04 JUN 2001 WHAT DO YOU THINK?

What's the Future of the Subscription Model?

by James Heskett

Summing Up

The Subscription Model: Down but Not Out
Just as manufacturing organizations are once again adopting a subscription model as a means of pricing product-service packages marketed as solutions, it appears that Internet-based businesses are abandoning it, instead giving away everything from information to music in order to sell advertising. As questions are being raised about the ability of telephone service providers, newspapers, and others to sell subscriptions in the future, I recently asked readers what the future of this wonderful Twentieth Century revenue generator might be.

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RICHARD FEDER MAINTAINS THAT THE SUBSCRIPTION MODEL WILL GAIN MOMENTUM ON THE INTERNET AS THE MEMORY OF FREE SERVICE FADES AND THE UTILITY OF NEW SERVICE INCREASES.

The response gives hope for those hoping to utilize the subscription model in the future.

"Down but not out" was the verdict of Jonathan Robertson, who went on to say, "The model isn't working for phone and cable companies, not because the model is bad, and not because they aren't providing value ... but ... the implementation at the phone companies is geared around giving more value to new customers than to existing customers. Any company pursuing the subscription model by taking its customers for granted should be pursuing another model."

Another view is that Internet companies will return to the subscription model given their signal lack of success in supporting themselves solely with advertising. Claiming that the advertising model "went bust," one respondent concludes that the "'free' connotation to the Internet is eroding away slowly."

Richard Feder maintains that the subscription model will gain momentum on the Internet as the memory of free service fades and the utility of new service increases. As he puts it, "Value to the subscriber base will increase as the frame of reference in which the subscriber determines value switches away from prior cost." He also suggests that positioning a new service in the prospect's mind as a "free trial subscription" can facilitate the transition.

Is this a case in which the Internet economy is out of step with more traditional business practice? Or are we seeing an irreversible trend in

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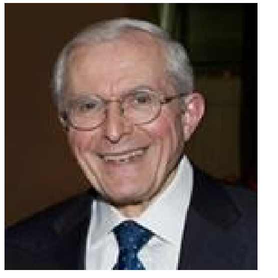

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some industries away from the subscription model, in part because of Internet-facilitated competition? What do you think?

Original Article

The subscription model has served as a wonderful revenue generator through the years for many companies in the media and communications industries. Organizations have built hard-to-beat revenue streams around it, enabling them to make long-range plans and even enjoy substantial "float" from advance payment for subscriptions.

Companies abandon the subscription model at their risk. Take the case of Xerox, for example. Many would argue that the company began its slippery slide toward obscurity when it ended the practice of leasing all or most of its equipment, an arrangement under which it charged a royalty for equipment usage, as I mentioned in an earlier column "Can You Hard-Wire Performance?" in this series. The model is so attractive that a number of "industrial" firms are adopting it, as shown by IBM's increasing emphasis on service contracts and GE's exit from the jet engine business and entry into the "thrust service" business, guaranteeing the on-demand delivery of various levels of power to jet aircraft. The subscription model, by tying a company's success to its ability to preserve its relationships with customers and the value of their lifetime revenue streams, can provide a strong incentive for continued product and service excellence.

At the same time that former manufacturing enterprises are adopting the subscription model, it appears that media and communications industries are questioning their use of it. We are told, for example, that standard telephone service is migrating toward becoming a free service, becoming a foundation instead for the sale of other information services. At least one New York daily newspaper has begun giving away its afternoon edition, relying instead on the advertising revenues it produces. Questions have been raised about whether

Napster users will be willing to pay a reasonable subscription fee for the use of the service after having been treated to its free use for many months. And an outcry has arisen over the $9.95 annual charge proposed for access to "out of market" radio broadcasts over the Internet. In fact, some have raised the question about whether, having enjoyed free digitized media and communications services, we have spoiled the revenue models for certain of these services.

Has the subscription model's time come and gone? Does it require so much time, effort, and cost to build a business around a subscription model that it's become impractical for this purpose? Or was it just that the "get big fast" strategy didn't allow time for the use of the model and that we will get back to it now that sanity has returned to the marketplace in the post dot.com era? Or will the subscription model become attractive only to those organizations that have already built a large customer following and thus might be converted more easily and economically to a subscription basis? What do you think?

COMMENTS

JONATHAN M. ROBERTSON **SR. VP STRATEGIC DEVELOPMENT AND GEN. COUNSEL, I/P BUS. UNIT, WASHINGTON GROUP INTL.**

The subscription model is down but not out. The recent dot-com binge and bust has done damage to the model because the dot-coms popularized the expectation that you can get value for free. Anyone who understands basic economics knows that value is never free.

On the flip side, if you provide desirable value people will pay. If you treat them well, if you show them that you care about them as a customer, if you provide them with a good and valuable service they will pay and remain loyal. The essence of the subscription model is that people pay for value and remain loyal because you show them you care.

The model isn't working for phone and cable companies, not because the model is bad, and not because they aren't providing value, but because everybody believes that they could give a rat's you know what about their existing customers. The implementation at the phone companies is geared around giving more value to new customers than to existing customers. Any [company] pursuing the subscription model by taking their customers for granted should be pursuing another model.

Thus the subscription model will only ever work for people willing to show their customers that the provider cares about them individually, will constantly provide them with value and will treat them as existing customers better than new customers. Of course that model does not happen overnight. The old rule of thumb about a new magazine was that it would take two to three years to see whether or not it could succeed. Unless people are willing to make or exploit that kind of investment in customer service and retention, they should pursue another model.

ANONYMOUS

You make a good point about existing subscription services. You might also consider that the financial services business is migrating to a tiered service offering: low end, price sensitive, on-line trading; infrequent activity clients using the traditional commission model; and the current push to move higher net worth clients to a fee based service business. For the individual financial professional in a full service firm, commissions are declining; pushing tremendous efforts towards the fee based subscription model.

This subscription model is the foundation for the HMO industry, as well. Methinks it operates somewhat better in the financial world than in the field of health maintenance. Which may have to do with the level chosen for the subscriptions by the two industries??? We shall see.

BILL HAMMETT CEO, APPS ON THE WEB INC.

Our company is the developer of state-of-the-art software products that provide a complete and highly scalable solution for the management of subscriptions, permissions and access to software, information and services over networks and the Internet. In this context, we obviously believe strongly in the subscription model.

Software piracy can be eliminated if the code is never installed on an end user's computer. With movies, music and print media the prevention of theft is more difficult because at some stage the user must see or hear the material and it can be copied. If a subscription model is adopted worldwide with users in the tens or hundreds of millions, prices can be lowered to the point where it is not worth the effort or the risk to steal the copyright material. This is the model that we believe will prevail. The big question is when will major enterprises and institutions make the switch.

PRASHANTH MANAGER, GLOBETRADES

The communication and entertainment industries were the forerunners in subscription model.

The advent of the Internet has changed the rules of the game. But the Internet companies started they wanted to follow the New York times example, i.e. they wanted to provide information and services free and earn revenues via advertising, but this model went bust.

When we consider the economics of the information industry, the marginal cost for information is very low, nearly zero. In such situations, the best model is the subscription model, wherein for a quantum sum of fees, a subscriber gets services and information. There will be variants of this model in the next generation of Internet companies, for the "free" connotation to the Internet is eroding away slowly. Hence subscription and syndication models shall flourish in the next generation of information industry and specially the Internet.

RICHARD A. FEDER

1. People will buy electronic subs to previously free media/services.

2. At first the subscriber will be small, as the value of the sub will be depressed by its prior cost.

3. Value to the subscriber base will increase as the frame of reference in which the subscriber determines value switches away from prior cost to utility and/or comparable services.

4. The subscriber base will grow when perceived value exceeds sub cost.

Sub value to non-subscribers will shift from free slowly, unless:

—the initial free subscription can be positioned in the prospects mind as free trial subscription, or

—the prospect is offered a "free premium" which has a higher perceived value than the cost of the subscription plus the inconvenience of ordering plus the value of the information (which will be discounted severely at first).

PAMELA VAN HORN PRESIDENT, VH ASSOCIATES

Anonymous may be correct about HMOs starting with a subscription model. Unfortunately, they lost focus on the customer satisfaction aspect and emphasized instead the profit picture to the exclusion of concerns about the subscriber, i.e. the customer. Relationships crumbled and HMOs are suffering.

Consideration of profits without customer loyalty and retention leads to the demise of the business entity. Sustained profits require nurturing. HMO's don't understand this concept.

RAVI SESHADRI ENGINEER, USDATA

As effective as it was to bring in consumers without having a serious commitment, the subscription model was an ineffective model for businesses charting their course of revenue. The "judgement calls" were very subjective and financial projections were mere speculations. I would agree with Jonathan M. Robertson's comment that the dot.com burst has done more than its share of damage to this revenue/business model. The soaring interest in a collaborative enterprise might change this a wee bit, with manufacturing facilities opening up with more-refined subscription services for access to their facility—as an extension to virtual manufacturing.

Finally, "the state of the economy" does not encourage any business out there today to experiment with their revenue model. That puts the subscription model at risk in most business environments the few exceptions being entertainment, training, and education.

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