

# The Subscription Generation

What are you doing to win over customers after they buy in?

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## Executive Summary

Like the Industrial Revolution before it, the Digital Revolution has, and will continue to reshape our global society. The proliferation of high-tech innovation has elevated buyer expectations in ways that have forced businesses to evolve their strategies. Today's consumers, led by the millennial generation, prefer experience-based subscription services over one-and-done purchases. A commitment to buy is now a commitment to an ongoing relationship, and brands need to be prepared to prove their worth. The point of purchase is now the starting line, and post-purchase profitability depends on how well you can deliver ongoing value, nurture customer loyalty and reduce involuntary subscriber churn.

To thrive in this new customer-obsessed economy requires agility in both monetization strategies and technology infrastructure. Customers want immediate and ongoing value with consistent and frictionless experiences. And they don't care how complex or challenging it is for your business to deliver those experiences, they just know they want it. As long as customers perceive value in the product or service you're delivering, they will continue to invest in your brand.

# Becoming a Subscriptions Business

The shift from one-and-done purchases to recurring subscription-like services is leading to the end of the ownership economy as we know it. Regardless of past successes, brands now have to keep up with rapidly changing consumer demands just to survive. Businesses that can transform a subscription model into a compelling competitive advantage will thrive.

The music industry provides a compelling example of creative monetization in the face of a seismic shift in buyer preferences. Digital downloads have altered the way we access and consume music so significantly that the industry has been forced to work twice as hard to catch up to the changing demands of the public. Today, users can cherry-pick their favorite songs from albums and stream live music that caters to their personal preferences, without having to own stacks upon stacks of CDs or vinyl records. Pandora and Spotify have turned the entire industry on its head by catering to a generation that prefers access over ownership.

While critics argue that these changes have hurt the music industry, it's clear that the consumers have spoken. Easy access and personalization of music will continue to be the main driver in years to come. While the industry points out that artists are being hurt by a loss of royalties typically culled from CD and vinyl sales, advocates counter that new and emerging artists have a much better chance of exposure, and popular bands are incentivized to offer more live shows—an experience-based commodity valued highly by millennials.

As online publication Digital Music News points out, there are new and innovative industries cropping up to fill in the money gap for artists. Sites like Kickstarter, PledgeMusic, Indiegogo and Patreon offer unconventional ways to offer rewards to fan-favorite bands while many other companies look for ways to offer incentives that fans will pay for. And while the big names in music sharing and non-ownership access like Pandora and Spotify might not be the best revenue models to emulate going forward, they have provided a wonderful litmus test for emerging consumer trends. Innovative new ideas will inevitably rise through the gaps in traditional markets, begging the question: Will your business evolve to meet these new opportunities, or become obsolete in the face of them?

Adobe is an excellent example of a successful transition from ownership to access. In 1990, Adobe Photoshop was released to the world as a CD ROM disk that was packaged and available on shelves at big box stores. Starting in 2013, Adobe stopped offering its creative suite as boxed software, instead opting for an entirely subscription-based model.<sup>1</sup> While the move enraged some users who didn't appreciate the potential for increased costs, it has been a highly successful change for the company. In their first year after moving to the cloud, Adobe shares jumped by 81%. The reason for the spike is due to the company's profitability since embracing a recurring revenue model. Bank of America predicts that the number of subscribers to Adobe's Creative Cloud will leap to 12.5 million between 2015 and 2019, with the average monthly selling price to rise from \$35 to \$40 and increased earnings before interest and taxes (EBIT margins) to grow from 55% to 60% during that same period.<sup>2</sup>



The temptation for many organizations transitioning to the cloud is to offer multiple price points to make up for lost revenue, but Adobe's success while offering three to four simple pricing options has proven that consumers prefer simple pricing plans. While there are pros and cons to both perpetual licensing and product-as-a-service, the cloud-based SaaS model that Adobe has adopted benefits everyone. Consumers benefit from a reduction in version compatibility errors and being able to spread out smaller payment amounts over time. IDC analyst Al Hilwa says "Most small shops are likely to find the subscription more palatable than large outlays of funds."<sup>3</sup> While the average order value declines under the SaaS model, the revenue cycle is more predictable and the company becomes more profitable due to reduced customer acquisition costs.

## Most common types of subscriptions

If you're considering a move to a subscription model, you're in good company. Subscriptions and recurring billing models are on the rise and highly successful when done right. But before you adopt a subscription model, you first need to understand which model will appeal to your customer base, work best for your products or services, and align with organization's business goals. Here are three common types of subscription services:



### Replenishment

Need-based consumer goods best sold through passive purchasing.



### Discovery

Experience-driven goods that give consumers the impression that they're receiving a gift.



### Productivity enabling

Access-based convenience services that make consumers more productive in their daily lives.



## Replenishment-based subscriptions

Replenishment-based subscriptions are most often used for those everyday products that people have come to rely on as part of their daily routine. In an increasingly flexible and connected world, the workday rarely comes to a resolute end, and exhausted consumers view activities like shopping for toothpaste or socks as chores. Co-founder of the London Sock Company, Ryan Palmer said bluntly in a recent interview with the Telegraph, "Who wants to go shopping for socks?" His sock subscription program takes a typically dreary purchase and makes it into a fun monthly package that arrives at customers' doors. He says "They [socks] are an add-on... These services make style more accessible with very little effort required."<sup>5</sup> The genius of this particular model is that it has taken a replenishment-based need and packaged and distributed it in a way that is interesting and fun.

One much talked about and highly successful company that has latched on to the replenishment-based model is Dollar Shave Club, a California startup that delivers razors to customer doorsteps at budget prices—a grassroots, simple subscription club that is causing major upset to mainstream, established players. Putting a dollar amount to Dollar Shave Club's success, Unilever purchased the company in July, 2016 for \$1 billion dollars in cash.<sup>6</sup> It's not just small startups who are getting in on the action. Retail giants like Amazon and Target were first in line with services like Amazon Pantry and Target Subscriptions, both of which offer incentives and discounts to consumers willing to sign up for monthly subscriptions. By offering these discounts and incentives, brands are able to secure loyalty initially without the need to compete every time a consumer makes a purchase. It is truly a set-it-and-forget-it model, and an advantage for businesses familiar with ruthless competition.





### Discovery-driven subscriptions

Perhaps best epitomized by the recent craze in subscription boxes, experience-based or 'discovery' subscriptions often come with a surprise gift and are marketed to consumers who buy certain types of goods regularly — from beauty products to pet food—but don't have a specific brand loyalty. Subscribing to a box is like having a personal shopper curate a selection of goods for you, allowing consumers to access what is essentially an experience-driven model. Graze, a subscription snack box allows customers to personalize their preferences but still allows flexibility for surprise and delight as the company curates new, novel munchies into every box. Another hugely popular subscription box is StitchFix, a personal styling fashion box that tailors hand-picked outfits according to taste, budget and lifestyle. Both examples take a potentially difficult and frustrating experience and replace it with a personalized, seamless subscription. The popularity of these boxes is eagerly shared by consumers, with plenty of social media shares and even videos of "unboxing" — a practice that demonstrates the delight recipients experience when opening their boxes.

Hitwise recently suggested that part of the growing popularity of the subscription boxes can be traced to consumer fatigue as "consumers are faced with a seemingly impossible diversity of choice; none more so than the generation that came of age with the Internet and online shopping."<sup>7</sup> Subscriptions offer an excellent antidote to this fatigue by leading consumers to curated products. More and more businesses are getting on board, and while the subscription box sites are still a niche market, it isn't one that looks to be slowing down anytime soon.



### Productivity-enabling subscriptions

These subscriptions offer access to increased productivity based on already familiar tasks—whether it be in your personal life, or at work. A familiar example is Apple's subscription to increased digital storage on iCloud. Consumers who would traditionally need a physical hard drive to back up and store files can now simply subscribe for more space. This simple, barrier free subscription service not only makes users lives measurably more productive; it guarantees an easy recurring revenue stream for Apple. A lot of productivity-enabling products work on tiered subscription platforms, with more expensive tiers offering additional benefits. These tiers are scalable and make incentivizing upgrades to existing subscribers easy. Slack, a team organization tool, is a great example of how productivity-enabling subscription products can be enriching and valuable for business and individuals who find that the small dollar amounts are worth the returns in increased productivity and time management.

Regardless of which category your product or service works best with, subscriptions are fulfilling consumer desires for fun, seamless service in lieu of tedious shopping trips and misspent time. Consumers aren't going to stop snacking, feeding their pets or getting dressed, but the way in which they consume products is changing quickly and businesses need to accommodate these new habits or be left behind.

## Recurring billing models

At a bird's-eye level, there are three basic recurring billing models to consider:



### Prepaid subscriptions

With a prepaid subscription model, there is no long-term commitment. Instead, consumers prepay on a monthly or annual basis, and services end when payments stop. Think Netflix. From antivirus subscriptions to Dollar Shave Club, prepaid subscription models are familiar to most consumers, which can be an advantage for brands who want to minimize barriers to adoption. Another advantage of this model is its simplicity, as it's the easiest to implement.



### Term-based subscriptions

Another subscription payment model to consider is the term-based contract subscription. If you've ever had a contract with a cable or satellite provider, you've partaken in this model as a consumer. In essence, the customer commits to a set term of service (12 months, 2 years, etc.) but is billed on a different cycle such as on a monthly or quarterly basis. One key advantage is the financial predictability this model brings, but in exchange for commitment, brands must often entice consumers with a discount.



### Usage-based billing

The third common subscription-based payment model is usage-based, in which consumers only pay for what they use after they've used it. While appealing to the customer, this model can provide a level of unpredictability for both parties. The "surprise" factor can lead to charge disputes and unpaid bills. As a result, many businesses only leverage usage-based billing for things like overages or special services on top of a regular subscription. For example, a consumer pays a fee in addition to their monthly cable bill for on-demand movies.



## Important considerations for shifting to a subscriptions model

Understanding how your service or product will best translate into a recurring revenue model is the first step in making that crucial transition. Millennials, the market's most fluent digital natives are leading the way and supporting companies with innovative ideas on how products can be bought and consumed. Businesses should take note as data shows that where millennials go, the rest of the consumer market is likely to follow. Subscriptions and other types of recurring transactions are expected to overtake one-off purchasing.

Autodesk is an example of a business that has made a successful shift to keep their business growing strong into the future. With their new subscription model, Autodesk has successfully linked their traditional products—desktop applications—with cloud-based support elements and updates leveraged within a subscription pricing model. Working from the cloud allows Autodesk to respond more nimbly to consumer demands while offering better platforms from which to respond to pervasive and difficult engineering obstacles. Updates too—a historically difficult challenge for software companies—are better solved within Autodesk's new subscription model. Where customers had to wait months or even years for updates in the old model, any software issues are resolved much faster in the new model. "Some of our products, we update every two weeks. It takes the complexity of [big upgrades] away from the user and they always have the latest updates," said Scott Reese, Vice President, Cloud Products at Autodesk.<sup>8</sup> The Autodesk example proves it's not about reinventing the wheel. Rather, subscription services can be excellent drivers of business evolution that deliver top performance and leaves customers happier than before.

Savvy business leaders are paying close attention to subscription commerce, and learning how to turn this business model into a compelling competitive advantage. Understanding the psychology and motivations of this trend will help to create a seamless transition. Remember the following important points to make a subscription strategy work for you.

### 1. Subscriptions are more than a payments strategy; they are a relationship strategy.

Forward-thinking business leaders are shifting their attention away from customer acquisition to focus more on customer retention. The longer a customer is willing to pay for your services, the greater their lifetime value, and the greater your profits. To keep customers happy and subscribed, you have to find the right balance of price and value. You'll thrive as long as you can deliver ongoing value and nurture the relationship between your customers and your brand over time.

### 2. Consider how your product can support a service or become a service and vice versa.

Adaptability is crucial as subscriptions tear down the walls between products and services. Innovative companies are creating subscription-based, experience-driven service models for everything from televisions to razor blades.

### 3. Pay attention to the psychology of subscriptions.

Subscriptions are supposed to make life easier—not complicate it. To be successful, the subscription needs to offer ongoing value to the end user, with consistent and enjoyable experiences. Additionally, access to the product or service needs to be seamless, with simplicity in packaging and delivery.

### 4. Be ready to fine tune your macro infrastructure as recurring transactions dominate the marketplace.

The implications of making the switch from one-time payments to recurring billing cycles is not to be underestimated. New technology, business processes and revenue management practices are needed to support such a shift.

### 5. Reduce involuntary churn to optimize profitability.

It may feel natural to focus on voluntary churn—when customers actively choose to opt out—since it's easier to influence those interactions with subscribers. But the greatest opportunity to influence long-term revenue growth lies within your ability to properly manage involuntary churn—when renewals fail due to reasons beyond the customer's choosing. According to a study conducted by Forrester Consulting, 34% of all subscriber churn is involuntary. That number can even reach 50% or more for high-tech software companies with a high percentage of auto renewals.<sup>9</sup> That's a significant amount of leaky profits. While most retention managers recognize that involuntary churn is a problem, few have the ability to properly manage it on their own. What makes it so difficult to manage is the variety of complexity and nuance involved with payment failures. It's not easy work, but increasing your retention rate by only 5% can lift profits by 25-95%.<sup>10</sup> Reducing involuntary churn requires focus, innovative billing technologies and extensive local acquirer partnerships—a mix that is often best achieved with a strategic, full-service partnership.



# Finding the Right Partner for Going Global

When seeking a partner to power your global subscriptions business, there are a number of complexities to keep in mind beyond merely selecting a platform. Finding and implementing new technology is an important start, but technology is just the beginning when it comes to the business of running an effective global subscriptions operation. To optimize customer experience and maximize revenue, you need the right processes and expertise to effectively manage every aspect of doing business worldwide. Any vulnerability in your back-end processes can expose your business to a multitude of liabilities and risk.

Depending on the systems you have in place, an integrated, full-service cloud solution with the right experience and infrastructure may be the answer to delivering the best return on your investment. In a marketplace inundated with subscription platforms, few provide everything you need, backed by a team of experts accountable for your success. Without full-service offerings, you're left filling in vital gaps and piecing your processes together through a hefty investment in internal resources or by managing multiple vendor relationships. It is vital to minimize your risk, create a seamless customer experience and find a solution that can scale with your business. The considerations can feel endless when looking for the right solution for your business, but knowing what to look for and who to trust will help you make an informed decision.

## Business processes to look for that are not offered by most subscription vendors:



### Global reach

When planning for global expansion, aggressive go-to-market timelines are nearly impossible to meet without a proactive ecommerce partner that already has the right processes in place. A full-service partner offers an established ecosystem of experts and local entities that you can plug into for greater speed and agility. Most companies who work globally don't have boots on the ground. Look for a partner with real people and experience in the countries you do business.



### Localization capabilities

Consumers expect a shopping experience in their own language, with their preferred payment methods. If you are unable to offer the right mix of local payment options, language and currency, your global business will be a bust. A full-service commerce partner should be able to optimize your global conversions by delivering a localized shopping experience wherever the customer calls home.



### Commerce platform and experience

In the age of the consumer, brands around the world are seeking the best solution to create a seamless experience across their entire customer lifecycle. Your online storefront, or the "glass" that consumers see when purchasing your product online, is important. You'll need to ensure that your presentation is localized and culturally relevant in all the countries you do business.



### Taxes, fraud and compliance

Data breaches, compliance failures, tax penalties—these are the types of threats that induce stress and rob business executives of valuable sleep. A full-service partner will not only safeguard your business—and your customers—from fraud; it will remove the complexities of international taxes, and untangle global compliance and regulations.



Understand that when you provide subscription services outside of your home market you will be dealing with an incredibly broad set of variables. From communications to taxes, each market will have a unique set of demands. Billing terms, opt-in rules, display currencies, payment methods and international tax structures all need to be carefully considered. If you are contemplating managing these capabilities in house, it's important not to underestimate the internal resources required. While in-house operations may offer greater control and flexibility, leveraging the already-established expertise and resources of a global partner can provide much greater return on investment.

Take a moment to consider some of the following necessities for going global:

- **Flexible billing.** Make sure you can offer a variety of billing options to meet your specific business and cultural needs.
- **Localized payment offerings.** Convert more global sales by offering the right payment mix of local currencies, languages and payment methods.
- **Personalized shopping experience.** Engage customers with a fully-customized storefront capable of supporting multiple languages and a variety of merchandising capabilities.
- **Custom communications.** Enhance the customer service experience with self-service capabilities, localized messaging and customizable emails.
- **Seamless integration.** Integrate your customer account systems, back-office applications and entitlement systems using service-based application programming interfaces (APIs).
- **Robust reporting tools.** Make the most of your data. You'll want to utilize extensive reporting dashboards to forecast renewals, track performance metrics and manage your customers.
- **Maximize renewal rates.** Support customer reorders and renewals with a wide range of communication and technology tools, designed to maximize your revenue potential.

Considering all of the vital areas of commerce that have to be executed with precision and the risks involved, it's no wonder that business leaders with big budgets and a do-it-yourself attitude are seeking partnership. Outsourcing critical areas of global ecommerce operations has proven to deliver a tremendous return on investment. A world-class global ecommerce partner will give your business greater agility, accelerate your expansion into new markets, provide best-of-breed technology, optimize conversions, lift customer retention rates, and protect your business from global risks.



# Subscribe to Tomorrow

Experts are confident that the future is trending toward subscriptions and passive purchasing with a greater emphasis on service and experience. As millennials continue to invoke industry change, businesses will either sink or swim when adapting to their preferences. In this market renaissance atmosphere, businesses have the opportunity to reinvent their existing offerings into products and services that have relevance with today's experience-driven consumers. These evolutions will not only transform the face of consumerism, but will also create entirely new markets that can thrive in the midst of the major changes that the Digital Revolution has brought. Now is the time to reshape your business so that it delivers meaningful experiences and value-added services that lock in loyalty for years to come.

If you're curious about how you can turn your product into a money-making subscription model and monetize lasting relationships with your customers worldwide, contact Digital River today. We have a team of customer-centric monetization experts who are fluent in powering profitable, tech-centric subscription businesses on a global scale.

**We're all-in, fully committed to each facet of your ecommerce business.**

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