



How product companies can succeed with subscription business models





**A subscription business model
adds value to both companies
and their customers.**

**How can your company succeed
in the subscription economy?**

In today's ever-changing business environment, companies continuously must adapt to customer needs and innovate their business offerings to stay competitive. Product-oriented companies are increasingly focusing on product innovation to create value and stay relevant to their customers. But value creation is not just a result of introducing new technology or product offerings, rather, value is created in how the business models are configured to bring the technology or product to the customers.

This article explores the concept of a subscription business model and how it can be successfully applied by product-oriented companies, by securing a clear strategic intent and a disciplined transformation approach.

SERVITIZATION IS THE FOUNDATION OF THE subscription economy



While traditional business models of product-oriented companies have been focusing on product sales and customer asset ownership, changing customer preferences and market conditions have shifted their focus. Product-oriented companies have started to reshape their business models around value creation through services performed with their products. This shift is known as **Servitization** and blurs the lines between products and services as they become integrated. Consequently, companies formerly known as product-oriented are starting to see themselves as service providers. Automotive OEMs shifting from cars to mobility solutions, and construction equipment companies shifting from tools and equipment to uptime and productivity services, are two of many examples.

Along with product companies servitizing, the way business is transacted radically transforms. A business environment arises where customers go from buying products to subscribing to services. Product companies start to define subscription fees instead of putting price tags to their products. Referred to as the **Subscription Economy**, this business environment is where companies that take on the **Subscription Business Model** thrive.

The subscription business model was previously dominated by newspapers, gyms, magazines, utilities, and telecommunication companies but is nowadays widely used by companies within all types of industries. One example from the B2C context is Spotify, who disrupted the music and record industry when they launched their online music streaming service in 2008. Another more recent example is Care by Volvo, launched by Volvo Cars in 2017 as an alternative to car ownership or leasing. A third example, from the B2B context, is Hilti's Fleet Management Service where construction companies subscribe to their tools instead of owning them, and the list goes on.

So, what is really a subscription business model?

Simply put, a subscription business model is a type of business model where the company creates, delivers, and captures value to their customers by having them subscribe to the offering. However, it is commonly mistaken as simply a pricing strategy, and companies too often fail in their attempts to apply it by doing so. To succeed with a subscription business model it requires major changes to a company's whole business logic and rationale, particularly in the case of a product-oriented company.

PRODUCT-ORIENTED COMPANIES CAN ACHIEVE GREAT

benefits from a subscription business model

For a subscription business model to be successful, it needs to add value to both companies and customers. If one party is not benefiting, the model will fail. However, when the model creates value for all involved actors, it has great benefits as compared to product-oriented business models.

Higher customer retention

A subscription model ensures that the business is retaining a larger number of customers on a consistent basis. This is since, in contrast to a traditional product purchase, the subscription ties the customer to the company through a continuous relationship that provides value for both sides. It does not necessarily have to be a close customer relationship, as the subscription can go on without the parties ever interacting. Take Spotify for instance, where customers barely ever interact with the company, but remain loyal subscribers to their service year after year. However, the subscription enables product-oriented companies to develop closer customer relationships if they wish to do so.

Better cash flow management

A subscription model provides the product-oriented company with the ability to predict their revenues through recurring sales. Although this might seem counter-intuitive or even provocative at first glance, this has many benefits. Instead of experiencing peaks or declines in product sales over the year, repetitive subscription sales provide stability in terms of cash flow management for both the company and the customer. It also enables improved inventory management and resource planning.

Flexibility

Subscription enables the product-oriented company to more frequently develop the physical product and to tailor it towards the changing customer needs, since the ownership remains within the company. This adds flexibility to product and service development, as well as operations. From a customer side, flexibility comes from not having to buy the actual product and being able to change or exit the subscription with altering needs.



THE STRATEGIC DIRECTION IS THE KEY TO

select the right subscription model

Several types of subscription models exist, commonly divided into nine¹ different types, where some are more applicable for certain industries, products or services than others. Out of these nine, three common models are the All-You-Can-Eat Library model, the Simplifier model, and the Freemium model:

The strategic direction should guide the decision

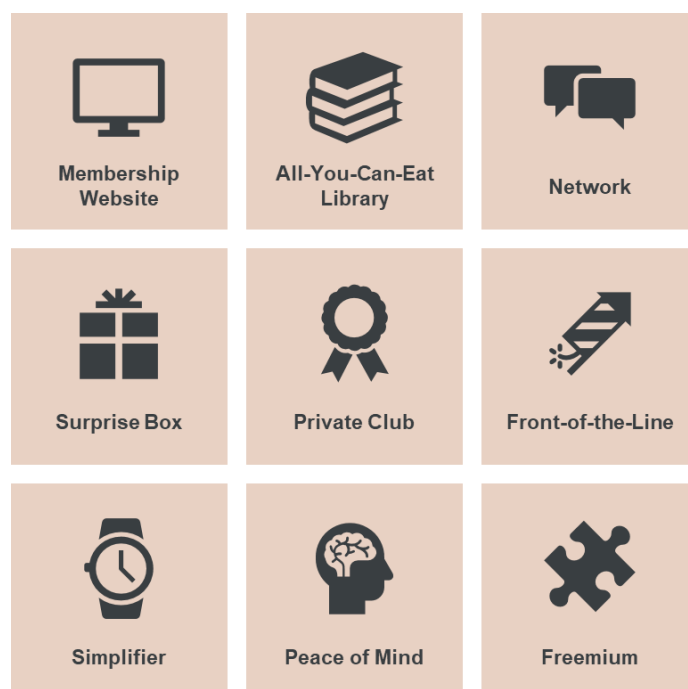
- The **All-You-Can-Eat Library** model gives the customer access to an unlimited amount of content for a fixed subscription fee. It is frequently used by companies offering a large amount of content within the same product category, such as music, books, or movies.
- The **Simplifier** model enables the customer to save time by subscribing to a service that takes a “to-do” off from their list. It is common within the automotive and construction equipment industries by outsourcing service and repair operations through e.g. service contracts.
- With the **Freemium** model, a basic service is provided for free, but can be upgraded to a premium service with extended functionality for a certain subscription fee. It is often used for software, games, and apps.

To achieve benefits from a subscription business model, careful consideration must be given to what type that fits the company and its value proposition the best. It is not unusual for companies to combine elements of several models and to explore with new configurations of a subscription business model.

So, which subscription model should we use?

Although a valid question for a product-oriented company aspiring to apply a subscription model, the answer is also a question: What do you wish to achieve with it? Selecting the right model is complex and requires definition of the underlying reason to why the company wishes to apply it. The model should then be selected and configured with the strategic direction of the company as the guiding principle.

NINE TYPES OF SUBSCRIPTION BUSINESS MODELS



¹ Adapted from Warrillow, J., 2016. The automatic customer: creating a subscription business in any industry.

all about the transformation

There are no shortcuts for a product-oriented company in the transformation towards a subscription business model. A successful implementation follows five distinct steps:

1. Define the strategic intent



As pointed out, succeeding with a subscription business model requires a well-defined underlying strategic intent. The company must know *why* they are going for a subscription business model, to know *how* to go ahead with it. Applying a subscription model just because competitors are doing so is not enough of a reason. Does the company want to increase sales? Strengthen customer relationships? Increase resource utilization? Re-state their brand image? These reasons could lead to completely different models.

2. Design the first hypothesis



With the strategic intent made clear, the initial design of the subscription model starts. A model is selected and configured based on what the company wishes to achieve through subscription, and the company's value proposition is re-designed accordingly. At this stage, the model should be considered a hypothesis that is still to be confirmed.

3. Validate the hypothesis



The model is validated to ensure that it supports the strategic intent. This is done as close to the customers as possibly, preferably through conducting commercial pilots. The company learns from the pilots, re-designs the hypothesis and continues to validate until the model is shown feasible, viable and desirable. Simultaneously, the impact on different parts of the organization is thoroughly analyzed to understand changes required to reflect the new value proposition.

4. Configure the business model



Once the value proposition is validated, it is time to configure the building blocks of the business model according to the new value proposition. For a product-oriented company, this usually implies completely new sales and distribution channels, a shift in key resources and activities, new dimensions to customer relationships, and a new logic to costs and revenue streams. All building blocks have to fit together before the subscription business model is ready for implementation.

5. Transform the business



To really succeed, the product-oriented company must not underestimate the transformation journey that lies before them to adapt the business to the new business model. The transformation is complex and requires alignment of all aspects of the business. It is therefore recommended to practice a disciplined transformation approach.

CONCLUSION – LOOKING FORWARD

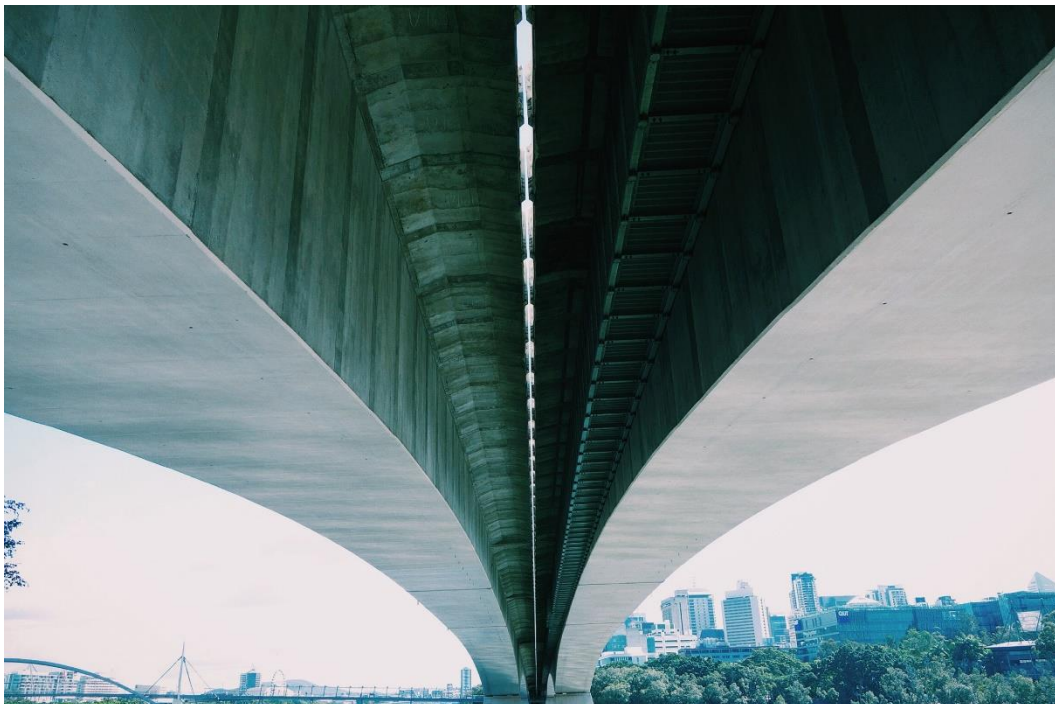
into the subscription economy

There is no doubt that product-oriented companies have benefits to gain from a subscription business model, including benefits for their customers that strengthen the offering. We already see many companies aspiring to grasp these benefits by launching subscription-based value propositions today, and more examples of companies following the same road are anticipated in the near future. With this development, the subscription economy will require companies to adapt to keep up. However, moving into the subscription economy is more complex than it may at first seem, and there are many aspects to consider to succeed with a subscription business model.

As pointed out earlier, subscription goes beyond a pricing strategy and requires more effort than just swapping the product price-tag into a monthly service fee. It is a fundamental change to the configuration of a product-oriented company's business model. Making this change requires a disciplined transformation to secure alignment of all aspects of the business, ranging from how value is created and captured, to how it is delivered. It requires a clear strategic intent and understanding of why the company is changing to a subscription business model, and what they wish to achieve by doing so.

**Subscription per se
it not a target.**

**What do you wish to
achieve with it?**



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