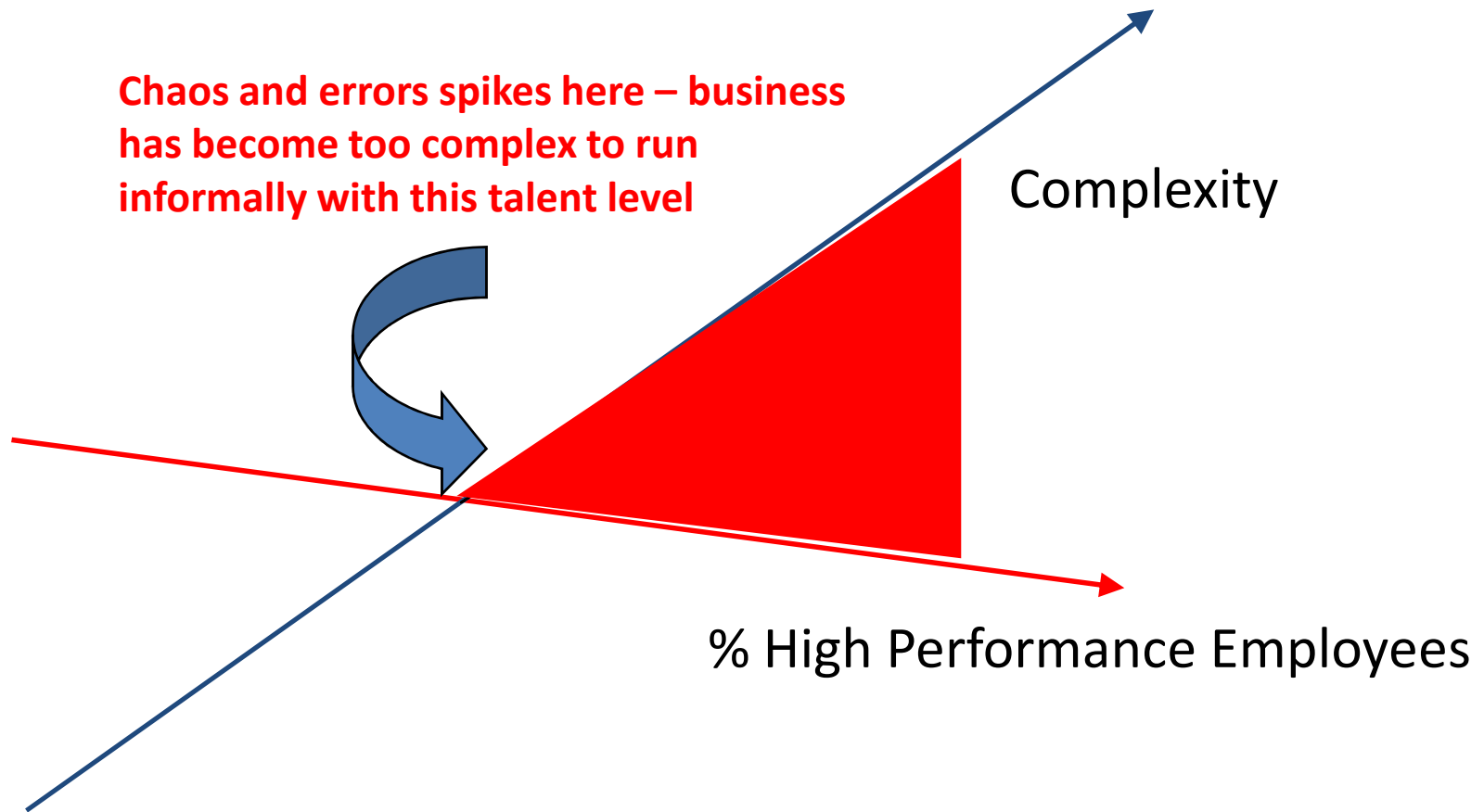# Creates Growth
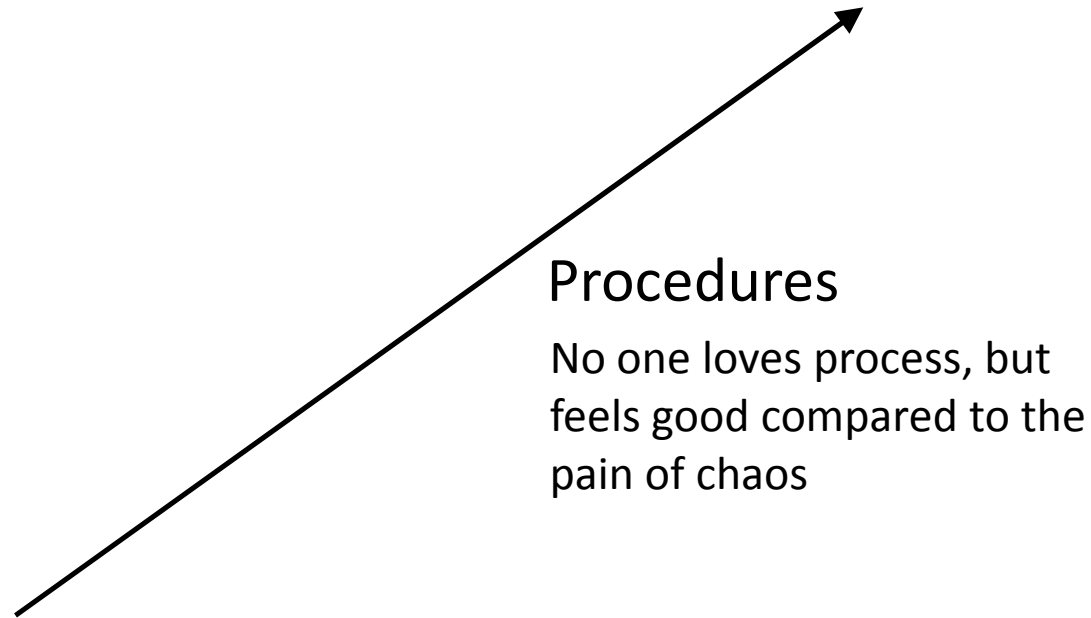
Growth

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Growth Increases Complexity

Complexity

Growth Shrinks Talent Density in Most Firms

Complexity

% High Performance Employees

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Chaos Emerges

Chaos and errors spikes here – business has become too complex to run informally with this talent level

Complexity

% High Performance Employees

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Process Emerges to Stop the Chaos

Procedures

No one loves process, but feels good compared to the pain of chaos

Process-focus Drives More Talent Out

% High Performance Employees

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Strong Near-Term Outcome

- A highly-successful process-driven company
  – With leading share in its market
  – Minimal thinking required
  – Few mistakes made – very efficient
  – Few curious innovator-mavericks remain
  – Very optimized processes for its existing market

Then the Market Shifts…

- Market shifts due to new technology or new competitors or new business models

- Company is unable to adapt quickly, because the employees are extremely good at following the existing processes, and process adherence is the value system

- Company generally grinds painfully into irrelevance, due to inability to respond to the market shift

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Seems Like Three Bad Options

1. Stay creative by staying small

2. Try to avoid rules as you grow, suffer chaos

3. Use process as you grow to drive efficient execution of current model, but cripple creativity, innovation, flexibility, and ability to thrive when market inevitably shifts
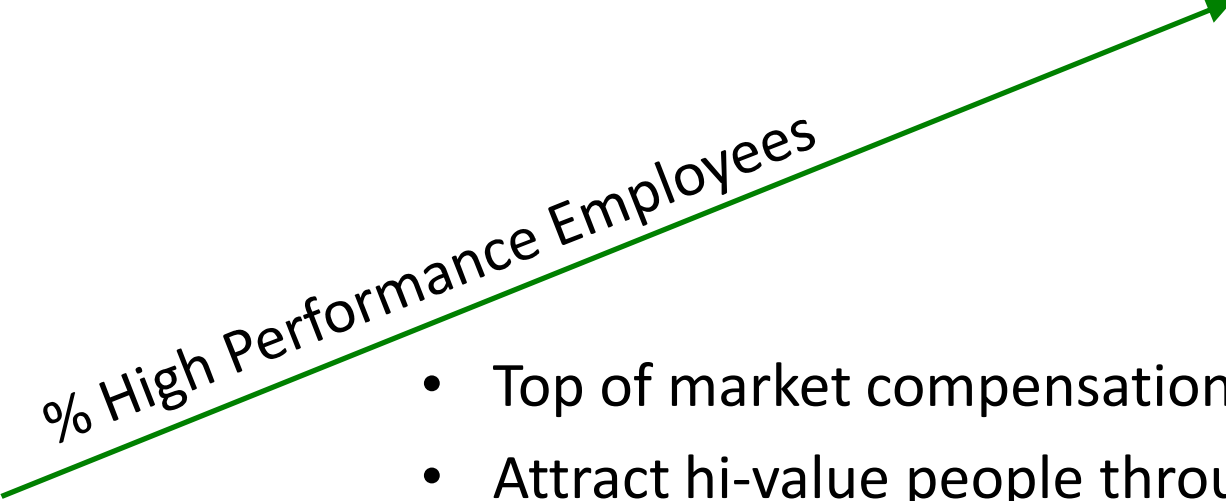
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A Fourth Option

- Avoid Chaos as you grow with Ever More High Performance People – not with Rules

- Then you can continue to run informally with self-discipline and avoid chaos

- The run informally part is what enables and attracts creativity

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The Key: Increase Talent Density faster than Complexity Grows

% High Performance Employees

Business Complexity

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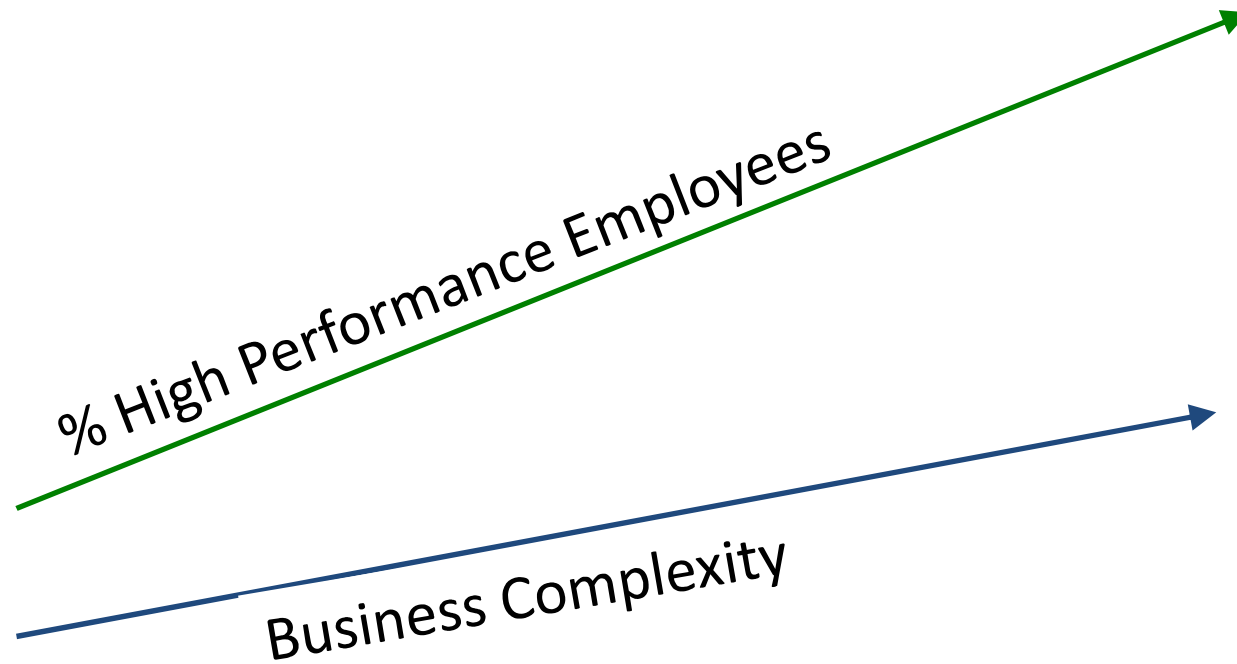
Increase Talent Density

% High Performance Employees

- Top of market compensation
- Attract hi-value people through freedom to make impact
- Be demanding about high performance culture

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Minimize Complexity Growth

- Few big products vs many small ones
- Eliminate distracting complexity (barnacles)
- Value simplicity

Business Complexity

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With the Right People,

Instead of a
Culture of Process Adherence,

Culture of
Freedom and Responsibility,
Innovation and Self-Discipline

Is Freedom Absolute?

Are all rules & processes bad?

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Freedom is not absolute.

Like "free speech"
there are some
limited exceptions to
"freedom at work"

Two Types of Necessary Rules

1. Prevent irrevocable disaster
   – E.g. Financials produced are wrong
   – E.g. Hackers steal our customers' credit card info

2. Moral, ethical, legal issues
   – E.g. Dishonesty, harassment are intolerable

Mostly, Though, **Rapid Recovery** is the Right Model

- Just fix problems quickly
  - **High performers make very few errors**
- We're in a creative-inventive market, not a safety-critical market like medicine or nuclear power
- You may have heard preventing error is cheaper than fixing it
  - Yes, in manufacturing or medicine, but…
  - **Not so in creative environments**

"Good" vs "Bad" Processes

- "Good" processes help talented people get more done
  - Web site push every two weeks rather than random
  - Spend within budget each quarter so don't have to coordinate every spending decision across departments
  - Regularly scheduled strategy and context meetings
- "Bad" processes try to prevent recoverable mistakes
  - Get pre-approvals for $5k spending
  - 3 people to sign off on banner ad creative
  - Permission needed to hang a poster on a wall
  - Multi-level approval process for projects
  - Get 10 people to interview each candidate

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Rule Creep

- "Bad" processes tend to creep in
  - Preventing errors just sounds so good
- We try to get rid of rules when we can, to reinforce the point

Example: Netflix Vacation Policy and Tracking

Until 2004 we had the standard
model of N days per year

Meanwhile…

We're all working online some nights and weekends, responding to emails at odd hours, and taking an afternoon now and then for personal time.

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An employee pointed out…

We don't track hours worked per day
or per week, so why are we tracking
days of vacation per year?

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We realized…

We should focus on what people get done,
not how many hours or days worked.   Just
as we don't have an 9-5 day policy, we don't
need a vacation policy.

Netflix Vacation Policy and Tracking

"there is no policy or tracking"

Netflix Vacation Policy and Tracking

"there is no policy or tracking"

"There is also no clothing policy at Netflix, but no one has come to work naked lately." – Patty McCord, 2004

Lesson: you don't need detailed policies for everything.

Another Example of Freedom and Responsibility...

Most companies have complex policies around what you can expense, how you travel, what gifts you can accept, etc.

Plus they have whole departments to verify compliance with these policies.

Netflix Policies
for Expensing, Entertainment,
Gifts & Travel:

"Act in Netflix's Best Interests"

(5 words long)

"Act in Netflix's Best Interests" *Generally* Means…

1. Expense only what you would otherwise not spend, and is worthwhile for work.

2. Travel as you would if it were your own money.

3. Disclose non-trivial vendor gifts.

4. Take from Netflix only when it is inefficient to not take, and inconsequential.

   – "taking" means, for example, printing personal documents at work or making personal calls on work phone: inconsequential and inefficient to avoid

Freedom and Responsibility

- Many people say one can't do it at scale

- But since going public in 2002, which is traditionally the beginning of the end for freedom, we've **increased** talent density and employee freedom substantially.

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Summary of
Freedom & Responsibility:

As We Grow, Minimize Rules.

Inhibit Chaos with Ever More
High Performance People.

Flexibility is More Important
than Efficiency in the Long Term

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"If you want to build a ship, don't drum up the people to gather wood, divide the work, and give orders. Instead, teach them to yearn for the vast and endless sea."

-Antoine De Saint-Exupery,
Author of <u>The Little Prince</u>

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*translation uses 'people' instead of 'men' to modernize

The best managers figure out how to get great outcomes by setting the appropriate context, rather than by trying to control their people

Context, not Control

Provide the insight and understanding to enable sound decisions

Context

- Strategy
- Metrics
- Assumptions
- Objectives
- Clearly-defined roles
- Knowledge of the stakes
- Transparency around decision-making

Control

- Top-down decision-making
- Management approval
- Committees
- Planning and process valued more than results

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Exceptions

- Control can be important in emergency
  - No time to take long-term capacity-building view
- Control can be important when someone is still learning their area
  - Takes time to pick up the necessary context
- Control can be important when you have the wrong person in a role
  - Temporarily, no doubt

Managers: When one of your
talented people
does something dumb,
don't blame them.

Instead,
ask yourself what context
you failed to set.

Managers: When you are tempted to "control" your people, ask yourself what context you could set instead

Are *you* articulate and inspiring
enough about goals and strategies?

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Good Context

- Link to company/functional goals
- Relative priority (how important/how time sensitive)
  – Critical (needs to happen now), or…
  – Nice to have (when you can get to it)
- Level of precision & refinement
  – No errors (credit cards handling, etc…), or…
  – Pretty good / can correct errors (website), or…
  – Rough (experimental)
- Key stakeholders
- Key metrics / definition of success

Why Managing Through Context?

High performance people will do better work if they understand the context

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Investing in Context

This is why we do new employee college, and why we are so open internally about strategies and results

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Three Models of Corporate Teamwork

1. Tightly-Coupled Monolith

2. Independent Silos

3. Highly Aligned, Loosely Coupled

Tightly-Coupled Monolith

- Senior management reviews and approves nearly all tactics

- Lots of x-departmental buy-in meetings

- Keeping other groups in agreement has equal precedence with pleasing customers

- Mavericks get exhausted trying to innovate

- Highly coordinated through centralization, but very slow, and slowness increases with size

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Independent Silos

- Each group executes on their objectives with little coordination

- Work that requires coordination suffers

- Alienation and suspicion between departments

- Only works well when areas are independent
  - e.g. GE: aircraft engines and Universal Studios

The Netflix Choice

1. Tightly-Coupled Monolith
2. Independent Silos
3. **Highly Aligned, Loosely Coupled**

Highly Aligned, Loosely Coupled

- Highly Aligned
  - Strategy and goals are clear, specific, broadly understood
  - Team interactions are on strategy and goals rather than tactics
  - Requires large investment in management time to be transparent and articulate and perceptive and open
- Loosely Coupled
  - Minimal cross-functional meetings except to get aligned on goals and strategy
  - Trust between groups on tactics without previewing/approving each one – groups can move fast
  - Leaders reaching out proactively for ad-hoc coordination and perspective as appropriate
  - Occasional post-mortems on tactics necessary to increase alignment

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Highly-Aligned Loosely-Coupled
teamwork effectiveness
is dependent on
high performance people
and **good context**

Goal is to be
Big and Fast and Flexible

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Pay Top of Market is Core to High Performance Culture

One outstanding employee gets more done
and costs less than two adequate employees

We endeavor to have only
outstanding employees

Three Tests for Top of Market
for a Person

1. What could person get elsewhere?

2. What would we pay for replacement?

3. What would we pay to keep person?

    –   If they had a bigger offer elsewhere

Takes Great Judgment

- Goal is to keep each employee at top of market *for that person*
  - Pay them more than anyone else likely would
  - Pay them as much as a replacement would cost
  - Pay them as much as we would pay to keep them if they had higher offer from elsewhere

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Titles Not Very Helpful

- Lots of people have the title "Major League Pitcher" but they are not all equally effective

- Similarly, all people with the title "Senior Marketing Manager" or "Director of Engineering" are not equally effective

- So the art of compensation is answering the Three Tests for each employee

Annual Comp Review

- Hiring is market-based at many firms, but at Netflix we also make the annual comp review market-based

  - Applies same lens as hiring

- Essentially, rehiring each employee each year, for purposes of comp

  - At annual comp review, manager has to answer the Three Tests for the personal market for each of their employees

No Fixed Budgets

- There are no centrally administered "raise pools" each year

- Instead, each manager aligns their people to market each year – the market will be different in different areas

Annual Comp Review

- Some people will move up in comp very quickly because their value in the marketplace is moving up quickly, driven by increasing skills and/or great demand for their area

- Some people will move down or stay flat because their value in the marketplace has moved down or stayed flat
  - Depends in part on inflation and economy
  - Still top of market, though, for that person

Compensation Not Dependent on Netflix Success

- Whether Netflix is prospering or floundering, we pay at the top of the market
  - i.e., sports teams with losing records still pay talent the market rate
- Employees can choose how much they want to link their economic destiny to Netflix success or failure by deciding how much Netflix stock or stock options they want to own

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Bad Ideas

- Manager sets pay at Nth percentile of title-linked compensation data
  - The "Major League Pitcher" problem
- Manager cares about internal parity instead of external market value
  - Fairness in comp is being true to the market
- Manager gives everyone a 4% raise
  - Very unlikely to reflect the market

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When Top of Market Comp
Done Right...

- Nearly all ex-employees will take a step down in comp for their next job

- We will rarely counter with higher comp when someone is voluntarily leaving because we have already moved comp to our max for that person

- Employees will feel they are getting paid well relative to their other options in the market

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Versus Traditional Model

- Traditional model is good prior year earns a raise, independent of market
  - Problem is employees can get materially under- or over-paid relative to the market, over time
  - When materially under-paid, employees switch firms to take advantage of market-based pay on hiring
  - When materially over-paid, employees are trapped in current firm
- Consistent market-based pay is better model

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Employee Success

- It's pretty ingrained in our society that the size of one's raise is the indicator of how well one did the prior year – but at Netflix there are other factors too – namely, the outside market

- In our model, employee success is big factor in comp because it influences market value
  - In particular, how much we would pay to keep the person
  - But employee success is not the only factor in comp, so the linkage of prior year performance to raise size is weak

Good For Each Employee to Understand Their Market Value

- It a healthy idea, not a traitorous idea, to understand what other firms would pay you, by interviewing and talking to peers at other companies
  - Talk with your manager about what you find
  - Minor exception: interviewing with groups that directly compete with Netflix, because their motive is in part confidential information

Efficiency

- Big salary is the **most efficient** form of comp
  - Most motivating for any given expense level
  - No bonuses – just include in salary – so much simpler
  - No free stock options – just big salary
  - Great health plan options, but high employee co-pay
  - No philanthropic match
  - Instead, **put all that expense into big salaries**
  - Give people big salaries, and the freedom to spend as they think best

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Optional Options

- Employees can request to trade salary for stock options, if they wish
- The options are fully vested, granted monthly, and cost employees in pre-tax salary approximately half of what such an option would cost in the open market
- Options ultimately valuable only if Netflix stock climbs over the next 10 years
- Investing in Netflix stock or stock options lets one participate in Netflix success or failure at whatever level is comfortable for employee

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In some time periods, in some groups, there will be lots of opportunity and growth at Netflix

Some people, through both luck and talent, will have extraordinary career growth

Baseball Analogy: Minors to Majors

- Very talented people usually get to move up, but only true for the very talented
- Some luck in terms of what positions open up and what the competition is
- Some people move to other teams to get the opportunity they want
- Great teams keep their best talent
- Some minor league players keep playing even though they don't move up because they love the game

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Netflix Doesn't Have to be for Life

- In some times, in some groups, there may not be enough growth opportunity for everyone

- In which case we should celebrate someone leaving for a bigger job that we didn't have available to offer them

- If that is what the person prefers

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Two Necessary Conditions for Promotion

- **Job has to be big enough**
  - We might have an incredible manager of something, but we don't need a director of it because job isn't big enough
    - If the incredible manager left, we would replace with manager, not with director
- **Person has to be a superstar in current role**
  - Could get the next level job here if applying from outside and we knew their talents well
  - Could get the next level job at peer firm that knew their talents well

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Timing

- If manager would promote employee to keep them if employee were thinking of leaving, manager should promote now, and not wait

- Both tests still have to be passed
  – Job big enough
  – Superstar in current role

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Development

- We develop people by giving them the opportunity to develop themselves, by surrounding them with stunning colleagues and giving them big challenges to work on
  - Mediocre colleagues or unchallenging work is what kills progress of a person's skills

Development

- Formalized development is rarely effective, and we don't try to do it
  - E.g. Courses, mentor assignment, rotation around a firm, multi-year career paths, etc.

- High performance people are generally self-improving through experience, observation, introspection, reading and discussion
  - As long as they have stunning colleagues and big challenges

Individuals should manage their own career paths, and not rely on a corporation for planning their careers

Like retirement planning – safer as individual responsibility

Individual's economic security is based upon their skills and reputation

We try hard to consistently provide opportunity to grow both

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Why is culture important?
What is our culture trying to support?

Culture is How a Firm Operates

What practices give Netflix the best chance of continuous success for many generations of technology and people?

Continuous Success =
Continuous growth in revenue, profits & reputation

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Need a culture that supports
rapid innovation *and*
excellent execution

Need a culture that supports
rapid innovation *and*
excellent execution

Both are required for continuous growth

There is tension between these two goals; between creativity and discipline

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Need a culture that supports **effective teamwork** of **high-performance** people

Need a culture that supports **effective teamwork** of **high-performance** people

**High performance people and effective teamwork
can be in tension also – stars have strong opinions**

Need a culture that avoids the rigidity, politics, mediocrity, and complacency that infects most organizations as they grow

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This slide deck is our current best thinking about maximizing our likelihood of continuous success

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Our culture is a work in progress

Every year we try to refine our culture further as we learn more