DEMYSTIFYING THE **SUBSCRIPTION MODEL**

How to make **servitization work for you**

Predictions estimate the subscription economy will grow to $1.5 trillion by 2025, double its current value. This significant growth is driven by the promises of upfront revenue, better connections to customers, and the data provided on the business.

The problem is that step one to making subscriptions work is to understand how they apply to an existing business, and that is proving difficult for many executives. From cyclical payment to ownership or participation, subscriptions can present a challenge: creating a successful model that fits the business.

A subscription business model creates forward-looking revenue through a voluntary contract in which regular payments are made to gain access to a product or service. The customer has designated ownership of the product or service during the length of the contract while the seller generates value from the subscription itself and a platform that scales to welcome additional customers.

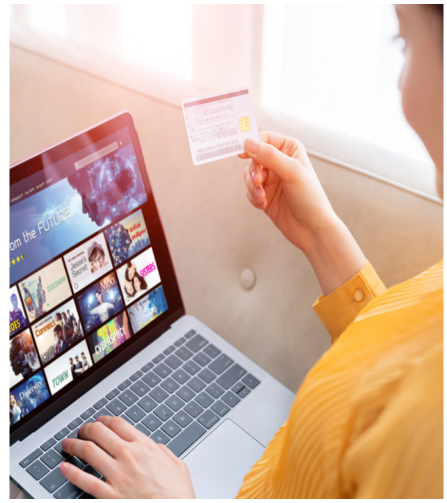
This definition is broad enough to provide a clear sense of direction that can then be used to customize the model to an existing business. For example, loyalty programs are not considered a subscription because there is no regular payment to get access. Similarly, car leases are basically agreements to borrow a car because the ownership of the car remains with the dealer. But fresh food by Blue Apron or razors by Gillette On Demand are examples of retailers making a natural move to subscription.

DETERMINING THE RIGHT **SUBSCRIPTION MODEL**

The details are critical, as businesses identify the model that is best suited for their products or services. For example, payment methods are key because, if applied correctly, a business can recognize the most value. The options are:

- Fixed or flat rate: charging a single amount for all services, which is paid based on the billing cycle
- Tiered pricing: package offers with various features and products at different price points, such as basic, standard, or premium
- Per unit or user: price changes for every user or seat added to use a product or service
- Usage-based: priced on the scale or consumption.

There are already companies creating hybrids with combinations of these options. This allows consumers to find the plan to fit their specific needs. It is rare to see only one model applied and more companies are moving towards consumption-based approaches. For example, Amazon Prime blends subscriptions and a-la-carte services successfully. But a move to more consumption-based pricing may require incentives like discounts and loyalty points to attract repeat customers.



CREATING THE RIGHT **HYBRID MODEL**

In the fixed-price model of Disney+ or the *Wall Street Journal*, there is only one option available, and a consumer can either participate or not. It is a more traditional offering but it is becoming less popular because it limits consumer choice and can lead to subscription fatigue. With most consumers having multiple content accounts, the take-it-or-leave-it approach to access services is not as appealing and customers are starting to value variety and price levels.

Snowflake, Zoom, AWS, and Dropbox already offer multiple tiered and per-unit pricing models. For example, Zoom has three paid levels with increasing value-added features but also sells per-person licenses as part of the package. So a customer can pick one level and then add to it.

The second high-level hybrid combines tiered and usage-based models. For example, Amazon Web Services (AWS) is a cloud service provider and offers different pricing tiers based around the capabilities, processes, and other cloud-based services it offers. However, pricing also fluctuates based on the consumer's usage in the cloud. If a consumer needs to run more Elastic Cloud Compute (EC2) instances during one pay cycle over another, the payments will fluctuate.

Using hybrids, a company can create a pricing model that effectively suits their customer's needs as well as revenue goals. More options mean customers have the flexibility to select the plan that is best for them now with room to grow in the future. This kind of customer experience leads to longer relationships.

VALUATING **SUBSCRIPTION MODELS**

Having a defined subscription model is key for revenue calculations. Confusion on how subscriptions are defined or not applying them properly can lead to incorrect valuation and lingering consequences.

With substantial growth over the past two decades, subscriptions are now considered essential to business. However, misunderstanding the model negatively impacts the business and shareholders. For example, if a company is identifying as a subscription-based business model, but it is not, its revenue could be misrepresented on financial statements. The mistake could result in a re-evaluation, hurting the company and shareholders.

Business forecasting can also be impacted. If a company is falsely reporting financials then the consequences are straightforward and could be costly. But a company with an inferior application of a subscription will also suffer. One of the greatest benefits of the subscription model is the ability to accurately forecast and budget for future quarters. If the subscription model is incorrect or poorly applied, it can create inaccurate forecasts that impact revenues and long-term growth.

Establishing an inclusive definition that is suited to a company will enable businesses to implement an effective subscription model and, in turn, avoid possible revenue and forecasting risks.

FINDING **SUBSCRIPTION SUCCESS**

Crafting an appropriate subscription model can drive more predictable and linear revenue with a lower cost of sales and higher gross margins. It also opens up new avenues to customers and drives innovative ways to deliver more value. Add in the ability to upsell and cross-sell and it is easy to see why companies want to move to a subscription model.

However, implementing this is disruptive to the business and will require additional skills and technology to be successful. By defining the subscription model at the beginning of the process, companies can avoid having poor visibility into their offerings. And they can build a foundation to be ready to modify or change to keep pace with the competition and customers.

Capgemini has helped clients move into a successful subscription model that supports the business and customers. It will be disruptive and require the entire company to migrate to a new way of thinking. We have helped clients overcome resistance and keep focused on retention as well as acquisition.

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