

Different Types of Revenue Models

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Abstract

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1) Introduction

1 INTRODUCTION

A revenue model gives a business a framework for generating income, and a yardstick by which they can measure their long-term profitability. Understanding the mechanics of a revenue model can help determine a company's success.

A revenue model is a blueprint that shows how a startup business will earn revenue or gross income from its standard business operations, and how it will pay for operating costs and expenses. This model is one of the key performance indicators (KPIs) for a company to measure the profitability of its pricing strategy and product sales.

Revenue model is sometimes used as another term for a business model, which is a structure for generating value for customers. However, these terms are not interchangeable but there is a connection between them. A revenue model is part of a business model, serving to explain how a company's goods or services are made, distributed, and sold for profit.

The purpose of a revenue model is to manage a company's revenue streams, which are its sources of income from target customers in different demographics and locations.

With a revenue model, a business can determine crucial factors that can help it thrive and grow. Companies use the information from a revenue model to determine how much money they will have to focus their sales and marketing on a target audience, develop new goods and services for customers, and ultimately determine their place and future in their particular market. Without a revenue model, companies, and especially startups, can generate costs that can make their business 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.

2.1 EXAMPLE OF ADVERTISING BASED REVENUE MODEL

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 advertis-

ers 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.

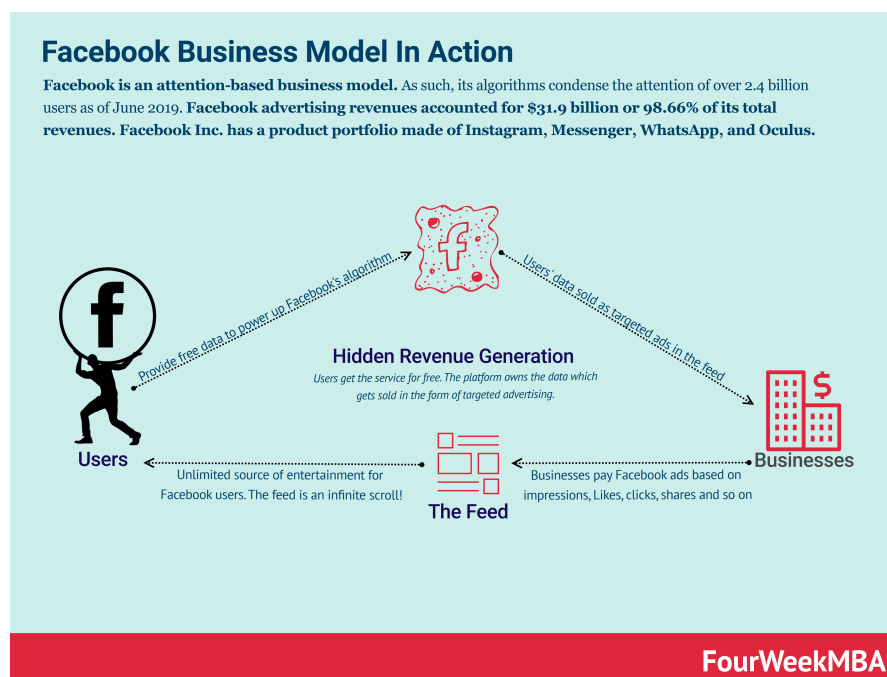


fig1: The above figure illustrate the Revenue generation model of facebook.

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

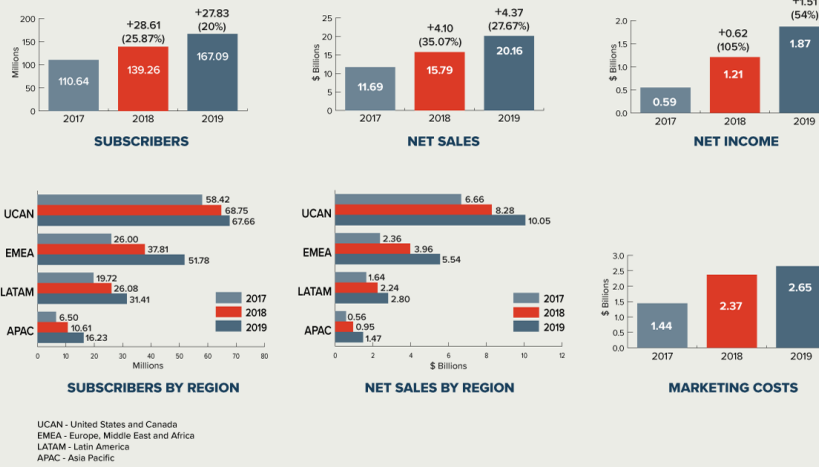
Netflix is one of the current pioneers of subscription-based content. It runs on a Subscription Video on Demand (SVOD) model. Subscribers pay for a monthly plan and are given access to a vast library of media—any time, anywhere. Thus, subscriptions are Netflix's main source of revenue.

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.

How Netflix Makes Money



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