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Anatomy of a Successful Subscription Business

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A successful subscription business is like an iceberg – the portion visible above water seems modest in size and simple but belies the size and complexity of what lies underneath.

Subscription Business Models (SBMs) hold a lot of promise. Customers find the concept digestible. Investors love the predictable revenue streams and companies see SBMs as a way to gain agility in business. For start-ups, an offering priced as a subscription serves as a proven method of customer acquisition. New companies often build their brand equity using the subscription model customer interaction as part of their whole product experience. Established companies look to subscriptions as means of reaching into new markets and serving new classes of customers. But what defines success of a subscription business? What are the key elements that define the characteristics of a successful subscription revenue business?

While there is not to-date a single universally accepted business benchmark that measures success of a subscription business, it is often expressed in terms of metrics such as:

- **Monthly Number of Subscribers** – number of net subscribers at the end of each month or an average over a period of time
- **Monthly Recurring Revenue (MRR)** – monthly revenue billed under subscription contracts
- **Retention** - percent of customers that renew at the end of a contract term

Successful subscription revenue businesses tend to have Retention rates above 80%, i.e. vast majority of their customers renew the subscription at the end of a contract term. The best ones have retention rates above 90%.

In addition to low churn, leaders in this space like Netflix also tend to have predictable business models with steady revenue and subscriber growth (10-15-20%), low customer acquisition cost, contract terms that are at least 1 year in length and strong margins.

These are the key business metrics that tend to be exposed to investors, business press and the general public. In some ways, a successful subscription business is a like an iceberg where the portion visible above water seems very simple and belies the size and complexity of what lies underneath. Below the waterline, there is a complex ecosystem of processes, tools, skill sets and more metrics, best practices and strategic planning.

MGI Research – an independent tech industry analyst firm defines ten key pillars that underpin a successful subscription business:

1. **PRICING:** Easy to Understand Subscription Pricing. Whether the offering is marketed online, via channel partners and/or via a direct sales force, success in subscription

The Ten Pillars of a Successful Subscription Business



MGI Source: MGI Research, LLC

business is often predicated on the clear and explicit nature of the economic proposition. What is the cost per month, per quarter or per year? What is the cost per unit of measurement – user seats, transactions, units of usage or revenue? Are there different plans that cover a spectrum of usage patterns? Are there discounts for pre-payment? A successful pricing definition tends to address the needs of over 60% of potential buyers. The fine print that defines more complex clauses like usage tiers, etc. needs to be unambiguous and not open to interpretation. The objective is not to confuse the customer in order to charge more at some future point in time. The goal is to have a customer that is assured about a relatively predictable nature of cost – something that helps insure renewal. *A jump in revenue at the expense of increased customer churn lowers the value of the business.*

2. **FRICTIONLESS SELF-SERVICE:** Whether the new subscription offering is aimed at the B2C or the B2B market, physical, digital or hybrid mix of goods and services, the expectation of a modern subscriber is ability to self-service changes in their plan, update payment methods, add features and services or cancel the service. The frictionless nature of this interaction must support the Whole Product Concept where the interaction to manage the service and/or the economic relationship between the subscriber and provider does not require training or telephone support. For companies rolling out services beyond their home countries, international aspects of supporting various localized payment methods, data privacy compliance, local language support – these are all key components of creating success with subscriptions globally.

3. **ENGAGE:** The valuation multiple for a subscription business is directly proportional to its rate of renewal or retention. Retention is a function of how often customers use a service, how engaged they are, and how broadly do they use different elements of the service. To drive engagement, companies need to develop a sophisticated and nuanced strategy that selectively uses direct communication, social media, public relations, events and other opportunities to stimulate usage and engagement. In different industries and geographies successful approaches will vary. A company that tends to be too hands off with its subscriber base may risk losing the attention of customers and thus put the renewal in peril as clients begin to forget what the value of the service really is. On the other hand, companies that “carpet bomb” their installed base with messaging risk overexposure – customers may feel fatigued and will just tune out. *The best companies integrate their subscription revenue engagement plan with an overall marketing framework and focus on strategies for retention; upsell and cross sell as well on communication of value to customers and continuously measuring the effectiveness of communication.* One should not assume that the marketing techniques from non-subscription businesses will be sufficient to insure a high rate of renewal.
4. **METRICS:** Successful subscription businesses tend to have a near religious and singular focus on core subscription metrics. They insist on clear-cut definitions, measurement methods, reporting and analytics as well as acceptable benchmarks of success, alert and failure. Some of the key metrics include retention rate, growth in revenue and in subscriber base, cost of customer acquisition, customer lifetime value, improvement in average term

duration and transaction value, share of pre-paid vs. post-paid subscriptions, as well as positive change in customer tenure.

Companies that are best in class in subscription oriented businesses tend to educate everyone on the team, regardless of seniority as to what the core metrics of success are and what are the levers that need to be applied to achieve results. That also comes with a lot of internal transparency, engenders trust and motivates the staff.

5. **TOOLS:** Mention a subscription business at a cocktail party and inevitably someone will offer an opinion on their own experience with a subscription billing tool. In recent years, the software products that generate recurring bills have become near synonymous with subscription businesses. Yet, the tools to manage subscription revenue and recurring billing are only a part of what is needed for success in this area. There is almost no one today who genuinely believes that a subscription business can be effectively managed from an Excel spreadsheet. Processing a few dozen recurring revenue invoices may be simple – if they never change. Once customers want to add services, change terms, cancel or add seats while co-terminating to the same date – just to do that alone, things can become relatively complex. *Best in class companies typically combine several tools to create a platform to manage billing, revenue recognition, feeds to general ledger as well as from CPQ, sales and customer service among others.*
6. **PEOPLE:** An informed multi-disciplinary team that includes professionals with backgrounds in technology, accounting, marketing, product management and customer service is a key to a successful launch and operation of a subscription revenue business. As mentioned earlier, a common understanding of key metrics, risk factors, compliance issues, technology options and financial impact is paramount to success of a new subscription business.
7. **PROCESS:** A well-functioning subscription business is in some ways like a well-managed restaurant: It has the right ingredients (food and tools), people (chefs, waiters, bartenders and front desk staff) and process (recipes) as well as pricing, marketing, PR and promotion, upsell and cross-sell, frictionless service and efficient payment management along with product sourcing and food safety. Just like a good subscription business, smart restaurant owners know how to engage their customers (waiters chat up the patrons, then the chef comes out to say hello) and insure renewal (returning diners who value recognition). In best restaurants, the experience seems organic and effortless, but in reality, almost akin to a film script, it is well planned, rehearsed and perfected. What separates the good dining establishments from great, super successful food empires is how they use process management to scale from one location to dozens and maintain a predictable level of high quality and repeat visits. Leaders in subscription businesses such as for example Amazon Prime, excel at process definition and monitoring. They tend to operate with equal finesse whether servicing 10 or 10 million subscribers. The process and workflow definitions are precise and these companies tend to utilize automated workflow management tools to insure consistent, predictable experience.
8. **DATA:** If the Process component is the central nervous system for a subscription business, Data is its blood. A system that lacks necessary data or operates with dirty

information faces existential risks. Since most subscription businesses operate on a fairly large scale, an “infection” in the data bloodline can be catastrophic. Best in class organizations focus on an active, persistent data cleansing capability, on master data management and on robust tools for data extraction, mediation, loading, analytics and reporting. This connects closely to the Metrics element, to Process and the Tools.

9. **SECURITY:** One of the first challenges that a go-live subscription business will face is security and privacy. Frequently, subscription businesses are developed through corporate skunkworks and escape the rigorous corporate security standards. This creates an obvious vulnerability compounded by the fact that in order to support credit card payments, subscription businesses need compliance with PCI and other security standards. *Compliance with data privacy mandates in numerous jurisdictions adds another layer of complexity. In practice, successful subscription businesses integrate security and privacy compliance into their strategy and process from the very beginning – not as an afterthought.* These companies tend to include security professionals in their overall planning and monitoring effort and invest into tools that combat credit card fraud.

10. **STRATEGY:** An overall business strategy and an operating business plan that lays out objectives, metrics of success, financial and operating targets. This is one of the most important and unifying elements of preparing to launch a successful subscription business. Even for an established company, this should be developed like a real business plan and outline the target market, the offering, its differentiation, competition, pricing, terms and

conditions as well as strategies to keep customers engaged, how to retain and upsell subscribers, how to communicate value in a persistent fashion and how to spot warning signs of potential churn. Companies that succeed with subscription businesses tend to take this part very seriously and focus on educating their teams about industry trends, tools, revenue recognition impact, best practices, metrics and vocabulary of subscriptions. Those that fail or produce mediocre results, tend to start out by believing that subscriptions are simple, that they already know most of what is needed and race on to buy a tool for subscription revenue billing. Those that succeed also tend to create multi-disciplinary subscription business teams early in the launch process.

Bottom Line

A subscription business can resemble an iceberg – there is a lot hidden below the waterline. Businesses that succeed with subscription revenue models tend to take a holistic approach defined by ten key elements:

- PRICING
- FRICTIONLESS SELF-SERVICE
- ENGAGEMENT
- METRICS
- PEOPLE
- TOOLS
- PROCESS
- DATA
- SECURITY
- STRATEGY

About Us

Navint Partners is a different kind of management consulting firm, blending unique industry experience and innovative thinking to address clients' business challenges in imaginative ways. Navint is the right partner

for organizations facing a journey to efficient and scalable recurring revenue streams. We help our clients with all aspects of the Subscription Business Model journey, from strategy development and rationalization to realization of the strategy through effective team, process, and technology design.

To learn more about Navint's Subscription service offerings, please visit us at <http://www.navint.com/subscriptionservices> or contact jwissink@navint.com or tflanagan@navint.com.