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Impact of Subscription Revenue Model on 21st Century Businesses

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Abstract

Subscription model is a revenue model where customers have to pay some amount of fee for services and products provided by companies before they can use it. This payment can be done daily, weekly, monthly, quarterly or yearly. The development cycle for a sustainable subscription model begins with acquiring customers, deliver consistent, high-quality service, look for opportunities to upsell or cross-sell, work to retain users and reduce churn and rinse and repeat. The types of subscription include subscription boxes / curation, repeat purchases / replenishment and access models. The benefits of subscription model to business owners are recurring revenue, financial forecasting, better inventory management, good relationship with customers, and faster feedback loop. Also, the benefits of subscription model to customers are convenience, personalized experience, assists in budgeting, and discoverability of new and unique products. Business that can use subscription model are those providing services and products such as access to content like video, music, books, membership sites, access to services such as software, utilities, insurance, leasing and access to products: personal care, food, pet care. The challenges of a subscription model include Subscription fatigue, difficulty in acquiring customers, credit card expiration. These challenges can be reduced by regular upgrade of products and services, provision of freemium to new or target customers and provision or recharge or renewal services to customers with expired credit cards.

Keywords: Subscription model, Repeat purchases, Recurring revenue, Leasing, Upsell, Cross sell, Freemium

INTRODUCTION

A revenue model is a framework for generating financial income. It identifies which revenue source to pursue, what value to offer, how to price the value, and who pays for the value. It is a key component of a company's business model. It primarily identifies what

product or service will be created in order to generate revenues and the ways in which the product or service will be sold. The revenue model helps businesses determine their revenue generation strategies such as: which revenue source to prioritize, understanding target customers, and how to price their products. Revenue models help business owners determine how to manage their revenue streams and are required to complete a business model. Without a clear and well-defined revenue model, with a clear plan of how to generate revenues, many new businesses will not be able to sustain the running costs. By having a clear revenue model, a business can focus on a target audience, fund development plans for a product or service, establish marketing plans, begin a line of credit and raise capital (Campbell, 2019). With a revenue model, one can set, track, and forecast business growth based on specific customer segments.

A revenue stream is an amount of money that a business gets from a particular source. A revenue model describes how a business generates revenue streams from its products and services. When choosing a model, factoring in costs is paramount to ensure profitability (Campbell, 2020). A good revenue model is not just about squeezing as much revenue possible out of a sales cycle; it is also about balancing the ambitions in the market with the resourcing requirements. A startup revenue model may be significantly different than one for an established business because their resources are vastly different. In the past 10 to 15 years, there have been a fast explosion of software businesses with the internet stimulating a number of viable revenue models. Choosing which revenue model works best for a business is paramount, the choice will help determine the sales strategy, and from there the growth rates, the amount of money one will need to invest initially. The cost of investing in a revenue model may include the cost of goods, that is how much it will cost to produce the goods or services that a company will sell. The cost of hardware will include the cost of testing and manufacturing; the software cost will include the whole software development cycle. Regardless of what is produced, administrative overheads will also apply. The cost of goods might be considerably less comprehensive metric than cost of revenue, which is the total cost of manufacturing and delivering a product or service to consumers. Similarly, investors must consider the kind of relationship that is likely to build with the customers. These choices greatly determine the future of proposed business.

Unfortunately, most business application developers or business owners do not put much interest in considering the type of revenue models to adopt in their business application development life cycle, some developers seem to adopt any kind of revenue model at the point implementation and deployment, they do not consider their target population, the market competition, and their primary ambition (Fox, 2020). It is against this backdrop that this work is done to review the subscription revenue model, one of the most popularly revenue model used with most business applications, to identify its merits, demerits and the limitations, its designs and the businesses that adopt it.

Concept Subscription Revenue Model

The subscription revenue model generates revenue by charging customers a recurring fee that is processed at regular intervals. Businesses charge a customer every month or year for use of a product or service. Subscription revenue is built on establishing long-term relationships with

customers who will pay regularly for access to the product or service, also called recurring revenue. Subscription revenue is a powerful revenues model in the sense that with it, revenue accumulates with each new subscriber. With each new subscriber a company acquires, revenue grows exponentially. The subscription model is perhaps the most popular among companies because of its versatility, promise of recurring revenue, and high value: customer lifetime balance. Customers become more valuable the longer they use their product or service. Companies that focus on keeping their customers will save on acquisition costs, since retention is cheaper than acquisition (Campbell, 2019).

The subscription revenue model has been a staple of industries—publications, utilities, and, more recently, software—since it first emerged in the 17th century (Campbell, 2019). In the past few years, subscriptions have seen a bit of a resurgence, there hardly an industry that has not gotten at least one subscription success, such companies as cars, groceries, airlines, fashion, electronics, software and houseplant. All revenue is deferred and then fulfilled in installments. Customers who use subscription model make regular payments to receive products or services at recurring intervals.

Subscription revenue model is different from regular revenues because of its two main features, namely; *recurring payments and customer retention*.

For a recurring payments, subscription payments happen on a scheduled basis, most often daily, weekly, monthly, quarterly, or yearly. Compared with one-off purchases, each recurring payment is smaller, this makes subscriptions affordable for all categories of consumers, and this implies that companies need to keep customers around longer to capture more revenue. While many subscription companies offer subscribers the flexibility of month-to-month subscriptions, others sell their services on a contractual basis. For example, the mobile data plan is a great example of this, end-users might pay on a monthly basis, but might be locked into an annual (or longer) contract with the subscription provider. As month-to-month subscriptions are better understood and customers demand more flexibility, though, the contract model is becoming less popular.

For customer retention, subscription companies rely on recurring revenue, they need to ensure customers are happy and are continuously getting value from the product or service over the long term. Companies often have to keep customers for months or even years before they finally see a positive return on their investment to acquire each new customer. Unlike the traditional businesses who don't need to retain customers for long stretches of time—the majority of buyers come in, buy a product maybe once or twice, then move on. Just as it is easy for customers to sign up for subscriptions, it is also very easy for them to cancel the subscription. This means subscription businesses must stay focused on retention. The key to building sustainable subscription revenue is to keep churn low and hold on to customers for as long as possible (Campbell, 2019).

Types of Subscription Model

According to Leary (2019), the three main types of subscription model are:

- (i) Subscription boxes / curation – This is the most popular subscription model, subscribers receive a selection of unique and interesting items on a regular basis, usually tailored to their personal tastes. Often, they don't know exactly what will arrive in their subscription box, which adds an element of surprise to increase appeal. Examples of subscription box services include Birchbox, graze and Barkbox.
- (ii) Repeat purchases / replenishment – here, consumers can automate the purchase of commodity items, thereby saving them time and money. Examples include Dollar Shave Club and Pink Parcel. Replenishment models are the [second most popular](#) type of subscription service.
- (iii) Access models – Here, customers or subscribers who pay regularly receive discounts or what is called member-only perks.

The subscription revenue model benefits both customers and companies. Customers enjoy the convenience of auto-renewals and having access to a high-value offer for a low ongoing investment. Meanwhile, companies offering subscriptions can scale with confidence, with predictable revenue and deeper relationships with their customer base. It's no wonder more and more companies are shifting to a subscription business model. And considering that the average old customer spends more than a new customer because of the fact that an old customer will want to subscribe to product or service with high value (Chen, Fenyo, Yang, and Zhang, 2018).

Benefits of Subscription Model for Business Owners

Recently, there is a meteoric rise of the subscription based business model. Subscriptions present a whole host of benefits for business and for customers, making them an attractive proposition in the modern ecommerce market. Some of these benefits according to Leary (2019), include:

- (i) Increased return on customer acquisition costs

The profit margin of a company is increased when a subscriber stays longer and loyal to the company products brand. The higher the retention rates and the greater their customer lifetime value (CLTV), the greater the profit margins. For subscription services, the customers' repeat business is implied at the time of purchase. Provided the companies make their subscribers happy, this type of model ensures a consistent source of recurring revenue from repeat customers

- (ii) Lower retention spend

Another benefit of having the customers automatically 'buying' from a company on a regular basis is that there's less need to target them with extensive remarketing. Subscribers who

are committed to regular payments are less likely to churn, which means you don't have to eat away at the budget with retention marketing.

(iii) Better financial forecasting

A huge benefit of a subscription-based business model is that a company can accurately and reliably predict her business' revenue stream. The company should be able to go into each month with a clear idea of how much profit the company should expect, unlike regular ecommerce retailers face huge monthly and seasonal fluctuations. Though customers may decide to cancel a subscription without warning, financial forecasting is much easier with a subscription model.

(iv) Better inventory management

A subscription retailer knows how many subscribers he/she has and how much stock her company needs. As a result, the company can anticipate demand and supply with confidence, this helps to make the business processes much more consistent. Merchants can manage and plan for a suitable level of inventory well ahead of time. The subscription retailer can place orders with suppliers and delivery services in advance, possibly even obtaining a discount or early bird' rates. This is not the case with the traditional e-commerce business model.

(v) Opportunities for better relationships with customers

Subscription ecommerce opens up opportunities to engage with customers on a regular basis across a range of channels. This is a valuable opportunity for merchants to build rich conversational relationships with customers. Subscription retailers can use the comprehensive understanding they have of their customers' preferences and usage behaviours to serve personalized content. Merchants can tailor messaging, recommendations and ads to each individual subscriber, providing a personal, memorable experience that fosters loyalty and engagement. Building a strong relationship with customers makes it easier to promote upsell and cross-sell offers. The bond of trust that's developed over the course of the subscription means that subscribers are often more receptive to any additional and complementary services that you promote to them.

(vi) Faster feedback loop

With a constant flow of regular orders, subscription retailers can continuously gather feedback from customers. The companies will become aware of any issues more quickly, enabling them to tackle problems as they arise. The best subscription businesses will learn from the feedback they receive from customers and use it to provide even better products. This business relationship will encourage the existing customers to stay loyal and be retained, it will also improve the company's reputation and attract new subscribers.

(vii) Amplified brand awareness

For subscribers, receiving their regular product or service is something they look forward to every month. There's often a build-up of anticipation before receiving subscription packages,

particularly if it's a curated box with surprise items. The subscription becomes something they want to shout about to their friends and family. With regular subscription packages, recommendations are fast and frequent – great news for raising the company's profile. Often, people will also share pictures of the contents of their subscription box on social media, spreading the word about the company's brand to their followers and beyond. Indeed, unboxing videos have taken YouTube and Instagram by storm in recent years. This is a great way to raise awareness of company's brand and build the subscription base without the skyhigh acquisition costs!

Benefits of subscriptions model for customers

According to Chen et al (2018), the benefits of subscription model for customers are as follows:

(i) Convenience

With the subscription model, customers can order and receive for any product or service at anytime and anywhere without any delay. Sometimes even the cost of products and services are at customers leverage.

(ii) Personalized experience

Increasingly, shoppers are demanding personalized ecommerce experiences tailored to their individual needs. Subscription ecommerce can help satiate this compelling desire that consumers have for personalization, where customers can order for specific product or service tailored to meet their specific needs. In particular, curation-based subscriptions enable merchants to deliver an intricately tailored customer experience. When a customer receives their monthly box of goodies that has been curated with their personal tastes and needs in mind, they feel understood, valued and connected. These benefits to the customer translate into significant commercial benefits for a business. It increases customer's engagement, loyalty and overall customer satisfaction, which drives retention and increases return on customer acquisition costs.

(iii) Assists with budgeting

A subscription also allows for easy budgeting. Having a set amount of money taken at regular intervals helps customers stick to their monthly budget and monitor their outgoings more efficiently. Some subscription plans provides a benefit called 'Subscribe & Save' options which enables customers to save money.

(iv) Discoverability of new and unique products

Often, subscription boxes feature samples of new products that the customers hasn't tried before. Subscribers get to embrace new products without the permanence of spending money on that specific item, which is one of the main attractions of a subscription.

What kinds of Businesses use a Subscription Revenue Model?

The consistent nature of recurring revenue is what makes the subscription revenue so popular, even with businesses you wouldn't expect. Companies have launched subscription models for all kinds of products and service and these include:

(i) Access to content: video, music, books, membership sites

Companies that provide ongoing access to content—like video, audio, or books—are more likely to offer subscription services to their customers. They provide a limited of their products free to customers as trial or teaser version and ask customers to subscribe for a higher value product. In the streaming-video realm, Netflix, Hulu, and HBO all provide high-quality entertainment for a low price. Music and books are also frequently sold by subscription. Amazon offers a subscription service for ebooks, and Audible offers unlimited access to audiobooks, as long as you remain a subscriber.

(ii) Access to services: software, utilities, insurance, leasing

Many software companies offer their software on a subscription basis instead of as a one-time purchase. With more traditional one-time software sales, it's much more difficult for developers to make changes and improvements to their products, relying on clunky update systems to deliver those improvements to the end customer. Offering remotely hosted software packages on a subscription basis makes it much easier for software companies to improve their product over time and perhaps make more gains through recurring revenue. Customers don't need to worry about how they'll host the software or how they'll keep it up to date.

Leasing an apartment, a house, car or a machine, a land etc is another example of a service-based subscription business that are offered by companies like Excedr. The customer pays rent to landlords or owners either monthly or yearly; landlords deal with retention, churn, and other aspects of a subscription business every day. Insurance Companies also charge customers monthly (or sometimes yearly) for home, auto, boat, and renters insurance, and customers are free to switch providers at any time their rent expires. The owners of the properties may upgrade the properties and lease or rent them to another, sometimes at higher cost.

- (iii) Access to products: personal care, food, pet care
Finally, many products are now available on a monthly basis. Subscription products tend to be split into two categories: convenience and curation. Any product that frequently needs replenishing is a good candidate for convenience subscriptions, products like food and drink can be subscribed for at convenience. Curated subscription boxes are generally based on a theme or target market. These subscription services deliver a curated selection of products on a monthly or quarterly basis—for example, Stitch Fix delivers a monthly box of hand-selected fashion items, while Art Crate delivers a similar service for home-decor products.

Subscription Revenue Model Life Cycle

Subscription revenue model life cycle involves the stages of building a sustainable revenue generation through subscription. According to (Campbell, 2020) there are five stages, which include:

- (i) Acquire customers
The first stage for every subscription company, of course, is to acquire customers. Subscription companies generally rely on the same methods as traditional companies to attract new customers, like inbound marketing, paid advertising, and search. It often takes months or even years to capture enough revenue to cover those customer acquisition costs.
Some software companies employ a software monetization strategy to offer a freemium model, where customers can use a free, sometimes feature-limited version of a product indefinitely. It widens the top of your funnel considerably and gives you more time to nurture new customer relationships. These products may be upgraded later with more features to a paid plan in the future.
- (ii) Deliver consistent, high-quality service
At this point, the sales and marketing teams of the company might have successfully completed their job, and have got a solid base of subscribers. The company will then deliver an experience that meets the customers' needs and continues to provide value over time. The hang-up most subscription companies run into here is not spending enough time to understand what their customers' needs are. The only way to solve this is to talk to subscribers constantly to understand their needs.
- (iii) Look for opportunities to upsell or cross-sell
Acquiring new customers isn't the only way for subscription companies to expand. In fact, it's easier to generate more revenue with existing subscribers through **expansion revenue** that is any revenue that is generated in excess from a customer's initial purchasing price or contract. There are two main ways for subscription companies to create expansion revenue, they are; Upselling by upgrading customers to a larger plan as their need for your product grows, create a pricing scale that increases what is charged as

customers increase their usage of the solution and Cross-selling customers additional features and services to augment the service they already have.

(iv) Work to retain users and reduce churn

Most subscription companies put all their efforts into acquiring new customers, when often it isn't the most effective way to grow. Retaining customers is even more important for growing your subscription revenue.

(v) Rinse and repeat

This is where the subscription flywheel really starts turning. As more and more happy subscribers stick around, the company will bring in steady revenue every month, without the ongoing acquisition costs that non-subscription businesses face each time the monthly clock resets. As the flywheel starts turning faster, subscription growth begins to compound. The magic of compounding means small improvements to your subscription revenue can accumulate into big money over time. But simple steps like tracking customer credit card expiration dates, communicating charging failures to customers, and keeping security protocols updated are all manageable problems. In isolation, fixing these problems might feel like you're only inching you towards your churn goals. But when you add them all up, they make a difference:

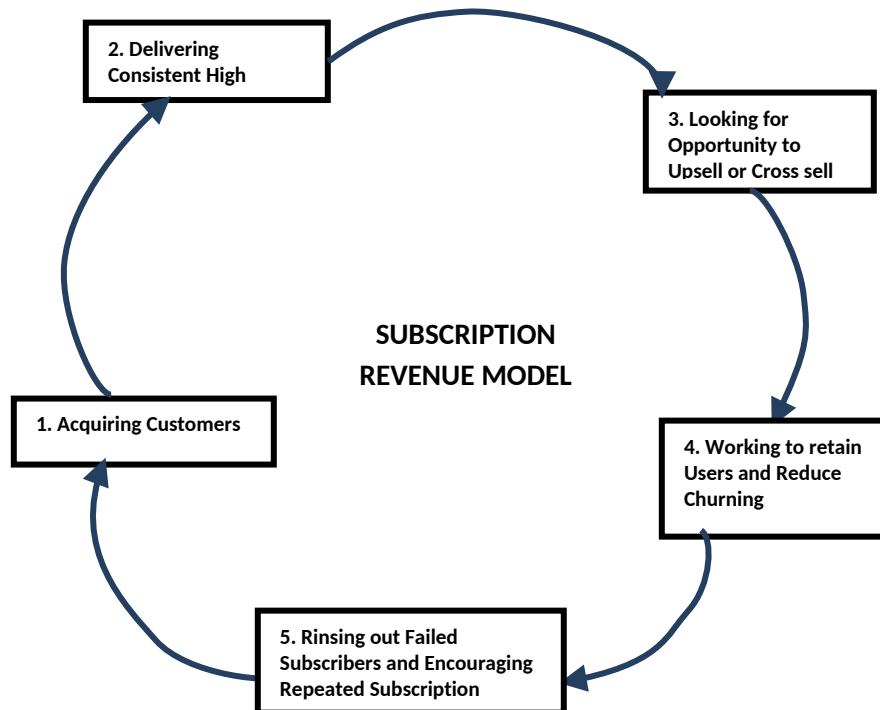


Figure 1: Life Cycle of Subscription Revenue Model

The Challenges of a Subscription Model and How to solve them

Though no subscription based business model presents challenges to retailers, there are yet few challenges to be known:

- (i) **Subscription fatigue** – Subscribers could become bored of the products, which means merchants need to work hard to upgrade products and services such as to add more new features, the collaborate with related companies to advertise or provide new products and services or even to create awareness on related features in order to maintain interest.
- (ii) **Difficult customer acquisition** – New customers are asked to make a commitment to regular spending, as opposed to a one-off purchase. This can make sign-ups harder to establish. Customers should be given freemium and the paid later for more valued products and services.
- (iii) **Credit card expiration** – Subscription billing can be more vulnerable to changes in payment details, such as card expirations. Luckily, modern subscription platforms like *ReCharge* allow customer credit cards to be updated automatically.

Summary

Subscription model is a revenue model where customers have to pay some amount of fee for services and products provided by companies before they can use it. This payment can be done daily, weekly, monthly, quarterly or yearly. Subscription model attract multiple recurring profit to companies. It makes it easy and cheaper for any category of customers to access products and services. It helps the companies develop good relationship with customers, thereby providing fast feedback which in turn helps business owners to improve on their products and services. The benefits of subscription model to customers are convenience, personalized experience, assists in budgeting, and discoverability of new and unique products. The challenges of a subscription model include subscription fatigue, difficulty in acquiring customers and credit card expiration.

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