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Different Types of Revenue Models

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Abstract

The paper discuss the common revenue models that are much more used and quiet popular among the big firms as well as startups. There is a brief explanation of revenue model and how it is different from business model and how A revenue model is a part of the business model that explains different mechanisms of income generation and its sources. With each revenue model discussed we have a case study based example which provides greater insights to reader who are reading and referring this paper.

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1 What is Revenue Model?

A revenue model provides a framework for producing revenue and a metric by which a company may assess its long-term profitability. Understanding how a revenue model works can aid in determining a company's performance.

A revenue model is a diagram that depicts how a new company will generate revenue or gross money from its regular operations, as well as how it will cover operational costs and liabilities. This model is one of a company's key performance indicators (KPIs) for determining how profitable its pricing strategy and product sales are.

A revenue model is a structure for creating value for customers that is frequently referred to as a business model. These words, however, are not interchangeable, although they do have a link. A revenue model is a component of a business model that explains how a company's goods or services are manufactured, delivered, and profitably sold.

A revenue model's goal is to manage a company's revenue streams, which are its sources of income from diverse demographics and geographies.

A revenue model allows a company to identify critical elements that can help it flourish and develop. Companies use revenue models to figure out how much money they'll need to focus their sales and marketing efforts on a specific audience, develop new products and services for consumers, and ultimately define their place and future in their industry. Without a revenue model, businesses, particularly startups, might incur expenditures that make their operations unsustainable.

2 Advertising Based Revenue Model

When you start a for profit business, a key part of your plan is how to generate revenue. Many companies sell goods, services or a combination of the two. Online businesses and media companies often look to advertisers for most or all of their revenue. This is known as an advertising-based revenue model. Online media sites and publishers commonly use the ad-based revenue model because it is difficult to get users to pay for content that they can find for free in most cases. The basic premise is to present news, information or feature articles that attract users and then sell advertising space to businesses that have a message for your audience. Online service providers with in-demand services such as music or picture editing often have more flexibility in that they can make money from paying customers or attract advertisers.

Offering free content or services, especially when it interests a very targeted market segment, can lead to excellent ad revenue opportunities. Sponsors are often willing to pay more to reach a select audience. Ad revenue also allows you to profit from offering solutions that have limited demand from paying customers. Ad models are often harder to predict, though. Your traffic may remain steady, but advertisers may come and go based on economic and industry factors. You also may miss opportunities to get fees from customers who are willing to pay them.

Facebook is not a monopoly, but with its more than 3 billion users worldwide across Facebook, Instagram and WhatsApp, it has a dominant market presence among social media and messaging tools. Facebook's gigantic user penetration worldwide is what makes it such a valuable company. Still, when it comes to Facebook's business model and how it makes money, users are not paying Facebook anything. At least not directly.

Facebook makes money predominantly by showing ads from advertisers within its Facebook and Instagram apps. Advertising represented 98% of Facebook's 86bn dollar revenue in 2020. The remaining 2% of revenue came mainly from selling Oculus and Portal devices and also payment fees from developers. The Facebook business model is based on offering its tools and services mostly for free to billions of users and then making money by allowing businesses to show Facebook's users advertising. Advertisers pay the price to Facebook that is determined in an auction, based on demand and supply.

That means that people who use Facebook services (users) are not the ones paying Facebook for it. Real customers are primarily small businesses advertising on some of Facebook's family of apps. Facebook's focus on small businesses became an even more apparent part of the Facebook strategy as it introduced the first version of its e-commerce tools called Facebook Shops.

Facebook is not the first nor the last business with a similar business model. Still, Facebook is an excellent example that this business model is not without issues when the interests of users and customers (advertisers) are not in line.

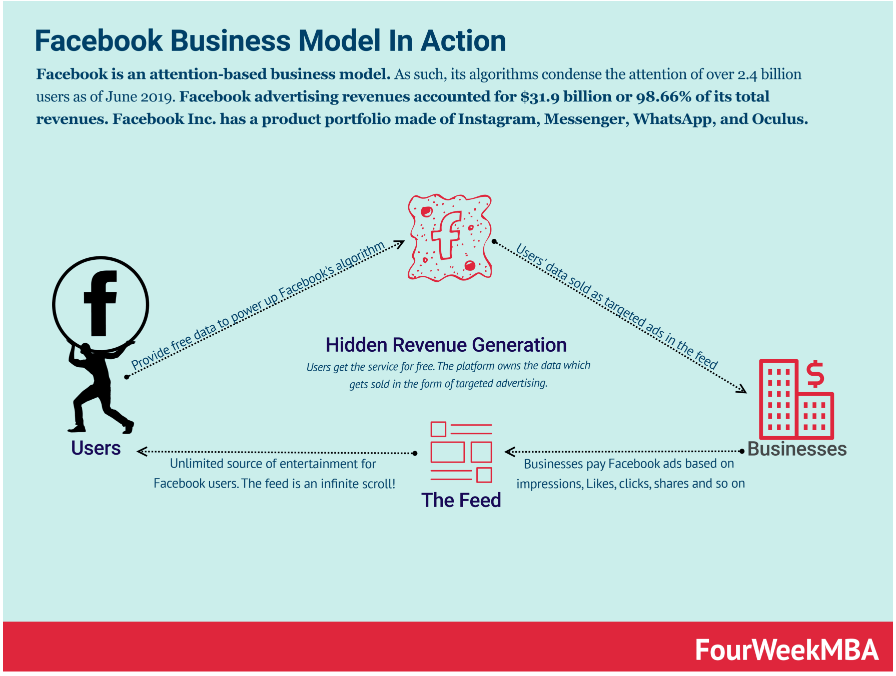

fig1: The above figure illustrate the Revenue generation model of facebook.

3 Subscription Based Revenue Model

The subscription revenue model allows a company's target audience to use a product or service for a predetermined and contracted rate and period of time. It's a popular source of revenue for cloud-based or software-as-a-service (SaaS) companies, and online entertainment hosting companies. This model differs from the licensing model in that the subscription has a fixed term, while licensing continues in perpetuity until the licensee or property owner terminates the deal.

3.1 Netflix Case Study

Netflix is one of the current pioneers of subscription-based content. It runs on a Subscription Video on Demand (SVOD) model. Subscribers pay for a monthly plan and are given access to a vast library of media—any time, anywhere. Thus, subscriptions are Netflix's main source of revenue.

But unlike apps like Spotify which also runs on premium subscription, there's no free option in Netflix. This means all members are paying for the content they want to watch. Users enjoy the convenience of ad-free entertainment, although ad trials have taken place recently.

It also has a DVD rental on a subscription basis, but only the streaming side of the business will be discussed in this blog.

Netflix offers different prices based on the quality of video required- Basic, Standard and Premium. Generally, it provides the first month of subscription for free. Basic with standard resolution is $7.99 a month, but it can only be used one device at a time. On the other hand, for $10.99 a month, one gets HD video on two devices, and shelling out $13.99 a month offers Ultra HD streaming on four devices. Additionally, opting in for Netflix's DVD service will be costly- with their Premium service, as it will be $30 a month when all is said and done.

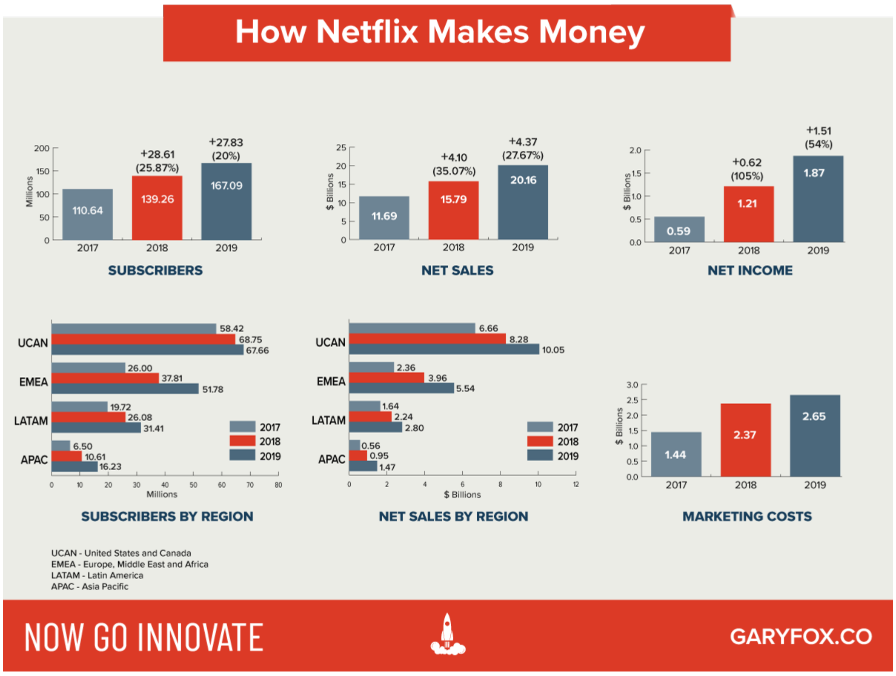

fig2: The above figure illustrate the Revenue generation model of Netflix.

4 Transactional Revenue Model

There are three main approaches to this model:

- You buy the product from one person/company and resell it to another for a higher price.
- You manufacture the product and sell it to a retailer, who then sells it to the end consumer.
- You manufacture the product and sell it directly to the consumer (DTC).

Additionally, you also have the option to sell in a brick and mortar location or go the online route. More companies are opting to go online with ecommerce because it has lower operating cost and the profit margins are higher.
If you have the itch to sell physical or digital products, this could be a good option to consider.

4.1 Target Revenue Model Example

Founded in 1902 as Dayton Dry Goods Company, Target started its first store in 1962 in Minnesota. Unlike Costco or Walmart, Target's market is limited to the United States. However, the company has been ramping up its e-commerce capabilities and is experiencing faster growth in this area. Target is a general merchandise retailer that has its stores operational across the United States in all 50 states. The company had 1868 stores operational as of 2019. Due to the high density of Target stores in the US, around 75% of the residents have a Target store within their easy reach. There are 41 distribution centers to support the operation of 1868 Target stores within the United States. Target has differentiated its business model from other retailers by creating its own range of private label brands. These company-owned brands and products account for around one-third of the total sales of the company. There are 41 brands owned by Target which are both a major source of revenue and a source of competitive advantage for the brand. While Target Corporation sources products from suppliers located all over the world, a large part of its merchandise is made up of the brands owned by the company. The company either produces them in company-owned facilities or gets them manufactured by external manufacturers according to the company guidelines. This has helped it differentiate its product line which drives higher demand for the company. The company generates substantially all of its revenue from the United States. Moreover, Target Corporation operates its entire business as one segment. Efficient supply chain management has also helped the company keep product prices low.

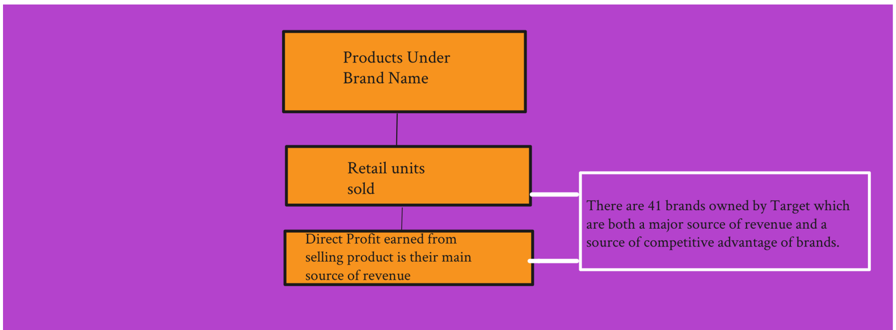

fig3. Target Business model

5 COMMISSION BASED REVENUE MODEL

With the commission revenue model, you make money from being a broker or an affiliate–a.k.a. "middleman"–that matches buyers with sellers. Unlike the advertising model, you only make money for successful transactions. It's usually done through product recommendations or by providing a marketplace.

Mint is an example of a company that uses this revenue model by recommending different financial products to its users. Their users are people interested in personal finance. Banks, credit card companies, and other companies that sell financial services and products allow Mint to recommend their offerings and pay a commission for each successful sale that comes from Mint.

Airbnb and Upwork are examples of the commission revenue model used in a marketplace. For instance, Airbnb sellers–the hosts–list their space for rent to buyers–the guests. In this case, when a guest wants to rent from a host, they pay the nightly rate for the space. Airbnb charges the host a fee when that transaction happens.

The amount you make as a commission is either a flat rate (i.e. 50$ for every successful sale you broker) or a percentage (i.e. 10% of each successful transaction). The more successful "matches" you make, the more revenue you earn.

This revenue model is good if you know how to build a buyer-ready audience. In other words, you're not just building a large audience. You need to build an audience that will buy the products or services you recommend. Otherwise, you won't generate any revenue

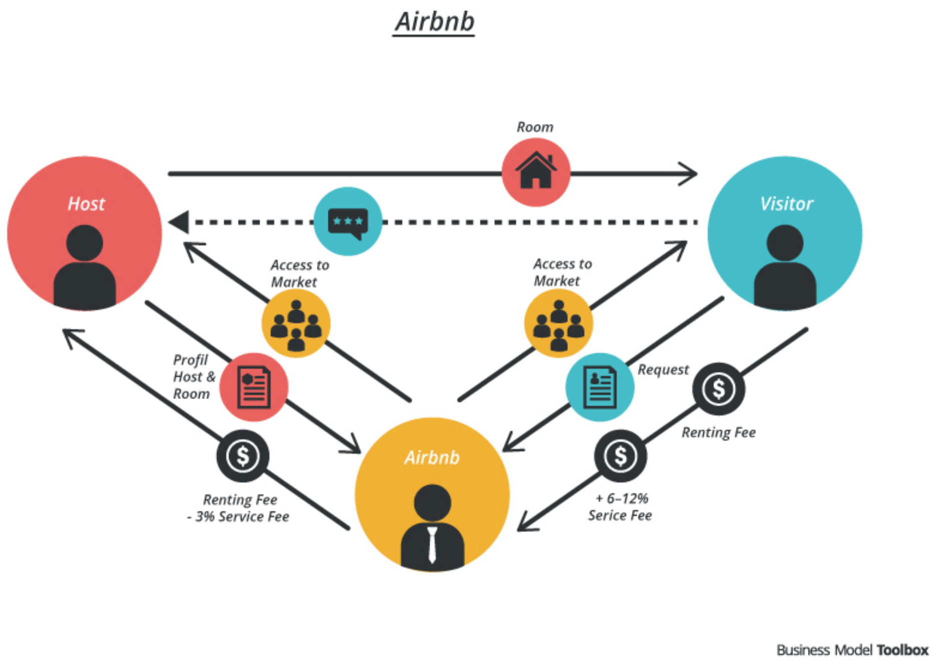

fig4: The above figure illustrate the Revenue generation model of Airbnb.

6 Service Based Revenue Model

One of the oldest revenue models on our list is the service-based revenue model. People have been exchanging services in some form or another for as long as they have existed.

One of the most appealing aspects of this model is that it can be used to

create a firm of any size.
For example, you may work as a single consultant with a dozen or more customers at a time. Or, like Maid Brigade, you may build a vast chain with thousands of customers.
The service-based income model might be a good fit if you don't have a lot of money to start with but have time and a certain specialty or ability.

6.1 Paytm As Service Provider

Commerce is enabled through Paytm's two-sided (customer and merchant) ecosystem. It uses technology to better the lives of its customers and assist merchants develop their companies by providing access to financial services through its financial institution partners. Paytm's business strategy and unit economics are built around consumer and merchant involvement.
Paytm's services are divided into following types:

1. Consumer side :
   - Payments: Bill payments, peer-to-peer money transfers, online payments, and in-store payments are all examples. Paytm, like other recharge service providers, have fixed charges from a variety of operators, including DTH providers and mobile service providers. They've also rewarded recharging with various cashbacks and bonuses.
   - Financial Services: Paytm also offers a variety of financial services, including a credit card, a savings account, and insurance. Paytm gains an advantage in gaining new users in this category since most processes, such as account opening and document verification, can be completed digitally.
2. Merchant side:
   - Consumer Payments: This makes it easier for different merchants to receive payments from customers. It may be classified into two types: online and offline. Payment gateways, links,

UPI payments, subscription-based payments, and settlements are all examples of online payments. In return to this paytm charges minimal fee.

- Business Payments and Software: Payouts, nodal accounts, POS Billing software, Advertising, and Business Khata are among them. These are services that make it easier for merchants to do business with nominal charges. Merchants are no longer required to understand the technical details of these procedures.

7 Conclusion

In this paper I have discussed some famous revenue model. The choice of revenue model depends on the type of work or product the company or startup provides. It's not necessary that one should only have these revenue models, There are many more revenue generation models such as freemium, Affiliate etc. And one can use multiple revenue models to create a revenue stream for his/her startup or company. At last it all depends on the company and startups how the want to generate income source, some have pivots in their revenue model, they shift from one model to other. Hence, the key is to shift to the best fitted model of revenue generation for your startup.

8 References

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