The software industry has become one of the fastest growing sectors of the economy. The trend of software servitization is more and more popular. This essay will compare advantages and disadvantages of pay-per-use vs software rental revenue models from a software provider’s viewpoint.

According to Ojala (2013), pay-per-use software is when customers are billed based on the units used, whereas software rental is when customers pay a negotiated subscription fee for an agreed period of time, regardless of usage.

Pay-per-use software is considered a better option if the vendors want to increase their market share quickly. This kind of software usually has low initial acquisition costs, making it an attractive choice if the customer's budget is limited. Furthermore, this billing method allows software providers to get better feedback of their products by collecting data on how customers interact with the software. This valuable information can help the companies to develop specialized features that cater to the needs of a particular client or improve the universal attributes intended for the mass market. On top of these benefits, Choudhary et al. (1998) noted that pay-per-use billing creates "network externalities effect", which means the larger the number of users is, the more well-known the product becomes. This can help the vendors to rapidly expand their user pool in a short period of time, resulting in a spike in revenue. On the other hand, pay-per-use services pose some problems. The most common is that profits are often fluctuating and unpredictable as customers’ usage pattern might change significantly in a given time frame. Another disadvantage is that customer loyalty is uncertain since it is fairly easy and inexpensive for clients to drop the product and opt for another alternative. These software products are superior in terms of flexibility and immediacy, but these characteristics also lower their lifetime value and reduce the likelihood that the customers will stick with the service for a long time. Finally, if the service does not introduce a threshold to customer's usage, they might be charged with an unexpected high bill. These random moments could cause huge dissatisfaction and push the customers to switch the service.

Software rental services are more appealing for those who prefer to have a fixed charge with no hidden or surprising fees. This can help providers to gain access to some highly restricted segments of the market, most notably public enterprises. In contrast to its pay-per-use peer, rental software generally has a longer lifecycle, thanks to a binding relationship between the product and the customers. For large clients with well-established development platforms, terminating a software subscription is often seen as a hassle and associated with heavy costs. Furthermore, a flat rate ensures financial security for the vendors because the customers are charged whether they are using the product or not. A constant flow of cash will ease the pressure to make profits, reducing uncertainty and allows upfront planning. However, software rental model still has limitations. Most of these drawbacks are similar to that of pay-per-use billing method, but there are some considerable differences. The most common one is that the price of rental can create "guilt” for the customers - they might be paying for irrelevant features that are not used. This problem could push them to look for alternatives, seek for a cheaper plan, or renegotiate the charge continuously. For small companies without strong leverage or financial backing, this can lead to catastrophic loss of customer base. Another drawback is that there is a constant need for providers to provide more value to their products. This might sound good on the surface as it promotes innovation, but when pushed to the edge it can place huge pressure, particularly on the development department of the providers. Too frequent updates could affect overall product quality, reduce profits and cause disruption to clients. The final argument against software rental is that providers often need to set up a customer support and maintenance team that works around the clock to assist customers. Pay-per-use software model also has similar teams but not as costly. They are not required to be constantly active as customers are not always using the product.

The ideas mentioned above explained some of the fundamental advantages and disadvantages of pay-per-use and rental software. Providers need to consider the characteristics and functionalities of their services to properly adopt a billing model. Software that provides access to products that people prefer not to or difficult to own should follow the subscription model, such as Spotify, Netflix or Microsoft Office 365. Other types of software whose usage can be effectively measured should be pay-per-use, like Voice over Internet Protocol service, Amazon Web Services or Microsoft Azure.

Reference list

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