IS SUBSCRIPTION THE END OF OWNERSHIP?

Several industries have disruptively transformed by offering subscriptions. For the subscription-based companies succeeding, the results are higher growth rates through new recurring revenue streams and increased value provided to the customers. In some industries, larger companies have not been able to manage the transformation fast enough and new entrants have taken market leading positions, outcompeting the late movers. **Is subscription the end of ownership?**

Many industrial companies still have potential to become successful subscription-based companies. However, companies struggle to shift from unit sales to recurring revenue focus. Together with partners, Triathlon Group has gained insights of subscription models and identified key areas going forward in order to take the leap.

Subscription is a dynamic recurring revenue model where a customer periodically pays for recurring access to products and services. With this mode, the customer can pay a monthly fee for access to the offering, regardless if using it or not, or pay per use or outcome. Sometimes subscription offerings are named "X As A Service" or "On-demand".

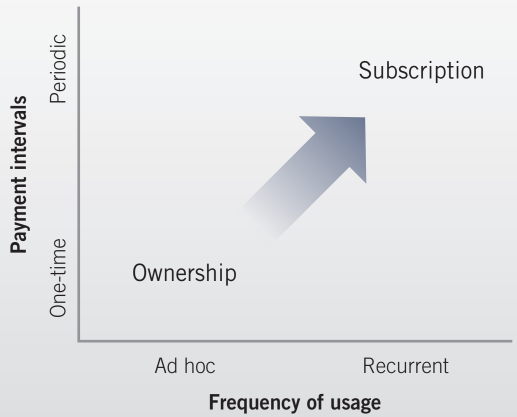
The traditional ownership model often constitutes a one-time charge for unlimited use of the product or service. The subscription model differs from the ownership model, since no ownership is transferred to the customer at acquisition. The supplier keeps owning and maintaining the product or service throughout the whole lifetime. The content in a traditional offering is often more limited. However, in a subscription offering the customer expect bundled packages and that the supplier takes care of installments, upgrades, maintenance and support without adding additional charges to the customers throughout the subscription period.

Another distinguishing dimension is whether or not the customer can use the product or service after payments stop. In the ownership model, the customer can use the product or services throughout the whole lifetime but if a subscription is cancelled, the customer does not have the privilege to access it anymore. **In relation to traditional leasing**, the subscriber is not tied up to just one product, often the customer can swap between different products and subscribes on a monthly basis rather than yearly.

Key customer benefits with subscription offerings are the promise from the supplier to the customer of a reliable source of value accessed each month, without the need to remember to reorder or take into consideration potential changes in volumes since that is taken care of by the supplier. The possibility to easily cancel the subscription and no additional costs, from e.g. breakdowns, **decreases the purchase and financial risk** for the customer. This also opens up for new decision makers with lower dedicated budgets and decreases the barrier to test and experience the offering. Furthermore, the **convenience** of no need to maintain or storage products, which are often correlated to additional charges, are key customer benefits.

THE SUBSCRIPTION VS OWNERSHIP CHART

The Subscription vs Ownership model chart illustrates two key dimensions in terms of payment intervals and frequency of use.



SHARING IS CARING

Subscription applicability

Subscriptions can facilitate different types of offerings such as circular and sharing. These offerings can stand alone or be combined.

Circular subscription offerings are applicable when supplying sustainable products comprehending "borrowed" components that can be reused in the value chain (e.g. when manufacturing of new products) or the offer itself can have residual output that can be seen as value instead of waste for other applications or customers.

An example is second life for batteries when the batteries are worn out for their main purpose due to the decrease of capacity levels but still have enough capacity to fulfill other purposes.

Sharing subscription offerings are applicable when supplying robust products with long lifetime but low utilization level per user.

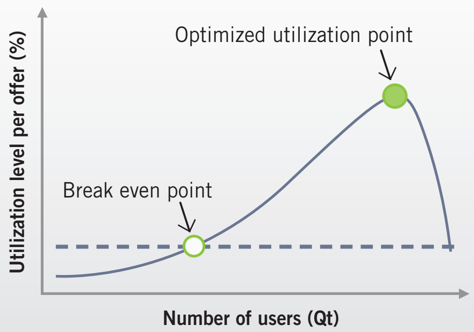
Examples are planes, cars, boats, bikes and electric scooters. The utilization level of these products for traditional usage can be low per user and before you use the product you may need to park, install, clean, maintain, fuel/charge it. With a full covered subscription offering including transportation services, subscription-based companies have changed the way people transport.

The Utilization Level chart illustrates the utilization level per offer in relation to number of users. The usage factor with traditional ownership is fixed meanwhile it increases if users share offer.

The supplier needs to balance the amount of offerings available in relation to the number of users in order to get close to the optimized utilization point per offer.

The supplier needs more users than the **break even point** to accelerate revenue growth but not go beyond the **optimized utilization point** since then there is too many users per offer available resulting in dissatisfaction and in some cases also penalties for the supplier.

UTILIZATION LEVEL CHART



NEWSLETTER

Q3 2019

WILL YOU TAKE THE LEAP?

The majority of the top 10 most valuable companies (e.g. Amazon) worldwide offer subscriptions today and have quickly outcompeted several previously listed industrial companies during the last 10 years.

9x faster growth of subscription companies than average*

*S&P 500 index

One company that throughout the 10 last years remained to keep top 10 position is Microsoft, which managed to convert from the traditional license pricing model to subscriptions. Today, the software industry is in the forefront of the subscription transformation and in 2020 Gartner anticipates that 80% of software companies will have transformed to subscriptions.

Why are subscription companies successful?
There are key common denominators between the successful subscription companies identified.

75-85% Constitutes customer retained of total revenue for most large companies

1 Shift to Customer Lifetime Value

Unlike product companies, which are focusing on getting the product to the market and drive unit sales, successful subscription-based companies know every customer in detail and likewise their customers are more informed about the supplier since most of purchasers research and assess potential suppliers before taking a purchase decision.

6-7x more effort to acquire a new customer than retain an existing one

The successful subscription-based companies focus on both customer engagement and retention, measured through Customer Lifetime Value. **The Customer Lifetime Value (CLV)** is defined as the profit expected from a customer over the entire life of the customer relationship.

75% of Amazon's purchases are derived from retention...

2.5x ...purchase these customers each time

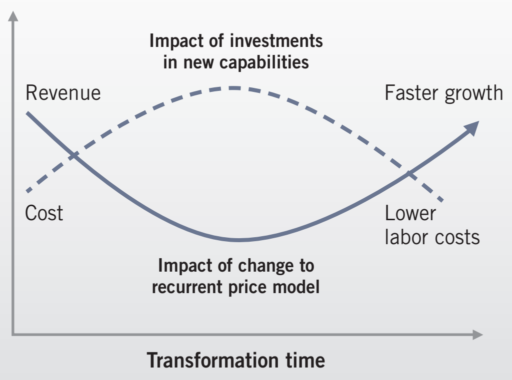
Amazon

So how to make the shift? The subscription-based companies succeeding have not built up just another silo isolated customer support department far down the value chain, these companies have changed their strategy, organization, and operations to be driven by smart analytics. **The more you get to know about your customers, the better you can serve their needs, providing more value throughout the customer lifetime.**

2 Catch the fish

The Fish Model illustrates the changes in revenues and costs during the transformation period. In the beginning revenue shifts down due to the impact of changing to a recurring price model and in parallel the costs increase due to the need of investments in new capabilities.

THE FISH MODEL



Source: Tien Tzuo, founder of Zuora

The Fish Model might look a bit terrifying during the transition period, when costs exceed revenues, for the board and management team, especially the CFO, but getting a strategic commitment across the functions is essential to make the subscription transformation.

In the subscription model, finance is the new business developer. Successful subscription-based companies have rapidly been able to scrap the traditional income statement and instead measure and predict Annual Recurring Revenue (ARR), the amount of revenue you expect your subscribers to pay every year, and review costs such as COGS, R&D etc. as recurring.

3 Let customers leave but make them not want to

Monthly payment of a subscription decreases the barrier to switch to another subscription. The successful subscription companies don't lock in their customers with large infrastructures, nor "hide the cancellation button". These companies measure and focus on decreasing the churn rate and abandonment rate by dynamically and continuously developing the offerings instead.

Nordic office (HQ)
Klippan 3B
414 51 Göteborg
Sweden
+46 31 704 12 90

West Europe office
95 Cours Lafayette
69006 Lyon
France
+33 472693843

East Europe office
Volokolamskoye sh., 1, bldg. 1
125080 Moscow
Russia
+4 915 066 66 61

North America office
850 New Burton Road,
Suite 201
Dover, Kent County,
Delaware 19904,
USA
+1 8004831140

Asia office
Metlife Kabutocho Bldg. 3F
5-1 Kabutocho Chuo-ku
Nihonbashi
103-0026 Tokyo
Japan
+81 3 5847 7936

Triathlon Group

Triathlon Group is a professional service firm and a leading actor in Performance Improvement. We serve large, multinational, Nordic clients internationally. We engage in client assignments to deliver lasting improvements in organizations, based on our areas of specific expertise.

By combining innovation and best practice, we develop substantial value to our clients through long-term relationship and genuine understanding of business needs in the industries we operate within. Triathlon's core business is our clients' 'out of the ordinary' operational management issues.

Strategy
Developing strategies and governance to reach objectives

Operations
Improving operations by combining innovation and best practice

Finance
Setting up business structure and control to support strategy and operations

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