



# Surviving the Subscription Economy



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## Introduction

It was not too long ago when people believed that luxury goods were only for the rich. Owning a car was the only way for people to commute at any time, watching a movie was only restricted to the ones who could purchase DVDs, and buying a furniture would be for a lifetime. However, if we fast forward to the present day scenario, you will see a drastic shift in the buyer's persona.

Even though the availability of options increased with the growth in technology, the willingness of the consumers to shell out on huge upfront amount reduced. The preference to rent out services or products and scaling it up based on requirements, increased. Hence, subscription business model, for today, becomes the right fit.

As the concept of subscription business model started penetrating across industries, the benefits to consumers and businesses grew alike. The adoption of this business model is only going to increase going forward.

Take a look at the revenue growth of some of the popular subscription-based businesses.

Company	5 Year Revenue Growth				
	2013	2014	2015	2016	2017
<i>Salesforce</i>	4.07B	5.37B	6.67B	8.39B	10.48B
<i>Netflix</i>	4.37B	5.5B	6.78B	8.83B	11.69B
<i>Adobe Systems</i>	4.02B	4.13B	4.74B	5.84B	7.27B
<i>Zendesk</i>	72.05M	127.0M	208.7 M	312.M	430.5M
<i>Spotify Technology</i>	-	-	2.15B	3.27B	4.61B

(source - [www.marketwatch.com](http://www.marketwatch.com))

So, What exactly is a subscription business model?

A subscription business model can be defined as a business model where a customer pays a recurring periodic price to have access to a product or service. That changes everything, from pricing, support, customer relationship, upfront capex in favor of the customer.

Customers generally access products or services on a regular basis and pay much lesser than what they would have otherwise paid.

With subscription business model in place, companies can establish a relationship with the customers, which thereby offers them plenty of opportunities to upsell new offerings, bill the subscribers on a monthly basis and also build a brand loyalty.

As the purchasing patterns of the subscribers and businesses started changing, many firms developed a fear of losing out on the subscription economy pie as firms that emerged out of the subscription model such as Amazon rose to popularity. However, the subscription economy has certainly attracted many firms to shift their models

## The Growth of Subscription Model

The subscription business model has grown exponentially in recent years. The Below shown chart indicates that the revenue growth for subscription companies have outstripped the global S&P 500 sales index. Between the year 2012 and 2017, the Subscription Economy Index registered an annual average growth rate of 17.5% in comparison with the S&P 500, which grew at 2.2%.



(Source - Zuora)

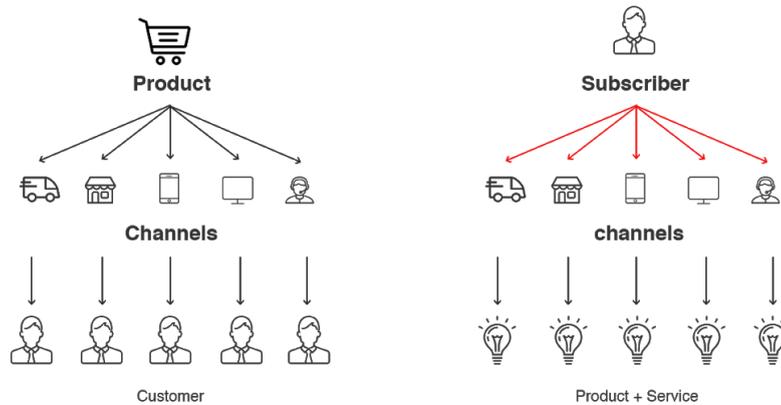
The subscription economy is pretty complex as it is vast. Companies must clearly understand the nuances of the subscription business model in order to be successful at it. The retention of the customers is one of the key aspects for ensuring success in the subscription economy.

*"80% of the software vendors will have moved to subscription-based business models by 2020"*

- Gartner

According to Gartner predictions, by the year 2020 more than 80% of the software vendors will have moved to subscription-based business models. The Premier Global Intelligence firm - IDC has also made a prediction that by the year 2020, the success of more than a half of globe's biggest enterprises will depend on their capability to build digitally enhanced products and experiences.

# A New Way of Thinking



## Companies capitalizing on the Subscription model

Here are some of the companies that have been doing amazingly well with the subscription model.

### A Unique Concept - Dollar Shave Club



**DOLLAR SHAVE CLUB**

The Dollar Shave Club business model is a subscription-based business model with an interesting twist. The brand positions itself as a lifestyle club for men and offers grooming products at a much cheaper price. The company believes in

investing in customers. Therefore it doesn't charge a huge price in order to convince the customer to be a part of the club. A customer becomes a member of the club when he purchases the first product from the company. Hence, the business strategy is "pick any product for \$1", this lets the customers buy any product for a dollar when they make a purchase from the club for the first time.

### **Music on the go - Spotify**



Spotify, a music, podcast, and video streaming service offer free as well as paid subscription packages to its users. It works on all the operating systems like any other SaaS, with all of its data saved on the servers. The company basically purchases the license from artists and publishers to stream the music on their platform.

### **Redefining Video Streaming - Netflix**

# NETFLIX

Here is another classic example of Netflix, a streaming content provider that lets its users watch TV series, movies and much more on a wide range of connected devices via the internet. It has over 100 million subscribers from 190 plus countries. The company offers 3 different plans to its subscribers based on the quality of the content provided.

## Benefits of Subscription Economy

Subscription-based business models are not new, however, over the years they have exponentially grown, which has thereby resulted in an increase in the number of companies offering pay as you go services. Product companies were affected due to globalization as it placed a margin strain on them. Whereas on the other side, the subscription-based businesses have been largely benefited from predictable stable revenue estimation and data-driven insights from direct subscriber relationships.

Shifting from an up-front business model to a subscription-based model can be a daunting task, it may even take ages to yield benefits. By focusing only on the long term, companies tend to miss out on an opportunity to adapt their business model quickly to the new way customers like to purchase software and hardware, i.e. flexibility, without big up-front investments, and with costs reflecting the business value, they derive.

The below-mentioned table brings out the differences between a One-time purchase model and the Subscription model.

	<b>One Time Purchase</b>	<b>Subscription model</b>
<b>Pricing</b>	Higher Upfront Cost	Smaller Ongoing Cost
<b>Support</b>	Usually up to 1 year after the product is sold	Ongoing value-added support
<b>Relationship</b>	Ends After Product is Sold	Strong ongoing relationship even after product sale
<b>Innovation</b>	Happens once in a few years	Have to offer regular upgrades/new features for sustenance

All of these benefit the customer. So what's in it for the business?

- Customer Success Culture
- Product Innovation
- Easier Adoption
- Predictable Revenue

Flexible subscription pricing not only allows companies to capture a lifetime value from existing customers but also provides an opportunity to reach out to previously untapped customer segments. Companies that are not ready to make upfront payments for products/services might be open to experimenting on a subscription basis.

One of the main reasons why people opt for a subscription-based model is that it can be canceled anytime. A subscription essentially means enjoying certain privileges and once this is no longer the case, customers can cancel the subscription.

### **Predictable Revenue**

Every businessman dreams of cash flow continuity and the subscription can be the best bet. The subscription economy can cause a change in the payment strategy. It is a switch from the large one-time payments to smaller recurring payments. Subscriptions help businesses grow steadily and attain financial stability.

Most often companies go for the major customers. At times, one major customer can contribute to the stability or even the existence of a company. However smaller customers can gradually add up to a stable cash flow. It is always better to have customers on a monthly basis than to bill them once and never see them again.

### **Customer Success Culture**

Most of the companies that sell products or services only focus on the initial part i.e. pursuing the customers to buy their offerings. The customer journey ends abruptly after the sale is closed. Whereas with the subscription-based model, the customer journey begins when they subscribe to the offerings. It is all about offering recurring service and customer satisfaction, after the product sale. The main focus area for companies is on the customer retention and fighting out the subscription cancellation.

The subscription business model has become a hit because of two main reasons subscription business model; i.e. 1) *Cloud*: Lower upfront cost and tech development cost. 2) *Availability of Capital*: Subscription businesses flywheel effect takes time, the venture capital funding keeps them going until then.

The recognition of the shift in consumer behavior is another reason behind its success. We now have a generation of people who prefer not to own a product/service but subscribe. The modern consumers are happy to subscribe to offerings that fulfill their needs when they need, rather than buying products that come with the burden of ownership.

## Surviving Subscription Economy

In order to thrive in the subscription economy, companies have to think beyond just setting a monthly pricing on products. The subscription-based model has to be rethought from the customers perspective, as the shift to this subscription economy is mainly driven by the customers.

Customers of the modern era are expecting a real-time experience with instant fulfillment. Subscribers also have the choice of switching between service providers, which puts the vendors at threat, therefore, they will have to earn the loyalty of their subscribers by providing ongoing value. In order to do this, they should be able to efficiently market, sell and deliver based on a proper understanding of consumer behavior.

In order to ensure long-term association with customers, companies migrating to a subscription-based model must work on certain key areas:

- **The identity of a subscriber:** The details of the customers should not be restricted to just their names and contact numbers. A subscriber identity record has to include purchases, payment history, refund details, renewal details, usage data and much more.
- **The Journey of a Subscriber:** Companies have to create and manage the subscriber journey, which deepens the connect from initial signup to include upgrades, new services or renewals.

- **Offer Discounts for longer-term subscriptions:** By offering subscribers a variety of payment options, and offering a reasonable discount to those who agree to pay upfront on a quarterly basis or a yearly basis, you have a better chance of attracting more number of customers.
- **Automate the renewal process:** Collect as much data as you possibly can about your customers and send out personalized emails on offers to convince them to renew before they churn, which is usually at the 6 or 12-month mark.

Just a decade ago, Blockbuster dominated the movie rental business and was valued at \$8 billion in 2005. Around the same time, Netflix was using the postal service to distribute DVDs, and it didn't seem to have a chance to compete with Blockbuster. Yet Blockbuster filed for bankruptcy in 2010 and around the same time Netflix gained 16 million subscribers by streaming movies online.

*So, how did Netflix upset Blockbuster?*

The executives of Netflix understood that the emerging technology was rapidly changing the delivery of movie rentals. They quickly developed a strategy around internet streaming, prompt customer service, and a remote/virtual firm to offer it flawlessly at an affordable price.

Netflix also improved its service and outmoded pricing. Blockbuster had charged \$5 for each movie, and customers hated the fees that were charged for late returns. Learning from Blockbuster's mistake, Netflix used a monthly subscription option that allows unlimited rentals without any late fees. These critical strategic moves helped Netflix become one of the best in the business.

*The Story of Adobe Systems*

Adobe Systems transitioned from a product-sales business model to cloud-based subscription 5 years ago. At this time the prices on its creative suite package were ranging from \$1,300 to \$ 2,500. Many customers openly went against this idea of renting cloud-based versions. However, subscription to Adobe's popular creative cloud software has powered a 44% increase in revenue since 2013.

*The Growth of Atlassian Stack*

Going with the Subscription trend, the popular enterprise software company launched *Atlassian Stack*, (a new subscription service that puts together all of the self-hosted developer tools into a single offering). Starting at \$186,875/ year for 1,000 licenses, this new bundle is meant to make the procurement process for enterprises easier and cheaper. At 1,000 licenses, the average price per user comes

out to around \$15.50/ month. For large enterprises that have more than 10K users on the platform, Atlassian dropped the price to \$6.50 per user per month.

## The Future of Subscription Economy

According to the CEO of Zuora-Tien Tzu, Subscription-based businesses are growing nine times faster than traditional businesses. However, the percentage of the total economy that is on this model (Subscription based business) is still low. For instance, Caterpillar is a company that is worth \$50 billion, even if they are billing around \$1 billion via subscription business, it will sum up to only 2% of the company. It is the same when it comes to cars, according to Mckinsey, \$1.5 trillion of value will be created by connected devices/connected car services and this is where all the focus is over the next decade. Interestingly, this is just 10 percent of the entire car industry.

Now that we know the potential of this business model, let's take a look at what can be expected from the subscription economy over the next several years:

### **Increased Personalization via Data**

One of the best things about subscriptions is that you get to use products without having to buy it, and because businesses can track your product/services usage pattern, they will be able to offer you a more personalized version of that service at a much lower price than it would be to buy the entire package. With the help of modern analytical tools, companies can understand your preferences and this allows them to send you more relevant and helpful content around that particular product or suggest new products that are similar to the one you already have.

### **Capitalizing on data to drive additional revenue streams**

One of the critical factors accelerating the adoption of subscription models is the data generated from subscriptions. As companies realize the potential of this rich data, they will have to start evaluating "how" and "where" the subscription services can be applied. Data is a priceless asset for companies operating on a subscription model, it enables them to streamline their services and identify new areas of activity and thereby increase revenue.

## Experimental pricing

The next big thing for future growth is to capitalize on the established subscriber relationship through experimentation with pricing. As per the bi-annual [Subscription Economy Index](#) Usage-based billing will be the growth accelerant. For instance, the metered use on the NYT (New York Times) website, where, you pay based on how much you read.

All the companies that have at least ten percent of their revenue coming through usage-based model will witness growth rates that are almost twice as high as their competitors. This is a big opportunity to amplify revenue and increase future subscriber growth.

Of course, the success of a company embracing this model will depend on its ability to gather data, analyze it and make business decisions based on its analysis. With rapidly evolving smart subscription technologies, businesses can certainly achieve exponential growth in the future.

The shift to the subscription economy is rapidly growing. Companies that want to become industry leaders and maintain long-term customer relationships, must start planning their transformation today.

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