Seizing the subscription business model

From one-time sales to lifetime customers

IBM

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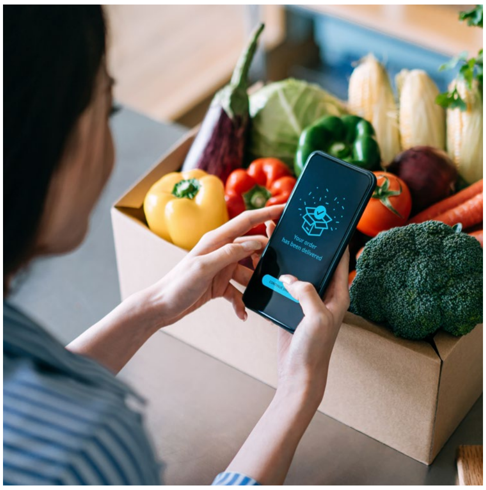


Key takeaways

The subscription market—the shift from a traditional pay-per-product model to recurring payments for ongoing goods and services—has been expanding rapidly across industries.

See subscriptions through customers' eyes

It's easy to understand why businesses find subscriptions so appealing. They can offer companies plenty of potential rewards, from customer growth to recurring revenue. But before transaction-based companies make the switch to subscriptions, they need to fully examine the impact this shift could have on their customers.

Cultivate relationships

For companies that have traditionally relied on transactional sales, or companies that haven't sold directly to the end customer, subscriptions require both a new business model and a new business mindset. It's not about selling one-off products or services; it's about cultivating lifelong customer relationships.

Change the way of working

To develop long-term subscribers, companies may need to transform the way they work and how they measure success. They need the people, processes, and technology that can enable and enhance customer relationships with staying power.

The subscription market: Are you ready?

More and more companies are converting their products and services into subscriptions—for immensely compelling reasons.

Organizations that offer subscriptions are gaining new customers, new revenue streams, and deep data on what they sell and to whom. They're turning occasional or even regular shoppers into potential lifelong customers. They're enjoying predictable recurring revenue and increased valuations, which can help sustain them through lean times. And they're accelerating revenue growth by continually introducing new subscription features and services to existing customers.[1]

Companies that have long sold one-off goods and services—what we refer to as transaction-based organizations—are eager to join the burgeoning subscription ranks so they can capture longer-term customer value. But for these companies, adopting a subscription model can also mean big changes in how they do business. The question is: are these organizations ready to make that transition?

To be sure, the subscription market—the shift from a traditional pay-per-product model to recurring payments for ongoing goods and services—has been expanding rapidly across industries (see "Perspective: The subscription evolution" on page 5). According to subscription management platform provider Zuora, subscription business revenue among its global users grew by 337% during the past decade.[2] As a result, the global subscription billing services market is expected to more than double in size from $5.1 billion in 2020 to $12.5 billion in 2026.[3]

The pandemic has accelerated this pivot. Stuck at home, many consumers started subscribing to products and services—from movies to groceries—that they couldn't readily access in person. In 2020, the number of subscribers increased by 90% over the previous year for subscription payment platform ReCharge.[4] According to one survey, US subscribers each had an average of 5 retail subscriptions in the last quarter of 2021—twice as many as in the first quarter.[5] 26% of US and 21% of UK consumers aged 18 to 40 purchased a new subscription in 2020, another survey found.[6]

Young consumers have spurred the subscription market, just as they have driven the sharing economy, which values access over ownership. In a recent IBM Institute for Business Value (IBV) study, more Gen Zs and Millennials, as compared to Gen Xers and older groups, have and want subscriptions (see Figure 1).[7] And there's room for growth: while roughly a third of Gen Zs and Millennials already have subscriptions, nearly as many say they would like to try them.

For transaction-based companies, however, transitioning an existing product or service into a new subscription offering isn't as simple as flipping a switch. Many of these organizations haven't had to engage directly with their end customer. Subscriptions change all that. It's one thing for an auto manufacturer to sell a car through a dealer, who then watches the customer drive it off the lot. It's quite another for the manufacturer to sell a car subscription that places it in an ongoing, direct relationship with the driver.

Subscription success requires a different business model.[8] For example, we see industrial products companies moving to recurring revenue models and building new subscriptions that could include products-as-a-service, one-time products, and connected services bundles. Even B2B distributors are finding ways to create and sell subscription offerings through their resellers, whether they be software-as-a-service (SaaS) products, bundles of SaaS, or customer services.

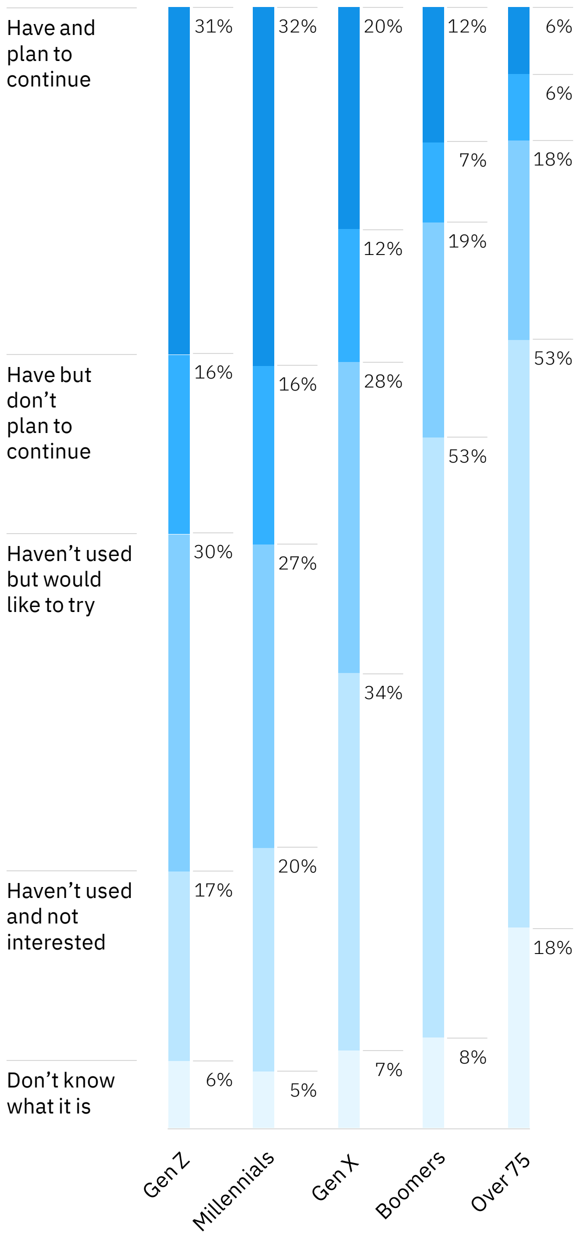
Underpinning these shifts is a strategy that clearly identifies why the business wants to adopt a subscription approach and how it can deliver and continually improve its offerings. Companies need a different way to determine value with new KPIs and success metrics. Subscriptions often require technology enhancements, improved data integration, and redefined workflows and models for numerous areas such as call center operations, AI-assisted support for customers and agents, order management, and supply chain operations. Organizations also need the talent to design and orchestrate the brand promise and interactions that can motivate one-time buyers to become recurring customers.

The subscription market is here. Are you ready to join it?

FIGURE 1

Room to grow

Consumer subscription footprint shows great potential to expand



A different mindset

64% of subscribers feel more connected to companies where they have subscriptions.[9]

Adopting this business model begins with a different business mindset.

With subscriptions, it's not about hitting targets for discrete unit sales, it's about creating customer experiences that lead to renewals. It's less about selling products, and more about building long-term relationships and staying relevant to customers' ongoing wants and needs.

For companies unaccustomed to nurturing sustained relationships with customers, subscriptions can represent a fundamental paradigm shift. Relationships generate not only tangible benefits but intangible rewards, too: the positive feeling that engaged customers get, which propels them to keep coming back for more. Organizations must find out what their customers love—that's where opportunities for future growth exist.

There's much at stake in getting these relationships right. 64% of subscribers feel more connected to companies where they have subscriptions than with companies where they have one-off transactions, according to Zuora.[9] However, a subscription offering that is hastily introduced and misses the mark could end up wasting an organization's time and money. Worst case, it could strike a blow to the business's value and its reputation.[10]

Companies new to subscriptions need to take the long view. For example, after shifting to SaaS, some tech companies found their costs exceeded revenue at first and their share value temporarily dipped—but then their revenue and stock price later surged.[11]

The key is to recognize that a change of this magnitude requires a carefully crafted strategy to steer the organization through its transformation. The process begins with a seemingly simple but essential question: why offer subscriptions?

Companies embarking on this journey often focus on reasons that reflect potential benefits to their businesses, including:

- *To increase revenue* by offering new or ancillary products and services or by acting as a gateway to break into new markets. For example, an automotive OEM can create a subscription that includes a car lease enhanced with personalized services for safety, security, and infotainment, thereby increasing its revenue beyond the standard lease of the car.
- *To improve resiliency* by maintaining a steady stream of predictable business that enables organizations to better weather market uncertainties and disruptions. The pandemic, especially, exposed how vulnerable companies can be when relying solely on discrete, one-off sales. Alternatively, companies can offer subscriptions for product reusables or bundles of products and reusables. The classic example of this driver is the razor company that gains business resiliency by providing blade refills over the life of the razor itself.
- *To build long-term relationships with customers* by engaging them directly over the life of a product or service. This has the potential to deliver more value over time to the business, compared to the cost of continually acquiring new customers. An HVAC manufacturer, for example, could elect to go direct to consumers by leasing the equipment to them and bundling their maintenance, reusables, and other products into a monthly subscription that supports the services business as well as signing the initial lease. And when it comes time to replace or upgrade the unit, there's a good chance a satisfied customer could continue doing business with the company.

These are all strong justifications for adopting a subscription model. However, these benefits overlook the primary consideration companies should be exploring at this stage: what's in it for the customer?

Perspective

The subscription evolution

The subscription business model is on the rise, but it isn't new. After news publishers pioneered the model in the 17th century, early subscriptions involved a simple interaction: recurring access for recurring fees.[12] Today, consumers use a platform ecosystem that in turn enables access to other services.

Modern subscription models and their payment structures, such as pay-as-you-go billing, have been made possible by advances in cloud technology. In 2013, Adobe switched from selling boxes of software to selling SaaS subscriptions. In just 5 years, the company went from $200 million in annual revenue to over $5 billion in recurring revenue.[13] Thanks to cloud technology, SaaS is now a dominant way to access software capabilities.

At the other end of the subscription-maturity spectrum are the auto industry, consumer packaged goods (CPG) manufacturers, and retailers. Some automakers and rental car companies now allow drivers to get behind the wheel for a monthly fee.[14] Car subscriptions can also include software services that provide autonomous and assisted driving capabilities—such as automatic assistance that helps keep a vehicle in its lane.[15]

Customer experience leads the way

Purpose-driven consumers now outnumber value-driven consumers.

Adopting a customer-centric approach is one of the first steps organizations need to take. A company is better able to design successful subscription offerings when it assesses its strategy through customers' eyes. This degree of examination goes beyond determining the advantages of products or services. It extends to fully understanding what customers want and need that is relevant enough for them to embark on a long-term trusted relationship with a brand.

You'll have to get to know your customers' current predilections well. Analysis of past purchasing patterns, segmentation and personalization strategies, and data will only get you so far. You also need to research how your target customers may have changed during the pandemic or in response to other global issues and events.

Cost, convenience, and value are the historical drivers of shopping behavior. But today, purpose-driven consumers who choose brands that align with their principles represent the largest segment of global consumers across all major product categories, according to a recent IBV survey.[16] At 44% of respondents, purpose-driven consumers have overtaken value-driven consumers (37%). For example, the market for reusable clothing that aligns with consumers' sustainability priorities has emerged as one of the strongest growth trends in the fashion industry.[17]

The pandemic has also had a profound impact on long-held B2B sales practices, with more than 70% of B2B decision makers now preferring to engage with suppliers virtually or through self-service rather than interacting in person with sales representatives.[18]

Instead of thinking about your customer experience through the lens of your current portfolio of products and services, take an outcome-based view to get at the essence of what customers need. For example, if an airline is looking for "continuous, no-interruption, operations," they don't just need jet engines. They also need ongoing monitoring and maintenance services, predictive maintenance, replacements, repairs, on-site inspections, operation failure recovery plans, and more. By probing outcomes, organizations can expand the aperture of related offerings they could provide and create new revenue opportunities ripe for a subscription model approach.

Subscribers want trust, relevance, and convenience. Whether you are introducing new benefits, resolving pain points, or both, appraising the potential impact and value for customers can point you toward the subscription model that meets their needs:

- *Replenishment*: replacing the same products with automated renewal
- *Access*: offering special access to members-only items or offering long-term service contracts that could include products, maintenance bundles, and cloud services
- *Curation*: providing highly personalized products, services, and experiences based on customer preferences

You might adopt one, a combination, or a sequence of these subscription models. You could start with replenishment, then move into curation, or offer both at once. You might also pursue a mixed model of both subscriptions and unit sales, keeping existing customers while attracting new ones.

A relationship-first focus can also help organizations avoid potential pitfalls. Even if companies make it relatively simple and inexpensive for customers to add yet another subscription, too many subscriptions can lead to customer fatigue. Unlike one-time purchases, recurring purchases carry the expectation of ever-evolving services. It would be a mistake to assume that once customers purchase a subscription, they will simply continue to renew. While the percentage of US consumers who had subscriptions grew in 2020, it tapered off somewhat in 2021—from 47% to 41%.[19] It takes a continuous effort to earn and keep customers' loyalty, and stay relevant month after month, year after year.

Subscribers want trust, relevance, and convenience.

Rethinking the way you work

Subscriptions require changes to processes, people, and technology.

Subscriptions aren’t operational add-ons. They require changes to processes, people, and technology. They alter how organizations earn and recognize revenue; how they track success; how they engineer their supply chains and operational workflows; and how they manage their customer relationships.

Revenue recognition

Moving to recurring revenue and subscription models can increase the overall market value of companies. Subscription revenue may be smaller than revenue generated from one-off sales, and it may take longer to recoup the cost of the goods sold. However, revenue recognition and future potential revenue often result in a higher valuation for a business than quarterly one-off sales because of the presumed stability and predictability of future revenue streams.[20]

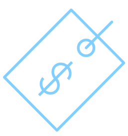
Transaction-based organizations need to adopt different revenue recognition and accounting systems capabilities and processes. Subscriptions and recurring revenue can be billed out in a variety of models that could also include one-time purchases (see Figure 2).

Organizations need to determine how changes, amendments, pauses and resumes, and cancellations of contracts and subscriptions can automatically flow through their financials and update their revenue backlog. This also translates into a whole new set of key metrics necessary to manage the business.

FIGURE 2

Rethinking revenue

Organizations select the revenue recognition model that supports their subscription approach

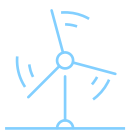


Fixed

Provide a product or service on a regular basis for a set price.

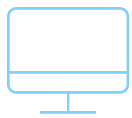
Quantity

Raise or lower prices based on pricing tiers.



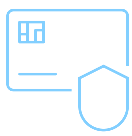
Usage and consumption

Charge only for what customers use.



One-off

Charge for one-time purchases, such as an initial setup fee or equipment.



Hybrid

Use a combination of models.

Metrics

Conventional means for measuring business value may not be sufficient to provide an accurate assessment of growth derived from subscriptions. For example, in place of unit sales, companies skilled at subscription-based business models measure the success of their customer relationships by tracking metrics such as:

- Number of subscribers
- Monthly active users (MAU)
- Average revenue per user (ARPU)
- Annual recurring revenue (ARR)
- Rates of churn and retention
- Customer acquisition cost (CAC)
- Customer lifetime value (CLV)

Apple was one of those companies that switched from tracking transactional unit sales to tracking annual recurring revenue. As iPhone sales slowed, the tech giant announced it would stop reporting the number of devices it sold. Instead, it focused on the revenue generated from its services—which, by 2021, had become an $86 billion business with 745 million paid subscribers, 160 million more than the year before.[21]

Supply chains and operations

In addition to changing accounting systems and processes, organizations also need to consider the impact recurring orders could have on their supply chains and operations. An organization may opt to customize their existing supply chain, or they may need to build a new one. They may need to implement more sophisticated order management, flow-path automation, and order visibility to avoid the customer experience pitfalls that can result in attrition. Process mining also enables organizations to use their digital data and system paths to visualize and re-engineer workflows for improved cost and efficiency. With these types of capabilities, organizations can create a unified, friction-free buying experience for customers on the front end and a unified invoicing and payment system on the back end.

Subscriber management

With subscriptions, products become services, and services become relationships. To get relationships right, organizations need a subscriber management team to monitor customer engagement so they can continually improve the experience, as well as sell new features. To be effective, the team needs advanced data and analytics capabilities, supported by the necessary infrastructure and technologies that enable efficient workflows. They may need to revamp privacy and security strategies. Organizations accustomed to a waterfall process to deliver new products intermittently will also need to adopt an agile approach to enhance offerings in an ongoing loop of analysis, insight, ideation, design, and execution.

Data, analytics, and AI

Organizations need the systems to collect a comprehensive data profile of their subscribers: who they are, their locations, how they use products and services, the channels they frequent, how they respond to communications and interactions, how they feel about a product or service, what type of reviews they post on social media, and so on. In essence, businesses need a 360-degree view of each subscriber across all products, channels, and touchpoints.

Customer analytics can be built on top of this foundational layer to align product and service preferences, communication preferences, pricing and promotion response behavior, and relevant cross-sell or upsell opportunities. Organizations may need to modernize their data architecture and processes to capitalize on all data signals to gain a better understanding of their customers and anticipate their needs.

This effort requires deep analytical skills, as well as the skills to respond with personalized interactions finely tuned to engage subscribers and grow their value and loyalty. AI can play a powerful role here. It can help predict customers' wants and needs for more tailored services and product recommendations, and provide insights that guide the development of new offerings.

Privacy and security

Data is the lifeblood of subscription models. The wealth of customer data that can be captured with subscriptions, including sensitive payment information, requires organizations to become vigilant protectors of customer data. Companies may need to update and tighten their privacy policies and upgrade their cybersecurity capabilities to provide the safeguards necessary to earn customer trust.

Designing for relevance and lifetime relationships

A customer-first focus should inform the entire subscription experience.

By delivering secure, relevant experiences that meet customers' individual needs and desires with convenience, ease, and a sense of value and purpose, companies can build the customer relationships that can drive retention. It's only with retained subscribers that an organization can achieve recurring revenue. This means subscriber retention and loyalty become equally important—if not more important—than acquiring customers. Consider the customer lifetime value, the customer acquisition cost, and churn. The longer relationships last, the higher their value. The shorter the relationships, the more businesses have to spend to find and develop new customers.

For instance, 4 in 5 US households had subscription video-on-demand (SVOD) services in 2021. But over one-third (35%) of them canceled their subscriptions. Acquiring just one new SVOD subscriber can cost $200.[22] And once you lose subscribers, it can be tough to win them back. While 80% of US consumers who signed up for new subscriptions in 2020 said they plan to keep them, those who unsubscribe have only an 11% likelihood of returning.[23]

A customer-first focus should inform the entire subscription experience. Make it both simple and attractive for customers to ease into the relationship. A free product or subscription period at the start could help lead to a devoted, dependable subscriber base.[24] Sending customers meaningful, personalized offers for new products or services based on their current usage, as well as social media mentions or other interactions, help keep customers intrigued and engaged.

And, though it may seem counterintuitive, make it easy for customers to leave. Almost one-quarter of US consumers who aren't interested in product subscriptions say it's because they don't want to be locked in. More than half (53%) say a simpler pause or cancellation process could actually sway them to sign up in the first place.[25]

Action guide

As a fundamentally different way of doing business, subscriptions can involve so much change that it can be overwhelming. But there are steps your organization can take to create an actionable subscription transformation strategy and become subscription ready.

01

Ask the hard "why"

Conduct a frank assessment of your current customer experience and how a shift to a subscription model would impact existing customers and future segments you plan to attract. Base your subscription transformation strategy on insights derived from data.

- *Mine existing customer data to identify behavior patterns* that can inform experience design decisions and features for your subscription service. Collect qualitative data from customer surveys and analysis of social commentary to uncover pain points and delights that may not be evident from your customer management systems.
- *Tap into the firsthand knowledge of your sales representatives and call center agents* who engage with customers directly to capture their perspectives on the customer impact of this shift.
- *Look beyond your organization* to gain a robust understanding of market opportunities, including new or expanded customer segments. Access market trend analysis from trusted external sources. Interview partners, vendors, and suppliers. Administer a competitive review to establish benchmarks for pricing and services. Explore other industries for innovations that could differentiate your offerings or approach.

02

Look under the hood

Once you are clear that adopting a subscription model has potential for your business and customers, map how this change would affect functions across your enterprise. Conduct a cost-benefit analysis and value assessment to weigh the impact.

- *Consider subscription requirements for your IT infrastructure, tech stack, and data management* that cut across the enterprise. Do you have the robust customer data platform and analytics required to generate the necessary customer insight? Are your digital platforms instrumented to enable cross-channel interactions with your customers?
- *Include changes to processes, policies, and skill sets in your analysis*. In addition to IT and data analytics, think broadly about how subscriptions might affect workflows and skills in areas such as security, finance, operations, supply chain, product development and management, marketing, sales, and customer support. Component Business Modeling can also help an organization better understand the interdependent functions and skill sets required to deliver a continuously excellent customer experience.[26]
- *Extend your analysis to your ecosystem*. Can your current mix of partners, vendors, and suppliers support the changes you want to make? If your proposed subscription strategy creates opportunities for expanded services or products, what new partnerships do you need to build?

Action guide

03

Pull the right team together

Subscription services should be designed and managed by an interdisciplinary team of customer experience professionals and subscription SMEs who understand customer expectations and touchpoint dynamics—both physical and digital—across the entire subscription process.

– *Determine the cross-functional skill sets that need to be represented on the team* for successful program design. In addition to the customer-facing functions such as sales, marketing, and customer care, include areas such as product and service BUs, digital commerce, operations, fulfillment, and finance.

– *Adopt an agile approach and culture*, providing training and change management to enable your team to conduct multiple workstreams simultaneously with deep alignment and collaboration.

– *Empower the team* to not only develop and launch the subscription service but manage ongoing governance, monitor and measure overall performance, and work across the various internal functions—with external providers as needed—to continuously improve the experience.

04

Start small, learn fast, and grow rapidly

How you start depends on your business goals. You might be initiating a major transformation from products to products-as-a-service. Or you may need to modernize a recurring revenue platform to scale faster and grow with more agility. Or perhaps you are testing a subscription model in a new market or for a new product or service. In each case, the depth and breadth of your upfront analysis can provide the insights you need to strategically map your subscription journey.

– *Test the waters by launching a Minimum Viable Experience (MVE).* It could be a subset of products or services that target a specific need or customer segment. As you execute, uncover leading practices that can quickly scale.

– *Measure the success of your customer relationships*. Establish benchmarks from the start that are tailored to subscription models, focusing on retention, churn, and the number of active subscribers. Assess the impact of each iteration as you continually make refinements.

– *Measure your employees' success*. Transforming your processes and workflows to be more efficient for employees can play a significant role in your subscription model's overall success. Pay close attention to employee satisfaction scores. Often, when they go up, so does the company's NPS score.

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