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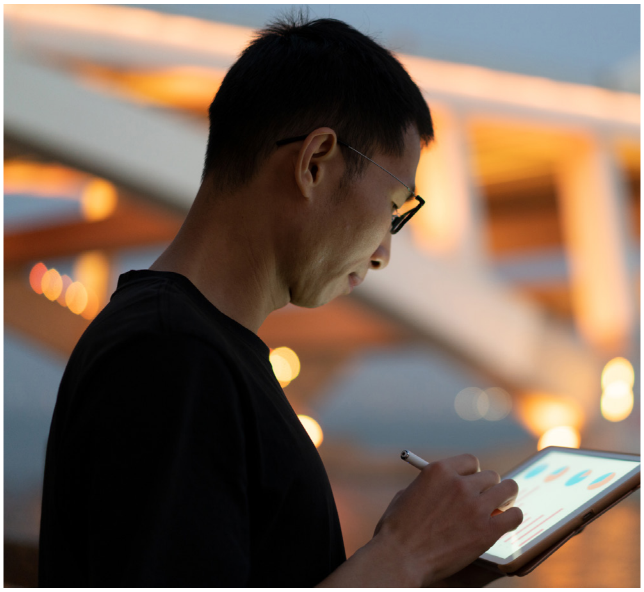
SOLUTION GUIDE

Guide to Successful Subscription Business Models

Subscription revenue models have steadily gained traction over the last decade. Netflix tops the list of the most recognizable subscription programs in the consumer world, with over 225 million subscribers. Microsoft 365, with over 345 million paid seats across one million subscriber companies, claims the same in business. In this guide we will review different subscription models, discuss the benefits and risks, and evaluate how companies can harness the power of their partners to improve the success of their subscription business.



What is a subscription?

From businesses engaged in multi-year, multi-million-dollar agreements to 99-cent/month mobile apps for consumers, subscription models are on the rise across industries, geographies, and sectors, no matter what or who they sell to.

Subscription revenue models allow customers to access a product or service in exchange for paying a recurring fee at specified intervals.

A subscription differs from a traditional sale in a few key points. The table below shows two perspectives on the differences:

Seller	Buyer
Predictable timing for payments – A subscription agreement or contract will specify the payment intervals.	**Low entry barriers** – The entry cost of a subscription is almost always lower than the cost for an outright purchase.
Continuity of revenue – Instead of the one-time transaction revenue of traditional sales, subscription models generate income at every agreed upon interval, in as long as the subscription remains.	**Low exit barriers** – Terminating or changing the terms of a subscription agreement is almost always simply a matter of notifying the vendor of the wish to stop or modify the subscription with no further complications or penalties.
Customer engagement – A subscription requires continuous customer interaction, nurture, and support to drive retention and renewal.	**Vendor relationship** –The continued engagement after the sale was closed leads buyers to build relationships with the vendor and partners.
Sales Process – Traditional sales, rental, and leases require going through the entire sales process every time the customer purchases the product or service. In a subscription, the complete sales process only applies to the initial sale. Afterward, recurring revenue is generated through customer retention.	**Surprise element** – In some cases (consider subscription boxes for example), customers won't know what was sent to them until they receive and open the box.
Metrics and KPIs – The key metrics to measure subscription performance are Monthly or Annual Recurring Revenue (MRR/ARR), Customer Churn Rate, and Customer Lifetime Value (CLV).	**Financing Model** – A subscription is financed as an operating expense rather than a capital expenditure, resulting in a different tax treatment and budget and purchase approval level.
Ownership – The seller retains the ownership of non-consumable products sold by subscription, simply giving the buyer the right to use the products.	**Flexibility** – The buyer does not own the product, which gives more flexibility around requesting changes in configuration or even asking to swap the product altogether.

One can sell almost anything as a subscription, including goods, services, or a combination of both – in either digitgal or physical form. The table below provides some examples:

Nature of the offer	Digital	Physical
Service	Cybersecurity	Parcel delivery
	Identity monitoring	Support/ helpdesk
	Desktop virtualization	Payments and auditing
	Live streaming	Gym subscription
	Data processing	Telephony
	Logistics delivery (LaaS)	Utilities
Product	Software applications (SaaS)	Consumables (e.g., pet food, cosmetics)
	Digital content (music, video, images, research, magazines)	Long-term use equipment (e.g., cars, printers, clothes, solar panels)
		Equipment consumables (ink, printer cartridges, vape cartridges, etc.)

Selling digital services and product subscriptions requires infrastructure and involves non-traditional partners, like hyper scalers, managed service providers, and independent software vendors.

Selling subscriptions to physical goods and services through a channel may involve traditional transactional partnerships but includes new types of partners to drive awareness and retention.

Types of subscriptions

Based on contract duration and renewal policy, subscriptions can be for a fixed term or evergreen.

Fixed-term subscriptions need to be renewed when the term ends. Vendors generally start a sales campaign to retain customers well before renewal is due and often try to cross-sell and upsell the initial contract. In contrast, customers may try to negotiate a better price or service ratio during a renewal sales cycle. Influencer partners are critical as they can balance these conflicting goals. Meanwhile, post-sales implementation, service, and support partners are essential in delivering a great customer experience that could lead to a renewal.

Evergreen subscriptions have a built-in auto-renewal clause. To exit an evergreen contract, the purchaser must notify the seller in advance. In the consumer world, customers will often continue to pay for evergreen subscriptions to digital products or services long after they stopped using what they originally signed up for. Banks and financial advisors have started offering services to help people terminate subscriptions they do not need or use, leading to a more significant customer churn. Influence partners can help with the initial sale of an evergreen subscription. They can also engage the customers post-sale, providing advice and messaging around the benefits of continued subscription utilization to prevent eventual churn.

Based on the pricing model, subscriptions can be flat-rate, tiered, usage-based, shared, and freemium.

In a **flat-rate subscription**, customers pay a fixed fee for unlimited access to the product or service. For example, Netflix offers unlimited streaming for a monthly fee. A flat-rate subscription can be user-based (i.e., each user accessing the product or service requires a subscription) or independent of the number of users.

In a **tiered subscription**, the customers can access different subscription levels, offering varying features or content at different prices. For example, Adobe Creative Cloud provides different tiers with varying levels of software access.

For a **usage-based subscription**, a customer's fee is determined by how much they use the product or service. For example, cloud service providers charge based on the amount of data stored or processed.

Subscription plans or **shared subscriptions** let providers bundle multiple users or services/goods under one contract. Examples could be shared family plans for Spotify or subscription packages that include broadband, media, entertainment streaming, and voice services.

Freemium pricing is another style of subscription, and there are many variations. A subscription can be free for a fixed term and then converted to a flat-rate or usage-based evergreen subscription. Or it can offer free access to basic services or product capabilities but require an upgrade to a paid subscription for more advanced features – like a tiered subscription where the first tier costs nothing.

Each subscription pricing model has pros and cons and can be suitable for different styles of partner engagement. Subscription plans suit value-added resellers who may include their own services or products in the bundle. Use-based subscriptions could be perfect for MSPs. Influence partners could prompt customers to try a freemium service that may later convert to a paid subscription.

Challenges, risks, and the payoff benefits

Subscription revenue models are extremely popular with both vendors and customers. However, vendors who are considering adding a subscription offer to their portfolio or switching entirely to this model must overcome a series of challenges and mitigate risks.

1. **Subscription Setup Costs:** Implementing subscription models requires upfront technology and partner onboarding investment:
   - Subscriptions also require different billing systems to accommodate recurring billing.
   - Currently, physical products represent 45% of the subscription market value. Consistently delivering subscription-based products requires continually collaborating with partners on order forecasts and inventory levels while automating repetitive tasks.
   - Companies selling via subscriptions have seen their partner ecosystem grow tenfold. Reaching the targeted subscription market relies on marketing automation solutions to help this broader set of partners generate demand and customer engagement.
   - Enabling and motivating partners to sell subscriptions requires new mechanisms to capture partner contribution to subscription sales and retention, new metrics and analytics to measure organization and partner performance, and increased training to help partners understand the latest offers and provide potentially higher levels of customer service and nurture.

2. **Customer Acquisition Costs:** One of the key advantages of subscription models is the predictability of revenue and cash. But making the switch requires a shift in how the company generates and manages cash. The overall CLV of a subscription customer might be higher than that of a customer buying a product or service outright –– but that larger revenue is delivered in small periodic increments. A business needs significantly more customers to make a subscription model work initially while generating the same monthly cash flow. Most companies shifting to subscription models expect to achieve rapid revenue growth, so they need more customers to start and many more customers to achieve their sales objectives. Acquiring new subscribers can be expensive, especially in competitive markets. A large ecosystem of influencer partners can help scale customer reach to grow the number of subscribers.

3. **Constant Innovation Required:** A few years back, subscriptions were still considered a novelty. today, they are commonplace, and that comes with the risk of market saturation and increasing difficulty to find competitive differentiation, acquire new customers, and retain current subscribers. Businesses must continually improve and evolve their products and services to keep customers engaged, which demands ongoing creativity and resources.

   Pricing a subscription can be a differentiating tool as well, but it introduces increased complexity. It is not about offering the lowest price but the most innovative and attractive combinations of tiering, free trials, and shared subscriptions that provide better value overall. Co-sell and co-innovate partners can play a significant role helping vendors develop better, differentiated, and combined solutions –– if partners can also offer their services and products on a subscription basis.

4. **Churn Risk:** Subscribers might cancel their subscriptions if they don't see ongoing value, and high churn rates can impact revenue stability and growth potential. Subscriptions offered and then cancelled as part of a free trial are also significant causes of churn. Other churn triggers are perceived lack of innovation, subscription fatigue, and market saturation. Partners can play a big role in preventing customer churn through influence, nurture, and support. Successfully doing so requires processes, technology, and metrics to measure and drive subscription utilization and customer satisfaction.

Vendors and their channel partners working together to resolve these challenges and risks stand to reap substantial benefits compared to outright sales:

1. **Steady and Predictable Revenue:** Subscriptions provide a consistent income stream, making it easier to plan budgets, invest in growth, and weather economic fluctuations.
2. **Customer Loyalty and Retention:** Subscribers tend to stick around longer due to the ongoing value they receive. This loyalty can lead to a dedicated customer base that provides stable revenue over time.
3. **Upselling and Cross-Selling Opportunities:** Regular interactions with subscribers offer chances to introduce new products, features, or upgrades, driving additional revenue without the need for new customer acquisition.
4. **Higher Company Valuation:** Ensuring a steady revenue stream and customer retention positively impacts financial metrics like CLV and MRR, leading to higher valuation multiples.
5. **Data-Driven Insights:** Subscription models give businesses access to valuable customer data for further use in personalized experiences, and refined marketing strategies for better results. They can also use knowledge of where the products are to implement circular economy initiatives.

Key Take Aways

Subscription models provide a wide range of benefits, but not without challenges. To amplify the benefits and mitigate some of the risks associated with this revenue model through an indirect channel requires a well-defined strategy that aligns partner roles, responsibilities, and incentives. It also requires:

- Extending the engagement lifecycle to involve partners in customer acquisition, onboarding, and support.
- Investing in technology to support partner interactions, manage subscriptions, and monitor performance.

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